Amendments to the Income Tax Act and Related Statutes

Explanatory Notes

Issued by
The Honourable Don Mazankowski
Minister of Finance

June 1992

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These explanatory notes are provided to assist in an understanding of amendments to the *Income Tax Act*, the *Canada Pension Plan*, the *Income Tax Conventions Interpretation Act*, the *Tax Rebate Discounting 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 *Canada Pension Plan*, the *Income Tax Conventions Interpretation Act*, the *Tax Rebate Discounting Act*, the *Unemployment Insurance Act*, and certain related Acts. The amendments are intended to implement the income tax measures put forth in the budget of February 25, 1992, as well as other proposals that have been previously announced and that require changes to the *Income Tax Act* for their implementation. This legislation also contains a 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 amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

Draft amendments to the *Income Tax Regulations*, with accompanying explanatory notes, are also included in this document.

The Honourable Don Mazankowski
Minister of Finance

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Clause 1

Income from Office or Employment

ITA
6(1)(e.1)(i)

Section 6 of the Act deals with employment income and provides for the inclusion of employment-related benefits in an employee's income. Pursuant to subsection 6(7) of the Act, the value of a benefit in respect of property or a service provided to an employee is to be determined net of any goods and services tax (GST) on the property or service. Except where the supply of the property or service is a zero-rated or exempt supply, paragraph 6(1)(e.1) requires an additional amount to be added to the income of the employee equal to 7 per cent of the value of the employee benefit net of any applicable provincial tax in respect of the property or service. This generally results in the employee being required to include in income the amount of GST that would have been payable in respect of the benefit had the property or service been purchased in the marketplace. The exclusion for zero-rated supplies (such as groceries) and exempt supplies (such as group life insurance) removes from this rule those benefits that would not be taxable under the GST if the employee were to acquire the property or service directly. This amendment, which is applicable to 1991 and subsequent years, extends the taxability of the value of GST where the employer is not a GST registrant or where the employer is denied an input tax credit in respect of the GST applied to the property or service.

Paragraph 6(1)(e.1) is also amended to provide that, in computing the GST portion under that paragraph to be added to the benefits included in income under paragraph 6(1)(a) or (e), the amount of any payment by the taxpayer to the employer for such benefits is not to be taken into account. This amendment applies to 1992 and subsequent years.

Clause 2

Deductions from Employment Income

ITA
8(1)(m.2)(iii)

Section 8 of the Act provides for the deduction of various amounts in computing income from an office or employment.

Paragraph 8(1)(m.2) of the Act allows a deduction in computing income from employment in respect of qualifying employee contributions made to a pension plan that is a retirement compensation arrangement (RCA), where the custodian of the RCA is resident in Canada.

Subparagraph 8(1)(m.2)(iii) is amended for 1992 and subsequent years so that qualifying employee contributions for this purpose include contributions made to a prescribed plan or arrangement. For further detail, reference may be made to the commentary on new subsection 207.6(6) of the Act.

Clause 3

Income from Business or Property

ITA
12

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

Subclause 3(1)

ITA
12(1)(p)

Paragraph 12(1)(p) of the Act requires a taxpayer to include in income any amount received in the year as a payment or as a refund of a levy under the *Western Grain Stabilization Act.* This paragraph is amended for 1991 and subsequent taxation years to also apply to any amount received in the year as a payment, or as a refund of a premium, in respect of the "gross revenue insurance program" under the *Farm Income Protection Act.* The "gross revenue insurance program" is a new agricultural program which combines the protection offered by a crop insurance program with the protection offered by a revenue insurance program. Further details of this program are provided in the *Farm Income Protection Act.*

Subclause 3(2)

ITA
12(1)(z)

New paragraph 12(1)(z) of the Act requires a taxpayer to include in computing income amounts in respect of an amateur athlete trust as provided in new section 143.1 of the Act. New paragraph 12(1)(z), which is applicable to the 1988 and subsequent taxation years, ensures that amounts so required to be included in the income of the athlete are treated as income from a business or property. This treatment recognizes that the funds held by an amateur athlete trust are generally derived from such sources.

Subclause 3(3)

ITA
12(2.2)

Subsection 12(2.2) of the Act provides that a taxpayer may elect to reduce the amount of an outlay or expense (other than an outlay or expense in respect of the cost of the property) where reimbursements, contributions, allowances or assistance, which would otherwise be included in income under paragraph 12(1)(x) of the Act, are received in respect of the outlay or expense. The election must be made by the filing date for the taxpayer's income tax return for the taxation year of such receipt or, if the related outlay or expense is not incurred until the following taxation year, by the filing date for the tax return for that following year. The amount elected by the taxpayer reduces the amount of the receipt that would otherwise be required to be included in income under paragraph 12(1)(x). Subsection 12(2.2) applies only in those cases where the set-off of an expense or outlay against a related receipt does not otherwise result under the Act. Currently, this election is available where the outlay or expense is made or incurred not more than three taxation years before or one taxation year after the taxation year of the related receipt.

Under new subsection 12(2.2), the incurring of the outlay or expense is not restricted to the preceding three taxation years, but rather may be incurred in any preceding taxation year or, as provided under the existing provision, in the year of the receipt or the following year. New subsection 12(2.2) is applicable to amounts received after January 1990.

Subclause 3(4)

ITA
12(3)

Subsection 12(3) of the Act requires corporations, partnerships and certain trusts to use the accrual method for computing income in respect of debt obligations. Certain debt interests are not, however, subject to these accrual rules. Subsection 12(3) is amended for 1991 and subsequent taxation years to extend this exemption to a net income stabilization account (NISA), which is defined in amended subsection 248(1). Further details in respect of the NISA program are provided in the commentary to new subsection 12(10.2).

Subclause 3(5)

ITA
12(9.1)

Subsection 12(9.1) of the Act applies with respect to dispositions of interests in stripped bonds (debt obligations from which the interest coupons have been removed and sold separately). The subsection ensures that when a coupon from a stripped bond is paid or sold, the taxpayer receives recognition for the cost of the coupon. The total inclusion in the taxpayer's income in respect of the coupon is limited to the amount by which the taxpayer's proceeds from the sale or redemption of the coupon exceed the cost of the coupon to the taxpayer.

Subsection 12(9.1) describes the types of debt obligations to which it applies by referring to certain debt obligations that are prescribed, by paragraph 7000(1)(b) of the *Income Tax Regulations*, for the purposes of subsection 12(9) of the Act. With the introduction of the rules relating to indexed debt obligations, it is proposed that subsection 7000(1) of the Regulations be amended to exclude indexed debt obligations from being prescribed debt obligations. Subsection 12(9.1) is amended as a consequence of this proposed change to the Regulations so that it will continue to apply with respect to all stripped bonds, including stripped bonds that are indexed debt obligations. This amendment is applicable with respect to dispositions of debt obligations occurring after October 16, 1991.

Subclause 3(6)

ITA
12(10.2) and (10.3)

The net income stabilization account ("NISA") program is a new agricultural program which is designed to assist farmers in the stabilization of their farm income.

Generally, a NISA is composed of two separate funds. NISA Fund No. 1 represents after-tax contributions of a farm producer. NISA Fund No. 2 is comprised of government contributions to the NISA and interest earned on all NISA contributions. The expressions "net income stabilization account" and "NISA Fund No. 2" are defined in amended subsection 248(1) of the Act. Additional details in respect of the NISA program are provided in the *Farm Income Protection Act.*

New subsection 12(10.2) provides that taxpayers are required to include in income, as income from a property, the total of all amounts determined by the formula A-B. The description of A is an amount paid at any particular time in the year out of the taxpayer's NISA Fund No. 2. The description of B provides a reduction from a payment out of a taxpayer's NISA Fund No. 2 to the extent that the taxpayer's NISA Fund No. 2 includes certain previously realized amounts minus the total of all such amounts applied in reduction of an amount that would otherwise be included in income under subsection 12(10.2). An example of the application of subsection 12(10.2) is contained in the commentary to new subsections 73(5) and 104(14.1).

There are a number of new other provisions of the Act which treat a taxpayer as having been paid an amount out of a NISA Fund No. 2 and thus will result in the application of new subsection 12(10.2). In this latter regard, see the commentary accompanying new subsections 70(5.4), 73(5), 104(5.1) and 104(14.1). For example, new subsection 70(5.4) provides that a deceased taxpayer will be considered to have been paid all amounts held for or on behalf of the taxpayer in the taxpayer's NISA Fund No. 2 immediately before death.

New subsection 12(10.3) of the Act ensures that a taxpayer will not be considered to have received an amount of income by reason only of the crediting or adding of an amount (e.g., interest) to the taxpayer's NISA Fund No. 2.

These amendments are applicable to 1991 and subsequent taxation years.

Subclause 3(7)

ITA
12(11)(a)(x) and (xi)

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. This paragraph is amended for 1991 and subsequent taxation years to exclude a "net income stabilization account" from the accrual rules in respect of investment income.

Clause 4

Depreciable Property

ITA
13(30)

Section 13 provides a number of special rules relating to the tax treatment of depreciable property. These rules apply for the purposes of sections 13 and 20 of this Act and the capital cost allowance regulations.

Subsection 13(26) of the Act provides that in computing a taxpayer's income from a business or property the cost of a property is not to be included in computing the undepreciated capital cost of a class of depreciable property until the property has become "available for use" by the taxpayer.

Subsection 13(30) of the Act provides that property which has become available for use by a transferor will also be treated, for the purposes of subsection 13(26), as having become available for use by a transferee to whom the transferor transferred the property in a non-arm's length transaction or in the course of certain divisive reorganizations. Under the existing Act the property is considered to have become available for use by the transferee in these circumstances at the time of its acquisition by the transferee.

Subsection 13(30) is amended to treat property to which that subsection applies as having become available for use at the earlier of the time the property was acquired by the transferee and, if applicable, a time prescribed in the *Income Tax Regulations*.

The proposed amendments to paragraph 1100(2.2)(j) of the *Income Tax Regulations* released on December 23, 1991 will be revised to consider a transferee's property to which that paragraph applies to have become available for use at the earlier of the time the property is acquired by the transferee and the time it became available for use by the transferor. In this regard, subsections 13(27) and (28) of the Act should be read without reference to paragraphs (c) and (d) thereof, respectively.

This amendment applies to property acquired after 1989.

Clause 5

Shareholder Benefits

ITA
15

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

Subclauses 5(1) and (2)

ITA
15(1)

Subsection 15(1) of the Act requires a shareholder of a corporation to include in income the amount or value of certain benefits conferred on the shareholder by the corporation. Benefits described in paragraphs 15(1)(a), (b) or (c) are excluded from the income inclusion. Paragraph (c), in particular, provides that no benefit will be considered to have been provided where a corporation confers on all the owners of its common shares a right to buy additional shares. New paragraph (c), which is applicable to benefits conferred on or after December 20, 1991, provides that a benefit will be excluded from income under paragraph 15(1)(c) only if the corporation confers the identical right at the same time per common share on each common shareholder to acquire additional shares of the capital stock of the corporation. For this purpose, rights will not be considered identical if the costs of acquiring the rights differ.

Subclause 5(3)

ITA
15(1.4)

Subsection 15(1.4) of the Act provides that, where subsection 15(1) requires the amount or value of a benefit to be included in computing the income of a shareholder in respect of a supply (other than a zero-rated supply or an exempt supply) of a property or service that is taxable under the goods and service tax (GST), the taxpayer must also include in income an amount equal to 7% of the amount or value of the benefit which is required by subsection 15(1) to be included in computing the taxpayer's income. This generally results in the shareholder being required to include in income the GST that would have been payable in respect of the benefit had the property or service been purchased in the marketplace. This amendment, which is applicable to 1991 and subsequent taxation years, extends the taxability of the value of the GST where the corporation is not a GST registrant or where the corporation is denied an input tax credit in respect of the GST applied to the property or service.

Subsection 15(1.4) is also amended to provide that, in computing the GST portion under that subsection to be added to the benefits under subsection 15(1), the amount of any payment by the taxpayer to the corporation for such a benefit is not to be taken into account. This amendment applies to 1992 and subsequent years.

Clause 6

Small Business Development Bonds

ITA
15.1 and 15.2

Section 15.1 of the Act contains the provisions that permitted eligible small business corporations to issue small business development bonds (SBDBs) after December 11, 1979 and before 1988. Interest on such bonds is not deductible by the issuer but is instead treated as a taxable dividend to the recipient. These amendments allow small business development bonds to be issued after February 25, 1992 and before 1993 by corporations in financial difficulty.

New section 15.1 reinstitutes essentially the small business development bond program which terminated at the end of 1987. However, the section has been re-enacted in order to remove obsolete provisions, improve clarity and correct certain anomalies.

New section 15.1 does not include a number of provisions that are in existing section 15.1: former subparagraphs (2)(d)(ii), (3)(b)(iii) and (d)(ii), paragraphs (3)(e) and (f), and subsections (4), (8) and (12). These provisions dealt with bonds issued before February 1982 to acquire specified property or make expenditures on qualified research and development. They are no longer relevant as SBDBs may be issued only in circumstances of financial difficulty, including bankruptcy or receivership.

The definition of "joint election" in subsection 15.1(3) has been amended to refer to "an election that is made in prescribed form, containing prescribed information". This will allow an election filed on either the previous or new forms issued by Revenue Canada (form T2216) to be accepted. The rules concerning the time for filing a joint election, including former subsection (10), are now consolidated in the definition of "small business development bond" and its coming-into-force provision. An election will be acceptable where it is filed within 90 days of Royal Assent to the amendments.

Subsection 15.1(6) of the present Act, which provides for the levying of penalties, and subsection (11), which places the burden of proof on the Minister of National Revenue in assessing such penalties, are now consolidated in new subsection 15.1(5).

Subsections 15.1(7) and (9) of the present Act are re-numbered as subsections (6) and (7), respectively. In addition, the rules in new subsection (6), which provide that only one joint election may be made within a group, have been amended to include in new paragraphs (6)(b) and (c) certain individuals and partnerships in the group. This ensures that subsection (6) corresponds with subsection (7), which provides an exception to the rule of allowing only one joint election per group where the total principal outstanding of the group does not exceed $500,000.
Paragraph 15.1(6)(a) now clarifies that the relevant time for determining whether a corporation is associated is "at the time the obligation was issued". This ensures that an issuer of a SBDB will not become ineligible if, after it issues the SBDB, it becomes associated with a corporation that has issued a SBDB.

Section 15.2 of the Act contains the provisions that permitted the issue, after November 12, 1981 and before 1988, of small business bonds (SBBs) in respect of an active business in Canada that was in financial difficulty and that was carried on by an individual resident in Canada or by a partnership of such individuals. The rules relating to small business bonds are similar to the rules in section 15.1 of the Act relating to small business development bonds issued by corporations. The amendment allows a small business bond to be issued after February 25, 1992 and before 1993.

New section 15.2 reinstitutes essentially the former small business bond program, which terminated at the end of 1987. However, the section has been re-enacted in order to improve clarity and correct certain anomalies.

Paragraph (2)(b) now refers to a small business bond rather than a small business development bond, and the penalty has been changed from 34% to 29% to reflect the reduction in the top marginal rate of federal personal income tax.

The definition of "eligible issuer" in subsection (3), which provides that only one SBB may be issued by a group, has been amended so that it parallels the relieving rules in subsection (7). New paragraph (b) of the definition of "eligible issuer" ensures that a partnership, regardless of whether there is a majority interest partner, will not be an eligible issuer where it has previously issued a SBB unless subsection (7) applies.

The definition of "joint election" in subsection 15.2(3) has been amended to refer to "an election that is made in prescribed form, containing prescribed information". This allows an election filed on either the previous or new forms issued by Revenue Canada (form T2218) to be accepted. Also, the rules concerning the time for filing a joint election, including former subsection (8), are now consolidated in the definition of "small business bond" and its coming-into-force provision. An election will be acceptable where it is filed within 90 days of Royal Assent to the amendments.

Subsection 15.2(5), which provides for the levying of penalties, and former subsection (9), which places the burden of proof on the Minister of National Revenue in assessing such penalties, are now consolidated in new subsection 15.2(5). The penalty in subsection (5) in respect of a false declaration has been changed from 102% to 87% to reflect the reduction in the top marginal rate of federal tax.

Subsection 15.2(7) is relieving and provides an exception to the rule in subsection (3) which defines an "eligible issuer" and effectively permits only one SBB to be issued per group. Subsection (7) permits more than one SBB to be issued in a group where the total principal outstanding of the group does not exceed $500,000. As a result of the amendment to the definition of "eligible issuer" described above, subsection (7) has been amended to permit a partnership having no majority interest partner to issue up to $500,000 of SBBs in total.

Clause 7

Debt Obligations

ITA
16

Section 16 of the Act deals with blended payments which are partly of a capital nature and partly of an interest or other income nature.

Subclause 7(1)

ITA
16(3)

Where an obligation is issued at a discount by a government or other tax-exempt issuer and the yield (including the discount) is more than 4/3 of the stated interest rate, the discount will be treated as income of the first owner of the obligation who is resident in Canada and not exempt from tax.

Prior to the enactment of the interest accrual rules in Part LXX of the *Income Tax Regulations*, in which non-interest bearing debt obligations were deemed to be prescribed debt obligations for the purpose of subsection 12(9), it was appropriate for subsection 16(3) to apply to non-interest bearing debt obligations. However, the application of both the interest accrual rules and subsection 16(3) may produce inappropriate results when applied to non-interest bearing debt obligations. This amendment, which applies to 1991 and subsequent taxation years, excludes from the application of subsection 16(3) an obligation that is a prescribed debt obligation for the purposes of subsection 12(9).

Subclause 7(2)

ITA
16(6)

New subsection 16(6) of the Act applies with respect to indexed debt obligations (as defined in subsection 248(1)). It sets out the tax treatment of the index adjustment both for taxpayers who are holders of such obligations and for borrowers who have issued such obligations. Generally, any increase in the amount owing under such an obligation that is determined by reference to a decrease in the purchasing power of money is to be treated as interest for income tax purposes. The increase will be included on an accrual basis in computing the income of the holder of the obligation and, provided the other criteria for interest deductibility are met, will be deductible on an accrual basis in computing the income of the debtor.

The amount to be included or deducted for a taxation year in computing the income of a taxpayer who is the holder or debtor in respect of an interest in an indexed debt obligation will be determined by regulation. Draft section 7001 of the *Income Tax Regulations*, released on October 16, 1991, contains the rules for determining such amounts. Where the purchasing power of money has declined, a prescribed amount will be treated as interest received and receivable in the year by the holder of the obligation, pursuant to new subparagraph 16(6)(a)(i), and will be treated as interest payable in respect of the year by the debtor, pursuant to new subparagraph 16(6)(b)(i).

In the event that the purchasing power of money increases, the resulting decrease in the amount owing under the obligation will be treated as interest payable by the creditor to the debtor. More particularly, new subparagraph 16(6)(a)(ii) provides that the decrease is considered to be interest paid and payable in respect of the year by the holder of the obligation under a legal obligation to pay interest on borrowed money used for the purpose of earning income from a business or property. As a result, a deduction will be available to the holder under paragraph 20(1)(c). New subparagraph 16(6)(b)(ii) treats the decrease in the amount payable as interest received and receivable in the year by the debtor in respect of the obligation.

Where subparagraph 16(6)(b)(i) has treated an amount as interest payable by the debtor and the debtor pays or credits an amount in respect of that amount, new paragraph 16(6)(c) treats that payment or crediting as being a payment or crediting of interest. This provision is particularly relevant for the purposes of paragraph 212(1)(b) of the Act, dealing with withholding tax exigible on the payment or crediting of interest to non-resident persons.

New subsection 16(6) is applicable in respect of indexed debt obligations issued after October 16, 1991.

Clause 8

Prohibited Deductions - Business and Property Income

ITA
18

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

Subclause 8(1)

ITA
18(5)

Subsection 18(5) of the Act defines certain expressions, including the term "specified shareholder" for the purpose of the "thin capitalization" rules in subsections 18(4) to (8) of the Act. The change to the preamble of subsection (5) is consequential on the inclusion of new subsection 18(5.1) in the Act, which deems a person that satisfies the criteria of the subsection not to be a specified shareholder of a corporation.

Subclause 8(2)

ITA
18(5)(a)(ii)

The thin capitalization rules in subsections 18(4) to (8) of the Act disallow the deduction by a corporation of interest on debts owing to certain specified non-residents to the extent that the corporation's debt/equity ratio in relation to the specified non-residents exceeds 3 to 1.

Paragraph 18(5)(a) of the Act defines a corporation's "outstanding debts to specified non-residents" for the purposes of the limit on interest deductibility under subsection 18(4). Subparagraph 18(5)(a)(ii) provides that a debt owing to a non-resident insurer by a corporation that the insurer controls will not be included under this definition if, for the purposes of section 138, the non-resident insurer treats the debt as property held by it in the year in the course of carrying on an insurance business in Canada.

This subparagraph is amended to eliminate the requirement that the corporation be controlled by the non-resident insurer. As a result, any debt owing to a non-resident insurer is to be excluded where the debt is part of the insurer's Canadian business property. The paragraph is also amended to provide that a debt will be excluded from the corporation's "outstanding debts to specified non-residents" only where it is included as property used by the non-resident insurer in carrying on business in Canada through a permanent establishment.

The amendments to subparagraph 18(5)(a)(ii) are applicable to 1991 and subsequent taxation years, and to the 1985 to 1990 taxation years where a corporation elects by notifying the Minister of National Revenue on or before the day that is six months after Royal Assent.

Subclause 8(3)

ITA
18(5)(c)

Paragraph 18(5)(c) of the Act provides that a person who owns 25% or more of the issued shares of any class of the capital stock of a corporation is a "specified shareholder" of that corporation for the purposes of the thin-capitalization rules. This paragraph is amended to provide that a specified shareholder of a corporation will include only those persons that own either 25% or more of the voting shares of the corporation or shares having a fair market value of 25% or more of the fair market value of all the issued and outstanding shares of the corporation. Paragraph 18(5)(c) is further amended to provide that, for the purposes of determining whether or not either of these 25% thresholds has been met, a person will be deemed to own any shares that he or she has the right to acquire and that any shares that the person has the right to require the corporation to redeem (other than those shares held by the person) shall be considered to have been so redeemed.

This amendment is applicable to 1993 and subsequent taxation years, except that a corporation may elect to have it apply also to its 1989 to 1992 taxation years.

Subclause 8(4)

ITA
18(5.1)

New subsection 18(5.1) of the Act is a saving provision which ensures that a person who would otherwise be a specified shareholder of a corporation will not be treated as such if the person becomes a specified shareholder in order to safeguard the person's rights in respect of indebtedness outstanding and owing to the person or a non-arm's length person, and it is reasonable to conclude that a condition or event contemplated in an agreement in effect at the time the provision is being applied will occur to cause the person no longer to be a specified shareholder.

This amendment is applicable to 1993 and subsequent taxation years, except that a taxpayer may elect to have it apply to the 1989 to 1992 taxation years.

Subclause 8(5)

ITA
18(9)(b)

Paragraph 18(9)(a) of the Act prohibits the deduction of certain prepaid expenses, including interest, in computing a taxpayer's income for a taxation year preceding that to which the expenses relate. Where a deduction for a prepaid expense in one year is denied by paragraph 18(9)(a), paragraph 18(9)(b) permits the deduction in the subsequent year to which the expense relates.

The amendment to paragraph 18(9)(b) provides that no deduction under subsection 18(9) is to be allowed to a corporation, partnership or trust in respect of prepaid interest. This amendment applies in respect of interest that is prepaid for periods that are after 1991 and is consequential to the introduction of the rules in new subsections 18(9.2) to (9.8) dealing with the treatment of prepaid interest.

Subclause 8(6)

ITA
18(9.2) to (9.8)

New subsections 18(9.2) to (9.8) of the Act provide rules relating to the measurement of interest payable in respect of borrowings on which interest has been prepaid. These rules are limited to corporations, partnerships and trusts and will apply only for the purpose of determining the amount of interest payable by a debtor after 1991 on a borrowing. Individuals, as well as corporations, partnerships and trusts that are engaged in a farming or fishing business and compute their income from that business using the cash-basis method of accounting, will be unaffected by these new rules. In addition the tax position of the holder of a debt obligation is unchanged by these amendments.

The principal rule is new subsection 18(9.2). Essentially, this subsection applies to treat the amount of principal owing on a debt as having been reduced by any interest prepayments that have been made thereon, and then calculates the interest payable on the debt by reference to this reduced principal balance. Any interest actually payable in excess of this calculated amount is also treated as a payment of principal for the purpose of calculating interest on the debt for future periods.

Subsection 18(9.2) will generally reduce, for the purposes of Part I of the Act, the amount of interest payable for a particular taxation year if, before or during that year, interest on the debt in question has been prepaid for future periods. However, any interest actually payable on the debt in excess of the amount determined under subsection 18(9.2) will be eligible for recognition in later years as each prepaid interest period passes.

The application of this rule is not limited to taxation years for which interest is payable on a current basis **and** has been prepaid for future years; rather, its effects also extend into the prepaid periods as a result of the carry-forward of excess interest payable from earlier years. However, the interest payable under subsection 18(9.2) for each later prepaid period will be calculated on the assumption that the nominal interest rate on the debt for that period (as opposed to a rate based on the actual amount prepaid in satisfaction of interest for that period) applies, thereby providing recognition for the full amount of interest actually payable on the debt over the course of its term.

The following example serves to illustrate the effects of new subsection 18(9.2) of the Act.

EXAMPLE

A corporation having a calendar taxation year borrows $1,000 for 10 years on January 1, 1992. The loan is subject to annual interest at a rate of 10% payable at the end of each year; however, the corporation prepays the interest for the last 5 years of the loan at the beginning of 1995. Assuming that the company is entitled to discount these future interest prepayments at the same rate as that applying under the loan, the present value of those payments at the beginning of 1995 would be:

Interest for:	Number of Years Discounted	Amount
1997	3	$75.13
1998	4	68.30
1999	5	62.09
2000	6	56.45
2001	7	51.31
Total Payment		$313.28

By calculating the amount of interest payable on the loan on the assumption that the principal owing were reduced by:

- prepaid interest for the taxation year in question and any subsequent taxation years, and

- the amount, if any, of interest payable for preceding years in excess of that allowed under subsection 18(9.2),

the following results are obtained:

Year	Principal Owing	Deduct: Prepaid Interest	Deduct: Excess Interest, Preceding Years	Deemed Interest Payable for Year (@ 10%)	Interest Otherwise Determined for Year
1992	$1000	0	0	$100.00	$100.00
1993	1000	0	0	100.00	100.00
1994	1000	0	0	100.00	100.00
1995	1000	$313.28	0	68.67	100.00
1996	1000	313.28	$31.33	65.54	100.00
1997	1000	313.28	65.79	62.09	75.13[1]
1998	1000	238.15	78.83	68.30	68.30
1999	1000	169.85	78.83	75.13	62.09
2000	1000	107.76	65.79	82.64	56.45
2001	1000	51.31[2]	39.60	90.91	51.31
Total				$813.28	$813.28

Notes: 1 It is assumed for the purposes of this example that the prepaid interest will be allocated to the respective periods on the same basis as that used for determining the discounted amounts; however, the results would be identical if one-fifth of the total prepayment had simply been allocated to each of years 1997 to 2001.

2 Under new subparagraph 18(9.2)(a)(ii), prepaid interest for the last year of the loan is not required to be deducted from the principal amount of the loan for the purpose of computing interest payable for that year. However, the existence of an overall limitation, in paragraph 18(9.2)(b), on the amount of interest payable on the loan produces a figure, for the last year of the loan, equal to that which would have arisen if the prepaid interest had been so deducted.

To illustrate the application of new subsection 18(9.2) in more detail, in 1997 the amount of interest payable on the loan would be computed as:

	$1,000	Principal Amount of the Loan
	(313.28)	Prepaid interest for years 1997 to 2001
$500.00		Interest Otherwise Determined for 1992 to 1996
434.21		Deemed Interest Payable under subsection 18(9.2) for 1992 to 1996
	(65.79)	Excess Interest for Preceding Years
	$620.93	Deemed Principal Outstanding
	x 10%	Nominal Interest Rate on Loan
	$62.09	Deemed Interest for 1997 under subsection 18(9.2)

As a result of the application of new subsection 18(9.2) in this example, the total amount of interest payable on the loan remains unchanged and only the allocation of the interest to particular taxation years has been affected. For future taxation years – if the loan were to remain outstanding after 2001 – no limitations on the amount of interest payable would arise as a result of this reallocation in respect of previous years.

ITA
18(9.2)

New paragraph 18(9.2)(a) of the Act provides the principal limitation on the amount that will be treated under Part I of the Act as interest payable by a corporation, partnership or trust (the "borrower") on a debt obligation for a taxation year. For the purposes of this paragraph, the interest payable on a debt obligation for a particular taxation year is to be computed on the assumption that the principal amount owing under the obligation during that year were reduced both by any prepaid interest for subsequent periods (including amounts paid to reduce the interest rate otherwise applying for a subsequent period) and by interest payable for previous taxation years (ending after 1991) in excess of that allowed under subsection 18(9.2) in respect of those previous years. In general terms, the amount determined under new paragraph 18(9.2)(a), and potentially deductible under paragraph 20(1)(c) (or otherwise recognized under Part I of the

Act), will be the interest otherwise payable on only that portion of the outstanding principal amount of the debt obligation that exceeds such prepaid interest and any "excess interest" for previous taxation years.

New paragraph 18(9.2)(a) requires a borrower to determine the amount of interest (to the extent that it does not exceed a reasonable amount) that would have been payable on a debt obligation in respect of a taxation year on the assumption that, except for the purposes of subparagraph 18(9.2)(a)(ii) (described below), no interest had been prepaid on the obligation in respect of the year. This requirement is intended to produce an amount equal to the nominal interest that would have been payable, under the terms and conditions of the debt obligation and based on a reduction of the outstanding principal balance of the obligation by the amounts determined under subparagraphs 18(9.2)(a)(ii) and (iii), in respect of the year.

New subparagraph 18(9.2)(a)(ii) describes those prepayments of interest which are to be deducted from the principal amount owing in respect of a debt obligation for the purposes of paragraph 18(9.2)(a). In this context, prepaid interest consists of any amounts that are paid in satisfaction, in whole or in part, of the obligation to pay interest for a future period, including:

- under new subsection 18(9.4), amounts paid by any person or partnership in satisfaction of interest payable on the debt obligation for a subsequent period, or as consideration for a reduction in the rate of interest payable on the obligation for a subsequent period; and

- under new subsection 18(9.5), the payment of amounts that, while payable ostensibly as interest on the debt obligation in respect of a particular period, may reasonably be regarded as consideration for a reduction in the amount of interest payable, or in the amount that may be paid in satisfaction of the obligation to pay interest, on the debt obligation for a subsequent period.

While it is important to note that subparagraph 18(9.2)(a)(ii) may apply to interest prepayments made before 1992 as well as those made after 1991, such prepayments will be included only if, at the particular time that this provision is being applied, they relate to a period (or part thereof) that is

1) after 1991,

2) after the beginning of the taxation year in question, and

3) after the time at which the payment was made.

Accordingly, prepayments of interest in respect of periods occurring before 1992 are never to be included in the amount determined under this subparagraph. Prepayments of interest that were made for a period that is after 1991, but in a preceding taxation year, will also not be included under subparagraph 18(9.2)(a)(ii) in subsequent years (but will form part of the amount determined under subparagraph (iii), described below). Similarly, where the prepayment of interest for future taxation years is made, for example, six months before the end of the current year, the prepayment would reduce, under new subparagraph 18(9.2)(a)(ii), the amount considered to be outstanding on account of the principal amount of the debt obligation for only the last six months of the current year. Finally, where a borrower has simply prepaid interest in respect of a period that is in the current taxation year, no amount will be required to be included in the amount determined under subparagraph 18(9.2)(a)(ii) in respect of that prepayment (unless, and only after the time at which, a prepayment of interest for a future year is also made within the current year).

New subparagraph 18(9.2)(a)(iii) describes the total interest that was payable on a debt obligation for preceding taxation years in excess of that deemed under subsection 18(9.2) to have been payable on the obligation for those years. Where a debt obligation was issued before 1992, this determination is required only in respect of taxation years ending after 1991.

New paragraph 18(9.2)(b) of the Act provides an overall limitation on the amount of interest that may, under subsection 18(9.2), be considered to be payable on a debt obligation by a borrower for a taxation year. Essentially, this limitation represents the difference between

- the amount of interest that would, in the absence of subsection 18(9.2), have been the total amount of interest payable on the debt obligation for the current year and all preceding taxation years ending after 1991, and

- the total amount of interest deemed by new subsection 18(9.2) to have been payable on the debt obligation for all such preceding taxation years.

New paragraph 18(9.2)(b) ensures that the amount of interest that is deemed to be payable on a debt obligation by reason of new subsection 18(9.2) may not exceed the amount of interest that was actually payable (that is, determined without reference to new subsection 18(9.2)) by the borrower in respect of that obligation.

EXAMPLE: TRANSITIONAL APPLICATION

The following example – which is identical to the first except that the loan is made on January 1, 1988 and the prepayment of interest is made on January 1, 1991 for the 1993-97 taxation years – illustrates the application of new subsection 18(9.2) to a debt obligation in respect of which prepayments were made before 1992 for periods that are after 1991.

Year	Principal Owing	Deduct: Prepaid Interest	Deduct: Excess Interest, Preceding Years	Deemed Interest Payable for Year (@ 10%)	Interest Otherwise Determined for Year
1988	$1000	N/A	N/A	N/A	$100.00
1989	1000	N/A	N/A	N/A	100.00
1990	1000	N/A	N/A	N/A	100.00
1991	1000	N/A	N/A	N/A	100.00
1992	1000	$313.28	0	$68.67	100.00
1993	1000	313.28	$31.33	65.54	75.13[1]
1994	1000	238.15	40.92	72.09	68.30
1995	1000	169.85	37.13	79.30	62.09
1996	1000	107.76	19.92	76.37[2]	56.45
1997	1000	0[3]	0	51.31[4]	51.31

Notes: 1 The allocation of prepaid interest in made on the same basis as that used for determining the discounted amounts. Even if, however, this prepayment had been "straight-lined" over the last five years of the loan, the amounts determined under subsection 18(9.2) for 1992 to 1997 would remain the same.

2 Under the formula in paragraph 18(9.2)(a), interest payable for 1996 would be $87.23; however, paragraph 18(9.2)(b) limits the interest payable for 1996 to the total of excess interest from previous years ($19.92) and interest otherwise payable for the year ($56.45).

3 Under subparagraph 18(9.2)(a)(ii), prepaid interest for the last year of the loan is not required to be deducted from the principal amount of the loan for the purpose of computing interest payable for that year.

4 During 1997 no prepaid interest is outstanding for a subsequent period and there is no excess interest from a prior taxation year, therefore paragraph 18(9.2)(b) limits the interest payable for the year to that which is actually payable.

The allowance of the full amount of interest payable for 1991 – notwithstanding the prepayment of $313.28 in interest at the beginning of that year – serves to reduce the effect of subsection 18(9.2) with respect to the 1992 and subsequent years. However, the total interest deemed under subsection 18(9.2) to have been payable on the loan for 1992 to 1997 is identical to the amount of interest actually payable for those years.

ITA
18(9.3)

Paragraph 79(c) of the Act provides that, where a creditor acquires or reacquires property as a consequence of the debtor's failure to pay all or part of a mortgage or other debt, the debtor's proceeds of disposition for the property is to include that part of the principal amount of any debt that is forgiven as a result of the acquisition or reacquisition. Section 80 of the Act sets out the rules that apply where a debt owed by a taxpayer is settled or extinguished for less than its principal amount.

New subsection 18(9.3) of the Act establishes rules relating to the application of paragraph 79(c) and section 80 in respect of a debt obligation of a corporation, partnership or trust where the amount of interest payable thereon has been limited under subsection 18(9.2) or interest on the obligation has been prepaid in respect of a future period. Subsection 18(9.3) provides that the amount of any prepaid interest for future periods, as well as the total amount of interest payable on a debt obligation for taxation years ending after 1991 in excess of that amount allowed under subsection 18(9.2), is:

- for the purposes of paragraph 79(c), to be deducted from the principal amount outstanding on the debt obligation in determining the borrower's proceeds of disposition from property acquired by the creditor in satisfaction of the obligation; and

- for the purposes of section 80, to be added to the amount otherwise paid to settle or extinguish the debt obligation in determining the amount by which any losses, or the cost base of any property, of the taxpayer are to be reduced as a result of the settlement or extinguishment.

Subsection 18(9.3), which effectively applies only to debt obligations in respect of which interest has been prepaid for periods after 1991 and that are settled or extinguished in the borrower's 1992 or subsequent taxation year, is designed to account for any prepaid interest for future periods and for the interest payable by the borrower for previous periods that was not recognized under subsection 18(9.2). It is not intended to alter the creditor's tax position in these circumstances, since the recognition of interest income on the debt obligation by the creditor has not been altered under these rules.

ITA
18(9.4) to (9.8)

New subsections 18(9.4) to (9.8) of the Act provide special rules relating to the application of new subsection 18(9.2) and, in certain limited cases, new subsection 18(9.3).

ITA
18(9.4)

New subsection 18(9.4) of the Act provides that, where at any time a person or partnership – including the borrower itself - prepays interest on a debt obligation (or buys down the rate of interest on the obligation) for a period that is after 1991, the amount of the prepayment is to be treated as interest payable by the borrower for that period and as an amount paid by the borrower at that time in satisfaction of interest for that period. This new subsection is intended to provide, subject to subsection 18(9.2), recognition for amounts that were formerly dealt with in either subsection 18(9) or (9.1) of the Act; however, its effects extend beyond those that were provided under those subsections by treating prepayments made by any person or partnership as interest payable by the borrower itself. More specifically, such prepayments will operate to reduce, under paragraph 18(9.2)(a), the outstanding principal balance of a debt obligation (for the periods prior to that to which they relate) for the purpose of determining the amount of interest payable on the obligation, but will also be eligible to be included in the amount of interest payable thereon in taxation years ending after the period for which the prepayments were made.

ITA
18(9.5)

New subsection 18(9.5) of the Act applies in circumstances in which it is reasonable to consider that any part of the interest payable (determined without reference to new subsection 18(9.2)) on a debt obligation for a particular period, including amounts that are deemed to be interest payable under new subsection 18(9.4), was payable as consideration for:

- a reduction in the amount of interest that would otherwise have been payable on the debt obligation for some future period, or

- a reduction in the amount that was or may be prepaid in satisfaction of the interest that would otherwise have been payable for a future period.

Where these circumstances arise, new subsection 18(9.5) provides that the portion of such interest that relates to the future period is to be treated as interest payable on the debt obligation for the future period and not to be interest attributable to the period in respect of which it would otherwise be considered to have been payable. This rule is intended to ensure that, while such interest will not be recognized as an amount payable for the earlier period, it may qualify for recognition in a subsequent year. New subsection 18(9.5) also provides that such interest will, once it has been paid, be regarded as a prepayment of interest for the purposes of applying new subparagraph 18(9.2)(a)(ii) and new paragraph 18(9.3)(a).

The determination of whether the amount of interest payable for one period was in full or partial satisfaction of interest that would otherwise have been payable for a later period, is to be made without reference to the existence of or the amount of any interest paid or payable on any other borrowing. Thus, for example, where a new debt is issued to cancel an existing debt on which interest has been prepaid, the borrower may not support the absence of interest (or the imposition of a lower rate of interest) on the new debt for subsequent periods on the basis of the prepaid interest on the cancelled debt.

ITA
18(9.6)

New subsection 18(9.6) of the Act sets out rules that apply where a borrower assumes the liability in respect of a debt obligation that was issued by another person. In effect, this new subsection places a person that assumes the liability for a debt obligation in the same position, with respect to the determination of the amount of interest payable on the obligation after that assumption, as the original debtor would have been had the assumption not taken place.

New paragraph 18(9.6)(a) provides that, for the purposes of applying new subsections 18(9.2) and (9.3) in respect of a debt obligation that has been assumed by a borrower, the borrower is to be treated as though it had been the debtor under the obligation since the commencement of its first taxation year ending after 1991 (or the beginning of the first period in respect of which interest was payable thereon, whichever is later) and as though subsection 18(9.2) had applied to the borrower in respect of that obligation since that time. For this purpose, subsection 18(9.6) treats a borrower that came into existence after the time at which interest became payable on a debt obligation as having been in existence since that time and having had annual taxation years ending on the day of the year on which its first actual taxation year ended.

ITA
18(9.7)

New subsection 18(9.7) of the Act applies where a prepayment of interest for a future period is greater than the prepayment that would have been required if the borrower had been entitled to discount its future interest liability, back to the time of the prepayment, at a rate equal to the interest rate applying under the debt obligation. Where these circumstances arise, only the figure produced under this assumption will be treated for the purposes of new subsections 18(9.2) to (9.6) and (9.8) to be interest paid, and payable, for the subsequent period to which it relates; the amount actually paid in excess of this figure will be treated as a payment described in paragraph 18(9.1)(d) which, subject to certain conditions set out in subsection 18(9.1), may be deductible or otherwise recognized in computing the borrower's income for the purposes of Part I.

In other words, subsection 18(9.7) applies where a borrower pays, in satisfaction of interest for a future period, an amount greater than that which – applying the interest rate under the borrowing in question – would have grown to equal the amount of interest otherwise payable for that future period. In such cases, subsection 18(9.7) ensures that the new rules in subsections 18(9.2) to (9.6) and (9.8) apply only to the portion of the payment that would equal, over time, the interest otherwise payable for the later period; the balance, however, is not affected by these new rules and may be deductible, or otherwise recognized, under subsection 18(9.1) of the Act.

ITA
18(9.8)

New subsection 18(9.8) of the Act imposes a general limitation on the application of new subsections 18(9.2) to (9.6). This subsection provides that the total amount of interest deemed under new subsection 18(9.2) to have been payable on a debt obligation by a corporation, partnership or trust, together with the amount of such interest payable by an individual (other than a trust), for taxation years ending after 1991 and before any particular time is not to exceed the total amount of interest payable – determined without reference to subsection 18(9.2) – on that obligation in respect of those years. More simply, the purpose of new subsection 18(9.8) is to ensure that new subsection 18(9.2) does not produce a total amount of interest payable in respect of a particular debt obligation in excess of the interest that was actually payable in respect of that obligation.

Subclauses 8(7) and (8)

ITA
18(11)

Paragraphs 20(1)(c), (d) and (e) of the Act permit a deduction for interest and certain other financing expenses relating to borrowed money used by an individual for the purposes of earning income from a business or property. These provisions are, however, subject to subsection 18(11) which prohibits the deduction of such expenses for certain purposes such as paying a "premium" to a registered retirement savings plan.

Paragraph 18(11)(b) is amended so that, for the purposes of subsection 18(11), a "premium" includes any contribution to an RRSP. This amendment is consequential on the amendment to the definition of "premium" in subsection 146(1) which excludes from the definition contributions which are repayments of amounts withdrawn under the new Home Buyers' Plan described in the commentary on new section 146.01. The effect of this amendment is that interest on money borrowed to make such repayments is not deductible in computing income. This amendment is applicable to 1992 and subsequent years.

New paragraph 18(11)(f) of the Act extends, for 1991 and subsequent taxation years, the prohibition on the deduction of certain interest and other financing expenses to indebtedness incurred to contribute to a "net income stabilization account".

Subsection 18(11) is also amended for 1991 and subsequent taxation years to clarify that, for the purposes of that subsection, it is only "to the extent that" an indebtedness is incurred by a taxpayer with respect to a property used for a purpose referred to in the subsection that the indebtedness in respect of that property is considered to be incurred for the restricted purpose.

Clause 9

Deductions in Computing Income
from Business or Property

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 9(1)

ITA
20(1)(ff)

Paragraph 20(1)(ff) of the Act provides taxpayers with a deduction for amounts paid as a levy under the *Western Grain Stabilization Act*. This paragraph is amended for 1991 and subsequent taxation years to also apply to premiums paid in respect of the "gross revenue insurance program" under the *Farm Income Protection Act* or amounts paid as an administration fee in respect of a "net income stabilization account".

Subclause 9(2)

ITA
20(1)(qq) and (rr)

Paragraph 20(1)(gg) of the Act, which allows a taxpayer to deduct reasonable costs relating to eligible disability-related modifications to the taxpayer's building is being repealed (see commentary under clause 157) and replaced with new paragraph 20(1)(qq). This amendment applies retroactively to the time the former paragraph became effective, i.e. with respect to renovations and alterations made after 1991.

Furthermore, new paragraph 20(1)(qq) provides that the cost of renovations and alterations made after February 25, 1992 may be deductible by a taxpayer even though the building is not owned by the taxpayer. New paragraph 20(1)(rr) allows a taxpayer to deduct, in computing income from a business or property, costs relating to eligible devices or equipment acquired primarily to assist individuals who have a sight or hearing impairment. The eligible devices or equipment, which will be prescribed in regulations, include the installation or acquisition of elevator car position indicators, visual fire alarm indicators, telephone devices, listening devices for group meetings and disability-specific computer software and hardware attachments. Paragraph 20(1)(rr) applies with respect to amounts paid after February 25, 1992.

Subclause 9(3)

ITA
20(12)

Subsection 20(12) of the Act permits non-business income tax paid to a foreign government to be deducted in computing a taxpayer's income, as an alternative to claiming that tax as a foreign tax credit under section 126 of the Act. This amendment, which applies to 1992 and subsequent taxation years, provides that a deduction under subsection 20(12) is available only with respect to foreign taxes paid in respect of income from a business or property, and also clarifies that any amount claimed under that subsection is to be deducted in computing income from the source to which that tax relates.

Subclause 9(4)

ITA
20(16.1)

Subsection 20(16.1) of the Act provides that a terminal loss in respect of a depreciable property that is a "passenger vehicle" costing more than a prescribed amount (currently set at $24,000) is not deductible in computing income. (Essentially, a passenger vehicle is an automobile acquired after June 17, 1987.) On the other hand, any recapture of capital cost allowance (CCA) upon the disposition of such a vehicle is not required to be included in income. However, where a taxpayer owns at the beginning of a particular year a passenger vehicle costing more than the prescribed amount and disposes of it before the end of that particular year, it is intended that the taxpayer benefit from a deduction equal to 50% of the CCA deduction that would have otherwise been available in respect of the former vehicle for that particular year had the taxpayer not disposed of that vehicle. The original requirement that the taxpayer acquire another vehicle at a cost in excess of the prescribed amount before the 50% CCA deduction be allowed has been deleted. Subsection 20(16.1) is amended in order that it override subsection 20(16) which would otherwise deny any CCA deduction in such circumstances.

This amendment is applicable to taxation years and fiscal periods commencing after June 17, 1987 that end after 1987.

Subclause 9(5)

ITA
20(21)(b)

Subsection 20(21) 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. The deduction is in respect of any previous over-inclusion of interest on that debt obligation and is measured as the excess of interest included in the taxpayer's income in the year of disposition or any preceding year over interest that was received or receivable at or before the time of disposition. This subsection is amended, with application to dispositions occurring after December 20, 1991, to ensure that all amounts received or that became receivable in respect of interest on the obligation in the year of disposition, or in a preceding taxation year, will be taken into account in computing the deduction.

Subclause 9(6)

ITA
20(24)

Subsection 20(24) of the Act provides that a taxpayer may deduct from income certain payments made to obtain another person's agreement to deliver goods or render services for which the taxpayer has included certain amounts in business income pursuant to paragraph 12(1)(a). Conversely, the other person must include the amount received in income and may be entitled to claim a reserve under paragraph 20(1)(m) of the Act with respect to goods to be delivered or services to be rendered after the recipient's year-end.

Subsection 20(24) is amended in two respects. First, its applicability is extended to circumstances where the other person is paid an amount to assume obligations to which paragraph 12(1)(a) applies, not merely those made with respect to undelivered goods or unrendered services. For example, taxpayers may be eligible to claim subsection 20(24) treatment in respect of payments made to another person who assumes the taxpayer's obligation to repay a customer who returns containers used to deliver goods (and for which the customer paid a deposit), or to another person who agrees to provide customers with the use of land or chattels for which rents or other amounts were received in advance by the taxpayer in the course of business. Further, where the amount is received by the other person in the course of business, paragraph 20(24)(b) requires that other person to include the amount in income under paragraph 12(1)(a), subject to any eligible reserve claim that may be deducted from income. Where the other person does not receive the amount in the course of business (e.g., as rental income from property), it would be required to be included in income as earned pursuant to section 9.

Secondly, paragraph 20(24)(a) is amended to provide that the taxpayer may not deduct a reserve in respect of the undertaking under paragraph 20(1)(m.1).

These amendments are applicable to 1991 and subsequent taxation years.

Clause 10

Treatment of Eligible Capital Property on Rollovers

ITA
24

Section 24 of the Act provides rules for the treatment of eligible capital property of a taxpayer who has ceased to carry on business.

Subclauses 10(1) and (2)

ITA
24(2)

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 by a corporation controlled by the taxpayer.

Paragraph 24(2)(a) is amended, effective after July 13, 1990, to clarify that the reference to cumulative eligible capital in that paragraph refers to cumulative eligible capital in respect of a business. New paragraph 24(2)(d), effective after July 13, 1990, prevents an overstatement of the deemed taxable capital gain or amount to be included in income on the subsequent disposition of eligible capital property by the spouse or corporation. Such an overstatement would occur because the calculation of the deemed taxable capital gain under subparagraph 14(1)(a)(v), or the amount to be included in income under paragraph 14(1)(b), of the spouse or corporation would not include any amount relating to cumulative eligible capital amounts deducted by the taxpayer under paragraph 20(1)(b) before the taxpayer's adjustment time, as defined in paragraph 14(5)(c) of the Act.

The following example illustrates the operation of new paragraph 24(2)(d):

Assume an individual, who owns a business with a calendar fiscal period, purchases an eligible capital property before the individual's adjustment time (when the inclusion rate for eligible capital property was one-half) for $300,000. This is the first and only eligible capital property held in respect of the individual's business. The individual takes deductions under paragraph 20(1)(b) totalling $40,650 before that adjustment time, and deductions under that paragraph totalling $11,482 subsequent to that adjustment time. The individual then transfers the property to the individual's spouse, immediately before which time the individual's cumulative eligible capital is $152,543. This is the only eligible capital property held by the spouse in respect of the business.

The spouse disposes of the eligible capital property for $500,000, before deducting any amount under paragraph 20(1)(b). In the absence of new paragraph 24(2)(d), the spouse's deemed taxable capital gain under subparagraph 14(1)(a)(v) would be $170,325, since no amount would be calculated under clause 14(1)(a)(v)(B) in respect of the disposition by the spouse.

Under the amendment to subsection 24(2), the calculations of the amount to be included in computing the spouse's income and the spouse's deemed taxable capital gain in the year in which the spouse disposes of the eligible capital property are as follows:

- the amount to be included in the spouse's income from the business for the year in which the eligible capital property is disposed of

  = lesser of (A) the negative balance in the spouse's cumulative eligible capital (the "excess"), and

  (B) the total of the spouse's and the individual's unrecaptured deductions

  = lesser of (A) [(3/4 of $500,000) - $152,543] = $222,457, and

  (B) $52,132

  = $52,132

- the amount deemed to be a taxable capital gain of the spouse

  = the amount by which the excess exceeds the total of the amount included in income plus 1/2 the total of the unrecaptured pre-adjustment time deductions of the spouse and the individual

  = $222,457 - ($52,132 + 1/2 of $40,650)

  = $150,000

Subclause 10(3)

ITA
24(3)

Subsection 24(1) of the Act provides a deduction, in computing the income of a taxpayer for a taxation year equal to the amount of the residual cumulative eligible capital of a business. The deduction is available in the first taxation year after the taxation year in which the taxpayer has ceased to carry on a business and in which the taxpayer has also disposed of all eligible capital property of value in respect of the business. New subsection 24(3), which is applicable after July 13, 1990, provides that, where a partnership has been dissolved in circumstances where neither subsection 98(3) nor subsection 98(5) applies, each former member of the partnership may deduct an amount equal to that former member's proportion of the amount that would be deductible under subsection 24(1) by the partnership had the partnership not ceased to exist.

Clause 11

Capital Gains and Losses

ITA
39(13)

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.

New subsection 39(13) of the Act provides, generally, that the portion of an amount that was applied in reduction of the adjusted cost base (ACB) of a taxpayer's non-depreciable capital property, and which is subsequently repaid by the taxpayer at a time that is after the disposition of that property, will be treated as a capital loss of the taxpayer. The reduction of the ACB of a property in these circumstances is provided in subparagraph 53(2)(k)(i) and subsection 53(2.1). In the absence of this amendment, a taxpayer would not receive tax recognition for the repayment notwithstanding that it represents an amount that was applied in reduction of the ACB of property that has been disposed of.

This amendment is applicable to 1991 and subsequent taxation years.

Clause 12

Principal Residence: Spousal Trusts

ITA
40(5)

Subsection 40(5) of the Act is a special rule that, in conjunction with subsection 40(4) and subparagraph 54(g)(vi), allows a spousal trust the benefit of the principal residence exemption for capital gains on a residence held by the trust in respect of a period of time during which the settlor spouse and beneficiary spouse occupied it. Subsection 40(5) is repealed, effective for dispositions occurring after 1990, as a consequence of the amended definition of principal residence in paragraph 54(g). This amended definition will allow personal trusts, including spousal trusts, to claim the principal residence exemption. This is explained in more detail in the commentary on the amendment to paragraph 54(g).

Clause 13

Dispositions of Remainder Interests in Property

ITA
43.1

An individual who is the owner of a real property may create different interests in the property, each of which would constitute a separate property. One of the interests that may be so created is a life estate, which refers to the right to occupy, use and deal with the property during the lifetime of a particular individual. Where this right is granted to an individual to last for the lifetime of another person, the estate is referred to as an estate *pur autre vie.* Another interest in real property is the remainder interest, which refers to the right to full ownership of the whole property after the death of the individual who is the measuring life for purposes of the life estate or estate *pur autre vie.* New section 43.1 of the Act provides rules to apply in dealing with such interests.

ITA
43.1(1)

New subsection 43.1(1) of the Act deals with the disposition of the remainder interest in a real property by a taxpayer who retains the life estate or estate *pur autre vie* (both of which terms are referred to as the "life estate" for purposes of new section 43.1) in the property. The new subsection, which is applicable to dispositions occurring after December 20, 1991, provides that in such a case, the taxpayer will be deemed to have disposed of the life estate that has been retained, for proceeds equal to its fair market value at the time the remainder interest is disposed of, and to have reacquired the life estate immediately after that time at the same fair market value.

For example, where an individual who owns a real property gives the remainder interest in the property to his or her child while retaining the life estate, subsection 43.1(1) ensures that there is a realization of any capital gain or loss that has accrued to the individual on the whole property at the time the remainder interest is disposed of. Without this provision, such a disposition could result in the deferral of the realization of any capital gain on the interest in the property retained by the individual until such time, after the individual's death, as the child disposes of the property. The provisions of new subsection 43.1(1) do not apply in cases where the remainder interest is disposed of to a registered charity that is not a charitable foundation. The provisions of this subsection also do not apply to the transfer of a remainder interest in a farm property to a child, if the provisions of subsection 73(3) otherwise apply to that transfer.

ITA
43.1(2)

New subsection 43.1(2) of the Act applies where a life estate to which subsection 43.1(1) has applied is terminated as a result of an individual's death. At the death of the measuring life for a life estate or an estate *pur autre vie*, the estate terminates, and the individual holding the remainder interest in the property at the time of the death becomes the owner of the whole property. Paragraph 43.1(2)(a) provides that the life estate holder is deemed to have disposed of the life estate immediately before the death of the measuring life for proceeds of disposition equal to its adjusted cost base. Thus, no capital gain or loss would arise in respect of such a disposition.

New paragraph 43.1(2)(b) provides for an addition to the adjusted cost base of the property in the hands of the individual who held the remainder interest at the time of the termination of the life estate, where that individual and the life estate holder were not dealing at arm's length at that time. In such a case, the adjusted cost base of the real property would be increased by an amount equal to the lesser of the adjusted cost base of the life estate in the property, immediately before its termination as a result of the death of the measuring life, and the amount, if any, by which the fair market value of the whole real property exceeds the adjusted cost base of the remainder interest at that time. This amendment recognizes that, pursuant to new paragraph 43.1(2)(a), the termination of the life estate did not give rise to a capital loss to the deceased life estate holder.

New section 43.1 of the Act applies to dispositions and terminations occurring after December 20, 1991.

Clause 14

Cost of Certain Property

ITA
52(1)

Section 52 of the Act sets out rules for determining the cost of certain property for the purposes of measuring any gain or loss on its disposition. Subsection 52(1) of the Act provides that where an amount in respect of the value of property has been included in computing a taxpayer's income, that amount will be added in determining the cost to the taxpayer of the property. To eliminate double-counting, the amendment to this subsection limits this addition to amounts that have not otherwise been added to the cost, or included in computing the adjusted cost base, to the taxpayer of the property.

The amendment to subsection 52(1) is applicable after October 16, 1991.

Clause 15

Adjustments to Cost of Property

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 gain or loss on its disposition.

Subclause 15(1)

ITA
53(1)(e)(vii.1)

Paragraph 53(1)(e) of the Act provides for additions in computing the adjusted cost base (ACB) to a taxpayer of an interest in a partnership. New subparagraph 53(1)(e)(vii.1) provides an addition in computing the ACB of the interest equal to the taxpayer's share of Canadian development expense or Canadian oil and gas property expense incurred by the partnership in a fiscal period. This subparagraph applies where an election is made by the taxpayer with respect to such a share under amended subparagraph 66.2(5)(a)(iv) or 66.4(5)(a)(ii). Under such an election, the taxpayer's share of such expenses is excluded in determining the taxpayer's Canadian development expense or Canadian oil and gas property expense. For further detail, reference may be made to the commentary on the amendments to those subparagraphs.

This amendment is applicable after July 1990.

Subclause 15(2)

ITA
53(1)(g.1)

New paragraph 53(1)(g.1) of the Act deals with indexed debt obligations, as defined in subsection 248(1). This paragraph provides for an addition to the adjusted cost base to a taxpayer of an interest in such an obligation. The amount to be added is the amount of the index adjustment that is required to be included in computing the taxpayer's income as interest, as determined under new subparagraph 16(6)(a)(i) of the Act and draft section 7001 of the Regulations. This amount reflects that portion of any increase in the amount owing to a taxpayer who has invested in an indexed debt obligation that is attributable to a decline in the purchasing power of money.

New paragraph 53(1)(g.1) is applicable in respect of indexed debt obligations issued after October 16, 1991.

Subclause 15(3)

ITA
53(1)(o)

New paragraph 53(1)(o) of the Act is strictly consequential on the introduction of special rules relating to life estates and remainder interests in real property provided under new section 43.1. This new paragraph provides for an increase in the adjusted cost base to a taxpayer of property in circumstances to which new paragraph 43.1(2)(b) applies. This amendment is effective as of December 20, 1991.

Subclause 15(4)

ITA
53(2)(l.1)

New paragraph 53(2)(l.1) of the Act provides for a deduction in computing the adjusted cost base to a taxpayer of an interest in an indexed debt obligation held by the taxpayer. The expression "indexed debt obligation" is defined in subsection 248(1). The total amount to be deducted is composed of two amounts. The first is the total of the amounts that were deductible in computing the taxpayer's income as interest under new subparagraph 16(6)(a)(ii) of the Act. These amounts reflect any decrease in amounts owing to the taxpayer in respect of amounts borrowed under the obligation that may be attributed to an increase in the purchasing power of money. The second is the total amount of any payments received or that became receivable by the taxpayer on account of the index adjustment, to the extent that the adjustment has, by reason of new paragraph 53(1)(g.1), been added to the adjusted cost base to the taxpayer of the obligation.

New paragraph 53(2)(l.1) is applicable in respect of indexed debt obligations issued after October 16, 1991.

Subclause 15(5)

ITA
53(2)(t)

New paragraph 53(2)(t) of the Act provides for a deduction in computing the adjusted cost base to the estate of a deceased taxpayer of employee stock options in respect of which the estate has made an election under new subsection 164(6.1) of the Act. The amount of that deduction is the amount treated by paragraph 164(6.1)(a) as being a loss of the deceased from employment for the year of death, determined as if that paragraph were read without reference to subparagraph (iii) thereof. New paragraph 53(2)(t), which applies July 13, 1990, is intended to prevent a loss in respect of those options from being claimed both as an employment loss of the deceased and as a capital loss of the estate.

Subclause 15(6)

ITA
53(2.1)

Subsection 53(2.1) of the Act permits a taxpayer to elect to reduce the adjusted cost base of a capital property by the amount of a related inducement, reimbursement, contribution or allowance received by the taxpayer that would otherwise be included in income pursuant to paragraph 12(1)(x). This subsection is amended to clarify that such an election may be made only in respect of capital property (other than depreciable property).

This amendment is applicable to 1991 and subsequent taxation years.

Clause 16

Principal Residence

ITA
54(g)

Paragraph 54(g) of the Act defines the expression "principal residence" for the purpose of the capital gains exemption provided for a principal residence in paragraph 40(2)(b). Under paragraph 54(g), only one property may generally be claimed as a principal residence in respect of a year for a family unit. (For this purpose, a family unit generally consists of an individual, his or her spouse and their minor children.) Under the present rules, only trusts that qualify as spousal trusts (as described in subsection 70(6) or 73(1)) are allowed the benefit of the principal residence exemption. The amendments to paragraph 54(g) allow certain personal trusts that are not spousal trusts also to qualify for the principal residence exemption. The expression "personal trust" is defined in subsection 248(1) of the Act.

New subparagraphs 54(g)(i.1) and (iii.1) are introduced so that any trust that qualifies as a personal trust may generally claim a property as a principal residence for a taxation year where, in that year, an individual "beneficially interested" in the trust ordinarily inhabits the property or has a spouse, former spouse or child who ordinarily inhabits it. The expression "beneficially interested" is defined in new subsection 248(25). Individuals so described in respect of a trust are referred to in the legislation as "specified beneficiaries" of the trust. To qualify for the exemption, the principal residence must be designated by the trust in prescribed form and manner. Each specified beneficiary is required to be listed in such a designation by the trust for its taxation year and is treated under amended subparagraph 54(g)(vi) as having designated the property as a principal residence for the calendar year ending in that year. Subparagraph 54(g)(vi), together with subparagraph 54(g)(iii) and new clause 54(g)(iii.1)(D), ensures that not more than one principal residence may be claimed, either directly or through a trust, by a family unit for a taxation year.

The new rule allowing personal trusts to claim the principal residence exemption with respect to a property does not apply where a corporation (other than a registered charity) or a partnership is beneficially interested in the trust.

Subparagraph 54(g)(ii), in conjunction with existing subparagraphs 54(g)(iii) and (iv), is meant to allow a taxpayer to claim property as a principal residence for up to 4 years without it being occupied by the taxpayer or a member of the taxpayer's family unit. (There are exceptions to the 4-year limit contained in section 54.1). Subparagraph 54(g)(ii)applies to property that is the subject of an election under subsection 45(2) or (3). A subsection 45(2) election may be made for a year where the use of the property in the year has changed from a non-income-producing use to an income-producing use. A subsection 45(3) election may be made where the use of property has changed from an income-producing use to use as a principal residence. Subparagraph 54(g)(ii) currently provides that property may be claimed under this subparagraph as a principal residence for a year only if such an election is made for the year.

Subparagraph 54(g)(ii) is amended to ensure that it extends to a change in use by a taxpayer of property subject to a subsection 45(2) election, where the change in use occurred prior to the year for which the property is claimed as a principal residence. However, the amended subparagraph does not apply where the subsection 45(2) election has been rescinded in the taxpayer's return of income for the year or a preceding year. Subparagraph 54(g)(ii) is also amended to ensure that it extends to a change in use by a taxpayer of property that is the subject of a subsection 45(3) election, where the change in use occurred subsequent to the year for which the property is being claimed as a principal residence. Amended subparagraph 54(g)(ii), in conjunction with new subparagraph 54(g)(ii.1), also provides that a personal trust electing under subsection 45(2) or (3) may claim property as a principal residence for a year, in which case each trust beneficiary in the year is considered to be a specified beneficiary for the purposes of subparagraph 54(g)(vi).

These amendments apply to dispositions occuring after 1990.

Clause 17

Amounts to be Included in 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 from a source other than property, business or employment and other than from the disposition of capital properties.

Subclause 17(1)

ITA
56(1)(b) and (c)

Paragraph 56(1)(b) of the Act requires the inclusion in income of periodic alimony payments received by a separated or divorced spouse pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written agreement, while paragraph 56(1)(c) provides for a similar inclusion in the case of maintenance payments received by such a spouse pursuant to an order of a competent tribunal. These two paragraphs are merged into revised paragraph 56(1)(b). This amendment applies to amounts received pursuant to a written agreement or a decree, order or judgment of a competent tribunal with respect to a breakdown of a marriage occurring after 1992.

Subclause 17(2)

ITA
56(1)(c.1)

Paragraph 56(1)(c.1) of the Act requires the inclusion in income of periodic maintenance allowances received pursuant to orders made under provincial laws which recognize a support obligation with respect to common-law spouses on a breakdown of their conjugal relationship, as well as situations where an individual receives support payments from the other parent of a child of the individual. The amendment to paragraph 56(1)(c.1) (which is now paragraph 56(1)(c)) deletes the reference to individuals of the opposite sex who cohabited in a conjugal relationship. This reference is no longer necessary since, as a result of the introduction of subsection 252(4) which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent, paragraph 56(1)(b) will apply to such a person. This amendment applies to amounts received pursuant to orders made after 1992.

Subclause 17(3)

ITA
56(1)(c.2)

Court-ordered alimony or other periodic maintenance allowances for the support of the recipient, children of the recipient or both are included in income under certain conditions by reason of paragraphs 56(b), (c) and (c.1), and are deductible by the payer under paragraph 60(b), (c) or (c.1). New paragraph 56(1)(c.2) requires that where such amounts are ordered reimbursed by a court, the amount received as the reimbursement is to be included in income in the year it is received. Conversely, new paragraph 60(c.2) allows a deduction from income in respect of the payment of such reimbursements.

This amendment applies to payments received after 1990.

Subclause 17(4)

ITA
56(1)(h.1)

Paragraph 56(1)(h.1) of the Act is introduced to make reference to certain amounts required to be included in income pursuant to the new Home Buyers' Plan described in detail in the commentary to section 146.01. Under the Home Buyers' Plan, a home buyer may withdraw up to $20,000 of RRSP funds before March 2, 1993 to acquire a qualifying home. Amounts may be included in income pursuant to new subsections 146.01(4), (5), (6) and (9).

This amendment applies to 1992 and subsequent years.

Subclause 17(5)

ITA
56(1)(1.1)

Paragraph 56(1)(1.1) of the Act requires a taxpayer to include in computing income amounts received as an award or reimbursement of legal expenses paid to collect or establish a right to a retiring allowance or benefits under a pension plan in respect of employment, other than legal expenses relating to a division or settlement of property arising from a marriage or other conjugal relationship.

This amendment, which removes the reference to "other conjugal relationship", is consequential on the introduction of subsection 252(4), which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. This paragraph is also amended to clarify that the exception to the inclusion in income of legal fees relating to a division or settlement of property only applies where such division or settlement arises out of a marriage or occurs as a result of a breakdown of the marriage.

These amendments apply after 1992.

Subclause 17(6)

ITA
56(4.1)(a)

Subsection 56(4.1) of the Act applies in certain cases to attribute income from a particular individual to another individual with whom the particular individual does not deal at arm's length. The rules do not apply unless the particular individual or a trust in which the particular individual is "beneficially interested" received a loan from, or became indebted to, the other individual. (The expression "beneficially interested" is currently defined for this purpose in subsection 74.5(10) of the Act.)

Subsection 56(4.1) is amended to eliminate the reference to subsection 74.5(10). This is because the expression "beneficially interested" is now defined in new subsection 248(25) rather than in subsections 74.5(10) and 94(7). The amendment is effective as of January 1, 1991.

Clause 18

Maintenance

ITA
56.1

Section 56.1 of the Act treats certain alimony and maintenance payments made to third parties for the benefit of an individual who is a taxpayer's spouse, former spouse, common-law spouse or a person who is a parent of the taxpayer's child (or for the benefit of children in the custody of such an individual) as having been received by the individual so that such payments will be included in the individual's income. The amendments to section 56.1, which delete the references to paragraph 56(1)(c.1) and to a taxpayer cohabiting in a conjugal relationship with a person of the opposite sex, are strictly consequential on the amendments to paragraphs 56(b),(c) and (c.1) and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. Revised section 56.1 applies to amounts received pursuant to a written agreement entered into after 1992 or a decree, order or judgment of a competent tribunal made after 1992.

Clause 19

Annuities

ITA
58(5)

Section 58 of the Act provides that, subject to an annual maximum, certain annuity payments received by a taxpayer under contracts with the Government of Canada or similar contracts entered into before June 25, 1940 may be deducted from the total of such annuity payments received by the taxpayer in the year. For contracts entered into before May 26, 1932, the maximum deductible in each year is $5,000. For contracts entered into after May 25, 1932 and before June 25, 1940, that maximum is set at $1,200. Subsection 58(5) provides that, where a husband and wife each receive annuity payments eligible for the deduction, the maximum amount deductible is computed as if all the eligible annuities belonged to the same person. The deduction may then be claimed by either of them or apportioned between them. This amendment, which replaces the expressions "husband" and "wife" with the expressions "taxpayer" and "taxpayer's spouse", applies after 1992 and is strictly consequential on the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Clause 20

Deductions in Computing Income

ITA
60

Section 60 of the Act provides for a variety of deductions in computing income, many of which relate to certain income inclusions required under section 56 of the Act.

Subclause 20(1)

ITA
60(b) and (c)

Paragraph 60(b) of the Act permits a deduction for periodic alimony payments made to a separated or divorced spouse pursuant to a decree, order or judgment of a competent tribunal or pursuant to a written agreement, while paragraph 60(c) provides for a similar deduction in the case of maintenance payments paid to such a spouse pursuant to an order of a competent tribunal. These two paragraphs are merged into revised paragraph 60(b). This amendment applies to amounts paid pursuant to a written agreement or a decree, order or judgment of a competent tribunal with respect to a breakdown of a marriage occurring after 1992.

Subclause 20(2)

ITA
60(c.1)

Paragraph 60(c.1) of the Act permits a deduction for periodic maintenance allowances paid pursuant to orders made under provincial laws which recognize a support obligation with respect to common-law spouses on a breakdown of their conjugal relationship, as well as situations where an individual makes support payments to the other parent of a child of the individual. The amendment to paragraph 60(c.1) (which is now paragraph 60(c)) deletes the reference to individuals of the opposite sex who cohabited in a conjugal relationship. This reference is no longer necessary since, as a result of the introduction of subsection 252(4) which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent, paragraph 60(b) will apply to such a person. This amendment applies to amounts paid pursuant to orders made after 1992.

Subclause 20(3)

ITA
60(c.2)

New paragraph 60(c.2) of the Act is the counterpart of new paragraph 56(1)(c.2) and provides for the deduction of repayments of alimony and maintenance allowances previously included in income. Specifically, paragraph 60(c.2) provides that, where amounts of court-ordered alimony or maintenance allowances were included in the income of the recipient for a year and a court subsequently orders the reimbursement by a taxpayer of the amounts (for example, by a cancellation or variation of the original order), the court-ordered reimbursement may be deducted by the taxpayer within a 3-year period.

This amendment applies to payments made after 1990.

Subclause 20(4)

ITA
60(i)

Paragraph 60(i) of the Act permits a deduction in respect of amounts that are deductible under section 146, including withdrawals of RRSP overcontributions that are deductible by reason of subsection 146(8.2). This paragraph is amended to permit a deduction in respect of amounts that are deductible by reason of new subsection 147.3(13.1). New subsection 147.3(13.1) permits a deduction in respect of amounts transferred in excess of allowable limits set out in section 147.3 from a registered pension plan to an RRSP or a registered retirement income fund.

This amendment is applicable to 1992 and subsequent years.

Subclause 20(5)

ITA
60(j)(i)

Paragraph 60(j) of the Act allows a taxpayer a special deduction in respect of amounts paid, in a year or within 60 days after the end of the year, to registered pension plans and registered retirement savings plans. The deduction available to a taxpayer under this paragraph is generally limited to lump sum payments received by a taxpayer from a pension plan (other than a registered pension plan) attributable to services rendered while the taxpayer or the taxpayer's spouse was not resident in Canada and included in computing the taxpayer's income. For this purpose, the term "spouse" has the meaning assigned by subsection 146(1.1). The amendment to subparagraph 60(j)(i), which deletes the reference to subsection 146(1.1), is consequential on the repeal of that subsection and the introduction of subsection 252(4) which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. The amendment applies after 1992.

Subclause 20(6)

ITA
60(j.02) to (j.04)

Three new rules are being added in paragraphs 60(j.02) to (j.04) of the Act to provide deductions in respect of certain payments to registered pension plans (RPPs).

New paragraph 60(j.02) provides transitional relief where an agreement to acquire past service benefits under an RPP may have been entered into with the expectation that payments under the agreement (including the repayment of benefits received from certain other RPPs) would be deductible, by virtue of paragraph 60(j), as transfers of pension income. Paragraph 60(j) was amended with respect to 1990 and subsequent years to terminate the rollover provided by that provision for periodic pension income. Paragraph 60(j.02) is intended to continue the deduction formerly provided by paragraph 60(j) for payments made pursuant to elections or agreements made or entered into before March 28, 1988, which is the date on which the amendments to paragraph 60(j) were first announced.

More specifically, paragraph 60(j.02), which is applicable to 1990 and subsequent taxation years, permits an individual to deduct the lesser of two amounts in computing income for a taxation year. The first amount is the sum of

- contributions made by the individual in the year to an RPP in respect of pre-1990 service, where the individual was obliged to make the contributions under the terms of a written agreement entered into before March 28, 1988,

- amounts paid by the individual in the year to an RPP as repayments of pension benefits received before 1990, where the repayments are made pursuant to a prescribed statutory provision and are required as a consequence of a written election made before March 28, 1988, and

- amounts paid by the individual in the year to an RPP as interest in respect of the repayments just described.

However, the first amount does not include amounts deductible under paragraph 8(1)(m) (employee's RPP contributions) or new paragraph 60(j.03) (repayments of pre-1990 pension benefits). The second amount is the total periodic pension income received by the individual in the year, other than income that has been designated for the purposes of the tax-free transfer to a spousal RRSP provided by paragraph 60(j.2).

New paragraph 60(j.03), which applies commencing with the 1991 taxation year, contains a rule applicable in limited circumstances in respect of the repayment of pre-1990 pension benefits. The paragraph allows an individual to claim a deduction in computing income for a taxation year for amounts paid by the individual to an RPP as repayments of pension benefits received before 1990 (or as interest in respect of such repayments), if the repayments are made pursuant to a prescribed statutory provision. This deduction of an individual for a year is limited to the excess of $3,500 minus RPP contributions (for past and current service) deducted in computing this individual's income for the year under paragraph 8(1)(m).

New paragraph 60(j.04), which applies commencing with the 1990 taxation year, provides a deduction in respect of the repayment of post-1989 pension benefits. The paragraph allows an individual to claim a deduction in computing income for a taxation year for amounts paid by the individual to an RPP as repayments of pension benefits received after 1989 (or as interest in respect of such repayments), where the repayments are made pursuant to a prescribed statutory provision. However, the deduction is available only to the extent that the repayments are not deductible under paragraph 8(1)(m), and is not available for repayments of pension benefits that have been designated for the purposes of paragraph 60(j.2) (tax-free transfer to spousal RRSP).

New paragraphs 60(j.02) to (j.04) contemplate the prescription in the *Income Tax Regulations* of a number of statutory provisions with respect to the repayment of pension benefits. For these purposes, it is intended to prescribe subsection 39(7) of the *Public Service Superannuation Act* and similar provisions in the *Canadian Forces Superannuation Act*, the *Members of Parliament Retiring Allowances Act* and the *Royal Canadian Mounted Police Superannuation Act.*

As noted above, new paragraphs 60(j.02) to (j.04) apply on a retroactive basis. Revenue Canada would be in a position to refund any tax and interest for the 1990 and 1991 taxation years resulting from the application of the new paragraphs only after they receive Royal Assent.

Subclauses 20(7) and (8)

ITA
60(l)(ii)

Where an individual has received a refund of premiums out of a registered retirement savings plan (RRSP) or has received certain other amounts, paragraph 60(l) of the Act provides a deduction for qualifying payments (not exceeding the amounts so received) made by the individual to an RRSP or registered retirement income fund, or to acquire an annuity described in subparagraph 60(l)(ii).

To qualify under subparagraph 60(l)(ii), an annuity must provide for equal periodic payments. The subparagraph is amended to allow the acquisition of annuities that provide for payments that are cost-of-living adjusted or that otherwise fluctuate in any of the ways permitted by subparagraphs 146(3)(b)(iii) to (v) for retirement income payable under an RRSP. This amendment applies to 1990 and subsequent years.

The term "spouse" is used in paragraph 60(l) to determine whether a particular refund of premiums qualifies for a deduction and to describe certain conditions regarding annuities that may be acquired. For the purpose of paragraph 60(l), the term "spouse" has the meaning assigned by subsection 146(1.1). The amendment to subclause 60(l)(ii)(A)(I), which deletes the reference to subsection 146(1.1), is consequential on the repeal of that subsection and the introduction of subsection 252(4) which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. This amendment applies after 1992.

Subclause 20(9)

ITA
60(o.1)(i)

Paragraph 60(o.1) of the Act provides for the deductibility of eligible legal expenses paid after 1985 to collect or establish a right to a retiring allowance or pension benefits. Eligible legal expenses do not include expenses relating to a division or settlement of property arising from a marriage or other conjugal relationship or to Canada or Quebec Pension Plan benefits. This amendment is consequential on the introduction of subsection 252(4), which extends the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a 12-month period or is a parent of a child of whom the person is a parent. This paragraph is also amended to clarify that the exception to the deduction from income of legal fees relating to a division or settlement of property only applies where such division or settlement arises out of a marriage or occurs as a result of a breakdown of the marriage.

These amendments apply after 1992.

Subclause 20(10)

ITA
60(s)

Paragraph 60(s) of the Act provides a deduction for certain policy loan repayments to the extent that an amount was previously included in the taxpayer's income in respect of the receipt of a policy loan. The amendment clarifies that the deductible portion will not include any amount in respect of interest paid on such a loan. Interest paid on a policy loan is treated as a premium paid under the policy, in accordance with paragraph 148(9)(e.1) of the Act, and is added in computing the adjusted cost basis of the taxpayer's interest in the policy under subparagraph 148(9)(a)(ii). Policy loan repayments which are not in respect of interest are included in computing the adjusted cost basis of the taxpayer's interest in the policy under subparagraph 148(9)(a)(iv) only to the extent the repayment is not deductible under paragraph 20(1)(hh) or 60(s).

This amendment to paragraph 60(s) is applicable to repayments made after December 20, 1991.

Clause 21

Eligible Amount

ITA
60.01(b)

Section 60.01 of the Act includes a lump sum payment from a foreign retirement arrangement as an eligible amount for the purposes of the deduction under paragraph 60(j) in respect of certain transfers of superannuation benefits where the payment is included in computing a taxpayer's income and is derived from contributions 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). The amendment to paragraph 60.01(b), which deletes the reference to subsection 146(1.1), applies after 1992 and is strictly consequential on the repeal of that subsection and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Clause 22

Maintenance

ITA
60.1

Section 60.1 of the Act treats certain alimony and maintenance payments made to third parties for the benefit of an individual who is a taxpayer's spouse, former spouse, common-law spouse or a person who is a parent of the taxpayer's child (or for the benefit of children in the custody of such an individual) as having been paid to and received by the individual, so that such payments may be deductible by the taxpayer. The amendments to section 60.1, which delete the reference to paragraph 60(c.1) and to a taxpayer cohabiting in a conjugal relationship with a person of the opposite sex, are strictly consequential on the amendments to paragraphs 60(b),(c) and (c.1) and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. Revised section 60.1 applies to amounts paid pursuant to a written agreement entered into after 1992 or a decree, order or judgment of a competent tribunal made after 1992.

Clause 23

Child Care Expenses

ITA
63

Section 63 of the *Income Tax Act* provides rules concerning the deductibility of child care expenses.

Subclause 23(1)

ITA
63(1)

These amendments to the preamble of subsection 63(1) of the Act ensure that the child care expenses eligible to be deductible in computing income for the year are those expenses incurred for services rendered in the same year. The preamble of subsection 63(1) is also amended to enable a taxpayer to claim an amount that is less that the maximum amount allowed under that subsection where it is advantageous for the taxpayer to do so. These amendments apply to 1992 and subsequent years.

Subclause 23(2)

ITA
63(1)(e)(ii)(A)

Clause 63(1)(e)(ii)(A) of the Act sets out the annual maximum amount of child care expenses that may be claimed for a year in respect of eligible children who are under 7 years of age at the end of the year or in respect of whom a disability tax credit may be claimed for the year. This amendment increases from $4,000 to $5,000 the annual maximum amount that may be claimed in respect of these children. This amendment applies to 1993 and subsequent years.

Subclause 23(3)

ITA
63(1)(e)(ii)(B)

Clause 63(1)(e)(ii)(B) of the Act sets out the annual maximum amount of child care expenses that may be claimed for a year in respect of eligible children who are 7 years of age or older at the end of the year. This amendment increases from $2,000 to $3,000 the annual maximum amount that may be claimed in respect of these children. This amendment applies to 1993 and subsequent years.

Subclauses 23(4) to (6)

ITA
63(2)(b)

Where two or more taxpayers contributed in a year to the support of an eligible child, the child care expense deduction for the year must generally be claimed by the taxpayer with the lower income for the year. However, in the circumstances specified in paragraph 63(2)(b) of the Act, the supporting person with the higher income may claim a deduction based on the number of weeks in the year throughout which the lower-income person is separated, infirm, confined to a bed or wheelchair, in prison or in full-time attendance at a designated educational institution. In the case of separation, the lower-income person must be living separate and apart from the higher-income person, at the end of the year and for at least 90 days commencing in the year, by reason of a breakdown of their marriage or similar domestic relationship. As a result of the introduction of subsection 252(4) which extends the meaning of "spouse" to individuals cohabiting in a conjugal relationship, the reference in paragraph 63(2)(b) to a "similar domestic relationship" is deleted since it is no longer necessary. These amendments to paragraph 63(2)(b) also increase the weekly maximum amount of the deduction from $120 to $150 with respect to child care expenses paid for eligible children who are under 7 years of age at the end of the year or in respect of whom a disability tax credit may be claimed and from $90 to $120 with respect to child care expenses paid for other eligible children.

These amendments apply to 1993 and subsequent years.

Subclauses 23(7) and (8)

ITA
63(3)(a)(iii)

Subparagraph 63(3)(a)(iii) of the Act contains a weekly maximum amount that may be claimed for a year in respect of expenses paid for a child's attendance at a boarding school or camp. These amendments increase the weekly maximum amounts of $120 and $60 to $150 and $90, respectively.

These amendments apply to 1993 and subsequent years.

Clause 24

Canadian Development Expense

ITA
66.2(5)(a)(iv)

Paragraph 66.2(5)(a) of the Act defines oil, gas and mining expenditures that qualify as Canadian development expenses. Subparagraph 66.2(5)(a)(iv) provides, subject to the at-risk rules in section 66.8, that a taxpayer's Canadian development expenses include the taxpayer's share of such expenses of a partnership.

Subparagraph 66.2(5)(a)(iv) is amended so that a taxpayer may elect to have such a share of a partnership's Canadian development expenses in a fiscal period excluded in determining the taxpayer's own Canadian development expenses. The election may be made within 6 months after the end of the taxpayer's taxation year in which the fiscal period of the partnership ends. If the taxpayer makes the election, the taxpayer is not allowed to deduct any amount in respect of such share in computing income. However, new subparagraph 53(1)(e)(vii.1) provides an addition equal to the amount of such a share in computing the adjusted cost base to the taxpayer of the taxpayer's interest in the partnership. This addition offsets the subtraction under paragraph 53(2)(c) of the same amount in computing the adjusted cost base to the taxpayer of the interest.

EXAMPLE

Corporation A is a member of a partnership. Its share of Canadian development expenses incurred by the partnership for the fiscal period of the partnership ending January 30, 1991 is $10,000. There is no income or loss at the partnership level in the fiscal period. What are the consequences to Corporation A if the partnership interest is disposed of for $110,000 on October 1, 1991, assuming Corporation A makes an election in respect of its share of the expenses under new subparagraph 66.2(5)(a)(iv) and the adjusted cost base to Corporation A before the end of the fiscal period is $90,000?

Result:

1. As a consequence of the election, Corporation A will not be entitled to deduct any portion of the $10,000 under subsection 66.2(2).

2. An amount of $10,000 in computing the adjusted cost base of the interest is deducted after the end of the fiscal period under paragraph 53(2)(c). However, this amount is offset by the addition of the same amount under new subparagraph 53(1)(e)(vii.1). The adjusted cost base after the end of the fiscal period to Corporation A thus remains $90,000.

3. Corporation A therefore has a capital gain of $20,000 from the disposition of the partnership interest.

This amendment is applicable with respect to fiscal periods of partnerships ending after July 1990, except that an election of a taxpayer with respect to such a fiscal period will be considered to have been made on a timely basis if it is filed with the Minister of National Revenue within 6 months of Royal Assent.

Clause 25

Canadian Oil and Gas Property Expense

ITA
66.4(5)(a)(ii)

Paragraph 66.4(5)(a) of the Act defines oil and gas expenditures that qualify as Canadian oil and gas property expenses. Subparagraph 66.4(5)(a)(ii) provides, subject to the at-risk rules in section 66.8, that a taxpayer's Canadian oil and gas property expenses include the taxpayer's share of such expenses of a partnership.

Subparagraph 66.4(5)(a)(ii) is amended so that a taxpayer may elect to have such a share of a partnership's Canadian oil and gas property expenses in a fiscal period excluded in determining the taxpayer's own Canadian oil and gas property expenses. The election may be made within 6 months after the end of the taxpayer's taxation year in which the fiscal period of the partnership ends. If the taxpayer makes the election, the taxpayer is not allowed to deduct any amount in respect of such share in computing income. However, new subparagraph 53(1)(e)(vii.1) provides an addition equal to the amount of such share in computing the adjusted cost base to the taxpayer of the taxpayer's interest in the partnership. This addition offsets the subtraction under paragraph 53(2)(c) of the same amount in computing the adjusted cost base to the taxpayer of the interest. For further detail, see the commentary on the corresponding amendment to subparagraph 66.2(5)(a)(iv).

This amendment is applicable with respect to fiscal periods of partnerships ending after July 1990, except that an election of a taxpayer with respect to such a fiscal period will be considered to have been made on a timely basis if it filed with the Minister of National Revenue within 6 months of Royal Assent.

Clause 26

Resource Expenses of Limited Partner

ITA
66.8(3)

Subsection 66.8(1) of the Act provides for the reduction of a taxpayer's share of a partnership's resource expenditures incurred in a fiscal period in certain cases where the taxpayer's share of such resource expenditures exceeds the taxpayer's "at-risk amount" at the end of the fiscal period in respect of the partnership. Where there is such a reduction, subsection 66.8(2) allows the amount of reduction to be carried forward and treated as if it were an expense incurred in the immediately following fiscal period.

Section 66.8 is amended so that a taxpayer's share of Canadian development expenses and Canadian oil and gas property expenses incurred by a partnership in a fiscal period is deemed to be nil where the taxpayer makes an election with respect to the share under subparagraph 66.2(5)(a)(iv) or 66.4(5)(a)(ii). This ensures that the at-risk rules do not affect such an election.

This amendment is applicable with respect to fiscal periods of partnerships ending after July 1990.

Clause 27

Inadequate Considerations

ITA
69

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

Subclause 27(1)

ITA
69(1.2)

New subsection 69(1.2) of the Act deals with the disposition of property which is subject to an agreement between persons not dealing at arm's length that provides for payments of less than a reasonable amount for the use of or the right to use the property. The existence of such a non-arm's length agreement may reduce the fair market value of the property and thus affect the amount of any capital gain on the disposition of the property.

The provisions of new subsection 69(1.2) apply where such a property is disposed of and the proceeds of disposition are less than the fair market value of the property determined without reference to the agreement. In such circumstances, the proceeds of disposition of the property for the purposes of the Act will be deemed to be the greater of the fair market value of the property determined without reference to the agreement, and the proceeds of disposition determined without reference to this subsection.

For example, where a taxpayer leases a property to a person with whom the taxpayer is not dealing at arm's length, for payments less than those that would otherwise have been reasonable in the circumstances, and subsequently gives the property to another person, both subsection 69(1) concerning gifts, and new subsection 69(1.2), will apply. The application of subsection 69(1) will give rise to proceeds of disposition equal to the property's fair market value at the time of the gift. Under subsection 69(1.2), if that fair market value is less than the fair market value of the property determined without reference to the existence of the lease, the proceeds of disposition will be deemed to be the fair market value of the property determined without reference to the lease. The same result would be obtained where there is a deemed disposition of property at fair market value on the death of an individual.

The provisions of new subsection 69(1.2) are applicable with respect to dispositions of property occurring after December 20, 1991.

Subclause 27(2)

ITA
69(13)

Subsection 69(13) of the Act provides a special rule for the purpose of determining whether subsection 69(11) is applicable in respect of an amalgamation or merger. This latter subsection sets out an anti-avoidance rule which prevents a person or partnership from disposing of a property as part of a series of transactions for less than fair market value proceeds so as to obtain the benefit of the tax deductions or entitlements of another person on a subsequent disposition of the property. The amendment to subsection 69(13) is consequential on the amendment to the definition of "cost amount" in respect of eligible capital property in subsection 248(1). That amendment multiplies by 4/3 the prorated cumulative eligible capital to take account of the 3/4 inclusion rate with respect to eligible capital property. This amendment applies to amalgamations occurring in or after a corporation's first taxation year commencing after June 1988.

Clause 28

Death of a Taxpayer

ITA
70

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

Subclause 28(1)

ITA
70(5)

Subsection 70(5) of the Act generally provides for the deemed realization of depreciable and other capital property owned by a taxpayer immediately before the taxpayer's death.

In the case of depreciable property of a prescribed class, paragraph 70(5)(b) currently provides that the property is to be treated as having been disposed of for an amount that is at the midpoint between the undepreciated capital cost and fair market value of the property. This result is in contrast with other capital property which is treated as having been disposed of for proceeds of disposition that equal the fair market value of the property immediately before the taxpayer's death.

Subsection 70(5) is amended to provide that the disposition of a taxpayer's depreciable property will be for proceeds that equal the fair market value of the property immediately before the taxpayer's death. This is effected by extending the application of paragraph 70(5)(a) to all capital property of a taxpayer. (Paragraphs 70(5)(c) and (e) become revised paragraphs 70(5)(b) and (c), respectively.) As such, terminal losses, recapture, and capital gains arising in respect of the disposition on death of a taxpayer's depreciable capital property will, as is the case for other capital property, be determined on the basis of proceeds of disposition that are equal to the fair market value of the property.

As is the case with corresponding amendments to subsections 104(5) and 107(4), this amendment is applicable with respect to dispositions occurring after 1992.

Subclause 28(2)

ITA
70(5.1)

Subsection 70(5.1) provides a tax deferral where, as a consequence of a taxpayer's death, any person (other than the taxpayer's spouse or a corporation controlled by the taxpayer) has acquired eligible capital property of the taxpayer. This subsection is amended to prevent an overstatement of the deemed taxable capital gain or the amount to be included in income on the subsequent disposition of eligible capital property by the person. Such an overstatement would occur because the calculation of the person's deemed taxable capital gain under subparagraph 14(1)(a)(v), or the amount to be included in income under paragraph 14(1)(b), would not include any amount relating to cumulative eligible capital amounts deducted by the taxpayer under paragraph 20(1)(b) before the taxpayer's adjustment time (as defined by paragraph 14(5)(c)). Reference may be made to the commentary concerning subsection 24(2) for an example of the operation of a similar amendment in circumstances where an individual ceases to carry on business and the business is subsequently carried on by the individual's spouse. The amendment to subsection 70(5.1) applies to acquisitions of eligible capital property occurring as a result of a taxpayer's death after the commencement of the first fiscal period of the taxpayer's business commencing after 1987.

Subclause 28(3)

ITA
70(5.4)

Subject to new subsection 70(6.1), new subsection 70(5.4) of the Act, which is applicable for 1991 and subsequent taxation years, provides that, where a taxpayer has a "net income stabilization account" at the time of death, the taxpayer shall be considered to have been paid all amounts in the taxpayer's NISA Fund No. 2 immediately before that time. (The expressions "net income stabilization account" and "NISA Fund No. 2" are each defined in amendments to subsection 248(1) of the Act). Accordingly, such amounts are generally required to be included under new subsection 12(10.2) in computing the income of the deceased taxpayer for the year of death.

Subclauses 28(4) to (6)

ITA
70(6)

Subsection 70(6) of the Act sets out certain rules that apply to the transfer of capital property on the death of a taxpayer where the transfer is to a spouse or spousal trust. The amendments to this subsection, which are applicable with respect to dispositions occurring after 1992, revise a number of cross-references to subsection 70(5) and are strictly consequential on the amendment of that subsection.

Subclauses 28(7) and (8)

ITA
70(6.1) and (6.2)

Subsection 70(6.1) of the Act provides that a trust is considered to have been created by a taxpayer's will if it was created under the terms of the will or by a court order in relation to the taxpayer's estate that provides for support or relief of the taxpayer's dependants pursuant to provincial law. The existing provision applies for the purposes of subsection 70(6) and paragraph 104(4)(a) under which transfers to qualifying spousal trusts may be made on a rollover basis with the recognition of gains delayed for tax purposes until the death of the surviving spouse.

Subsection 70(6.1) is repealed for 1990 and subsequent taxation years. Instead, the rule currently in subsection 70(6.1) will apply for all purposes under new subsection 248(9.1). This means that the rule will now also apply to the new definition of a "pre-1972 spousal trust" in new paragraph 108(1)(f.2), to new subsection 248(9.2) and to section 70 as a whole.

New subsection 70(6.1) of the Act provides that where, as a consequence of death and provided certain conditions are satisfied, a taxpayer transfers a "net income stabilization account" (NISA) to a spouse or a spousal trust, there will be a rollover of the deceased taxpayer's NISA Fund No. 2 to the spouse or the spousal trust.

Subsection 70(6.2) allows a deceased taxpayer's legal representative to make an election, in respect of capital property of the taxpayer which would otherwise be eligible for rollover treatment under subsection 70(6), to have the general rules in subsection 70(5) apply to the disposition of capital property. Subsection 70(6.2) is amended to provide that an election may also be made to have new subsection 70(5.4), rather than new subsection 70(6.1), apply to the deceased taxpayer's NISA Fund No. 2. Accordingly, all amounts held in a deceased taxpayer's NISA Fund No. 2 immediately before the taxpayer's death may be reported as income on that taxpayer's terminal return of income, notwithstanding that such amounts are generally eligible for a rollover on death to a spouse or a spousal trust.

New subsections 70(6.1) and (6.2) are applicable to 1991 and subsequent taxation years.

Subclauses 28(9) and (10)

ITA
70(7)

Subsection 70(7) of the Act provides rules under which certain "tainted" spousal trusts may be considered qualifying spousal trusts for the purposes of the rollover of capital property under subsection 70(6). These rules apply where a spousal trust is not a qualifying spousal 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 certain property of the trust so listed by the legal representatives of the deceased taxpayer whose will created the trust. For this purpose, and pursuant to paragraph 70(7)(a), a deceased taxpayer's legal representative is allowed to file the taxpayer's terminal return up to 18 months following the taxpayer's death. This extension in the filing period in such circumstances does not, however, result in any reduction of interest arrears computed under section 161.

Subsection 70(7) is amended to ensure that the extension of the filing period to 18 months in respect of a deceased taxpayer's terminal return also applies to circumstances where the deceased taxpayer's net income stabilization account has been transferred or distributed as a consequence of the taxpayer's death to a qualifying spousal trust (see new subsection 70(6.1)).

Further, paragraph 70(7)(b) is amended in four respects. First, that paragraph is amended to provide that a net income stabilization account is not one of the properties that may be so listed for the purpose of "purifying" a spousal trust. Secondly, it is amended to ensure that any election made under subsection 70(7) in respect of a taxpayer is made on the taxpayer's terminal return. Thirdly, the first reference to "other than money" in paragraph 70(7)(b) is removed as money is property and that reference is, therefore, unnecessary. Finally, the references to property that is "specified" is unnecessary and has been deleted.

These amendments are applicable to 1991 and subsequent taxation years.

Subclauses 28(11), (12) and (14)

ITA
70(9) and (9.2)

Subsections 70(9) and (9.2) of the Act provide rules allowing a rollover of capital gains on transfers of farm property, shares of the capital stock of a family farm corporation and an interest in a family farm partnership from a taxpayer to a child of the taxpayer as a result of the death of the taxpayer.

Subsection 70(9) currently requires that the farm property must be used in a farming business by the taxpayer or the taxpayer's spouse or children immediately before the death of the taxpayer. This subsection is amended, applicable to dispositions occurring after 1992, to clarify the required extent of the use of the property and of the involvement of the taxpayer, spouse or children in the farming business. Before the death of the taxpayer, the farm property must have been used principally in a farming business in which the taxpayer or the taxpayer's spouse or children were actively engaged on a regular and continuous basis.

Subsections 70(9) and (9.2) are also amended, applicable to dispositions occurring after 1992, to revise references to subsection 70(5) as a consequence of the amendment of that subsection.

Subclauses 28(13), (15) and (16)

ITA
70(9.1) and (9.3)

Subsections 70(9.1) and (9.3) of the Act allow qualifying farm properties, qualifying shares of a family farm corporation and qualifying interests in a partnership carrying on a farming business to be transferred from a spousal trust on the beneficiary spouse's death on a rollover basis without recognition under subsections 104(4) and (5) of any accrued gains at the time of such death.

These subsections are amended to clarify that the exemption from the rules in subsections 104(4) and (5) applies in respect of property held by a spousal trust. The exemption would not extend, for example, to property held by another trust to which property has been transferred after the death of the beneficiary spouse. These amendments are applicable after December 20, 1991.

Subparagraph 70(9.3)(b)(i) is amended to take into account the amendment to paragraph 70(10)(b). This amendment applies to 1992 and subsequent taxation years.

Subclause 28(17)

ITA
70(10)(b)

Paragraph 70(10)(b) of the Act provides a definition of the expression "share of the capital stock of a family farm corporation". This definition is relevant for the purpose of the special rollover rules provided in sections 70 and 73 dealing with the transfer of a share of the capital stock of a family farm corporation or an interest in a family farm partnership by a taxpayer to a child. The current definition requires that, at the time of determination, all or substantially all of the property of the corporation either be used by the corporation in carrying on the business of farming in Canada in which the taxpayer, the taxpayer's spouse or child was actively engaged or, alternatively, be shares or certain debt obligations issued by other corporations that meet that property requirement. A number of changes are being made to this definition, applicable to 1992 and subsequent taxation years.

The definition is amended to clarify that the share of the capital stock of a family farm corporation must be owned by the taxpayer at the relevant time. The definition has been further modified to clarify that the property of the family farm corporation is not required to be used in the course of carrying on the business of farming at the relevant time. Provided that the other conditions of the definition have been satisfied, prior use of the property in the circumstances described in subparagraph (i) of the definition will suffice.

As well, the type of property that the corporation may own has been broadened to include any indebtedness of other corporations that satisfy the conditions of the definition. This change is consistent with amendments being made to the definition of "interest in a family farm partnership".

The definition is also being amended to require that, at the relevant time, all or substantially all of the fair market value of the corporation's property be attributable to property that has been used principally in the course of carrying on a farming business in Canada in which the taxpayer or certain other qualifying individuals were actively engaged on a regular and continuous basis. The requirement that eligible individuals be actively engaged in carrying on a farm business on a regular and continuous basis is intended merely to clarify the amount of involvement necessary on the part such individuals. Similarly, basing the test on the fair market value of the property will provide greater certainty and is consistent with recent amendments made to the definitions "small business corporation" in section 248 and "qualified small business corporation share" in section 110.6. A corresponding amendment is being made to the definition of the expression "interest in a family farm partnership" in paragraph 70(10)(c).

Finally, the list of qualifying users of the property is expanded to include a parent of the taxpayer and a family farm partnership of a qualifying user. Thus, a share owned by a person will qualify provided that at the time of the disposition of the share all or substantially all of the fair market value of the property owned by the corporation was attributable to property used by either the corporation, the person, the spouse, parent or child of the person or a family farm partnership of any such person in the course of carrying on the business of farming in Canada in which any such person was actively engaged on a regular and continuous basis.

Subclause 28(18)

ITA
70(10)(c)

Paragraph 70(10)(c) of the Act provides a definition of the expression "interest in a family farm partnership". This definition is relevant for the purpose of the special rollover rules provided in sections 70 and 73 dealing with the transfer of a share of the capital stock of a family farm corporation or an interest in a family farm partnership by a taxpayer to a child. The current definition requires that all or substantially all of the property of the partnership at the relevant time be used by the partnership in carrying on the business of farming in Canada in which the person, the person's spouse or child was actively engaged. A number of changes have been made to this definition applicable to 1992 and subsequent taxation years.

The definition is amended to clarify that the interest in a family farm partnership must be owned by the person at the relevant time. The definition has been further modified to clarify that the property is not required to be used in the course of carrying on the business of farming at the relevant time. Provided that the other conditions of the definition have been satisfied, prior use of the property in the circumstances described in subparagraph (i) of the definition will suffice.

The definition is also being amended to require that, at the relevant time, all or substantially all of the fair market value of the partnership's property was attributable to property that has been used principally in the course of carrying on a farming business in Canada in which the person or certain other qualifying persons were actively engaged on a regular and continuous basis (or to shares or indebtedness of corporations that meet this test). The requirement that such eligible persons be actively engaged in carrying on a farming business on a regular and continuous basis is merely intended to clarify the amount of involvement necessary on the part of such individuals. Similarly, basing the test on the fair market value of the property will provide greater certainty and is consistent with recent amendments made to the definitions "small business corporation" in section 248 and "qualified small business corporation share" in section 110.6. A corresponding amendment is being made to the definition of the expression "share of the capital stock of a family farm corporation" in paragraph 70(10)(b).

The types of property that the partnership may own has been expanded to include shares or any indebtedness of farm corporations all or substantially all of the fair market of the property of which is property used in a farming business in which the individual or the individual's family members are engaged on a regular and continuous basis.

Finally, the list of qualifying users of the property is expanded to include a parent of the taxpayer and a family farm corporation of qualifying users.

Subclause 28(19)

ITA
70(11)

New subsection 70(11) of the Act, which is applicable to 1992 and subsequent years, ensures that the fair market value of a net income stabilization account (NISA) is considered to be nil for the purposes of determining whether a share is a "share of the capital stock of a family farm corporation" in paragraph 70(10)(b). That paragraph is relevant for the purposes of the special rollover rules provided in sections 70 and 73 dealing with the transfer of a capital share of a family farm corporation by a taxpayer to a child.

Clause 29

Inter vivos Transfers of Property

ITA
73

Section 73 of the Act provides rules governing the tax treatment of certain *inter vivos* transfers of property.

Subclause 29(1)

ITA
73(1)

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 benefit. Paragraph 73(1)(d) extends these benefits to 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 a person of the opposite sex with whom the taxpayer cohabited in a conjugal relationship before that time. This paragraph is no longer necessary as a result of the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. The repeal of paragraph 73(1)(d) becomes effective after 1992.

Subclauses 29(2) to (5)

ITA
73(3)

Subsection 73(3) of the Act provides rules relating to the *inter vivos* transfer by a taxpayer to the taxpayer's children of family farm properties on a rollover basis. There are several amendments to the subsection.

Subsection 73(3) currently requires that farm properties must be used in a farming business by the taxpayer or the taxpayer's spouse or children immediately before the transfer. This subsection is being amended, applicable to transfers occurring after 1992, to clarify the required extent of the use of the property and of the involvement of the taxpayer, spouse or children in the farming business. Before the transfer, the farm property must be used principally in a farming business in which the taxpayer or the taxpayer's spouse or children were actively engaged on a regular and continuous basis.

The balance of the amendments to subsection 73(3) are applicable to transfers by a taxpayer occurring after the commencement of the first fiscal period of the taxpayer's business commencing after 1987.

The amendment to clause 73(3)(b.1)(i)(B) clarifies the intended application of this provision in circumstances where the taxpayer transfers one of several eligible capital properties in respect of a business to a child or transfers different eligible capital properties in respect of a business to a child.

Subsection 73(3) is further amended to ensure that the amount referred to in subparagraph (d)(ii) thereof (that is, the amount of unrecaptured deductions under paragraph 20(1)(b)) is multiplied by 4/3 to provide that, in view of the 3/4 inclusion rate in respect of eligible capital expenditures, the child is placed in the same tax position as the parent with respect to the property.

Finally, subsection 73(3) is amended to prevent an overstatement of the deemed taxable capital gain or amount to be included in income on the subsequent disposition of eligible capital property by the child. Such an overstatement would occur because the calculation of the child's deemed taxable capital gain under subparagraph 14(1)(a)(v), or the amount to be included in the child's income under paragraph 14(1)(b), would not include any amount relating to cumulative eligible capital amounts deducted by the taxpayer under paragraph 20(1)(b) before the taxpayer's adjustment time (as defined in paragraph 14(5)(c)). In this respect, reference may be made to the commentary on subsection 24(2), which provides an example of the operation of a similar amendment in circumstances where an individual ceases to carry on a business and the business is subsequently carried on by the individual's spouse.

Subclause 29(6)

ITA
73(5)

New subsection 73(5), which is applicable to the disposition after 1990 by a taxpayer of an interest in the taxpayer's NISA Fund No. 2, requires that an amount equal to the balance in the fund so disposed of is to be considered to have been paid out of the fund at that time to the taxpayer. Accordingly, such amount is included in subsection 12(10.2) for the purpose of determining whether it is an amount that is required to be included in the taxpayer's income. The application of new subsection 12(10.2) is discussed in the commentary on that subsection.

Paragraph 73(5)(a) provides, where certain conditions exist, for a tax-deferred disposition of an interest in a NISA Fund No. 2 to a spouse or former spouse of the taxpayer on the breakdown of a marriage or other conjugal relationship.

Paragraph 73(5)(b) provides that, where the disposition of a taxpayer's NISA Fund No. 2 is made to a taxable Canadian corporation in a transaction in which an election was made under section 85 of the Act, the transferor taxpayer is considered to have been paid out of the transferor's NISA Fund No. 2 an amount equal to the elected proceeds of disposition in respect of the transferred interest. Those elected proceeds may generally be equal to an amount between nil and the fair market value of the transferred portion of the NISA Fund No. 2. However, the commentary on the amendment to paragraph 85(1)(c.1) should be taken into account.

EXAMPLE

Where paragraph 73(5)(b) applies to pay an amount out of the transferor's NISA Fund No. 2 as proceeds of deposition under section 85 (also see commentary on the amendment to paragraph 85(1)(c.1)).

ASSUME:

At the end of 1995, the balance in T taxpayer's NISA Fund No. 2 is equal to **$100,000** and no previous withdrawals were made from the fund.

In the year 1996:

- T taxpayer is paid **$10,000** out of the fund.

- T taxpayer transfers the fund to Corporation A after being paid the $10,000 and elects that proceeds of disposition in respect of that NISA Fund No. 2 be equal to **$80,000** (of the total of **$102,000**). The total of **$102,000** in respect of NISA Fund No. 2 exceeds $90,000 (i.e., $100,000 -10,000) because **$12,000** of interest was credited to the fund prior to the transfer.

- Corporation A is paid **$30,000** out of its NISA Fund No. 2 prior to acquiring T taxpayer's NISA Fund No. 2.

- After the section 85 transfer, Corporation A is paid **$60,000** out of its NISA Fund No. 2.

In the year 1997 Corporation A is paid **$54,000** from its NISA Fund No. 2.

Application of subsection 12(10.2) (T taxpayer)

Year
1996: 12(10.2) = **10,000*** + **80,000**** = $90,000

	*(A) 10,000 **		(A) 80,000
less	(B) N/A		(B) N/A
	10,000		**80,000**

Application of subsection 12(10.2) (Corporation A)

Year
1996: 12(10.2) = **30,000*** + **Nil**** = $30,000

	*(A) 30,000		**(A) 60,000
less	(B) N/A		(B) 80,000***
	30,000		**NIL**

***		(B)(a) 80,000
less		(b) -
		80,000

1997: 12(10.2) = **34,000*** = $34,000

	*(A) 54,000		**(B)(a) 80,000
less	(B) 20,000**	less	(b) 60,000
	34,000		**20,000**

In the above example, Corporation A receives credit for T taxpayer having included $80,000 in income. In effect, that amount is considered to have been paid out of the NISA Fund No. 2 at the time of its disposition to Corporation A. Any amount paid out of Corporation A's NISA Fund No. 2 in excess of that $80,000 is included in Corporation A's income. It should also be noted that the ability of a farm producer to transfer an interest in a net income stabilization account is restricted under the NISA program, as established under the *Farm Income Protection Act*.

Clause 30

Transfers for Fair Market Consideration

ITA
74.5(10)

Subsection 74.5(10) of the Act provides that, for the purposes of the attribution rules in sections 74.1 to 74.5, a person is "beneficially interested" in a trust if that person has any right whatsoever to receive income or capital of the trust, whether directly or indirectly through one or more trusts.

This subsection is repealed as of January 1, 1991. It is replaced by new subsection 248(25), which defines the expression "beneficially interested" in the same manner for the purposes of the Act.

Clause 31

Drought-Induced Sale of Livestock
ITA
80.3(1)

Subsection 80.3(4) of the Act provides a tax deferral in respect of the proceeds of sales by farmers of certain "breeding animals" in prescribed drought areas. Paragraph 80.3(1)(b) of the Act defines breeding animals for this purpose as bovine cattle, bison, goats and sheep that are over 12 months of age and are kept for breeding. This provision is amended to include in the definition "deer, elk and other similar grazing ungulates".

This amendment applies to fiscal periods and taxation years ending after 1990.

Clause 32

Loans to Employees

ITA
80.4(1)

Subsection 80.4(1) of the Act treats an individual 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. This subsection is amended to clarify that it applies whether the loan is made as a consequence of a prior, current or future employment.

This amendment is applicable with respect to taxation years commencing after 1991.

Clause 33

Exempt Income

ITA
81(1)(h)

Section 81 of the Act lists various amounts that are not included in computing a taxpayer's income. Paragraph 81(1)(h) 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. This exemption does not apply where the foster person is related to the individual or is cohabiting in a conjugal relationship with the individual. This amendment, which deletes the reference to a person cohabiting in a conjugal relationship in paragraph 81(1)(h), applies after 1992 and is consequential on the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Clause 34

Non-Arm's Length Disposition of Shares

ITA
84.1(2)(e)

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.
Paragraph 84.1(2)(b) treats a taxpayer as not being at arm's length

with the transferee corporation if the taxpayer was, immediately before the transfer, one of a group of less than 6 persons that controlled the acquired corporation and, immediately after the transfer, was a member of the same group that controlled the transferee corporation.

Subsection 84.1(2) is amended by adding new paragraph 84.1(2)(e) which is effective for dispositions occurring after December 20, 1991. It provides that:

(1) in determining whether a corporation is controlled by a group of persons, a group in respect of that corporation means any two or more persons each of whom owns shares of the corporation,

(2) a corporation can be considered to be controlled by a person or particular group of persons notwithstanding that the corporation is also controlled by another person or group of persons. As a consequence, a corporation can be considered to be controlled at the same time by several persons or groups of persons, and

(3) a group controls a corporation notwithstanding that one member of that group has control of the corporation.

Clause 35

Transfer of Property to Corporation
by Shareholders

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 35(1)

ITA
85(1)(c.1)

Paragraph 85(1)(c.1) of the Act provides that the amount elected by a taxpayer and a taxable Canadian corporation on a section 85 rollover in respect of inventory, non-depreciable capital property and property that is a security or debt obligation used or held by the taxpayer in the business of insurance or lending money cannot be below the lesser of its fair market value and its cost amount. The expression "cost amount" is defined in subsection 248(1). Paragraph 85(1)(c.1) is amended, with respect to dispositions occurring after 1990, to extend its application to property that is a taxpayer's NISA Fund No. 2 (as defined under subsection 248(1) of the Act). Such property is not considered to be capital property (see the definition of "capital property" in paragraph 54(b) and the meaning of capital gain and capital loss in section 39).

Subclause 35(2)

ITA
85(1)(d.1)

New paragraph 85(1)(d.1) is applicable with respect to the disposition of property to a corporation occurring after the commencement of its first taxation period commencing after June 1988. It is intended to prevent an overstatement of the amount to be included by virtue of paragraph 14(1)(b) in computing the income of the corporation in a taxation year as a result of a disposition by the corporation of eligible capital property subsequent to the transfer.

The following example illustrates the operation of new paragraph 85(1)(d.1). Assume an individual, with a calendar fiscal period for the individual's business, purchases an eligible capital property before the individual's adjustment time (when the income inclusion rate for eligible capital property was one half) for $300,000. This is the first and only eligible capital property held in respect of the individual's business. The individual takes deductions under paragraph 20(1)(b) totalling $40,650 before adjustment time, and deductions under that paragraph totalling \$11,482 subsequent to adjustment time. The individual then transfers the property to a corporation in circumstances to which subsection 85(1) apply. Immediately before the time of the transfer the individual's cumulative eligible capital is \$152,543, and the fair market value of the property at that time is \$500,000. The amount elected by the parties to be the individual's proceeds of disposition and the corporation's cost of the property is 4/3 of the individual's cumulative eligible capital in respect of the business immediately before the disposition, i.e., \$203,391. After the disposition, this is the only eligible capital property held by the corporation in respect of the business.

The corporation disposes of the eligible capital property for \$500,000, before deducting any amount under paragraph 20(1)(b). In the absence of new paragraph 85(1)(d.1), the amount to be included in computing the corporation's income under paragraph 14(1)(b) in the year in which the disposition occurred would

= the amount by which

(A) the negative balance in the corporation's cumulative eligible capital (the "excess")

exceeds

(B) 1/2 of the corporation's unrecaptured pre-adjustment time deductions under paragraph 20(1)(b)

= the amount by which

(A) 3/4 (\$500,000) - \$152,543 = \$222,457

exceeds

(B) \$0

= \$222,457

Under new paragraph 85(1)(d.1), the calculation of the amount to be included in computing the corporation's income for the year in which the eligible capital property is disposed of

= the amount by which

(A) the negative balance in the corporation's cumulative eligible capital (the "excess")

exceeds

(B) 1/2 the total of the corporation's pre-adjustment time deductions under paragraph 20(1)(b) and those of the individual

= the amount by which

(A) $222,457

exceeds

(B) 1/2 ($0 + $40,650)

= $202,132

Subclauses 35(3) and (4)

ITA
85(1.1)(f) and (i)

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 includes inventory other than real property inventory. Paragraph 85(1.1)(f) is amended, effective for dispositions of property occurring after December 20, 1991, to clarify that in addition to real property inventory, interests in and options in respect of real property are also excluded from the definition of eligible property where they form part of a taxpayer's inventory.

This definition of eligible property is also amended by adding new paragraph (i) applicable to dispositions occurring after 1990, to include a NISA Fund No. 2 as property eligible for transfer under the provisions of section 85 of the Act.

Clause 36

Share-for-Share Exchange

ITA
85.1(1)

Section 85.1 of the Act permits a tax-deferred rollover for shareholders who exchange shares of a corporation (the "acquired corporation") for shares of the purchasing Canadian corporation in the course of an arm's length sale of the acquired corporation's shares. This section applies to most arm's length share-for-share exchanges where there is no consideration given by the purchaser for the exchanged shares other than shares of its capital stock. Subsection 85.1(1) is amended so that, for share exchanges occurring after December 20, 1991, it applies only where the exchanged shares are shares of the capital stock of a taxable Canadian corporation.

Clause 37

Amalgamations

ITA
87

Section 87 of the Act provides rules which apply on the amalgamation of two or more taxable Canadian corporations.

Subclause 37(1)

ITA
87(1)(c)

Generally, the new corporation formed as a result of an amalgamation to which section 87 applies is treated as a continuation of the predecessor corporations for the purposes of the Act. Subsection 87(1), which provides a definition of an amalgamation for the purposes of these rules, sets out several conditions that must be satisfied in order for a merger to be considered an amalgamation for the purposes of section 87. Paragraph 87(1)(c) requires that, where there has been an amalgamation, all of the shareholders of the predecessor corporations immediately before the merger must receive shares of the new corporation. Paragraph 87(1)(c) is amended to clarify that any such shareholders that did not actually own shares of any predecessor corporation immediately before the amalgamation (such as a policyholder of a mutual insurance corporation) do not have to receive shares of the amalgamated corporation. This amendment is applicable in respect of amalgamations occurring after 1989.

Subclauses 37(2) and (9)

ITA
87(1.4) and (2.11)

Although section 87 treats an amalgamated corporation as a continuation of its predecessor corporations for many purposes, it does not currently permit losses incurred by the amalgamated corporation to be carried back to be deducted in computing the taxable income of a predecessor for a taxation year ending before the amalgamation. New subsection 87(2.11) provides that where the predecessor corporations are a parent corporation and one or more of its subsidiary wholly-owned corporations, the amalgamated corporation is deemed to be a continuation of the predecessor parent corporation for the purposes of section 111 and Part IV of the Act. New subsection 87(2.11) thus permits losses of the amalgamated corporation to be carried back to the predecessor parent, subject to the rules in section 111, in the case of what is commonly known as a "vertical short-form amalgamation" or any other amalgamation of a corporation and one or more subsidiary wholly-owned corporations.

A consequential amendment ensures that the definition of "subsidiary wholly-owned corporation" in subsection 87(1.4) of the Act applies for the purposes of new subsection 87(2.11).

These amendments are applicable with respect to amalgamations occurring after 1989.

Subclause 37(3)

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

Paragraph 87(2)(f) of the Act treats the cumulative eligible capital of a predecessor corporation in respect of a business as forming part of the cumulative eligible capital of the new corporation where the new corporation carries on the business. The amendment to paragraph 87(2)(f), which is applicable with respect to amalgamations occurring after June 1988, is intended to ensure that the new corporation is placed in the same position as the predecessor corporation with regard to eligible capital property of a business previously carried on by the predecessor corporation which is now carried on by the new corporation. Also, paragraph 87(2)(f.1) is repealed as a consequence of the amendment to paragraph 87(2)(f).

Subclause 37(4)

ITA
87(2)(j)

Paragraph 87(2)(j) provides that, for the purposes of claiming reserves available under paragraph 20(1)(m), (m.1) or (m.2) or section 32, an amalgamated corporation is considered to have included in its income by reason of paragraph 12(1)(a) amounts previously included in a predecessor's income pursuant to that latter paragraph. Paragraph 87(2)(j) does not, however, refer to subsection 20(24), which provides a deduction in respect of certain payments made to another taxpayer who assumes obligations for which amounts were previously included in the income of the predecessor corporation pursuant to paragraph 12(1)(a). As such, when an unearned payment is included in the income of a predecessor corporation pursuant to paragraph 12(1)(a), an amalgamated corporation is not eligible to claim a deduction under subsection 20(24).

This amendment, which applies to amalgamations occurring and windings-up commencing after 1990, corrects this deficiency by providing a reference to subsection 20(24). Further, for the purposes of claiming amounts under paragraph 20(1)(m), (m.1) or (m.2) or subsection 20(24), an amalgamated corporation will be treated as a continuation of its predecessor corporation. The reference to section 32 in existing paragraph 87(2)(j) is deleted as a result of an amendment made previously to paragraph 87(2)(j.6) of the Act.

Subclause 37(5)

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. The amendment to this paragraph, which is applicable after January 1990, is strictly consequential on the introduction of subsections 12(2.2), 39(13) and 152(4.3) of the Act, and treats the new corporation as a continuation of its predecessors for the purposes of these provisions.

Subclause 37(6)

ITA
87(2)(j.91)

New paragraph 87(2)(j.91) of the Act is consequential to amendments made under Parts I.3 and VI of the Act. These amendments provide that a corporation may deduct, in computing its taxes payable for a taxation year under Part I.3 and Part VI, any corporate surtax or Part I tax, as the case may be, payable by it for the year or for its seven preceding and three following taxation years (to the extent that the taxes for those other years were not previously deducted).

This amendment is intended to treat a new corporation formed on an amalgamation as a continuation of its predecessors, so that the new corporation may obtain recognition for any undeducted surtax, or Part I tax, that was payable by those predecessors in any of the seven taxation years preceding the amalgamation. This amendment is to apply in respect of amalgamations occurring and windings-up commencing after 1990. In addition, pursuant to paragraph 88(1)(e.2) of the Act, new paragraph 87(2)(j.91) will apply to allow a parent corporation to claim such undeducted taxes of its subsidiary following its winding-up in circumstances described in subsection 88(1).

Subclause 37(7)

ITA
87(2)(l.3)

Paragraph 87(2)(l.3) currently applies in respect of property of a predecessor corporation that was unlawfully taken, lost, destroyed, or taken under statutory authority prior to the amalgamation or winding-up. The "replacement property rules" under sections 13 and 44 apply to the new corporation as through it had been in existence and owned the property at the time it was so lost, destroyed or taken. Further, the cost or capital cost, as the case may be, of that property to the new corporation is considered to be the same as that of the predecessor corporation. Also, where the predecessor corporation had acquired a replacement property for that property before the amalgamation, the new corporation is considered to have acquired that replacement property immediately after the amalgamation. These rules also apply, by reason of paragraph 88(1)(e.2) following the winding-up of a corporation to which subsection 88(1) applies.

Paragraph 87(2)(l.3) is amended to apply to voluntary dispositions of former business property. In addition, for the purposes of that paragraph, the new corporation will be considered to be a continuation of the predecessor corporation.

Previous amendments to the replacement property rules have restricted their application to replacement property that is taxable Canadian property. This amendment also clarifies the status of replacement property of former property disposed of under previous legislation. For example, where a predecessor corporation disposed of property before April 3, 1990, the new corporation's replacement property for that former property need not be taxable Canadian property as the new corporation is considered to be a continuation of the predecessor corporation for that purpose.

This amendment is applicable in respect of amalgamations occurring and windings-up commencing after 1989.

Subclause 37(8)

ITA
87(2)(aa)

Paragraph 87(2)(aa) of the Act provides for the flow-through of the refundable dividend tax on hand (RDTOH) of the predecessor corporations to the new corporation on an amalgamation. This provision applies to add the RDTOH of predecessor corporations to the balance of the new corporation's RDTOH for a taxation year only if the new corporation was a private corporation continuously from the time of the amalgamation until the end of that year. Pursuant to this amendment the new corporation will be required to be a private corporation only until after the beginning of the year. This amendment applies to 1993 and subsequent taxation years.

Subclauses 37(10) and (11)

ITA
87(3) and (3.1)

Subsection 87(3) of the Act provides for the computation of the paid-up capital in respect of a class of shares of the capital stock of the new corporation formed on the amalgamation of two or more taxable Canadian corporations. The subsection requires a paid-up capital reduction when the paid-up capital of the new corporation exceeds the aggregate of the paid-up capital of the predecessor corporations with the effect that the reduction is averaged across all classes of shares of the new corporation. This averaging can give unintended results in circumstances where a class of shares of a predecessor has impaired capital for tax purposes and the impairment is exclusive to that class. This subsection is amended, applicable to amalgamations occurring after 1990, to permit the special treatment provided for in new subsection 87(3.1).

New subsection 87(3.1) of the Act provides that in certain specified circumstances, subsection 87(3) will not apply in respect of the paid-up capital computation of a class of shares of the new corporation formed on the amalgamation. In order that subsection 87(3) not apply to the paid-up capital computation, each class of shares (other than classes cancelled on the amalgamation) of each predecessor must be converted into a separate class of shares of the new corporation. As well, after the amalgamation, the number of shareholders of each class, their proportionate ownership in each class, the paid-up capital of each class and the terms and conditions of each class must be identical to those that existed immediately before the amalgamation. If these conditions are met, and the new corporation elects in its first return of income to have this subsection apply, each class of shares of the new corporation issued on the amalgamation will be treated, for tax purposes, as the same class as and a continuation of each class of shares of each of the predecessors converted on the amalgamation. New subsection 87(3.1) is applicable to amalgamations occurring after 1990.

Subclause 37(12)

ITA
87(7)(a)

Subsection 87(7) of the Act provides that where, as a result of an amalgamation, a debt of a predecessor corporation has become a debt of the amalgamated corporation, the provisions of the Act do not apply with respect to the transfer of the liability and the amalgamated corporation is to be treated as if it had originally issued the debt. Paragraph 87(7)(a) of the Act excludes from the application of subsection 87(7) debts owing between the amalgamating corporations. This exclusion is unnecessary since such debts are extinguished on the amalgamation and therefore this amendment deletes the exclusion for inter-predecessor indebtedness. This amendment applies after Royal Assent to the implementing legislation.

Subclause 37(13)

ITA
87(9)(a.3) and (a.4)

Subsection 87(9) of the Act provides rules for "triangular amalgamations". A triangular amalgamation is a merger of two or more taxable Canadian corporations to form a new corporation that is immediately after the merger controlled by a taxable Canadian corporation (the "parent"), where shares of the parent were issued to shareholders of the predecessors corporations in exchange for their shares.

New paragraph 87(9)(a.3) clarifies that the rollover provisions in subsection 87(5) dealing with options to acquire shares of a predecessor also apply in respect of triangular amalgamations.

New paragraph 87(9)(a.4) provides that, for the purposes of paragraph 87(9)(c), new shares include all the shares of the new corporation acquired by the parent on the merger. This change is necessary because the term "new shares", as provided by subsection 87(4), applies only to the shares of the new corporation acquired by the parent in exchange for its shares in the predecessor corporations. As amended, the shares of the new corporation acquired by the parent as consideration for its shares issued to other shareholders of the predecessor corporations will be new shares as well.

New paragraphs 87(9)(a.3) and (a.4) are applicable to amalgamations occurring after December 20, 1991.

Clause 38

Winding-up of a Corporation

ITA
88

Section 88 of the Act deals with the tax consequences arising on the winding-up of a corporation.

Subclause 38(1)

ITA
88(1)(a)(ii)

Subsection 88(1) of the Act 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. The repeal of subparagraph 88(1)(a)(ii) is consequential on the amendment to the definition of "cost amount" in respect of eligible capital property in subsection 248(1). This amendment is applicable with respect to distributions of property on the winding-up of a subsidiary in a taxation year of the subsidiary commencing after June 1988.

Subclause 38(2)

ITA
88(1)(c)(ii)(A)

Paragraph 88(1)(c) of the Act provides that the cost to a parent of a property (other than an interest in a partnership) acquired on the winding-up of a subsidiary is deemed to be equal to the amount determined under paragraph 88(1)(a) to be the subsidiary's proceeds of disposition of the property. Paragraph 88(1)(c) is amended to accommodate situations in which the subsidiary's proceeds of disposition are determined under subsection 69(11), rather than under paragraph 88(1)(a). In such a case, the parent's cost of the property will be the amount that would, but for subsection 69(11), have been the proceeds of disposition to the subsidiary under paragraph 88(1)(a).

This amendment applies to windings-up commencing after December 20, 1991.

Subclause 38(3)

ITA
88(1)(c.1)

Subparagraph 88(1)(a)(iii) of the Act provides that any property of a subsidiary, other than a Canadian resource property or foreign resource property, is deemed to have been disposed of on its winding-up for proceeds of disposition equal to its cost amount to the subsidiary immediately before the winding-up. Under subparagraph 88(1)(c)(ii), the cost of such property is equal to such proceeds of disposition. New paragraph 88(1)(c.1) is intended to prevent an overstatement of the amount to be included by reason of paragraph 14(1)(b) in computing the income of the parent in a taxation year as a result of a disposition by the parent of eligible capital property subsequent to the winding-up of the subsidiary. The commentary to new paragraph 85(1)(d.1) provides an example of the operation of a similar amendment in circumstances where property is transferred to a corporation by a shareholder.

This amendment is applicable with respect to distributions of property occurring on the winding-up of a subsidiary in a taxation year of the subsidiary commencing after June 1988.

Subclause 38(4)

ITA
88(1)(d.2)

On the winding-up of a subsidiary, paragraphs 88(1)(c) and (d) of the Act permit the parent to increase the cost base of certain non-depreciable capital properties owned by the subsidiary at the time that the parent last acquired control of the subsidiary and continuously thereafter until such time as the properties were distributed to the parent. The time at which "the parent last acquired control of the subsidiary" has an extended meaning in circumstances where control is acquired from persons not dealing at arm's length. Paragraph 88(1)(d.2) provides this extended meaning. This paragraph does not give appropriate results in certain circumstances where control is acquired through an inheritance by a non-arm's length person. Paragraph 88(1)(d.2) is therefore amended, applicable for windings-up commencing after December 20, 1991, to provide that, for the purposes of paragraph 88(1)(d.2) and subsection 186(2) as it applies to that paragraph, where a taxpayer acquires control of a corporation as a result of the acquisition, of shares of the corporation through a bequest or an inheritance, the taxpayer, the person from whom the taxpayer acquired the shares and any person related to that person shall be treated, at the time of the acquisition and at any time previous to the acquisition, as dealing at arm's length with the taxpayer.

Subclause 38(5)

ITA
88(1)(e.5)

Paragraph 88(1)(e.5) of the Act provides the transfer of the refundable dividend tax on hand (RDTOH) of a subsidiary corporation to a parent corporation on a winding-up of the subsidiary. This provision applies to add the subsidiary's RDTOH to the balance of the parent's RDTOH for a taxation year only if the parent was a private corporation continuously from the time of the winding-up until the end of that year. Pursuant to this amendment, the parent would be required to be a private corporation only until after the beginning of that year. This amendment applies to 1993 and subsequent taxation years.

Subclause 38(6)

ITA
88(1.3)(a)

Section 88(1.3) of the Act treats a parent corporation as having been in existence during the period in which its subsidiary was in existence in order to permit the parent to carry forward the charitable donations, losses, unused foreign tax credits and investment tax credits of its subsidiary that were not deducted before it was wound up. Paragraph 88(1.3)(a) is amended, effective for windings-up commencing after 1988, to refer to the subsidiary's "expenditure year". This change ensures that a subsidiary's investment tax credit account flows through to its parent following a winding-up.

Clause 39

Non-Resident Trusts

ITA
94(7)

Subsection 94(7) of the Act provides that, for the purposes of the attribution rules in section 94, a person is "beneficially interested" in a trust if that person has any right whatsoever to receive income or capital of the trust, whether directly or indirectly through one or more trusts.

This subsection is repealed as of January 1, 1991. It is replaced by new subsection 248(25), which defines the expression "beneficially interested" in the same manner for the purposes of the Act.

Clause 40

Partnerships

ITA
96

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

Subsection 40(1)

ITA
96(1)(d)

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

Paragraph 96(1)(d) is amended so that resource allowance under paragraph 20(1)(v.1) may not be claimed at the partnership level. It is intended that section 1210 of the *Income Tax Regulations* will be amended so that a partner will be allowed to claim a proportionate share of resource allowances disallowed as a deduction at the partnership level.

This amendment applies to fiscal periods of partnerships commencing after December 20, 1991.

Subclause 40(2)

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 the authority to act for the partnership.

Subsection 96(3) is amended to add a reference to section 15.2, applicable to joint elections in respect of small business bonds made after February 25, 1992.

Clause 41

Disposition of Partnership Interest

ITA
98

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

Subclause 41(1)

ITA
98(3)(b)

Subsection 98(3) of the Act is an elective provision permitting, provided certain conditions are met, property of a Canadian partnership which has ceased to exist to be distributed to its members, for proceeds to the partnership, and at a cost to the members, equal to the cost amount of the property to the partnership. This provision also allows a special increase or "bump-up" in the tax value of the distributed partnership property where the adjusted cost base of a member's partnership interest exceeds the amount of money and the cost amount to the partnership of the property that the member has received upon the dissolution of the partnership.

Paragraph 98(3)(b), which provides rules for determining the cost to each member of partnership property, is amended to include within the cost to the proprietor of eligible capital property an amount equal to 4/3 of the unrecaptured deductions under paragraph 20(1)(b) in respect of the business of the partnership. This amendment is intended to ensure that the members of the dissolved partnership are placed in a tax position equivalent to that of the partnership with respect to the property.

Subclause 41(2)

ITA
98(3)(g)

New subparagraph 98(3)(g)(i) of the Act provides that, for the purposes of determining any amount relating to cumulative eligible capital, eligible capital amount, eligible capital expenditure or eligible capital property, a member is deemed to carry on the business of the partnership until that member's undivided interest in the eligible capital property is disposed of. New subparagraph 98(3)(g)(ii) provides rules for determining the cumulative eligible capital of the proprietor in view of the gross-up of unrecaptured deductions in new subparagraph 98(5)(b)(i.1). Finally, new subparagraph 98(3)(g)(iii) prevents an overstatement of the deemed taxable capital gain under subparagraph 14(1)(a)(iv), or an overstatement of the amount to be included in income under paragraph 14(1)(b).

The following example illustrates the operation of the amendments to paragraph 98(3)(b) and new paragraph 98(3)(g):

Assume a partnership, with two equal partners, A and B, and with a calendar year fiscal period for its business, purchases an eligible capital property for $300,000 at a time before the partnership's adjustment time (when the inclusion rate for eligible capital property was one-half). This is the first and only eligible capital property held by the partnership in respect of the partnership business. The partnership takes deductions under paragraph 20(1)(b) totalling $40,650 before its adjustment time, and deductions under that paragraph totalling $11,482 after its adjustment time.

The partnership ceases to exist, and the partners elect under subsection 98(3). Immediately before the partnership ceases to exist, the partnership's cumulative eligible capital is $152,453.

- The cost to A of A's undivided interest in the eligible capital property immediately after the partnership ceases to exist

= A's percentage of the cost amount to the partnership of the property, plus A's percentage of 4/3 of the unrecaptured paragraph 20(1)(b) deductions taken by the partnership,

= 50% (4/3 of $152,543) + 50% (4/3 of $52,132)

= $101,695.33 + $34,754.67

= $136,450

- A's cumulative eligible capital in respect of the business immediately after the partnership ceases to exist

  = 3/4 of the cost to A of the property, minus 3/4 of A's percentage of 4/3 of the unrecaptured paragraph 20(1)(b) deductions taken by the partnership

  = 3/4 of ($136,450) - 3/4 of ($34,754.67)

  = $102,337.50 - $26,066

  = $76,271.50

Assume A disposes of A's undivided interest in the property for $250,000 before taking any deductions under paragraph 20(1)(b).

- The amount to be included in computing A's income in the year in which the undivided interest in the property is disposed of

  = lesser of (A) the negative balance in A's cumulative eligible capital (the "excess"), and

  (B) A's percentage of the unrecaptured paragraph 20(1)(b) deductions taken by the partnership

  = lesser of (A) 3/4 of ($250,000) - $76,271.50 = $111,228.50, and

  (B) 1/2 of ($52,132) = $26,066

  = $26,066

- The amount deemed to be A's taxable capital gain

  = the amount by which the excess exceeds the total of the amount included in income plus 1/2 of the amount of A's percentage of the partnership's unrecaptured pre-adjustment time paragraph 20(1)(b) deductions

  = $111,228.50 - ($26,066 + 50%[1/2($40,650)])

  = $111,228.50 - $36,228.50

  = $75,000

Subclause 41(3)

ITA
98(5)(b)

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

Paragraph 98(5)(b), which provides rules for determining the cost to the remaining member of partnership property, is amended to include within the cost to the proprietor of eligible capital property an amount equal to 4/3 of the unrecaptured deductions under paragraph 20(1)(b) in respect of the business of the partnership. This provision which is applicable to acquisitions of property occurring as a consequence of a partnership ceasing to exist after the commencement of its first fiscal period commencing after 1987, is intended to ensure that the remaining member is placed in the same tax position as the partnership with respect to the property.

Subclause 41(4)

ITA
98(5)(h)

New subparagraph 98(5)(h)(i) provides rules for determining the cumulative eligible capital of the proprietor in view of the gross-up of unrecaptured deductions in new subparagraph 98(5)(b)(i). New subparagraph 98(5)(h)(ii) prevents an overstatement of the deemed taxable capital gain under subparagraph 14(1)(a)(iv), or an overstatement of the amount to be included in income under paragraph 14(1)(b). The commentary to paragraph 98(3)(g) provides an illustration of the operation of a similar amendment in circumstances where a partnership ceases to exist and an election is made under that subsection.

All of the amendments to section 98 of the Act are applicable to acquisitions of property occurring as a consequence of a partnership ceasing to exist after the commencement of its first fiscal period commencing after 1987.

Clause 42

Trusts and their Beneficiaries

ITA
104

Section 104 of the Act provides rules governing the tax treatment of trusts and their beneficiaries.

Subclause 42(1)

ITA
104(4) and (5)

Subsections 104(4) to (5.2) of the Act set out what is generally referred to as the "21-year deemed realization" rule for trusts. The purpose of the rule is to prevent the use of trusts to defer indefinitely the recognition for tax purposes of gains accruing on capital properties, resource properties and land inventories. These subsections generally treat such properties as having been disposed of and reacquired by trusts every 21 years at their fair market value (or in the case of depreciable property, at the mid-point between fair market value and undepreciated capital cost). However, this rule does not apply to unit trusts and certain trusts established to provide pension and other employee benefits. In addition, the 21-year deemed realization rule is modified in the case of certain spousal trusts.

Under the existing rules, the first deemed realization for those spousal trusts described in paragraph 104(4)(a) occurs on the day on which the beneficiary spouse dies. A spousal trust described in this paragraph includes a testamentary trust created as a consequence of the death of a taxpayer after 1971 under which the surviving spouse was exclusively entitled to the income of the trust before his or her death and no other person was entitled before that time to the capital of the trust. It also includes a similar trust created by a taxpayer during the taxpayer's lifetime for the benefit of the taxpayer's spouse, provided the trust was created after June 17, 1971 or was a trust created on or before that date which does not qualify for graduated rates of personal tax because of subsection 122(1).

Subsection 104(4) is amended to clarify that a deemed realization of non-depreciable capital property or land inventory on a day determined thereunder occurs at the end of the day.
Subsection 104(5) is amended so that a deemed realization of depreciable property likewise occurs at the end of a day determined under subsection 104(4).

Subsection 104(4) is also amended so that it does not result in the realization of gains with respect to "excluded property", as defined in new paragraph 108(1)(d.12). "Excluded property" is a share of the capital stock of a non-resident-owned investment corporation (as defined in section 133) which does not constitute taxable Canadian property. This amendment is consistent with the other taxation rules with respect to such corporations in subsections 104(10) and (11), section 133 and subsection 212(9) which allow a trust holding such shares exclusively for the benefit of non-residents to be treated as a conduit for its beneficiaries.

Paragraph 104(4)(a) is amended so that a post-1971 spousal testamentary trust referred to therein includes a trust that, immediately after any capital property, Canadian or foreign resource property or land inventory vested indefeasibly in the trust on a rollover basis as a consequence of the death of a taxpayer, was a trust under which the surviving spouse of the taxpayer was exclusively entitled to the income of the trust before his or her death and no other person was entitled before such death to the capital of the trust. This amendment recognizes that subsections 70(5.2) and (6) allow beneficiaries of a trust to make disclaimers, releases and surrenders pursuant to subsection 248(8) in order for property to be transferred on a rollover basis on death of a taxpayer for the benefit of the taxpayer's spouse. It is thus appropriate that a deemed realization occurs with respect to such a trust when the beneficiary spouse dies. This amendment is applicable with respect to deaths of beneficiary spouses occurring after December 20, 1991.

Paragraph 104(4)(a) is also amended so that it will no longer apply to "tainted" *inter vivos* spousal trusts created before June 18, 1971 (i.e. those trusts that have failed to meet all the conditions set out in paragraphs 122(2)(b) to (e)). Such trusts would generally fall within the new category of "pre-1972 spousal trusts", as described below.

Under the rule introduced in new paragraph 104(4)(a.1), the first deemed realization for a trust that is a pre-1972 spousal trust on January 1, 1993 occurs on the later of the day on which the beneficiary spouse dies and January 1, 1993. The expression "pre-1972 spousal trust" is discussed in the commentary on new paragraph 108(1)(f.2).

Paragraph 104(4)(b) is amended so that it causes a deemed realization with respect to a pre-1972 spousal trust only 21 years after any deemed realization under paragraph 104(4)(a.1). This is consistent with the existing rule for post-1971 spousal trusts.

Paragraph 104(4)(c) provides for further deemed realizations 21 years after any other deemed disposition day under subsection 104(4). It is amended to avoid the determination of a deemed disposition day with respect to a spousal trust that is determined under paragraph 104(4)(b).

Subsection 104(5) is also amended so that the "mid-point" rule for deemed dispositions, under which depreciable property of a prescribed class is disposed of at the mid-point between its fair market value of the property and its undepreciated capital cost, no longer applies. Instead, depreciable property (like other capital property) is deemed to have been disposed of by a trust at its fair market value. As is the case with the similar amendments to subsections 70(5) and 107(4), this amendment is applicable after 1992.

Except as noted above, these amendments are applicable to taxation years of trusts ending after February 11, 1991.

Subclause 42(2)

ITA
104(5.1)

New paragraph 104(5.1) of the Act provides that every spousal trust that holds an interest in a NISA Fund No. 2 transferred to it in circumstances to which new paragraph 70(6.1)(b) applied will be considered to have been paid the amount, if any, by which the fund's balance at the end of the day on which the spouse dies exceeds the amount included in that spouse's income. (The expression "NISA Fund No. 2" is defined in an amendment to subsection 248(1) of the Act.) In effect, a NISA Fund No. 2 is taxed in the hands of the generation for which it was established. The commentary on new subsection 104(14.1) gives an example of the application of both subsections 104(5.1) and (14.1) on the death of a spouse.

This amendment is applicable to 1991 and subsequent taxation years.

Subclause 42(3)

ITA
104(5.3) to (5.7)

Subsection 104(5.3) of the Act is introduced to provide a further exception to the 21-year deemed realization rule. This exception applies where a trust so elects in prescribed form filed with Revenue Canada within 6 months after the end of its taxation year that includes the day that, but for the election, would be its first deemed realization day (or its second deemed realization day in the case of a post-1971 spousal trust to which the rules in paragraph 104(4)(a) apply). Where the trust elects and, at the end of such day, any individual is an exempt beneficiary under the trust, the deemed realization day is postponed to the first day of the first taxation year of the trust beginning after the first day throughout which there is no exempt beneficiary under the trust. (This deemed realization day may be advanced under new subsection 104(5.8), however, if property is transferred to the trust from another trust.) Thus, a deemed realization of a trust's property would generally be postponed to the first day of the first taxation year following the death of the last-surviving exempt beneficiary.

Where an election is made by a trust under subsection 104(5.3), a rollover of trust property to a beneficiary on a tax-free basis under subsection 107(2) of the Act may, in the period after the otherwise determined 21-year deemed realization date and before the day after the newly determined 21-year deemed realization date, be made only to an individual who is an exempt beneficiary. Any other distribution of trust property in that period would be treated as a disposition at fair market value under subsection 107(2.1).

A further consequence of an election by a trust under subsection 104(5.3) is that transfers of capital property from one trust to another, in the period described above in respect of the trust, may not be made on a tax-free basis under paragraph 54(c)(v). An exception to this rule is provided where there is merely a change in trustees with respect to transferred property. If the property is regarded as being transferred from one trust to another in these circumstances, subparagraph 54(c)(v) will still apply and the transferee trust will be regarded as the same trust as the transferor trust.

"Exempt beneficiary"

For the purpose of the rules described above, an "exempt beneficiary" under a trust is defined in new subsection 104(5.4) as a living beneficiary under the trust, where the following two conditions are satisfied:

(a) in the case of a trust created after February 11, 1991, the beneficiary or a brother or sister of the beneficiary was alive at the time the trust was created (or, if earlier, the creation time of all other trusts transferring land inventory, capital property or resource properties to the trust in circumstances to which new subsection 104(5.8) applies), and

(b) either

- the beneficiary or the beneficiary's spouse or former spouse was the designated contributor in respect of the trust, or

- the beneficiary or the beneficiary's spouse or former spouse was a grandparent, parent, brother, sister, child, niece or nephew of the designated contributor of the trust or of the spouse or former spouse of the designated contributor in respect of the trust.

The expressions "beneficiary" and "designated contributor", as used in subsection 104(5.4), are defined in new subsections 104(5.5) and (5.6).

"Beneficiary"

For the purposes of determining whether an individual is an "exempt beneficiary", a beneficiary under new subsections 104(5.5) and 248(25) is generally a person who has any contingent or absolute right under the trust. However, under paragraph 104(5.5)(a), no individual will be regarded as an exempt beneficiary under certain trusts in which all of the interests of individuals who are exempt beneficiaries (determined without reference to the paragraph) depend on the exercise of discretion. This paragraph applies where this discretion could result in the interests of all such individuals (and other individuals who are children of deceased individuals who were exempt beneficiaries under the trust) terminating before the death of the last survivor of such individuals and the other individuals and without any of such individuals or the other individuals enjoying any future benefit in respect of their interests. This paragraph applies only to trusts created or materially varied after February 11, 1991.

Under paragraph 104(5.5)(b), a beneficiary's right under a trust will also be disregarded for the purposes of the "exempt beneficiary" definition if it is reasonable to consider that one of the main purposes for creating the right was to defer the day determined in respect of the trust under paragraph 104(4)(a.1) or (b). This could be the case, for example, where an individual is given a nominal absolute interest under the trust or a contingent interest which is virtually certain not to vest.

"Designated contributor"

The "designated contributor" in respect of a spousal trust is the individual who created, or whose will created, the trust. Where the trust is a non-spousal testamentary trust, as of the end of a taxation year for which an election is made under subsection 104(5.3), the designated contributor is the individual as a consequence of whose death the trust was created. In any other case, the "designated contributor" in respect of a trust is an individual who was, or was related to, a beneficiary under the trust, is designated by the trust and qualifies under subparagraph 104(5.6)(c)(i), (ii) or (iii).

An individual generally qualifies as a designated contributor in respect of an *inter vivos* trust under subparagraph 104(5.6)(c)(i) where, at each time in the relevant period in respect of the trust (as defined in paragraph 104(5.7)(a)), the total amount of property transferred or loaned before that time by the designated individual to the trust

- was greater than the total amount so transferred or loaned before that time by each other individual who was born before the designated individual and who was related to a beneficiary of the trust, and

- was greater than or equal to the total amount so transferred or loaned before that time by each other individual who was born after the designated individual and who was related to a beneficiary of the trust.

Paragraph 104(5.7)(a) provides that the relevant period in respect of a trust, for the purposes of subsection 104(5.6), is the period commencing one year after the day that the trust was created and ending on the day that, but for the trust's election, would be its deemed realization day under paragraph 104(4) (a.1) or (b). In addition, under paragraph 104(5.7)(b), two individuals are considered to be related to each other, for the purposes of subsection 104(5.6), if one of them is the aunt, great-aunt, uncle or great-uncle of the other.

Where no individual qualifies under subparagraph 104(5.6)(c)(i), an individual who transferred or loaned money to the trust may nevertheless be designated under subparagraph 104(5.6)(c)(ii) if he or she was born before all other individuals who are related to the beneficiaries of the trust and who transferred or loaned property to the trust.

An individual also generally qualifies as a designated contributor under subparagraph 104(5.6)(c)(iii) where, throughout the relevant period in respect of the trust, the property of the trust consisted primarily of

(a) shares of the capital stock of a corporation controlled, at the time the trust was created or at the beginning of the relevant period in respect of the trust, by such individual or, where no single individual controlled such corporation, by such individual and one or more other individuals born after, and related to, such individual;

(b) shares of the capital stock of a corporation all or substantially all of the value of which derived, throughout the relevant period, from property transferred to the corporation by such individual or by such individual and one or more other individuals born after, and related to, such individual;

(c) shares in a holding corporation all or substantially all of the value of which derived, throughout such part of that period during which the holding corporation shares were held by the trust, from the shares described in paragraph (a) or (b) above;

(d) property substituted for the shares described above;

(e) property attributable to profits, gains or distributions with respect to the properties described above; or

(f) any combination of the properties described above.

For the purposes of paragraphs (b) and (c) above, new paragraph 104(5.7)(d) provides that, in determining whether the value of shares is derived from other property, the other property is deemed to include property substituted for the other property and property attributable to profits, gains and distributions with respect to the other property and the substituted property.

New paragraph 104(5.7)(c) provides that an individual shall not be considered to be a designated contributor with respect to a trust where it is reasonable to consider that one of the main purposes of a series of transactions or events that includes a borrowing or an acquisition of any property by an individual was to defer the application of the 21-year deemed realization rule under paragraph 104(4)(b). This anti-avoidance rule also applies where an individual is made trustee of a trust to allow the individual to be a designated contributor under subparagraph 104(5.6)(c)(iii).

The application of the new election in subsection 104(5.3) is illustrated below.

EXAMPLE 1

Trust A is a testamentary trust created on the death of Mrs. A prior to 1972. The beneficiaries of the trust are Mrs. A's children, nieces and grandchildren all of whom are alive on January 1, 1993.

Result:

1. The trust may elect under subsection 104(5.3) in its 1993 income tax return to defer the application of the 21-year rule deemed realization rule.

2. Mrs. A is the "designated contributor" (paragraph 104(5.6)(b)) in respect of the trust. The children and nieces of Mrs. A are "exempt beneficiaries" under paragraph 104(5.4)(b).

3. The election will result in the deemed realization of the trust property being delayed until the first day of the first taxation year of the trust commencing after the death of all of Mrs. A's children and nieces or the termination of their interests in the trust.

EXAMPLE 2

Trust B is an *inter vivos* trust created before 1972 the beneficiaries of which are the children and grandchildren of Mr. B. Mr. B sold property with a fair market value of $1,000 to the trust 6 months after it was created. Mr. B's two children each subsequently loaned (i) $600, or (ii) $1,200 to the trust in 1974 which has been repaid. No other property was transferred or loaned to the trust before the end of the relevant period.

Result:

1. The trust may designate Mr. B as the designated contributor under paragraph 104(5.6)(c). If $600 was subsequently loaned by the two children, Mr. B is the designated contributor under subparagraph 104(5.6)(c)(i) by

reason of having transferred or loaned more to the trust than each of his sons throughout the relevant period. If $1,200 was subsequently loaned, then Mr. B is the designated contributor under subparagraph 104(5.6)(c)(ii) by reason of being the oldest individual who loaned or contributed property to the trust before the end of the relevant period.

2. If the trust elects under subsection 104(5.3), it may elect Mr. B as the designated contributor in which case Mr. B's children will be exempt beneficiaries. The grandchildren will not be exempt beneficiaries.

3. The election will result in the deemed realization of trust property being delayed until the first day of the first taxation year of the trust commencing after the death of all of Mr. B's children or the termination of their interests in the trust.

EXAMPLE 3

Opco Corporation is controlled by Mr. K. Opco undergoes a corporate freeze at the end of 1973. In March, 1974 Opco issues common shares to an *inter vivos* trust created on January 1, 1974. The trust beneficiaries are Mr. K's children. The common shares appreciate between 1974 and 1995. The trust's assets in that period consist primarily of those shares and public company shares acquired through dividends paid on Opco shares.

Result:

1. The trust may elect under subsection 104(5.3) in its 1995 income tax return to defer the application of the 21-year deemed realization rule.

2. Mr. K is the "designated contributor" in respect of the trust under subparagraph 104(5.6)(c)(iii). Mr. K's children are "exempt beneficiaries".

3. The election will result in the deemed realization of the trust property being delayed until the first day of the first taxation year of the trust commencing after the death of all of Mr. K's children or the termination of their interests in the trust.

These amendments apply after February 11, 1991, except as noted above.

ITA
104(5.8)

New subsection 104(5.8) of the Act is a special rule designed to prevent the avoidance of the 21-year deemed realization rule through the use of trust transfers. It generally applies where a trust transfers property to which the 21-year deemed realization rule applies to another trust on a rollover basis and the first deemed realization date after the transfer in respect of the transferee trust would otherwise occur after such date determined in respect of the transferor trust.

In these circumstances, the first deemed realization date for the transferee trust is generally advanced to such date in respect of the transferor trust. However, the deemed realization date for the transferee trust is advanced to the day after the transfer in two cases. The first case is where the transferor trust is a pre-1972 spousal trust described in paragraph 108(1)(f.2) or a spousal trust described in paragraph 104(4)(a) the beneficiary spouse of which is still alive at the time of the transfer from the transferor trust. The second case is where the deemed realization date of the transferee trust is determined (without reference to the transfer rule in subsection 104(5.8)) as of the time of the transfer under new subsection 104(5.3). In neither of these cases would it be possible to determine whether a deemed realization in respect of the transferee trust would occur, without reference to the transfer rule in subsection 104(5.8), before or after a deemed realization in respect of the transferor trust.

Paragraph 104(5.8)(b) applies where paragraph 104(5.8)(a) would otherwise apply in the first case described above. In these circumstances, paragraph 104(5.8)(b) provides that paragraph 104(5.8)(a) does not apply where the transferee trust is also a spousal trust described in paragraph 104(4)(a) or (a.1) in respect of which the beneficiary spouse is still alive at the time of the transfer.

Paragraph 104(5.8)(c) provides that an advanced deemed realization date under subparagraph 104(5.8)(a)(i) is considered for the purposes of subsection 104(5.3) to be a day determined under paragraph 104(4)(a.1) or (b). The purpose of this rule is to allow a transferee trust to which subsection 104(5.8) applies the capacity to make a subsection 104(5.3) election. However, the election will not be available where the transferee trust has previously had a deemed realization under paragraph 104(4)(a.1) or (b) and thus previously had the opportunity to make such an election.

This amendment is applicable in respect of property transferred after February 11, 1991. However, the rules do not apply to transfers on or before December 20, 1991 where either the transferor trust or the transferee trust is a spousal trust in respect of which the beneficiary spouse is still alive.

Subclause 42(4)

ITA
104(6)(b)

Paragraph 104(6)(b) of the Act provides that a trust may deduct, in computing its income, amounts that become payable or are paid out of trust income to or for the benefit of beneficiaries. However, the deduction does not allow a post-1971 spousal trust described in paragraph 104(4)(a) to reduce its income below the amount included in its income by reason of the deemed disposition of properties under subsections 104(4), (5) and (5.2).

Paragraph 104(6)(b) is amended, applicable to 1991 and subsequent taxation years, to provide that no deduction may be claimed by a trust in respect of trust income derived from a payment out of a NISA Fund No. 2 (as defined in subsection 248(1)) unless the payment is made to a spousal trust described in paragraph 70(6.1)(b) and during the lifetime of the beneficiary spouse.

Paragraph 104(6)(b) is also amended so that the restriction with respect to post-1971 spousal trusts applies only in respect of a deemed disposition that occurs on the day the beneficiary spouse dies. This amendment recognizes that there is no reason that income distributions to non-spouse beneficiaries should not be deducted under subsection 104(6) once gains accruing up to the death of the beneficiary spouse have been realized for tax purposes. It applies to 1993 and subsequent taxation years.

Paragraph 104(6)(b) is also amended so that post-1971 spousal trusts are not allowed to deduct amounts payable in a taxation year ending after December 20, 1991 to anyone except the beneficiary spouse if the beneficiary spouse is still alive. The rule does not, however, apply to spousal trusts that have been varied on or before December 20, 1991 to allow for such distributions. This amendment is consistent with subsection 107(4) which provides for no rollover of trust property by a post-1971 spousal trust to a non-spouse beneficiary until after there has been a deemed disposition pursuant to paragraph 104(4)(a) at the time the spouse dies.

Subclause 42(5)

ITA
104(14.1)

New subsection 104(14.1) of the Act provides an election in respect of amounts paid out of a NISA Fund No. 2 to a spousal trust by reason of the application of new subsection 104(5.1) (discussed in the commentary on that subsection). In effect, on the death of the spouse the trust and the spouse's legal representative may elect in prescribed manner to treat the amount paid out of NISA Fund No. 2 as having been paid out of the spouse's NISA Fund No. 2.

Accordingly, it is the spouse, and not the trust, who includes the designated amount in income on the spouse's terminal return of income pursuant to new subsection 12(10.2). Also, while this amount is not included in the description of 'A' in the formula in new subsection 12(10.2) in respect of the trust, the trust may apply that amount in reduction of subsequent payments made out of the NISA Fund No. 2 to the trust (see the description of B in the formula in new subsection 12(10.2) which is discussed in commentary on that subsection). The following example indicates the application of these rules.

EXAMPLE: Where subsection 104(5.1) applies to pay an amount out of a NISA Fund No. 2 on the death of the spouse and an election under subsection 104(14.1) is filed in respect of a portion of that amount.

ASSUME:

At the end of 1995 the fair market value of spousal trust's NISA Fund No. 2 equals **$100,000** and no previous payments were made out of the fund.

In the year 1996:

- the trust is paid **$10,000** from the fund.

- in the same year and after that time the spouse dies and subsection 104(5.1) applies.

- an election is filed in prescribed manner to include **$40,000** on the spouse's terminal return instead of in the income of the trust.

- there has been no growth in the fund prior to the spouse's death (i.e., on death the balance was $90,000). In effect, **$50,000** is considered to have been paid to the trust and **$40,000** to the spouse.

- at the end of 1996 and after the death of the spouse, the trust is paid **$40,000** out of the NISA Fund No. 2.

In 1997 the trust is paid **$55,000** out of the NISA Fund No. 2 (this payment includes $5,000 of interest credited to the fund from the date of the spouse's death).

Application of subsection 12(10.2) - PER THE SPOUSE

Year

1996: 12(10.2) = **$40,000*** = $40,000

*(A) 40,000 (per subsection 104(14.1))
less (B) N/A
40,000

Application of subsection 12(10.2) - PER THE TRUST

1996: 12(10.2) = **\$10,000*** + **\$50,000** ** + **NIL***** = \$60,000

	*(A) 10,000	**(A) 50,000	***(A) 40,000
less	(B) N/A	(B) N/A	(B) 90,000****
	10,000	**50,000**	**Nil**

**** (B)(a) 90,000 (50,000 + 40,000)
less (b) -
90,000

1997: 12(10.2) = **5,000*** = \$5,000

	*(A) 55,000	****(B)(a)	90,000
		less (b)	
less	(B) 50,000****		40,000
	5,000		**50,000**

This amendment is applicable to 1991 and subsequent taxation years.

Subclause 42(6)

ITA
104(15)(a)

Subsections 104(12) and (14) of the Act provide that a trust and a preferred beneficiary under the trust may elect that an amount not exceeding the preferred beneficiary's "share" in "accumulating income" of the trust be deducted in computing the trust's income and be included in computing the beneficiary's income. Subsection 108(1) defines the expressions "preferred beneficiary" and "accumulating income". A preferred beneficiary's "share" in the accumulating income of a trust is determined under subsection 104(15). Paragraph 104(15)(a) provides that, in the case of a post-1971 spousal trust referred to in paragraph 104(4)(a) in which the beneficiary spouse is alive at the end of the year, only the spouse is a beneficiary to whom the trust's accumulating income for the year may be allocated.

Paragraph 104(15)(a) is amended so that a preferred beneficiary's share of accumulating income for a year under a trust that is, at the end of the year, a pre-1972 spousal trust is determined on the same basis. The expression "pre-1972 spousal trust" is defined in new paragraph 108(1)(f.2).

This amendment is applicable to taxation years of trusts ending after December 20, 1991.

Subclause 42(7)

ITA
104(21.2)(b)

Subsection 104(21.2) of the Act sets out the rules for allocating net taxable capital gains of a trust to its beneficiaries for the purposes of section 110.6 of the Act. The allocation of net gains according to the formula in paragraph (b) of that subsection determines the extent to which an individual would be eligible to claim a capital gains exemption under section 110.6. The description of "F" in the formula used in paragraph 104(21.2)(b) is amended, applicable to 1992 and subsequent taxation years, to eliminate the allocation of non-eligible taxable capital gains of a trust from the disposition of non-qualifying real property. This change parallels the changes made to section 110.6 which are discussed in the notes for the amendments to that section.

EXAMPLE

A personal trust with a calendar year-end realizes $120,000 of capital gains in 1992. Gains realized on the disposition of qualified small business corporation shares amounted to $80,000, while the remaining $40,000 was realized on the disposition of non-qualifying real property of the trust. Of that $40,000 gain, $24,000 was an eligible real property gain of the trust, as determined under subsections 108(1) and 110.6(1). Designations were made by the trust under subsection 104(21) for its 1992 taxation year in respect of the entire $90,000 taxable capital gain (3/4 of $120,000). The trust designated $60,000 in respect of beneficiary X and $30,000 in respect of beneficiary Y.

The amount that will be deemed, under subparagraphs 104(21.2)(b)(ii) and (iii) to be a taxable capital gain of each beneficiary from the disposition of qualified small business corporation shares and other property for purposes of the capital gains exemption is determined as follows:

Amounts Determined for Formula

1. the annual gains limit of the trust is 3/4 x ($80,000 + $24,000) or $78,000.

2. The letter A in the formula, which is the eligible taxable capital gains of the trust, is $78,000.

3. The letter B in the formula, which is the amount designated by the trust in respect of the beneficiaries, is:

   (i) $60,000 for Beneficiary X
   (ii) $30,000 for Beneficiary Y.

4. The letter C in the formula, which is the net taxable capital gains of the trust, is $90,000.

5. The letter D in the formula, which is the taxable capital gains from the disposition of qualified farm properties of the trust, is nil.

6. The letter E in the formula, which is the taxable capital gains from the disposition of qualified small business corporation shares of the trust, is (3/4 x $80,000) or $60,000.

7. The letter F in the formula, which is the lesser of the net taxable capital gains from the disposition of non-qualifying real property of the trust and the trust's net eligible real property gains, is $18,000, being the lesser of:

   (i) 3/4 x $24,000
   (ii) 3/4 x $40,000.

8. The letter G in the formula, which is the sum of (D + E + F), is $78,000.

Amounts Determined under Formula in Subsection 104(21.2)

Beneficiary X

Qualified Small Business Corporation Shares

$78,000 x ($60,000/$90,000) x $60,000/$78,000 = $40,000

Other Property

$78,000 x ($60,000/$90,000) x $18,000/$78,000 = $12,000

Beneficiary Y

Qualified Small Business Corporation Shares

$78,000 x ($30,000/$90,000) x $60,000/$78,000 = $20,000

Other Property

$78,000 x ($30,000/$90,000) x $18,000/$78,000 = $6,000

Subclauses 42(8) and (9)

ITA
104(27) and (27.1)

Subsection 104(27) of the Act allows the flow-through to a beneficiary of a testamentary trust that is resident in Canada of the character of certain pension benefits received by the trust and included in the beneficiary's income. This flow-through is provided, in part, for the purposes of the pension income tax credit in subsection 118(3), but only where the beneficiary was the spouse of the individual as a consequence of whose death the trust arose.

Subsection 104(27.1) applies where a testamentary trust that is resident in Canada receives a lump sum payment from a deferred profit sharing plan (DPSP) as a consequence of the death of the settlor of the trust, but only where the settlor was an employee of an employer who participated in the DPSP. The portion of the lump sum that is required by subsection 147(10) to be included in the trust's income and that is payable to (and therefore included in the income of) a beneficiary who was a spouse of the settlor at the time of the settlor's death is declared, by subsection 104(27.1), to be an eligible amount for the purposes of the tax-free transfer under paragraph 60(j) if the portion is designated in respect of the beneficiary in the trust's tax return.

For the purposes of both subsections 104(27) and (27.1), "spouse" includes a common-law spouse as defined in subsection 146(1.1). The amendments to subparagraph 104(27)(c)(ii) and paragraph 104(27.1)(e), which delete the references to subsection 146(1.1), apply after 1992 and are strictly consequential on the repeal of that subsection and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of the child of whom the person is a parent.

Subclause 42(10)

ITA
104(29)(b)

Subsection 104(29) of the Act allows a trust to flow through to a beneficiary a reasonable share of "phantom income" realized at the trust level through an inclusion of provincial Crown royalties in the trust's income. The "phantom income" is calculated net of the trust's resource allowance deduction claimed under paragraph 20(1)(v.1).

Subsection 104(29) is amended so that "phantom income" of a trust will not be reduced by the trust's resource allowance deduction claimed under paragraph 20(1)(v.1) that arises by reason of the trust's membership in a partnership. This amendment is strictly consequential to the changes to subsection 96(1) under which the resource allowance may no longer be claimed at the partnership level.

This amendment is applicable to taxation years ending after December 20, 1991.

Clause 43

Capital Interests in Trusts

ITA
107

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

Subclauses 43(1) and (2)

ITA
107(2)(e) and (f)

Subsection 107(2) of the Act provides a tax-deferred transfer or rollover 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 the trust. Paragraph 107(2)(e) permits eligible capital property of such a trust to be transferred from the trust to a beneficiary for proceeds of disposition equal to 4/3 of its cost amount. The repeal of paragraph 107(2)(e), and its replacement by new paragraph 107(2)(f), is intended to take into account, where the transfer occurs after 1987, the change in inclusion rates for eligible capital property from one half to three quarters in respect of fiscal periods commencing after that time. The repeal of paragraph 107(2)(e), which is applicable to distributions of eligible capital property occurring after July 13, 1990, is also consequential on the amendment to the definition of "cost amount" in respect of eligible capital property in subsection 248(1).

New paragraph 107(2)(f), which is applicable to distributions of eligible capital property occurring after 1987, is also intended to prevent an overstatement of the deemed taxable capital gain under subparagraph 14(1)(a)(v), or of the amount to be included in computing income under paragraph 14(1)(b), on the subsequent disposition of eligible capital property by the beneficiary. Such an overstatement would occur because the calculation of the beneficiary's deemed taxable capital gain under subparagraph 14(1)(a)(v), or the amount to be included in income under paragraph 14(1)(b), would not include any amount relating to cumulative eligible capital amounts dedicated by the trust under paragraph 20(1)(b) before the taxpayer's adjustment time (as defined in paragraph 14(5)(c)).

Subclause 43(3)

ITA
107(2.01)

Subsection 107(2.01) of the Act allows a spousal trust to elect to be treated as if it had disposed of, and reacquired, a principal residence at its fair market value immediately before distributing that property to one of its beneficiaries under subsection 107(2). This effectively allows a spousal trust to take advantage of the principal residence exemption. The election is made in the trust's tax return for the year of distribution.

Strictly as a consequence of the new rules in paragraph 54(g) that would allow a wider range of personal trusts to take advantage of the principal residence exemption, subsection 107(2.01) is amended with respect to distributions after 1990 to allow trustees of all personal trusts to take advantage of the election under that subsection. A transitional rule allows trusts (other than spousal trusts) to make the election by notifying the Minister of National Revenue up to 6 months after Royal Assent to this amendment, where the distribution took place after 1990 and on or before the day of Royal Assent.

Subclause 43(4)

ITA
107(4)

Subsection 107(4) of the Act applies where a post-1971 spousal trust distributes capital property, resource properties or land inventory during the beneficiary spouse's lifetime to a beneficiary other than the spouse. It provides for a realization of such property by the trust at fair market value or, in the case of depreciable property, at the mid-point between undepreciated capital cost and fair market value.

Subsection 107(4) is amended to ensure that the rules therein apply where property is transferred to a non-spouse beneficiary before the end of the day on which the beneficiary spouse dies. This amendment is applicable with respect to distributions occurring after December 20, 1991.

Subsection 107(4) is also amended to eliminate the "mid-point" rule described above with respect to distributions occurring after 1992, so that depreciable property is treated like other capital property. This is consistent with similar amendments to subsections 70(5) and 104(5).

Subclause 43(5)

ITA
107(5)

Subsection 107(5) of the Act provides that where trust property is distributed by a personal trust or a prescribed trust to a non-resident beneficiary in satisfaction of the beneficiary's interest in the trust, the rollover provisions of subsection 107(2) are not applicable unless the property is taxable Canadian property (as defined in subsection 115(1)) or Canadian resource property.

Subsection 107(5) is amended to extend this rollover treatment to shares in the capital stock of a non-resident-owned investment corporation that is not taxable Canadian property. This amendment, which applies to distributions made after 1991, puts the non-resident beneficiary in the same position as if the share were held directly by the non-resident beneficiary rather than through a trust.

Clause 44

Trusts: Definitions

ITA
108

Section 108 of the Act sets out certain definitions and rules that apply for the purposes of subdivision k of Division B of Part I of the Act which deals with the computation of income of trusts and their beneficiaries.

Subclause 44(1)

ITA
108(1)(a)

Paragraph 108(1)(a) of the Act defines the expression "accumulating income" for the purposes of the rules in subsections 104(12), (14) and (15) relating to the preferred beneficiary election. The preferred beneficiary election allows a trust and a specified beneficiary under the trust to jointly make an election which results in an amount of the trust's accumulating income being taxed in the beneficiary's hands and not at the trust level. Amounts subsequently paid out of such income are not taxable in the recipient's hands.

Paragraph 108(1)(a) is amended so that pre-1972 spousal trusts at the end of a taxation year are treated in the same way as post-1971 spousal trusts for the purposes of the preferred beneficiary election for the year. Thus, accrued gains with respect to trust property may not be "sprinkled" to trust beneficiaries under a pre-1972 spousal trust to the extent such gains are realized under subsections 104(4), (5) or (5.2). The expression "pre-1972 spousal trust" is defined in new paragraph 108(1)(f.2).

Paragraph 108(1)(a) is also amended so that a trust making an election to defer its deemed realization day under subsection 104(5.3) must also disregard any income arising under subsections 104(4), (5) and (5.2) in determining its accumulating income for the purpose of the preferred beneficiary election. This amendment also prevents the "sprinkling" of gains arising under subsections 104(4), (5) or (5.2) to trust beneficiaries.

Paragraph 108(1)(a) is further amended to exclude from "accumulating income" amounts that are paid to a trust from a net income stabilization account (as defined in subsection 248(1) of the Act) unless paid to a spouse trust described in paragraph 70(6.1)(b) and before the death of the beneficiary spouse.

These amendments are applicable to 1991 and subsequent taxation years.

Subclause 44(2)

ITA
108(1)(d.1)(d.11) and (d.12)

"eligible real property gain", "eligible real property loss" and "excluded property"

"Eligible real property gain" and "eligible real property loss" of an individual for a taxation year from a disposition of non-qualifying real property are defined in subsection 110.6(1) of the Act for 1992 and subsequent years and represent the portion of a capital gain or capital loss arising from the disposition of non-qualifying real property of the individual that enters into the determination of taxable capital gains for the purposes of the capital gains exemption. Where a trust has realized a capital gain or loss on the disposition of non-qualifying real property, these definitions are relevant in determining the amounts that may be designated by the trust under subsection 104(21.2) of the Act in respect of a beneficiary as taxable capital gains of the beneficiary for the purposes of the capital gains exemption.

New paragraph 108(1)(d.12) of the Act, which is effective as of February 12, 1991, defines the expression "excluded property" for the purposes of subsections 104(4) and (5.8) and 107(4). "Excluded property" at any time is a share of the capital stock of a non-resident-owned investment corporation (as defined in section 133) if, on the first day of the first taxation year ending at or after that time, the corporation did not own any property referred to in clauses 115(1)(b)(v)(A) to (D). The effect of this definition is that a share of a non-resident-owned investment corporation will be excluded property, unless it is taxable Canadian property described in paragraph 115(1)(b) of the Act.

Subclause 44(3)

ITA
108(1)(f.1) and (f.2)

"non-qualifying real property" and "pre-1972 spousal trust"

The taxable portion of eligible real property gains realized by an individual on the disposition of non-qualifying real property is eligible for the capital gains exemption under subsection 110.6(3) of the Act. Similarly, the taxable portion of an eligible real property gain realized by a trust on the disposition of non-qualifying real property can be designated under subsection 104(21.2) of the Act in respect of a beneficiary of the trust as a taxable capital gain of the beneficiary eligible for the capital gains exemption. "Non-qualifying real property" of a trust is defined, applicable to 1992 and subsequent years, as having the same meaning as under subsection 110.6(1) of the Act in the case of a personal trust and as having the meaning assigned by subsection 131(6) in any other case.

Paragraph 108(1)(f.2) of the Act is introduced, effective as of February 12, 1991, to define a "pre-1972 spousal trust". This expression is relevant for the purposes of the amendments relating to the 21-year deemed realization rule in section 104. Pre-1972 spousal trusts fall into one of two categories: trusts created by the will of a taxpayer who died before 1972 and *inter vivos* trusts created before June 18, 1971. In either case, throughout the period commencing when it was created and ending at the earliest of January 1, 1993, the day of the beneficiary spouse's death and the time at which the definition is applied, the beneficiary spouse is required to be entitled to receive all the income of the trust that arose before the beneficiary spouse's death. In addition, a trust is no longer a pre-1972 spousal trust where a person other than the spouse received or otherwise obtained the benefit of the trust income or capital before the end of that period.

It should be noted that a trust may qualify as a pre-1972 spousal trust even where there is a condition such that beneficiaries other than the spouse may have access to the income or capital of the trust – for example, in the event that a beneficiary spouse re-marries. In such a case, the trust would cease to be a pre-1972 spousal trust only in the event that the beneficiary spouse actually did re-marry.

Subclauses 44(4) to (6)

ITA
108(1)(j)

Paragraph 108(l)(j) of the Act defines "trust" for the purposes of a number of the special provisions for trusts. The definition excludes unit trusts for the purposes of applying the 21-year deemed realization rule and the preferred beneficiary rules. It also excludes employee benefit trusts and certain other trusts from the same rules and the rules in subsections 104(13.1) and (13.2) and sections 105 to 107.

This definition is amended for 1988 and subsequent taxation years so that the exclusion with respect to employee benefit trusts also applies with respect to a trust that is an "amateur athlete trust", as that expression is defined by new subsection 143.1(1).

The definition is amended for 1993 and subsequent taxation years so that the exclusion with respect to unit trusts also applies to trusts under which all interests in which have vested indefeasibly and in which no interest may become effective in the future. The ability of a trust beneficiary to sell his or her interest in the trust or gift the interest during his or her lifetime or on death through the terms of a will is not intended to bring a trust outside the terms of this exclusion. The definition is to apply on an on-going basis. For example, the 21-year deemed realization rule will not apply to a pre-1972 trust if such conditions are satisfied on January 1, 1993. However, the amendment does not apply in respect of post-1971 spousal trusts or trusts which have made an election under new subsection 104(5.3). In addition, the amendment does not apply in respect of trusts which so elect in their tax return for their first taxation year ending after 1992. This amendment is relevant primarily for those commercial trusts which do not qualify as unit trusts.

Paragraph 108(1)(j) is also amended for 1993 and subsequent taxation years so that a trust under which all direct beneficiaries are trusts described in subparagraph 108(1)(j)(ii) (employee benefit and amateur athlete trusts), (iii) (related segregated fund trust) or (v)(RCA trusts) will likewise not be subject to the 21-year deemed realization rule.

Subclause 44(7)

ITA
108(3)

Subsection 108(3) of the Act defines the "income" of a trust for the purposes of subparagraphs 70(6)(b)(i), 73(1)(c)(i) and 104(4)(a)(iii), each of which require a beneficiary spouse to receive all "income" of a trust arising before death in order for it to qualify as a spousal trust. For these purposes, "income" is considered to be trust accounting income minus specified dividends.

Subsection 108(3) is amended so that the same definition applies for the purposes of subparagraphs 70(6)(b)(ii), 73(1)(c)(ii) and 104(4)(a)(iv), each of which require that no beneficiary of a trust (other than the beneficiary spouse) is to receive any of the "income" of the trust before the beneficiary spouse's death if the trust is to qualify as a spousal trust.

Subsection 108(3) is also amended so that "income" is defined in the same manner for the purposes of the new definition of "pre-1972 spousal trust" in paragraph 108(1)(f.2) and for the purposes of new paragraph 70(6.1)(b). The latter paragraph describes a spousal trust to which a net income stabilization account has been transferred.

These amendments are applicable to 1991 and subsequent taxation years.

Subclause 44(8)

ITA
108(4)

Subsection 108(4) of the Act provides that a trust is not disqualified as a spousal trust under paragraph 70(6)(b), 73(1)(c) or 104(4)(a) merely because of the payment of estate, income or similar taxes. Subsection 108(4) is amended to provide that it also applies to pre-1972 spousal trusts (as defined in new paragraph 108(1)(f.2)) and spousal trusts to which a net income stabilization account has been transferred.

This amendment is applicable to 1991 and subsequent taxation years.

Subclause 44(9)

ITA
108(6)

New subsection 108(6) of the Act provides that, for the purposes of the 21-year deemed realization rule, a trust is not treated as a separate trust by reason of a variation of its terms. As a consequence, the amendment ensures that a trust is not considered to have been newly created for the purposes of the 21-year deemed realization rule by virtue of the variation. However, where a pre-1972 spousal trust (as defined in paragraph 108(1)(f.2)) is varied before 1993 so that the spouse beneficiary is no longer entitled to receive all the income of the trust, the first 21-year deemed realization for the trust will occur on January 1, 1993 under paragraph 104(4)(b) (rather than on the later of that date and the day on which the spouse beneficiary dies).

This amendment is applicable with respect to variations after February 11, 1991.

Clause 45

Taxable Income Deductions

ITA
110(1)(f)(iii)

Paragraph 110(1)(f) of the Act allows certain items of income to be deducted in computing a taxpayer's taxable income. New subparagraph 110(1)(f)(iii) extends this taxable income deduction to income from employment with a prescribed international organization. It is intended that the United Nations and certain U.N. agencies will be prescribed for the purposes of this provision. This deduction, which applies to 1991 and subsequent taxation years, replaces the tax credit that was previously available under subsection 126(3) with respect to such income.

Clause 46

Charitable Donations

ITA
110.1(3)

Subsection 110.1(3) of the Act provides that where a corporation donates capital property to a charity, it may elect a value between the adjusted cost base and the fair market value of the donated property to be both its proceeds of disposition (for purposes of calculating any capital gain on the disposition), and the amount of the gift (for purposes of calculating the deduction in respect of charitable donations available under subsection 110.1(1) of the Act). This amendment is consequential on changes to subsection 110.1(1) of the Act contained in S.C. 1991, C. 49, (Bill C-18). It applies to gifts made after December 11, 1988 to ensure that the elected value under subsection 110.1(3) will be the amount on which the charitable donation deduction is based.

Clause 47

Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules for calculating an individual's entitlement to the lifetime capital gains exemption. This section is amended to implement technical changes announced in December 1991 and to exclude from eligibility for the $100,000 exemption all or part of the capital gain realized on a disposition of non-qualifying real property, as announced in the February 1992 budget.

In general terms, this exclusion is accomplished by first distinguishing "non-qualifying real property" from other types of capital property. Capital gains realized by an individual on a disposition of non-qualifying real property are then prorated, based on the ratio that the number of months after 1971 and before March 1992 during which the property was owned by the individual is of the number of months after 1971 during which the property was owned by the individual, to determine the individual's "eligible real property gain". The taxable portion of the resulting eligible real property gain is added to the individual's annual gains limit, while the remaining taxable portion of the gain is added to the individual's investment income for the year, which is used in determining the individual's cumulative net investment loss at the end of the year.

Subclause 47(1)

ITA
110.6(1)

"annual gains limit"

The annual gains limit of an individual for a taxation year is one of the factors applicable in determining the individual's entitlement to the capital gains exemption in that year. It consists of the amount by which the individual's net taxable capital gains for the year, other than from dispositions of property prior to 1985, exceed the total of the individual's net capital losses carried over from other years and the individual's allowable business investment losses realized in the year.

The description of 'A' in the formula used in the definition is amended in respect of capital gains and capital losses realized on dispositions of "non-qualifying real property" of an individual. The amount determined under 'A' in respect of an individual for taxation year is the lesser of the amount determined in respect of the individual for the year under paragraph 3(b) of the Act and the amount that would be determined under that paragraph if pre-1985 dispositions were ignored and if the individual's only capital gains and capital losses for the year from dispositions of non-qualifying real property were the individual's "eligible real property gains" and "eligible real property losses". By excluding the non-eligible portion of such gains and losses from the calculation, the individual is denied the capital gains exemption under subsection 110.6(3) in respect of such net taxable capital gains. For the purposes of computing the individual's cumulative net investment loss, however, the taxable portion of such non-eligible gains will be treated as investment income of the individual for the year. A number of examples illustrating the operation of these provisions follow the notes to this subsection.

The description of 'B' used in the definition is amended to recognize that an individual's net capital losses for other taxation years deducted under paragraph 111(1)(b) in a taxation year should be limited in the extent to which they reduce the individual's annual gains limit for the year. For example, capital gains realized prior to 1985 but included in income for the year through the capital gains reserve mechanism are not eligible for the exemption since they are excluded from paragraph (a) of the definition. Therefore net capital losses of other years used to offset such gains should not reduce the individual's annual gains limit. Net capital losses of other years used to offset the portion of an individual's taxable capital gain from the disposition of a non-qualifying real property that is not eligible for the exemption should also not reduce the individual's annual gains limit. 'B' is therefore amended to include net capital losses of other years deducted in the year only to the extent that they exceed the difference between the amount determined under paragraph 3(b) of the Act in respect of the individual for the year and the amount included under 'A' of this definition in respect of the individual for the year. This amendment provides, in effect, an ordering provision which assumes that net capital losses of other years are used first to offset taxable capital gains not eligible for the exemption before being applied against gains that are eligible for the exemption.

These amendments are applicable to the 1988 and subsequent taxation years, except that new paragraph (b) of the description of 'A', which deals with dispositions of non-qualifying real property, is applicable only to 1992 and subsequent years.

"cumulative gains limit"

The cumulative gains limit of an individual as of the end of a taxation year is one of the factors applicable in determining the individual's entitlement to the capital gains exemption in that year. It represents the extent to which individual's cumulative net capital gains after 1984 may qualify for the capital gains exemption.

The amendments to this definition, applicable to the 1988 and subsequent taxation years, are consequential on the amendments to the definition of "annual gains limit" and merely revise the references to that definition.

Subclause 47(2)

ITA
110.6(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) of the Act.

A number of changes, applicable to 1992 and subsequent taxation years, are being made to the definition of "interest in a family farm partnership" in subsection 110.6(1).

The definition has been modified to clarify that the property held by the partnership is not required to be used in the course of carrying on the business of farming at the time of the disposition of the partnership interest. Provided that the other conditions of the definition have been satisfied, prior use of the property throughout any 24-month period before the time of disposition will suffice.

The types of qualifying property are extended to include property that is shares or any indebtedness of farm corporations all or substantially all of the fair market value of the property of which is attributable to property that has been used in a farming business in which the individual or the individual's family members were engaged on a regular and continuous basis. This change is consistent with recent amendments to the definition of "share of the capital stock of a family farm corporation".

In order to ensure that an interest in a family farm partnership does not qualify as such after the partnership's farming assets may have been disposed of in favour of non-farming assets, paragraph (b) of the definition imposes the requirement that, at the time of disposition of the partnership interest, all or substantially all of the fair market value of the partnership property must be attributable to property that has been used principally in the course of carrying on a farming business in Canada by the partnership, the individual or other persons referred to in paragraph (a). The scope of paragraph (b) has been broadened to include shares or any indebtedness of corporations that satisfy those property criteria. This change is consistent with the amendment to paragraph (a) of the definition.

Subclause 47(3)

ITA
110.6(1)

"investment expense"

An individual's "investment expense" for a taxation year is relevant in computing the individual's "cumulative net investment loss" at the end of that year, which is used in determining the individual's entitlement to the capital gains exemption for the year.

The definition of "investment expense" is amended, applicable to 1992 and subsequent years, as a consequence of the amendments to the definitions of "annual gains limit" and "investment income". The amendments to these three definitions taken together ensure that taxable capital gains realized in a taxation year that are not eligible for the exemption – such as a portion of those realized on dispositions of non-qualifying real property of an individual – will nonetheless serve to reduce the individual's cumulative net investment loss to the extent that such gains are not offset by net capital losses of other years deducted in the year.

New paragraph (f) of the definition of "investment expense" provides that, commencing with the 1992 taxation year, net capital losses of other years deducted by an individual in the year will be included in the individual's investment expense for the year to the extent that they exceed the amount determined in respect of the individual for the year under paragraph (a) of the description of 'B' in definition of "annual gains limit". The latter amount is the amount by which such net capital losses exceed the difference between the amount included in the individual's income for the year under paragraph 3(b) and the amount included in computing the individual's annual gains limit for the year under the description of 'A' in the formula used in that definition. That difference represents net taxable capital gains for the year that are not eligible for the exemption. Since that difference is also included in computing the individual's investment income for the year under new paragraph (f) of that definition, the net effect of the two provisions will not be to increase the individual's cumulative net investment loss. A number of examples illustrating the operation of these provisions follow the notes to this subsection.

Subclause 47(4)

ITA
110.6(1)

"investment income"

An individual's "investment income" for a taxation year is relevant in computing the individual's "cumulative net investment loss" at the end of that year, which is used in determining the individual's entitlement to the capital gains exemption for the year.

New paragraph (f) of the definition, applicable to 1992 and subsequent years, ensures that net taxable capital gains that are not eligible for the exemption by reason of being excluded from the description of 'A' in the formula used in the definition of "annual gains limit" are included in computing an individual's investment income. Examples of such gains are those realized on the disposition of non-qualifying real property that are not "eligible real property gains" and those realized in respect of pre-1985 dispositions but included in income in subsequent years through the capital gains reserve mechanism (although the latter is now of limited application). Although such net taxable capital gains are included in an individual's investment income for the year in which they are realized, where they have been, in effect, offset by net capital losses of other years deducted by the individual under paragraph 111(1)(b), an amount corresponding to the amount of the offset is added to the individual's investment expense, as described in the commentary on the definition of that expression.

Subclause 47(5)

ITA
110.6(1)

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

This definition has been modified to clarify that the property of a family farm corporation is not required to be used in the course of carrying on the business of farming at the time of the disposition of the share. Provided that the other conditions of the definition have been satisfied, prior use of the property in the circumstances described in paragraph (a) of the definition will suffice. A corresponding amendment is being made to the definition of an "interest in a family farm partnership" in subsection 110.6(1). This amendment applies to 1992 and subsequent years.

Subclause 47(6)

ITA
110.6(1)

"eligible real property gain" and "eligible real property loss"

"Eligible real property gain" and "eligible real property loss" of an individual for a taxation year are new definitions that are used in determining the portion of a capital gain or capital loss realized on the disposition of non-qualifying real property of the individual that is to be included in computing the individual's annual gains limit for the year. Capital gains realized on dispositions of non-qualifying real property will not be taken into account in computing an individual's annual gains limit, and will therefore not be eligible for the exemption unless they are eligible real property gains of the individual.

An individual's eligible real property gain or loss realized on a disposition of non-qualifying real property is computed as the capital gain or loss otherwise determined multiplied by the ratio that the number of calendar months in the period that commences with the calendar month in which the property was last acquired by the individual and ends with February 1992 is of the number of calendar months in the period that commences with the calendar month in which the property was last acquired by the individual and ends with the calendar month in which the property was disposed of by the individual. Calendar months before 1972 are excluded from both the numerator and denominator of this ratio, since gains accrued prior to 1972 are not taxed. Examples illustrating this calculation follow the notes to this subsection.

New subsection 110.6(18) of the Act may apply for the purposes of this calculation to change the date on which an individual is treated as having acquired non-qualifying real property or otherwise modify the number of months to be used in the formula. That subsection provides special rules that apply to identical properties, attributed capital gains, property transferred under one of the "rollover" provisions of the Act, principal residences and capital gains realized by a partnership.

"non-qualifying real property"

As described earlier, capital gains realized on the disposition of non-qualifying real property may not be eligible for the capital gains exemption. "Non-qualifying real property" of an individual means (with a number of exceptions) property disposed of by the individual, or by a partnership of which the individual is a member, after February 1992 that is real property, or a share of the capital stock of a corporation or interest in a partnership or trust the fair market value of which is derived principally from real property. Also included in the definition are interests or options in respect of such real property, shares or interests.

Non-qualifying real property of an individual does not include qualified farm property of the individual. Capital gains realized on a disposition of qualified farm property therefore remain eligible for both the enhanced capital gains exemption provided under subsection 110.6(2) of the Act and the basic deduction provided under subsection 110.6(3).

Pursuant to subparagraph (a)(ii) of the definition, real property disposed of by an individual (or by the individual's spouse where, as a result of the attribution rules, the resulting capital gain is taxed in the hands of the individual) will not be non-qualifying real property of the individual if it was used, during the time specified in clause (a)(ii)(A) or (B) of the definition (described below), principally in an active business carried on by a person described in any of clauses (a)(ii)(C) to (H) of the definition. These persons include the individual (and where the individual is a personal trust, a preferred beneficiary under the trust), the individual's (or beneficiary's) spouse, child or parent and a corporation, personal trust or a partnership where all or substantially all of the fair market value of the shares of which, or trust or partnership interests in which, were owned by one or more persons described in subparagraph (a)(ii). The definition accommodates tiered ownership structures – for example, where real property owned by an individual is used in an active business carried on by a wholly-owned subsidiary of the individual's holding corporation.

To qualify for this exception, the property must have been so used either at all times during that part of the 24-month period preceding the disposition while it was owned by the individual or the individual's spouse, or throughout all or substantially all of the time preceding the disposition while it was owned by the individual or the individual's spouse. The latter provision accommodates the sale of real property that may have been used for many years in an active business but lay idle for a period of time preceding the sale.

For the purposes of this definition, an active business carried on by a person means any business other than a business the principal purpose of which is to derive income from property, unless the person (or, where the person carries on business as a member of a partnership, the partnership) employs in the business more than 5 persons on a full-time basis or in the course of carrying on the business uses services equivalent to those that could reasonably be expected to be provided by more than 5 persons employed in the business on a full-time basis. As in paragraph 125(7)(e) of the Act, the business of leasing property other than real property or the business of a credit union is considered to be an active business even if the business employs fewer than 6 persons on a full-time basis.

Subparagraph (a)(iii) applies where an individual is a member of a partnership that has disposed of real property. Except where the individual (or, in the case of attributed gains, the individual's spouse) is a specified member of the partnership, real property will not be considered to be non-qualifying real property of the individual if it was used, during the time specified in clause (a)(iii)(A) or (B) (described below), principally in an active business carried on by the individual (or, where the individual is a personal trust, a preferred beneficiary under the trust), the individual's (or beneficiary's) spouse, child or parent or a corporation or personal trust all or substantially all of the fair market value of the shares of which, or interests in which, were owned by one or more persons described in subparagraph (a)(iii).

To qualify for the exception, the property must have been so used either at all times during that part of the 24-month period preceding the disposition while it was property of the partnership, the individual or the individual's spouse, or throughout all or substantially all of the time preceding the disposition while it was property of the partnership, the individual or the individual's spouse. As described above, "active business" is defined for these purposes in the concluding words of the definition.

A share of the capital stock of a family farm corporation of an individual and an interest in a family farm partnership of an individual will not constitute non-qualifying real property of the individual. Capital gains realized on the disposition of such shares or interests remain eligible for the enhanced capital gains exemption provided under subsection 110.6(2) of the Act and the basic exemption provided under subsection 110.6(3). Similarly, qualified small business corporation shares of an individual will not be non-qualifying real property of the individual. Capital gains realized on their disposition remain eligible for both the enhanced exemption provided under subsection 110.6(2.1) of the Act and the basic exemption available under subsection 110.6(3).

Where the fair market value of a share of the capital stock of a corporation disposed of by an individual after February 1992 is derived principally from real property, the share will not be non-qualifying real property of the individual if that real property was used, during the time specified in subparagraph (b)(i) or (ii), principally in an active business carried on by the corporation or persons described in any of clauses (a)(ii)(C) to (H). These persons include the individual (and, where the individual is a personal trust, a preferred beneficiary under the trust), the individual's (or beneficiary's) spouse, child or parent and a corporation, personal trust or one or more members of a partnership, where all or substantially all of the fair market value of the shares of which, or trust or partnership interests in which, were owned by one or more persons described in subparagraph (a)(ii). To qualify for this exception, the property must have been so used either at all times during the 24-month period preceding the disposition while it was owned by the corporation or persons described in any of clauses (a)(ii)(C) to (H) or throughout all or substantially all of the time preceding the disposition while it was owned by the corporation or such persons. As described above, "active business" is defined for these purposes in the concluding words of the definition.

Similar exceptions are provided under paragraphs (c) and (d) of the definition for interests in a partnership or trust the fair market value of which is derived from real property used principally in an active business.

EXAMPLES OF NON-QUALIFYING REAL PROPERTY RULES

In all of the following examples, it is assumed that the property disposed of is capital property that is non-qualifying real property of an individual resident in Canada.

EXAMPLE 1: eligible real property gain; annual gains limit; investment income.

An individual, Mr. X, acquired land in 1967. Its V-day value was $12,000. Mr. X sold the land on September 4, 1992 at its fair market value of $112,000, realizing a capital gain of $100,000. Mr. X has never claimed the capital gains exemption, has no cumulative net investment loss and has no other gains or losses in the year.

Mr. X's eligible real property gain is $97,188.76, determined as A x B / C, where

A = $100,000	[capital gain on disposition]
B = 242	[# of months from January 1972 to February 1992, inclusive]
C = 249	[# of months from January 1972 to September 1992, inclusive]

Mr. X's annual gains limit for 1992 is

¾ x $97,188.76 = $72,891.57 [subparagraph (b) (ii) of 'A' in definition of "annual gains limit"]

Mr. X must include $75,000 in his 1992 income but may claim a capital gains deduction under subsection 110.6(3) of $72,891.57. Mr. X will have investment income for the year of $2,108.43 ($75,000 - $72,891.57) by reason of new paragraph (f) of that definition, which will reduce any cumulative net investment loss otherwise determined.

EXAMPLE 2: annual gains limit; net capital loss carryovers.

Ms. Y acquired shares of the capital stock of a corporation in February 1990 at a cost of $25,000. She sold them in July 1992 for $37,000. The shares are non-qualifying real property of Ms. Y. Ms. Y also realized $20,000 of capital gains in 1992 from the disposition of other investments that were not non-qualifying real property. Ms. Y had $6000 of net capital losses from previous years which she deducted under paragraph 111(1)(b) in 1992.

Eligible real property gain:	$10,000 = [($37,000 - $25,000) x 25 / 30]
Amount included in income under paragraph 3(b):	$24,000 = [($12,000 + $20,000) x ¾]
Annual gains limit:	$18,000 = [[($10,000 + $20,000) x ¾] - [$6,000- ($24,000 - $22,500)]]
Investment expense [para.(f)]:	$ 1,500 = [$6,000 - $4,500]
Investment income [para.(f)]:	$ 1,500 = [$24,000 - $22,500]
Cumulative net investment loss:	NIL

Only $18,000 of Ms. Y's total taxable capital gains of $24,000 are eligible for the subsection 110.6(3) exemption due to the $6,000 of net capital losses of other years deducted in 1992. In effect, this $6,000 has been applied first against the $1,500 of the taxable capital gain realized on the disposition of non-qualifying real property that is not eligible for the exemption and then against the $22,500 taxable capital gain that would otherwise be eligible for the exemption.

**EXAMPLE 3: annual gains limit;
net capital loss carryovers.**

Assume the same facts as in Example 2, except that Ms. Y deducted $24,000 rather than $6,000 of net capital losses of other years under paragraph 111(1)(b) in 1992.

Eligible real property gain: $10,000

Amount included in income
under paragraph 3(b): $24,000

Annual gains limit: Nil = [[($10,000 + $20,000) x 3/4] -
[$24,000 - ($24,000-$22,500)]]

Investment expense [para. (f)]: $ 1,500 = [$24,000 - $22,500]

Investment income [para. (f)]: $ 1,500 = [$24,000 - $22,500]

Cumulative net investment loss: NIL

EXAMPLE 4: eligible real property gain; identical properties.

Mr. Z acquired 200 shares of Holdco Ltd. in December 1991 at $5 per share. In March 1992 he acquired another 600 shares of the company at $6 each. In September 1992 he sold 300 shares at $7 each. The shares are identical properties and are non-qualifying real property of Mr. Z.

Proceeds of disposition:	$ 2100 = [$7 x 300]
Adjusted cost base:	$ 1725 = [$5.75 x 300, per subsection 47(1)]
Capital gain:	$ 375
Eligible real property gain:	$ 75 = [(200 x ($7 - $5.75) x 3/10 + (100 x ($7 - $5.75) x 0/7)]
Annual gains limit:	$56.25 = [¾ x $ 75]
Investment income [para. (f)]:	$ 225 = [(¾ x $375) - $56.25]

Paragraph 110.6(18)(a) deems Mr. Z to have disposed of the shares in the order in which they were acquired. Therefore Mr. Z may claim the subsection 110.6(3) exemption in respect of the taxable portion ($56.25) of his $75 eligible real property gain. The taxable portion ($225) of the $300 capital gain that is not eligible for the exemption is treated as investment income to Mr. Z for purposes of determining his cumulative net investment loss. Capital gains realized by Mr. Z on a subsequent disposition of the remaining shares will not be eligible for the exemption if they are still non-qualifying real property of Mr. Z at the time of the disposition.

Subclause 47(7)

ITA
110.6(1.1)

New subsection 110.6(1.1) of the Act, which is applicable to 1991 and subsequent taxation years, ensures that the fair market value of a net income stabilization account (NISA) is considered to be nil for the purposes of determining whether a share satisfies the definitions "qualified small business corporation share" or "share of the capital stock of a family farm corporation". In effect, the value of a NISA held by a corporation will not influence the determination of whether a particular share meets the criteria set out in those definitions.

Subclause 47(8)

ITA
110.6(2)(a)(iii)(A)

Subsection 110.6(2) of the Act provides for the deduction of the capital gains exemption of an individual (other than a trust) for a taxation year in respect of net taxable capital gains realized on a disposition of qualified farm property either in the year or in a preceding taxation year ending after 1984. The income inclusion rate for capital gains increased from one-half to two-thirds in 1988 and to three-quarters in 1990.

Paragraph 110.6(2)(a) of the Act determines the unused portion of the individual's lifetime capital gain exemption limit in respect of capital gains realized on dispositions of qualified farm property. The unused portion is limited to $375,000 and is reduced by claims made in prior years under section 110.6. The $375,000 limit reflects $500,000 of capital gain multiplied by the three-quarters inclusion rate.

Subparagraphs 110.6(2)(a)(ii) and (iii) ensure that claims made prior to 1988 and 1990 are grossed up appropriately to reflect the increases in the inclusion rate in 1988 and 1990. After 1989, clause 110.6(2)(a)(iii)(A) provides for an increase of one-eighth of amounts deducted prior to 1990. Amounts deducted prior to 1988, grossed up to reflect a two-thirds inclusion rate for capital gains in 1988 and 1989 under subparagraph 100.6(2)(a)(ii), are further increased by a factor of one-eighth under clause 110.6(2)(iii)(B) to reflect the increases in the inclusion rate from one-half to two-thirds and subsequently to three-quarters. However, the increase provided by clause (a)(iii)(A) is inappropriate for amounts deducted in 1988 or 1989 with respect to taxable capital gains that are deemed by reason of subparagraph 14(1)(a)(v) to be taxable capital gains realized on the disposition of eligible capital property as such amounts were includable in the taxpayer's income at a rate of three-quarters for 1988 and 1989.

Clause 110.6(2)(a)(iii)(A) is amended, applicable to 1990 and subsequent years, to exclude from the one-eighth gross-up requirement any amount that has been included in the taxpayer's income for 1988 and 1989 by reason of subparagraph 14(1)(a)(v) of the Act.

This adjustment will, by an existing reference in subsection 110.6(2.1) to subparagraph 110.6(3)(a)(iii), also apply in calculating the unused portion of capital gains realized on dispositions of qualified small business corporation shares. A corresponding amendment is being made to clause 110.6(3)(a)(iii)(A) in respect of gains arising on the disposition of property other than qualified farm property or qualified small business corporation shares.

Subclause 47(9)

ITA
110.6(3)(a)

Subsection 110.6(3) of the Act provides the capital gains exemption for individuals (other than trusts) in respect of net taxable capital gains realized in the year. The income inclusion rate for capital gains increased from one-half to two-thirds in 1988 and to three-quarters in 1990.

Paragraph 110.6(3)(a) of the Act determines a taxpayer's unused lifetime capital gains exemption limit. The unused portion of the lifetime exemption is limited to $75,000 and is reduced by claims made in prior years under subsection 110.6(3). The $75,000 limit represents $100,000 of capital gains multiplied by the three-quarters inclusion rate. Claims in prior years, with inclusion rates of less than three-quarters, are grossed up for the purposes of calculating the taxpayer's remaining lifetime exemption limit. In this way, the exemption limit will always reflect the inclusion rate in effect for the particular year on $100,000 of capital gains.

In calculating the taxpayer's remaining lifetime exemption limit after 1989, any amount deducted prior to 1990 will be increased by one-eighth by virtue of clause 110.6(3)(a)(iii)(A). These amounts are increased by a factor of one-eighth to reflect the increase in the inclusion rate for capital gains from two-thirds to three-quarters in 1990. Where these amounts were deducted prior to 1988 they are first grossed up by one-third under subparagraph 110.6(3)(a)(ii) to reflect the increase in the inclusion rate for capital gains (for 1988 and 1989) from one-half to two-thirds. However the one-eighth increase under clause 110.6(3)(a)(iii)(A) is inappropriate for amounts deducted with respect to taxable capital gains that are deemed by reason of subparagraph 14(1)(a)(v) to be taxable capital gains realized on the disposition of eligible capital property as such amounts were includable in the taxpayer's income at a rate of three-quarters for 1988 and 1989.

Clause 110.6(3)(a)(iii)(A) is amended for 1990 and subsequent years to exclude any amount that has been included in the individual's income by reason of subparagraph 14(1)(a)(v) of the Act from the one-eighth increase.

A corresponding amendment is being made to subparagraph 110.6(2)(a)(iii) in respect of gains arising on the disposition of qualified farm property and qualified small business corporation shares.

Subclause 47(10)

ITA
110.6(12)

Subsection 110.6(12) of the Act allows those post-1971 spousal trusts described in paragraph 104(4)(a) to take advantage of any unused capital gains exemption of the beneficiary spouse after that spouse dies. The amendment to that subsection accords the same treatment to pre-1972 spousal trusts described in paragraph 104(4)(a.1), where a deemed realization occurs pursuant to that paragraph on the later of January 1, 1993 and the death of the spouse. However, to avoid administrative complexity, similar treatment is not extended to pre-1972 spousal trusts described in paragraph 104(4)(a.1) which make an election under subsection 104(5.3).

This amendment is applicable to 1993 and subsequent years.

Subclause 47(11)

ITA
110.6(12)(b)

Although subsection 104(21.2) of the Act may permit a trust beneficiary to claim a capital gains exemption in respect of gains realized by the trust, with one exception, trusts cannot claim a capital gains exemption in their own right. That exception is found in subsection 110.6(12) of the Act, which allows certain spousal trusts to claim the unused exemption of the beneficiary spouse when he or she dies.

The amount of the exemption available to the trust may, however, be limited by clause 110.6(12)(b)(i)(A). That clause describes the net taxable capital gains of the trust for the year in which the exemption is being claimed, determined without reference to pre-1985 dispositions and dispositions of qualified farm properties or certain qualified small business corporation shares.

Subparagraph 110.6(12)(b)(i) is amended, applicable to 1992 and subsequent years, also to exclude from the amount determined thereunder taxable capital gains and allowable capital losses realized in the year on dispositions of non-qualifying real property of the trust unless such taxable capital gains and allowable capital losses are eligible real property gains or eligible real property losses of the trust, as defined in subsection 110.6(1). This restriction appears in new subclause 110.6(12)(b)(i)(A.1)(II). Pursuant to new clause 110.6(12)(b)(i)(A), in no case may the amount determined under subparagraph (b)(i) exceed the amount determined in respect of the trust for that year under paragraph 3(b) of the Act in respect of capital gains and losses.

Subclause 47(12)

ITA
110.6(17) and (18)

For taxation years ending after 1989, clauses 110.6(2)(iii)(A) and (3)(a)(iii)(A) of the Act increase by one-eighth any amount deducted prior to 1990 under subsections 110.6(2) and (3). These amounts are increased by a factor of one-eighth to reflect the increase in the inclusion rate from two-thirds to three-quarters for taxation years ending after 1989. Those clauses are being amended to provide that any amount that has been included in the individual's income for the 1988 and 1989 taxation years under subparagraph 14(1)(a)(v) of the Act, and thus included at a rate of three-quarters for those years, is not subject to the one-eighth increase.

New subsection 110.6(17) is intended to clarify that where an individual has claimed an exemption for capital gains under subsection 110.6(2) or (3) prior to 1990, it will be assumed that, to the extent such an exemption was available, the individual claimed an exemption for capital gains realized on the disposition of eligible capital property first prior to having claimed an exemption in respect of capital gains realized on the disposition of any other capital property. This provision is intended to ensure that individuals that have not claimed the maximum capital gains exemption in 1990 and subsequent taxation years do not have their capital gains exemptions inappropriately reduced.

New subsection 110.6(18) of the Act provides rules that apply in determining an individual's eligible real property gain or eligible real property loss, as defined in subsection 110.6(1). These amounts need only be determined where the individual has disposed of non-qualifying real property.

The rule in paragraph 110.6(18)(a) treats an individual as having disposed of identical properties in the order in which they were acquired. This paragraph will typically apply where the non-qualifying real properties disposed of are shares.

Paragraph 110.6(18)(b) applies where a capital gain of another person has been attributed to an individual in a taxation year and paragraph 74.2(2)(b) of the Act applies to deem the individual to have disposed of property in the year. Under this rule, where such property is non-qualifying real property of the individual, he or she will be treated as having last acquired the property at the time at which the other person last acquired it and to have disposed of it at the time at which the other person disposed of it. The time at which non-qualifying real property was last acquired by the individual is relevant in computing the amount of the attributed capital gain that may be eligible for the capital gains exemption.

Paragraph 110.6(18)(c) applies where non-qualifying real property disposed of by an individual was acquired by the individual under circumstances where one of the listed "rollover" provisions of the Act applied. Where the individual acquired the property for an amount not exceeding the adjusted cost base of the property to the transferor, the individual will be treated, for the purpose of determining his or her eligible real property gain or loss on the disposition, as having acquired the property at the time it was last acquired by the transferor. Where the acquisition cost on the rollover was greater than the adjusted cost base of the property to the transferor – which would occur, for example, under some of the listed provisions if the transferor elected to recognize part of the accrued gain on the property – the individual will not be entitled to the benefit of the earlier acquisition date.

Paragraph 110.6(18)(d) provides that in determining the number of months to be used in both the numerator and denominator of the fraction used in the formula for determining an individual's eligible real property gain or loss, months that are in a taxation year in which the property disposed of was a principal residence of the individual or the individual's spouse are to be excluded. In most cases, an individual's gain from the disposition of a principal residence will be nil and this paragraph will be of no relevance. Paragraph (d) will typically apply where there has been a change in the use of property so that it was a principal residence of the individual only for part of the time it was owned.

Paragraph 110.6(18)(e) applies to an individual's share of any capital gains or losses realized on a disposition of non-qualifying real property, where the property was disposed of by a partnership of which the individual was a member. In determining the portion of such a gain or loss that is to be treated as an eligible real property gain or loss of the individual, the individual is treated as having acquired and disposed of the property giving rise to the gain or loss at the times at which the partnership acquired and disposed of the property. Where the individual had previously disposed of the property to the partnership and an election was made under subsection 97(2) of the Act in respect of the disposition, the individual will be treated as having last acquired the property at the time he or she last acquired it before that disposition, provided that the elected amount was not greater than the adjusted cost base to the individual of the property at the time of its disposition to the partnership.

Clause 48

Northern Tax Benefits

ITA
110.7(1)(a)

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 in an eligible area throughout a period of at least 6 consecutive months commencing or ending in the year. The deduction allowed under paragraph 110.7(1)(a) offsets the income inclusion in respect of benefits provided by an employer to an employee or to 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 trips. This amendment, which is applicable to 1992 and subsequent years, ensures that this deduction is available only to the extent that any reimbursement or any other form of assistance with respect to the travelling expenses is included in income.

Clause 49

Loss Carryovers

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 49(1)

ITA
111(8)(b)(i)(A)

Paragraph 111(8)(b) of the Act defines the "non-capital loss" of a taxpayer for a taxation year. Clause 111(8)(b)(i)(A) lists certain amounts to be included in calculating a taxpayer's non-capital loss. Effective for 1991 and subsequent taxation years, clause 111(8)(b)(i)(A) is amended by adding a reference to net capital loss carryover deductions made by a taxpayer for the taxation year under paragraph 111(1)(b) in computing the taxpayer's taxable income for that year. As a result of this amendment, business losses of a taxation year that have been used to reduce the amount of a taxable capital gain for that year may be reinstated where net capital losses of other taxation years are carried over to that year.

Subclause 49(2)

ITA
111(8)(c)

In the case of non-residents, paragraph 111(8)(c) provides that only certain losses from Canadian sources will be included in determining the non-resident's loss carryovers. Paragraph 111(8)(c) is amended, applicable to 1991 and subsequent taxation years and with respect to the computation of taxable income and taxable income earned in Canada for those years, to include allowable business investment losses, as well as losses from duties of an office or employment performed by the non-resident in Canada, as a loss eligible for carryover.

Clause 50

Taxable Income Earned in Canada

ITA
115(1)(c)

Section 115 of the Act provides rules for the calculation of the "taxable income earned in Canada" by a non-resident, which is subject to tax under Part I of the Act. Paragraphs 115(1)(a) to (c) provide the sources of income and losses to be included, while paragraphs 115(1)(d) to (f) provide the allowable deductions that may be taken, in computing a non-resident's taxable income earned in Canada. Paragraph (c) is amended, applicable to 1991 and subsequent taxation years, to provide for the inclusion of both losses from the duties of an office or employment performed by the non-resident in Canada and from allowable business losses in respect of property any gain from the disposition of which would have been included in determining the non-resident's income.

Clause 51

Competent Authority Agreements

ITA
115.1

Section 115.1 of the Act permits the Minister of National Revenue to enter into an agreement to defer Canadian tax, pursuant to a prescribed tax treaty provision, that would otherwise be payable in respect of the disposition of property by a non-resident, while at the same time protecting the Canadian tax base. Section 115.1, which is designed to prevent double taxation, sets out rules applicable to both the vendor and the purchaser in such cases. To date, two tax treaty provisions have been prescribed for the purposes of section 115.1. They are paragraph 8 of Article XIII of the Canada-United States Tax Convention and paragraph 6 of Article 13 of the Canada-Netherlands Income Tax Convention. It is expected that similar provisions will be included in many of Canada's future tax treaties.

Section 115.1 is amended, applicable after 1984. New section 115.1 accommodates the situations to which the current version applies, and also extends to a broader range of transactions. New subsection 115.1(1) provides that where the Minister of National Revenue and the taxpayers enter into an agreement, pursuant to a provision in a tax convention or agreement with another country that has the force of law in Canada, to defer tax in Canada, the terms of such an agreement will govern the taxation of the persons involved.

New subsection 115.1(2) provides that where a taxpayer's rights and obligations have been assigned to another person with the concurrence of the Minister, such other person is to be bound by the terms of the original agreement. This provision will help to ensure that the tax deferral agreement will be binding on the taxpayers involved in subsequent taxation years.

Finally, new section 115.1 permits a taxpayer who may qualify for relief under this subsection to enter into a tax deferral agreement in advance of the transactions involved, thereby providing taxpayers with additional flexibility.

Clause 52

Pension Credit

ITA
118

Section 118 of the Act contains the following personal tax credits: single, married status, equivalent-to-married, dependant, age and pension credits.

Subclause 52(1)

ITA
118(3)

Paragraph 118(3)(b) of the Act provides a tax credit of up to $170 for qualifying individuals under age 65 years of age who are in receipt of specified pension income. Subparagraphs 118(3)(b)(ii) and (iii) provide that this credit may be claimed by an individual under 60 years of age only if the individual is in receipt of a CPP/QPP disability or survivor pension or the individual has not deducted an amount under paragraph 60(j) in computing income for the year.

Subsection 118(3) is amended so that all individuals under age 65 years of age who are in receipt of specified pension income are eligible for the pension tax credit. This is appropriate because paragraph 60(j) may no longer be used to transfer periodic pension income to an RRSP or a registered pension plan.

This amendment is applicable to 1992 and subsequent years.

Subclause 52(2)

ITA
118(7)(b)

Section 118 of the Act provides for a number of credits that are deductible in computing the tax payable by an individual, including the pension credit in subsection 118(3). The pension credit available to a taxpayer who is under 65 years of age is based on the taxpayer's qualified pension income, as defined in paragraph 118(7)(b). Qualified pension income includes certain amounts, such as annuity payments under a registered retirement savings plan received by the taxpayer as a consequence of the death of the taxpayer's spouse. For this purpose, "spouse" includes a common-law spouse as defined in subsection 146(1.1). The amendment to paragraph 118(7)(b), which applies after 1992, deletes the reference to subsection 146(1.1) and is strictly consequential on the repeal of that subsection and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Clause 53

Charitable Donations by Individuals

ITA
118.1(6)

Subsection 118.1(6) of the Act provides that where an individual donates capital property to a charity, he or she may elect a value between the adjusted cost base and the fair market value of the donated property to be both proceeds of disposition (for purposes of calculating any capital gain on the disposition), and the amount of the gift (for purposes of calculating the tax credit in respect of charitable donations available under subsection 118.1(1) of the Act). The amendment is consequential on changes to subsection 118.1(1) of the Act contained in S.C. 1991, c. 49 (Bill C-18). It applies to gifts made after December 11, 1988 to ensure that the elected value under subsection 118.1(6) will be the amount on which the charitable donation tax credit is based.

Clause 54

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.

Subclause 54(1)

ITA
118.2(2)(l.3)

Subsection 118.2(2) contains a list of expenditures which qualify as eligible medical expenses. New paragraph 118.2(2)(l.3), which applies to 1992 and subsequent years, adds to this list reasonable expenses relating to rehabilitative therapy (including training in sign language and lip reading) to adjust for speech or hearing loss.

Subclause 54(2)

ITA
118.2(3)(b)

Paragraph 118.2(3)(b) of the Act provides that the amount of any reimbursement that is received for medical expenses, and that is not included in an individual's income under Part I of the Act, will reduce the amount of medical expenses that would otherwise be eligible for the medical expense tax credit.

The amendments to paragraph 118.2(3)(b) provide that this treatment of reimbursements of medical expenses will also apply to reimbursements of medical expenses received by another individual for whom the taxpayer is otherwise entitled to claim medical expenses.

These amendments to paragraph 118.2(3)(b) of the Act also ensure that where an individual receives an amount as reimbursement for medical expenses and the amount is both included in computing income under Part I of the Act, and is deductible in computing taxable income, that amount will reduce the medical expenses eligible for the medical expense tax credit.

Clause 55

Mental or Physical Impairment

ITA
118.3(2)(b)

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)(b) provides that the supporting individual's claim will be allowed only if a medical expense credit is not claimed for amounts paid to an attendant in respect of the disabled person. This amendment, which is applicable to 1991 and subsequent years, enables the supporting individual to claim the disabled person's unused disability tax credit where amounts have been paid to a part-time attendant of the disabled person and were included, by reason of paragraph 118.2(2)(b.1), in computing a medical expense tax credit.

Clause 56

Tuition Fees

ITA
118.5(1)(a)

Subsection 118.5(1) of the Act provides a tax credit in respect of tuition fees paid to certain educational institutions.
Paragraph 118.5(1)(a) is amended for 1992 and subsequent years to ensure that, except for fees paid to educational institutions certified by the Department of Employment and Immigration, only that portion of the tuition fees that relates to courses at the post-secondary school level will be eligible. Tuition fees paid to an educational institution certified by the Department of Employment and Immigration and that relate to a particular year will not be eligible for the credit unless the student is at least 16 years of age at the end of the year and the purpose of the course is to provide occupational skills.

Clause 57

Education Tax Credit

ITA
118.6

Section 118.6 of the Act provides rules for determining eligibility for the education tax credit.

Subclause 57(1)

ITA
118.6(2)

Subsection 118.6(2) of the Act provides for an education tax credit and the formula for calculating the amount of the credit. This amount is currently determined by multiplying the appropriate percentage (17%) by $60 and by the number of months in the year during which the individual was enrolled as a full-time student in a qualifying educational program at a designated educational institution. This amendment, which applies to 1992 and subsequent years, increases from $60 to $80 the monthly amount used in the formula to calculate the credit.

Subclause 57(2)

ITA
118.6(3)

Subsection 118.6(2) of the Act restricts the education tax credit to students enrolled on a full-time basis in a qualifying educational program at a designated educational institution. New subsection 118.6(3), which applies to 1992 and subsequent years, removes the requirement that a student be enrolled on a full-time basis where the student is eligible for the disability tax credit for the year or cannot be enrolled on a full-time basis at any time in the year by reason of the student's mental or physical impairment, as certified in writing by a medical doctor.

Clause 58

Tuition Fees and
Education Credit Spousal Transfer

ITA
118.8

Section 118.8 of the Act governs the transfer to a spouse of certain unused tax credits. The credits which may be transferred are the tuition fee and education credits (up to a maximum of $600) and the age, pension and disability tax credits. The amount of the transfer is determined in accordance with an algebraic formula. Component A of this formula provides for the maximum amount that may be transferred to a spouse with respect to the unused portion of the tuition fee and education tax credits. This amendment, which applies to 1992 and subsequent years, increases from $600 to $680 the maximum amount of tuition fee and education tax credits transferable to a spouse.

Clause 59

Tuition Fees and
Education Credit Transfer

ITA
118.9(1)

Section 118.9 of the Act governs the transfer of an individual's tuition fee and education credits to the individual's parent or grandparent. Where no tax credit is claimed by the individual's spouse in respect of the individual as a dependant under section 118 or by way of the transfer of unused credits permitted by section 118.8, the individual's parent or grandparent may deduct, up to a maximum of $600, the individual's unused tuition fee and education tax credits.

The amendment to subsection 118.9(1) of the Act, which applies to 1992 and subsequent years, increases the maximum amount transferable to a parent or grandparent from $600 to $680. The amendment also ensures that, where an individual is entitled to a tuition fee credit in respect of fees paid for one or more courses, the transferability of the unused portion of the credit to the individual's parent or grandparent will not depend on the nature or level of those courses.

Clause 60

Goods and Services
Tax Credit

ITA
122.5

Section 122.5 of the Act provides the rules for determining the goods and services tax (GST) credit for individuals.

Subclause 60(1)

ITA
122.5(1)

"adjusted income"

A taxpayer's total GST credit in respect of a year is reduced by five cents for each dollar of the taxpayer's adjusted income in excess of an indexed threshold ($25,921 for 1992). For this purpose, a taxpayer's "adjusted income" for a year is the total of the incomes for the year of the taxpayer, the taxpayer's qualified relation for the year and any person who claims for the year a dependent tax credit in respect of a qualified dependant of the taxpayer for the year. Consequential on the introduction of the child tax benefit which, among other things, replaces the dependant tax credit currently available for dependant children under 18 years of age, the definition of "adjusted income" is amended to include only the incomes of the taxpayer and the taxpayer's qualified relation. This amendment applies to 1992 and subsequent years.

Subclause 60(2)

ITA
122.5(1)

"qualified relation"

For the purposes of the GST credit, a "qualified relation" of an individual is generally defined as a person of the opposite sex who is the individual's spouse or, where the individual and another person are the parents of a child, that other person. An individual's spouse who is living separate and apart from the individual at the end of a year by reason of a marriage breakdown is treated as not being a qualified relation of that individual for that year. This amendment, which defines an individual's qualified relation for a year as being the individual's cohabiting spouse at the end of the year, is consequential on the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. To ensure uniformity between the tax treatment of "spouse" for the purposes of the GST and the child benefit provisions, a "qualified relation" of an individual for a year is defined for the purposes of the GST credit as being the person who, for the purposes of the new child benefit, is the individual's cohabiting spouse at the end of the year. This amendment generally applies to 1992 and subsequent years.

Subclauses 60(3) to (5)

ITA
122.5(5) and (6)

Subparagraph 122.5(5)(b)(i) provides that the goods and services tax credit will not be paid for amounts less than $1. This subparagraph is repealed, effective on Royal Assent, since the provision for the non-payment of the credit in such circumstances is included in the broader administrative policy of Revenue Canada dealing with the levy and refund of small amounts.

Subparagraph 122.5(c)(ii) provides that no goods and services tax credit will be paid to an individual where the individual's return of income for the relevant taxation year is not filed within 3 years from the end of that year. The repeal of this subparagraph is consequential on the repeal, as part of the "Fairness Package" legislation released in May 1991 by the Minister of National Revenue, of the provision requiring that, for tax refund purposes, the return of income be filed within 3 years. The repeal of this subparagraph is retroactive to 1989, which is the first taxation year for which the goods and services tax credit was provided.

The amendment to subsection 122.5(6) of the Act is consequential on the amendment to subsection 122.5(5) and merely changes a reference to that provision.

Clause 61

Corporation Surtax

ITA
123.2(a)

Section 123.2 of the Act levies a 3% surtax on the federal tax payable under Part I of the Act by a corporation, other than a non-resident-owned investment corporation. The amendment to this section provides that the corporate surtax is to be based on the amount of federal income tax payable before taking into account any deduction under subsection 137(3), which provides a special tax credit to credit unions.

This amendment to section 123.2 applies to 1992 and subsequent taxation years. However, a transitional provision allows a corporation to deduct, in computing the amount of federal tax on which its surtax will be based for a taxation year beginning before January 1, 1992, the portion of any deduction under subsection 137(3) that relates to the period in the year before that date.

Clause 62

Corporate Tax Abatement

ITA
124(3)

Section 124 of the Act provides for an abatement of federal income tax payable by corporations. It takes the form of a deduction from the tax otherwise payable by a corporation equal to 10 per cent of all of a corporation's taxable income earned in a taxation year in a province. Subsection 124(3) denies the deduction from tax payable where the corporation is a prescribed federal Crown corporation.

Various enactments of the Parliament of Canada, including section 149 of the *Income Tax Act*, exempt certain taxpayers from tax under Part I of the Act. Subsection 124(3) is amended, applicable for 1992 and subsequent taxation years, to provide that for the purposes of determining the amount of federal abatement, any part of a corporation's taxable income that is exempt from tax under Part I by reason of an enactment of the Parliament of Canada is to be ignored. This limitation ensures that the abatement from federal tax otherwise payable by a corporation under Part I of the Act will not be available with respect to any part of a corporation's taxable income that is not subject to tax under Part I by reason of a statutory exemption.

Clause 63

Small Business Deduction

ITA
125

Section 125 of the Act provides for a corporate tax reduction (referred to as the "small business deduction") in respect of income of a Canadian-controlled private corporation from an active business carried on by it in Canada.

Subclause 63(1)

ITA
125(1)(b)

The small business deduction is calculated as 16% of the least of three amounts. The first is the net active business income of the corporation for the taxation year as determined under paragraph 125(1)(a) of the Act. The second amount, as determined under paragraph 125(1)(b), is the corporation's taxable income for the year reduced by amounts that represent income that may be considered to have borne foreign tax equivalent to Canadian federal tax and which, therefore, will not give rise to actual Canadian tax liability. The third amount is the corporation's business limit for the year.

Various enactments of the Parliament of Canada, including section 149 of the *Income Tax Act*, exempt certain taxpayers from tax under Part I of the Act. This amendment to paragraph 125(1)(b), which applies to 1992 and subsequent taxation years, ensures that a corporation will not receive the small business deduction in respect of taxable income for the year that is exempt from tax under Part I by reason of a statutory exemption.

Subclause 63(2)

ITA
125(5)(a)

Paragraph 125(5)(a) of the Act provides for the calculation of a corporation's business limit where the corporation has two or more taxation years ending in a calendar year in which it is associated with another Canadian-controlled private corporation. This rule provides that, subject to the prorating rule for short taxation years in paragraph 125(5)(b), the business limit for each such taxation year of the corporation is the amount allocated to the corporation for its first such taxation year ending in the calendar year under subsection 125(3) or (4).

However, where a group of associated corporations has more than one taxation year ending in a calendar year, they may allocate $200,000 of business limit to a corporation that becomes a new member of the group in any taxation year ending in the calendar year subsequent to the first such year while still permitting each of the old members a certain amount of business limit in such a taxation year. This arises because the allocation under subsection 125(3) in any taxation year ending in the calendar year subsequent to the first such year is overridden by paragraph 125(5)(a) which deems the business limit of each associated corporation for such a taxation year to be equal to the subsection 125(3) allocation amount for the first such taxation year.

EXAMPLE

Assume that A Co and B Co are associated corporations with taxation years that end on June 30, 1991 and A Co and B Co allocate to themselves $100,000 each of business limit for that taxation year under subsection 125(3) of the Act. Further assume that C Co, a corporation whose taxation year ends on December 31, 1991, becomes associated with A Co and B Co on November 1, 1991 and A Co and B Co both adopt December 31, 1991 year ends to coincide with C Co's year end.

For the taxation year ending December 31, 1991, the three corporations may allocate their combined $200,000 business limit entirely to C Co under subsection 125(3). Yet, notwithstanding this allocation, subsection 125(5) of the Act deems both A Co and B Co to have business limits of approximately $100,000 for that same taxation year prior to any proration required under paragraph 125(5)(b) for a short taxation year.

Paragraph 125(5)(a) is amended, for taxation years ending after December 20, 1991, to provide that the business limit for each such corporation for a particular taxation year ending in the calendar year other than the first such year is, subject to the prorating rule in paragraph 125(5)(b), the lesser of the amount allocated to the corporation for its first such taxation year ending in the calendar year under subsection 125(3) or (4) and the amount allocated to the corporation for that particular taxation year under subsection (3) or (4). This amendment will ensure that the aggregate of the amounts determined as the business limit for the year for a group of Canadian-controlled private corporations that are associated with each other in any second or subsequent taxation years ending in a calendar year does not exceed $200,000 for such years.

Subclause 63(3)

ITA
125(7)(c)

Paragraph 125(7)(c) defines "income of the corporation from an active business" for the purposes of calculating a

Canadian-controlled private corporation's small business deduction pursuant to subsection 125(1). Paragraph 125(7)(c) is amended for 1991 and subsequent taxation years to include in this definition amounts received from a corporation's NISA Fund No. 2 (as defined under subsection 248(1) of the Act).

Clause 64

Manufacturing and Processing Tax Credit

ITA
125.1(1)

Section 125.1 of the Act provides a reduced rate of corporate tax on Canadian manufacturing and processing profits. The rate reduction takes the form of the deduction, from Part I tax otherwise payable, of an amount equal to a specified percentage – currently 5% – of a corporation's Canadian manufacturing and processing profits (other than income eligible for the section 125 small business deduction). This amendment increases that percentage to 6% for 1993 and to 7% for 1994 and subsequent years, and thus further reduces the tax rate on income from manufacturing and processing. A transitional rule for taxation years ending after 1992 and commencing before 1994 calculates the deduction under section 125.1 as 5%, 6% or 7% for the portion of the year falling in 1992, 1993 or 1994, respectively.

Clause 65

Part VI Tax Credit

ITA
125.2

Part VI of the Act levies a tax on capital employed in Canada by large financial institutions. Section 125.2 of the Act currently 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 institution's tax payable under Part VI as well as its unused Part VI tax credits for the seven preceding and three following taxation years.

Other amendments in this Bill will reverse – generally with effect for 1992 and subsequent taxation years – the current system of crediting taxes payable under Part VI against those arising under Part I. However, section 125.2 is to be maintained for the purpose of: first, allowing excess Part VI tax, for the first three years following this change in the crediting system, to be carried back and deducted against Part I for previous years; and second, permitting excess Part VI tax, for years ending before the system is reversed, to be carried forward and deducted within the present 7-year carryforward period.

Subclause 65(1)

ITA
125.2(1)

The present rule in subsection 125.2(1) of the Act will continue to permit a three year carryback of unused Part VI tax credits (as defined in amended subsection 125.2(3)) to taxation years ending before 1992. Where a special election is made under Part VI of the Act, the present law will permit a three year carryback of unused Part VI tax credits to taxation years ending before 1991.

Under amended subsection 125.2(1), a financial institution may continue to deduct, in computing its tax payable under Part I of the Act for a taxation year ending after 1991 (generally), such amount as it chooses of its unused Part VI tax credits for the seven preceding taxation years that end before 1992. The maximum amount deductible under this subsection in a year is equal to the difference between a corporation's Part I tax payable for the current year (including surtax to the extent that it exceeds the corporation's Large Corporation Tax Under Part I.3 of the Act) and its Part VI tax payable for the year (that is, Part VI tax before the deduction provided under new subsection 190.1(3)). In other words, Part I tax for 1992 and subsequent taxation years must be used to reduce that year's Part VI tax before it may itself be reduced by a carryover of pre-1992 Part VI tax credits.

Subsection (1) is applicable to 1992 and subsequent taxation years. Where a corporation makes a special election under Part VI, it applies to 1991 and subsequent taxation years in respect of pre-1991 Part VI credits.

Subclause 65(2)

ITA
125.2(3)

Subsection 125.2(3) of the Act defines the term "unused Part VI tax credit" for the purposes of determining the amount a corporation is permitted to deduct from its Part I tax payable pursuant to subsection 125.2(1). This definition will, as a result of other amendments reversing the system of crediting taxes payable under Part I and Part VI of the Act, have limited application in the future. However it is necessary to measure a corporation's "unused Part VI tax credit" for future years where that credit may be carried back and claimed against Part I tax for a year ending before 1992 (or 1991, where the corporation so elects).

The amendments to this definition of "unused Part VI tax credit" ensure that it is to be applied without reference to the new Part I credit provided under Part VI of the Act – that is, that a corporation's Part VI liability, for the purpose of calculating the amount of any excess of that liability over Part I tax payable, is to be determined before accounting for the reduction of Part VI tax by the new Part I credit. Further, these amendments provide that the difference between Part VI and Part I tax is to be calculated without reference to any surtax that was creditable against the corporation's liability under Part I.3 of the Act – that is, that Part I tax which was already credited under Part I.3 – will not also reduce the amount of Part VI tax that may be eligible for carryover to other years.

These amendments apply in computing a corporation's "unused Part VI tax credit" for taxation years ending after 1991. Where, however, a corporation has elected to have the system of crediting its taxes under Parts I and VI changed for 1991 and subsequent taxation years, these amendments will apply to taxation years ending after 1990.

Clause 66

Part I.3 Tax Credit

ITA
125.3

Part I.3 of the Act levies a tax on taxable capital employed in Canada by large corporations. Section 125.3 of the Act currently provides a deduction, in computing a corporation's tax payable under Part I of the Act for a taxation year, of an amount determined by reference to the corporation's "Canadian surtax payable" for the year and the total of its Large Corporations Tax payable under Part I.3 for the year and its unused Part I.3 tax credits for the seven preceding and three following taxation years.

Other amendments in this Bill will reverse – with effect for 1992 and subsequent taxation years – the current system of crediting taxes payable under Part I.3 against Part I. However, section 125.3 is to be maintained for the purpose of: first, allowing excess Part I.3 tax, for the first three years following this change in the crediting system, to be carried back and deducted against its Part I tax for previous years; and second, permitting excess Part I.3 tax, for years ending before the system is reversed, to be carried forward and deducted against Part I tax within the present seven year carryforward period.

Subclause 66(1)

ITA
125.3(1) and (1.1)

The present rule in subsection 125.3(1) of the Act will continue to permit a three year carryback of unused Part I.3 tax credits (as defined in amended subsection 125.3(4)) to taxation years ending before 1992.

Under amended subsection 125.3(1), a corporation that is not a financial institution may continue to deduct, in computing its Part I payable for a taxation year ending after 1991, such amount as it chooses of its unused Part I.3 tax credits for any of the seven preceding taxation years that end before 1992. The maximum amount deductible under this subsection in a year is equal to the difference between a corporation's Canadian surtax payable for the year and its Part I.3 tax for the year (that is, Part I.3 tax before the deduction provided under new subsection 181.1(4)). In other words, Canadian surtax payable in respect of a year ending after 1991 must be used to reduce that year's Part I.3 tax before it may itself be reduced by a carryover of pre-1992 Part I.3 tax credits.

New subsection 125.3(1.1) of the Act will permit a financial institution to deduct, in computing its Part I tax payable for a taxation year, such amount as it chooses of its unused Part I.3 tax credits for any of the seven preceding taxation years that end before 1992. The maximum amount deductible under this subsection in a year is equal to the lesser of (a) its Canadian surtax payable for the year in excess of Part I.3 tax for the current year (before the deduction provided under new subsection 181.1(4)), and (b) its total Part I tax payable for the year in excess of gross Parts I.3 and VI taxes. That is, Canadian surtax payable in respect of a year must be used to reduce that year's Part I.3 and Part VI taxes before it may itself be reduced by a carryover of prior Part I.3 taxes payable.

This amendment is applicable to 1992 and subsequent taxation years.

Subclause 66(2)

ITA
125.3(4)

Subsection 125.3(4) of the Act provides definitions for the terms "unused Part I.3 tax credit" and "Canadian surtax payable" for the purposes of determining the amount a corporation is permitted to deduct from its Part I tax payable pursuant to subsection 125.3(1) or (1.1). The definition of "unused Part I.3 tax credit" will, as a result of other amendments reversing the system of crediting taxes payable under Part I and Part VI, have limited application in the future. However it is necessary to measure a corporation's "unused Part I.3 tax credit" for future years where that credit may be carried back and claimed against Part I tax for a year ending before 1992.

The amendments to the definition of "unused Part I.3 tax credit" ensure that it is to be applied without reference to the new surtax credit provided under Part I.3 – that is, that Part I.3 liability, for the purpose of calculating the amount of any excess of that liability over Canadian surtax payable, is to be determined before accounting for the reduction of Part I.3 tax by the new surtax credit.

Clause 67

Foreign Tax Credit

ITA
126(3)

Subsection 126(3) of the Act provides a tax credit in respect of the tax payable on income from employment with an international organization. Paragraph 126(3)(a) is amended to eliminate this tax credit for those individuals that are employed by prescribed international organizations. This amendment is consequential on the introduction of new subparagraph 110(1)(f)(iii), which provides a taxable income deduction for an individual's employment income from such organizations.

Paragraph 126(3)(b) sets out the method by which an individual's income for the year is computed for the purposes of subsection 126(3). This paragraph is amended to reduce the amount of such income by any amounts deductible under paragraphs 110(1)(d.1), (d.2), (d.3) or (j), which provide deductions in respect of stock option benefits, prospector's or grubstaker's shares, deferred profit-sharing plans and home relocation loans. The effect of the amendment is to increase the amount of the tax credit provided under subsection 126(3) for individuals eligible for one or more of the deductions listed.

The amendments have effect with respect to 1991 and subsequent taxation years.

Clause 68

Tax Credits

Section 127 of the Act permits a deduction from tax otherwise payable in respect of logging taxes, political contributions and investment tax credits.

ITA
127

Subclause 68(1)

ITA
127(1)

Subsection 127(1) of the Act permits a taxpayer to claim a logging tax credit equal to the lesser of 2/3 of any logging tax paid to a province and 6-2/3% of the taxpayer's income for the year from logging operations in that province. The total credit in respect of logging tax paid in all provinces may not exceed 6-2/3% of the taxpayer's taxable income for the year. Subsection 127(1) is amended to provide that, for the purposes of the overall restriction of the tax credit, taxable income is to be computed before the deductions under paragraphs 60(b) to (c.2) (alimony and maintenance payments or repayments), 60(i) (registered retirement savings plan contributions), 60(v) (contributions to certain provincial pension plans), and sections 62 (moving expenses), 63 (child care expenses), and 64 (attendant care expenses). Thus, the amendment, which is applicable to the 1991 and subsequent taxation years, effectively increases the base for determining this credit.

Subclause 68(2)

ITA
127(9)

Subsection 127(9) of the Act provides the various definitions used in the provisions relating to investment tax credits. An investment tax credit is available for most current and capital expenditures made for research and development (R&D) carried on in Canada.

Where a Canadian taxpayer contracts to have R&D activities carried out on its behalf by another party, the amount paid under the contract is an R&D expenditure for income tax purposes. For the Canadian party performing the contract, the amount received under the contract reduces the amount of R&D expenditures eligible for the investment tax credit. In this way duplication of the investment tax credit is avoided. The definition of "contract payment" in subsection 127(9) is modified, applicable to amounts that become payable after December 20, 1991, to provide that an amount payable for R&D is deemed to be a contract payment to the extent that it can reasonably be considered to have been performed for, or on behalf of, a person entitled to a deduction in respect of such R&D.

Subclause 68(3)

ITA
127(10.8)

Subsection 127(11.1) of the Act requires that the base upon which an investment tax credit (ITC) is earned by a taxpayer be reduced by any assistance receivable in respect of the related expenditure. Where assistance is repaid, the ITC base is reinstated at the specified percentage in respect of the original expenditure (pursuant to paragraph (e.1) of the definition of "investment tax credit" in subsection 127(9) of the Act).

Upon repayment of assistance, a taxpayer's ITC base may be eligible to be increased by two amounts. The first amount is the specified percentage of assistance which previously reduced the base. A similar adjustment is provided in paragraph 37(1)(c) for research and development (R&D) expenditures. Secondly, a "top-up" amount is added back to the ITC base of an eligible small business corporation in respect of R&D expenditures in circumstances where the corporation would otherwise have been eligible to claim the top-up amount in respect of that expenditure, but for being eligible to receive assistance. Effectively, the ITC base of such taxpayers is increased by an amount that entitles the corporation to claim up to the 35% high rate R&D credit pursuant to subsections 127(10.7) and (10.1) and paragraph (e) of the definition of "investment tax credit" in subsection 127(9).

There is, however, no existing provision to allow a taxpayer to regenerate entitlement to an ITC where entitlement to assistance expires before being claimed by the taxpayer. New subsection 127(10.8) treats expired assistance of a taxpayer as repaid assistance. As such, a taxpayer's ITC base and R&D expenditures will be increased to regenerate such entitlements in circumstances where a taxpayer may no longer be reasonably expected to receive the assistance.

This amendment is applicable to 1991 and subsequent taxation years.

Clause 69

Labour-Sponsored Funds Tax Credit

ITA
127.4(2)

Section 127.4 of the Act provides a tax credit to individual taxpayers in respect of the purchase of "approved shares" of prescribed labour-sponsored venture capital corporations. The labour-sponsored funds tax credit is available only if the individual is the first purchaser of the shares. In any year, the credit is limited to the lesser of 20% of the cost of the shares and $700. Subsection 127.4(2) is amended to increase this maximum credit base from $700 to $1,000, as a consequence of the 1992 budget measures concerning labour-sponsored venture capital funds. This amendment is applicable to 1992 and subsequent taxation years.

Clause 70

Minimum Tax

ITA
127.52(1)(d)

Paragraph 127.52(1)(d) of the Act provides that, in computing an individual's adjusted taxable income for minimum tax purposes, the total amount of capital gains is to be taken into account. This is achieved through an appropriate reference to sections 38 and 41 of the Act. However, where a trust designates a taxable capital gain to be a taxable capital gain of a beneficiary pursuant to section 104, sections 38 and 41 have no application. Thus, the beneficiary of the trust avoids the payment of any minimum tax on the exempt portion of the capital gain. This amendment, which is applicable to 1991 and subsequent taxation years, corrects this anomaly.

Clause 71

Application of Minimum Tax Provisions

ITA
127.55(e)

Paragraph 127.55(e) of the Act exempts a post-1971 spousal trust from the payment of minimum tax for the taxation year that includes the time of death of the beneficiary spouse. The amendment to that paragraph would extend this exemption to pre-1972 spousal trusts described in new paragraph 104(4)(a.1) for the 1993 taxation year or a later year in which the beneficiary spouse dies.

The amendment is applicable to 1993 and subsequent taxation years.

Clause 72

Home Buyers' Plan

ITA
128(2)(d)

Subsection 128(2) of the Act contains a number of special rules applicable where an individual becomes a bankrupt. For most purposes, paragraph 128(2)(*d*) divides the calendar year in which an individual becomes a bankrupt into two taxation years: one taxation year that runs from January 1 to the day before the bankruptcy and the other that commences on the day of the bankruptcy and runs to December 31.

Under the new Home Buyers' Plan described in the commentary to section 146.01 of the Act, a home buyer may withdraw up to $20,000 of RRSP funds on a tax-free basis to acquire a qualifying home. A specified repayment in respect of the withdrawal is determined for the years 1994 to 2008. Any excess of the specified repayment of an individual for a year over the actual repayments to one or more RRSPs for that year by the individual is included in the individual's income under new subsection 146.01(4). The Home Buyers' Plan also provides for an income inclusion under new subsection 146.01(9) for the 1992 taxation year, as explained in the commentary to that subsection.

Paragraph 128(2)(*d*) is amended so that it does not apply for the purposes of subsections 146.01(4) and (9). As a consequence, the income inclusion will arise under those subsections only in respect of a taxation year ending at the end of a calendar year.

This amendment is applicable to 1992 and subsequent taxation years.

Clause 73

Refundable Dividend Tax on Hand

ITA
129

Section 129 of the Act provides a mechanism under which a portion of the tax paid by a private corporation on its investment income (the portion referred to as "refundable dividend tax on hand" or "RDTOH") is refundable to the corporation when dividends are paid to its shareholders. This refundable tax mechanism provides integration of the taxation of investment income by ensuring that the total tax paid on investment income and capital gains earned through a Canadian-controlled private corporation and distributed to an individual shareholder approximates the tax that would, but for the capital gains exemption, have been payable if that income were earned directly by the individual.

Subclauses 73(1) and (3)

ITA
129(1) and (3)

Subsection 129(1) of the Act currently enables corporations to claim a dividend refund for a taxation year of $1 for each $4 of taxable dividends paid in the year. The dividend refund may not exceed a corporation's RDTOH and is available only to corporations that are private at the end of the taxation year. Under the amendments to these provisions, a corporation will be entitled to a dividend refund in respect of taxable dividends paid by it while it is private, whether or not it is private at the end of the year for which the dividend refund is claimed. Thus, for example, if a private corporation becomes a public corporation during a taxation year it will be eligible for a dividend refund for the year on taxable dividends paid by it before it became public. These amendments apply to taxable dividends paid after 1992.

Subclause 73(2)

ITA
129 (2.1) and (2.2)

The Act does not currently provide for the payment of interest on a claim made for a dividend refund under section 129. New subsection 129(2.1) of the Act provides that the Minister of National Revenue is to pay interest on dividend refunds at the prescribed rate. The period in respect of which interest is payable starts on the later of the day that is 120 days after the end of the taxation year to which the actual dividend refund relates, and the day on which the corporation's income tax return for that year is filed. The period ends on the day on which the dividend refund is paid to the corporation or applied to another liability of the corporation.

Where interest has been paid to a corporation under new subsection 129(2.1) of the Act, or applied under that subsection to another liability of the corporation, and it is subsequently determined that the interest paid or applied was excessive because the actual dividend refund was less than the putative dividend refund in respect of which the interest was paid or applied, new subsection 129(2.2) of the Act allows the Minister of National Revenue to recover the excess interest that was paid or applied, together with interest on that amount at the prescribed rate.

The prescribed rate of interest applicable under new subsections 129(2.1) and (2.2) is determined under section 4301 of the *Income Tax Regulations*. That section provides that the prescribed rate during a quarter of a calendar year is the average rate on 90-day Treasury bills sold during the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

A consequential amendment adds references to new subsections 129(2.1) and (2.2) in subsection 248(11) of the Act to require the interest computed under subsections 129(2.1) and (2.2) to be compounded daily.

New subsections 129(2.1) and (2.2) are applicable with respect to dividend refunds paid or applied with respect to taxation years commencing after 1991.

Subclause 73(4)

ITA
129(4)(a)(ii)

Paragraph 129(4)(a) of the Act defines a corporation's "Canadian investment income" for the purposes of calculating its refundable dividend tax on hand.

Subparagraph 129(4)(a)(ii) is amended, applicable to 1991 and subsequent taxation years, to exclude payments received under a net income stabilization account from "Canadian investment income". Rather, as discussed in the commentary to amended paragraph 125(7)(c), such payments are treated as active business income.

Clause 74

Investment Corporations

ITA
130(2)

Section 130 of the Act sets out special rules relating to the taxation of investment corporations. Subsection 130(2) allows an investment corporation that is not a mutual fund corporation to qualify for a "capital gains refund" on the payment by the investment corporation of a capital gains dividend, in the same way that it would so qualify if the corporation were a mutual fund corporation. The provisions relating to capital gains refunds to mutual fund corporations are modified by the addition of new subsections 131(3.1) and (3.2) of the Act, which provide for the payment of interest on capital gains refunds and the recovery of excessive payments of interest on capital gains refunds, as explained in the commentary on those new subsections. The amendment to subsection 130(2) of the Act, which applies to capital gains refunds paid or applied with respect to taxation years commencing after 1991, adds references to new subsections 131(3.1) and (3.2) to make those interest provisions applicable with respect to capital gains refunds to investment corporations that are not mutual fund corporations.

Clause 75

Mortgage Investment Corporations

ITA
130.1

Section 130.1 of the Act sets out rules that apply to mortgage investment corporations and their shareholders. A mortgage investment corporation is essentially treated as a conduit in that its income may be flowed through to its shareholders and taxed in their hands rather than in the corporation.

Section 130.1 is amended as a consequence of the 1992 budget measures that limit availability of the capital gains exemption for gains realized on the disposition of certain real property or other assets the value of which is derived principally from certain real property.

Subclause 75(1)

ITA
130.1(4)

Electing capital gains dividend

Subsection 130.1(4) of the Act provides that a mortgage investment corporation may elect to treat a dividend paid to its shareholders in the period commencing 91 days after the beginning of a taxation year and ending 90 days after the end of the year as a capital gains dividend to the extent of the amount of its undistributed capital gains for the year. Such a dividend is treated as a capital gain of the shareholder, who may be eligible for the capital gains exemption under section 110.6 of the Act in respect of that gain.

Subsection 130.1(4) is amended, applicable to 1992 and subsequent taxation years, to provide that an election to treat a dividend as a capital gains dividend must be made under one of either new paragraph 130.1(4)(a) or (b). A dividend deemed to be a capital gains dividend by reason of an election made under paragraph (a) is considered to have been paid out of qualifying taxed capital gains and may be eligible for the capital gains exemption in the hands of the shareholder to whom it is paid. A dividend deemed to be a capital gains dividend by reason of an election made under paragraph (b) is considered to have been paid out of non-qualifying taxed capital gains and will not be eligible for the capital gains exemption in the hands of that shareholder, since new subparagraph 130.1(4)(b)(ii) treats the dividend as being a capital gain of the shareholder from a disposition of non-qualifying real property of the shareholder, as that term is defined in subsection 110.6(1). Also, the shareholder's eligible real property gain from that disposition is deemed to be nil under new clause 130.1(4)(b)(ii)(B).

Clause 130.1(4)(a)(i)(A) provides that the amount of a dividend that is treated as a capital gains dividend which may be eligible for the capital gains exemption is limited to 4/3 of the "qualifying taxed capital gains" of the mortgage investment corporation. New clause 130.1(4)(b)(i)(A) provides that the amount of the dividend that is treated as a capital gains dividend which will not be eligible for the exemption is limited to 4/3 of the "non-qualifying taxed capital gains" of the corporation. These terms are defined in subsection 130.1(9) of the Act.

Subclause 75(2)

ITA
130.1(9)(b)

"non-qualifying taxed capital gains"

The amount of a mortgage investment corporation's non-qualifying taxed capital gains for a taxation year limits the extent to which a dividend paid by the corporation may be treated as a capital gains dividend under paragraph 130.1(4)(b) of the Act. The shareholder to whom such a capital gains dividend is paid will not be eligible to claim a capital gains deduction under section 110.6 of the Act in respect of the taxable portion of the dividend.

Where a mortgage investment corporation realizes a capital gain on a disposition of "non-qualifying real property" of the corporation, as defined in new paragraph 131(6)(c.1), a portion of the resulting taxable capital gain may form part of the corporation's "qualifying taxed capital gains" pursuant to new subparagraph 130.1(9)(c)(ii). The portion of that taxable capital gain which is not taken into account under that subparagraph is included in computing the corporation's non-qualifying taxed capital gains by reason of new subparagraph (b)(i) of this definition. Similarly, the portion of an allowable capital loss of the corporation that is not taken into account in computing the corporation's qualifying taxed capital gains will be included in computing the corporation's non-qualifying taxed capital gains by reason of new subparagraph 130.1(9)(b)(ii).

A mortgage investment corporation's non-qualifying taxed capital gains for a taxation year is the amount determined under new subparagraph (b)(i) minus the total of the amounts determined under new subparagraphs (b)(ii), (iii) and (iv). The amount determined under subparagraph (b)(iii) represents net capital losses of the corporation of other years deducted in the year under paragraph 111(1)(b) of the Act. Accounting for such deductions in computing the corporation's non-qualifying taxed capital gains rather than in computing its qualifying taxed capital gains ensures that the use of those losses by the corporation will first reduce taxable capital gains that would not be eligible for the capital gains exemption in the hands of a shareholder before reducing those that would. Subparagraph (b)(iv) represents the amount by which allowable capital losses taken into account in determining the corporation's qualifying taxed capital gains exceed taxable capital gains taken into account in making that determination. This is, in effect, what would be the negative balance of the corporation's qualifying taxed capital gains account if that definition could result in a negative balance. An example illustrating the calculation of these amounts follows the notes to this section.

ITA
130.1(9)(c)

"qualifying taxed capital gains"

The extent to which a dividend paid by a mortgage investment corporation may be treated as a capital gains dividend under paragraph 130.1(4)(a) of the Act is determined by the amount of the corporation's qualifying taxed capital gains for a taxation year. The shareholder to whom such a capital gains dividend is paid may be able to claim a deduction under section 110.6 of the Act in respect of the taxable portion of such a dividend.

A mortgage investment corporation's qualifying taxed capital gains for a taxation year consists of its taxable capital gains for the year from dispositions of property other than non-qualifying real property plus a portion of its taxable capital gains for the year from dispositions of non-qualifying real property. From this is deducted the total of the corporation's allowable capital losses for the year from dispositions of property other than non-qualifying real property, a portion of its allowable capital losses for the year from dispositions of non-qualifying real property and any negative balance in the corporation's non-qualifying taxed capital gains account for the year. The portion of its taxable capital gain or allowable capital loss from a disposition of non-qualifying real property of the corporation that is included in this calculation is computed in a manner similar to that provided under subsection 110.6(1) of the Act in determining an individual's eligible real property gain or eligible real property loss. "Non-qualifying real property" of a corporation is defined in new paragraph 131(6)(c.1) of the Act.

The amount of the corporation's taxable capital gain or allowable capital loss for the year from a disposition of non-qualifying real property of the corporation that is to be included under subparagraph (ii) or (iv) of this definition is the taxable capital gain or allowable capital loss otherwise determined, multiplied by the ratio that the number of calender months in the period that commences with the calendar month in which the property was last acquired by the corporation and ends with February 1992 is of the number of calendar months in the period that commences with the calendar month in which the property was last acquired by the corporation and ends with the calendar month in which the property was disposed of. Calendar months before 1972 are excluded from both the numerator and denominator of this fraction, since gains accrued prior to 1972 are not taxed. The portion of the gain or loss that is excluded from subparagraph (ii) or (iv) of this definition will be included in computing the corporation's non-qualifying taxed capital gains for the year under subparagraph (i) or (ii) of that definition. An example illustrating the calculation of these amounts follows the notes to this section.

ITA
130.1(9)(d)

"non-qualifying real property"

"Non-qualifying real property" of a corporation is defined in new paragraph 131(6)(c.1) of the Act and described in the notes to that paragraph.

EXAMPLE

During its 1993 taxation year, a mortgage investment corporation realized the following taxable capital gains and allowable capital losses:

Taxable capital gain on disposition of
non-qualifying real property (Property "A"): $150,000
other property: 40,000

Allowable capital loss on disposition of
non-qualifying real property (Property "B"): 30,000
other property: 90,000

In addition, the corporation deducted in its 1993 taxation year, under paragraph 111(1)(b), $45,000 of net capital losses of other years. Property "A" was acquired by the corporation in May 1991 and disposed of in May 1993. Property "B" was acquired by the corporation in March 1989 and disposed of in August 1993.

The corporation's qualifying taxed capital gains for its 1993 taxation year is nil and is computed as the amount by which [$40,000 + ($150,000 x 10/25)] exceeds $110,000 or [$90,000 + ($30,000 x 36/54) + Nil]

The corporation would therefore not be able to make an election under paragraph 130.1(4) (a) in respect of a dividend paid in the period commencing 91 days after the start of its 1993 taxation year and ending 90 days after it.

The corporation's non-qualifying taxed capital gains for its 1993 taxation year is $25,000 and is computed as the amount by which $90,000 or ($150,000 - $60,000) exceeds $65,000 or [($30,000 - $20,000) + $45,000 + ($110,000 - $100,000)]

The corporation could therefore elect under paragraph 130.1(4)(b) to treat dividends of up to $33,333 (4/3 of $25,000) paid in the period commencing 91 days after the beginning of its 1993 taxation year and ending 90 days after it to be capital gains dividends. Such dividends would not qualify for the capital gains exemption in the hands of any shareholder to whom they were paid.

Clause 76

Mutual Fund Corporations

ITA
131

Section 131 of the Act sets out rules relating to the taxation of mutual fund corporations and their shareholders. Section 131 is amended, applicable to 1992 and subsequent taxation years, as a consequence of the 1992 budget measures that limit the use of the capital gains exemption for gains realized on the disposition of certain real property or other assets the value of which is derived principally from certain real property.

Subclause 76(l)

ITA
131(1)

Election re capital gains dividend

Subsection 131(l) of the Act allows a mutual fund corporation to elect to treat a dividend payable by the corporation to its shareholders as a capital gains dividend. This rule also applies to investment corporations by reason of subsection 130(2) of the Act. Such an election permits the shareholder to whom the dividend is paid to treat the dividend as a capital gain and may entitle the corporation to a capital gains refund under subsection 131(2).

Subsection 131(1) is amended, applicable to 1992 and subsequent taxation years, to provide that a mutual fund corporation may elect under new paragraph 131(1)(a) to treat a dividend as a capital gains dividend payable out of its capital gains dividend account or may elect under new paragraph 131(1)(b) to treat the dividend as a capital gains dividend payable out of its non-qualifying real property capital gains dividend account. The "non-qualifying real property capital gains dividend account" of a mutual fund corporation is a new term defined in subsection 131(6). A shareholder who receives a capital gains dividend payable out of the corporation's capital gains dividend account may be eligible for the capital gains exemption under subsection 110.6(3) of the Act in respect of the dividend. A shareholder who receives a capital gains dividend payable out of the corporation's non-qualifying real property capital gains dividend account will not be eligible for a deduction under section 110.6 in respect of the dividend, by reason of new subparagraph 131(1)(b)(ii) and amendments to section 110.6.

Subclause 76(2)

ITA
131(3.1) and (3.2)

Although the taxable capital gains of a mutual fund corporation are subject to the full corporate tax rate, this tax (referred to as "refundable capital gains tax on hand") is refunded to the corporation when its taxable capital gains are distributed to its shareholders in the form of "capital gains dividends". The tax that is so refunded is referred to as the corporation's "capital gains refund" for the year to which the capital gains dividends relate.

The existing Act does not provide for the payment of interest on capital gains refund. New subsection 131(3.1) of the Act provides that the Minister of National Revenue is to pay interest on capital gains refunds at the prescribed rate. The period in respect of which interest is payable starts on the later of the day that is 120 days after the end of the year to which the capital gains refunds relates and the day on which the corporation's income tax return for that year is filed. The period ends on the day on which the capital gains refund is paid to the mutual fund or applied to another of its liabilities.

Where interest has been paid to a mutual fund under new subsection 131(3.1), or applied to another liability, and it is subsequently determined that the interest paid or applied was excessive because the actual capital gains refund was less than the putative capital gains refund in respect of which the interest was paid or applied, the Minister of National Revenue is permitted to recover the excess interest that was paid or applied, together with interest on that amount at the prescribed rate.

The prescribed rate of interest applicable under new subsections 131(3.1) and (3.2) is determined under section 4301 of the *Income Tax Regulations*. That section provides that the prescribed rate during a quarter of a calendar year is the average rate on 90-day Treasury bills sold during the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

A consequential amendment adds references to new subsections 131(3.1) and (3.2) in subsection 248(11) of the Act to require the interest computed under those subsections to be compounded daily.

These amendments are applicable with respect to capital gains refunds paid or applied with respect to taxation years commencing after 1991.

Subclause 76(3)

ITA
131(6)(b)

Capital gains dividend account

The extent to which a dividend payable by a mutual fund corporation will be treated as a capital gains dividend by reason of an election made under paragraph 131(1)(a) of the Act is governed by the amount of the corporation's capital gains dividend account at the time the dividend becomes payable. Such a dividend may be eligible for the capital gains exemption in the hands of a shareholder to whom it is paid.

The definition of "capital gains dividend account" of a mutual fund corporation is amended, applicable to 1992 and subsequent taxation years, as a consequence of the introduction of a new account: the "non-qualifying real property capital gains dividend account" of a mutual fund corporation. The new account is necessary to track capital gains realized on the disposition of "non-qualifying real property" of the corporation which are not eligible for the capital gains exemption in the hands of a shareholder to whom a capital gains dividend in respect of those gains is paid. The sum of each of these accounts, at any time after the new rules become applicable, will be equal to what would have been the amount of the corporation's capital gains dividend account if the rules had not been changed.

As amended, a mutual fund corporation's capital gains dividend account at any time consists of its capital gains for all taxation years commencing more than 60 days before that time from dispositions of property other than non-qualifying real property, plus a portion of its capital gains for those years from dispositions of non-qualifying real property less the amounts determined under subparagraphs 131(6)(b)(iii) to (vii). The portion of the capital gain from each disposition of non-qualifying real property of the corporation that is included in its capital gains dividend account is the gain otherwise determined multiplied by the ratio that the number of calendar months in the period that commences with the calendar month in which the property was last acquired by the corporation and ends with February 1992 is of the number of calendar months in the period that commences with the calendar month in which the property was last acquired by the corporation and ends with the calendar month in which the property was disposed of. Calendar months before 1972 are excluded from both the numerator and denominator of this ratio, since capital gains accrued prior to 1972 are not subject to tax. The portion of each such gain that is not included in computing the corporation's capital gains dividend account under new subparagraph 131(6)(b)(ii) is included under new subparagraph 131(6)(c)(i) in computing the corporation's non-qualifying real property capital gains dividend account.

In computing a mutual fund corporation's capital gains dividend account at any time, the amount determined above is reduced by the corporation's capital losses for all taxation years commencing more than 60 days before that time from dispositions of property other than non-qualifying real property, plus a portion of its capital losses for such years from dispositions of non-qualifying real property. The portion of the capital loss from each disposition of non-qualifying real property of the corporation that reduces its capital gains dividend account is determined for each such capital loss in the manner described above for capital gains. The portion of each such loss that is not taken into account under new subparagraph 131(6)(b)(iv) in computing the corporation's capital gains dividend account will be taken into account under subparagraph 131(6)(c)(ii) in computing the corporation's non-qualifying real property capital gains dividend account.

Subparagraph 131(6)(b)(v) of the Act (formerly clause 131(6)(b)(ii)(B)) provides that capital gains dividends that become payable by a mutual fund corporation in the period set out therein will reduce the corporation's capital gains dividend account otherwise determined. This provision is amended to exclude any such dividends that became payable out of the corporation's non-qualifying real property capital gains dividend account. Those dividends are accounted for in subparagraph (iii) of the definition of the latter account.

Former clause (b)(ii)(C) of the definition has not been amended but has been renumbered as subparagraph (b)(vi).

New subparagraph 131(6)(b)(vii) of the Act provides that a mutual fund corporation's capital gains dividend account, as otherwise determined at any time, is to be reduced by the amount by which the total of the amounts determined under clauses 131(6)(c)(ii)(A) and (B) exceeds the amount determined under subparagraph 131(6)(c)(i) at that time. This amount represents what would be the negative balance of the corporation's non-qualifying real property capital gains dividend account at that time if the definition of that account allowed for negative balances.

An example illustrating the calculation of a mutual fund corporation's capital gains dividend account and non-qualifying real property capital gains dividend account follows the notes to this section.

ITA
131(6)(c)

Non-qualifying real property capital gains dividend account

The extent to which a dividend payable by a mutual fund corporation will be treated as a capital gains dividend by reason of an election made under paragraph 131(1)(b) of the Act is governed by the amount of the corporation's non-qualifying real property capital gains dividend account at the time the dividend becomes payable. Such a dividend will not be eligible for the capital gains exemption in the hands of a shareholder to whom it is paid.

A mutual fund corporation's "non-qualifying real property capital gains dividend account" at any time is the amount by which its capital gains, for taxation years commencing more than 60 days before that time, from dispositions of non-qualifying real property exceed the portion of any such gains that have been included in its capital gains dividend account and the total of the amounts determined under subparagraphs 131(6)(c)(ii), (iii) and (iv). The amount determined under subparagraph 131(6)(c)(ii) is the amount of the corporation's capital losses for those years from dispositions of its non-qualifying real property, other than the portion of any such loss that has been included in computing the corporation's capital gains dividend account. The amount determined under subparagraph 131(6)(c)(iii) is the amount of all capital gains dividends that become payable out of the corporation's non-qualifying real property capital gains dividend account before that time and more than 60 days after the end of the last taxation year ending more than 60 days before that time. The amount determined under subparagraph 131(b)(c)(iv) represents what would be the negative balance of the corporation's capital gains dividend account at that time if the definition of that account allowed for negative balances.

ITA
131(6)(c.1)

Non-qualifying real property

New paragraph 131(6)(c.1) of the Act defines "non-qualifying real property" of a corporation or a trust that is not a personal trust. The definition is used in determining the portion of a capital gain realized on the disposition of non-qualifying real property of an investment corporation, mortgage investment corporation, mutual fund corporation or a trust that is not a personal trust that may be eligible for the capital gains exemption in the hands of a shareholder to whom a capital gains dividend is paid or a beneficiary in respect of whom a designation is made under subsection 104(21.2) of the Act.

"Non-qualifying real property" of a corporation or a trust other than a personal trust means, with some exceptions, property disposed of after February 1992 by the corporation or trust that is real property, or a share of the capital stock of a corporation or an interest in a partnership or trust, the fair market value of which is derived principally from real property. An option or interest in any such real property, share or partnership or trust interest will constitute non-qualifying real property. A share of the capital stock of a corporation the fair market value of which is derived principally from real property will not constitute non-qualifying real property of a corporation or trust other than a personal trust if that real property is used, either throughout the 24-month period preceding the disposition while it was owned by the corporation or a related corporation or throughout all or substantially all of the time preceding the disposition while it was owned by the corporation or a related corporation, principally in an active business carried on by the corporation or a related corporation. A similar exception is provided for an interest in a partnership or a trust the fair market value of which is derived principally from real property used in an active business carried on by one or more members of the partnership or by the trust. For the purpose of these exceptions, an "active business" carried on by a person means any business carried on by the person other than a business the principal purpose of which is to derive income from property, unless the person employs in the business more than 5 persons on a full-time basis or, in the course of carrying on the business, uses services equivalent to those that could reasonably be expected to be provided by more than 5 persons employed in the business on a full-time basis. As in paragraph 125(7)(e) of the Act, a business of leasing property other than real property or the business carried on by a credit union is considered to be an active business even if the business employs fewer than 6 persons on a full-time basis.

EXAMPLE

A mutual fund corporation with a December 31 year-end has a capital gains dividend account balance of nil on March 1, 1992, after taking into account all capital gains dividends of previous years. During 1992 it engaged in the following transactions:

July 10	Sold non-qualifying real property acquired May 30, 1991. Capital gain: $600,000.
Dec. 18	Sold non-qualifying real property acquired September 1, 1989. Capital loss: $1,200,000.
Various	Capital gains from dispositions of properties other than non-qualifying real property: $2,500,000 Capital losses from dispositions of properties other than non-qualifying real property: $100,000.

No capital gains dividends have become payable in 1992. Its non-qualifying real property capital gains dividend account as at December 31, 1992 is nil, being the amount by which $200,000 or [$600,000 - ($600,000 x 10 / 15)] exceeds $300,000 or [$1,200,000 - ($1,200,000 x 30 / 40)].

The corporation's capital gains dividend account as at December 31, 1992 is $1,800,000, being the amount by which the total of $2,500,000 and $400,000 ($600,000 x 10 / 15) exceeds the total of $900,000 ($1,200,000 x 30 / 40) and $100,000 plus the negative balance of $100,000 in the non-qualifying real property capital gains dividend account.

The corporation could therefore elect under paragraph 131(1)(a) of the Act to treat dividends of up to $1,800,000 that become payable as being capital gains dividends. Such dividends may be eligible for the capital gains exemption in the hands of shareholders to whom they are paid. No election would be possible under paragraph 131(1)(b).

Clause 77

Mutual Fund Trusts

ITA
132(2.1) and (2.2)

The taxable capital gains of a mutual fund trust are subject to federal income tax at a rate of 29 per cent. This tax (referred to as "refundable capital gains tax on hand") is refunded to the trust as the trust's unitholders redeem their interests in the trust. The tax that is so refunded is referred to as the trust's "capital gains refund" for the year for which the refund is made.

The existing Act does not provide for the payment of interest on capital gains refund. New subsection 132(2.1) of the Act provides that the Minister of National Revenue is to pay interest on capital gains refunds at the prescribed rate. The period in respect of which interest is payable starts on the later of the day that is 135 days after the end of the year to which the capital gains refunds relates and the day that is 45 days after the trust's income tax return for that year is filed. The period ends on the day on which the capital gains refund is paid to the mutual fund or applied to another of its liabilities.

Where interest has been paid to a mutual fund under new subsection 132(2.1), or applied to another liability, and it is subsequently determined that the interest paid or applied was excessive because the actual capital gains refund was less than the putative capital gains refund in respect of which the interest was paid or applied, the Minister of National Revenue is permitted to recover the excess interest that was paid or applied, together with interest on that amount at the prescribed rate.

The prescribed rate of interest applicable under new subsections 132(2.1) and (2.2) is determined under section 4301 of the *Income Tax Regulations.* That section provides that the prescribed rate during a quarter of a calendar year is the average rate on 90-day Treasury bills sold during the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

A consequential amendment adds references to new subsections 132(2.1) and (2.2) in subsection 248(11) of the Act to require the interest computed under those subsections to be compounded daily.

These amendments are applicable with respect to capital gains refunds paid or applied with respect to taxation years commencing after 1991.

Clause 78

Non-Resident-Owned Investment Corporations

ITA
133(7.01) and (7.02)

Section 133 of the Act sets out special rules relating to the taxation of a non-resident-owned investment corporation (or "NRO"). An NRO is subject to a 25 per cent rate of tax which approximates that which would have been payable if its non-resident shareholders had invested in Canada directly rather than through the corporation. The portion of this tax paid on its taxable income other than capital gains (its "allowable refundable tax on hand") is, however, refundable to the corporation upon payment of taxable dividends to its shareholders. The tax that is so refunded, or that is applied to another liability of the corporation, is called the corporation's "allowable refund" for the year in which the taxable dividends were paid.

The existing Act does not provide for the payment of interest on an allowable refund. New subsection 133(7.01) of the Act provides that the Minister of National Revenue is to pay interest on allowable refunds at the prescribed rate. The period in respect of which interest is payable starts on the later of the day that is 120 days after the end of the year to which the allowable refund relates and the day on which the corporation's income tax return for that year is filed. The period ends on the day on which the allowable refund is paid to the corporation or applied to another liability of the corporation.

Where interest has been paid to a corporation under new subsection 133(7.01) of the Act, or applied under that subsection to another liability of the corporation, and it is subsequently determined that the interest paid or applied was excessive because the actual allowable refund was less than the putative allowable refund in respect of which the interest was paid or applied, new subsection 133(7.02) of the Act allows the Minister of National Revenue to recover the excess interest that was paid or applied, together with interest on that amount at the prescribed rate.

The prescribed rate of interest applicable under new subsections 133(7.01) and (7.02) is determined under section 4301 of the *Income Tax Regulations*. That section provides that the prescribed rate during a quarter of a calendar year is the average rate on 90-day Treasury bills sold during the first month of the preceding quarter, rounded up to the nearest percentage point, plus 2 percentage points.

A consequential amendment adds references to new subsections 133(7.01) and (7.02) in subsection 248(11) of the Act to require the interest computed under those subsections to be compounded daily.

New subsections 133(7.01) and (7.02) are applicable with respect to allowable refunds paid or applied with respect to taxation years commencing after 1991.

Clause 79

Credit Unions

ITA
137(5.2)(c)

Subsection 137(5.1) of the Act allows a central credit union to allocate taxable dividends and taxable capital gains (in excess of allowable capital losses) to its member credit unions. Any taxable dividend so allocated reduces, pursuant to paragraph 137(5.2)(a), the amount of the deduction that would otherwise be 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 its taxable income for the year in which the allocation is made.

Paragraph 137(5.2)(c) is amended, applicable to 1991 and subsequent taxation years, to correct a technical deficiency that occurs in cases in which the taxation year during which the member credit union receives such amounts (and in respect of which the allocation was made) has ended before the date that the allocation by the central credit union was made. In such a case, a timing difficulty arises because such an allocation increases the income of the central credit union for a particular taxation year in respect of which the allocation was made but does not provide that member credit union with a corresponding deduction in computing its taxable income until its taxation year that included the time the amount was allocated. As a result, a mismatch of the flow-through of allocated amounts was possible.

Paragraph 137(5.2)(c) provides that each amount allocated to a member credit union under 137(5.1) is deductible by that member in computing its taxable income for the taxation year that includes the last day of the taxation year of the payer in respect of which the amount was so allocated.

Clause 80

Segregated Funds

ITA
138.1(7)

Subsection 138.1(7) of the Act is intended to ensure that where a segregated fund policy is issued as a registered retirement savings plan (RRSP) or pursuant to a registered pension plan, the policyholder will not be required to include in income those amounts which are deemed to become payable out of the income of the related segregated fund trust to the policyholder under subsection 138.1(1). The amendment to subsection 138.1(7) clarifies this intent and extends its application to segregated fund policies which are issued as registered retirement income funds (RRIFs). Segregated fund policies can be issued or effected as RRSPs or RRIFs, if they conform to the rules which govern these plans or funds. This amendment applies to 1991 and subsequent taxation years.

Clause 81

Amateur Athletes' Reserve Funds

ITA
143.1

New section 143.1 of the Act provides for the calculation of tax payable on certain amounts received by or on behalf of individuals who are amateur athletes. Under the eligibility standards of certain international sport federations, in order to preserve the eligibility status of an athlete for international competition, certain types of income earned by the athlete must be deposited with and controlled and administered by the applicable national sport organization. Such national organizations are, or are eligible to be, registered Canadian amateur athletic associations for purposes of the Act. New section 143.1 is intended to clarify the treatment of such arrangements for the organizations and the athletes.

New section 143.1 applies commencing on January 1, 1992, except that a taxpayer and a national sport organization may jointly elect to have the provisions of the section commence to apply in any earlier year ending after 1987 throughout which the taxpayer was resident in Canada.

ITA
143.1(1)

New subsection 143.1(1) of this Act provides that any arrangement under which amounts earned by an athlete are required to be held by a national sport organization that is a registered Canadian amateur athletic association in accordance with the rules of an international sport federation, to preserve the athlete's eligibility to compete in a sporting event sanctioned by the federation, will result in the creation, for tax purposes, of an *inter vivos* trust (referred to as an "amateur athlete trust"). The trust is deemed to be created on the later of the day the first payment is received by the organization and January 1, 1992. Property held under the arrangement is considered to be the property of the amateur athlete trust, and the individual athlete is not taxed on amounts received by the organization during the existence of the amateur athlete trust. The organization holding the amounts is deemed to be the trustee of the trust, and the individual athlete is deemed to be the beneficiary under the trust. No tax under Part I of the Act is payable by the trust.

ITA
143.1(2)

New subsection 143.1(2) of the Act provides that any amounts distributed to the beneficiary under an amateur athlete trust are to be included in computing the beneficiary's income. Amounts distributed by the trust, as provided in paragraph 143.1(1)(d), include all payments by the national sport organization under the arrangement to or for the benefit of the athlete. Such amounts will be included in the individual's income under the provisions of new paragraph 12(1)((z) of the Act.

ITA
143.1(3)

New subsection 143.1(3) of the Act is intended to ensure that amounts held by amateur athlete trusts are included in an individual's income within a reasonable time period. It provides that where an individual has not competed in an international sporting event as a Canadian national team member for eight years, the amounts held by the amateur athlete trust at the end of the year are deemed to be distributed to the individual athlete at that time. Where the athlete is a non-resident at the time, the amount of such deemed distribution is reduced to 64% of the fair market value at that time of the property of the trust. This is intended to provide the trustee with the tax payable at a 36% rate pursuant to new subsection 210.2(1.1). The eight year period commences with the later of the last year in which the athlete so competed and the year in which the trust was created. For an arrangement entered into prior to 1992, the trust is deemed to be created on January 1, 1992, pursuant to paragraph 143.1(1)(a). At the time new subsection 143.1(3) applies in respect of an amateur athlete trust, it will cease to exist, as provided for under new paragraph 143.1(1)(a).

ITA
143.1(4)

New subsection 143.1(4) of the Act applies in the event that the beneficiary under an amateur athlete trust dies. In such circumstances, all amounts remaining in the amateur athlete trust are deemed to have been distributed to the beneficiary immediately before death, and as a consequence, will be included in his or her income for the year of death. Where the athlete is a non-resident at the time, the amount of such deemed distribution is reduced to 64% of the fair market value at that time of the property of the trust. This is intended to provide the trustee with the tax payable at the 36% rate provided under new subsection 210.2(1.1). At the time new subsection 143.1(4) applies in respect of the trust, it will cease to exist, as provided for under new paragraph 143.1(1)(a).

Clause 82

Registered Retirement Savings Plans

ITA

146

Section 146 of the Act provides rules governing the tax treatment of registered retirement savings plans (RRSPs).

Subclauses 82(1) and (2)

ITA
146(1)(c)

Paragraph 146(1)(c) of the Act defines "earned income", which is relevant in determining the maximum deduction in respect of premiums under an RRSP.

The addition of new subparagraph 146(1)(c)(ii.1) is necessary to implement the proposal announced in the Budget of February 25, 1992, concerning disability pensions paid under the Canadian and Quebec Pension Plans. Such disability pension payments will be included in the definition of earned income for the purpose of determining the amount that an individual may contribute to an RRSP, so long as the individual was resident in Canada at the time of receipt.

New subparagraph 146(1)(c)(ii.1) is applicable to 1991 and subsequent years. Because RRSP contributions are based on earned income of the immediately preceding year, this will enable individuals to make RRSP contributions in 1992, based on Canada and Quebec disability pension amounts received in 1991.

It should be noted that the full amount of any such benefits received in a year is included in the definition of earned income for RRSP purposes in the year of receipt, even where all or part of the amount is attributable to a prior year and the individual opts, as provided for by subsection 56(8) and section 120.3 of the Act, to have that portion relating to a prior year included in computing the individual's income for that prior year.

Paragraph 146(1)(c) is also amended to add a reference in subparagraph (ii) to new paragraph 56(1)(c.2) and a reference to new paragraph 60(c.2) in subparagraph (vi). Both these amendments are consequential to changes to the tax treatment of reimbursements of alimony and maintenance payments under sections 56 and 60, which provide that such reimbursements are to be included in the income of the recipient, and deducted from the income of the individual who makes the reimbursing payment. These amendments to subparagraphs 146(1)(c)(ii) and (iv) are applicable to 1991 and subsequent years.

Subclause 82(3)

ITA
146(1)(d.1)

Paragraph 146(1)(d.1) of the Act defines a taxpayer's net past service pension adjustment (net PSPA) for the purpose of computing the taxpayer's RRSP deduction limit and the taxpayer's unused RRSP deduction room. A taxpayer's net PSPA for a year is equal to the total of the taxpayer's past service pension adjustments (PSPAs) for the year minus the taxpayer's PSPA transfers and PSPA withdrawals for the year as determined by regulations.

When paragraph 146(1)(d.1) was enacted, it was intended that PSPA transfers be defined to be amounts transferred to a defined benefit provision of a registered pension plan (RPP) from certain other RPPs, deferred profit sharing plans (DPSPs) and RRSPs to fund benefits provided on a past service basis. However, as these amounts are taken into account under Part LXXXIII of the *Income Tax Regulations* in determining provisional PSPAs associated with the benefits, it is not appropriate to also take them into account in determining net PSPAs under paragraph 146(1)(d.1). Accordingly, paragraph 146(1)(d.1) is amended to eliminate the deduction of PSPA transfers.

Paragraph 146(1)(d.1) is further amended to provide that the calculation of net PSPA may produce a negative amount. This amendment is necessary since, under section 8307 of the *Income Tax Regulations*, the amount of a taxpayer's PSPA withdrawals for a year may exceed the taxpayer's PSPA for the year. This could occur, for example, if a taxpayer's unused RRSP deduction room is a negative amount at the time a PSPA is submitted to Revenue Canada for certification and, in order to obtain the certification, the taxpayer withdraws from an RRSP an amount equal to the PSPA plus an amount to eliminate the negative unused RRSP deduction room. (The negative unused RRSP deduction room would most likely have arisen as a consequence of a PSPA in a previous year that was not subject to certification.)

These amendments to paragraph 146(1)(d.1) apply after 1988.

Subclause 82(4)

ITA
146(1)(*f*)

Paragraph 146(1)(*f*) of the Act defines the term "premium" as a payment made by an individual to an RRSP in consideration for benefits provided under the plan.

The definition of premium is amended so that, except for specified purposes, it does not include payments designated under new subsection 146.01(3) or repayments described in subparagraph (*b*)(ii) of the definition of "excluded withdrawal" in subsection 146.01(1). Amounts designated under subsection 146.01(3) are repayments of eligible amounts received pursuant to the Home Buyers' Plan. Repayments described in the definition of "excluded withdrawal" are essentially repayments of amounts that had been expected to become eligible amounts when withdrawn. (See the commentary on the definition of "eligible amount" in subsection 146.01(1).) As a consequence of the amendment, these repayments are not taken into account in determining RRSP deductions, in determining the computation of the penalty tax under Part X.1 of the Act or for any other purpose (other than for the purposes of the prohibition of the payments of premiums after maturity of an RRSP and for the purposes of defining a "benefit" under an RRSP).

This amendment is applicable to 1992 and subsequent years.

Subclause 82(5)

ITA
146(1.1)

Subsection 146(1.1) of the Act contains a definition of "spouse" for the purposes of certain provisions relating to RRSPs. The repeal of this subsection, which becomes effective after 1992, is consequential on the introduction of new subsection 252(4) which extends for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Subclause 82(6)

ITA
146(5)(a)

Subsection 146(5) of the Act provides a deduction for contributions made by an individual to RRSPs of which the individual is the annuitant. In general terms, the deduction for a taxation year is limited to the lesser of the individual's post-1990 contributions that have not been deducted and the individual's "RRSP deduction limit" for the year (as defined in paragraph 146(1)(g.1)).

Paragraph 146(5)(a) is amended so that the amount that may be deducted by an individual under subsection 146(5) is reduced by any deduction in respect of post-1990 RRSP contributions claimed by the individual under new subsection 147.3(13.1), which provides a deduction for withdrawals of certain post-1988 RRSP contributions. The amendment to subsection 146(5) is required to prevent an RRSP contribution, including a contribution to a registered retirement income fund that is deemed to be an RRSP contribution under amended subsection 147.3(10), from being deducted under subsection 146(5) if the contribution has been withdrawn on a tax-free basis by virtue of new subsection 147.3(13.1).

This amendment is applicable to 1992 and subsequent years.

Subclause 82(7)

ITA
146(8) and (8.01)

Subsection 146(8) of the Act provides that amounts received by an individual in a taxation year out of an RRSP are required to be included in computing the individual's income for the year.

Subsection 146(8) is amended so that "excluded withdrawals" received by an individual pursuant to the Home Buyers' Plan described in section 146.01 are not required to be included in computing the individual's income. These amounts are described in greater detail in the commentary to the definition of "eligible amount" in subsection 146.01(1).

New subsection 146(8.01) of the Act applies where an amount is withdrawn by an individual from an RRSP pursuant to the Home Buyers' Plan and it is ultimately determined that such amount is not an "excluded withdrawal". In these circumstances, there is no entitlement to an income exclusion for the withdrawal under amended subsection 146(8) for the individual or, where the attribution rules in subsection 146(8.3) apply, for the individual's spouse. New subsection 146(8.01) ensures that the Minister of National Revenue is able to assess or reassess the tax, interest and penalties for the individual or the individual's spouse outside the normal time limits to recognize that any exclusion claimed did not apply.

These amendments are applicable to 1992 and subsequent years.

Subclause 82(8)

ITA
146(8.2)(b)

Subsection 146(8.2) of the Act is a relieving measure which provides a deduction for RRSP or RRIF distributions included in computing an individual's income that are in respect of non-deducted RRSP premiums paid by the individual to his or her own RRSP or to a spousal RRSP. Subject to an anti-avoidance rule in paragraphs 146(8.2)(e) and (f), the subsection allows non-deducted RRSP premiums (typically RRSP overcontributions) to be withdrawn on a tax-free basis within a specified time-frame.

Subsection 146(8.2) is amended for 1991 and subsequent taxation years to clarify that it does not apply with respect to the withdrawal of RRSP contributions that have been made by direct transfer from

- a deferred profit sharing plan in accordance with subsection 147(19), or

- a registered pension plan (RPP) in accordance with any of subsections 147.3(1) and (4) to (7).

This amendment is made for greater certainty, since subsections 147(20) and 147.3(9) can be considered to prohibit the deduction of such withdrawals.

Subsection 146(8.2) is also amended for 1992 and subsequent taxation years to provide that it does not apply with respect to the withdrawal of RRSP contributions made by direct transfer from an RPP, where such transfer has not been made in accordance with any of subsections 147.3(1) and (4) to (7). New subsection 147.3(13.1) contains a special rule which provides a deduction for such withdrawals.

Subclauses 82(9) and (10)

ITA
146(16)

Subsection 146(16) of the Act allows a taxpayer to transfer the funds in his or her registered retirement savings plan (RRSP) to another RRSP or to a registered retirement income fund (RRIF) before maturity of the transferor RRSP. It also permits a transfer from a taxpayer's RRSP to an RRSP or RRIF of his or her spouse or former spouse pursuant to a court order or written separation agreement on a marriage breakdown. Since 1988, this subsection includes a reference to other conjugal relationships in addition to marriage.

Subsection 146(16) is amended to delete the reference to other conjugal relationships. The amendment applies after 1992 and is consequential on the introduction of subsection 252(4) of the Act, which extends the meaning of "spouse" to individuals of the opposite sex cohabiting in a conjugal relationship.

Subsection 146(16) is also amended to clarify that, where a taxpayer has made overcontributions to a transferor RRSP, the taxpayer will not be prevented from withdrawing the overcontributions on a tax-free basis under subsection 146(8.2) from another RRSP to which amounts have been transferred from the transferor RRSP under subsection 146(16). However, no part of the amount of the transfer in these circumstances will be considered to be an overcontribution to the transferee RRSP for the purposes of subsection 146(8.2). This amendment is applicable to 1991 and subsequent taxation years.

Clause 83

Home Buyers' Plan

ITA
146.01

The rules relating to the Home Buyers' Plan are set out in new section 146.01 of the Act. Under the Home Buyers' Plan, a home buyer may withdraw amounts (referred to in the section as "eligible amounts") from one or more of his or her RRSPs on a tax-free basis after February 25, 1992 and before March 2, 1993 and repay the amounts on a non-deductible basis over the 15 years from 1994 to 2008. The total of the eligible amounts withdrawn by an individual must not exceed $20,000.

By the end of 1994, a home buyer is required to repay to an RRSP at least 1/15 of the total of all eligible amounts received by the home buyer. Any shortfall is included in the home buyer's income for the year. The required minimum repayment for each subsequent year is a fraction of the home buyer's "balance" under the Home Buyers' Plan at the beginning of the year. This balance, at the beginning of a particular year, is equal to the total of all eligible amounts received by the home buyer minus the sum of repayments made before that time and shortfalls included in the home buyer's income for previous years. The fraction is 1/14 for 1995, 1/13 for 1995, and so on until the fraction is 1 for 2008. As a result, over the 15-year period from 1994 to 2008, the total of all eligible amounts received by a home buyer under the Home Buyers' Plan will be repaid or, to the extent that required repayments are not made, included in the home buyer's income. A statement of the required repayment of a home buyer for each year under the Home Buyers' Plan will be provided by Revenue Canada to the home buyer before the end of the year.

Special rules are provided where a home buyer dies or ceases to be resident in Canada at any time. In this case, there is an income inclusion for the home buyer equal to the balance described above at that time. If a home buyer becomes a non-resident in a year, the home buyer may avoid the income inclusion to the extent that the balance is repaid before filing a return of income for the year and within 90 days of becoming a non-resident. When a home buyer dies, the surviving spouse may elect with the legal representatives of the deceased to avoid any such income inclusion. If this election is made, the surviving spouse in effect assumes the position of the deceased by being treated as having received an eligible amount equal to the balance outstanding at the time of the deceased's death. This amount is added to any balance of eligible amounts received by the surviving spouse that have not been previously repaid to RRSPs.

An individual who participates in the Home Buyers' Plan is prevented from obtaining any net tax benefit from a deduction of RRSP premiums that are paid after February 25, 1992 and before March 2, 1993. This is provided by means of an income inclusion generally equal to the lesser of the amount of those premiums and the total RRSP withdrawals pursuant to the Home Buyers' Plan.

Examples 1 to 3 illustrate the operation of the basic rules with respect to the Home Buyers' Plan. The operation of the special rules on death and with respect to non-residents is illustrated in the commentary to subsections 146.01(5) to (7). The commentary to subsections 146.01(9) to (11) explains more fully the income inclusion referred to in the previous paragraph.

EXAMPLE 1

An individual withdraws an eligible amount of $15,000 from his or her RRSP in July 1992 and uses the funds for a downpayment on a qualifying home. The individual makes designated repayments of $1,000 per year to RRSPs under which the individual is the annuitant in each of the years 1994 to 2008.

Result:

There are no income tax implications for the individual. The $15,000 withdrawal is not included in the individual's income for 1992 and the annual repayments in subsequent years are not deductible in computing the individual's income.

EXAMPLE 2

An individual withdraws an eligible amount of $15,000 from his or her RRSP in July 1992 and uses the funds for a downpayment on a qualifying home. In 1994, the individual makes a designated repayment of $750.

Result:

The $15,000 withdrawal is not included in the individual's income for the 1992 taxation year. Because the required repayment for 1994 is $1,000 ($15,000/15) and only $750 is repaid, the shortfall of $250 is required to be included in the individual's income for 1994.

EXAMPLE 3

An individual withdraws an eligible amount of $15,000 from his or her RRSP in July 1992 and uses the funds for a downpayment on a qualifying home. In 1994, a designated repayment of $2,400 is made. In July 1995, a designated repayment of $600 is made.

Result:

The $15,000 withdrawal is not included in the individual's income for the 1992 taxation year. As in examples 1 and 2, the required repayment for the year 1994 is $1,000. Since more than this amount was repaid, there is no income inclusion required for 1994. The required repayment for 1995 is $900 (($15,000-2,400)/14). The shortfall of $300 for 1995 is required to be included in the individual's income for 1995. The required repayment for 1996 is also $900(($15,000 - ($3,000 + $300))/13).

ITA
146.01(1)

Subsection 146.01(1) of the Act defines various expressions for the purposes of the Home Buyers' Plan. The terms "annuitant", "benefit", "issuer" and "premium" are defined by reference to the existing definitions used for the purposes of the provisions relating to RRSPs in subsection 146(1).

For 1992, the term "spouse" is defined by reference to subsection 146(1.1) of the Act, which includes a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who has either so cohabited for a period of at least one year or is a parent of a child of whom that person is also a parent. After 1992, when the repeal of subsection 146(1.1) becomes effective, the term "spouse" in section 146.01 will be subject to the expanded definition of "spouse" in subsection 252(4) which is also effective after 1992. (Reference may be made to the commentary on that subsection).

The other definitions are discussed below.

"eligible amount"

An "eligible amount" received by an individual out of an RRSP under the Home Buyers' Plan is not included in the individual's income because it is an "excluded withdrawal" that is not taxable by reason of amended subsection 146(8). There are a number of conditions that must be satisfied for an RRSP withdrawal to qualify as an "eligible amount".

Paragraphs (*a*) and (*b*) of the definition of "eligible amount" require that an eligible amount must be received out an RRSP after February 25, 1992 but before March 2, 1993 further to written request of an individual resident in Canada. This request must be made on a form prescribed by the Minister of National Revenue and contain the address of a qualifying home that the individual intends to use as a principal place of residence within 1 year of its acquisition. Before receiving the amount out of the RRSP the individual is required to have entered into an agreement in writing for the purchase of the qualifying home or with respect to its construction. Paragraph (*d*) requires that the qualifying home must not have been previously acquired by the individual or the individual's spouse more than 30 days before the withdrawal.

Paragraphs (*c*) and (*e*) of the definition of "eligible amount" provide conditions that are generally required to be satisfied after the time of the withdrawal of RRSP funds by an individual. A qualifying home or "replacement property" (as described in the commentary on that definition) for the qualifying home must be acquired after February 25, 1992 and before October 1, 1993. If the qualifying home (or replacement property for it) is under construction by the individual, it is intended that it be considered to have been acquired by the individual at such time as it becomes inhabitable. (However, as discussed in the commentary to subsection 146.01(2), a qualifying home or replacement property for it will in specified circumstances be deemed to have been acquired before October 1, 1993 for the purposes of the Home Buyers' Plan.) An additional condition, applicable except where the individual acquired the qualifying home in the 30-day period prior to the withdrawal, is that the individual must be resident in Canada until the individual acquires the qualifying home (or replacement property for it).

Paragraph (*f*) of the definition provides that an individual's the total eligible amounts cannot exceed $20,000.

If an amount withdrawn from an RRSP fails to qualify as an eligible amount because the conditions in paragraph (*c*) or (*e*) of the definition are not satisfied, all or part of the withdrawn amount still qualifies as a non-taxable "excluded withdrawal" of an individual in two cases. The first case is where the individual dies before 1994 and had not ceased to be resident in Canada. The second case is where the individual repays all or part of the withdrawn amount to the RRSP issuer from which the amount was originally withdrawn before 1994 (or, in exceptional cases described in the commentary to subsection 146.01(2), before 1995) and the individual notifies the RRSP issuer of the repayment in on a prescribed form submitted to the issuer at the time of the repayment. If an individual is not resident of Canada at the time of filing a tax return for the year in which the amount was withdrawn from the RRSP, the repayment to the RRSP must also be made before the individual files that return. Any such repayment is, for most purposes, not considered to be a "premium" paid to an RRSP and thus will not affect RRSP deduction limits or the computation of penalty tax under Part X.1. on over contributions

"excluded premium"

This definition is discussed on the commentary to new subsections 146.01(9) to (11).

"excluded withdrawal"

This definition is discussed on the commentary to the definition of "eligible amount", above.

"qualifying home"

A "qualifying home" is defined as a housing unit located in Canada. It also includes a share of the capital stock of a cooperative housing corporation, where the holder of the share is entitled to possession of a housing unit located in Canada. However, where the context requires, a home that is a such a share means the housing unit to which the share relates. For RRSP funds received by an individual to qualify as an "eligible amount", it is generally required that an individual acquire a qualifying home before October 1, 1993.

"quarter"

A "quarter" of a calendar year is defined as any of the following periods in the year: January 1 to March 31, April 1 to June 30, July 1 to September 30 and October 1 to December 31. The definition is relevant for the filing requirements set out in new subsection 146.01(8).

"replacement property"

The definition of "replacement property" is relevant for the purposes of determining whether an RRSP withdrawal is an "eligible amount", and thus excluded from income under subsection 146(8) in the year of its withdrawal.

For an RRSP withdrawal to qualify as an eligible amount, it is normally required that the qualifying home in respect of which the withdrawal was made be acquired by October 1, 1993. If the qualifying home is not acquired by that date, the individual may repay the amount to the RRSP issuer from which the withdrawal was made and subsequently make another withdrawal before March 2, 1993 pursuant to the Home Buyers' Plan with respect to another qualifying home.

However, the individual may choose not to repay the RRSP withdrawal described above and still satisfy the acquisition requirement in paragraph (*c*) of the definition of "eligible amount" if a "replacement property" for the qualifying home is acquired by October 1, 1993 (or is deemed to have been so acquired under paragraph 146.01(2)(*c*)). Replacement property for a particular qualifying home means any other qualifying home where

- the individual agreed to acquire, or commenced the construction of, the other qualifying home after the latest time that the individual requested an RRSP withdrawal in respect of the particular qualifying home,

- the individual intends to use the other qualifying home as a principal place of residence within one year after its acquisition, and

- the individual or the individual's spouse had not previously acquired the other qualifying home.

ITA
146.01(2)

Subsection 146.01(2) of the Act provides a number of special rules that are relevant for the purposes of the definitions in subsection 146.01(1).

Paragraph 146.01(2)(*a*) ensures that an individual is considered to have acquired a qualifying home if was jointly acquired with one or more other persons.

Paragraph 146.01(2)(*b*) applies where an individual agrees to purchase a condominium unit. In this case, the individual is treated as having acquired the unit on the date the individual is entitled to immediate vacant possession of the unit. This provision enables an amount withdrawn by an individual to qualify as an "eligible amount" under subsection 146.01(1) where the individual is able to occupy a unit before the end of September 1993 but does not become a registered owner of the condominium unit until sometime later.

Paragraph 146.01(2)(*c*) applies where an individual has withdrawn an amount from a RRSP pursuant to the Home Buyers' Plan in respect of a qualifying home, but the individual has not acquired the qualifying home (or replacement property for the qualifying home) before October 1993. In these circumstances, the individual is deemed to acquire the home on September 30, 1993 and thus satisfy paragraph (*c*) of the definition of "eligible amount" in subsection 146.01(1), where the conditions set out in clause 146.01(2)(*c*)(ii)(A) or (B) are satisfied.

Clause 146.01(2)(*c*)(ii)(A) applies where the individual is obliged under the terms of an agreement in writing in effect on October 1, 1993 to acquire the qualifying home or replacement property for it and the individual ultimately acquires such property before October 1, 1994. The clause also requires that the individual be resident in Canada until such property is acquired. In the event that this clause does not apply because such property is not acquired by October 1, 1994 and the RRSP funds withdrawn are not eligible amounts as a consequence, the individual has the opportunity to repay the RRSP issuer from which the eligible amount was received before January 1, 1995 (rather than the normal deadline of January 1, 1994) to avoid an income inclusion for the year in which the RRSP funds were withdrawn. The extension of the deadline in these circumstances is provided in the definition of "excluded withdrawal" in subsection 146.01(1).

Clause 146.01(2)(*c*)(ii)(B) applies where the individual is building the qualifying home (or replacement property for it) and the individual has made payments after the withdrawal of RRSP funds under the Home Buyers' Plan to arm's length contractors and suppliers with respect to the construction of such property of an amount not less than the total amount of such RRSP funds.

ITA
146.01(3)

Subsection 146.01(3) of the Act provides that an individual may designate a payment into an RRSP under which the individual is the annuitant as a repayment of an "eligible amount". The designation is required to be made on a prescribed form submitted by the individual to the RRSP issuer at the time of the repayment or at such later time as is acceptable to the Minister of National Revenue. As a consequence of the definition of "premium" in paragraph 146(1)(*f*), the result of such a designation is that the repayment is disregarded for the purposes of determining deductible RRSP contributions and the special penalty tax on overcontributions under Part X.1 of the Act. For the purposes of subsection 146.01(3), an "excluded premium" (as defined in new subsection 146.01(1)) may not be designated as a repayment. Because of the RRSP registration rules, no repayments under new subsection 146.01(3) may be made to an RRSP of which an individual is the annuitant after the end of the calendar year in which the individual attains 71 years of age.

The amount that may be designated by an individual under subsection 146.01(3) in respect of an amount paid at any time to his or her RRSP cannot exceed the total of all eligible amounts previously received by the individual minus the total of all repayments previously designated and amounts previously included in the individual's income under subsections 146.01(4) and (5) of the Act.

ITA
146.01(4)

Subsection 146.01(4) of the Act provides that in the 1994 taxation year an individual is required to include in income 1/15 of all eligible amounts received by the individual minus any repayments made under subsection 146.01(3) before the end of the year in respect of the eligible amounts. The repayment required to avoid an income inclusion for any subsequent taxation year is a fraction of the individual's "balance" under the Home Buyers' Plan at the beginning of the year. This balance, at the beginning of a particular year, is equal to the total of all eligible amounts received by the individual minus the sum of repayments made before that time and shortfalls included in the individual's income for previous years. The fraction is 1/14 for 1995, 1/13 for 1995, and so on until the fraction is 1 for 2008. Any balance remaining in the year 2008 must either be repaid to an RRSP or included in income in that year.

The application of this subsection is illustrated in Examples 2 and 3, which are contained in the introduction to this section.

ITA
146.01(5)

Subsection 146.01(5) of the Act is a special rule that applies where an individual ceases to be resident in Canada after having withdrawn an "eligible amount" under the Home Buyers' Plan. The rule provides for an income inclusion for an individual in these circumstances equal to the total eligible amounts received by the individual in the taxation year or a preceding taxation year minus the total of

- all previous income inclusions under subsection 146.01(4), and

- all repayments under subsection 146.01(3) in respect of those eligible amounts made before the individual files a return of income for the year in which he or she became non-resident and not more than 90 days after the date on which the individual ceased to be resident in Canada.

EXAMPLE 4

An individual resident in Canada withdraws RRSP funds in 1992 for the purpose of acquiring a qualifying home. On April 2, 1993, the individual ceases to be resident in Canada prior to acquiring the qualifying home. On April 30, 1993, the individual files an income tax return for the 1992 taxation year.

Result:

By definition, the amount received from the RRSP cannot be an "eligible amount" because the individual is not resident in Canada at the time of the acquisition of the qualifying home. As a consequence, the individual will be required to include the RRSP withdrawal in income in the taxation year of its receipt, except to the extent it is an "excluded withdrawal" repaid to the RRSP before April 30, 1993. This is discussed further in the commentary to the definition of "eligible amount" in subsection 146.01(1).

EXAMPLE 5

An individual withdraws an eligible amount of $15,000 from his or her RRSP in July 1992 and uses the funds for a downpayment on a qualifying home. In 1993, a designated repayment of $3,000 is made. In November 1994, the individual ceases to be resident in Canada. In January 1995, a further designated repayment of $1,000 is made by the individual. The individual files a return of income for 1994 in March 1995.

Result:

The individual is required to include the amount of $11,000 ($15,000 - $3,000 - $1,000) in his or her income for the period in the 1994 taxation year during which the individual was resident in Canada. If the individual had repaid a further $11,000 within 90 days of becoming a non-resident, this income inclusion would be avoided.

ITA
146.01(6) and (7)

Subsection 146.01(6) of the Act provides rules that apply in the event that an individual dies and has previously received eligible amounts or excluded withdrawals which have not been repaid to RRSPs. (See commentary on the definition of "eligible amount" in subsection 146.01(1).) Where the total of such amounts exceeds the sum of designated amounts repaid by the individual and income inclusions of the individual under subsections 146.01(4) and (5), the excess is included in computing the individual's income for the year of death. An exception to this rule is made where an election in writing is made under subsection 146.01(7).

An election may be made under subsection 146.01(7) where the deceased individual has a spouse who is resident in Canada immediately before the individual's death. Where the surviving spouse and the deceased spouse's legal representative so elect in the deceased's terminal return, the excess is not included in the deceased's income. Instead, the surviving spouse is treated as having received an eligible amount, at the time of the deceased's death, equal to the excess. This amount is added to the surviving spouse's own balance of eligible amounts that have not have repaid at that time to RRSPs.

EXAMPLE 6

An individual withdraws an eligible amount of $15,000 from his or her RRSP in July 1992 and uses the funds for a downpayment on a qualifying home. In 1994, a designated repayment of $3,000 is made. In November 1995, the individual dies.

Result:

The individual's income inclusion for 1995 would be $12,000 ($15,000 - $3,000). This amount is required to be reported on the individual's tax return for the year of death.

EXAMPLE 7

Same facts as in example 6, except that an election is made by the deceased's spouse under subsection 146.01(7).

Result:

No amount is included in the deceased's income. The tax consequences to the spouse are determined as if the spouse had withdrawn an eligible amount of $12,000 in the year of death. The spouse's required repayments commence in 1996 and may end as late as 2008.

ITA
146.01(8)

New subsection 146.01(8) of the Act provides that a prescribed form submitted to an issuer of an RRSP in connection with the Home Buyers' Plan must be filed with Revenue Canada no later than 15 days after the calendar quarter in which it was submitted to the issuer. Prescribed forms are submitted under paragraph (*a*) of the definition of "eligible amount" in subsection 146.01(1) (request for tax-free withdrawal from RRSP), subparagraph (*b*)(ii) of the definition of "excluded withdrawal" in subsection 146.01(1) (repayment to RRSP in event of failure to purchase qualifying home) and subsection 146.01(3) (repayment of eligible amounts).

ITA
146.01(9) to (11)

New subsection 146.01(9) of the Act provides an income inclusion with respect to RRSP premiums paid after February 25, 1992 and before March 2, 1993 (referred to below as the "relevant period") by an individual who participates in the Home Buyers' Plan. It applies, for example, where RRSP premiums paid in the relevant period are withdrawn by the individual or the individual's spouse under the Home Buyers' Plan.

Subsection 146.01(9) of the Act applies only to the 1992 taxation year. An individual is required to include in computing income the lesser of two amounts. The first amount is the "net premium balance" of the individual. As defined in new subsection 146.01(10), the net premium balance is equal to the total premiums paid by the individual in the relevant period (other than "excluded premiums") **minus** RRSP withdrawals (other than amounts attributed to the individual's spouse or related to RRSP premiums paid after March 1, 1993) received by the individual or the individual's spouse after February 25, 1992 and before 1994 and included in computing the individual's income for the 1992 or 1993 taxation year under subsection 146(8) or (8.3). As described in example 8, such withdrawals will enable an individual to reverse the tax consequences of paying an RRSP premium. The second amount is the sum of

- total eligible amounts withdrawn from an RRSP by the individual under the Home Buyers' Plan in 1992 or 1993, and

- the lesser of

  - premiums (other than "excluded premiums", described below) paid by the individual to a spousal RRSP in the relevant period, and

  - total eligible amounts withdrawn by the individual's spouse minus the net premium balance of the individual's spouse.

"Excluded premiums" do not enter into the determination of a net premium balance or otherwise affect the determination of any income inclusion under subsection 146.01(9). As defined in subsection 146.01(1), excluded premiums are

- RRSP premiums designated for the purposes of paragraph 60(*j*) (lump sum transfers to RRSP from foreign pension plans and arrangements), paragraph 60(*j*.1) (transfer of retiring allowance to RRSP), paragraph 60(*j*.2) (transfer of pension income to spousal RRSP) and paragraph 60(*l*) (transfer of refund of premiums on death and certain other amounts),

- amounts transferred directly from an RRSP, registered pension plan, registered retirement income fund or deferred profit sharing plan to an RRSP,

- RRSP premiums deductible under subsection 146(6.1) (recontributions of certain withdrawals made for the purposes of acquiring past service benefits under a registered pension plan), and

• RRSP premiums paid after February 25, 1992 and before March 1, 1992 that were deducted in computing income for the 1991 taxation year.

New subsection 146.01(11) ensures that the Minister of National Revenue is able to assess or reassess the tax, interest and penalties for an individual outside the normal time limits to recognize an income inclusion under subsection 146.01(9).

EXAMPLE 8

An individual pays an RRSP premium of $2,100 in April 1992. The individual withdraws an eligible amount of $8,000 in January 1993 and uses it for a downpayment on a qualifying home. The individual has $2,400 of RRSP deduction room for the 1992 taxation year.

Result:

The individual is required to include $2,100 in income for the 1992 taxation year under subsection 146.01(9). The $2,100 income inclusion is offset by a $2,100 RRSP deduction for the 1992 taxation year. In this case, only $300 of unused RRSP room ($2,400 - $2,100) would be available to be carried forward to future taxation years.

However, if the premium has not been withdrawn pursuant to the Home Buyers' Plan, the individual may choose to withdraw it before 1994 under subsection 146(8.2). In this case, there would be no income inclusion under subsection 146.01(9). The withdrawal would be included in income under subsection 146(8), but would be offset by a deduction under subsection 146(8.2). The $2,400 of unused 1992 RRSP room would be carried forward and the individual could accordingly deduct an RRSP premium of that amount paid after March 1, 1993 and before March 2, 1994 in computing income for the 1993 taxation year.

EXAMPLE 9

An individual pays a spousal RRSP premium of $10,000 in April 1992. The individual and the individual's spouse each withdraw an eligible amount of $7,000 in January 1993 and use the $14,000 total for a downpayment on a qualifying home. The individual's spouse pays no RRSP premiums in the relevant period. The individual has $10,000 of RRSP deduction room for the 1992 taxation year.

Result:

The individual is required to include $10,000 in income for the 1992 taxation year under subsection 146.01(9). The $10,000 income inclusion is offset by a $10,000 RRSP deduction for the 1992 taxation year. The individual will have no RRSP room to carry forward to the 1993 taxation year.

However, the individual's spouse could withdraw $10,000 from the spousal RRSP under subsection 146(8.2) where this amount was not withdrawn under the Home Buyers' Plan. In this case, there would be no income inclusion under for the individual under subsection 146.01(9). The $10,000 withdrawal would be included in the individual's income under subsection 146(8.3), but would be offset by a $10,000 deduction under subsection 146(8.2). The $10,000 of unused 1992 RRSP room would be carried forward and the individual may accordingly deduct an RRSP premium of that amount paid after March 1, 1993 and before March 2, 1994 in computing income for the 1993 taxation year.

Clause 84

Registered Retirement Income Funds

ITA
146.3

Section 146.3 of the Act provides the rules for registered retirement income funds (RRIFs).

Subclause 84(1)

ITA
146.3(1)(a)

An "annuitant" under a RRIF is the individual to whom the carrier of the fund has undertaken to make payments out of or under the fund. Where the first annuitant elects under paragraph 146.3(1)(f) of the Act, or provides in his or her will, a spouse of the first annuitant will become the annuitant on the death of the first annuitant. In the absence of such an election or provision, on the death of the annuitant, the carrier of a RRIF is required to distribute all the property held in connection with the fund pursuant to paragraph 146.3(2)(d) and no rollover may be made for the benefit of a surviving spouse under paragraph 60(l) of the Act.

The definition of "annuitant" in paragraph 146.3(1)(a) is amended so that no election is required by the first annuitant under a RRIF for a surviving spouse to become the annuitant under the fund on the death of the first annuitant, provided that the legal representative of the first annuitant consents and the carrier of the fund undertakes to make payments to the surviving spouse. In addition, should the surviving spouse re-marry, the new spouse of the surviving spouse may also become the annuitant under the fund on the death of the surviving spouse, provided the carrier of the fund undertakes to make payments to the new spouse and the legal representative of the surviving spouse consents.

This amendment is applicable to deaths occurring after 1990.

Subclause 84(2)

ITA
146.3(1)(b.1)

Paragraph 146.3(1)(b.1) of the Act defines the "minimum amount" that is required to be paid out of a RRIF to an annuitant each year. The "minimum amount" of a RRIF for a year is calculated by dividing the value of the RRIF at the beginning of the year by the difference between 90 and the age of the annuitant (or the annuitant's spouse, if the annuitant so elects) at that time. For example, where the RRIF's value at the beginning of a year is $38,000 and the annuitant is 71 years of age at that time, the minimum amount for the year is $2,000 ($38,000/(90 - 71)). Because of the manner in which the minimum amount is determined, RRIF funds are generally fully paid out in the taxation year in which the annuitant (or the annuitant's spouse, if the annuitant so elects) attains 90 years of age.

Paragraph 146.3(1)(b.1) is amended to clarify that the payout schedule for a RRIF is not changed by virtue of a surviving spouse becoming the annuitant under the RRIF. If a surviving spouse wishes to have the payout schedule changed, a transfer could be made to another RRIF under paragraph 60(1).

Paragraph 146.3(1)(b.1) is also amended, in conjunction with the proposed introduction of section 7308 of the *Income Tax Regulations* (a draft of which is appended to these notes), to allow RRIF payments to be made for the lifetime of an annuitant. Under the new rules, the minimum amounts for ages under 71 are determined in the same manner as described above. For ages 71 to 77, the minimum amounts under the new rules are marginally higher than the minimum amounts that would be determined above. At age 78, the minimum amount under the new rules is the same as the minimum amount that would be determined above. For ages over 78, the minimum amounts under the new rules are less than the minimum amounts that would be determined above. However, as described below, the minimum amounts for ages 71 to 77 will remain the same for certain qualifying retirement income funds (in general terms, RRIFs entered into before 1993 and RRIFs replacing such RRIFs).

The new rules require the minimum amount in respect of a RRIF for a taxation year to be determined by multiplying the value of the RRIF at the beginning of the year by a prescribed factor corresponding to the age of the annuitant (or, where the annuitant so elects, the annuitant's spouse). The table below sets outs these factors in respect of qualifying and other retirement income funds. For this purpose, the expression "qualifying retirement income fund" means a retirement income fund entered into before 1993 in respect of which the carrier has not accepted any property as consideration after 1992 and at or before the time at which the expression is applied. In addition, a qualifying retirement income fund includes a retirement income fund in respect of which the carrier has not accepted any property as consideration after 1992 and before the time at which the expression is applied, other than property transferred from another qualifying retirement income fund.

	OLD RULES[1]	NEW RULES	
		General	Qualifying RRIFs
AGE			
71	.0526	.0738	.0526
72	.0556	.0748	.0556
73	.0588	.0759	.0588
74	.0625	.0771	.0625
75	.0667	.0785	.0667
76	.0714	.0799	.0714
77	.0769	.0815	.0769
78	**.0833**	**.0833**	**.0833**
79	.0909	.0853	.0853
80	.1000	.0875	.0875
81	.1111	.0899	.0899
82	.1250	.0927	.0927
83	.1429	.0958	.0958
84	.1667	.0993	.0993
85	.2000	.1033	.1033
86	.2500	.1079	.1079
87	.3333	.1133	.1133
88	.5000	.1196	.1196
89	1.0000	.1271	.1271
90	N/A	.1362	.1362
91	N/A	.1473	.1473
92	N/A	.1612	.1612
93	N/A	.1792	.1792
94 or older	N/A	.2000	.2000

[1] The factors in this column are equal to 1/(90 - X), where X is equal to the age of the annuitant or the annuitant's spouse, as the case may be.

The new definition of "minimum amount" applies to 1992 and subsequent taxation years. However, consistent with the existing law, the new definition does not apply to a fund entered into before March 1986 unless the fund is revised or amended after February 1986. In addition, for the purposes of determining withholding taxes in accordance with the rules in Part I of the *Income Tax Regulations*, the application of the spousal attribution rule for RRIFs in subsection 146.3(5.1) of the Act and the application of section 5 of the *Income Tax Conventions Interpretation Act*, the new definition does not apply to payments made before 1993.

Subclause 84(3)

ITA
146.3(1.1)

Subsection 146.3(1.1) of the Act provides that the extended definition of spouse in subsection 146(1.1) of the Act applies for the purposes of specified RRIF rules.

Subsection 146.3(1.1) is amended so that it also applies for the purposes of the amendment to the definition of "annuitant", described above. The amendment applies after 1990.

The repeal of subsection 146.3(1.1), which becomes effective after 1992, is strictly consequential on the repeal of subsection 146(1.1) and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Subclause 84(4)

ITA
146.3(2)(d)

One of the conditions for registration of a RRIF is that the carrier is required to distribute property held in connection with the fund on the death of the annuitant, except where the annuitant's spouse becomes the annuitant pursuant to the terms of the fund or the provisions of the will of the deceased annuitant.

Paragraph 146.3(2)(d) is amended so that the exception therein applies whenever the annuitant's spouse becomes the annuitant. This amendment is strictly consequential to the expanded definition of "annuitant" in subsection 146.3(1).

This amendment is applicable after 1990.

Subclauses 84(5) and (6)

ITA
146.3(2)(f)

Subsection 146.3(2) of the Act sets out the conditions that must be satisfied by a RRIF for it to be registered. Paragraph 146.3(2)(f) prohibits a RRIF from receiving property other than property transferred from sources listed in that paragraph.

Paragraph 146.3(2)(f) is amended, applicable after August 29, 1990, so that a RRIF of which an individual is the annuitant may receive property transferred directly from an RPP. The amendment also permits a transfer from an RPP of which an individual is a member to a RRIF of which the individual's spouse is the annuitant, provided the transfer is in accordance with subsection 147.3(5) or (7). Amendments are also being made to the transfer rules in section 147.3 to permit such transfers to be made.

Subparagraph 146.3(2)(f)(iv) is being amended to delete the reference to "other conjugal relationship". This amendment, which applies after 1992, is strictly consequential on the introduction of subsection 252(4), which extends for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Subclause 84(7)

ITA
146.3(14)(b)

Subsection 146.3(14) of the Act provides that amounts transferred from one RRIF of an annuitant to another RRIF, or from an annuitant's RRIF to an RRSP or RRIF of the annuitant's spouse or former spouse pursuant to a court order or written separation agreement on the breakdown of a marriage or other conjugal relationship are considered not to be received by the annuitant. This amendment, which deletes the reference to "other conjugal relationship", applies after 1992 and is strictly consequential on the introduction of subsection 252(4) which extends the meaning of "spouse" as described above.

Clause 85

Registered Pension Plans

ITA
147.1

Section 147.1 of the Act sets out rules relating to the registration, amendment and administration of pension plans as well as the conditions and procedures for the revocation of pension plan registration. The section also contains the pension adjustment limits and the restriction on the payment of past service benefits, which are central elements of the system for restricting tax-assisted retirement savings.

Subclause 85(1)

ITA
147.1(1)

Subsection 147.1(1) of the Act defines terms that are relevant for the provisions of the Act and regulations relating to registered pension plans (RPPs).

"money purchase limit"

The definition of "money purchase limit" is relevant for a number of provisions. For example, subsection 147.1(8) of the Act requires that an individual's pension adjustment (PA) for a year not exceed the money purchase limit for the year. The money purchase limit also provides the basis for the dollar limit on deductible contributions to a registered retirement savings plan (RRSP), the dollar limit on pensions payable under a defined benefit provision of an RPP and the dollar limit on contributions to a deferred profit sharing plan (DPSP).

The definition of "money purchase limit" is amended so that for 1992 the limit remains frozen at the 1991 level of $12,500. After 1992, the limit will increase by $1,000 a year until it reaches $15,500 in 1995. For years after 1995, the limit will be $15,500 adjusted to reflect increases in the average wage.

The effect of this amendment is to defer for one year the phase-in of higher contribution and benefit limits for RPPs, DPSPs and RRSPs.

This amendment is applicable after 1991.

(Reference should be made to the consequential amendments to Parts LXXXIII and LXXXV of the *Income Tax Regulations* (which deal with the calculation of PAs and the registration of pension plans) that are set out in Appendix C to these notes.)

Subclause 85(2)

ITA
147.1(1)

For the purposes of sections 147.1, 147.2 and 147.3 of the Act, the term "spouse" has the meaning assigned by subsection 146(1.1). The repeal of the definition of "spouse" in subsection 147.1(1), which becomes effective after 1992, is strictly consequential on the repeal of subsection 146(1.1) and the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

Subclause 85(3)

ITA
147.1(2)(b) and (c)

Paragraph 147.1(2)(b) of the Act provides that, where a pension plan is submitted for registration before January 1, 1991, the registration is effective from the day specified in writing by the Minister of National Revenue. Paragraph 147.1(2)(c) of the Act provides that, where a pension plan is submitted for registration after December 31, 1990, the registration is effective from

January 1st in the year in which the application is made or, if later, the plan's date of commencement.

Paragraphs 147.1(2)(b) and (c) are amended, applicable after 1990, to provide that the rule in paragraph (b) is applicable with respect to pension plans submitted for registration in 1991.

Clause 86

Transfers from Registered Pension Plans

ITA
147.3

Section 147.3 of the Act sets out the rules for lump sum transfers of funds from registered pension plans (RPPs) to other RPPs and to registered retirement savings plans (RRSPs).

Subclauses 86(1) to (4)

ITA
147.3(1) and (4) to (7)

Subsections 147.3(1) and (4) to (7) of the Act permit a direct transfer on behalf of an individual of a lump sum amount from a defined benefit or money purchase provision of an RPP to a money purchase provision of another RPP or to an RRSP subject to limits set out in those subsections. These subsections are amended to allow transfers from RPPs to registered retirement income funds (RRIFs) to be made on the same basis as transfers from RPPs to RRSPs. These amendments are applicable with respect to transfers occurring after August 29, 1990.

Subsection 147.3(4) of the Act, which permits the tax-free transfer on behalf of an individual of a lump sum amount from a defined benefit provision of an RPP to a money purchase provision of another RPP, is further amended to clarify that the amount may be transferred whether or not the individual has a vested entitlement to the amount. This amendment is applicable with respect to transfers made after 1988.

Subsection 147.3(5) of the Act permits the direct transfer of a lump sum amount for the benefit of the spouse or former spouse of a plan member, where the amount is transferred pursuant to a court order or written separation agreement relating to a division of property on the breakdown of a marriage or other conjugal relationship. Subsection 147.3(5) is also being amended to delete the reference to "other conjugal relationship" in paragraph 147.3(5)(b), after 1992. This amendment is strictly consequential on the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent.

ITA
147.3(4.1)

Section 147.3 of the Act does not permit the transfer of surplus from a defined benefit provision of an RPP to a money purchase provision of another RPP, except in the limited circumstances set out in subsection 147.3(8). An employer can effect such a transfer of surplus indirectly by withdrawing the surplus from the defined benefit provision and then contributing it to the money purchase provision. However, this option may not be available for some plans because the plan terms or pension benefits legislation may prevent the employer from withdrawing the surplus.

New subsection 147.3(4.1) is introduced to permit surplus to be transferred directly from a defined benefit provision of an RPP to a money purchase provision of another RPP, where the surplus is credited to members' accounts under the money purchase provision. This will enable an employer to use a defined benefit surplus, for example, to satisfy its obligations to make contributions under a money purchase provision.

As a consequence of the introduction of subsection 147.3(4.1), the *Income Tax Regulations* will be amended so that

(i) a surplus may be transferred from a defined benefit provision of an RPP to a money purchase provision of the same RPP,

(ii) a surplus that is transferred from a defined benefit provision to a money purchase provision and credited to members' accounts is included in the determination of pension credits under the money purchase provision, and

(iii) a transfer in accordance with subsection 147.3(4.1) is an acceptable distribution from an RPP.

Subsection 147.3(4.1) applies with respect to amounts transferred after 1990.

Subclauses 86(5) and (6)

ITA
147.3(10) and (11)

Subsections 147.3(10) and (11) of the Act contain rules that apply where an amount is transferred on behalf of an individual from an RPP to an RRSP or to another RPP otherwise than in accordance with any of subsections 147.3(1) to (7). In these circumstances, the excess portion that is not transferred in accordance with those provisions is deemed to have been paid from the RPP directly to the individual and to have been contributed by the individual to the RRSP or other RPP. This ensures that the excess is included in the individual's income and that the rules with respect to the deductibility of contributions or premiums to RPPs and RRSPs will apply. In addition, the special tax under Part X.1 of the Act on excess contributions to an RRSP may be payable.

Subsections 147.3(10) and (11) are amended so that they also apply with respect to an amount transferred from an RPP to a RRIF in excess of the amount permissible by subsections 147.3(1) and (4) to (7). A further amendment to subsection 147.3(10) provides that, for the purposes of computing RRSP deductions and penalty tax under Part X.1, the excess amount so transferred is considered to have been paid by the individual as a premium to an RRSP under which the individual is the annuitant. This amendment ensures that the excess amount will be treated in the same way as an excess transfer to an RRSP.

These amendments are applicable with respect to transfers occurring after August 29, 1990.

Subclause 86(7)

ITA
147.3(12)

Subsection 147.3(12) of the Act provides that, except in limited circumstances, an RPP becomes a revocable plan where an amount is transferred from the plan to an RRSP or to another RPP otherwise than in accordance with any of subsections 147.3(1) to (8). Subsection 147.3(12) is amended so that it also applies where an amount is transferred from an RPP to a RRIF otherwise than in accordance with any of those subsections. This amendment is strictly consequential to the amendments which allow the transfer of amounts from RPPs to RRIFs.

This amendment is applicable with respect to transfers occurring after August 29, 1990.

Subclause 86(8)

ITA
147.3(13.1)

New subsection 147.3(13.1) of the Act is introduced to provide relief from double taxation where amounts are transferred from an RPP to an RRSP or RRIF in excess of the amounts permissible by subsections 147.3(1) and (4) to (7). Such an excess amount is required to be included in the income of the individual on whose behalf it is transferred, and is considered to be a premium paid by the individual to an RRSP. Since the individual will be taxed on the amount when it is subsequently received from the RRSP or RRIF, the result is that the individual pays tax twice in respect of the same amount. At present, the individual is able to avoid double taxation on an excess transfer from an RRSP only if the individual has sufficient unused RRSP room to deduct the premium (or has such room at some future time) or is able to withdraw the excess amount and claim a deduction under subsection 146(8.2).

Subsection 147.3(13.1) allows an individual a deduction in computing income for a taxation year equal to the lesser of two amounts. The first amount is the total amount included in the individual's income for the year by virtue of specified RRSP and RRIF rules (as described below) **minus** the total of "prescribed withdrawals" (as described below) and the deductions claimed for the year by the individual under paragraph 60(l) (deduction for qualifying payments when certain amounts received from RRSPs or RRIFs) and subsection 146(8.2) (withdrawal of excess RRSP premiums).

The specified RRSP and RRIF rules resulting in income that is included in the first amount are: subsection 146(8) (RRSP benefits included in income, including benefits deemed to be received on death), subsection 146(12) (income inclusion where plan ceases to qualify as an RRSP), subsection 146.3(5) (RRIF receipts included in income, including deemed receipts on death), subsection 146.3(11) (income inclusion where plan ceases to qualify as a RRIF) and subsections 146(8.3) and 146.3(5.1) (attribution of income from spousal RRSPs and RRIFs). "Prescribed withdrawals" referred to above are intended to be the same amounts qualifying as "prescribed withdrawals" under subsection 146(8.2). (As set out in subsection 8307(6) of the *Income Tax Regulations*, "prescribed withdrawals" are amounts withdrawn by an individual from an RRSP that result in the individual being able to acquire past service benefits for 1990 and subsequent years.)

The second amount determined under subsection 147.3(13.1) is the amount included in the individual's income for the year and for preceding years in respect of those transfers from RPPs to RRSPs and RRIFs on behalf of the individual that are deemed, by paragraph 147.3(10)(b) or (c), to be premiums paid by the individual to RRSPs (in other words, excess transfers on behalf of the individual), minus the sum of

- deductions claimed by the individual under subsection 147.3(13.1) for preceding taxation years, and

- deductions claimed by the individual under subsection 146(5) for a preceding taxation year, to the extent that the deductions may reasonably be considered to be in respect of such premiums.

Subsection 147.3(13.1) enables an individual on whose behalf an excess transfer has been made to an RRSP or RRIF, and who withdraws the excess or another amount from an RRSP or RRIF, to claim a deduction in respect of the withdrawn amount to offset the income inclusion resulting from the withdrawal.
Subsection 147.3(13.1) is similar to, but broader than, subsection 146(8.2), which provides a deduction with respect to the withdrawal of excess contributions to RRSPs. In particular, subsection 147.3(13.1) does not contain a time limit for the withdrawal of excess premiums. Subsection 146(8.2) is being

amended so that it does not apply in circumstances in which a deduction is available under subsection 147.3(13.1).

EXAMPLE

Ms. B is a member of a defined benefit RPP. The relevant provincial law does not allow Ms. B to receive directly any portion of the commuted value of the pension. On January 1, 1992, $54,500 is transferred from the RPP on behalf of Ms. B to an RRIF under which Ms. B is the annuitant. Of the $54,500 so transferred, only $40,000 is in accordance with subsection 147.3(4). What are the income tax consequences for Ms. B if

- her RRSP deduction limit for 1992 is $2,000,
- her "earned income" after 1991 is nil, and
- she withdraws $3,000 from her RRIF at the beginning of each of her 1993 to 1997 taxation years?

Result:

1. The $40,000 amount is transferred on a tax-free basis – subsections 147.3(9) and (11).

2. The $14,500 excess is included in Ms. B's income and is considered to be an RRSP contribution of which Ms. B may deduct $2,000 by virtue of her 1992 RRSP deduction limit. For the 1992 taxation year, Part X.1 penalty tax is therefore payable on $4,500 ($14,500 - $2,000 - $8,000). (The $8,000 amount is the threshold in subsection 204.2(1.1) above which Part X.1 penalty tax is payable pursuant to subsection 204.2(1.1).)

3. Ms. B may deduct $3,000 for her 1993 taxation year under new subsection 147.3(13.1). This is the lesser of $3,000 and $12,500 – the amounts set out in paragraphs 147.3(13.1)(a) and (b), respectively, assuming that Ms. B claimed the $2,000 RRSP deduction for the 1992 taxation year. For the 1993 taxation year, the amount on which Part X.1 penalty tax is payable would be reduced from $4,500 to $1,500.

4. Ms. B may deduct $3,000 for each of the 1994 to 1996 taxation years and $500 for the 1997 taxation year under subsection 147.3(13.1). After the 1993 taxation year, there is no amount in respect of which Part X.1 penalty tax is payable. The total deducted under subsection 147.3(13.1) is thus $12,500 – the amount of the $14,500 excess minus the $2,000 deemed RRSP contribution deducted under subsection 146(5).

5. The tax consequences for Ms. B would have been the same if the $14,500 excess had been transferred by Ms. B to an RRSP rather than an RRIF.

Subsection 147.3(13.1) applies to 1992 and subsequent taxation years. However, it is modified in its application to the 1992 taxation year so that an individual can claim an additional deduction in that year equal to the total of the deductions that the individual would have been permitted to claim in the 1989 to 1991 taxation years if the subsection had been applicable in those years.

Clause 87

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 87(1)

ITA
148(1)(b.1)

Subsection 148(1) of the Act provides for the inclusion in the income of a holder of an interest in a life insurance policy of certain amounts in respect of dispositions of such interests. The addition of new paragraph 148(1)(b.1) is consequential on the change to subsection 138.1(7) of the Act and will ensure that a life insurance policy which is effected as a registered retirement income fund (RRIF) will not be subject to subsection 148(1). Such policies are subject to the special rules which govern RRIFs. This amendment applies to 1991 and subsequent taxation years.

Subclause 87(2)

ITA
148(2)

Subsection 148(2) of the Act treats an interest in a life insurance policy as having been disposed of in certain circumstances and for certain purposes. Paragraph 148(2)(a) provides that such a disposition will occur where a policyholder becomes entitled to receive a policy dividend. The amendment to this provision provides that where any part of such a policy dividend is automatically applied to pay a premium or repay a policy loan, as provided for under the terms and conditions of the policy, that part of the dividend will not be included in the proceeds of the disposition in respect of the policy dividend.

This amendment applies to policy dividends arising in taxation years beginning after December 20, 1991.

Subclause 87(3)

ITA
148(8.1)(a)(iii)

Subsection 148(8.1) of the Act allows an *inter vivos* transfer of a life insurance policy to be treated as a disposition for proceeds equal to the adjusted cost basis of the policy, where the transfer is made to a spouse or former spouse. Subparagraph 148(8.1)(a)(iii) extends this benefit to a person with whom the policyholder cohabited in a conjugal relationship, provided the transfer is made in accordance with provincial law and as part of a court order. This subparagraph is no longer necessary as a result of the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. The repeal of subparagraph 148(8.1)(a)(iii) becomes effective after 1992.

Subclauses 87(4), (5), (7) and (8)

ITA
148(9)(a) and (e.2)

Subsection 148(9) of the Act defines certain terms for purposes of calculating the amounts to be included in computing a taxpayer's income in respect of certain life insurance policies. Paragraph 148(9)(a) defines the "adjusted cost basis" of a policy, and paragraph 148(9)(e.2) defines "proceeds of the disposition".

The amendments to paragraph 148(9)(a) ensure that where proceeds of the disposition are reduced pursuant to the amendments to subsection 148(2) or paragraph 148(9)(e.2) (described above), the adjusted cost basis of the life insurance policy will not be increased by the amount of the premium, loan repayment or policy surrender that has not been included in such proceeds of the disposition.

The amendments to paragraph 148(9)(e.2) provide that where any amount in respect of a policy surrender or policy loan is automatically applied to pay a premium under the policy, as provided for under the terms and conditions of the policy, such amount is not to be included in the proceeds of the disposition in respect of the surrender or loan.

These amendments to section 148 are applicable to transactions occurring in taxation years commencing after December 20, 1991.

Subclause 87(6)

ITA
148(9)(a)(v.2)

The definition of the adjusted cost basis of a life insurance policy is contained in paragraph 148(9)(a) of the Act. This definition is relevant to the computation of income arising on policy dispositions under subsection 148(1) and (1.1), as well as under the accrual rules in section 12.2. The amendment to this provision adds new subparagraph 148(9)(a)(v.2), which applies where an interest in a life insurance policy has, as provided in subsection 148(8.2), been transferred on a rollover basis to a surviving spouse on the death of a policyholder.

In such circumstances, as provided by the new subparagraph, the adjusted cost basis of the policy to the spouse will be increased by the amount of the mortality gain, if any, that resulted from the policyholder's death. Such a mortality gain could arise where the policy provided for a waiver of premiums in the event of the death of the policyholder. New subparagraph 148(9)(a)(v.2), which applies to transfers and distributions occurring after 1989, appropriately recognizes the value of such benefits received under the policy as an addition to the adjusted cost basis of the policy to the surviving spouse.

Clause 88

Exempt Persons

ITA
149

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 88(1)

ITA
149(1)(v)

New paragraph 149(1)(v) provides an exemption under Part I of the Act for amateur athlete trusts. The rules governing the taxation of these trusts and their beneficiaries are provided for in new section 143.1 of the Act. This amendment applies to the 1988 and subsequent taxation years.

Subclause 88(2)

ITA
149(2)

The tax-exempt status of certain organizations provided by subsection 149(1) of the Act is conditional on no part of the income of the organization being payable to or otherwise available for the personal benefit of any person, or on the organization expending a certain percentage of its income on specified activities. Subsection 149(2) provides that, for the purposes of applying these conditions (which are contained in paragraphs 149(1)(e), (i), (j) and (l)), the amount of any taxable capital gains that would otherwise be included in the income of the organization is to be excluded. This amendment provides that, for these purposes, neither taxable capital gains nor allowable capital losses are included in the calculation of such income.

This amendment is applicable to 1992 and subsequent taxation years.

Subclause 88(3)

ITA
149(10)

Subsection 149(10) provides special rules where a corporation becomes exempt or ceases to be exempt from tax under Part I of the Act.

The amendment to subsection 149(10) of the Act adds, applicable to 1992 and subsequent taxation years, new paragraph 149(10)(a.1) which provides that in determining the income of a corporation for its first taxation year ending after the time of change of its tax status, the corporation will be treated as having claimed or deducted, in the year ending immediately before that time, the maximum amount which it was entitled to claim or deduct as a reserve under sections 20, 138 and 140 of the Act. Consequently, such reserves are included in determining a corporation's income for the year in which it ceases or commences to be exempt from Part I tax. This paragraph is intended to ensure that a corporation does not accumulate or "bank" certain discretionary tax deductions in years in which it is exempt from tax on its taxable income.

Subclause 88(4)

ITA
149(12)

New subsection 149(12) requires an agricultural organization, board of trade, chamber of commerce or non-profit organization, which is exempt from tax under paragraph 149(1)(e) or (l) of the Act, to file an information return for a fiscal period ending after 1992 if the organization has received dividends, interest, rentals or royalties in excess of $10,000 in that period or if the total assets of the organization exceed $200,000 at the end of the immediately preceding fiscal period. (For these purposes, the amount of total assets of an organization is the book value of such assets as determined in accordance with generally accepted accounting principles.) New subsection 149(12) also requires that once an organization has been required to file an information return in respect of a fiscal period, it will be required to file returns for all subsequent periods. The information return is to be filed within 6 months of the end of the fiscal period.

Paragraphs 149(1)(e) and (l) of the Act encompass a wide range of organizations. These entities may take the form of corporations, trusts or other organizations. The exemption from tax provided for these organizations is conditional upon a determination that no part of the income of the organization is available for the personal benefit of the members of the organization. Under the existing provisions of the Act, the requirement to file a return of income is not uniform, as it depends upon the form that such an organization takes. For example, if a non-profit organization is incorporated, it is required to file an annual return of income under section 150. If the same organization were not incorporated, a return of income would not be required to be filed unless the organization were a trust to which subsection 149(5) applied in the year.

New subsection 149(12) provides a uniform requirement that all such organizations file information returns, in addition to any returns that may be required under the existing provisions of the Act. This new requirement to file an information return is similar to that currently existing in respect of other organizations enjoying tax-exempt status, such as registered charities. It is intended that the information requested in this new return will include information concerning the activities of the organizations and the sources and amounts of its revenues.

Clause 89

Electronic Filing of Returns

ITA
150.1

New section 150.1 of the Act provides for the use of electronic media for filing tax returns. Subsections (1) to (4) apply for 1992 and subsequent taxation years. The coming-into-force date for subsection (5) is described below.

ITA
150.1(1)

New subsection 150.1(1) of the Act defines "electronic filing" as the use of electronic media in a manner specified in writing by the Minister of National Revenue. This enables the Minister to specify types of electronic transmission of data as constituting electronic filing. Thus, new developments in electronic data capture and transmission can be added to the system as necessary.

ITA
150.1(2)

New subsection 150.1(2) of the Act permits the Minister of National Revenue to specify criteria for establishing eligibility for electronic filing. This is to ensure that electronic filers use equipment and software compatible with Revenue Canada's systems. The Minister of National Revenue is also able to set criteria to determine who is eligible to file during the period of gradual implementation of electronic filing. Initially, bulk filers (those who are in the business of filing returns on behalf of others) will be eligible to file on behalf of individuals.

Other eligibility criteria for electronic filing will be developed by the Minister.

ITA
150.1(3)

New subsection 150.1(3) of the Act deems a return of income filed electronically to be a return of income filed with the Minister of National Revenue in prescribed form. The return is deemed to be filed on the day that the Minister acknowledges its acceptance. The latter is intended to ensure that returns are received in a form compatible with Revenue Canada's systems.

ITA
150.1(4)

New subsection 150.1(4) allows for the provision of Regulations to the *Income Tax Act* to require certain persons filing tax returns electronically on behalf of other persons to obtain signed statements in prescribed form from the persons on whose behalf such returns are filed. The electronic filer and a person signing such a statement are each required to retain a copy of the statement for six years.

ITA
150.1(5)

New subsection 150.1(5) of the Act provides that new section 150.1 applies to Parts I.1 to XIII with such modifications as the circumstances require. This subsection applies to 1992 and subsequent taxation years, except in respect of Parts X, X.1, X.2, X.4, XI, and X.2 of the Act where new subsection 150.1(5) applies after 1991.

Clause 90

Reassessments

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer.

Subclause 90(1)

ITA
152(3.1)

The time within which the Minister of National Revenue may generally reassess is known as the "normal reassessment period", as defined in subsection 152(3.1) of the Act. For mutual fund trusts and corporations other than Canadian-controlled private corporations, that period is the four-year period 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. For all other taxpayers, that period has a similar starting date but runs for only three years. Subsection 152(3.1) is amended to make the definition of "normal reassessment period" apply also for the purposes of new subsection 152(4.3).

Subclause 90(2)

ITA
152(4.3) and (4.4)

New subsection 152(4.3) of the Act allows the Minister to reassess beyond the normal reassessment period for a taxation year where it is necessary to do so in order to make a recalculation of a taxpayer's "balance" for that year as a result of an adjustment to an amount deducted or included in computing a "balance" of the taxpayer for another taxation year. A "balance" of a taxpayer for a taxation year is defined in new subsection 152(4.4) as the income, taxable income, taxable income earned in Canada or any loss of the taxpayer for the year, or as the tax or other amount payable by, refundable to, or deemed to have been paid by, the taxpayer for the year.

The reassessment may be made only where the adjustment of the amount deducted or included in the other year's balance was made in an assessment for that year or as a result of a decision on an appeal from an assessment for that year. A reassessment of a taxation year under new subsection 152(4.3) outside the normal reassessment period for that year may not be made after the end of one year after all rights of objection and appeal have expired or been determined with respect to the other year. Such a reassessment may be made only where the Act requires the inclusion, or allows the deduction, in computing a taxpayer's balance for the year of an amount relating to the deduction or inclusion that was adjusted for the other year.

Under the same conditions that a Minister may make a reassessment under new subsection 152(4.3), the Minister is to make a reassessment where so requested in writing by the taxpayer.

This provision might be applied, for example, where a decision on appeal has changed the amount of a reserve claimed in a taxation year, and a subsequent taxation year for which an amount relating to the reserve is required to be included, or is allowed to be deducted, in computing income has become barred from reassessment.

A consequential amendment is made to the definition of "normal reassessment period" in subsection 152(3.1) of the Act to make the definition apply for the purposes of new subsection 152(4.3).

These amendments are applicable to reassessments and redeterminations made after Royal Assent to the implementing legislation, where the reassessment or redetermination is made as a result of an adjustment to a balance for another taxation year as a consequence of an assessment made or decision on appeal rendered with respect to that year after December 20, 1991.

Where all rights of objection and appeal with respect to the other year have expired or been determined before the date of Royal Assent to the implementing legislation, the one-year period for consequential reassessments or redeterminations with respect to preceding or subsequent taxation years shall not start to run until that date.

Clause 91

Withholding

ITA
153(1)

Subsection 153(1) of the Act authorizes the withholding of tax from any of the payments described in paragraphs 153(1)(a) to (r). The person making the payment is required to remit any tax so withheld to the Receiver General on behalf of the payee. This subsection is amended to require that remittances made after 1992 by an employer that is a "prescribed person" be made to the account of the Receiver General at a financial institution. It is intended that prescribed persons will generally be employers and payroll service companies that are required to remit amounts under subsection 153(1) of this Act, subsection 21(1) of the *Canada Pension Plan*, and subsection 53(1) of the *Unemployment Insurance Act* and that had a monthly average of the total of such amounts remitted in the second preceding calendar year of $50,000 or more.

Clause 92

Other Individuals

ITA
156(1)

Subsection 156(1) of the Act requires certain individuals, other than farmers and fishermen, to pay quarterly tax instalments based on either their estimated tax payable for the year or their instalment base for the preceding year. The instalments are due on March 15, June 15, September 15 and December 15 of the year. The amendment to subsection 156(1), which applies to 1992 and subsequent years, allows individuals to make their first two quarterly instalments on the basis of their tax payable for the second preceding year. Under this option, the amount of each of the third and fourth instalment required to be made is equal to 50% of the excess of the individual's tax liability for the preceding year over the total of the first two instalments.

Clause 93

Exemption from Instalments

ITA
156.1(2)

Section 156.1 of the Act relieves individuals from any obligation to pay instalments of taxes in certain circumstances. Subsection 156.1(2) specifically relieves the legal representative of a deceased individual from the obligation of making tax instalments on the individual's behalf that would otherwise become due after the individual's death. This subsection is amended to include a reference to paragraph 156(1)(b). This amendment, which applies to 1992 and subsequent years, is strictly consequential on the amendment made to subsection 156(1) and ensures that the legal representative will continue to benefit from this relief.

Clause 94

Corporate Income Tax Payments

ITA
157

Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable.

Subclauses 94(1) to (4)

ITA
157(1), (2) and (2.1)

Subparagraph 157(1)(a)(i) of the Act contains rules relating to the determination of a corporation's instalment liability in respect of tax payable under Parts I (Income Tax) and VI.1 (Tax on Certain Dividends). Subparagraph 157(1)(a)(i) is amended to integrate the instalment requirements for tax payable under Parts I and VI.1 with those for tax payable under Parts I.3 (Tax on Large Corporations) and VI (Tax on Financial Institutions). This amendment will ensure that a corporation will not be subject to interest or penalties on deficient instalments in respect of, for example, tax payable under Part I, where the deficiency is offset by an overpayment in respect of the instalments due under either Part I.3, VI or VI.1.

This amendment to paragraph 157(1)(b) combines the tax payable by a corporation under Part I.3 and Part VI for a taxation year with its tax payable under Part I and Part VI.1 tax for the purposes of determining the remainder of tax payable by a corporation at the final tax payment date for the year. It is intended that consequential changes to Part LIII of the Regulations be made to parallel these amendments to the Act.

Subsection 157(2) of the Act sets out conditions under which a co-operative corporation or a credit union is permitted to make only one payment of the whole of its tax estimated to be payable under Part I and Part VI.1 for a taxation year, rather than having to make instalments. Subsection 157(2) is amended to provide that this relief from the obligation to make instalment payments will apply only where the co-operative corporation or credit union, as the case may be, also has no Part I.3 or Part VI tax payable for the year or the preceding year. The subsection is further amended to provide that where a corporation is so exempted from the requirement to make instalment payments, the total of the tax payable under Parts I, I.3, VI, and VI.1 for the year must be paid at the appropriate balance due date - either two or three months after the end of the year.

Subsection 157(2.1) of the Act provides that where a corporation's tax payable under Parts I and VI.1 or its first instalment base for the year is less than $1,000, the corporation is exempt from the requirement to make instalment payments. Subsection 157(2.1) is amended as a consequence of other amendments which integrate Parts I, I.3, VI and VI.1 for the purpose of determining a corporation's instalment and final tax obligation, to add references to Parts I.3 and VI and to new subparagraphs 161(7)(a)(ix) and (x).

These amendments to section 157 of the Act apply to 1992 and subsequent taxation years.

Subclause 94(5)

ITA
157(3)(b)

Pursuant to paragraph 157(3)(b) each monthly tax instalment payment required of a private corporation in a taxation year is reduced by 1/12 of its dividend refund for the taxation year. As a consequence of the amendment to subsection 129(1) of the Act, which permits dividend refunds to be paid to non-private, as well as private, corporations, paragraph 157(3)(b) is amended to provide this relief to all corporations (other than mutual fund corporations and non-resident-owned investment corporations which are dealt with in paragraphs 157(3)(c) and (d)). This amendment applies to 1993 and subsequent taxation years.

Clause 95

Election by Trusts

ITA
159(6.1) and (7)

New subsection 159(6.1) of the Act, in conjunction with amended subsection 159(7), allow trusts to elect to pay the income tax arising from the 21-year deemed realization rule in up to 10 annual instalments. As under the similar election currently provided to individuals with respect to the deemed realization on death, interest at the prescribed rate will apply to the unpaid tax. As a condition for this election, the taxpayer must furnish security for the unpaid instalments and interest.

This amendment is applicable to 1993 and subsequent taxation years.

Clause 96

Interest

ITA
161

Section 161 of the Act provides that interest is payable by a taxpayer on any outstanding amount of tax payable under Part I for a taxation year, as well as any late or deficient instalments in respect of such tax.

Subclause 96(1)

ITA
161(1)

Subsection 161(1) is amended to add a reference to Parts I.3, VI, and VI.1 of the Act. This amendment, which applies to 1992 and subsequent taxation years, is intended, in conjunction with amendments to section 157 and other amendments to section 161 to integrate Parts I, I.3, VI, and VI.1 for the purposes of determining a corporation's instalment and final tax payment obligations (as well as its entitlement to any refund or interest thereon).

Subclause 96(2)

ITA
161(4) and (4.1)

Subsection 161(4) of the Act provides that, in calculating the interest charged on an individual's deficient tax instalments, the interest on the instalments shall be based on the lesser of the individual's tax payable for the year and the individual's tax payable for the preceding year. Revised subsection 161(4) (which now applies to farmers and fishermen) and new subsection 161(4.01) (which applies to other individuals) limit the interest charged where an individual makes tax instalments in accordance with a notice sent for this purpose by the Minister of National Revenue. In such a case, no interest is charged where the individual makes, on or before the due date, an instalment at least equal to the amount indicated on the notice.

Subsection 161(4.1) of the Act provides that, for the purposes of determining the amount of interest payable by a corporation on late or deficient instalments, the corporation is considered to have been liable to pay instalments calculated by reference to its tax payable under Parts I and VI.1 for the year, its first instalment base for the year, or a combination of its first and second instalment bases for the year, whichever method gives rise to the least amount of interest charges. Subsection 157(3) allows private corporations, mutual fund corporations and non-resident-owned investment corporations to reduce their monthly instalments to take into account their dividend refunds, capital gains refunds or allowable refunds respectively for the year. Thus, subsection 161(4.1) is amended to reflect this reduction in the amount of the monthly instalments. Paragraph 161(4.1)(a) is amended to add a reference to Parts I.3 and VI. This change is one of a number of changes designed to integrate the instalment requirements for tax payable under Parts I, I.3, VI, and VI.1.

Amendments to subsections 161(4) and (4.1) also add references in those subsections to section 163.1 of the Act, effective for instalments payable after Royal Assent. Section 163.1 provides a penalty for late or deficient instalment payments in addition to the interest charged under subsection 161(2) of the Act. The effect of the addition of references to section 163.1 in subsections 161(4) and (4.1) is to clarify that those subsections will apply for the purposes of section 163.1 of the Act, so that the penalty under that section will be determined by reference to the actual tax payable rather the taxpayer's estimate of tax payable.

These amendments apply to 1992 and subsequent taxation years, except that subsections 161(4), (4.01) and (4.1) are to be read without reference to section 163.1 with respect to instalments of tax that become payable on or before the day that these subsections receive Royal Assent.

Subclause 96(3)

ITA
161(7)

Subsection 161(7) of the Act provides that where the tax payable for a taxation year is reduced as a consequence of the carryback of a loss, tax credit or other amount from a subsequent year, interest on any unpaid tax for earlier years is calculated without regard to the reduction until generally the later of the day following the end of the subsequent year and the day on which the taxpayer's return for that subsequent year is filed. A reference to section 163.1 of the Act is added to subsection 161(7) so that in computing the penalty under section 163.1 for late or deficient tax instalment payments in respect of a taxation year, the tax payable for the year is not to be reduced as a consequence of the carryback of a loss, tax credit or other amount from a subsequent year until the same day on which it would be so reduced for purposes of computing instalment interest. This amendment is applicable with respect to instalments payable after Royal Assent.

Subclauses 96(4) to (6)

ITA
161(7)(a) and (b)

New subparagraphs 161(7)(a)(ix) and (x) of the Act are consequential on the introduction of the surtax credit under new subsection 181.1(4) and the Part I tax credit under new subsection 190.1(3), which permit a three year carry-back of such unused credits. These amendments provide that a reduction of tax resulting from the carryback of an unused surtax credit or Part I tax credit from a subsequent taxation year will not be taken into account in determining interest charges on any unpaid tax until the later of the dates noted above. New subparagraph 161(7)(a)(ix) of the Act applies to 1992 and subsequent taxation years and new subparagraph 161(7)(a)(x) applies to 1991 and subsequent taxation years.

Clause 97

Refunds

ITA
164

Section 164 of the Act provides rules relating to income tax refunds.

Subclause 97(1)

ITA
164(1.1)

Subsection 164(1.1) of the Act provides for the repayment of amounts in controversy. A taxpayer who disputes an assessment under the Act may file a notice of objection or may, in certain circumstances, appeal directly to the Tax Court of Canada from the assessment. Where the taxpayer has made payments on account of the disputed amount, or has provided security for that amount, the taxpayer is in most cases entitled to a repayment (or a return of the security). The taxpayer can keep disputed amounts until the issue is settled, although the taxpayer will be liable for interest if the assessment is upheld. Paragraph 164(1.1)(d) is amended to provide that where a taxpayer is a "large corporation" within the meaning assigned by new subsection 225.1(8) of the Act, the taxpayer is entitled to a repayment or a return of security in respect of only half of any disputed amount.

This amendment applies after the day on which it receives Royal Assent, except that a transitional rule will entitle a taxpayer that is a large corporation to be repaid three-quarters of a disputed amount, rather than half. This transitional rule applies where the taxpayer has objected to a notice of assessment mailed before 1992, and remains in force until 1994.

Subclause 97(2)

ITA
164(1.5)(b)

Subsection 164(1.5) of the Act gives the Minister of National Revenue discretion to refund all or any portion of any overpayment to which an individual or a testamentary trust may be entitled as a consequence of a requested adjustment made after the normal three year reassessment period. Subsection 164(1.5) also applies to all taxpayers where reassessments are made to take into consideration late, amended or revoked elections.

Paragraph 164(1.5)(b) is amended for the 1985 and subsequent taxation years to add a reference to subsection 220(3.1) to permit the Minister to refund part or all of a penalty or interest where the penalty or interest has been cancelled.

Subclauses 97(3) and (4)

ITA
164(3)

Subsection 164(3) of the Act provides for the payment of interest on tax refunds. For individuals, the interest is computed for the period beginning on the latest of (i) the day the taxpayer's return for the year is required to be filed (the "due date") (ii) the day the return is filed and (iii) the day the overpayment arose, and ending on the day the refund is made. The amendments to subsection 164(3), which apply to refunds relating to returns of income filed after 1992, provide that, in the case of individuals, no interest is paid on tax refunds for the 45-day period after the later of the due date of the return and the day on which the return is filed.

Subclause 97(5)

ITA
164(3.2)

Subsection 164(3.2) of the Act provides that interest will be paid on an overpayment of tax determined by reason of subsections 152(4.2) and 220(3.4) from the day that the Minister of National Revenue receives an acceptable request for an adjustment to the day the amount is refunded or applied, as the case may be. Subsection 152(4.2) of the Act gives authority to the Minister of National Revenue to make a reassessment or a redetermination after 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. 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 subsection 220(3.2), even if the normal reassessment period for that year has expired.

Subsection 164(3.2) of the Act is amended to include a reference to subsection 220(3.1). Amended subsection 220(3.1) provides for an assessment after the normal reassessment period, where the assessment results from the waiver of cancellation of a penalty or interest.

These changes apply to 1985 and subsequent taxation years.

Subclauses 97(6) and (7)

ITA
164(5) and (5.1)

Subsection 164(5) of the Act provides that where the tax payable for a taxation year is reduced as a consequence of the carryback of a loss, tax credit or other amount from a subsequent year, interest payable to a taxpayer on any resulting overpayment of tax is to be calculated as if the overpayment had arisen after the end of a subsequent year or on the date of filing of the return for the subsequent year, whichever is later.

New paragraphs 164(5)(h.2) and (h.3) of the Act are consequential on the introduction of the surtax credit under new subsection 181.1(4) and the Part I tax credit under new subsection 190.1(3), which permit a three year carryback of such unused credits. This amendment, which in respect of paragraph (h.2) is applicable to 1992 and subsequent taxation years and in respect of paragraph (h.3) is applicable to 1991 and subsequent taxation years, provides that an overpayment of tax resulting from the carryback of an unused surtax credit or Part I tax credit from a subsequent taxation year will not be taken into account in determining interest payable on a refund until the later of the dates noted above.

The provisions of subsection (5.1) of the Act parallel the rules contained in subsection 164(5) except that this provision deals with interest payable in the case of repayment of an amount in controversy rather than a refund of an overpayment of tax. The amendments to subsection (5.1) are similar to those made to subsection 164(5) which are discussed in the commentary above. These amendments are applicable to 1992 and subsequent taxation years in respect of paragraph 164(5.1)(h.2) and to 1991 and subsequent taxation years in respect of paragraph 164(5.1)(h.3).

Subclause 97(8)

ITA
164(6.1)

New subsection 164(6.1) of the Act applies to certain employee stock options in respect of which a benefit has been included in a deceased taxpayer's income by reason of paragraph 7(1)(e) of the Act. New subsection 164(6.1) has been patterned on the rule in existing subsection 164(6) of the Act applicable with respect to capital properties.

Paragraph 7(1)(e) of the Act provides that where a taxpayer holds unexercised employee stock options at the time of his or her death, an amount is to be included in the deceased's income as an employment benefit for the year in which the taxpayer dies, if the fair market value of the options exceeds their cost to the deceased. If the value of those options subsequently declines, this benefit will be overstated when compared to the benefit, if any, actually realized by the deceased's estate on the exercise of the options. Proposed subsection 164(6.1) allows the deceased's legal representative to elect to treat an amount determined under that subsection as a loss of the deceased from employment for the year in which the taxpayer died.

Proposed subsection 164(6.1) will apply where the employee stock option is exercised or disposed of by the deceased's legal representative within the first taxation year of the deceased's estate. It will also apply where the option expires within that taxation year without being exercised since the expiry of the option is treated as a disposition by reason of clause 54(c)(ii)(D) of the Act. The amount of the loss that the legal representative may elect to carry back to the taxation year in which the taxpayer died is equal to the amount of the benefit deemed to have been received by the deceased in that year by reason of paragraph 7(1)(e) in respect of the option, reduced by the excess, if any, of the value of the option immediately before the time it was exercised or disposed of over the amount paid by the deceased to acquire the option. Where a deduction was claimed under paragraph 110(1)(d) in respect of the amount included in the deceased's income by reason of paragraph 7(1)(e), the amount of the loss that may be carried back, as described above, will be further reduced by ¼.

The adjusted cost base to the estate of the option will be reduced by the amount of the loss that would be determined under new paragraph 164(6.1)(a) if that paragraph were read without reference to subparagraph (iii) thereof. Thus, any amount deducted under paragraph 110(1)(d) in respect of the option for the taxation year in which the taxpayer died is ignored in computing the adjusted cost base of the option to the estate, since the estate acquired the option at its fair market value at the time of death.

The election under new subsection 164(6.1) is to be made by the deceased's legal representative and, pursuant to anticipated amendments to the *Income Tax Regulations*, is to set out the computation of the amount determined under paragraph 164(6.1)(a). To give effect to the loss, the deceased's legal representative will be required to file an amended return of income for the deceased for the taxation year in which he or she died. The time period within which the election and amended return must be filed will be the same as that which currently exists for elections made under subsection 164(6) of the Act, as set out in subsection 1000(2) of the Regulations. As a transitional measure, however, in no case will filings in respect of subsection 164(6.1) elections be required before 90 days after December 20, 1991.

New subsection 164(6.1) of the Act is applicable in respect of deaths occurring after July 13, 1990.

Subclause 97(9)

ITA
164(7)

Subsection 164(7) of the Act defines "overpayment" for the purpose of determining the amount of the refund of Part I taxes, interest and penalties to which a taxpayer is entitled. The amendment to this subsection, which is applicable to 1992 and subsequent taxation years, extends the definition in the case of a corporation to include overpayments of taxes paid under Parts I.3, VI and VI.1 of the Act.

Clause 98

Objections to Assessments

ITA
165

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 98(1)

ITA
165(1.1)(a)

Subsection 165(1.1) of the Act restricts the matters to which a taxpayer may object in certain cases where the Minister has issued a notice of assessment or determination to those matters which gave rise to the assessment or redetermination. The amendment to paragraph 165(1.1)(a), which is applicable after Royal Assent, adds a reference to new subsection 152(4.3) of the Act to the list of those provisions under which assessments may be issued that will prompt the application of subsection 165(1.1). New subsection 152(4.3) allows reassessments in limited circumstances after the normal reassessment period for a year where the reassessment is made to conform the deduction or inclusion of an amount in the year with a related deduction or inclusion that has been the subject of an assessment or court decision in another year.

Subclause 98(2)

ITA
165(1.2)

Subsection 165(1.2) of the Act precludes a taxpayer from objecting to an assessment made under subsection 152(4.2) of the Act. Subsection 152(4.2) allows the Minister of National Revenue to reassess beyond the normal reassessment period at the request of certain taxpayers in order to give refunds or to reduce tax payable.

Subsection 165(1.2) is amended, effective on Royal Assent, to add references to new subsection 169(3) and to amended subsection 220(3.1), so that taxpayers will not be able to object to a reassessment made under new subsection 169(3) or amended subsection 220(3.1). New subsection 169(3) allows a reassessment at any time, with the consent of a taxpayer, for the purpose of disposing of an appeal. Amended subsection 220(3.1) provides for an assessment resulting from the waiver or cancellation of a penalty or interest.

Subclause 98(3)

ITA
165(3) and (4)

Paragraph 165(3)(a) of the Act provides that upon receiving from a taxpayer a notice of objection to an assessment, the Minister of National Revenue is to reconsider the assessment and either vacate, confirm or vary it or reassess, and to notify the taxpayer of that action by registered mail. One of the amendments to subsection 165(3) deletes the requirement for the mailed notice to be by registered mail. Instead, the notice given will only have to be in writing. The other amendment to subsection 165(3) repeals paragraph 165(3)(b). That paragraph allowed the taxpayer to waive reconsideration by the Minister. In such cases, if the Minister consented, an appeal to the Tax Court of Canada would then commence by the filing of a copy of the notice of objection with the Registrar of the Court. Paragraph 165(3)(b) has very seldom been used. The repeal of the paragraph is in the interest of avoiding unnecessary appeals, since in many cases where objections are filed, the objections are resolved when the assessment is reconsidered by the Minister. As a consequence of the repeal of paragraph 165(3)(b), subsection 165(4) is also repealed. Subsection 165(4) provided the effect of filing a notice of objection with the Court under paragraph 165(3)(b). These amendments are effective on Royal Assent.

Clause 99

Extension of Time

ITA
166.1(5)

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. Subsection 166.1(5) provides that, after considering such an application and either granting or refusing it, the Minister is to notify the taxpayer of the decision by registered mail. The amendment to this subsection, which applies after Royal Assent to the implementing legislation, removes the requirement for that notice to be by registered mail. Instead, the requirement will simply be that the Minister notify the taxpayer in writing.

Clause 100

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 that the assessment has been vacated or confirmed or that there has been a reassessment.

Subclause 100(1)

ITA
169(2)(a)

Subsection 169(2) of the Act restricts the matters with respect to which a taxpayer may appeal in certain cases to those matters which gave rise to the assessment or determination that is under appeal. The amendment to the subsection adds a reference to new subsection 152(4.3) of the Act to the list of those provisions under which assessments may be made that are subject to the restrictions on appeals. New subsection 152(4.3) allows reassessments in limited circumstances after the normal reassessment period for a year where the reassessment is made to conform the deduction or inclusion of an amount in the year with a related deduction or inclusion that has been the subject of an assessment or court decision in another year. As a result of this amendment to subsection 169(2), an appeal with respect to a reassessment under new subsection 152(4.3) may not raise issues other than those raised in the reassessment. This amendment to subsection 169(2) is applicable after Royal Assent.

Subclause 100(2)

ITA
169(3) and (4)

New subsection 169(3) of the Act allows the Minister of National Revenue to reassess tax, interest, penalties or other amounts payable by a taxpayer under the Act at any time, even if the normal reassessment period has expired, if the taxpayer consents in writing to the reassessment and the reassessment is made for the purpose of disposing of an appeal under the Act. This provision is applicable after Royal Assent.

New subsection 169(4) of the Act provides that the provisions of Division I of Part I of the Act are applicable, with such modifications as the circumstances require, in respect of a reassessment made under new subsection 169(3) as though the reassessment had been made under the normal reassessment provision in section 152 of the Act. Division I sets out rules relating to reassessments. New subsection 169(4) is applicable after Royal Assent.

Clause 101

Institution of Appeals

ITA
175

Section 175 of the Act provides rules governing the institution of an appeal to the Tax Court of Canada. In a case where a taxpayer has chosen under paragraph 165(3)(b) of the Act to appeal to the Court with respect to an assessment without having the assessment reconsidered by the Minister of National Revenue, paragraph 175(1)(b) and subsections 175(2) and (3) describe how the appeal is to be instituted, including rules relating to the service of documents. Paragraph 175(1)(b) and subsections 175(2) and (3) are repealed, effective after Royal Assent, as a consequence of the repeal of paragraph 165(3)(b). The repeal of paragraph 165(3)(b) is explained in the commentary on that paragraph.

Clause 102

Grounds for Appeals

ITA
179.1

Section 179.1 of the Act authorizes a penalty where an appeal is groundless and the appeal was instituted for the purpose of deferring the payment of tax. On application by the Minister, the Tax Court of Canada may order the taxpayer to pay to the Receiver General up to 10% of the amount that was in controversy, whether or not the Court has awarded costs in the appeal. Section 179.1 is amended to specify that it can apply with respect to any part of an appeal, as well as to the entire proceeding. The amendment therefore enables the Court to distinguish between those parts of an appeal for which there are reasonable grounds, and those for which there are none. If the court finds that part of the appeal was groundless and was raised in order to defer tax, the Court will be able to require the taxpayer to pay up to 10% of the amount disputed in that part of the appeal.

This amendment applies only to appeals instituted after June 30, 1992.

Clause 103

Individual Surtax

ITA
180.1

Section 180.1 of the Act imposes a surtax on individuals at a rate of 5% of tax payable under Part I of the Act. An additional 5% surtax is imposed on that portion of an individual's Part I tax in excess of $12,500.

Subclause 103(1)

ITA
180.1(1)(a)

This amendment to paragraph 180.2(1)(a) of the Act reduces the rate of the general surtax from 5% to 4 1/2% for 1992 and to 3% for 1993 and subsequent years. The rate of the additional surtax remains at 5%.

Subclause 103(2)

ITA
180.1(1.1)

Subsections 180.1(1.1) and (1.2) allow two deductions in computing an individual's surtax. However, the amount of the deduction allowed under each of these subsections can only be determined by knowing the deduction, where applicable, that is permitted by the other subsection. This amendment, which is applicable to the 1988 and subsequent taxation years, corrects this circularity.

Clause 104

Part I.3: Definitions

ITA
181(1)

Subsection 181(1) of the Act provides the definition of "long-term debt" for the purposes of Part I.3. This definition is relevant in determining the capital of, and consequent tax payable under Part I.3 by, financial institutions. Paragraph (b) of this definition relates to financial institutions other than banks, and the amendment to this paragraph provides that the long-term debt of a prescribed federal Crown corporation is not to include any debt issued to and held by the federal government. The effect of this amendment, which applies to 1991 and the subsequent taxation years, is to exclude such debt from the determination of the capital on which Part I.3 tax is levied.

Clause 105

Part I.3:
Large Corporations Tax

ITA
181.1

Part I.3 of the Act levies a tax on capital employed in Canada by large corporations.

Subclause 105(1)

ITA
181.1(2)

Subsection 181.1(2) of the Act deals with the situation where a corporation has a short taxation year. If the taxation year of the corporation is less than 51 weeks, the Part I.3 tax payable by the corporation for the year will be prorated on the basis of the number of days in the year over 365. This subsection is amended for 1992 and subsequent taxation years to ensure that the deduction in new subsection 181.1(4) in respect of the amount of surtax attributable to a short taxation year is applied after prorating the corporation's Part I.3 tax under subsection 181.1(2).

Subclause 105(2)

ITA
181.1(3)(f)

Subsection 181.1(3) of the Act exempts certain corporations from tax under Part I.3. New paragraph 181.1(3)(f) extends the Part I.3 tax exemption to co-operative corporations, as defined in subsection 136(2) of the Act, that have as their principal business the marketing or processing of natural products of their members or customers. The exemption provided under this amendment applies to taxation years ending after June 1989.

Subclause 105(3)

ITA
181.1(4)

Under the existing provisions of the Act, corporations are permitted to reduce their Part I tax payable by an amount set, in part, by reference to their tax payable under Part I.3. New subsection 181.1(4) of the Act reverses the current system for 1992 and subsequent taxation years by providing a deduction under Part I.3 in respect of a corporation's "Canadian surtax payable".

A corporation may deduct, in computing its tax payable under Part I.3 of the Act for a taxation year, an amount equal to the total of its Canadian surtax payable for the year and such amount as it chooses of its unused surtax credits for the seven preceding and three following taxation years that end after 1991.

ITA
181.1(5)

New paragraph 181.1(5)(a) of the Act provides that unused surtax credits, as defined in new subsection 181.1(6), must be utilized in the order in which they arose so that, for example, an unused surtax credit for a corporation's 1992 taxation year must be claimed before a credit in respect of its 1993 taxation year may be used. New paragraph 181.1(5)(b) of the Act ensures that an unused surtax credit claimed in a particular taxation year may not be deducted again in a subsequent year.

ITA
181.1(6)

New subsection 181.1(6) of the Act defines the term "unused surtax credit" for the purposes of determining the amount a corporation is permitted to deduct from its Part I.3 tax payable for 1992 and subsequent taxation years pursuant to new subsection 181.1(4). The "unused surtax credit" of a corporation for a taxation year ending after 1991 is the amount by which its Canadian surtax payable for the year exceeds the total of its Part I.3 tax payable (determined before deducting any amount under new subsection 181.1(4)) and any unused Part I.3 tax credits for taxation years ending before 1992 that were carried forward and deducted against the tax payable under Part I for the later year.

This subsection also provides that the definition of "Canadian surtax payable" in subsection 125.3(4) is to apply for the purposes of Part I.3 of the Act.

ITA
181.1(7)

New subsection 181.1(7) of the Act restricts the amount deductible in respect of a corporation's surtax liability where control of the corporation has been acquired either prior to or after the taxation year in which that liability arose. In such circumstances, Canadian surtax payable by the corporation for a taxation year ending before control was acquired is deductible (pursuant to the carryover provisions and subject to the limitations set out in new subsection 181.1(4)) in a taxation year ending after control is acquired only if the business to which the tax relates is carried on throughout that later year and only against the portion of the corporation's Part I.3 tax payable for the later year that relates to that business or similar businesses. Similar restrictions apply in deducting an unused surtax credit for a taxation year ending after the time at which control of a corporation has been acquired in computing Part I.3 tax payable for a taxation year ending before that time.

Clause 106

Part I.3: Calculation

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 Part I.3.

Subclause 106(1)

ITA
181.2(3)(d)

Subsection 181.2(3) of the Act defines the capital of a corporation (other than a financial institution or corporation not resident in Canada) for the purposes of Part I.3. Included, under paragraph 181.2(3)(d), in the capital of a corporation is the amount of its indebtedness at the end of the year represented by bonds, debentures, notes, mortgages or similar obligations.
Paragraph 181.2(3)(d) is amended to include in the capital of a corporation the amount of its indebtedness at the end of the year evidenced by bankers' acceptances drawn by the corporation. This amendment has effect with respect to taxation years ending after December 20, 1991.

Subclauses 106(2) and (3)

ITA
181.2(4) and (6)

Subsection 181.2(4) of the Act defines the "investment allowance" of a corporation (other than a financial institution), which represents the value of certain investments in other corporations and which may be deducted in computing its taxable capital for the purposes of Part I.3. New paragraph 181.2(4)(d.1) provides that a corporation will also be entitled to an investment allowance for certain debts owed to the corporation by a partnership, where all of the members of the partnership are corporations as well. No allowance is available, however, with respect to a debt owed by a partnership to one of its members or where any of the members of the partnership are either financial institutions or corporations (other than non-resident corporations that at no time in the year carried on business in Canada through a permanent establishment) that are exempt from tax under Part I.3. This amendment applies to 1991 and subsequent taxation years.

New subsection 181.2(6) provides that where, in certain circumstances, a trust is used as a conduit for loaning money from a corporation to another related corporation (other than a financial institution), the loan will, for the purposes of determining the first corporation's investment allowance under subsection 181.2(4), be considered to have been made directly from the lending corporation to the borrowing corporation. This new subsection will apply after June 1989.

Clause 107

Part I.3: Financial Institutions

ITA
181.3(1)(a)

Section 181.3 of the Act provides rules for determining several amounts relevant in computing the tax payable under Part I.3 of the Act by a financial institution. Subsection 181.3(1) applies in determining an institution's taxable capital employed in Canada and, by virtue of paragraph 181.3(1)(a), includes the carrying value at the end of the year of the institution's tangible property used in Canada. This amendment to paragraph 181.3(1)(a) provides that a financial institution's tangible property used in Canada will not include any property acquired by the institution, in the year or the preceding taxation year, through foreclosure or otherwise as a result of the default or anticipated default on a debt owed to the institution and held primarily for the purpose of resale.

This amendment applies to taxation years ending after June 1989.

Clause 108

Part I.3: Returns

ITA
181.6

Section 181.6 of the Act requires a corporation liable to pay tax under Part I.3 of the Act for a taxation year to file a return containing an estimate of its tax payable. This section is amended, for 1992 and subsequent taxation years, to provide that such a return must be filed where a corporation, but for the deduction under new subsection 181.1(4), would have been liable to pay tax under Part I.3.

Clause 109

Part I.3: Administration

ITA
181.7

Sections 181.7 to 181.9 of the Act are repealed as a consequence of the integration of the provisions relating to interest, instalments, and the remainder of tax payable for Parts I, I.3, VI and VI.1 of the Act. New section 181.7 replaces section 181.9 and provides that certain provisions of Part I of the Act relating to assessments, interest, penalties, objections and appeals apply equally to Part I.3. As a consequence of the new deduction provided under subsection 181.1(4), which permits a three year carryback of unused surtax credits, the section is further amended to provide that a corporation may require a reassessment of its tax payable under Part I.3 for a taxation year where it has claimed a deduction under new subsection 181.1(4) in respect of an unused surtax credit from a subsequent taxation years. This amendment applies to 1992 and subsequent taxation years.

Clause 110

Part IV Tax

ITA
186

The purpose of the tax levied under Part IV of the Act is to prevent individuals from benefitting from the deferral of tax that would otherwise be possible if, instead of receiving dividends directly, they arranged to have their investments in shares held by a corporation. Because dividends are generally received tax-free by corporations, the interposition of a holding company would, in the absence of Part IV tax, provide a significant deferral of tax for these individuals. Section 186, therefore, imposes a tax of 25% on dividends received by a corporation that is a private or a subject corporation at any time in the year in which the dividends are received. This tax is fully refunded to the corporation, as a dividend refund under section 129, upon the payment of taxable dividends to its shareholders.

Subclause 110(1)

ITA
186(1)(a)

Paragraph 186(1)(a) of the Act includes in the Part IV tax base dividends from corporations with which the recipient corporation is not connected (i.e., generally from corporations in which the shareholder corporation has no more than a 10% interest). This paragraph is amended to subject to Part IV tax only such dividends that are received at a time when the shareholder is a private or subject corporation.

Subclause 110(2)

ITA
186(1)(b)

Where a corporation that has paid tax under Part IV on dividends received by it or that has paid refundable taxes on other investment income subsequently pays taxable dividends it is entitled to a refund of tax. Where such dividends are received by a connected corporation, paragraph 186(1)(b) of the Act levies Part IV tax on the recipient of the dividend in an amount calculated by reference to the dividend refund in respect thereof obtained by the corporation that paid the dividend. Like paragraph 186(1)(a), paragraph 186(1)(b) is amended to exact Part IV tax only on dividends received when the shareholder is a private or subject corporation.

Subclause 110(3)

ITA
186(1)(b)(iii)

Subparagraph 186(1)(b)(iii) of the Act is amended as a consequence of the amendment to subsection 129(1), which permits a dividend refund to be paid to a corporation only for dividends paid by it while it is a private corporation or a subject corporation. Accordingly, since the amount of Part IV tax levied under paragraph 186(1)(b) on a dividend received by a corporation that is connected to the dividend-paying corporation is intended to equal the portion of the payer's dividend refund that was received by it by virtue of the payment of that dividend,
subparagraph 186(1)(b)(iii) is amended to refer to dividends paid by the payer corporation at a time when it was a private corporation or a subject corporation.

Subclause 110(4)

ITA
186(5)

Subsection 186(5) of the Act provides that a subject corporation (as defined in subsection 186(1)) is considered to be a private corporation for the purposes of section 129 and certain other provisions in order that the corporation may claim a dividend refund under section 129 of Part IV tax paid in respect of its dividend income. This rule applies only if the corporation was a subject corporation at the end of the taxation year for which the dividend refund is claimed. This amendment deletes this requirement as a consequence of the amendment to subsection 129(1) which permits the payment of dividend refunds to all corporations, rather than only those corporations which are private corporations at the end of the taxation year for which the refund is claimed.

The amendments described in subclauses (1) to (3) apply to dividends received after 1992. The amendment described in subclause (4) applies to 1993 and subsequent taxation years.

Clause 111

Part VI Tax

ITA
190.1(2)

Part VI of the Act levies a tax on capital employed in Canada by large financial institutions. Subsection 190.1(2) of the Act deals with the situation where a corporation has a short taxation year. If the taxation year of the corporation is less than 51 weeks, the Part VI tax payable by the corporation for the year will be prorated on the basis of the number of days in the year over 365. This subsection is amended for 1991 and subsequent taxation years to ensure that the deduction in new subsection 190.1(3) in respect of the amount of Part I tax attributable to the short taxation year is applied after prorating the corporation's Part VI tax payable under subsection 190.1(2).

ITA
190.1(3)

Under the current provisions of the Act, a financial institution is permitted to reduce its Part I tax liability by the amount of its Part VI tax payable. New subsection 190.1(3) reverses the current system for 1992 and subsequent taxation years (and for 1991, where a special election is made) by providing a credit under Part VI in respect of a corporation's tax payable under Part I of the Act.

A corporation may deduct in computing its tax payable under Part VI of the Act for a taxation year an amount equal to the total of its Part I tax liability for the year and such amount as it chooses of its unused Part I tax credits and unused surtax credits for the seven preceding and three following taxation years that end after 1991 (or after 1990, where the special election is made).

ITA
190.1(4)

New paragraph 190.1(4)(a) of the Act provides that unused Part I tax credits and unused surtax credits, as defined in subsection 190.1(5), must be utilized in the order in which they arose so that, for example, an unused Part I tax credit for a corporation's 1992 taxation year must be claimed before a credit in respect of its 1993 taxation year may be utilized. New paragraph 190.1(4)(b) of the Act ensures that an unused Part I tax credit or an unused surtax credit claimed in a particular taxation year may not be deducted again in a subsequent year.

ITA
190.1(5)

New subsection 190.1(5) of the Act defines the term "unused Part I tax credit" for the purposes of determining the amount a corporation is permitted to deduct from its Part VI tax payable for 1992 and subsequent taxation years pursuant to new subsection 190.1(3). The "unused Part I tax credit" of a corporation for a taxation year ending after 1991 is the amount by which its tax payable under Part I for the year exceeds the total of its Part VI tax payable (determined before deducting any amount under new subsection 190.1(3)) and the corporation's Canadian surtax payable for the year. This definition is applicable to 1992 and subsequent taxation years and, where a corporation has so elected, its 1991 and subsequent taxation years (in which latter case the reference in the preceding sentence to 1991 should be read as 1990).

This subsection also provides that the definition of "unused surtax credit" in subsection 181.1(6) is to apply for the purposes of Part VI of the Act.

ITA
190.1(6)

New subsection 190.1(6) of the Act restricts the amount deductible under Part VI in respect of a corporation's Part I tax liability where control of the corporation has been acquired either prior to or after the taxation year in which that liability arose. In such circumstances, Part I tax payable by the corporation for a taxation year ending before control was acquired is deductible (pursuant to the carryover provisions and subject to the limitations set out in new subsection 190.1(4) in a taxation year ending after control is acquired only if the business to which the tax relates is carried on throughout that later year and only against the portion of the corporation's Part VI tax payable for the later year that relates to that business or similar businesses. Similar restrictions apply in deducting a credit in respect of Part I tax for a taxation year ending after the time at which control of a corporation has been acquired in computing Part VI tax payable for a taxation year ending before that time.

Clause 112

Part VI Tax: Capital Deduction

ITA
190.15(6)

Section 190.14 of the Act provides, for the purposes of the tax on financial institutions under Part VI, an investment allowance in respect of shares and certain debts of a financial institution that are held by a related institution. Under section 190.15 of the Act, a financial institution is entitled to a deduction of between $200 and $220 million in determining the base capital on which Part VI tax is levied. Where the institution is a member of a related group of financial institutions, this capital deduction must be shared among the members of the related group.

New subsection 190.15(6) provides that, for the purpose of sections 190.14 and 190.15, financial institutions will not be considered to be related merely because of the existence of a right to acquire control of a corporation or as a result of control of the corporations by Her Majesty in right of Canada or a province. This new subsection is to apply with respect to the 1989 and subsequent taxation years.

Clause 113

Part VI: Returns

ITA
190.2

Section 190.2 of the Act requires a corporation liable to pay tax under Part VI of the Act for a taxation year to file a return containing an estimate of its tax payable. This section is amended for 1991 and subsequent taxation years to provide that such a return must be filed where a corporation, but for the new deduction under subsection 190.1(3), would have been liable to pay tax under Part VI.

Clause 114

Part VI: Administration

ITA
190.21 to 190.24

Sections 190.21 to 190.24 of the Act are repealed as a consequence of the integration of the provisions relating to interest, instalments and the remainder of tax payable for Parts I, I.3, VI and VI.1 of the Act. New section 190.21 replaces section 190.24 and provides that certain provisions of Part I of the Act relating to assessments, interest, penalties, objections and appeals apply equally to Part VI. As a consequence of the new deduction provided under subsection 190.1(3), which permits a three-year carryback of unused Part I tax credits, the section is further amended to provide that a corporation may require a reassessment of its tax payable under Part VI where it has claimed a deduction under new subsection 190.1(3) as a result of a carryback of an unused Part I tax credit or unused surtax credit from a subsequent taxation year.

This amendment applies to 1992 and subsequent taxation years. However, subsection 190.24 of the Act has also been amended, with effect only for the 1991 taxation year, to provide that a corporation that has elected to have new subsections 190.1(3) to (6) apply to such years may require a reassessment of its tax for the year due to a carryback of an unused Part I tax credit or unused surtax credit from a subsequent year.

Clause 115

Part VI.1 Tax

ITA
191(3)

Part VI.1 of the Act provides for a special tax to be paid by a corporation with respect to dividends, other than excluded dividends, paid by it on taxable preferred shares. Under subsection 191(1), excluded dividends include dividends paid by the corporation to a shareholder that had a "substantial interest" in the corporation at the time the dividend was paid. The definition of substantial interest is contained in subsection 191(2), but is subject to certain limitations set out in subsection 191(3).

Paragraphs 191(3)(a) and (b) of the Act provide that an interest acquired in a corporation will be deemed not to be a substantial interest where the principal purpose of the acquisition was to avoid the application of Part IV.1 (a tax on the recipients of certain dividends) or Part VI.1. These paragraphs are amended with respect to dividends paid or received after December 20, 1991, to extend the application of paragraphs 191(3)(a) and (b) to situations in which an interest is acquired to avoid the application of Part I of the Act.

Where a shareholder of a corporation is a trust, it is generally deemed by paragraph 191(3)(d) not to have a substantial interest in the corporation except where it is a trust in which only one person is "beneficially interested" or in which all persons who are "beneficially interested" in the trust are related to each other. The definition of "beneficially interested" is provided through a cross reference to subsection 94(7). This paragraph is amended, effective January 1, 1991, to eliminate this cross reference. The cross reference is no longer necessary because new subsection 248(25) provides the same definition of "beneficially interested" for the purposes of the Act.

Clause 116

Part VI.1: Administration

ITA
191.4(2)

Subsection 191.4(2) of the Act provides that certain provisions of Part I of the Act relating to assessments, interest, penalties, objections and appeals apply equally to Part VI.1.
Subsection 191.4(2) is amended to delete the reference therein to subsection 161(1) and (2). This change is consequential on the integration, in section 161 of the Act, of the provisions relating to interest payable on overdue taxes and late or deficient instalments for Parts I, I.3, VI and VI.1.

Clause 117

Net Past Service Pension Adjustment

ITA
204.2

Part X.1 of the Act imposes a tax on excess contributions to registered retirement savings plans (RRSPs). Excess contributions made by a taxpayer after 1990 are measured by the cumulative excess amount of the taxpayer in respect of RRSPs, as computed pursuant to subsection 204.(1.1). Subsection 204.2(1.3) defines, for the purpose of this computation, a taxpayer's net past service pension adjustment. This definition is similar to the definition of net PSPA set out in paragraph 146(1)(d.1) of the Act.

The amendments to subsection 204.2(1.3), which are effective after 1988, are the same as those to paragraph 146(1)(d.1). For a description of the amendments, reference may be made to the commentary on paragraph 146(1)(d.1).

Clauses 118 and 119

National Labour-Sponsored Venture Capital Corporations

ITA
204.8 and 204.81

Part X.3 of the Act deals with national labour-sponsored venture capital corporations (NLSVCCs), the shares of which are eligible for a tax credit under subsection 127.4(2).

NLSVCCs are required to make "eligible investments", which include debt and shares issued by qualifying corporations and partnerships. Under paragraph (f) of the definition of "eligible investments" in section 204.8 of the Act, a qualifying corporation or partnership (and all corporations related to it) cannot have more than a total of $35 million in assets. This paragraph is amended so that the $35 million limit is increased to $50 million.

A NLSVCC is required to be incorporated by a "national central labour body", that receives Class B shares of the NLSVCC and appoints at least half of the board of directors of the NLSVCC. A "national central labour body" is an organization composed of 2 or more interprovincial trade unions. Part X.3 of the Act is further amended so that the definition of "national central labour body" is replaced by the new definition of "eligible labour body". An "eligible labour body" includes a single interprovincial trade union, in addition to an organization composed of 2 or more such unions.

These amendments are applicable to 1992 and subsequent taxation years.

Clause 120

Foreign Property Tax

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.

Paragraph 206(2)(a) is amended so that this tax will not be imposed in respect of property that was not foreign property when it was acquired, but that subsequently becomes foreign property. This may be the case, for example, in respect of the shares of a Canadian corporation the value of which, at any time, becomes primarily derived from portfolio investments in foreign property. Under the amendment, the shares in such a case would not be subject to the foreign property limits until two years after such time.

New subsection 206(3.1) extends the relief provided by the amendment to paragraph 206(2)(a). It applies to two cases. The first case is where a corporate security that is foreign property to a taxpayer is exchanged for another corporate security that is foreign property to the taxpayer, in the course of a corporate merger or reorganization of capital or a transaction in which there is a change of control of the corporation which issued the first-mentioned security. In these circumstances, where the other security was not subject to the foreign property limits for a two year period described in paragraph 206(2)(a), the new security will likewise not be subject to the limits for the same period.

The second case to which subsection 206(3.1) applies is where a corporate security that is not foreign property is exchanged, in the course of a merger of two or more corporations or of a transaction in which there is change of control of the corporation which issued the security for another security that is foreign property. In these circumstances, the new security will not be subject to the foreign property limits for two years after the merger.

These amendments are applicable to months ending after December 20, 1991.

Clause 121

RCA Rules

ITA
207.6(6)

New subsection 207.6(6) of the Act sets out a number of new rules that apply to plans and arrangements that are prescribed for the purposes of the provisions of the Act relating to retirement compensation arrangements (RCAs). It is proposed that a new section 6803 be added to Part LXVIII of the *Income Tax Regulations* to prescribe specific plans and arrangements for this purpose. The purpose of subsection 207.6(6) is to extend the RCA rules to certain plans and arrangements maintained by the provincial and federal governments. However, it is proposed that subsection 103(7) of the Regulations be amended so that there is no withholding requirement at the time that amounts are credited under these plans and arrangements.

It is proposed that a particular plan or arrangement be prescribed for the purposes of subsection 207.6(6) (and new clause 8(1)(m.2)(iii)(C)) only where all of the following conditions are satisfied:

- the plan or arrangement is established to provide retirement benefits for employees in respect of years after 1991 and is not a registered pension plan,
- the government responsible for the plan or arrangement applies for it to be prescribed,
- a single account is established in the accounts of the government of Canada or of a province in respect of the plan or arrangement to which are credited actual employee and employer contributions, refunds under subsection 207.7(2) and any other amounts required by the plan or arrangement to be credited to the account and to which are debited distributions under the plan or arrangement, and
- the balance in the account can, at all times, reasonably be expected to approximate or exceed the actuarial liabilities for benefits payable under the plan or arrangement.

Under paragraph 207.6(6)(a), a prescribed plan or arrangement is treated as a retirement compensation arrangement. Under paragraph 207.6(6)(b), any amount credited to the account established in connection with the plan in the accounts of Canada or a province is, with the exception of a refund of RCA tax determined under subsection 207.7(2), treated as a contribution to the plan or arrangement. As a consequence, such credited amounts are subject to the RCA tax. Under paragraph 207.6(6)(c), the custodian of the plan or arrangement is Her Majesty, either in right of Canada or a particular province, depending on which government establishes the plan or arrangement. Finally, paragraph 207.6(6)(d) provides that the balance in the account is considered to be cash. This results in the plan or arrangement being able to take advantage of the election in subsection 207.5(2) should the plan or arrangement terminate.

This amendment is applicable after 1991.

Clause 122

Tax on Designated Income of Certain Trusts

ITA
Part XII.2

Part XII.2 of the Act imposes a special tax on the designated income of certain trusts with regard to distributions to non-resident beneficiaries.

New subsection 210.2(1.1) of the Act extends the tax under Part XII.2 to amateur athlete trusts, which are provided for in new section 143.1, in circumstances where amounts are distributed by such trusts to non-resident beneficiaries. This amendment is applicable after December 31, 1991.

Clause 123

Non-Resident Withholding Tax

ITA
212

Section 212 of the Act imposes a withholding tax on certain payments to non-residents.

Subclause 123(1)

ITA
212(1)(b)(iv)

Subparagraph 212(1)(b)(iv) of the Act provides an exemption from non-resident withholding tax for interest payable on certain obligations to a person holding a valid certificate of exemption issued under subsection 212(14). New subparagraph 212(1)(b)(iv) provides that this exemption is to be available only where the payer and the recipient of the interest deal at arm's length.

This amendment applies with respect to amounts paid or credited after 1991, under obligations issued after 1991. Where an obligation was issued before 1992, the amendment will apply only to amounts paid or credited after 1992.

Subclause 123(2)

ITA
212(1)(b)(vii)(F)

Subparagraph 212(1)(b)(vii) of the Act provides an exemption from non-resident withholding tax for interest paid to an arm's length lender on a corporate debt obligation under which the issuer cannot be required to repay more than 25% of the principal within five years of the date of issue. New clause 212(1)(b)(vii)(F) provides that interest paid on a corporate debt obligation will not be disqualified from this exemption merely because the borrower may be required to make an early repayment of the debt as a consequence of the death of the lender. This amendment applies to interest paid or credited after 1991.

Subclause 123(3)

ITA
212(1)(h)(iii.1)

Paragraph 212(1)(h) of the Act provides for withholding tax in respect of the payment of pension benefits to non-residents, with certain exemptions. The exemptions are extended to include pension benefits that are transferred, pursuant to an authorization in prescribed form, to a registered retirement income fund (RRIF) where subsection 147.3(9) would exclude the pension benefits from the non-resident person's income if the person were a Canadian resident. This amendment, which is applicable for payments made after August 29, 1990, is consequential to the amendments to section 147.3 permitting the direct transfer of amounts from registered pension plans to RRIFs.

Subclause 123(4)

ITA
212(1)(t) and (u)

New paragraph 212(1)(t) provides for the application withholding tax under Part XIII in respect of amounts paid to a non-resident taxpayer out of the taxpayer's NISA Fund No. 2 (as defined in subsection 248(1)). This new paragraph applies with respect to payments made after 1990.

New paragraph 212(1)(u) of the Act extends the application of the Part XIII withholding tax to any amount that is paid by an amateur athlete trust (which is described in new section 143.1) to a non-resident beneficiary, that would have been included in the beneficiary's income for a year if Part I were applicable. This tax will apply in respect of such payments made after 1991.

Clause 124

Non-Arm's Length Disposition of Shares

ITA
212.1(3)(d)

Subsection 212.1 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 by a non-resident of shares from one Canadian corporation to another Canadian corporation. Paragraph 212.1(3)(a) treats a non-resident as not being at arm's length with the transferee corporation if the non-resident was, immediately before the transfer, one of a group of less than 6 persons that controlled the acquired corporation and, immediately after the transfer, was a member of the same group that controlled the transferee corporation.

Subsection 212.1(3) is amended by adding new paragraph 212.1(3)(d), effective for dispositions occurring after December 20, 1991. It provides that:

(1) in determining whether a corporation is controlled by a group of persons, a group in respect of that corporation means any two or more persons each of whom owns shares of the corporation,

(2) a corporation can be considered to be controlled by a person or particular group of persons notwithstanding that the corporation is also controlled by another person or group persons. As a consequence, a corporation can be considered to be controlled at the same time by several persons or groups of persons, and

(3) a group controls a corporation notwithstanding that one member of that group has control of the corporation.

Clause 125

Deemed Payments

ITA
214

Section 214 of the Act sets out special rules relating to the application of non-resident withholding tax.

Subclause 125(1)

ITA
214(3)(k) and (l)

Subsection 214(3) of the Act deems certain income amounts to be payments for the purposes of Part XIII. New paragraph 214(3)(k) is consequential on new section 143.1 of the Act, which provides special rules for amateur athlete trusts. This new paragraph, which applies to amounts distributed by such trusts after 1991, ensures that distributions under such arrangements which would be included in the income of the beneficiary if Part I applied, will be treated as amounts paid for the purposes of Part XIII.

New paragraph 214(3)(l) of the Act is consequential to new subsection 12(10.2), which concerns the inclusion in income of amounts paid out of a taxpayer's NISA Fund No. 2 (as defined in subsection 248(1) of the Act). This paragraph applies after 1990.

Subclause 125(2)

ITA
214(8)(c)

Where a non-resident transfers a debt obligation to a resident at a price exceeding the amount for which it was issued, subsection 214(7) of the Act treats the excess as a payment of interest for the purpose of the non-resident withholding tax in Part XIII of the Act. This rule does not apply, however, if the debt obligation is an "excluded obligation". Subsection 214(8) lists debt obligations that are excluded obligations for the purpose of subsection 214(7). Pursuant to paragraph 214(8)(c), an obligation is excluded if it was issued for at least 97% of its principal amount and its annual yield is not more than 4/3 of the interest stipulated to be payable on the obligation.

Paragraph 214(8)(c) is amended to limit the exclusion in that paragraph to debt obligations that are not indexed debt obligations, as defined in subsection 248(1). Consequently, subsection 214(7) will apply with respect to the transfer of an indexed debt obligation by a non-resident to a resident, unless the obligation is an excluded obligation pursuant to paragraph 214(8)(a) or (b) or is excluded by reason of paragraph 214(7)(c). This amendment is applicable in respect of indexed debt obligations issued after October 16, 1991.

It should be noted that subsection 214(7) will, by reason of subsection 214(14), apply where an indexed debt obligation is redeemed or cancelled. However, to the extent that the excess of the redemption price over the issue price is already treated as interest by paragraph 16(6)(c), subsection 214(7) will not cause the same amount to be treated as another payment of interest. It should be noted that subsection 214(10) of the Act may enable a non-resident to recover a portion of the amount withheld under Part XIII where the non-resident has not held an indexed debt obligation from its date of issue.

Clause 126

Branch Tax

ITA
219

Part XIV of the Act levies a tax, generally referred to as the "branch tax", on corporations (other than Canadian corporations), carrying on business in Canada. In computing the amount on which this tax for a corporation is based, paragraph 219(1)(a.3) adds the amount of any resource allowance claimed by the corporation and paragraph 219(1)(e) subtracts tax payable by the corporation under Part I.

Paragraph 219(1)(a.3) is amended so that, where a corporation claims a deduction under paragraph 20(1)(v.1) by reason of being a member of a partnership, the amount on which Part XIV tax is levied is not affected. This amendment is strictly consequential to the changes to subsection 96(1) under which resource allowance may no longer be claimed at the partnership level. It is applicable after December 20, 1991.

Paragraph 219(1)(e) is amended, effective for taxation years ending after June 1989, so that any taxes payable under Part I.3 and VI of the Act may also be deducted in computing the amount on which a corporation's branch tax liability is based.

Clause 127

Income Tax Administration

ITA
220

Section 220 of the Act sets out a number of rules relating to the administration and enforcement of the *Income Tax Act.*

Subclause 127(1)

ITA
220(2.1)

New subsection 220(2.1) of the Act applies to 1992 and subsequent taxation years and provides discretion to the Minister of National Revenue to waive any requirement in the *Income Tax Act* or Regulations to file a prescribed form, receipt or other document, or to provide prescribed information. Even though the Minister may have waived such a requirement, the document or information must be provided if subsequently requested by the Minister.

Subclause 127(2)

ITA
220(3.1)

Subsection 220(3.1) of the Act gives the Minister of National Revenue discretion to waive or cancel a penalty or interest payable under the Act.

Subsection 220(3.1) is amended to provide for an assessment resulting from the waiver or cancellation of a penalty or interest, where the year being reassessed is beyond the normal reassessment period. This change applies to 1985 and subsequent taxation years.

Subclause 127(3)

ITA
220(4.1)

Subsection 220(4.1) of the Act permits a taxpayer who objects to or appeals from an assessment under the Act to provide security to the Minister instead of paying the disputed amount while the objection or appeal is outstanding. Subsection 220(4.1) is amended to provide that the Minister is not required to accept security for a disputed amount to the extent that that amount may be collected under new subsection 225.1(7) of the Act. Subsection 225.1(7) permits the Minister to collect one half of any amount disputed by a large corporation (within the meaning assigned by new subsection 225.1(8) of the Act); this right of collection is limited only by the discretion retained by the Minister to accept security under subsection 220(4) of the Act.

This amendment applies upon Royal Assent.

Clause 128

Re-appropriation of Amounts

ITA
221.2

In certain situations, a taxpayer may wish to have amounts paid on one account transferred to another account. This may occur where a taxpayer has overpaid on one liability and underpaid on another. In the absence of any special provisions, this situation would give rise to interest being charged on the deficiency despite the fact that an amount that would eliminate the shortfall had been paid on another account.

New section 221.2 is intended to provide explicit authority for the Minister of National Revenue to accept transfers of payments from one tax account to another, and from one year to another. Under this new provision, which applies after Royal Assent, any amount transferred - at the taxpayer's request and with the Minister's concurrence - from one account to another will be treated as though it had never been paid on account of the first account, and had initially been a payment made in respect of the second.

Clause 129

Certification of an Amount Payable

ITA
223(3)

Section 223 of the Act allows the Minister of National Revenue to register with the Federal Court a certificate specifying an amount payable by a taxpayer under the Act, the *Unemployment Insurance Act*, the *Canada Pension Plan* or the income tax law of a province with which the federal government has a tax collection agreement. When registered, the certificate has the same effect as if it were a judgment of the Court for the amount specified plus interest. Subsection 223(3) is amended, effective after Royal Assent, to clarify that the interest that is applicable is the rate provided for by the statute under which the amount certified is payable (for example, the *Income Tax Act* or the *Canada Pension Plan*), rather than interest as provided under the *Federal Court Act.*

Clause 130

Garnishment

ITA
224(1.2)

Subsection 224(1.2) of the Act provides the Minister of National Revenue with an enhanced garnishment power to intercept payments that are owed to a tax debtor or to a secured creditor of the tax debtor who has a security interest such as an assignment of trade receivables. Upon receipt of an enhanced garnishment letter by a person who owes money to another person who has failed to remit source deductions, the garnished amount becomes the property of Her Majesty and must be paid to the Receiver General in priority over any security interest in that money.

This amendment to subsection 224(1.2), which applies on Royal Assent, clarifies that the money that is the subject of an enhanced garnishment letter becomes property of Her Majesty only to the extent of the tax debtor's liability for unremitted source deductions as assessed by the Minister.

Clause 131

Collection Restrictions

ITA
225.1

Section 225.1 of the Act restricts the collection of unpaid amounts for which a taxpayer has been assessed under the Act where the taxpayer objects to or appeals from the assessment. In most cases, the Minister of National Revenue is precluded from taking any of various collection actions, listed in paragraphs 225.1(1)(a) to (g), until either 90 days have passed since the assessment or any objection or appeal by the taxpayer has been disposed of.

Subclauses 131(1) and (2)

ITA
225.1(1) and (2)

Subsection 225.1(1) of the Act precludes the Minister from taking collection actions until 90 days have passed since the mailing of a notice of assessment; subsection 225.1(2) similarly precludes those actions until 90 days have passed since the mailing of a confirmation or variation of an assessment to which the taxpayer has objected. These provisions are amended, effective upon Royal Assent, to clarity that the period during which the Minister's actions are restricted includes the day that is 90 days after the day on which the notice of assessment or the confirmation or variance is mailed.

Subclause 131(3)

ITA
225.1(7) and (8)

New subsection 225.1(7) of the Act overrides the normal rules in subsections 225.1(1) to (4), and allows the Minister of National Revenue to collect one half of any assessed amount disputed by a "large corporation" – a term defined for this purpose in new subsection 225.1(8)

New subsection 225.1(7) provides that where a large corporation is assessed an amount under the Act, the Minister may, despite subsections 225.1(1) to (4), collect part of the amount assessed. A taxpayer has 90 days to object to or appeal from an assessment: during that period, the Minister may collect up to one half of the assessed amount. After the time for objections or appeals has elapsed, the Minister may collect the amount, if any, by which the assessed amount exceeds the total of amounts previously collected and one half of any amount in controversy.

New subsection 225.1(8) of the Act defines "large corporation" for the purposes of new subsection (7) of the Act. A corporation is a large corporation in a particular taxation year if it meets either of two tests. The first test is whether tax under Part I.3 of the Act (the "large corporations tax" or "LCT") was payable by it for the particular year (or, where the particular year ended before the introduction of the LCT in July 1989, for the corporation's first taxation year ending after June 1989). This test is set out in paragraph 225.1(8)(a). It should be noted that, for the purposes of new subparagraph 225.1(8)(a)(i), a corporation formed through an amalgamation or merger is deemed to be the same corporation as and a continuation of each of its predecessors.

The second test, found in paragraph 225.1(8)(b) of the Act, provides that a corporation is a large corporation if, at the end of the particular year, it is related to a corporation that is itself a large corporation in its taxation year that includes the end of the particular year. Only corporations that are related for the purposes of section 181.5 are related for the purposes of this paragraph.

New subsections 225.1(7) and (8) apply after the day on which they receive Royal Assent, except that a transitional version of new subsection 225.1(7) will allow the Minister to collect only one-quarter of a disputed amount. This transitional rule applies where the taxpayer has objected to a notice of assessment mailed before 1992, and remains in force until 1994.

Clause 132

Amounts Withheld

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 132(1) and (3)

ITA
227(8)(b) and 227(9)(b)

Subsection 227(8) of the Act imposes a two-tier penalty for failure to deduct or withhold an amount as required by subsection 153(1) or section 215. Paragraph 227(8)(a) imposes a penalty of 10% of the amount that should have been deducted or withheld under subsection 153(1) or section 215 for the first failure in a calendar year to deduct or withhold such an amount. Paragraph 227(8)(b) imposes a second-tier penalty of 20% of the amount not deducted or withheld, where, at the time of the failure, a penalty under subsection 227(8) had previously been assessed against the same person during the same calendar year.

Subsection 227(9) imposes a similar two-tier penalty for failure to remit or pay an amount deducted or withheld as and when required under the Act or a regulation.

The circumstances in which the second-tier penalties under paragraphs 227(8)(b) and (9)(b) will apply are amended so that after 1992 (except with respect to amounts required to be remitted before 1993) the second-tier penalties will not apply unless the failure to deduct or withhold under subsection 227(8), or the failure to remit or pay under subsection 227(9), was made knowingly or under circumstances amounting to gross negligence.

Subclauses 132(2) and (5)

ITA
227(8.5) and 227(9.5)

Subsection 227(8.5) of the Act modifies the application of the two-tier penalty under subsection 227(8) where a person has failed to deduct or withhold amounts under paragraph 153(1)(a) in respect of salary, wages or other remuneration paid by two or more offices or establishments of the payer. It provides that the second-tier penalty under paragraph 227(8)(b) applies only where the payer has already been assessed a penalty under subsection 227(8) for failing to deduct or withhold another amount during that calendar year in respect of a similar payment it made from the same establishment. This prevents a failure by one establishment from triggering a second-tier penalty in another establishment upon that other establishment's first failure to deduct or withhold an amount.

Subsection 227(9.5) of the Act provides a similar rule which modifies the application of the two-tier penalty under subsection 227(9) where a person has failed to remit or pay an amount deducted or withheld under paragraph 153(1)(a).

Both subsections 227(8.5) and (9.5) are repealed applicable after 1992 (except with respect to amounts required to be remitted before 1993). In their place, new subsection 227(9.5) simply deems each establishment of a person to be a separate person for the purpose of applying the second-tier penalties in paragraphs 227(8)(b) and 227(9)(b).

Subclause 132(4)

ITA
227(9.1)

Subsection 227(9.1) of the Act restricts the application of the penalty contained in subsection 227(9) for late or deficient remittances to the amount by which the total of the required remittance of source deductions and amounts required to be remitted under the *Canada Pension Plan* and the *Unemployment Insurance Act*, 1971 for the particular period exceeds $500. This $500 threshold does not apply where the person required to remit such amounts has wilfully delayed in remitting or has wilfully remitted less than the required amount. As a consequence of the amendment to paragraph 227(9)(b) which makes the two-tiered penalty applicable in cases of gross negligence, the two occurrences of the word "wilfully" in subsection 227(9.1) are replaced with "knowingly or under circumstances amounting to gross negligence", applicable after 1992 (except with respect to amounts required to be remitted before 1993).

Clause 133

Receipts for Political Contributions

ITA
230.1

Section 230.1 of the Act requires certain books and records to be kept and returns of information to be filed in respect of contributions to political parties and candidates. The amendments to this section are intended to provide for the retention of more specific information in order to verify the accuracy of claims for income tax credits arising from such contributions and to eliminate requirements for information that may be redundant.

The amendment to subsection 230.1(1) ensures that the duplicate receipts, which registered agents of political parties and official agents of candidates are required to keep, contain the same prescribed information as the receipts which are issued to individuals making the contributions. The amendment to subsection 230.1(2) eliminates the requirement that duplicate receipts be filed with the Minister of National Revenue, consequential on the amendment to subsection 230.1(1). This amendment also updates a reference to a section of the *Canada Elections Act*. Subsection 230.1(4) is amended as a consequence of the amendment to subsection 230.1(2).

These amendments are applicable to 1992 and subsequent taxation years.

Clause 134

Filing Requirements for Non-Profit Organizations

ITA
233

Section 233 of the Act authorizes the Minister of National Revenue to demand information from persons who are required to file information returns by virtue of a regulation made under paragraph 221(1)(d). The amendments to this section broaden that authority, so that the Minister may make such a demand in any case where an information return is required to be filed under the Act or the *Income Tax Regulations*. Thus, for example, such a demand may be made where an information return is required to be filed by virtue of new subsection 149(12), or under existing section 233.1. This amendment is applicable after Royal Assent.

Clause 135

Penalty

ITA
235

Section 235 of the Act provides a 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). The penalty is ¼ of 1% per month after the filing deadline on the combined amount payable under the large corporations tax and the financial institutions capital tax.

The description of A in the formula used in section 235 is amended for 1991 and subsequent taxation years to provide that the penalty is imposed on the Parts I.3 and VI tax payable before any amount is deducted under either subsection 181.1(4) or 190.1(3). The amendment is consequential on the new tax credits under Parts I.3 and VI.

Clause 136

Offences

ITA
239(2.2), (2.21) and (2.22)

Section 239 of the Act establishes various offences. Existing subsection 239(2.2) provides that the unauthorized use or communication of tax information by any person constitutes an offence punishable on summary conviction by a fine of up to $5,000 and imprisonment for up to 12 months. That subsection is replaced by new subsections 239(2.2) and (2.21), each of which establishes an offence, and new subsection 239(2.22), which defines terms used in subsections 239(2.2) and (2.21).

Subsection 241(1) of the Act prohibits disclosure of information obtained for the purposes of the Act where the disclosure is made knowingly by an official except as authorized by that section. Subsection 241(4) allows information to be provided to certain persons for specific purposes. Existing subsection 239(2.2) makes it an offence for any person to contravene subsection 241(1) or to use or communicate information provided to that person under subsection 241(4) for any purpose other than the purpose for which it was provided.

The amendments leave the offence for contravening subsection 241(1) in subsection 239(2.2) and move the offence relating to subsection 241(4) to new subsection 239(2.21). The penalty is the same for both subsections, but new subsection 239(2.21) applies only to officials in the case of information provided under paragraph 241(4)(a) and new paragraph 241(4)(e), whereas subsection 239(2.2) applies to any person. "Official" is defined for that purpose in new subsection 239(2.22) as having the same meaning as provided in subsection 241(10) of the Act. Basically, officials are current and former federal and provincial government employees and agents. In the case of information provided under paragraph 241(4)(b), (c), (e), (h) or (k), new paragraph 239(2.21)(a) provides that the offence for misuse or unauthorized communication of the information will apply to any person to whom the information has been provided under that paragraph. Paragraphs 241(4)(d) and (i) only allow information to be given to officials, so the offence for misuse or unauthorized disclosure of information provided under those paragraphs will be confined to officials in new paragraph 239(2.21)(b).

These amendments are in part consequential on new paragraph 241(4)(a), which allows taxpayer information to be provided by an official to any person for the purpose of administering or enforcing the Act, the *Canada Pension Plan* or the *Unemployment Insurance Act.* This authority to disclose information for administrative purposes clarifies that taxpayer information may be used, for example, to locate tax debtors or to determine if an amount that could be garnished is owing to a tax debtor. In such cases, it may be necessary that some information about a tax debtor be disclosed to persons who are not government employees in order to obtain information from those persons.

Section 239 is also amended as a consequence of other amendments to subsection 241, such as the addition of new paragraphs 241(4)(f) and (h) and subsection 241(4.1). Paragraph 241(4)(h) allows taxpayer information to be provided to any person for the purpose of supervision, evaluation or discipline of an employee of Revenue Canada, Taxation. New subsection 241(4.1) allows the person presiding at a legal proceeding relating to the supervision, evaluation or discipline of a Revenue Canada, Taxation employee to order such measures as the person may deem necessary to ensure that taxpayer information disclosed in the course of that proceeding is not used or provided to any person for any purpose not relating to that proceeding. The contravention of an order made under new subsection 241(4.1) is made an offence under subsection 239(2.2). New subsection 239(2.21) also makes it an offence for any person to whom information has been provided under paragraph 241(4)(h) in relation to the supervision or discipline of a Revenue Canada, Taxation employee to misuse or make an unauthorized disclosure of that information.

New paragraph 241(4)(f) allows the communication of taxpayer information for the purposes of the remission and debt write-off provisions in sections 23 to 25 of the *Financial Administration Act.* Such information may be communicated to either officials or persons other than officials. For example, in the case of a remission of tax, taxpayer information relating to the remission may be published in the Canada Gazette. Because the reference to new paragraph 241(4)(f) is added to new paragraph 239(2.2)(b) rather than new paragraph 239(2.2)(a), where taxpayer information is provided to a person under new paragraph 241(4)(f), subsection 239(2.21) will apply to use or disclosure of that information by that person only where that person is an official.

New subsection 239(2.21) applies with respect to "taxpayer information". The term "taxpayer information" is defined in new subsection 239(2.22) as having the same meaning as provided in its new definition in subsection 241(10). The definition excludes information that does not directly or indirectly reveal the identity of the taxpayer to whom it relates.

The amendments to section 239 are applicable on Royal Assent.

Clause 137

Communication of Information

ITA
241

Section 241 of the Act prohibits the use or communication by an official of information obtained under the Act unless specifically authorized by one of the exceptions found in that section.

The amendments to section 241:

- adopt a new definition of "taxpayer information" for the purpose of describing the kind of information that is subject to the rules against unauthorized use or disclosure: taxpayer information does not include information that does not reveal the identity of the taxpayer to whom it relates;

- amend paragraph 241(3)(a) to allow the use of taxpayer information in criminal proceedings that have been commenced by the preferring of an indictment;

- amend paragraph 241(3)(b) to allow the use of taxpayer information in legal proceedings relating to the administration or enforcement of a federal or provincial law providing for the imposition or collection of a tax or duty;

- adopt terminology that is more consistent with the offence provisions in subsections 239(2.2) and (2.21); in particular, the new wording refers to providing information rather than communicating information;

- delete references to the *Petroleum and Gas Revenue Tax Act* by providing in new subsection 241(11) that references in subsections 241(1), (3), (4) and (10) to "this Act" include references to the *Petroleum and Gas Revenue Tax Act*;

- add references, in paragraph 241(1)(c), (3)(b) and (4)(a) and the definitions "authorized individual" and "authorized person" in subsection 241(10), to the *Canada Pension Plan* and the *Unemployment Insurance Act*; these new references reflect the fact that officials of Revenue Canada, Taxation use taxpayer information for the purpose of administering parts of those statutes;

- allow taxpayer information to be provided to any official – federal or provincial - for the purposes of the administration or enforcement of a federal law providing for the imposition or collection of a tax or duty or for preparing to administer a fiscal policy;

- add new subsection 241(3.1), which allows the Minister of National Revenue to disclose taxpayer information to alert appropriate persons of situations involving imminent danger of death or physical injury to any individual;

- add new paragraph 241(4)(h) and subsection 241(4.1) and revise the definition of "authorized person" in subsection 241(10); these amendments relate to the disclosure of taxpayer information for the purposes of the supervision and discipline of employees of Revenue Canada, Taxation;

- clarify that taxpayer information may be disclosed to provincial governments for the purpose of the evaluation or formulation of fiscal policy;

- provide, in new paragraph 241(4)(g), that taxpayer information may be used to compile statistical information or other information that does not reveal the identity of the taxpayers to whom it relates;

- provide, in amended subsection 241(5), that taxpayer information can be disclosed to anyone with the consent of the taxpayer to whom it relates;

- delete existing paragraph 241(4)(e), subparagraphs 241(4)(f)(iv) and (vi) and paragraphs 241(4)(h.1) and (h.2) because the authority provided by those paragraphs is provided by new paragraphs 241(4)(a) and (b); new paragraph 241(4)(b) corresponds to existing paragraph 241(4)(d) and allows taxpayer information to be disclosed to a taxpayer who needs it for the purpose of determining tax or other amounts payable by or to the taxpayer under the Act;

- clarify in paragraph 241(4)(a) that taxpayer information may be provided to any person for the purposes of administering or enforcing the Act, the *Canada Pension Plan* or the *Unemployment Insurance Act*;

- allow taxpayer information (such as an address) relating to a particular taxpayer to be used for the purpose of providing that taxpayer with information;

- eliminate the need for regulations made for the purposes of existing subparagraph 241(4)(f)(iii) and paragraph 241(4)(h) to describe programs referred to in the corresponding provisions in new subparagraphs 241(4)(d)(v) and (x);

- regroup a number of the paragraphs and subparagraphs of subsection 241(4) into new paragraph 241(4)(d), which lists government officials to whom taxpayer information may be given for specific purposes;

- add to new paragraph 241(4)(d) new subparagraph (xiv), which allows the communication of information for the purposes of the set-off provisions in section 7.1 of the *Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act*;

- list, in new paragraph 241(4)(e), a number of federal statutes which relate to the disclosure of taxpayer information;

- provide, in new paragraph 241(4)(f), that taxpayer information may be provided for the purposes of the remission and debt write-off provisions in sections 23 to 25 of the *Financial Administration Act*;

- broaden the definition of "official" in subsection 241(10) to include persons engaged, or formerly engaged, by or on behalf of Her Majesty, and amend the definition of "authorized person" in that subsection to exclude provincial civil servants and provincial Crown agents.

The amendments to section 241 are applicable on Royal Assent.

The concordance between the provisions of existing section 241 and new section 241 is as follow:

Existing Section 241		New Section 241
241(1)		241(1)
(2)		(2)
(3)		(3)
(4)(a)		(4)(a)
(b)		(d)(iii)
(c)		(k)
(d)		(b)
(e)	deleted because covered by	(b)
(e.1)		(c)
(f)(i)		(d)(i)
(ii)		(ii)
(iii)		(v)
(iv)	deleted because covered by	(a)
(v)		(d)(iv)
(vi)	deleted because covered by	(a)
(f.1)		(d)(viii)
(g)		(ix)
(h)		(x)
(h.1)	deleted because covered by	(b)
(h.2)	deleted because covered by	(b)
(i)		(e)(v)
(j)		(d)(vii)
(k)		(xi)
(l)		(xii)
(m)		(xiii)
(5)		(5)
(6)		(6)
(7)	(not amended)	(7)
(8)	(not amended)	(8)
(10)		(10)

New Section 241		Existing Section 241
241(1)		241(1)
(2)		(2)
(3)		(3)
(3.1)	(new)	
(4)(a)		(4)(a)
(b)		(d)
(c)		(e.1)
(d)(i)		(f)(i)
(ii)		(ii)
(iii)		(b)
(iv)		(b)
(v)		(f)(iii)
(vi)		(f)(v)
(vii)		(j)
(viii)		(f.1)
(ix)		(g)
(x)		(h)
(xi)		(k)
(xii)		(l)
(xiii)		(m)
(xiv)	(new)	
(e)(i)	(new)	
(ii)	(new)	
(iii)	(new)	
(iv)	(new)	
(v)		(i)
(vi)	(new)	
(vii)	(new)	
(viii)	(new)	
(ix)	(new)	
(x)	(new)	
(xi)	(new)	
(xii)	(new)	
(f)	(new)	
(g)	(new)	
(h)	(new)	
(i)	(new)	
(j)	(new)	
(k)		(c)
(4.1)	(new)	
(5)		(5)
(6)		(6)
(7)	(not amended)	(7)
(8)	(not amended)	(8)
(10)		(10)

Clause 138

Administration and Enforcement

ITA
244(21) and (22)

This amendment to section 244 of the Act adds two new subsections.

New subsection 244(21) of the Act applies to 1992 and subsequent taxation years and is consequential on the introduction of new section 150.1 dealing with electronic filing. New subsection 244(21) of the Act provides that a document presented by the Minister of National Revenue purporting to be a print-out of the information received by the Minister under section 150.1 from a person will be *prima facie* proof of the return filed by that person on behalf of the taxpayer.

New subsection 244(22) of the Act applies after 1991 and provides that an information return filed electronically at any time in the manner described in new section 150.1 will be deemed to have been filed at that time with the Minister of National Revenue. A document presented by the Minister purporting to be a print-out of the information so received by the Minister will be *prima facie* proof of the information return.

Clause 139

Interpretation

ITA
248

Section 248 of the Act defines a number of terms which apply for the purposes of the Act, and also sets out various rules relating to the interpretation and application of various provisions of the Act.

Subclause 139(1)

248(1)

"person"

The amendment in subsection 248(1) to the definition of "person" broadens its application to include any tax-exempt entity described in subsection 149(1) of the Act. Where such entities do not take the form of corporations or trusts, it is intended that they be subject to the obligations imposed upon persons under the Act or regulations, including, where applicable, the requirement to file information returns contained in new subsection 149(12). This amendment applies after Royal Assent.

Subclause 139(2)

ITA
248(1)

"cost amount"

Subsection 248(1) defines "cost amount" which is used throughout the Act, particularly in provisions relating to the transfer of properties to or from corporations, trusts and partnerships.

The definition of "cost amount" with respect to eligible capital property in paragraph 248(1)(d) of the Act is amended to multiply by 4/3 the prorated cumulative eligible capital to take account the 3/4 inclusion rate with respect to eligible capital property. The amendment to this definition is intended to provide consistent treatment with respect to those provisions of the Act providing for the transfer of eligible capital property between taxpayers and in which the term "cost amount" is used. This amendment is applicable, in the case of corporations, to taxation years commencing after June 1987, and in any other case, to fiscal periods commencing after 1987.

Paragraph (e) of that definition defines that amount, in respect of property that is a debt owing to the taxpayer or any other right of the taxpayer to receive an amount, as being the amortized cost of the property or, where the property does not have an amortized cost to the taxpayer, as being the amount of the debt or right that was outstanding at that time. Paragraph (e) is amended, applicable to 1991 and subsequent taxation years, to exclude from its application a "net income stabilization account" (see below for the commentary concerning the definition of this account).

The cost amount of a NISA Fund No. 1 is determined under paragraph (b) of the definition of "cost amount" as being the taxpayer's adjusted cost base in respect of the non-depreciable property. In this latter regard, paragraph 54(a) defines the adjusted cost base of non-depreciable capital property to be the "capital cost" of the property to the taxpayer. Generally, the capital cost of a NISA Fund No. 1 is the amount contributed to the fund by the taxpayer less any withdrawals.

With respect to the "cost amount" of a taxpayer's NISA Fund No. 2, paragraph (f) of the definition of "cost amount" provides that the taxpayer's cost amount is the "cost" of the property to the taxpayer except to the extent that such cost has been deducted from income. In this regard, a NISA Fund No. 2 does not include contributions made to the NISA by the respective farm producers. Accordingly, a taxpayer's cost and cost amount in respect of the taxpayer's NISA Fund No. 2 is nil.

Subclause 139(3)

ITA
248(1)

"death benefit"

The term "death benefit" is defined in subsection 248(1) of the Act to be an amount received by a person upon or after the death of an employee in recognition of the employee's service in an office or employment minus a portion of the amount which is exempt from taxation. Where the recipient is the employee's surviving spouse, the exempt portion is the first $10,000 of the benefit. Where more than one taxpayer other than a surviving spouse receive benefits in respect of an employee, the $10,000 exempt portion is apportioned among them, based on the amount received by each of them. This amendment, which limits the application of the former rule to situations where there is a benefit to only one surviving spouse, ensures that the apportionment rule applies where a benefit is paid to more than one surviving spouse of the deceased employee. This situation may arise as a result of the introduction of subsection 252(4) which extends, for all purposes of the Act, the meaning of "spouse" to a taxpayer who is cohabiting in a conjugal relationship with a person of the opposite sex and who either has so cohabited with the person throughout a preceding 12-month period or is a parent of a child of whom the person is a parent. This amendment applies to 1993 and subsequent years.

Subclause 139(4)

ITA
248(1)

"personal trust"

A "personal trust" is currently defined as a testamentary trust or an *inter vivos* trust in which no beneficial interest was acquired for consideration payable to the trust. However, the mere retention of an interest in an *inter vivos* trust by the individual or related individuals who settled the trust will not disqualify a trust as a personal trust. Property may be distributed on a tax-free basis to a beneficiary under a personal trust pursuant to subsection 107(2).

The "personal trust" definition is expanded so that any one person may acquire a beneficial interest in a trust for consideration payable to the particular trust, without the trust being disqualified as a personal trust. The same rule applies to a group of two or more "related" persons. (For this purpose, a person and a particular trust which is a beneficiary under another trust are "related" if the person is a beneficiary or is related to a beneficiary under the particular trust. Two trusts which are beneficiaries under a third trust are "related" if a beneficiary under the first trust is a beneficiary or is related to a beneficiary under the second trust.)

This amendment is applicable after 1987.

Subclause 139(5)

ITA
248(1)

"small business corporation"

The definition of "small business corporation" in subsection 248(1) is amended to treat the fair market value of a corporation's net income stabilization account (NISA) as being nil for the purposes of that definition. In effect, whether or not a particular corporation is a small business corporation will be determined without reference to the existence of a NISA. This amendment is applicable to 1991 and subsequent taxation years.

Subclause 139(6)

ITA
248(1)

"specified shareholder"

The amendment to the definition of "specified shareholder" in subsection 248(1) provides a rule for determining whether a beneficiary of discretionary trust is a specified shareholder. This definition is relevant to a number of provisions of the Act, including the attribution rules in sections 74.4 and 74.5.

Paragraph (b) of the definition of "specified shareholder" provides that for the purposes of the definition, each beneficiary of a trust is deemed to own a proportion of the shares of a corporation owned by the trust. New paragraph (e) of the definition, which is applicable after 1991, provides that, notwithstanding paragraph (b), where a discretionary trust owns shares in a corporation, any beneficiary capable of benefitting under that trust will be considered to own each share of the corporation held by the trust.

Subclause 139(7)

ITA
248(1)

"amateur athlete trust"

Subsection 248(1) of the Act is amended to provide that the term "amateur athlete trust" has the meaning described in new subsection 143.1(1) for all purposes of the Act. This amendment applies to the 1988 and subsequent taxation years.

"indexed debt obligation"

Subsection 248(1) of the Act is amended to add the definition of "indexed debt obligation". This term is used in new subsection 16(6), new paragraphs 53(1)(g.1) and (2)(1.1) and amended paragraph 214(8)(c) of the Act, which set out the tax treatment of such obligations.

An indexed debt obligation is a debt obligation that provides for an adjustment to an amount payable determined by reference to a change in the purchasing power of money. By way of example, a debt obligation that provides for a lower-than-market rate of interest but also provides for payment to the investor on maturity of the amount invested plus an amount that offsets the loss in purchasing power of the amount invested while the obligation was outstanding, as measured by reference to the Consumer Price Index, would be an indexed debt obligation. This definition applies to debt obligations issued after October 16, 1991.

"net income stabilization account"
"NISA Fund No. 2"

For the purposes of the Act, a "net income stabilization account" ("NISA") means an account of a taxpayer under the "net income stabilization program" under the *Farm Income Protection Act.*

A taxpayer's NISA is made up of two separate funds. Fund No. 1 of a NISA represents amounts contributed on an after-tax basis by a farm producer to a NISA. Fund No. 2 is discussed below. Further details in respect of both funds are provided in the *Farm Income Protection Act.*

"NISA Fund No. 2" means the portion of a taxpayer's NISA described in paragraph 8(2)(b) of the *Farm Income Protection Act.* This paragraph provides that Fund No. 2 includes all amounts paid to a NISA in respect of a farm producer other than producer contributions. In effect, a taxpayer's NISA Fund No. 2 is the portion of the NISA that includes all third party contributions, interest and bonuses credited to the producer's NISA. These amendments are applicable to 1991 and subsequent taxation years.

Subclause 139(8)

ITA
248(9.1) and (9.2)

New subsection 248(9.1) of the Act provides that a trust is considered to have been created by a taxpayer's will if it was created under the terms of the will or by a court order in relation to the taxpayer's estate that provides for support or relief of the taxpayer's dependants pursuant to provincial law. This provision replaces a narrower rule that was found in subsection 70(6.1) of the Act, and is applicable to 1990 and subsequent taxation years.

New subsection 248(9.2) applies to a number of rollover provisions in the Act which allow for the deferral of accrued gains on property of a deceased taxpayer transferred to a spouse, child or grandchild of the taxpayer, or to a trust for the spouse of the taxpayer. These rollover provisions apply in respect of eligible property "vested indefeasibly" in a qualifying individual or trust within a 36-month or longer period following the death of the transferor.

Subsection 248(9.2) clarifies that, for the purposes of the Act, eligible property will be considered to have become "vested indefeasibly" in a qualifying individual only before the death of the qualifying individual and, in a trust for a spouse, only before the death of the spouse. This amendment ensures that a rollover of property on the death of an individual to a qualifying individual or spousal trust is permitted only in circumstances where appropriate gains will be recognized on the death of the beneficiary spouse under the spousal trust or the qualifying individual. It is applicable in respect of deaths occurring after December 20, 1991.

Subclause 139(9)

ITA
248(11)

Subsection 248(11) of the Act provides that interest computed at a prescribed rate under certain provisions of the Act is to be compounded on a daily basis. References are added in this subsection to new subsections 129(2.1) and (2.2), 131(3.1) and (3.2), 132(2.1) and (2.2) and 133(7.01) and (7.02) of the Act so that interest required to be computed at the prescribed rate under those provisions is also required to be compounded daily. Those new provisions generally relate to interest on various kinds of refunds, as explained in the commentary on those provisions.

Subsection 248(11) is also amended to refer to interest being "applied", since some provisions of the Act allow interest payable by the Minister of National Revenue to a taxpayer to be applied to a liability of the taxpayer rather than paid to the taxpayer. The amendments to subsection 248(11) are applicable with respect to refunds paid or applied for taxation years commencing after 1991.

Subclause 139(10)

ITA
248(25)

New subsection 248(25) of the Act provides that a person or partnership is "beneficially interested" in a trust if that person or partnership has any right whatsoever to receive income or capital of the trust, whether directly or indirectly through one or more trusts. This subsection applies for the purposes of the Act as a whole and, as a result, replaces subsections 74.5(10) and 94(7).

This amendment is applicable as of January 1, 1991.

Clause 140

Extended Meaning of "Spouse" and "Former Spouse"

ITA
252

Section 252 of the Act provides an extended meaning of the terms "child", "parent", "spouse", "former spouse", "brother", "sister", "parent" and "grandparent" for the purposes of the Act.

Subclauses 140(1), (2) and (3)

ITA
252(2), (3) and (4)

Subsection 252(3) of the Act provides that, for a number of purposes, "spouse" and "former spouse" include a party to a void or voidable marriage. Subsection 252(3) is amended so that this rule also applies for the purposes of subsections 70(6) and 104(4) and paragraph 108(1)(f.2), each of which relates to spousal trusts, as well as for the purposes of the definition of "exempt beneficiary" in subsection 104(5.4). The amendment also provides that this rule applies to new subsections 70(6.1), 73(5) and 104(5.1), relating to transfers of a taxpayer's NISA Fund No. 2 to the taxpayer's spouse. This amendment is applicable to 1991 and subsequent taxation years.

New subsection 252(4), which applies after 1992, provides that the term "spouse" of a taxpayer includes a person of the opposite sex who is cohabiting with the taxpayer in a conjugal relationship and has so cohabited with the taxpayer throughout a preceding twelve-month period or is a parent of a child of whom the taxpayer is also a parent. The amendment to subsection 252(2), which amends the definitions "brother", "grandparent", "parent" and "sister" and which adds the definitions "aunt or great-aunt", "uncle or great-uncle" and "niece or nephew", applies after 1992 and is consequential on the extended meaning of "spouse" in subsection 252(4).

Clause 141

Guaranteed Shares

ITA
258(3)

Clause 247 of Bill C-18 (1991) amended the coming-into-force provision of an amendment in S.C. 1988, c. 55 to subsection 258(3) of the *Income Tax Act*, which treats certain dividends as having been received in the form of interest. The purpose of clause 247 was to clarify the application of three provisions:
paragraph 258(3)(b) of the Act, as it existed prior to its amendment in 1988; the current version of the same provision; and
subsection 258(5) of the Act. As it is expressed, clause 247 of Bill C-18 may be construed as providing that the pre-1988 version of subsection 258(3) is applicable in respect of shares issued after June 18, 1987. To avoid this unintended result, this amendment modifies subsection 258(3) itself, rather than its coming-into-force, and will ensure that the three provisions in question apply as follows:

- former (pre-June 18, 1987) paragraph 258(3)(b) applies to shares last acquired before 8:00 p.m., June 18, 1987;

- amended (post-June 18, 1987) paragraph 258(3)(b) generally applies to shares issued before, but last acquired after, 8:00 p.m., June 18, 1987; and

- subsection 258(5) applies to shares (other than grandfathered shares) issued or deemed to have been issued after 8:00 p.m., June 18, 1987.

As a result of this amendment, which takes effect on the same basis as the amendment to subsection 258(3) in S.C. 1988, c. 55, clause 247 of Bill C-18 is to be repealed.

Clause 142

Qualified Trusts

ITA
259(3)(c)

Section 259 of the Act permits a "qualified trust" to make an election so that its beneficiaries will be considered to hold a proportionate interest in the underlying assets of the trust for the purposes of the qualified investment and foreign property provisions of the Act. The expression "qualified trust" is defined in subsection 259(3) and excludes a trust which has, at any time, borrowed money.

Paragraph 259(3)(c) is amended so that "qualified trusts" are permitted to borrow money after 1990 for a term of not more than 90 days, provided that the borrowing is not part of a series of loans or other transactions and repayments. This is consistent with the short-term borrowing privileges permitted for "master trusts" that are prescribed, pursuant to paragraph 149(1)(o.4), in section 5001 of the *Income Tax Regulations.*

Clause 143

Remittances

Subclause 143(1)

CPP
21(1)

Subsection 21(1) of the *Canada Pension Plan* authorizes employers to withhold required employee CPP contributions. The employer is required to remit the withheld amounts to the Receiver General at the prescribed time. This subsection is amended to require that remittances made after 1992 by an employer that is a "prescribed person" be made to the account of the Receiver General at a financial institution. It is intended that prescribed persons will generally be employers and payroll service companies that are required to remit amounts under subsection 153(1) of the *Income Tax Act*, subsection 21(1) of this Act, and subsection 53(1) of the *Unemployment Insurance Act* and that had a monthly average of the total of such amounts remitted in the second preceding calendar year of $50,000 or more.

Subclause 143(2)

CPP
21(7)(b)

Subsection 21(7) of the Act imposes a two-tier penalty on an employer who, in a calendar year, fails to remit to the Receiver General an amount that was required to be remitted under the Act. Paragraph 21(7)(a) imposes a penalty of 10% of the amount not remitted for a first time failure. Paragraph 21(7)(b) imposes a second-tier penalty of 20% of the amount not remitted, where, at the time of the failure, a penalty under subsection 21(7) has previously been assessed against the same employer during the same calendar year. The circumstances in which the second-tier penalty under paragraph 21(7)(b) will apply are amended so that after 1992 (except with respect to amounts required top be remitted before 1993) the second-tier penalty of 20% will not apply unless the failure to remit was made knowingly or under circumstances amounting to gross negligence.

Clause 144

Applications and Appeals

CPP
27(4)

Section 27 of the *Canada Pension Plan* (CPP) provides for applications to the Minister of National Revenue for the determination of questions concerning liability to make CPP contributions. It also provides for appeals to the Minister for the reconsideration of assessments made by the Minister as to amounts payable under the CPP. Subsection 27(4) provides that applications and appeals under section 27 are to be in prescribed form and sent by registered mail to the Deputy Minister of National Revenue for Taxation at Ottawa. Subsection 27(4) is amended, with respect to applications and appeals made after Royal Assent, to remove the requirement that the application or appeal be made in prescribed form and by registered mail and to provide, instead, that the application or appeal is to be addressed to the Chief of Appeals in a District Office of the Department of National Revenue, Taxation and delivered or mailed to that office.

Clause 145

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.

Subsection 33(2) of the *Canada Pension Plan* provides special rules for individuals whose chief source of income is farming or fishing. These individuals must remit on or before December 31 of the year two-thirds of the CPP contributions in respect of their estimated self-employed earnings from farming or fishing for the year. The remainder is required to be paid before the individual's balance-due day. The amendment to this subsection, which applies to 1992 and subsequent years, allows such an individual to make the December 31 instalment of CPP contributions on the basis of the individual's self-employed earnings for the preceding year.

Subsection 33(3) of the *Canada Pension Plan* provides that, in the case of individuals (other than individuals whose chief source of income is farming or fishing), instalments of CPP contributions in respect of their estimated self-employed earnings for a year are required to be made on or before the 15th day of March, June, September and December of the year. This subsection is first amended to allow an individual to use as the basis the individual's self-employed earnings for the preceding year. This subsection is also amended to permit individuals to make their first two CPP instalments for a year on the basis of 25% of their CPP contributions required to be made on their self-employment earnings for the second preceding year. Under this option, the amount of each of the third and fourth instalments of these individuals is equal to 50% of the excess of their CPP instalments required for the preceding year over the total of the first two instalments. These amendments apply to 1992 and subsequent years.

Clause 146

Interest on Unpaid Contributions

CPP
34(3) and (4)

Section 34 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 the "balance-due day" of the person for the year, which is generally April 30 of the following year.

Subsection 34(3) of the *Canada Pension Plan* provides that the interest charged on an individual's deficient CPP instalments shall be based on the excess of the individual's required CPP contributions for the year over $40. Revised subsection 34(3) (which now applies to individuals whose chief source of income is farming or fishing) and new subsection 34(4) (which applies to other individuals) provide that interest charges on deficient CPP instalments are to be based on the least of: (i) the contributions required to be made for the year over $40; (ii) the contributions required for the preceding year; and (iii) where the individual makes CPP instalments in accordance with a notice sent for this purpose by the Minister of National Revenue, the amount indicated on the notice.

These amendments apply to 1992 and subsequent years.

Clause 147

Definitions

ITCIA
5

The *Income Tax Conventions Interpretation Act* contains rules that govern the interpretation of certain provisions of the tax treaties concluded by Canada. Section 5 defines a number of terms, both for the purposes of the treaties and for the purposes of that section. The amendment to section 5 adds definitions of the terms "annuity" and "periodic pension payment". These new definitions are applicable with respect to amounts paid after 1991.

"annuity"

The new definition of "annuity" restricts the meaning that the term might otherwise have in the tax treaties by excluding any pension payments arising in Canada that are not periodic pension payments. "Pension" is defined for this purpose in new section 5.1. The definition of "annuity" ensures, in particular, that those pension payments that are specifically excluded from the meaning of "periodic pension payment" will not be eligible for the reduced rate of withholding tax applicable under various tax treaties to annuity payments.

"periodic pension payment"

The new definition of "periodic pension payment" provides that certain pension payments arising in Canada are considered not to be periodic pension payments. Consequently, such payments will not qualify for the reduced withholding rate applicable under various tax treaties to periodic pension payments. The definition is also relevant for the new definition of "annuity". It should be noted that payments may fail to be periodic pension payments even though they are not specifically excluded by this definition.

A payment under an RPP will not be a periodic pension payment if it is a lump sum payment, or an instalment of a lump sum amount. The exclusion of instalment payments ensures, for example, that where a plan member receives the commuted value of accrued benefits in several payments, the payments will not be regarded as periodic. In general, a lump sum payment would not be considered to be a periodic pension payment even in the absence of this new definition.

The definition of "periodic pension payment" excludes payments made under an RRSP before the maturity of the plan, as well as any payment made in full or partial commutation of the retirement income under such a plan.

Payments under a RRIF in any year that would otherwise be periodic are not periodic pension payments to the extent that total payments under the RRIF in the year exceed twice the minimum amount under the fund for the year or, if greater, 10% of the fair market value of the property held in connection with the fund at the beginning of the year. Where property has been transferred to a RRIF in the year, the minimum amount and the fair market value of the RRIF's property are to be determined on the assumption that the transfer took place immediately before the year. Certain payments are to be ignored in determining the total payments made under a RRIF in a year: (i) payments that are neither required to be included in computing income nor subject to non-resident withholding tax, and (ii) payments in respect of which a deduction is available under paragraph 60(l) of the *Income Tax Act.*

Payments under any arrangement other than an RPP, RRSP or RRIF will fail to qualify as periodic pension payments if they are not (i) part of a series of payments to be made annually or more frequently over the lifetime of the recipient or over a period of at least 10 years, (ii) payments made to a recipient by reason of a disability of the recipient, or (iii) the continuation of payments to a beneficiary of a deceased individual who was receiving periodic pension payments and whose pension payments were guaranteed for a minimum number of years. A pension payment which satisfies this requirement will nonetheless not be periodic if, at the time the payment is made, it is reasonable to conclude that

- the total payments to the recipient in the year will exceed twice the total payments made in the preceding year (unless this requirement is not satisfied because payments commenced to be made in the preceding year), or

- the total payments to the recipient in the year will exceed twice the total payments to be made in any future year (except where the reason for the excess is the termination of payments in that future year, or the reduction in the level of payments is as a consequence of the death of another person).

In determining total payments to a recipient, non-periodic payments and payments that are not periodic pension payments because of the first requirement described above are to be ignored.

Clause 148

Definition of "pension"

ITCIA
5.1

New section 5.1 of the *Income Tax Conventions Interpretation Act* adds a definition of "pension" for the purposes of the new definitions of "annuity" and "periodic pension payment" in section 5 of that Act. The new definition of "pension" provides that the term includes payments arising in Canada under any of the following plans or arrangements:

- registered pension plans (RPPs),
- registered retirement savings plans (RRSPs),
- registered retirement income funds (RRIFs),
- retirement compensation arrangements (RCAs),
- deferred profit sharing plans (DPSPs), profit sharing plans for which the registration has been revoked, and annuity contracts purchased pursuant to such plans,
- annuity contracts for which the premium was deductible under paragraph 60(l) of the *Income Tax Act*, or would have been deductible if the annuitant had been resident in Canada (paragraph 60(l) provides a deduction where a refund of premiums under an RRSP, a payment under a RRIF in excess of the minimum required payments or certain other amounts are used to acquire an eligible annuity), and
- any superannuation, pension or retirement plan not referred to above.

Clause 149

Refund to Discounter

TRDA
2.1

Where a taxpayer has assigned his or her right to a tax refund to a discounter under the *Tax Rebate Discounting Act*, Revenue Canada, Taxation still makes the refund cheque payable to the taxpayer but mails the cheque to the discounter. New section 2.1 of the Act allows the refund cheque to be payable to the discounter. This will increase administrative efficiency by allowing one cheque to be sent to each discounter for the refunds that the discounter has acquired the right to receive.

Where a taxpayer's refund that a discounter has acquired the right to receive has been made to the discounter, the refund will be treated as having been made to the taxpayer in order to discharge

Revenue Canada's liability to the taxpayer. However, where the refund (not including interest) exceeds by $10 or more the amount estimated to be the refund at the time the discounter acquired the right to receive the refund, the excess will be considered to be held in trust for the taxpayer by the discounter – whether or not the discounter does in fact hold the excess separate from his or her own money – so that in the event of the liquidation, assignment or bankruptcy of the discounter, the excess will not form part of the estate in liquidation, assignment or bankruptcy.

New section 2.1 is applicable with respect to refunds of tax for 1992 and subsequent taxation years.

Clause 150

TRDA
4(2)(a)

Applicable after 1991, paragraph 4(2)(a) of the *Tax Rebate Discounting Act* is amended to provide that the statement referred to in subparagraph 4(1)(b)(i) does not have to be filed with the return of income where the return is filed electronically in the manner provided in new subsection 150.1 of the *Income Tax Act.*

Clause 151

Remittances

UI
53

Subclause 151(1)

UI
53(1)

Subsection 53(1) of the *Unemployment Insurance Act* authorizes employers to withhold required employee U.I. premiums. The employer is required to remit the withheld amounts to the Receiver General at the prescribed time. This subsection is amended to require that remittances made after 1992 by an employer that is a "prescribed person" be made to the account of the Receiver General at a financial institution. It is intended that prescribed persons will generally be employers and payroll service companies that are required to remit amounts under subsection 153(1) of the *Income Tax Act*, subsection 21(1) of the *Canada Pension Plan*, and subsection 53(1) of this Act and that had a monthly average of the total of such amounts remitted in the second preceding calendar year of $50,000 or more.

Subclause 151(2)

UI
53(7)(b)

Subsection 53(7) of the *Unemployment Insurance Act* imposes a two-tier penalty on an employer who, in a calendar year, fails to remit to the Receiver General an amount that was required to be remitted under the Act. Paragraph 53(7)(a) imposes a penalty of 10% of the amount not remitted for a first time failure. Paragraph 53(7)(b) imposes a second-tier penalty of 20% of the amount not remitted, where, at the time of the failure, a penalty under subsection 53(7) has previously been assessed against the same employer during the same calendar year. The circumstances in which the second-tier penalty under paragraph 53(7)(b) will apply are amended so that after 1992 (except with respect to amounts required to be remitted before 1993) the second-tier penalty of 20% will not apply unless the failure to remit was made knowingly or under circumstances amounting to gross negligence.

Clause 152

Applications and Appeals

UI
61(5)

Section 61 of the *Unemployment Insurance Act* (UI Act) provides for applications to the Minister of National Revenue for the determination of questions concerning liability to pay unemployment insurance premiums. It also provides for appeals to the Minister for the reconsideration of assessments made by the Minister as to amounts payable under the UI Act. Subsection 61(5) provides that applications and appeals made to the Minister under section 61 are to be in a form authorized by the Minister and sent by registered mail to the Deputy Minister of National Revenue for Taxation at Ottawa. Subsection 61(5) is amended, with respect to applications and appeals made after Royal Assent, to remove the requirement that the application or appeal be made in the form authorized by the Minister and by registered mail and to provide, instead, that the application or appeal is to be addressed to the Chief of Appeals in a District Office of the Department of National Revenue, Taxation and delivered or mailed to that office.

Clause 153

Priority
S.C. 1986, c.6, Subsections 118(2) and (4)

ITA
227(10.2) to (10.8)

Subsections 227(10.2) to (10.8) of the *Income Tax Act* were intended to create a priority in favour of Her Majesty in Right of Canada in respect of amounts owing under the Act by a person as unremitted source deductions as against the claims of most other creditors. These subsections were to be applicable to assessments in respect of amounts deducted or withheld after a date to be fixed by proclamation. No such date has ever been fixed, so the provisions have never been effective. Subsequent to the enactment of subsections 227(10.2) to (10.8), the "enhanced" garnishment provisions in subsections 224(1.2) and (1.3) of the Act were enacted.

The details for implementing subsections 227(10.2) to (10.8) were never fully resolved, and enhanced garnishment has proven to be a satisfactory alternate means for the collection of unremitted source deductions. Accordingly, subsections 227(10.2) to (10.8) are being repealed.

Clauses 154 and 155

Priority
R.S. 1985 (2nd Supp.), c.5,
Subsections 1(3) and (5) and 4(2) and (3)

Subsections 1(3) and (5) of R.S. 1985 (2nd Supp.), c.5 would have added subsections 23(7) to (13) to the *Canada Pension Plan*. Subsections 4(2) and (3) of R.S. 1985 (2nd Supp.), c.5 would have added subsections 57(7) to (13) to the *Unemployment Insurance Act*. Those provisions of the *Canada Pension Plan* and the

Unemployment Insurance Act were intended to create a priority in favour of Her Majesty in Right of Canada in respect of amounts owing under those Acts by a person as unremitted source deductions as against the claims of most other creditors. Those subsections were to be applicable to assessments in respect of amounts deducted after a day to be fixed by proclamation. No such date has ever been fixed, so the provisions have never been effective. The enhanced garnishment provisions under subsections 224(1.2) and (1.3) of the *Income Tax Act* are now used for the collection of unremitted source deductions. Accordingly, subsections 23(7) to (13) of the *Canada Pension Plan* and subsections 57(7) to (13) of the *Unemployment Insurance Act* are being repealed.

Clause 156

Corporate Surtax
S.C. 1990, c.39, s.28

Corporate Surtax of Credit Unions and Cooperative Corporations

ITA
123.2

Section 28 of the Statutes of Canada 1990, c.39, amended section 123.2 of the *Income Tax Act* by altering the base on which the corporate surtax is determined. As a result of this amendment, that surtax is now determined on the federal income tax that would be payable without taking into account the small business deduction and certain tax credits. The coming-into-force of that amendment provided some transitional relief for the taxation year of a Canadian-controlled private corporation (CCPC) that commenced before July 1989 and ended after June 1989.

Subsections 136(1) and 137(7) of the *Income Tax Act* provide, with some exceptions, that cooperative corporations and credit unions are not private corporations for purposes of the Act. Cooperative corporations and credit unions that would otherwise be considered CCPCs were therefore excluded from the transitional relief provided for CCPCs. This result is not appropriate. The coming-into-force of S.C. 1990, c.39, s.28 is amended, applicable from the date on which it received Royal Assent, to ensure that cooperative corporations and credit unions that would be CCPCs but for subsection 136(1) or 137(7) of the *Income Tax Act* are eligible for the 1989 transitional relief provided to CCPCs.

Clause 157

Disability-Related Modifications to Buildings

S.C. 1991, c.49,

Subsection 15(3)

ITA
20(1)(gg)

Subsection 15(3) of S.C. 1991, c.49 (Bill C-18) enacted paragraph 20(1)(gg) of the *Income Tax Act*. This paragraph allows a taxpayer to deduct reasonable costs relating to eligible disability-related modifications to the taxpayer's building used for the purposes of earning income from a business or property. This paragraph is repealed and replaced with new paragraph 20(1)(qq). This amendment applies retroactively to the time paragraph 20(1)(gg) became effective, i.e., with respect to renovations and alterations made after 1991.

Clause 158

Guaranteed Shares

S.C. 1991, c.49, s.247

ITA
258(3)

Section 247 of S.C. 1991, c.49 (Bill C-18) altered the coming-into-force of a previous amendment to subsection 258(3) of the *Income Tax Act*, and was intended to clarify the application of that subsection. An amendment to subsection 258(3) of the Act, described in the commentary concerning that provision, has been made to ensure that this subsection applies correctly; accordingly, section 247 of S.C. 1991, c.49 is no longer required and is being repealed.

Clause 159

Elections to be Made Before 1992

S.C. 1991, c.49

A number of the coming-into-force provisions in S.C. 1991, c.49 (Bill C-18) allowed taxpayers to elect or request earlier effective dates for certain amendments to the *Income Tax Act.* Those elections or requests were required to be made before 1992, but Bill C-18 did not receive Royal Assent until December 17, 1991, so some taxpayers who may have wished to make such an election or request may not have done so in the short period between the date of Royal Assent and the end of the year. This provision allows such elections or requests to be made within six months after the day on which the legislation implementing this clause is assented to.

Appendix A

Draft Income Tax Regulation and Explanatory Note

Prescribed Securities

and Shares

(1) Paragraphs 6201(4)(a) and (b) of the *Income Tax Regulations* are revoked and the following substituted therefor:

"(a) 10 per cent of the shares of that class that were issued and outstanding at the last time before the particular time at which the other corporation or a restricted financial institution with which the other corporation does not deal at arm's length acquired a share of that class, where no dividend is received at that time by any such corporation in respect of a share (other than a share prescribed under subsection (5)) of that class acquired after December 15, 1987 and before the particular time; or

(b) 5 per cent of the shares of that class that were issued and outstanding at the last time before the particular time at which the other corporation or a restricted financial institution with which the other corporation does not deal at arm's length acquired a share of that class, where a dividend is received at the particular time by any such corporation in respect of a share (other than a share prescribed under subsection (5)) of that class acquired after December 15, 1987 and before the particular time."

(2) Subparagraph 6201(5)(b)(i) and all that portion of subparagraph 6201(5)(b)(ii) preceding clause (c) thereof is revoked and the following substituted therefor:

"(i) dividends are received at the particular time by the other corporation or by the other corporation and corporations controlled by the other corporation in respect of more than 10 per cent of the shares of that class issued and outstanding at the particular time (or, for the purposes of the definition "taxable RFI share", shares of that class that were issued and outstanding at the last time before the particular time at which any such corporation acquired a share of that class),

(ii) the other corporation is a restricted financial institution and

(A) the share is not a taxable preferred share,

(B) dividends are received at the particular time by the other corporation or by the other corporation and corporations controlled by the other corporation in respect of more than 5 per cent of the shares of that class issued and outstanding at the particular time (or, for the purposes of the definition "taxable RFI share", shares of that class that were issued and outstanding at the last time before the particular time at which any such corporation acquired a share of that class), and"

2. Section 1 is applicable with respect to dividends received after December 20, 1991.

Explanatory Note

Income Tax Regulations

6201(4) and (5)

Section 6201 of the *Income Tax Regulations* lists certain types of shares, and identifies a limited number of particular shares, as "prescribed shares" for the purposes of subsection 112(2.2) of the *Income Tax Act* (dealing with guaranteed shares) and the definitions of "short-term preferred share", "taxable preferred share", taxable RFI share" and "term preferred share" in subsection 248(1) of the Act.

These amendments to subsections 6201(4) and (5) of the Regulations relate to "taxable RFI shares", which may be generally described as shares issued before June 18, 1987 that would have met the definition of "taxable preferred share" if issued after that date. (A taxable preferred share may, in turn, generally be described as a share in respect of which either the dividends payable thereon, or the amount to which the shareholder may be entitled on a liquidation, is fixed or limited.) Dividends paid after 1987 on taxable RFI shares acquired after June 18, 1987 are, subject to certain exceptions, taxable under Part IV.1 of the Act – at a rate of 10% – where the recipient is a restricted financial institution.

Subsections 6201(4) and (5) provide that shareholdings not exceeding a stipulated percentage – either 5 or 10%, depending upon the date that any such shares were last acquired – are to be excluded from the taxable RFI share definition. However, a financial institution's percentage ownership of a particular class of shares is assessed as of the date on which a dividend is received on those shares, rather than on the date on which any such shares were last acquired. As a result, an institution's shareholding may be adversely affected by, for example, the redemption of other persons' shares of the same class, despite the fact that the institution was within the prescribed limits at the time that the institution acquired its shares.

It is intended, as a general matter, that a reduction in the size of an outstanding share issue cause a corresponding reduction in the number of shares that any particular person may hold (for the purposes of determining, for example, the availability of an exemption from the term preferred share rules). However, this objective was not intended to be a feature of the taxable RFI share rules, which, as noted above, are limited to shares issued before June 18, 1987. Accordingly, these amendments to subsections 6201(4) and (5) are designed to provide that, for the purposes of the definition of taxable RFI share, a financial institution's percentage holding of a particular class of shares is to be measured in relation to the number of those shares that were outstanding at the time that institution (or another member of the same corporate group) last acquired any such shares.

These amendments apply to dividends received after December 20, 1991.

Appendix B

Draft Income Tax Regulation and Explanatory Note

Retirement Income Funds

1. Part LXXIII of the *Income Tax Regulations* is amended by adding thereto the following section:

7308.(1) For the purposes of this section, a retirement income fund is a qualifying retirement income fund at a particular time if

(a) the fund was entered into before 1993 and the carrier has not accepted any property as consideration thereunder after 1992 and at or before that time, or

(b) the carrier has not accepted any property as consideration thereunder after 1992 and at or before that time, other than property transferred from a retirement income fund that, immediately before the time of the transfer, was a qualifying retirement income fund.

(2) For the purposes of paragraph 146.3(1)(*b*.1) of the Act, the prescribed amount in respect of an individual for a year in connection with a retirement income fund that was a qualifying retirement income fund at the beginning of the year is the factor, determined pursuant to the following table, that corresponds to the age in whole years (in the table referred to as "X") attained by the individual at the beginning of the year or that would have been so attained by the individual if the individual had been alive at the beginning of the year.

X	Factor
under 79	1/(90 - X)
79	.0853
80	.0875
81	.0899
82	.0927
83	.0958
84	.0993
85	.1033
86	.1079
87	.1133
88	.1196
89	.1271
90	.1362
91	.1473
92	.1612
93	.1792
94 or older	.2

(3) For the purposes of paragraph 146.3(1)(*b*.1) of the Act, the prescribed amount in respect of an individual for a year in connection with a retirement income fund (other than a fund that was a qualifying retirement income fund at the beginning of the year) is the factor, determined pursuant to the following table, that corresponds to the age in whole years (in the table referred to as "Y") attained by the individual at the beginning of the year or that would have been so attained by the individual if the individual had been alive at the beginning of the year.

Y	Factor
under 71	1/(90 - Y)
71	.0738
72	.0748
73	.0759
74	.0771
75	.0785
76	.0799
77	.0815
78	.0833
79	.0853
80	.0875
81	.0899
82	.0927
83	.0958
84	.0993
85	.1033
86	.1079
87	.1133
88	.1196
89	.1271
90	.1362
91	.1473
92	.1612
93	.1792
94 or older	.2

2. Section 1 is applicable to the 1992 and subsequent taxation years.

Explanatory Note

Income Tax Regulations

7308

The explanation of this draft regulation is set out in the commentary on the amendment to the definition of "minimum amount" in subsection 146.3(1) of the Act.

Appendix C

Draft Income Tax Regulations and Explanatory Notes

Pension and RRSP Limits

1.(1) Paragraphs 8302(2)(b) and (c) of the said Regulations are revoked and the following substituted therefor:

(b) where the year is after 1989 and before 1995, determine the lesser of the amount determined under paragraph (a) and

(i) for 1990, $1,277.78,

(ii) for 1991 and 1992, $1,388.89,

(iii) for 1993, $1,500.00, and

(iv) for 1994, $1,611.11; and

(c) where, in determining the amount of lifetime retirement benefits payable to the individual under the provision, there is deducted from the amount of such benefits that would otherwise be payable the amount of lifetime retirement benefits payable to the individual under a money purchase provision of a registered pension plan or the amount of a lifetime annuity payable to the individual under a deferred profit sharing plan, reduce the amount determined under paragraph (a) (if the year is before 1990 or after 1994) or paragraph (b) (if the year is after 1989 and before 1995) by 1/9 of the aggregate of all amounts each of which is the pension credit of the individual for the year under such a money purchase provision or deferred profit sharing plan.

(2) Paragraph 8302(3)(g) of the said Regulations is revoked and the following substituted therefor:

(g) where the amount of the individual's lifetime retirement benefits depends on the individual's remuneration and the particular year is after 1989 and before 1995, benefits, to the extent that they can reasonably be considered to be in respect of the following range of annual remuneration, were excluded:

(i) where the particular year is 1990, the range from $63,889 to $86,111,

(ii) where the particular year is 1991 or 1992, the range from $69,444 to $86,111,

(iii) where the particular year is 1993, the range from $75,000 to $86,111, and

(iv) where the particular year is 1994, the range from $80,556 to $86,111;

(3) The definition "defined benefit limit" in subsection 8500(1) of the said Regulations is revoked and the following substituted therefor:

"defined benefit limit" for a calendar year means

(a) for years before 1996, $1,722.22, and

(b) for years after 1995, 1/9 of the money purchase limit for the year; (plafond des prestations déterminées)

(2) Sections 1 to 3 are applicable after 1991.

Explanatory Note

Income Tax Regulations

These amendments to Parts LXXXIII and LXXXV of the *Income Tax Regulations* are necessary as part of the implementation of the one-year deferral of the phase-in of higher contribution and benefit limits for registered pension plans, deferred profit sharing plans and registered retirement savings plans.

Part LXXXIII

Part LXXXIII of the Regulations provides rules for calculating pension adjustments (PAs) and past service pension adjustments (PSPAs). These amounts enter into the determination of an individual's RRSP deduction limit. Also, by imposing limits that must be satisfied by PAs, the Act restricts the benefits that can be provided under, and the contributions that can be made to, RPPs and DPSPs.

Benefit Accrual for Year

ITR
8302(2)(b) and (c)

Subsection 8302(2) sets out rules for determining an individual's benefit accrual under a defined benefit provision of an RPP in respect of a calendar year. The benefit accrual is used to calculate the individual's pension credit under the provision, which is then used in calculating the individual's PA for the year.

Paragraph 8302(2)(b) limits the amounts calculated as benefit accruals for years before 1994. The effect of the limit is to ensure that at least $1,000 of deduction room is available for supplementary money purchase contributions to an RRSP, RPP or DPSP.

Paragraph 8302(2)(b) is amended to reduce the benefit accrual limits for 1992 and 1993 and to introduce a limit for 1994. For 1992, the limit remains frozen at the 1991 level of $1,388.89. For 1993 and 1994, the limits are $1,500.00 and $1,611.11 respectively.

The amendment to paragraph 8302(2)(b) is consequential to the amendment to the definition of "money purchase limit" in subsection 147.1(1) of the Act and ensures that $1,000 of deduction room continues to be available for supplementary money purchase contributions.

Paragraph 8302(2)(c) provides for a reduction in calculating an individual's benefit accrual under a defined benefit provision of an RPP where the benefits provided to the individual under the provision are offset by benefits payable under a DPSP or a money purchase provision of an RPP. This paragraph is amended strictly as a consequence of the amendment to paragraph 8302(2)(b).

The amendments to paragraphs 8302(2)(b) and (c) are applicable after 1991.

Normalized Pensions

ITR
8302(3)(g)

Subsection 8302(3) sets out rules for determining the normalized pension of an individual under a defined benefit provision of an RPP. Determining the individual's normalized pension is the first step in determining the individual's PA for a year. In general terms, an individual's normalized pension is the total pension actually accrued to the individual to the end of the year, determined with the adjustments required by subsection 8302(3).

Paragraph 8302(3)(g) requires that benefits in respect of a specified range of earnings be excluded in determining normalized pensions for the transition years 1990 to 1993. The purpose of this exclusion is to ensure that defined benefit pension credits for the transition years bear an appropriate relationship to the money purchase limits that apply in those years. Without this exclusion, a number of arrangements would give rise to PAs that would violate the limits in subsection 147.1(8) of the Act during the transition years even though PAs under those arrangements would be within the limits after 1993.

Paragraph 8302(3)(g) is amended to modify the specified range of earnings for 1992 and 1993 and to introduce a specified range for 1994. The range for 1992 is the same as for 1991, that is, $69,444 to $86,111. For 1993, the range is $75,000 to $86,111. For 1994, the range is $80,556 to $86,111. This amendment is consequential to the amendment to the definition of "money purchase limit" in subsection 147.1(1) of the Act.

This amendment is applicable after 1991.

Registered Pension Plans – Interpretation

ITR
8500(l)

Part LXXXV of the Regulations contains many of the rules relating to the registration of pension plans. Section 8500 defines terms and contains several interpretive provisions that are relevant for the purposes of Part LXXXV.

"defined benefit limit"

Subsection 8500(1) defines the phrase "defined benefit limit" for a calendar year. For years before 1995, the defined benefit limit is $1,722.22. For years after 1994, the defined benefit limit is 1/9th of the money purchase limit for the year – or $1,722.22 indexed to reflect increases in the average wage. This definition is relevant for the limits in section 8504 on the amount of retirement benefits that may be paid under a defined benefit provision of an RPP.

The definition of "defined benefit limit" is amended as a consequence of the one-year deferral of the increases in the money purchase limit. Accordingly, the limit will remain at $1,722.22 for 1995 and will be indexed for 1996 and subsequent years to reflect increases in the average wage.

This amendment is applicable after 1991.