

---

# Draft Amendments to the Income Tax Act

---

Debt Forgiveness and  
Foreclosures

---

Issued by  
The Honourable Paul Martin P.C., M.P.  
Minister of Finance

July 1994

Canada

---

# Draft Amendments to the Income Tax Act

---

Debt Forgiveness and  
Foreclosures

---

Issued by  
The Honourable Paul Martin P.C., M.P.  
Minister of Finance

July 1994



Department of Finance  
Canada

Ministère des Finances  
Canada

For additional copies of this document  
please contact:

Distribution Centre  
Department of Finance  
300 Laurier Avenue West  
Ottawa K1A 0G5

Tel: (613) 995-2855

Fax: (613) 996-0518

Cette publication est également disponible en français.



---

# Draft Legislation on Debt Forgiveness and Foreclosures

---

## Table of Contents

Clause in Legis- lation	Section of the Income Tax Act	Topic	Page
1	6	Employment income . . . . .	1
2	12	Business and property income . . . . .	1
3	13	Depreciable property . . . . .	2
4	14	Eligible capital property . . . . .	3
5	15	Shareholder benefits . . . . .	5
6	18	Prohibited deductions-business and property income . . . . .	6
7	20	Deductions in computing income from business or property . . . . .	7
8	28	Farming or fishing business . . . . .	8
9	31	Loss from farming . . . . .	9
10	39	Capital gains and losses . . . . .	9
11	40	Capital gains - special rules . . . . .	10
12	44	Exchange of property . . . . .	10
13	47	Identical properties . . . . .	11
14	49	Options . . . . .	11
15	50	Bad debts and shares of bankrupt corporations . . . . .	12
16	51	Convertible property . . . . .	13
17	53	Adjustments to cost of property . . . . .	14
18	54	Definitions . . . . .	16

Clause in Legis- lation	Section of the Excise Tax Act	Topic	Page
19	56.2	Reserve for debt forgiveness .....	17
20	61.2	Reserve for debt forgiveness .....	17
21	66	Resource expenditures .....	18
22	66.2	Canadian development expenses .....	19
23	66.4	Canadian oil and gas property expenses .....	20
24	66.7	Successor rules .....	21
25	70	Death of a taxpayer .....	23
26	73	Inter vivos transfer of property .....	23
27	79	Surrender of property by debtor .....	23
27	79.1	Seizure of property by creditor .....	28
28	80	Debtor's gain on settlement of debt .....	31
28	80.01	Deemed settlement of debts .....	50
28	80.02	Rules for distress preferred shares .....	55
28	80.03	Gains on subsequent dispositions .....	58
28	80.04	Transfers of forgiven amounts .....	62
29	85	Transfer of property to corporations by shareholders .....	68
30	86	Exchange of shares .....	68
31	87	Amalgamations .....	69

---

Clause in Legis- lation	Section of the Income Tax Act	Topic	Page
32	88	Windings-up .....	70
33	95	Foreign accrual property income .....	70
34	96	Partnership rules .....	72
35	97	Transfers to partnerships .....	72
36	107	Trust rules .....	73
37	111	Losses deductible .....	73
38	138	Insurance corporations .....	75
39	191.3	Part VI.1 tax .....	76
40	248	Interpretation .....	76
41	256	Acquisitions of control .....	77
42	26	(ITAR) Capital gains .....	78

**1.(1) Subsection 6(15) of the *Income Tax Act* is replaced by the following:**

Forgiveness of employee debt

(15) For the purpose of paragraph (1)(a),

(a) a benefit shall be deemed to have been enjoyed by an individual at any time an obligation issued by any debtor (including the individual) is settled or extinguished; and

5

(b) the value of that benefit shall be deemed to be the forgiven amount at that time in respect of the obligation.

Forgiven amount

10

(15.1) For the purpose of subsection (15), the "forgiven amount" at any time in respect of an obligation issued by a debtor has the meaning that would be assigned by subsection 80(1) if

15

(a) the obligation were a commercial obligation (within the meaning assigned by subsection 80(1)) issued by the debtor;

(b) no amount included in computing income because of the obligation being settled or extinguished at that time were taken into account;

20

(c) the definition "forgiven amount" in subsection 80(1) were read without reference to paragraphs (f) and (h) of the description of B in that definition; and

25

(d) section 80 were read without reference to paragraph (2)(b) of that section.

**(2) Subsection (1) applies to taxation years that end after February 21, 1994.**

30

**2.(1) Subsection 12(1) of the Act is amended by adding the following after paragraph (e):**

Reserves in respect of debt forgiveness

(e.1) where the taxpayer was not a bankrupt during the year, any amount deducted under paragraph 20(1)(n.1) in computing the taxpayer's income for the preceding taxation year;

35



(2) Subsection 12(1) of the Act is amended by striking out the word "and" at the end of paragraph (y), by adding the word "and" at the end of paragraph (z) and by adding the following after paragraph (z):

Debt forgiveness

5

(aa) any amount required because of subsection 80(13) to be included in computing the taxpayer's income for the year.

(3) Subsections (1) and (2) apply to taxation years that end after February 21, 1994.

10

3.(1) The portion of subsection 13(7.1) of the Act before paragraph (a) is replaced by the following:

Deemed capital cost of certain property

(7.1) For the purposes of this Act, where section 80 applied to reduce the capital cost to a taxpayer of a depreciable property or a taxpayer deducted an amount under subsection 127(5) or (6) in respect of a depreciable property or received or is entitled to receive assistance from a government, municipality or other public authority in respect of, or for the acquisition of, depreciable property, whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance or as any other form of assistance other than

15

20

(2) Paragraph 13(7.1)(c) of the Act is replaced by the following:

(c) the capital cost of the property to the taxpayer, determined without reference to this subsection, subsection (7.4) and section 80, and

25

(3) Subsection 13(7.1) of the Act is amended by striking out the word "and" at the end of paragraph (e), by adding the word "and" at the end of paragraph (f) and by adding the following after paragraph (f):

(g) all amounts by which the capital cost of the property to the taxpayer is required because of section 80 to be reduced at or before that time.

30

(4) Paragraph (h) of the definition "proceeds of disposition" in subsection 13(21) of the Act is replaced by the following:

(h) any amount included because of section 79 in computing a taxpayer's proceeds of disposition of the property;

35

**(5) The formula in the definition "undepreciated capital cost" in subsection 13(21) of the Act is replaced by the following:**

$$(A + B + C + D) - (E + \underline{E.1} + F + G + H + I + J)$$

**(6) The definition "undepreciated capital cost" in subsection 13(21) of the Act is amended by adding the following after the description of E:**

E.1 is the total of all amounts each of which is an amount by which the undepreciated capital cost to the taxpayer of depreciable property of that class is required (otherwise than because of a reduction in the capital cost to the taxpayer of depreciable property) to be reduced at or before that time because of subsection 80(5),

**(7) Subsections (1) to (6) apply to taxation years that end after February 21, 1994.**

**4.(1) The portion of subsection 14(1) of the Act before paragraph (a) is replaced by the following:**

Inclusion in income from business

14.(1) Where, at the end of a taxation year, the total of all amounts each of which is an amount determined, in respect of a business of a taxpayer, for E in the definition "cumulative eligible capital" in subsection (5) (in this section referred to as an "eligible capital amount"), or for F or G in that definition exceeds the total of all amounts determined for A to D in that definition in respect of the business (which excess is referred to in this subsection as "the excess"),

**(2) Clause 14(1)(a)(iv)(B) of the Act is replaced by the following:**

(B) the total of the amounts determined for F and G in the definition "cumulative eligible capital" in subsection (5) at the end of the year in respect of the business

**(3) The first formula in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:**

$$(A + B + C + D + D.1) - (E + F + \underline{G})$$

**(4) The definition "cumulative eligible capital" in subsection 14(5) of the Act is amended by striking out the word "and" at the end of the description of E, by adding the word "and"**

at the end of the description of F and by adding the following after the description of F:

G is the total of all amounts each of which is an amount by which the cumulative eligible capital of the taxpayer in respect of the business is required to be reduced at or before that time because of subsection 80(7); 5

(5) Section 14 of the Act is amended by adding the following after subsection (8):

Deemed eligible capital expenditure

(9) For the purposes of this Act, where a taxpayer received or is entitled to receive assistance from a government, municipality or other public authority in respect of, or for the acquisition of, property the cost of which is an eligible capital expenditure of the taxpayer in respect of a business, whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance or as any other form of assistance, that eligible capital expenditure shall at any time be deemed to be the amount, if any, by which the total of 10 15

(a) that eligible capital expenditure, determined without reference to this subsection, and 20

(b) such part, if any, of the assistance as the taxpayer repaid before

(i) the taxpayer ceased to carry on the business, and 25

(ii) that time

under a legal obligation to pay all or any part of the assistance

exceeds 30

(c) the amount of the assistance the taxpayer received or is entitled to receive before the earlier of that time and the time the taxpayer ceases to carry on the business. 35

Receipt of public assistance

(10) For the purpose of subsection (9), where at any time a taxpayer who is a beneficiary under a trust or a member of a partnership received or is entitled to receive assistance from a government, municipality or other public authority, whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance or as any other form of assistance, the amount of the assistance that can reasonably be considered to be in respect of, or for the acquisition of, property the cost 40

of which was an eligible capital expenditure of the trust or partnership shall be deemed to have been received at that time by the trust or partnership, as the case may be, as assistance from the government, municipality or other public authority for the acquisition of such property.

5

**(6) Subsections (1) to (4) apply to taxation years that end after February 21, 1994.**

**(7) Subsection (5) applies to assistance that a taxpayer receives or becomes entitled to receive after February 21, 1994 and repayments of such assistance.**

10

**5.(1) Subsection 15(1.2) of the Act is replaced by the following:**

Forgiveness of shareholder debt

(1.2) For the purpose of subsection (1), the value of the benefit where an obligation issued by a debtor is settled or extinguished at any time shall be deemed to be the forgiven amount at that time in respect of the obligation.

15

Forgiven amount

(1.21) For the purpose of subsection (1.2), the "forgiven amount" at any time in respect of an obligation issued by a debtor has the meaning that would be assigned by subsection 80(1) if

20

(a) the obligation were a commercial obligation (within the meaning assigned by subsection 80(1)) issued by the debtor;

25

(b) no amount included in computing income (otherwise than because of paragraph 6(1)(a)) because of the obligation being settled or extinguished were taken into account;

(c) the definition "forgiven amount" in subsection 80(1) were read without reference to paragraphs (f) and (h) of the description B in that definition; and

30

(d) section 80 were read without reference to paragraph (2)(b) of that section.

35

**(2) Subsection (1) applies to taxation years that end after February 21, 1994.**

**6.(1) The portion of subsection 18(9.3) before paragraph (a) is replaced by the following:**

Idem

(9.3) Where at any time in a taxation year of a borrower a debt obligation of the borrower is settled or extinguished or the holder of the obligation acquires or reacquires property of the borrower in circumstances to which section 79 applies in respect of the debt obligation and the total of

5

**(2) Paragraphs 18(9.3)(e) and (f) of the Act are replaced by the following:**

10

(e) for the purpose of applying section 79 in respect of the borrower, the principal amount at that time of the debt obligation shall be deemed to be equal to the amount, if any, by which

(i) the principal amount at that time of the debt obligation

exceeds

15

(ii) the excess amount, and

(f) the excess amount shall be deducted at that time in computing the forgiven amount in respect of the obligation (within the meaning assigned by subsection 80(1)).

**(3) Subsection (1) and paragraph 18(9.3)(e) of the Act, as enacted by subsection (2), apply to the 1992 and subsequent taxation years.**

20

**(4) Paragraph 18(9.3)(f) of the Act, as enacted by subsection (2), applies to taxation years that end after February 21, 1994, except that it does not apply to any obligation settled or extinguished**

(a) before February 22, 1994,

25

(b) after February 21, 1994 under the terms of an agreement in writing entered into on or before that date,

(c) before 1996 pursuant to a restructuring of debt in connection with a proceeding commenced in a court in Canada before February 22, 1994,

30

(d) before 1996 in connection with a proposal (or notice of intention to make a proposal) that was filed under the *Bankruptcy and Insolvency Act* before February 22, 1994, or

(e) before 1996 in connection with a written offer that was made by, or communicated to, the holder of the obligation before February 22, 1994. 5

**7.(1) Paragraph 20(1)(n) of the Act is replaced by the following:**

Reserve for unpaid amounts

(n) where an amount included in computing the taxpayer's income from the business for the year or for a preceding taxation year in respect of property sold in the course of the business is payable to the taxpayer after the end of the year and, except where the property is real property, the amount was, at the time of the sale, not due until at least 2 years after that time, a reasonable amount as a reserve in respect of such part of the amount as can reasonably be regarded as a portion of the profit from the sale; 10 15

Reserve with respect to debt forgiveness

(n.1) where a particular amount was, because of the application of section 80 to the settlement at a particular time of an obligation payable by the taxpayer to a person with whom the taxpayer deals at arm's length, included under subsection 80(13) in computing the taxpayer's income for the year or for a preceding taxation year and the taxpayer is a non-resident person who carried on business through a fixed place of business in Canada at the end of the year or a corporation or trust resident in Canada throughout the year, such amount as the taxpayer claims as a reserve in a prescribed form filed with the taxpayer's return of income under this Part for the year not exceeding the lesser of 20 25 30

(i) the amount, if any, by which 30

(A) the particular amount

exceeds the total of 35

(B) the amount by which the particular amount exceeds such portion of the amount, if any, included under paragraph 12(1)(e.1) in computing the taxpayer's income for the year as relates to the particular amount, and 40

(C) the amount, if any, deducted under paragraph 80(15)(a) in respect of the particular amount in computing the taxpayer's income for the year or the preceding year, and

(ii) the amount determined by the formula

$$A/5 \times B$$

where

A is the amount, if any, by which 4 exceeds the number of preceding taxation years of the taxpayer that end after the particular time, and

B is the particular amount;

(2) Subsection 20(1) of the Act is amended by adding the following after paragraph (hh):

Idem

(hh.1) 3/4 of any amount (other than an amount to which paragraph 14(9)(b) applies in respect of the taxpayer) repaid by the taxpayer in the year under a legal obligation to repay all or part of an amount to which paragraph 14(9)(c) applies in respect of the taxpayer;

(3) Subsection 20(1) of the Act is amended by striking out the word "and" at the end of paragraph (qq), by adding the word "and" at the end of paragraph (rr) and by adding the following after paragraph (rr):

Debt forgiveness

(ss) any amount deducted in computing the taxpayer's income for the year because of paragraph 80(15)(a) or subsection 80.01(10).

(4) Subsections (1) and (3) apply to taxation years that end after February 21, 1994, except that a form referred to in paragraph 20(1)(n.1) of the Act, as enacted by subsection (1), shall be deemed to have been filed on a timely basis if it is filed with the Minister of National Revenue before 1996.

(5) Subsection (2) applies to amounts repaid after February 21, 1994.

8.(1) Paragraph 28(1)(d) of the Act is replaced by the following:

(d) the total of all amounts each of which is an amount included in computing the taxpayer's income for the year from the business because of paragraph 12(1)(e.1), subsection 13(1), 14(1), 80(13) or 80.3(3) or (5),

**(2) Paragraph 28(1)(g) of the Act is replaced by the following:**

5

(g) the total of all amounts each of which is an amount deducted for the year under paragraph 20(1)(a), (b), (n.1) or (ss), subsection 20(16) or 24(1), section 30 or subsection 80.3(2) or (4) in respect of the business,

**(3) Subsections (1) and (2) apply to taxation years that end after February 21, 1994.**

10

**9.(1) The portion of subsection 31(1) of the Act following subparagraph (b)(i) is replaced by the following:**

exceeds

(ii) the amount determined under subparagraph (a)(i).

15

Restricted farm loss

(1.1) For the purposes of this Act, a taxpayer's "restricted farm loss" for a taxation year is the amount, if any, by which

(a) the amount determined under subparagraph (1)(a)(i) in respect of the taxpayer for the year

20

exceeds

(b) the total of the amount determined under subparagraph (1)(a)(ii) in respect of the taxpayer for the year and all amounts each of which is an amount by which the restricted farm loss of the taxpayer for the year is required to be reduced because of section 80.

25

**(2) Subsection (1) applies to taxation years that end after February 21, 1994.**

**10.(1) The portion of subsection 39(3) of the Act after paragraph (b) is replaced by the following:**



to the extent that the amount determined under paragraph (a) or (b) would not, if section 3 were read in the manner described in paragraph (1)(a) of this section and this Act were read without reference to subsections 80(12) and (13), be included or be deductible, as the case may be, in computing the taxpayer's income for the year or any other taxation year. 5

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

11.(1) Clause 40(1)(a)(iii)(C) of the Act is replaced by the following: 10

(C) a reserve equal to that proportion of the amount determined under subparagraph (i) in respect of the disposition of the property that

(I) such of the proceeds of disposition of the property as are payable to the taxpayer after the end of the year 15

is of

(II) the proceeds of disposition of the property, and

(2) Subsection 40(2) of the Act is amended by adding the following after paragraph (e):

(e.1) a taxpayer's loss, if any, from the disposition at any time to a particular person or partnership of an obligation that was, immediately after that time, payable by another person or partnership to the particular person or partnership is nil where the taxpayer, the particular person or partnership and the other person or partnership are related to each other at that time or would be related to each other at that time if paragraph 80(2)(j) applied for the purpose of this paragraph; 20 25

(3) Subsection (1) applies to taxation years that end after February 21, 1994.

(4) Subsection (2) applies to dispositions that occur after Announcement Date, other than dispositions pursuant to agreements in writing entered into on or before Announcement Date. 30

12.(1) Clause 44(1)(e)(iii)(C) of the Act is replaced by the following:

(C) a reserve equal to that proportion of the amount determined under subparagraph (i) in respect of the disposition of the property that

(I) such of the proceeds of disposition of the property as are payable to the taxpayer after the end of the year

5

is of

(II) the proceeds of disposition of the property, and

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

13.(1) Subsection 47(1) of the Act is amended by striking out the word "and" at the end of paragraph (a) and by adding the following after paragraph (b):

10

(c) there shall be deducted, after the particular time, in computing the adjusted cost base to the taxpayer of each such identical property, the amount determined by the formula

15

$$A/B$$

where

20

A is the total of all amounts deducted under paragraph 53(2)(g.1) in computing immediately before the particular time the adjusted cost base to the taxpayer of the previously-acquired properties, and

25

B is the number of such identical properties owned by the taxpayer immediately after the particular time or, where subsection (2) applies, the quotient determined under that subsection in respect of the acquisition; and

30

(d) there shall be added, after the particular time, in computing the adjusted cost base to the taxpayer of each such identical property the amount determined under paragraph (c) in respect of such property.

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

35

14.(1) Section 49 of the Act is amended by adding the following after subsection (3):

Idem

(3.01) Where at any time a taxpayer exercises an option to acquire a specified property,

(a) there shall be deducted after that time in computing the adjusted cost base to the taxpayer of the specified property the total of all amounts deducted under paragraph 53(2)(g.1) in computing, immediately before that time, the adjusted cost base to the taxpayer of the option; and

(b) the amount determined under paragraph (a) in respect of that acquisition shall be added after that time in computing the adjusted cost base to the taxpayer of the specified property.

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

15.1) All that portion of subsection 50(1) of the Act preceding paragraph (b) is replaced by the following:

Bad debts and shares of bankrupt corporations

50.1) For the purposes of this subdivision and sections 79.1 and 80.01, where

(a) an amount is

(i) deducted in computing a taxpayer's income for a taxation year, or

(ii) added at any time in the year in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts of the taxpayer

because a debt is established to have become a bad debt,

(a.1) a debt (other than a debt in respect of which paragraph (a) applies or a debt owing to the taxpayer in respect of the disposition of personal-use property) is owing to the taxpayer at the end of the year and the debt is established by the taxpayer to have become a bad debt in the year, or

(2) The portion of subsection 50(1) of the Act after subparagraph (b)(ii) is replaced by the following:

(iii) at the end of the year,

(A) the corporation is insolvent,

(B) neither the corporation nor a corporation controlled by it carries on business,

(C) the fair market value of the share is nil, and

(D) it is reasonable to expect that the corporation will be dissolved or wound up and will not commence to carry on business

and, where paragraph (a.1) or (b) applies, the taxpayer elects in the taxpayer's return of income under this Part for the year to have this subsection apply in respect of the debt described in paragraph (a.1) or the share, as the case may be, the taxpayer shall be deemed to have disposed of the debt or the share, as the case may be, at the end of the year for proceeds equal to nil and to have reacquired it immediately after the end of the year at a cost equal to nil.

**(3) Paragraph 50(1.1)(a) of the Act is replaced by the following:**

(a) a taxpayer was deemed by subsection 50(1) to have disposed of a share of the capital stock of a corporation at the end of a taxation year; and

**(4) Subsections (1) to (3) apply to taxation years that end after February 21, 1994.**

**16.(1) Subsection 51(1) of the Act is amended by adding the following after paragraph (d):**

(d.1) there shall be deducted, after the exchange, in computing the adjusted cost base to the taxpayer of a share acquired by the taxpayer on the exchange, the amount determined by the formula

$$A \times B/C$$

where

A is the total of all amounts deducted under paragraph 53(2)(g.1) in computing, immediately before the exchange, the adjusted cost base to the taxpayer of the convertible property,

B is the fair market value, immediately after the exchange, of that share, and

C is the fair market value, immediately after the exchange, of all the shares acquired by the taxpayer on the exchange,

(d.2) the amount determined under paragraph (d.1) in respect of a share shall be added, after the exchange, in computing the adjusted cost base to the taxpayer of the share,

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

**17.(1) Paragraph 53(1)(f.1) of the Act is replaced by the following:**

(f.1) where the taxpayer is a taxable Canadian corporation and the property was disposed of by another taxable Canadian corporation to the taxpayer in circumstances such that paragraph 85(4)(b) does not apply so as to increase the adjusted cost base to the other corporation of shares of the capital stock of the taxpayer and the capital loss from the disposition was deemed by paragraph 40(2)(e) or (e.1) or 85(4)(a) to be nil, the amount that would otherwise have been the capital loss from the disposition;

(f.11) where the property was disposed of by a person (other than a non-resident person or a person exempt, because of subsection 149(1), from Part I tax on all or part of the person's income) or by an eligible Canadian partnership (within the meaning assigned by subsection 80(1)) to the taxpayer in circumstances such that paragraph (f.1) does not apply so as to increase the adjusted cost base to the taxpayer of the property and the capital loss from the disposition was deemed by paragraph 40(2)(e.1) to be nil, the amount that would otherwise be the capital loss from the disposition;

(2) Subsection 53(1) of the Act is amended by striking out the word "and" at the end of paragraph (n), by adding the word "and" at the end of paragraph (o) and by adding the following after paragraph (o):

(p) any amount required under paragraph (4)(b), (5)(b), (6)(b), 47(1)(d), 49(3.01)(b), 51(1)(d.2), 86(4)(b) or 87(5.1)(b) or (6.1)(b) to be added in computing the adjusted cost base to the taxpayer of the property.

(3) Subsection 53(2) of the Act is amended by adding the following after paragraph (g):

(g.1) any amount required under paragraph (4)(a), (5)(a), (6)(a), 47(1)(c), 49(3.01)(a), 51(1)(d.1), 86(4)(a) or 87(5.1)(a) or (6.1)(a) to

be deducted in computing the adjusted cost base to the taxpayer of the property or any amount by which that adjusted cost base is required to be reduced because of subsection 80(9), (10) or (11);

**(4) Section 53 of the Act is amended by adding the following after subsection (3):**

5

**Recomputation of adjusted cost base on transfers and deemed dispositions**

(4) Where at any time in a taxation year a person or partnership (in this subsection referred to as the "vendor") disposes of a specified property and the proceeds of disposition of the property are determined under paragraph 48.1(1)(c), section 70 or 73, subsection 85(1), paragraph 85.1(1)(a), 87(4)(a) or (c) or 88(1)(a), subsection 97(2) or 98(2), paragraph 98(3)(f) or (5)(f), subsection 104(4), paragraph 107(2)(a), (2.1)(a), (4)(d) or (5)(a), 111(4)(e) or section 128.1,

10

15

(a) there shall be deducted after that time in computing the adjusted cost base to the person or partnership (in this subsection referred to as the "transferee") who acquires or reacquires the property at or immediately after that time the amount, if any, by which

20

(i) the total of all amounts deducted under paragraph (2)(g.1) in computing, immediately before that time, the adjusted cost base to the vendor of the property,

25

exceeds

(ii) the amount that would be the vendor's capital gain for the year from that disposition if this Act were read without reference to subparagraph 40(1)(a)(iii) and subsection 100(2); and

30

(b) the amount determined under paragraph (a) in respect of that disposition shall be added after that time in computing the adjusted cost base to the transferee of the property.

35

**Recomputation of adjusted cost base on other transfers**

(5) Where at any time in a taxation year a person or partnership (in this subsection referred to as the "vendor") disposes of a specified property to another person or partnership (in this subsection referred to as the "transferee"), the vendor and the transferee do not deal with each other at arm's length (or would not deal with each other at arm's length if paragraph 80(2)(j) applied for the purpose of this subsection) and the

40

45

proceeds of disposition of the property at that time are not determined under any of the provisions referred to in subsection (4),

(a) there shall be deducted after that time in computing the adjusted cost base to the transferee of the property the amount, if any, by which 5

(i) the total of all amounts deducted under paragraph (2)(g.1) in computing, immediately before that time, the adjusted cost base to the vendor of the property 10

exceeds

(ii) the amount that would be the vendor's capital gain for the year from that disposition if this Act were read without reference to subparagraph 40(1)(a)(iii) and subsection 100(2); and 15

(b) the amount determined under paragraph (a) in respect of that disposition shall be added after that time in computing the adjusted cost base to the transferee of the property. 20

#### Recomputation of adjusted cost base on amalgamation

(6) Where a capital property that is a specified property is acquired by a new corporate entity at any time as a result of the amalgamation or merger of 2 or more predecessor corporations, 25

(a) there shall be deducted after that time in computing the adjusted cost base to the new entity of the property the total of all amounts deducted under paragraph (2)(g.1) in computing, immediately before that time, the adjusted cost base to a predecessor corporation of the property, unless those amounts are otherwise deducted under that paragraph in computing the adjusted cost base to the new entity of the property; and 30

(b) the amount deducted under paragraph (a) in respect of the acquisition shall be added after that time in computing the adjusted cost base to the new entity of the property. 35

**(5) Subsections (1) to (4) apply to taxation years that end after February 21, 1994. 40**

**18.(1) Paragraph (h) of the definition "proceeds of disposition" in section 54 of the Act is replaced by the following:**

(h) any amount included in computing a taxpayer's proceeds of disposition of the property because of section 79, and

**(2) Section 54 of the Act is amended by adding, in alphabetical order, the following definition:**

"specified property"  
«bien déterminé»

5

"specified property" of a taxpayer is capital property of the taxpayer that is

(a) a share,

10

(b) a capital interest in a trust,

(c) an interest in a partnership, or

(d) an option to acquire specified property of the taxpayer;

15

**(3) Paragraph (e) of the definition "superficial loss" in section 54 of the Act is replaced by the following:**

(e) was a disposition of property by the taxpayer to which paragraph 40(2)(e.1) or subsection 85(4) applies.

**(4) Subsections (1) to (3) apply to taxation years that end after February 21, 1994.**

20

**19.(1) The Act is amended by adding the following after section 56.1:**

Reserve claimed for debt forgiveness

25

56.2 There shall be included in computing an individual's income for a taxation year during which the individual was not a bankrupt the amount, if any, deducted under section 61.2 in computing the individual's income for the preceding taxation year.

**(2) Subsection (1) applies to the 1995 and subsequent taxation years.**

30

**20.(1) The Act is amended by adding the following after section 61.1:**

Reserve for debt forgiveness

35

61.2 There may be deducted in computing the income for a taxation year of an individual (other than a trust) resident in Canada throughout the year such amount as the individual claims in a prescribed form filed



with the individual's return of income under this Part for the year not exceeding the amount determined by the formula

$$A + B - .2(C - \$40,000)$$

5

where

A is the amount, if any, by which

(a) the total of all amounts each of which is an amount that, because of the application of section 80 to an obligation payable by the individual to a person with whom the individual deals at arm's length was included under subsection 80(13) in computing the income of the individual for the year (to the extent that the amount did not arise because of the failure of the individual to designate amounts to the maximum extent permitted under subsections 80(5), (7), (8), (9) and (10))

10

15

exceeds

20

(b) the total of all amounts deducted because of paragraph 80(15)(a) in computing the individual's income for the year,

B the amount, if any, included under section 56.2 in computing the income of the individual for the year, and

25

C is the income of the individual for the year, determined without reference to this section, section 56.2, paragraph 60(w) and subsection 80(13).

30

(2) Subsection (1) applies to the 1994 and subsequent taxation years, except that a form referred to in section 61.2 of the Act, as enacted by subsection (1), shall be deemed to have been filed on a timely basis if it is filed with the Minister of National Revenue before 1996.

35

**21.(1) Paragraph 66(4)(a) of the Act is replaced by the following:**

(a) the amount, if any, by which

(i) the total of the foreign exploration and development expenses incurred by the taxpayer before the end of the year

exceeds the total of

40

(ii) such of the expenses described in subparagraph (i) as were deductible in computing the taxpayer's income for a preceding taxation year, and

(iii) all amounts by which the amount described in this paragraph in respect of the taxpayer is required because of subsection 80(8) to be reduced at or before the end of the year, and

(2) Subsection (1) applies to taxation years that end after February 21, 1994.

22.(1) The formula in the definition "cumulative Canadian development expense" in subsection 66.2(5) of the Act is replaced by the following:

$$(A + B + C + D + D.1) - (E + F + G + H + I + J + K + L + M + \underline{M.1} + N + O)$$

(2) Subparagraph (b)(i) of the description of F in the definition "cumulative Canadian development expense" in subsection 66.2(5) of the Act is amended by striking out the word "and" at the end of clause (B), by adding the word "and" at the end of clause (C) and by adding the following after clause (C):

(D) no reduction under subsection 80(8) at or after the relevant time were taken into account

(3) Subparagraph (b)(ii) of the description of F in the definition "cumulative Canadian development expense" in subsection 66.2(5) of the Act is amended by striking out the word "and" at the end of clause (C) and by adding the following after clause (D):

(E) no reduction under subsection 80(8) at or after the relevant time were taken into account, and

(4) The definition "cumulative Canadian development expense" in subsection 66.2(5) of the Act is amended by adding the following after the description of M:

M.1 is the total of all amounts by which the cumulative Canadian development expense of the taxpayer is required because of subsection 80(8) to be reduced at or before that time,

(5) Subsections (1) to (4) apply to taxation years that end after February 21, 1994.

23.(1) The formula in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is replaced by the following:

$$(A + B + C + D + D.1) - (E + F + G + H + I + \underline{I.1} + J)$$

(2) Subparagraph (b)(i) of the description of F in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is amended by striking out the word "and" at the end of clause (B), by adding the word "and" at the end of clause (C) and by adding the following after clause (C): 5

(D) no reduction under subsection 80(8) at or after the relevant time were taken into account 10

(3) Subparagraph (b)(ii) of the description of F in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is amended by striking out the word "and" at the end of clause (B) and by adding the following after clause (C): 15

(D) no reduction under subsection 80(8) at or after the relevant time were taken into account, and

(4) Subparagraph (c)(i) of the description of F in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is amended by striking out the word "and" at the end of clause (B), by adding the word "and" at the end of clause (C) and by adding the following after clause (C): 20

(D) no reduction under subsection 80(8) at or after the relevant time were taken into account 25

(5) Subparagraph (c)(ii) of the description of F in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is amended by striking out the word "and" at the end of clause (C) and by adding the following after clause (D): 30

(E) no reduction under subsection 80(8) at or after the relevant time were taken into account, and

(6) The definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5) of the Act is amended by striking out the word "and" at the end of the description of I and by adding the following after the description of I: 35

I.1 is the total of all amounts by which the cumulative Canadian oil and gas property expense of the taxpayer is required because of subsection 80(8) to be reduced at or before that time, and

**(7) Subsections (1) to (6) apply to taxation years that end after February 21, 1994.**

5

**24.(1) Paragraph 66.7(2)(a) of the Act is replaced by the following:**

**(a) the amount, if any, by which**

**(i)** the foreign exploration and development expenses incurred by the original owner before the original owner disposed of the particular property to the extent that those expenses were not otherwise deducted in computing the successor's income for the year, were not deducted in computing the successor's income for a preceding taxation year and were not deductible by the original owner, or deducted by any predecessor owner of the particular property, in computing income for any taxation year

10

15

exceeds

**(ii)** the total of all amounts each of which is an amount by which the amount described in this paragraph is required because of subsection 80(8) to be reduced at or before the end of the year, and

20

**(2) Paragraph 66.7(3)(a) of the Act is replaced by the following:**

**(a) the amount, if any, by which**

**(i)** the total of

25

**(A)** the cumulative Canadian exploration expense of the original owner determined immediately after the disposition of the particular property by the original owner, and

**(B)** all amounts required to be added under paragraph (9)(f) to the cumulative Canadian exploration expense of the original owner in respect of a predecessor owner of the particular property, or the successor, as the case may be, at any time after the disposition of the particular property by the original owner and before the end of the year,

30

to the extent that an amount in respect of that total was not

35

(C) deducted or required to be deducted under subsection 66.1(2) or (3) by the original owner or deducted by any predecessor owner of the particular property in computing income for any taxation year,

(D) otherwise deducted in computing the successor's income for the year, 5

(E) deducted in computing the successor's income for a preceding taxation year, or

(F) designated by the original owner pursuant to subsection 66(14.1) for any taxation year, 10

exceeds

(ii) the total of all amounts each of which is an amount by which the amount described in this paragraph is required because of subsection 80(8) to be reduced at or before the end of the year, and 15

**(3) Paragraph 66.7(4)(a) of the Act is amended by striking out the word "and" at the end of subparagraph (ii) and by adding the following after subparagraph (iii):**

(iv) all amounts each of which is an amount by which the amount described in this paragraph is required because of subsection 80(8) to be reduced at or before the end of the year, and 20

**(4) The portion of paragraph 66.7(5)(a) after clause (i)(B) and before subparagraph (ii) is replaced by the following: 25**

exceeds the total of

**(5) Paragraph 66.7(5)(a) of the Act is amended by adding the following after subparagraph (ii):**

(iii) the total of all amounts each of which is an amount by which the amount described in this paragraph is required because of subsection 80(8) to be reduced at or before the end of the year, and 30

**(6) Paragraph 66.7(9)(f) of the Act is replaced by the following:**

(f) the amount required to be deducted by paragraph (e) shall be added at the particular time to the cumulative Canadian exploration expense of the original owner in respect of the corporation for the purpose of paragraph (3)(a).

(7) Subsections (1) to (6) apply to taxation years that end after February 21, 1994. 5

25.(1) Subparagraph 70(5.1)(c)(ii) of the Act is replaced by the following:

(ii)  $\frac{4}{3}$  of that proportion of the total of the amounts, if any, determined for F and G in the definition "cumulative eligible capital" in subsection 14(5) in respect of the business of the taxpayer at that time that the fair market value immediately before that time of the particular property is of the fair market value immediately before that time of all eligible capital property of the taxpayer in respect of the business, 10  
15

(2) Subsection (1) applies to transfers occurring after February 21, 1994.

26.(1) The description of A in subparagraph 73(3)(d.1)(ii) of the Act is replaced by the following:

A is the total of the amounts determined for F and G in the definition "cumulative eligible capital" in subsection 14(5) in respect of the business of the taxpayer immediately before the time of the transfer, 20

(2) Subsection (1) applies to acquisitions occurring after February 21, 1994. 25

27.(1) Section 79 of the Act is replaced by the following:

Surrender of property by debtor

79.(1) In this section, 30

"creditor"

«créancier»

"creditor" of a particular person includes a person to whom the particular person is obligated to pay an amount under a mortgage or similar obligation and, where property was sold to the particular person 35

under a conditional sales agreement, the seller of the property (or any assignee with respect to the agreement) shall be deemed to be a creditor of the particular person in respect of that property;

"debt"  
«dette»

5

"debt" includes an obligation to pay an amount under a mortgage or similar obligation or under a conditional sales agreement;

10

"person"  
«personne»

"person" includes a partnership;

15

"property"  
«bien»

"property" does not include money or indebtedness owed by or guaranteed by the government of a country, or a province, state, or other political subdivision of that country;

20

"specified amount"  
«montant déterminé»

25

"specified amount" at any time of a debt owed or assumed by a person means

(a) the unpaid principal amount of the debt at that time, and

30

(b) unpaid interest accrued to that time on the debt.

Application of section 79

35

(2) For the purposes of this section, a property is surrendered at any time by a person to another person where the beneficial ownership of the property is acquired or reacquired at that time from the person by the other person and the acquisition or reacquisition of the property was in consequence of the person's failure to pay all or part of one or more specified amounts of debts owed by the person to the other person immediately before that time.

40

# Proceeds of disposition for debtor

(3) Where a particular property is surrendered at any time by a person (in this subsection referred to as the "debtor") to a creditor of the debtor, the debtor's proceeds of disposition of the particular property shall be deemed to be the amount determined by the formula 5

$$(A + B + C + D + E - F) \times G/H$$

where 10

A is the total of all specified amounts of debts of the debtor that are in respect of properties surrendered at that time by the debtor to the creditor and that are owing immediately before that time to the creditor; 15

B is the total of all amounts each of which is a specified amount of a debt that is owed by the debtor immediately before that time to a person (other than the creditor), to the extent that the amount ceases to be owing by the debtor as a consequence of properties being surrendered at that time by the debtor to the creditor; 20

C is the total of all amounts each of which is a specified amount of a particular debt that is owed by the debtor immediately before that time to a person (other than a specified amount included in the amount determined for A or B as a consequence of properties being surrendered at that time by the debtor to the creditor), where 25

(a) any property surrendered at that time by the debtor to the creditor was security for 30

(i) the particular debt, and

(ii) another debt that is owed by the debtor immediately before that time to the creditor, and 35

(b) the other debt is subordinate to the particular debt in respect of that property;

D is 40

(a) where a specified amount of a debt owed by the debtor immediately before that time to a person (other than the creditor) ceases, as a consequence of the surrender at that time of properties by the debtor to the creditor, to be secured by all properties owned by the debtor immediately before that time, the lesser of 45



(i) the amount, if any, by which the total of all such specified amounts exceeds the portion of that total included in any of the amounts determined for B or C as a consequence of properties being surrendered at that time by the debtor to the creditor, and

5

(ii) the amount, if any, by which the total cost amount to the debtor of all properties surrendered at that time by the debtor to the creditor exceeds the total amount that would, but for this description and the description of F, be determined under this subsection as a consequence of the surrender, and

10

(b) in any other case, nil;

E is

15

(a) where the particular property is surrendered at that time by the debtor in circumstances in which paragraph 69(1)(b) would, but for this subsection, apply and the fair market value of all properties surrendered at that time by the debtor to the creditor exceeds the amount that would, but for this description and the description of F, be determined under this subsection as a consequence of the surrender, that excess, and

20

(b) in any other case, nil;

25

F is the total of all amounts each of which is the lesser of

(a) the portion of a particular specified amount of a particular debt included in the amount determined for A, B, C or D in computing the debtor's proceeds of disposition of the particular property, and

30

(b) the total of

35

(i) all amounts included under paragraph 6(1)(a) or subsection 15(1) in computing the income of any person because the particular debt was settled, or deemed by subsection 80.01(8) to have been settled, at or before the end of the taxation year that includes that time,

40

(ii) all amounts renounced under subsection 66(10), (10.1), (10.2) or (10.3) by the debtor in respect of the particular debt,

(iii) all amounts each of which is a forgiven amount (within the meaning assigned by subsection 80(1)) in respect of the debt at a previous time that the particular debt was deemed by subsection 80.01(8) to have been settled,

45

(iv) where the particular debt is an excluded obligation (within the meaning assigned by subsection 80(1)), the particular specified amount, and

(v) the lesser of

5

(A) the unpaid interest accrued to that time on the particular debt, and

(B) the amount, if any, by which the total of all amounts included because of section 80.4 in computing the debtor's income for the taxation year that includes that time or for a preceding taxation year in respect of interest on the particular debt exceeds the total of all amounts paid before that time on account of interest on the particular debt;

10

15

G is the fair market value at that time of the particular property; and

H is the fair market value at that time of all properties surrendered by the debtor to the creditor at that time.

20

#### Subsequent payment by debtor

(4) An amount paid at any time by a person as, on account of or in satisfaction of, a specified amount of a debt that can reasonably be considered to have been included in the amount determined for A, C or D in subsection (3) in respect of a property surrendered before that time by the person shall be deemed to be a repayment of assistance, at that time in respect of the property, to which

25

30

(a) subsection 39(13) applies, where the property was capital property (other than depreciable property) of the person immediately before its surrender,

(b) paragraph 20(1)(hh.1) applies, where the cost of the property to the person was an eligible capital expenditure,

35

(c) the description of E in the definition "cumulative Canadian exploration expense" in subsection 66.1(6), the description of D in the definition "cumulative Canadian development expense" in subsection 66.2(5) or the description of D in the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5), as the case may be, applies, where the cost of the property to the person was a Canadian exploration expense, a Canadian development expense or a Canadian oil and gas property expense, or

40

45

(d) paragraph 20(1)(hh) applies, in any other case.

Subsequent application of provisions with respect to employee or shareholder debt

(5) Any amount included in computing a person's income for a taxation year under paragraph 6(1)(a) or subsection 15(1) that can reasonably be considered to have been included in the amount determined for A, C or D in subsection (3) as a consequence of properties being surrendered before the year by the person shall be deemed to be a repayment by the person, immediately before the end of the year, of assistance to which subsection (4) applies. 5 10

Surrender of property does not constitute payment or repayment by debtor

(6) Where a specified amount of a debt is included in the amount determined at any time for A, B, C or D in subsection (3) in respect of a property surrendered at that time by a person to a creditor of the person, for the purpose of computing the person's income, no amount shall be considered to have been paid or repaid by the person as a consequence of the acquisition or reacquisition of the surrendered property by the creditor. 15 20

Seizure of property by creditor

79.1(1) In this section, "creditor", "debt", "person", "property" and "specified amount" have the meanings assigned by subsection 79(1) and "specified cost" to a person of a debt owing to the person means, 25

(a) where the debt is capital property of the person, the adjusted cost base to the person of the debt, and 30

(b) in any other case, the cost to the person of the debt.

Application of section 79.1

(2) For the purposes of this section, a property is seized at any time by a person in respect of a debt where the beneficial ownership of the property is acquired or reacquired at that time by the person and the acquisition or reacquisition of the property was in consequence of another person's failure to pay to the person all or part of the specified amount of the debt. 35 40

Creditor's capital gains reserves

(3) Where a property is seized at any time in a particular taxation year by a creditor in respect of a debt, for the purpose of computing the income of the creditor for the particular year, the amount claimed by the creditor under subparagraph 40(1)(a)(iii) or 44(1)(e)(iii) in computing 45

the creditor's gain for the preceding taxation year from any disposition before the particular year of the property shall be deemed to be the amount, if any, by which the amount so claimed exceeds the total of all amounts each of which is an amount determined under paragraph (6)(a) or (b) in respect of the seizure.

5

#### Creditor's inventory reserves

(4) Where a property is seized at any time in a particular taxation year by a creditor in respect of a debt, for the purpose of computing the income of the creditor for the particular year, the amount deducted under paragraph 20(1)(n) in computing the income of the creditor for the preceding taxation year in respect of any disposition of the property before the particular year shall be deemed to be the amount, if any, by which the amount so deducted exceeds the total of all amounts each of which is an amount determined under paragraph (6)(a) or (b) in respect of the seizure.

10

15

#### Adjustment for creditor where disposition and reacquisition of capital property in same year

20

(5) Where a property is seized at any time in a taxation year by a creditor in respect of one or more debts and the property was capital property of the creditor that was disposed of by the creditor at a previous time in the year, the proceeds of disposition of the property to the creditor at the previous time shall be deemed to be the lesser of the amount of the proceeds (determined without reference to this subsection) and the amount that is the greater of

25

(a) the amount, if any, by which the amount of such proceeds (determined without reference to this subsection) exceeds such portion of the proceeds as is represented by the specified amounts of those debts immediately before that time, and

30

(b) the cost amount to the creditor of the property immediately before the previous time.

35

#### Cost of seized properties for creditor

(6) Where a particular property is seized at any time in a taxation year by a creditor in respect of one or more debts, the cost to the creditor of the particular property shall be deemed to be the amount, if any, by which the total of

40

(a) that proportion of the total specified costs immediately before that time to the creditor of those debts that

45

(i) the fair market value of the particular property immediately before that time

is of

(ii) the fair market value of all properties seized by the creditor immediately before that time in respect of those debts, and

(b) the total of all amounts each of which is an outlay or expense made or incurred, or a specified amount at that time of a debt that is assumed, by the creditor at or before that time to protect the creditor's interest in the particular property, except to the extent the amount

(i) was included in the cost to the creditor of property other than the particular property,

(ii) included before that time in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts of the creditor, or

(iii) was deductible in computing the creditor's income for the year or a preceding taxation year

exceeds

(c) the amount, if any, claimed or deducted by the creditor under paragraph 20(1)(n) or subparagraph 40(1)(a)(iii) or 44(1)(e)(iii), as the case may be, in respect of the particular property in computing the creditor's income or capital gain for the preceding taxation year or the amount by which the proceeds of disposition of the creditor of the particular property are reduced because of subsection (5) in respect of a disposition of the particular property by the creditor occurring before that time and in the year.

Treatment of debt

(7) Where a property is seized at any time in a taxation year by a creditor in respect of a debt, the amount received on account of the debt as a consequence of the seizure shall be deemed to be equal to the specified cost to the creditor of the debt.

Claims by creditor for bad and doubtful debts

(8) Where a property is seized at any time in a taxation year by a creditor in respect of a debt, no amount in respect of the principal amount of the debt shall be

(a) deductible in computing the creditor's income for the year or a subsequent taxation year as a bad or doubtful debt; or

(b) included after that time in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts of the creditor as a bad or doubtful debt. 5

**(2) Subsection (1) applies to property acquired or reacquired after February 21, 1994, other than property acquired or reacquired pursuant to a court order made before February 22, 1994.**

**(3) Where a taxpayer so elects in writing filed with the Minister of National Revenue, paragraph 79(f) of the Act shall apply to the taxpayer in respect of property reacquired by the taxpayer after 1991 as if it read as follows:** 10

(e.1) where the property is capital property of the taxpayer and was disposed of by the taxpayer to the other person in the year and subsequently reacquired by the taxpayer in the year, the taxpayer's proceeds of disposition of the property shall be deemed to be the lesser of the proceeds of disposition of the property to the taxpayer (determined without reference to this paragraph) and the amount that is the greater of 15 20

(i) the amount, if any, by which such proceeds (determined without reference to this paragraph) exceeds such portion of the proceeds as is represented by the taxpayer's claim, and

(ii) the cost amount to the taxpayer of the property immediately before its disposition by the taxpayer; 25

(f) the taxpayer shall be deemed to have reacquired the property at the amount, if any, by which the cost at that time of the taxpayer's claim exceeds the amount described in subparagraph (e)(i) or (ii) in respect of that property or the amount, if any, by which the proceeds of disposition of the property are reduced because of paragraph (e.1), as the case may be; 30

**28.(1) Section 80 of the Act is replaced by the following:**

Debtor's gain on settlement of debts

80.(1) In this section, 35

"commercial debt obligation"  
«créance commerciale»

"commercial debt obligation" issued by a debtor means a debt obligation issued by the debtor

5

(a) where interest was paid or payable by the debtor in respect of it pursuant to a legal obligation, or

(b) if interest had been paid or payable by the debtor in respect of it pursuant to a legal obligation,

10

an amount in respect of the interest was or would have been deductible in computing the debtor's income, taxable income or taxable income earned in Canada, as the case may be, if this Act were read without reference to subsections 15.1(2) and 15.2(2), paragraph 18(1)(g), subsections 18(2), (3.1) and (4) and section 21;

15

"commercial obligation"  
«dette commerciale»

20

"commercial obligation" issued by a debtor means

(a) a commercial debt obligation issued by the debtor, or

25

(b) a distress preferred share issued by the debtor;

"debtor"  
«débiteur»

30

"debtor" includes any corporation that has issued a distress preferred share;

"directed person"  
«personne désignée»

35

"directed person" at any time in respect of a debtor means

(a) a taxable Canadian corporation or an eligible Canadian partnership by which the debtor is controlled at that time, directly or indirectly, in any manner whatever, or

40

(b) a taxable Canadian corporation or an eligible Canadian partnership that is controlled at that time, directly or indirectly, by a person described in paragraph (a);

45

"distress preferred share"  
«action privilégiée de renflouement»

"distress preferred share" issued by a corporation means, at any time, a share issued after February 21, 1994 (other than a share issued pursuant to an agreement in writing entered into on or before that date) by the corporation that is a share described in paragraph (e) of the definition "term preferred share" in subsection 248(1) that would be a term preferred share at that time if that definition were read without reference to paragraphs (e) and (f); 5 10

"eligible Canadian partnership"  
«société de personnes canadienne admissible»

"eligible Canadian partnership" at any time means a Canadian partnership none of the members of which is, at that time, 15

(a) a non-resident owned investment corporation,

(b) a person exempt, because of subsection 149(1), from Part I tax on all or part of the person's taxable income, 20

(c) a partnership, other than an eligible Canadian partnership, or

(d) a trust, other than a trust in which no non-resident person and no person described in paragraph (a), (b) or (c) is beneficially interested; 25

"excluded obligation"  
«dette exclue»

"excluded obligation" means an obligation issued by a debtor where 30

(a) the proceeds from the issue of the obligation

(i) were included in computing the debtor's income, 35

(ii) were deducted in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts, or

(iii) reduced the capital cost or cost amount to the debtor of any property of the debtor, 40

(b) an amount paid by the debtor in satisfaction of the entire principal amount of the obligation would be included in the amount determined under paragraph 28(1)(e) or section 30 in respect of the debtor, 45

(c) section 78 applies to the obligation, or



(d) the principal amount of the obligation would, if this Act were read without reference to sections 79 and 80 and the obligation were settled without any amount being paid in satisfaction of its principal amount, be included in computing the debtor's income because of the settlement of the obligation;

5

"excluded property"  
«bien exclu»

10

"excluded property" at any time means property of a non-resident debtor that would not, if it were disposed of at that time by the debtor, be taxable Canadian property of the debtor;

"excluded security"  
«valeur mobilière exclue»

15

"excluded security" issued by a corporation to a person as consideration for the settlement of a debt means

20

(a) a distress preferred share issued by the corporation to the person,

(b) a share issued by the corporation to the person under terms of the debt, where the debt was a bond, debenture or note and the terms were in effect before February 22, 1994, or

25

(c) a share issued by the corporation to the person under the terms of the debt, where the debt was a bond, debenture or note listed on a prescribed stock exchange in Canada and the terms for the conversion to the share were not established or substantially modified after the later of February 22, 1994 and the time that the bond, debenture or note was issued;

30

"forgiven amount"  
«montant remis»

35

"forgiven amount" at any time in respect of a commercial obligation issued by a debtor is the amount determined by the formula

$$A - B$$

40

where

A is the lesser of the amount for which the obligation was issued and the principal amount of the obligation, and

45

B is the total of

- (a) the amount, if any, paid at that time in satisfaction of the principal amount of the obligation,
- (b) the amount, if any, included under paragraph 6(1)(a) or subsection 15(1) in computing the income of any person because of the settlement of the obligation at that time, 5
- (c) the amount, if any, deducted at that time under paragraph 18(9.3)(f) in computing the forgiven amount in respect of the obligation, 10
- (d) the capital gain, if any, of the debtor resulting from the application of subsection 39(3) to the purchase at that time of the obligation by the debtor, 15
- (e) such portion of the principal amount of the obligation as relates to an amount renounced under subsection 66(10), (10.1), (10.2) or (10.3) by the debtor,
- (f) any portion of the principal amount of the obligation that is included in the amount determined for A, B, C or D in subsection 79(3) in respect of the debtor for the taxation year of the debtor that includes that time or for a preceding taxation year, 20
- (g) the total of all amounts each of which is a forgiven amount at a previous time that the obligation was deemed by subsection 80.01(8) or (9) to have been settled, 25
- (h) such portion of the principal amount of the obligation as can reasonably be considered to have been included under section 80.4 in computing the debtor's income for a taxation year that includes that time or for a preceding taxation year, and
- (i) where the debtor is a bankrupt at that time or the obligation is an excluded obligation, the principal amount of the obligation; 30

"person"  
«personne»

"person" includes a partnership;

"relevant loss balance" 35  
«solde de pertes applicable»

"relevant loss balance" at a particular time in respect of a commercial obligation that relates to a debtor's non-capital loss, farm loss, restricted farm loss or net capital loss, as the case may be, for a particular taxation

year means the amount of such loss that would be deductible in computing the debtor's taxable income or taxable income earned in Canada, as the case may be, for the taxation year that includes that time if

(a) the debtor had sufficient incomes from all sources and sufficient taxable capital gains, 5

(b) subsections (3) and (4) did not apply to reduce such loss at or after that time, and

(c) subsections 111(4) and (5) did not apply to the debtor,

except that, where the debtor is a corporation the control of which was acquired at a previous time by a person or group of persons and the particular year ended before the previous time, the relevant loss balance at the particular time in respect of the obligation that relates to such loss for the particular year shall be deemed to be nil unless 10

(d) the obligation was issued by the debtor before, and not in contemplation of, the acquisition of control, or 15

(e) all or substantially all of the proceeds from the issue of the obligation were used to satisfy the principal amount of another obligation to which paragraph (d) or this paragraph would apply if the other obligation were still outstanding; 20

"successor pool"  
«compte de société remplaçante»

"successor pool" at any time in respect of a commercial obligation that relates to an amount determined in relation to a debtor means such portion of that amount as would be deductible under subsection 66.7(2), (3), (4) or (5), as the case may be, in computing the debtor's income for the taxation year that includes that time, if 25

(a) the debtor had sufficient incomes from all sources,

(b) subsection (8) did not apply to reduce the amount so determined at that time, 30

(c) the year ended immediately after that time, and

(d) paragraphs 66.7(4)(a) and (5)(a) were read without reference to the expressions "30% of" and "10% of", respectively,

except that the successor pool at that time in respect of the obligation shall be deemed to be nil unless 35

(e) the obligation was issued by the debtor before, and not in contemplation of, the event described in paragraph (8)(a) that gives rise to the deductibility of all or part of that amount under subsection 66.7(2), (3), (4) or (5), as the case may be, in computing the debtor's income, or

5

(f) all or substantially all of the proceeds from the issue of the obligation were used to satisfy the principal amount of another obligation to which paragraph (e) or this paragraph would apply if the other obligation were still outstanding;

"unrecognized loss"  
«perte non constatée»

10

"unrecognized loss" at a particular time, in respect of an obligation issued by a debtor, from the disposition of a property means the amount that would, but for subparagraph 40(2)(g)(ii), be a capital loss from the disposition before the particular time of a debt or other right to receive an amount, except that where the debtor is a corporation the control of which was acquired before the particular time and after the time of the disposition by a person or group of persons, the unrecognized loss at the particular time in respect of the obligation shall be deemed to be nil unless

15

20

(a) the obligation was issued by the debtor before, and not in contemplation of, the acquisition of control, or

(b) all or substantially all of the proceeds from the issue of the obligation were used to satisfy the principal amount of another obligation to which paragraph (a) or this paragraph would apply if the other obligation were still outstanding.

25

#### Application of debt forgiveness rules

(2) For the purposes of this section,

(a) an obligation issued by a debtor is settled at any time where the obligation is settled or extinguished at that time (otherwise than by way of a bequest or inheritance);

30

(b) an amount of interest payable by a debtor in respect of an obligation issued by the debtor shall be deemed to be an obligation issued by the debtor that

(i) has a principal amount, and

35

(ii) was issued by the debtor for an amount,

equal to the portion of the amount of such interest that was deductible, or would, but for subsection 18(2) or (3.1) or section 21, have been deductible in computing the income of the debtor for a taxation year;

(c) subsections (3) to (5) and (7) to (13) apply to the forgiven amount in respect of a commercial obligation in numerical order; 5

(d) the applicable fraction of the unapplied portion of a forgiven amount at any time in respect of an obligation issued by a debtor is

(i) in respect of a loss for a taxation year that ends after 1989,  $\frac{3}{4}$ , 10

(ii) in respect of loss for a taxation year that ended before 1988,  $\frac{1}{2}$ , and

(iii) in respect of a loss for any other taxation year, the fraction required to be used under section 38 for that year;

(e) where an applicable fraction (as determined under paragraph (d)) of the unapplied portion of a forgiven amount is applied under subsection (4) to reduce at any time a loss for a taxation year, the portion of the forgiven amount so applied shall, except for the purpose of reducing the loss, be deemed to be the quotient obtained when the amount of the reduction is divided by the applicable fraction; 15  
20

(f) where  $\frac{3}{4}$  of the unapplied portion of a forgiven amount is applied under subsection (7) to reduce cumulative eligible capital, except for the purpose of reducing the cumulative eligible capital, the portion of the forgiven amount so applied shall be deemed to be  $\frac{4}{3}$  of the amount of the reduction; 25

(g) where any part of the consideration given to a person for the settlement of a debt issued by a corporation and payable to the person consists of a share (other than an excluded security) issued by the corporation to the person, the amount paid in satisfaction of the debt because of the issue of the share shall be deemed to be equal to the fair market value of the share at the time it was issued; 30

(h) where any part of the consideration given by a debtor to another person for the settlement at any time of a particular commercial debt obligation issued by the debtor and payable to the other person consists of another commercial debt obligation issued by the debtor to the other person 35

(i) an amount equal to the principal amount of the other obligation shall be deemed to be paid by the debtor at that time, because of the issue of the other obligation, in satisfaction of the principal amount of the particular obligation, and

(ii) the other obligation shall be deemed to have been issued for an amount determined by the formula 5

$$A \times B/C$$

where

A is equal to the principal amount of the other obligation,

B is equal to the amount for which the particular obligation was issued, and 10

C is equal to the principal amount of the particular obligation;

(i) where 2 or more commercial obligations issued by a debtor are settled at the same time, those obligations shall be treated as if they were settled at different times in the order designated by the debtor in a prescribed form filed with the debtor's return of income under this Part for the debtor's taxation year that includes that time or, if the debtor does not designate any such order, in the order designated by the Minister; 15

(j) for the purpose of determining, at any time, whether 2 persons are related to each other or whether any person is controlled by any other person, it shall be assumed that 20

(i) each partnership and each trust is a corporation having a capital stock of a single class of voting shares divided into 100 issued shares, 25

(ii) each member of a partnership and each beneficiary under a trust owned at that time the number of issued shares of that class that is equal to the proportion of 100 that

(A) the fair market value at that time of the member's interest in the partnership or the beneficiary's interest in the trust, as the case may be 30

is of

(B) the fair market value at that time of all members' interests in the partnership or all beneficiaries' interests in the trust, as the case may be, and 35

(iii) where a beneficiary's share of the income or capital of a trust depends upon the exercise by any person of, or the failure by any person to exercise, any discretionary power, the fair market value at any time of the beneficiary's interest in the trust is equal to

(A) where the beneficiary is not entitled to receive or otherwise obtain the use of any of the income or capital of the trust before the death after that time of one or more other beneficiaries under the trust, nil, and 5

(B) in any other case, the total fair market value at that time of all beneficiaries' interests under the trust; 10

(k) where an obligation is denominated in a currency (other than the Canadian currency), the forgiven amount at any time in respect of the obligation shall be determined with reference to the relative value of that currency and the Canadian dollar at the time the obligation was issued; and 15

(l) where an amount is paid in satisfaction of the principal amount of a particular commercial obligation issued by a debtor and, as a consequence of the payment, the debtor is legally obliged to pay that amount to another person, the obligation to pay that amount to the other person shall be deemed to be a commercial obligation that was issued by the debtor at the same time and in the same circumstances as the particular obligation. 20

#### Reductions of non-capital losses

(3) Where a commercial obligation issued by a debtor is settled at any time, the forgiven amount at that time in respect of the obligation shall be applied to reduce at that time, in the following order: 25

(a) the debtor's non-capital loss for each taxation year that ends before that time to the extent that the amount so applied

(i) does not exceed the amount (in subsection (4) referred to as the debtor's "ordinary non-capital loss at that time for the year") that would be the relevant loss balance at that time that relates to the debtor's non-capital loss for the year if the description of E in the definition "non-capital loss" in subsection 111(8) were read without reference to the expression "the taxpayer's allowable business investment loss for the year", and 30 35

(ii) does not, because of this subsection, reduce the debtor's non-capital loss for a preceding taxation year;

(b) the debtor's farm loss for each taxation year that ends before that time, to the extent that the amount so applied

(i) does not exceed the amount that is the relevant loss balance at that time in respect of the obligation that relates to the debtor's farm loss for the year, and

5

(ii) does not, because of this subsection, reduce the debtor's farm loss for a preceding taxation year; and

(c) the debtor's restricted farm loss for each taxation year that ends before that time, to the extent that the amount so applied

(i) does not exceed the amount that is the relevant loss balance at that time in respect of the obligation that relates to the debtor's restricted farm loss for the year, and

10

(ii) does not, because of this subsection, reduce the debtor's restricted farm loss for a preceding taxation year.

#### Reductions of capital losses

15

(4) Where a commercial obligation issued by a debtor is settled at any time, the applicable fraction of the remaining unapplied portion of a forgiven amount at that time in respect of the obligation shall be applied to reduce at that time, in the following order:

(a) the debtor's non-capital loss for each taxation year that ends before that time to the extent that the amount so applied

20

(i) does not exceed the amount, if any, by which

(A) the relevant loss balance at that time in respect of the obligation that relates to the debtor's non-capital loss for the year

25

exceeds

(B) the debtor's ordinary non-capital loss (within the meaning assigned by subparagraph (3)(a)(i)) at that time for the year, and

(ii) does not, because of this subsection, reduce the debtor's non-capital loss for a preceding taxation year; and

30

(b) the debtor's net capital loss for each taxation year that ends before that time, to the extent that the amount so applied



(i) does not exceed the lesser of the relevant loss balance at that time in respect of the obligation that relates to the debtor's net capital loss for the year, and

(ii) does not, because of this subsection, reduce the debtor's net capital loss for a preceding taxation year.

5

### Reductions with respect to depreciable property

(5) Where a commercial obligation issued by a debtor is settled at any time, the remaining unapplied portion of the forgiven amount at that time in respect of the obligation shall be applied, in such manner as is designated by the debtor in a prescribed form filed with the debtor's return of income under this Part for the taxation year that includes that time, to reduce immediately after that time the following amounts:

10

(a) the capital cost to the debtor of a depreciable property of a prescribed class that is owned by the debtor immediately after that time;

15

(b) the capital cost to the debtor of a depreciable property, other than a depreciable property of a prescribed class, that is owned by the debtor immediately after that time; and

(c) the undepreciated capital cost to the debtor of depreciable property of a prescribed class immediately after that time.

20

### Restriction with respect to depreciable property

(6) Where a commercial obligation issued by a debtor is settled at any time,

(a) an amount may be applied under subsection (5) to reduce, immediately after that time, the capital cost to the debtor of a depreciable property of a prescribed class only to the extent that

25

(i) the undepreciated capital cost to the debtor of depreciable property of that class at that time

exceeds

(ii) the total of all other reductions immediately after that time to that undepreciated capital cost; and

30

(b) an amount may be applied under subsection (5) to reduce, immediately after that time, the capital cost to the debtor of a depreciable property (other than a depreciable property of a prescribed class) only to the extent that

35

(i) the capital cost to the debtor of the property at that time

exceeds

(ii) the amount that was allowed to the debtor before that time under Part XVII of the Regulations in respect of the property.

#### Reductions of cumulative eligible capital

5

(7) Where a commercial obligation issued by a debtor is settled at any time, 3/4 of the remaining unapplied portion of the forgiven amount at that time in respect of the obligation shall be applied (to the extent designated in a prescribed form filed with the debtor's return of income under this Part for the taxation year that includes that time) to reduce immediately after that time the cumulative eligible capital of the debtor in respect of each business of the debtor (or, in the case where the debtor was non-resident, in respect of each business carried on in Canada by the debtor).

10

#### Reductions of resource expenditures

15

(8) Where a commercial obligation issued by a debtor is settled at any time, the remaining unapplied portion of the forgiven amount at that time in respect of the obligation shall be applied (to the extent designated in a prescribed form filed with the debtor's return of income under this Part for the taxation year that includes that time) to reduce immediately after that time the following amounts:

20

(a) where the debtor is a corporation resident in Canada throughout that year, each particular amount that would be determined in respect of the debtor under paragraph 66.7(2)(a), (3)(a), (4)(a) or (5)(a) if paragraphs 66.7(4)(a) and (5)(a) were read without reference to the expressions "30% of" and "10% of", respectively, as a consequence of the acquisition of control of the debtor by a person or group of persons, the debtor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the debtor by way of an amalgamation or merger, where the amount so applied does not exceed the successor pool immediately after that time in respect of the obligation that relates to the particular amount;

25

30

(b) the cumulative Canadian development expense (within the meaning assigned by subsection 66.2(5)) of the debtor;

(c) the cumulative Canadian oil and gas property expense (within the meaning assigned by subsection 66.4(5)) of the debtor; and

35

(d) the total determined under paragraph 66(4)(a) in respect of the debtor, where

(i) the debtor is resident in Canada throughout that year, and

(ii) the amount so applied does not exceed such portion of the total of such of the debtor's foreign exploration and development expenses (within the meaning assigned by subsection 66(15)) as were incurred by the debtor before that time and would be deductible under subsection 66(4) in computing the debtor's income for that year if the debtor had sufficient income described in subparagraph 66(4)(b)(ii) and if that year ended at that time. 5 10

#### Reductions of adjusted cost bases of capital properties

(9) Where a commercial obligation issued by a debtor is settled at any time and amounts have been designated under subsections (5), (7) and (8) to the maximum extent permitted in respect of the settlement,

(a) the remaining unapplied portion of the forgiven amount at that time in respect of the obligation shall be applied (to the extent designated in a prescribed form filed with the debtor's return of income under this Part for the taxation year that includes that time) to reduce immediately after that time the adjusted cost bases to the debtor of capital properties (other than shares of the capital stock of corporations of which the debtor is a specified shareholder at that time, debts issued by corporations of which the debtor is a specified shareholder at that time, interests in partnerships that are related to the debtor at that time, depreciable property that is not of a prescribed class, personal-use properties and excluded properties) that are owned by the debtor immediately after that time; 15 20 25

(b) an amount may be applied under this subsection to reduce, immediately after that time, the capital cost to the debtor of a depreciable property of a prescribed class only to the extent that

(i) the capital cost immediately after that time to the debtor of the property (determined without reference to the settlement of the obligation at that time) 30

exceeds

(ii) its capital cost immediately after that time to the debtor for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and any regulations made for the purpose of paragraph 20(1)(a) (determined without reference to the settlement of the obligation at that time); and 35

(c) for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and any regulations made for the purpose of paragraph 20(1)(a), no amount shall be considered to have been applied under this subsection.

#### Reduction of adjusted cost bases of certain shares and debts

5

(10) Where a commercial obligation issued by a debtor is settled at any time in a taxation year and amounts have been designated by the debtor under subsections (5), (7), (8) and (9) to the maximum extent permitted in respect of the settlement the remaining unapplied portion of that forgiven amount shall be applied (to the extent that it is designated in a prescribed form filed with the debtor's return of income under this Part for the year) to reduce immediately after that time the adjusted cost bases to the debtor of capital properties, owned by the debtor immediately after that time, that are shares of the capital stock of corporations of which the debtor is a specified shareholder at that time and debts issued by corporations of which the debtor is a specified shareholder at that time (other than shares of the capital stock of corporations related to the debtor at that time, debts issued by corporations related to the debtor at that time and excluded properties).

10

15

#### Reduction of adjusted cost bases of certain shares, debts and partnership interests

20

(11) Where a commercial obligation issued by a debtor is settled at any time in a taxation year and amounts have been designated by the debtor under subsections (5), (7), (8), (9) and (10) to the maximum extent permitted in respect of the settlement, the remaining unapplied portion of that forgiven amount shall be applied (to the extent that it is designated in a prescribed form filed with the debtor's return of income under this Part for the year) to reduce immediately after that time the adjusted cost bases to the debtor of

25

(a) shares and debts that are capital properties (other than excluded properties and properties the adjusted cost bases of which are reduced at that time under subsection (9) or (10)) of the debtor immediately after that time, and

30

(b) interests in partnerships that are related to the debtor at that time that are capital properties (other than excluded properties) of the debtor immediately after that time.

35

## Capital gain where current year capital loss

(12) Where a commercial obligation issued by a debtor (other than a partnership) is settled at any time in a taxation year and amounts have been designated by the debtor under subsections (5), (7), (8) and (9) to the maximum extent permitted in respect of the settlement,

5

(a) the debtor shall be deemed to have a capital gain for the year from the disposition of capital property (or, where the debtor is non-resident at the end of the year, taxable Canadian property), equal to the lesser of

(i) the remaining unapplied portion of the forgiven amount at that time in respect of the obligation, and

10

(ii) the amount, if any, by which the total of

(A) all of the debtor's capital losses from the dispositions of properties (other than listed personal properties and excluded properties), and

15

(B)  $\frac{4}{3}$  of the amount that would, because of subsection 88(1.2), be deductible under paragraph 111(1)(b) in computing the debtor's taxable income for the year, if the debtor had sufficient income and taxable capital gains for the year,

20

exceeds the total of

(C) all of the debtor's capital gains for the year from the dispositions of such properties (determined without reference to this subsection), and

(D) all amounts each of which is an amount deemed by this subsection to be a capital gain of the debtor for the year as a consequence of the application of this subsection to other commercial obligations settled before that time, and

25

(b) the forgiven amount at that time in respect of the obligation shall be considered to have been applied under this subsection to the extent of the amount deemed by this subsection to be a capital gain of the debtor for the year as a consequence of the application of this subsection to the settlement of the obligation at that time.

30

## Income inclusion

(13) Where a commercial obligation issued by a debtor is settled at any time in a taxation year, there shall be added, in computing the debtor's income for the year from the source in connection with which the obligation was issued, the amount determined by the formula

5

$$A + B - C - D$$

where

A is the remaining unapplied portion of the forgiven amount at that time in respect of the obligation,

B is the lesser of

10

(a) the total of all amounts designated under subsection (11) by the debtor in respect of the settlement of the obligation at that time, and

(b) the residual balance at that time in respect of the settlement of the obligation,

15

C is the total of all amounts each of which is an amount specified in an agreement filed under section 80.04 in respect of the settlement of the obligation at that time, and

D is

(a) where the debtor has designated amounts under subsections (5), (7), (8), (9) and (10) to the maximum extent permitted in respect of the settlement, the amount, if any, by which

20

(i) the total of all amounts each of which is an unrecognized loss at that time, in respect of the obligation, from the disposition of a property

25

exceeds

(ii) the total of all amounts each of which is an amount by which the amount determined before that time under this subsection in respect of a settlement of an obligation issued by the debtor has been reduced because of an amount determined under this paragraph, and

30

(b) in any other case, nil.

## Residual balance

(14) For the purpose of subsection (13), the residual balance at any time in respect of the settlement of a particular obligation issued by a debtor is the amount, if any, by which

- (a) the total of all amounts each of which is an amount that would be applied under any of subsections (3) to (10) and (12) in respect of the settlements of separate commercial obligations issued by the debtor (and directed persons at that time in respect of the debtor) if
  - (i) those obligations were issued at that time by the debtor and by those directed persons and were settled immediately after that time, 5
  - (ii) an amount equal to the remaining unapplied portion of the forgiven amount at that time in respect of the particular obligation were the forgiven amount immediately after that time in respect of each of those obligations, 10
  - (iii) amounts were designated by the debtor and those directed persons under subsections (5), (7), (8), (9) and (10) to the maximum extent permitted in respect of the settlement of each of those obligations, and 15
  - (iv) no amounts were designated by the debtor or any of those directed persons under subsection (11) in respect of the settlement of any of those obligations. 20

exceeds the total of

- (b) the amount that would be included under subsection (13) in computing the debtor's income for the year in respect of the settlement of the particular obligation at that time if the amounts determined for B and D in subsection (13) were nil, 25
- (c) all amounts each of which is an amount that would, if the amount determined for D in subsection (13) were nil, be included under subsection (13) in computing the income of any of those directed persons in respect of the settlement of the obligation that is deemed by paragraph 80.04(4)(e) to have been issued by the directed person because of the filing of an agreement under section 80.04 in respect of the settlement of the particular obligation at that time, and 30
- (d) all amounts each of which is an amount specified in an agreement (other than an agreement with any of those directed persons) filed under section 80.04 in respect of the settlement of the particular obligation at that time. 35

## Members of partnerships

(15) Where a commercial debt obligation issued by a partnership (in this subsection referred to as the "partnership obligation") is settled at any time in a fiscal period of the partnership that ends in a taxation year of a member of the partnership,

5

(a) the member may deduct, in computing the member's income for the year, such amount as the member claims not exceeding the relevant limit in respect of the partnership obligation;

(b) for the purpose of paragraph (a), the relevant limit in respect of the partnership obligation is the amount that would, if the partnership had designated amounts to the maximum extent permitted under subsections (5), (7), (8), (9) and (10) in respect of each obligation settled in that fiscal period, be included in computing the member's income for the year as a consequence of the application of subsection (13) and section 96 to the settlement of the partnership obligation; and

10

15

(c) for the purposes of this section and section 80.04,

(i) the member shall be deemed to have issued a commercial debt obligation that was settled at the end of that fiscal period,

(ii) the amount deducted under paragraph (a) in respect of the partnership obligation in computing the member's income shall be treated as if it were the forgiven amount at the end of that fiscal period in respect of the obligation referred to in subparagraph (i),

20

(iii) subject to subparagraph (iv), the obligation referred to in subparagraph (i) shall be deemed to have been issued at the same time at which, and in the same circumstances in which, the partnership obligation was issued,

25

(iv) where the member is a corporation the control of which was acquired at a particular time that is before the end of that fiscal period and before the corporation became a member of the partnership and the partnership obligation was issued before the particular time,

30

(A) subject to the application of this subparagraph to an acquisition of control of the corporation after the particular time and before the end of that fiscal period, the obligation referred to in subparagraph (i) shall be deemed to have been issued by the member after the particular time, and

35



(B) paragraph (e) of the definition "relevant loss balance" in subsection (1), paragraph (f) of the definition "successor pool" in that subsection and paragraph (b) of the definition "unrecognized loss" in that subsection do not apply in respect of that acquisition of control, and

5

(v) the source in connection with which the obligation referred to in subparagraph (i) was issued shall be deemed to be the source in connection with which the partnership obligation was issued.

#### Deemed settlement of debts

80.01(1) In this section,

10

"commercial debt obligation"  
«créance commerciale»

"commercial debt obligation" has the meaning assigned by subsection 80(1);

"commercial obligation"  
«dette commerciale»

15

"commercial obligation" has the meaning assigned by subsection 80(1);

"debtor"  
«débiteur»

"debtor" has the meaning assigned by subsection 80(1);

20

"distress preferred share"  
«action privilégiée de renflouement»

"distress preferred share" has the meaning assigned by subsection 80(1);

"forgiven amount"  
«montant remis»

25

"forgiven amount" has the meaning assigned by subsection 80(1) except that, where an amount would be included in computing a person's income under paragraph 6(1)(a) or subsection 15(1) as a consequence of the settlement of an obligation if the obligation were settled without any payment being made in satisfaction of its principal amount, "forgiven amount" in respect of that obligation has the meaning assigned by subsection 6(15.1) or 15(1.21), as the case may be;

30

"person"  
«personne»

"person" has the meaning assigned by subsection 80(1);

"specified cost"  
«coût déterminé»

5

"specified cost" at any time to a person of an obligation means,

(a) where the obligation is capital property of the person at that time, the adjusted cost base at that time to the person of the property, and

(b) in any other case, its cost to the person.

#### Application

10

(2) Paragraphs 80(2)(a), (b), (j) and (l) apply for the purposes of this section, except that paragraph 80(2)(b) does not apply for the purpose of subsection (3).

#### Deemed settlement on amalgamation

(3) Where a commercial obligation or another obligation (in this subsection referred to as the "indebtedness") of a debtor that is a corporation to pay an amount to another corporation (in this subsection referred to as the "creditor") is settled on an amalgamation of the debtor and the creditor, the indebtedness shall be deemed to have been settled immediately before the time that is immediately before the amalgamation by a payment made by the debtor and received by the creditor of an amount equal to the amount that would have been the creditor's cost amount of the indebtedness at that time if the definition "cost amount" in subsection 248(1) were read without reference to paragraph (e) of that definition.

15

20

25

#### Deemed settlement on winding-up

(4) Where

(a) there is a winding-up of a subsidiary to which the rules in subsection 88(1) apply and

(i) a debt or other obligation (in this subsection referred to as the "subsidiary's obligation") of the subsidiary to pay an amount to its parent, or

30

(ii) a debt or other obligation (in this subsection referred to as the "parent's obligation") of the parent to pay an amount to its subsidiary

is, as a consequence of the winding-up, settled at any time without any payment of an amount or by the payment of an amount that is less than the lesser of the principal amount of the subsidiary's obligation or the parent's obligation, as the case may be, and the amount that would have been the cost amount to the parent or subsidiary of the subsidiary's obligation or the parent's obligation immediately before that time if the definition "cost amount" in subsection 248(1) were read without reference to paragraph (e) of that definition, and

(b) the parent so elects in a prescribed form on or before the day on or before which the parent is required to file a return of income pursuant to section 150 for the taxation year that includes that time,

the amount paid at that time in satisfaction of the principal amount of the subsidiary's obligation or the parent's obligation shall be deemed to be equal to the amount that would be the cost amount to the parent or the subsidiary, as the case may be, of the subsidiary's obligation or the parent's obligation immediately before the winding-up if the definition "cost amount" in subsection 248(1) were read without reference to paragraph (e) of that definition.

Idem

(5) Where there is a winding-up of a subsidiary to which the rules in subsection 88(1) apply and, as a consequence of the winding-up, a distress preferred share issued by the subsidiary and owned by its parent (or a distress preferred share issued by the parent and owned by the subsidiary) is settled at any time without any payment of an amount or by the payment of an amount that is less than the lesser of the principal amount of the share and its adjusted cost base to the parent or the subsidiary, as the case may be, immediately before that time, for the purposes of applying the provisions of this Act to the issuer of the share, the amount paid at that time in satisfaction of the principal amount of the share shall be deemed to be equal to its adjusted cost base to the parent or to the subsidiary, as the case may be.

Specified obligation in relation to debt parking

(6) For the purpose of subsection (7), an obligation issued by a debtor is, at a particular time, a specified obligation of the debtor where

(a) at any previous time (other than a time before the last time, if any, the obligation became a parked obligation before the particular time),

(i) a person who owned the obligation

5

(A) dealt at arm's length with the debtor, and

(B) where the debtor is a corporation, was not a specified shareholder of the debtor, or

10

(ii) the obligation was acquired by the holder of the obligation from another person who was, at the time of that acquisition, not related to the holder or related to the holder only because of paragraph 251(5)(b), or

15

(b) the obligation is deemed by subsection 50(1) to be reacquired at the particular time.

Parked obligation

20

(7) For the purposes of this subsection and subsections (6) and (8),

(a) an obligation issued by a debtor is a "parked obligation" at any time where at that time

25

(i) the obligation is a specified obligation of the debtor; and

(ii) the holder of the obligation

30

(A) does not deal at arm's length with the debtor, or

(B) where the debtor is a corporation and the holder acquired the obligation after Announcement Date (otherwise than pursuant to an agreement in writing entered into on or before Announcement Date), is a specified shareholder of the debtor; and

35

(b) an obligation that is, at any time, acquired or reacquired in circumstances to which subparagraph (6)(a)(ii) or paragraph (6)(b) applies shall, if the obligation is a parked obligation immediately after that time, be deemed to have become a parked obligation at that time, whether or not the obligation was a parked obligation immediately before that time.

40

## Deemed settlement after debt parking

(8) Where at any particular time after February 21, 1994 a commercial debt obligation that was issued by a debtor becomes a parked obligation (otherwise than pursuant to an agreement in writing entered into before February 22, 1994) and the specified cost at the particular time to the holder of the obligation is less than 80% of the principal amount of the obligation, for the purposes of applying the provisions of this Act to the debtor

(a) the obligation shall be deemed to have been settled at the particular time; and

(b) the forgiven amount at the particular time in respect of the obligation shall be determined as if the debtor had paid an amount at the particular time in satisfaction of the principal amount of the obligation equal to that specified cost.

## Statute-barred debt

(9) Where at any particular time after February 21, 1994 a commercial debt obligation issued by a debtor that is payable to a person (other than a person with whom the debtor is related at the particular time) becomes unenforceable in a court of competent jurisdiction and the obligation would, but for this subsection, not have been settled or extinguished at the particular time, for the purposes of applying the provisions of this Act to the debtor, the obligation shall be deemed to have been settled at the particular time.

## Subsequent payments in satisfaction of debt

(10) Where a commercial debt obligation issued by a debtor is first deemed by subsection (8) or (9) to have been settled at a particular time and, at a subsequent time, a payment is made by the debtor of an amount in satisfaction of the principal amount of the obligation, in computing the debtor's income for the taxation year that includes the subsequent time from the source in connection with which the obligation was issued, there may be deducted the amount determined by the formula

$$.75(A - B)$$

where

A is the amount of the payment, and

B is the amount, if any, by which

(a) the principal amount of the obligation

exceeds the total of

(b) all amounts each of which is a forgiven amount at any time 5

(i) in the period beginning at the particular time and ending immediately before the subsequent time, and

(ii) at which a particular portion of the obligation is deemed by subsection (8) or (9) to be settled 10

in respect of the particular portion, and

(c) all amounts paid in satisfaction of the principal amount of the obligation in the period beginning at the particular time and ending immediately before the subsequent time. 15

#### Foreign currency gains and losses

(11) Where an obligation issued by a debtor is denominated in a currency (other than the Canadian currency) and the obligation is deemed by subsection (8) or (9) to have been settled, those subsections do not apply for the purpose of determining any gain or loss of the debtor on the settlement that is attributable to a fluctuation in the value of the currency relative to the value of the Canadian dollar: 20 25

#### Rules for distress preferred shares

80.02(1) In this section, "commercial debt obligation", "commercial obligation", "distress preferred share" and "person" have the meanings assigned by subsection 80(1). 30

#### General rules

(2) For the purpose of applying the provisions of this Act to an issuer of a distress preferred share, 35

(a) the principal amount, at any time, of the share shall be deemed to be the amount (determined at that time) for which the share was issued; 40

(b) the amount for which the share was issued shall, at any time, be deemed to be the amount, if any, by which the total of 45

(i) the amount for which the share was issued, determined without reference to this paragraph, and

(ii) all amounts by which the paid-up capital in respect of the share increased after the share was issued and before that time

exceeds

(iii) the total of all amounts each of which is an amount paid before that time on a reduction of the paid-up capital in respect of the share, except to the extent that the amount is deemed by section 84 to have been paid as a dividend;

(c) the share shall be deemed to be settled at such time as it is redeemed, acquired or cancelled by the issuer; and

(d) a payment in satisfaction of the principal amount of the share is any payment made on a reduction of the paid-up capital in respect of the share to the extent that the payment would be proceeds of disposition of the share within the meaning that would be assigned by the definition "proceeds of disposition" in section 54 if that definition were read without reference to paragraph (j).

#### Substitution of distress preferred share for debt

(3) Where any part of the consideration given by a corporation to another person for the settlement or extinguishment at any time of a commercial debt obligation that was issued by the corporation and owned immediately before that time by the other person consists of a distress preferred share issued by the corporation to the other person,

(a) for the purposes of section 80, the amount paid at that time in satisfaction of the principal amount of the obligation because of the issue of that share shall be deemed to be equal to the lesser of

(i) the principal amount of the obligation, and

(ii) the amount by which the paid-up capital in respect of the class of shares that include that share increases because of the issue of that share; and

(b) for the purpose of subparagraph (2)(b)(i), the amount for which the share was issued shall be deemed to be equal to the amount deemed by paragraph (a) to have been paid at that time.

#### Substitution of commercial debt obligation for distress preferred share

(4) Where any part of the consideration given by a corporation to another person for the settlement at any time of a distress preferred share that was issued by the corporation and owned immediately before

that time by the other person consists of a commercial debt obligation issued by the corporation to the other person, for the purposes of section 80

(a) the amount paid at that time in satisfaction of the principal amount of the share because of the issue of that obligation shall be deemed to be equal to the principal amount of the obligation; and 5

(b) the amount for which the obligation was issued shall be deemed to be equal to its principal amount. 10

#### Substitution of distress preferred share for other distress preferred share

(5) Where any part of the consideration given by a corporation to another person for the settlement at any time of a particular distress preferred share that was issued by the corporation and owned immediately before that time by the other person consists of another distress preferred share issued by the corporation to the other person, for the purposes of section 80 15

(a) the amount paid at that time in satisfaction of the principal amount of the particular share because of the issue of the other share shall be deemed to be equal to the amount by which the paid-up capital in respect of the class of shares that includes the other share increases because of the issue of the other share; and 20

(b) for the purpose of subparagraph (2)(b)(i), the amount for which the other share was issued shall be deemed to be equal to the amount deemed by paragraph (a) to have been paid at that time. 25

#### Substitution of non-commercial obligation for distress preferred share 30

(6) Where any part of the consideration given by a corporation to another person for the settlement at any time of a distress preferred share that was issued by the corporation and owned immediately before that time by the other person consists of another share (other than a distress preferred share) or an obligation (other than a commercial debt obligation) issued by the corporation to the other person, for the purposes of section 80, the amount paid at that time in satisfaction of the principal amount of the distress preferred share because of the issue of the other share or obligation shall be deemed to be equal to the fair market value of the other share or obligation, as the case may be, at that time. 35

#### Deemed settlement on expiry of term 45

(7) Where at any time a distress preferred share becomes a share that is not a distress preferred share, for the purposes of section 80



(a) the share shall be deemed to have been settled immediately before that time; and

(b) a payment equal to the fair market value of the share at that time shall be deemed to have been made immediately before that time in satisfaction of the principal amount of the share.

5

#### Gains on subsequent dispositions

80.03(1) In this section, "commercial debt obligation", "commercial obligation", "distress preferred share", "forgiven amount" and "person" have the meanings assigned by subsection 80(1) and "taxable dividend" does not include any capital gains dividends (within the meaning assigned by subsection 131(1)).

10

15

#### Deferred recognition of debtor's gain on settlement of debt

(2) Where at any time in a taxation year a person (in this subsection referred to as the "transferor") surrenders a particular capital property (other than a distress preferred share) that is a share, a capital interest in a trust or an interest in a partnership, the person shall be deemed to have a capital gain from the disposition at that time of another capital property (or, where the particular property is a taxable Canadian property, another taxable Canadian property) equal to the amount, if any, by which

20

25

(a) the total of all amounts deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the transferor of the particular property immediately before that time

30

exceeds the total of

(b) the amount that would be the transferor's capital gain for the year from the disposition of the particular property if this Act were read without reference to subsection 100(2), and

35

(c) where, at the end of the year, the transferor is resident in Canada or is a non-resident person who carries on business in Canada through a fixed place of business, the amount designated under subsection (7) by the transferor in respect of the disposition, at that time or immediately after that time, of the particular property.

40

#### Surrender of capital property

(3) For the purpose of subsection (2), a person shall be considered to have surrendered a property at any time only where

45

(a) in the case of a share of the capital stock of a particular corporation,

(i) the person is a corporation that disposed of the share at that time and the proceeds of disposition of the share are determined under paragraph 88(1)(b), or

(ii) the person is a corporation that owned the share at that time and, immediately after that time, amalgamates or merges with the particular corporation;

(b) in the case of a capital interest in a trust, the person disposed of the interest at that time and the proceeds of disposition are determined under paragraph 107(2)(c); and

(c) in the case of an interest in a partnership, the person disposed of the interest at that time and the proceeds of disposition are determined under paragraph 98(3)(a) or (5)(a).

#### Dispositions by corporations

(4) Where at any time in a taxation year a corporation (in this subsection referred to as the "vendor") disposes of a particular capital property that is a share, an interest in a partnership or a capital interest in a trust, otherwise than by way of a disposition to which subsection (2) or 53(6) applies, a disposition to another corporation in circumstances to which subsection 53(5) applies, or a disposition the proceeds from which are determined under subsection 47(1), section 86 or any of the provisions (other than subsection 97(2)) referred to in subsection 53(4), the vendor shall be deemed to have a capital gain from the disposition at that time of another capital property (or where the particular property is a taxable Canadian property, another taxable Canadian property) equal to the amount, if any, by which the lesser of

(a) all amounts deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the vendor of the particular property immediately before that time, and

(b) where the particular property

(i) is a share, the total of all amounts each of which is

(A) a taxable dividend on the share that was received in the specified period relating to the disposition of the share, to the extent that the dividend is deductible in computing taxable income of a holder of the share or a beneficiary under a trust that held the share, or

(B) a capital dividend on the share that was received in the specified period relating to the disposition of the share,

(ii) is an interest in a partnership, the total of all amounts each of which is

5

(A) the share of a taxable dividend relating to the interest that was received after Announcement Date and in a fiscal period of the partnership ending in the specified period relating to the disposition of the interest, to the extent that such share is deductible in computing taxable income of a person holding the interest in the partnership or a beneficiary under a trust that held the interest in the partnership, or

10

(B) the share of a capital dividend relating to the interest that was received after Announcement Date and in a fiscal period of the partnership ending in the specified period relating to the disposition of the interest,

15

(iii) is a capital interest in a trust, the total of all amounts each of which is such portion of a taxable dividend that was received by the trust in the specified period relating to the disposition of the capital interest and that was deemed by subsection 104(19) to have been received in respect of the capital interest, to the extent that such portion was deductible in computing taxable income of a person holding the capital interest

20

25

exceeds the total of

(c) the amount that would be the vendor's capital gain for the year from the disposition of the particular property if this Act were read without reference to subparagraph 40(1)(a)(iii) and subsection 100(2), and

30

(d) where the vendor is resident in Canada at the end of the year or is a non-resident person who carries on business in Canada through a fixed place of business at the end of the year, the amount designated under subsection (7) by the vendor in respect of the disposition of the particular property.

35

40

Specified period

(5) For the purpose of subsection (4), the specified period relating to a disposition at a particular time of a property by a person is the period

45

(a) beginning at or on the later of Announcement Date and the last time before the particular time that the person acquired the property, and

(b) ending at the particular time.

#### Idem

(6) For the purposes of this subsection and subsection (5), where, as a consequence of the disposition at a particular time of a property to a person, an amount was deducted under paragraph 53(2)(g.1) in computing the adjusted cost base of the property after the particular time, the person shall be deemed not to have acquired the property at the particular time and to have acquired the property at the time it was last acquired before the particular time.

#### Alternative treatment

(7) Where at any time in a taxation year a person disposes of a property, for the purposes of subsections (2) and (4) and section 80

(a) the person may designate an amount in a prescribed form filed with the person's return of income under this Part for the year; and

(b) where an amount is designated by the person under paragraph (a) in respect of the disposition,

(i) the person shall be deemed to have issued a commercial debt obligation at that time that is settled immediately after that time,

(ii) the lesser of the amount so designated and the amount that would, but for this subsection, be a capital gain determined in respect of the disposition because of subsection (2) or (4) shall be treated as if it were the forgiven amount at the time of the settlement in respect of the obligation referred to in subparagraph (i),

(iii) the source in connection with which the obligation referred to in subparagraph (i) was issued shall be deemed to be the business, if any, carried on by the person the end of the year, and

(iv) where the person does not carry on a business at the end of the year, the person shall be deemed to carry on an active business at the end of the year and the source in connection with which the obligation referred to in subparagraph (i) was issued shall be deemed to be the business deemed by this subparagraph to be carried on.

#### Lifetime capital gains exemption

(8) Where, as a consequence of the disposition at any time by an individual of a property that is a qualified farm property of the

individual or a qualified small business share of the individual (within the meanings assigned by subsection 110.6(1)), the individual is deemed by subsection (2) to have a capital gain at that time from the disposition of another property, for the purposes of sections 3, 74.3 and 111, as they apply for the purpose of section 110.6, the other property shall be deemed to be a qualified farm property of the individual or a qualified small business share of the individual, as the case may be. 5

#### Transfers of forgiven amounts 10

80.04(1) In this section, "commercial debt obligation", "commercial obligation", "debtor", "eligible Canadian partnership", "forgiven amount" and "person" have the meanings assigned by subsection 80(1).

#### Eligible transferee 15

(2) For the purpose of this section, an "eligible transferee" of a debtor at any time is a corporation or partnership that throughout

(a) the taxation year or fiscal period, as the case may be, of the debtor that includes that time, and 20

(b) the taxation year or fiscal period, as the case may be, of the corporation or the partnership that includes that time 25

is a taxable Canadian corporation or eligible Canadian partnership related (otherwise than because of a right referred to in paragraph 251(5)(b)) to the debtor. 30

#### Application 30

(3) Paragraphs 80(2)(a), (b), (j) and (l) apply for the purpose of this section. 35

#### Agreement respecting transfer of forgiven amount 35

##### (4) Where

(a) a particular commercial obligation (other than an obligation deemed by paragraph (e) to have been issued) issued by a debtor is settled at a particular time, 40

(b) amounts have been designated by the debtor under subsections 80(5) to (10) to the maximum extent permitted in respect of the settlement of the particular obligation at the particular time, 45

(c) the debtor and an eligible transferee of the debtor at the particular time file under this section an agreement between them in respect of that settlement, and

(d) an amount is specified in that agreement

5

the following rules apply:

(e) except for the purposes of paragraph 20(1)(n.1), subsection 80(11) and section 61.2, the transferee shall be deemed to have issued a commercial debt obligation that was settled at the particular time,

10

(f) the specified amount shall be deemed to be the forgiven amount at the particular time in respect of the obligation referred to in paragraph (e),

15

(g) subject to paragraph (h), the obligation referred to in paragraph (e) shall be deemed to have been issued at the same time (in paragraph (h) referred to as the "time of issue") at which, and in the same circumstances in which, the particular obligation was issued,

20

(h) where the transferee is a corporation the control of which was acquired by a person or group of persons after the time of issue and the transferee and the debtor were not related to each other immediately before that acquisition of control,

25

(i) the obligation referred to in paragraph (e) shall be deemed to have been issued after that acquisition of control, and

30

(ii) paragraph (e) of the definition "relevant loss balance" in subsection 80(1), paragraph (f) of the definition "successor pool" in that subsection and paragraph (b) of the definition "unrecognized loss" in that subsection do not apply in respect of that acquisition of control, and

35

(i) the source in connection with which the obligation referred to in paragraph (e) was issued shall be deemed to be the source in connection with which the particular obligation was issued.

40

Consideration for agreement

(5) For the purposes of this Part,

45

(a) any amount paid or payable by a debtor and received or receivable by an eligible transferee as consideration for entering into an agreement filed under this section shall be deemed to be nil; and

(b) no benefit shall be deemed to have been conferred on the debtor as a consequence of the debtor entering into an agreement filed under this section.

Manner of filing agreement

5

(6) Subject to subsection (7), a particular agreement between a debtor and an eligible transferee in respect of an obligation issued by the debtor that was settled at any time shall be deemed not to have been filed under this section

10

(a) where it is not filed with the Minister in a prescribed form

(i) on or before the later of

15

(A) the day on or before which the debtor's return of income under this Part is required to be filed for the taxation year or fiscal period, as the case may be, that includes that time (or would be required to be filed if tax under this Part were payable by the debtor for the year), and

20

(B) the day on or before which the transferee's return of income under this Part is required to be filed for the taxation year or fiscal period, as the case may be, that includes that time, or

25

(ii) within the period within which the debtor or the transferee may serve a notice of objection to an assessment of tax payable under this Part for a taxation year or fiscal period, as the case may be, described in clause (i)(A) or (B), as the case may be;

30

(b) where it is not accompanied by,

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

35

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

40

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

45

(iv) where the transferee is a corporation and its directors are not legally entitled to administer its affairs, a certified copy of the

document by which the person legally entitled to administer its affairs authorized the agreement to be made; or

- (c) if an agreement amending the particular agreement has been filed in accordance with this section, except where subsection (8) applies to the particular agreement. 5

#### Idem

- (7) For the purpose of subsection (6), where an obligation is settled at any time in a fiscal period of a partnership, it shall be assumed that 10

(a) the partnership is required to file a return of income under this Part for the fiscal period on or before the latest day on or before which any member of the partnership during the fiscal period is required to file a return of income under this Part for the taxation year in which that fiscal period ends (or would be required to file such a return of income if tax under this Part were payable by the member for that year), and 15

(b) the partnership may serve a notice of objection described in subparagraph (6)(a)(ii) within each period within which any member of the partnership during the fiscal period may serve a notice of objection to tax payable under this Part for a taxation year in which that fiscal period ends. 20 25

#### Related corporations

- (8) Where at any time a corporation has become related to another corporation and it can reasonably be considered that the main purpose of the corporation becoming related to the other corporation was to enable the corporations to file an agreement under this section, the amount specified in the agreement shall be deemed to be nil for the purpose of the description of C in subsection 80(13). 30 35

#### Assessment of taxpayers in respect of agreement

- (9) The Minister shall, notwithstanding subsections 152(4) to (5), assess or reassess the tax, interest and penalties payable under this Act by any taxpayer in order to take into account an agreement filed under this section. 40

#### Liability of debtor

- (10) Without affecting the liability of any person under any other provision of this Act, where a debtor and an eligible transferee file an agreement between them under this section in respect of an obligation 45



issued by the debtor that was settled at any time, the debtor is, to the extent of 40% of the amount specified in the agreement, liable to pay

(a) where the transferee is a corporation, all taxes payable under this Act by it for taxation years ending in the period beginning at that time and ending 10 calendar years after that time, 5

(b) where the transferee is a partnership, the total of all amounts each of which is the tax payable under this Act by a person for a taxation year 10

(i) beginning or ending in that period, and

(ii) that includes the end of a fiscal period of the partnership during which the person was a member of the partnership, and 15

(c) interest and penalties in respect of such taxes.

Joint liability 20

(11) Where taxes, interest and penalties are payable under this Act by a person for a taxation year and those taxes, interest and penalties are payable by a debtor because of subsection (10), the debtor and the person are jointly and severally liable to pay those amounts. 25

Assessments of in respect of liability

(12) Where a debtor and an eligible transferee file an agreement between them under this section in respect of an obligation issued by the debtor that was settled at a particular time, 30

(a) where the debtor is an individual or a corporation, the Minister may at any subsequent time assess the debtor in respect of taxes, interest and penalties for which the debtor is liable because of subsection (10); and 35

(b) where the debtor is a partnership, the Minister may at any subsequent time assess any person who has been a member of the partnership in respect of taxes, interests and penalties for which the partnership is liable because of subsection (10), to the extent that those amounts relate to taxation years of the transferee (or, where the transferee is another partnership, members of the other partnership) that end at or after 45

(i) where the person was not a member of the partnership at the particular time, the first subsequent time the person becomes a member of the partnership, and

(ii) in any other case, the particular time.

5

#### Idem

(13) The provisions of Division I apply to an assessment under subsection (12) as though it had been made under section 152.

10

#### Partnership members

(14) For the purposes of paragraphs (10)(b) and (12)(b) and this subsection, where at any time a member of a particular partnership is another partnership, each member of the other partnership shall be deemed to be a member of the particular partnership at that time.

15

(2) Sections 80 to 80.04 of the Act, as enacted by subsection (1), apply to taxation years that end after February 21, 1994, except that

(a) subsection (1) does not, other than for the purposes of subsections 6(15) and (15.1), 15(1.2) and (1.21) and 79 of the Act, apply to any obligation settled or extinguished

20

(i) before February 22, 1994,

(ii) after February 21, 1994 under the terms of an agreement in writing entered into on or before that date,

25

(iii) before 1996 pursuant to a restructuring of debt in connection with a proceeding commenced in a court in Canada before February 22, 1994,

(iv) before 1996 in connection with a proposal (or notice of intention to make a proposal) that was filed under the *Bankruptcy and Insolvency Act* before February 22, 1994, or

30

(v) before 1996 in connection with a written offer that was made by, or communicated to, the holder of the obligation before February 22, 1994; and

(b) in its application with respect to interest accruing before July 14, 1990, the words "was deductible" in paragraph 80(2)(b) of the Act, as enacted by subsection (1), shall be read as "was deducted"; and

35

(c) a form referred to in section 80 or subsection 80.03(7) or 80.04(6) of the Act, as enacted by subsection (1), shall be deemed to have been filed on a timely basis if it is filed with the Minister of National Revenue before 1996.

29.(1) The portion of paragraph 85(4)(b) of the Act before subparagraph (i) is replaced by the following: 5

(b) except where the property so disposed of was, immediately after the disposition, an obligation that was payable to the corporation by another corporation that is related to the corporation or by a corporation or a partnership that would be related to the corporation if paragraph 80(2)(j) applied for the purpose of this paragraph, in computing the adjusted cost base to the taxpayer of all shares of any particular class of the capital stock of the corporation owned by the taxpayer immediately after the disposition, there shall be added that proportion of the amount, if any, by which 10 15

(2) Subsection (1) applies to property disposed of after Announcement Date, other than property disposed of pursuant to an agreement in writing entered into on or before Announcement Date.

30.(1) Section 86 of the Act is amended by adding the following after subsection (3): 20

Computation of adjusted cost base of property

(4) Where a taxpayer has disposed of old shares in circumstances described in subsection (1), 25

(a) there shall be deducted after the disposition in computing the adjusted cost base to the taxpayer of each new share the amount determined by the formula 30

$$A \times B/C$$

where

A is the amount, if any, by which 35

(i) the total of all amounts deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the taxpayer of the old shares immediately before the disposition, 40

exceeds

(ii) the amount that would be the taxpayer's capital gain for the taxation year that includes the time of the disposition from the disposition of the old shares if paragraph 40(1)(a) were read without reference to subparagraph (iii) of that paragraph,

5

B is the fair market value of the new share at the time it was acquired by the taxpayer in consideration for the disposition of the old shares, and

C is the total of all amounts each of which is the fair market value of a new share at the time it was acquired by the taxpayer in consideration for the disposition of the old shares; and

10

(b) the amount determined under paragraph (a) in respect of the acquisition shall be added in computing the adjusted cost base to the taxpayer of that share after the disposition.

15

**(2) Subsection (1) applies to taxation years that end after February 21, 1994.**

**31.(1) Subsection 87(2) of the Act is amended by adding the following after paragraph (h):**

20

**Idem**

(h.1) for the purposes of paragraph 20(1)(n.1), the description of F in subsection 79(3), the definition "forgiven amount" in subsection 80(1), subsection 80.03(7) and section 80.04, the new corporation shall be deemed to be the same corporation as, and a continuation of, each predecessor corporation;

25

**(2) Section 87 of the Act is amended by adding the following after subsection (5):**

**Adjusted cost base of option**

30

(5.1) Where the cost to a taxpayer of a new option is determined at any time under subsection (5),

(a) there shall be deducted after that time in computing the adjusted cost base to the taxpayer of the new option the total of all amounts deducted under paragraph 53(2)(g.1) in computing, immediately before that time, the adjusted cost base to the taxpayer of the old option; and

35

(b) the amount determined under paragraph (a) shall be added after that time in computing the adjusted cost base to the taxpayer of the new option.

**(3) Section 87 of the Act is amended by adding the following after subsection (6):**

5

**Adjusted cost base of property**

(6.1) Where the cost to a taxpayer of a particular property that is a bond, debenture or note is determined at any time under subsection (6) and the terms of the bond, debenture or note conferred upon the holder the right to exchange that bond, debenture or note for shares,

10

(a) there shall be deducted after that time in computing the adjusted cost base to the taxpayer of the bond, debenture or note the total of all amounts deducted under paragraph 53(2)(g.1) in computing, immediately before that time, the adjusted cost base to the taxpayer of the property for which the particular property was exchanged at that time; and

15

(b) the amount determined under paragraph (a) in respect of the particular property shall be added after that time in computing the adjusted cost base to the taxpayer of the particular property.

20

**(4) Subsections (1), (2) and (3) apply to taxation years that end after February 21, 1994.**

**32.(1) Clause 88(1)(c)(ii)(B) of the Act is replaced by the following:**

25

(B) any reduction of the cost amount to the subsidiary of the property made because of section 80 on the winding-up,

**(2) Subsection (1) applies to windings-up that begin after July 13, 1990.**

30

**33.(1) The formula in the definition "foreign accrual property income" in subsection 95(1) of the Act is replaced by the following:**

$$(A + \underline{A.1} + \underline{A.2} + B + C) - (D + E + F + \underline{G})$$

**(2) The portion of the description of A in the definition "foreign accrual property income" in subsection 95(1) before paragraph (a) is replaced by the following:**

35

A is the amount that would, if section 80 did not apply to the affiliate for the year or a preceding taxation year, be the total of the affiliate's incomes for the year from property and businesses (other than active businesses), other than

**(3) The definition "foreign accrual property income" in subsection 95(1) of the Act is amended by adding the following after the description of A:** 5

A.1 is the total of all amounts included in computing the affiliate's income from property or businesses (other than active businesses) for the year because of subsection 80(13), 10

A.2 is the amount determined for G in respect of the affiliate for the preceding taxation year,

**(4) The definition "foreign accrual property income" in subsection 95(1) of the Act is amended by striking out the word "and" at the end of the description of E, by adding the word "and" at the end of the description of F and by adding the following after the description of F:** 15

G is amount, if any, by which

(a) the total of amounts determined for A.1 and A.2 in respect of the affiliate for the year 20

exceeds

(b) the total of all amounts determined for D to F in respect of the affiliate for the year; 25

**(5) Subsection 95(2) of the Act is amended by adding the following after paragraph (g):**

(g.1) in computing the foreign accrual property income of a foreign affiliate of a taxpayer the Act shall be read 30

(i) as if the expression "income, taxable income or taxable income earned in Canada, as the case may be" in the definition "commercial debt obligation" in subsection 80(1) were read as "foreign accrual property income (within the meaning assigned by subsection 95(1))", and 35

(ii) without reference to subsections 80(3) to (12) and (15) and 80.01(5) to (11) and sections 80.02 to 80.04; 40

**(6) Subsections (1) to (5) apply to taxation years that end after February 21, 1994.**

**34.(1) Subsection 96(3) of the Act is replaced by the following:**

Agreement or election of partnership members

(3) Where a taxpayer who was a member of a partnership during a fiscal period has, for any purpose relevant to the computation of the taxpayer's income from the partnership for the fiscal period, made or executed an agreement or an election under or in respect of the application of any of subsections 13(4), (15) and (16), 14(6), 20(9) and 21(1) to (4), section 22, subsection 29(1), section 34, clause 37(8)(a)(ii)(B) and subsections 44(1) and (6) and 50(1), section 80.04 and subsection 97(2) that, but for this subsection, would be a valid agreement or election, the following rules apply:

(a) the agreement or election is not valid unless

(i) it was made or executed on behalf of the taxpayer and each other person who was a member of the partnership during the fiscal period, and

(ii) the taxpayer had authority to act for the partnership;

(b) unless the agreement or election is invalid because of paragraph (a), each other person who was a member of the partnership during the fiscal period shall be deemed to have made or executed the agreement or election; and

(c) notwithstanding paragraph (a), any agreement or election deemed by paragraph (b) to have been made or executed by any person shall be deemed to be a valid agreement or election made or executed by that person.

**(2) Subsection (1) applies to fiscal periods that end after February 21, 1994.**

**35.(1) The portion of paragraph 97(3)(b) of the Act before subparagraph (i) is replaced by the following:**

(b) except where the property so disposed of was, immediately after the disposition, an obligation that was payable to the partnership by a corporation that is related to the taxpayer or by a corporation or partnership that would be related to the taxpayer if paragraph 80(2)(j) applied for the purposes of this paragraph, in computing at any time

after the disposition the adjusted cost base to the taxpayer of the taxpayer's interest in the partnership immediately after the disposition, there shall be added the amount, if any, by which

(2) Subsection (1) applies to property disposed of after Announcement Date, other than property disposed of pursuant to an agreement in writing entered into on or before Announcement Date. 5

36.(1) Paragraph 107(1)(a) of the Act is replaced by the following:

(a) where the trust is a personal trust or a prescribed trust, for the purpose of computing the taxpayer's taxable capital gain, if any, from the disposition, the adjusted cost base to the taxpayer of the interest, or the part of the interest, as the case may be, immediately before the disposition shall be deemed to be the greater of 10

(i) its adjusted cost base, otherwise determined, to the taxpayer immediately before the disposition, and 15

(ii) the amount, if any, by which

(A) its cost amount to the taxpayer immediately before the disposition

exceeds 20

(B) the total of all amounts deducted under paragraph 53(2)(g.1) in computing its adjusted cost base to the taxpayer immediately before the disposition;

(2) Subsection (1) applies to taxation years that end after February 21, 1994. 25

37.(1) The formula in the definition "farm loss" in subsection 111(8) of the Act is replaced by the following:

$$A - B - \underline{C}$$

(2) The definition "farm loss" in subsection 111(8) of the Act is amended by striking out the word "and" at the end of the description of A, by adding the word "and" at the end of the description of B and by adding the following after the description of B: 30



C is the total of all amounts by which the farm loss of the taxpayer for the year is required to be reduced because of section 80;

**(3) The definition "net capital loss" in subsection 111(8) of the Act is replaced by the following:**

"net capital loss"  
«perte en capital nette»

5

"net capital loss" of a taxpayer for a taxation year means the amount determined by the formula

$$A - B + \underline{C} - \underline{D}$$

where

10

A is the amount, if any, determined under subparagraph 3(b)(ii) in respect of the taxpayer for the year,

B is the lesser of the total determined under subparagraph 3(b)(i) in respect of the taxpayer for the year and the amount determined for A in respect of the taxpayer for the year,

15

C is the least of

(a) the amount of the allowable business investment losses of the taxpayer for the taxpayer's seventh preceding taxation year,

(b) the amount, if any, by which the amount of the non-capital loss of the taxpayer for the taxpayer's seventh preceding taxation year exceeds the total of all amounts in respect of that non-capital loss deducted in computing the taxpayer's taxable income or claimed by the taxpayer under paragraph 186(1)(c) or (d) for the year or for any preceding taxation year, and

20

(c) where the taxpayer is a corporation the control of which was acquired by a person or group of persons before the end of the year and after the end of the taxpayer's seventh preceding taxation year, nil, and

25

D is the total of all amounts by which the net capital loss of the taxpayer for the year is required to be reduced because of section 80;

30

**(4) The first formula in the definition "non-capital loss" in subsection 111(8) of the Act is replaced by the following:**

$$(A + B) - (C + D + \underline{D.1} + \underline{D.2})$$

(5) The definition "non-capital loss" in subsection 111(8) of the Act is amended by striking out the word "and" at the end of the description of D, by adding the word "and" at the end of the description of D.1 and by adding the following after the description of D.1:

5

D.2 is the total of all amounts by which the non-capital loss of the taxpayer for the year is required to be reduced because of section 80;

(6) Subsections (1) to (5) apply to taxation years that end after February 21, 1994.

10

38.(1) Subsection 138(11.93) of the Act is replaced by the following:

Property acquired on default in payment

(11.93) Where, at any time in a taxation year of an insurer, the beneficial ownership of property is acquired or reacquired by the insurer in consequence of the failure to pay all or any part of an amount (in this subsection referred to as the "insurer's claim") owing to the insurer at that time in respect of a bond, debenture, mortgage, hypothec, agreement of sale or any other form of indebtedness owned by the insurer, the following rules apply to the insurer:

15

20

(a) section 79.1 does not apply in respect of the acquisition or reacquisition;

(b) the insurer shall be deemed to have acquired or reacquired, as the case may be, the property at an amount equal to the fair market value of the property, immediately before that time;

25

(c) the insurer shall be deemed to have disposed at that time of the portion of the indebtedness represented by the insurer's claim for proceeds of disposition equal to that fair market value and, immediately after that time, to have reacquired that portion of the indebtedness at a cost of nil;

30

(d) the acquisition or reacquisition shall be deemed to have no effect on the form of the indebtedness; and

(e) in computing the insurer's income for the year or a subsequent taxation year, no amount is deductible under paragraph 20(1)(l) in respect of the insurer's claim.

35

**(2) Subsection (1) applies to property acquired or reacquired after February 21, 1994, other than acquisitions or reacquisitions pursuant to a court order made before February 22, 1994.**

**39.(1) Section 191.3 of the Act is amended by adding the following after subsection (1):**

5

Consideration for agreement

(1.1) For the purposes of Part I of the Act,

(a) any amount paid or payable by a transferor corporation or received or receivable by a transferee corporation as consideration for entering into an agreement filed under this section shall be deemed to be nil; and

10

(b) no benefit shall be deemed to have been conferred on the transferor corporation as a consequence of the transferor corporation entering into an agreement filed under this section.

15

**(2) Subsection (1) applies to the 1988 and subsequent taxation years.**

**40.(1) Subsection 248(1) of the Act is amended by adding in alphabetical order the following definition:**

20

"bankrupt"  
«failli»

"bankrupt" and "estate of the bankrupt" have the meanings assigned by the *Bankruptcy and Insolvency Act*;

25

**(2) The definition "restricted farm loss" in subsection 248(1) of the Act is replaced by the following:**

"restricted farm loss"  
«perte agricole restreinte»

30

"restricted farm loss" has the meaning assigned by subsection 31(1.1);

**(3) Section 248 of the Act is amended by adding the following after subsection (25):**

Debt obligations

(26) For greater certainty, where at any time a person or partnership (in this subsection referred to as the "debtor") becomes liable to repay

35

money borrowed by the debtor or becomes liable to pay an amount (other than interest)

(a) as consideration for any property acquired by the debtor or services rendered to the debtor, or

5

(b) that is deductible in computing the debtor's income

for the purposes of applying the provisions of this Act relating to the treatment of the debtor in respect of the liability, the liability shall be considered to be an obligation, issued at that time by the debtor, that has a principal amount at that time equal to the amount of the liability at that time.

10

Parts of debt obligations

15

(27) For greater certainty,

(a) unless the context requires otherwise, an obligation issued by a debtor includes any part of a larger obligation that was issued by the debtor;

20

(b) the principal amount of that part shall be considered to be the portion of the principal amount of that larger obligation that relates to that part; and

25

(c) the amount for which that part was issued shall be considered to be the portion of the amount for which that larger obligation was issued that relates to that part.

(4) Subsections (1) to (3) apply to taxation years that end after February 21, 1994.

30

41.(1) The portion of subsection 256(7) of the Act before paragraph (a) is replaced by the following:

Acquiring control

(7) For the purposes of subsection 13(24), section 37, subsections 66(11), (11.4) and (11.5), 66.5(3) and 66.7(10) and (11), section 80, paragraph 80.04(4)(h), subsections 85(1.2), 87(2.1) and (2.11), 88(1.1) and (1.2) and 89(1.1), sections 111 and 127 and subsection 249(4),

35

(2) Subsection 256(8) of the Act is replaced by the following:

40

## Deemed acquisition of shares

(8) Where at any time a taxpayer acquires a right referred to in paragraph 251(5)(b) with respect to shares and it can reasonably be concluded that one of the main purposes of the acquisition is

(a) to avoid any limitation on the deductibility of any non-capital loss, net capital loss, farm loss, expense or other amount referred to in subsection 66(11), 66.5(3) or 66.7(10) or (11), 5

(b) to avoid the application of subsection 13(24), paragraph 37(1)(h) or subsection 66(11.4) or (11.5) or 111(4), (5.1), (5.2) or (5.3),

(c) to avoid the application of paragraph (j) or (k) of the definition "investment tax credit" in subsection 127(9), or 10

(d) to affect the application of section 80,

in determining whether control of the corporation is acquired for the purposes of subsection 13(24), section 37, subsections 66(11), (11.4) and (11.5), 66.5(3), 66.7(10) and (11), section 80, paragraph 80.04(4)(h), 15  
sections 111 and 127 and subsection 249(4), the taxpayer shall be deemed to acquire the shares at that time.

**(3) Subsection (1) applies to acquisitions, redemptions, cancellations and amalgamations occurring after February 21, 1994.**

**(4) Subsection (2) applies to acquisitions of rights occurring after February 21, 1994.** 20

**42.(1) Subparagraph 26(3)(c)(iv) of the *Income Tax Application Rules* is replaced by the following:**

(iv) all amounts required by subsection 53(1) of the amended Act (other than paragraphs 53(1)(f.1) to (f.2)) to be added in computing its adjusted cost base to the taxpayer immediately before the disposition, and 25

**(2) Clause 26(5)(c)(ii)(A) of the Rules is replaced by the following:**

(A) a capital loss or an amount that would, but for paragraph 40(2)(e) or (e.1) or subsection 85(4) of the amended Act, be a capital loss from the disposition to a corporation after 1971 of the property by a person who owned the property before it so vested in the subsequent owner, or 30

**(3) Subsections (1) and (2) apply to taxation years that end after February 21, 1994.**

---

Explanatory Notes  
to Draft Legislation  
on Debt Forgiveness  
and Foreclosures

---

## PREFACE

The legislation to which these explanatory notes relate contains draft amendments to the *Income Tax Act* and the *Income Tax Application Rules* relating to the measures on debt forgiveness and foreclosures announced in the budget of February 22, 1994.

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 Paul Martin  
Minister of Finance

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



## Table of Contents

Clause in Legis- lation	Section of the Income Tax Act	Topic	Page
1	6	Employment income . . . . .	1
2	12	Business and property income . . . . .	2
3	13	Depreciable property . . . . .	3
4	14	Eligible capital property . . . . .	5
5	15	Shareholder benefits . . . . .	6
6	18	Prohibited deductions-business and property income . . . . .	8
7	20	Deductions in computing income from business or property . . . . .	9
8	28	Farming or fishing business . . . . .	12
9	31	Loss from farming . . . . .	12
10	39	Capital gains and losses . . . . .	13
11	40	Capital gains - special rules . . . . .	14
12	44	Exchange of property . . . . .	16
13	47	Identical properties . . . . .	16
14	49	Options . . . . .	18
15	50	Bad debts and shares of bankrupt corporations . . . . .	19
16	51	Convertible property . . . . .	20
17	53	Adjustments to cost of property . . . . .	21
18	54	Definitions . . . . .	26
19	56.2	Reserve for debt forgiveness . . . . .	28
20	61.2	Reserve for debt forgiveness . . . . .	28

Clause in Legis- lation	Section of the Income Tax Act	Topic	Page
21	66	Resource expenditures . . . . .	31
22	66.2	Canadian development expenses . . . . .	32
23	66.4	Canadian oil and gas property expenses . . . . .	33
24	66.7	Successor rules . . . . .	34
25	70	Death of a taxpayer . . . . .	34
26	73	Inter vivos transfer of property . . . . .	35
27	79	Surrender of property by debtor . . . . .	36
27	79.1	Seizure of property by creditor . . . . .	43
28	80	Debtor's gain on settlement of debt . . . . .	47
28	80.01	Deemed settlement of debts . . . . .	80
28	80.02	Rules for distress preferred shares . . . . .	87
28	80.03	Gains on subsequent dispositions . . . . .	90
28	80.04	Transfers of forgiven amounts . . . . .	94
29	85	Transfer of property to corporations by shareholders . . . . .	99
30	86	Exchange of shares . . . . .	100
31	87	Amalgamations . . . . .	101
32	88	Windings-up . . . . .	104
33	95	Foreign accrual property income . . . . .	105
34	96	Partnership rules . . . . .	107

Clause in Legis- lation	Section of the Income Tax Act	Topic	Page
35	97	Transfers to partnerships . . . . .	108
36	107	Trust rules . . . . .	108
37	111	Losses deductible . . . . .	109
38	138	Insurance corporations . . . . .	110
39	191.3	Part VI.1 tax . . . . .	111
40	248	Interpretation . . . . .	111
41	256	Acquisitions of control . . . . .	113
42	26	(ITAR) Capital gains . . . . .	114
Appendix: Draft Income Tax Regulations and Explanatory Notes on Debt Forgiveness			

## Clause 1

### Employment income

ITA

6(15) and (15.1)

Subsection 6(15) of the *Income Tax Act* provides that, for the purposes of paragraph 6(1)(a), the value of a benefit for an individual arising on the settlement or extinguishment of a loan or other obligation is the amount of the outstanding obligation that was settled or extinguished, minus the amount paid by the individual on the settlement or extinguishment of the obligation. Under paragraph 6(1)(a), the benefit is included in computing an individual's employment income if it is received or enjoyed in respect of, in the course of or by virtue of, an office or employment of the individual.

Subsection 6(15) is amended to provide that the value of a benefit enjoyed by an individual in connection with an obligation that is issued by a debtor (typically the individual) and that is settled or extinguished is the "forgiven amount" in respect of the obligation, as defined by new subsection 6(15.1). Reference in this context should be made to new subsections 248(26) and (27), which clarify the circumstances in which an obligation is considered to be issued by a debtor and affect partial settlements of obligations.

Under subsection 80(1), the "forgiven amount" in respect of an obligation is essentially the lesser of the principal amount of the obligation and the amount for which it was issued minus any amount paid in satisfaction of the principal amount of the obligation and other adjustments which reflect the extent to which the unpaid amount of the obligation has otherwise been recognized for income tax purposes. Subsection 6(15.1) defines this expression in the same way, except that

- ° any amount included in computing income because of the obligation being settled or extinguished is not taken into account,
- ° the forgiven amount is not reduced to reflect the extent to which the obligation is taken into account under new subsection 79(3) in determining the proceeds of disposition of any property, and

- ° interest payable on the principal amount of the obligation is not taken into account.

In the event that an obligation with respect to interest payable on such indebtedness is settled, subsection 6(15) does not have any effect because of paragraph 6(15.1)(d). Instead, the rules in section 79 or 80 will apply in the event that the obligation is a "commercial obligation" (as defined under amended subsection 80(1)).

A discussion of the interaction between subsections 6(15) and 15(1.2) and sections 78 to 80 is contained in the commentary on the amendments to section 80. In addition, new section 80.01 is relevant in determining whether an obligation is settled for the purposes of subsection 6(15).

These amendments apply to taxation years ending after February 21, 1994.

## **Clause 2**

### **Business and property income**

#### **ITA**

#### **12(1)(e.1) and (aa)**

Subsection 12(1) of the Act sets out various amounts included in computing a taxpayer's income from a business or property.

New paragraph 12(1)(e.1) provides that a reserve deducted by a taxpayer under new paragraph 20(1)(n.1) for a taxation year is added back in computing the taxpayer's income for the following taxation year. For further discussion, see the commentary on paragraph 20(1)(n.1). It should be noted, however, that paragraph 12(1)(e.1) does not apply to a taxation year during which a taxpayer is a bankrupt.

New paragraph 12(1)(aa) provides that income of a taxpayer arising from the application of new subsection 80(13) to the taxpayer is included in computing the taxpayer's income from a business or

property. This amendment is consequential on the amendments to section 80, described below.

These amendments apply to taxation years ending after February 21, 1994.

### **Clause 3**

#### **Depreciable property**

Subclauses 3(1) to (3)

ITA  
13(7.1)

Subsection 13(7.1) of the Act provides for reductions in the capital cost of a depreciable property equal to the amounts of deducted investment tax credits and certain other government assistance in respect of the property.

Subsection 13(7.1) is amended to provide for a reduction in the capital cost of a depreciable property, in the event that the reduction is required under section 80. The reduction under the new rules is generally provided only under subsection 80(5). However, for the purposes of determining capital cost (otherwise than for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and the capital cost allowance regulations), a further reduction in capital cost is provided under subsection 80(9) in certain cases.

This amendment applies to taxation years ending after February 21, 1994.

Subclause 3(4)

ITA  
13(21)  
"proceeds of disposition"

The expression "proceeds of disposition" is defined under subsection 13(21) of the Act for the purposes of the income tax rules

with respect to depreciable property. Where a taxpayer's property is acquired or reacquired by a creditor in consequence of the taxpayer's failure to pay a debt to the creditor (e.g., as a result of foreclosure proceedings), paragraph (h) of the definition provides that the proceeds of disposition of that property for the taxpayer include amounts determined under existing paragraph 79(c).

Paragraph (h) of the definition is amended to refer to section 79 generally, rather than a specific provision of it. This amendment is consequential on the amendments to section 79, described in the commentary below, under which proceeds of disposition for a debtor are determined under new subsection 79(3).

This amendment applies to taxation years ending after February 21, 1994.

Subclauses 3(5) and (6)

ITA

13(21)

"undepreciated capital cost" (description of E.1)

Subsection 13(21) of the Act defines the expression "undepreciated capital cost".

This definition is amended to provide a reduction in the undepreciated capital cost of depreciable property of a class to the extent that such reduction is required by reason of new subsection 80(5). The new rule does not apply, however, to the extent that such reduction results from the reduction under subsection 80(5) or (9) of the capital cost of depreciable property. Reductions in capital cost arising from section 80 are dealt with, instead, under amended subsection 13(7.1). The amendment to this definition is consequential on the amendments to section 80, as described in the commentary below.

This amendment applies to taxation years ending after February 21, 1994.

## **Clause 4**

### **Eligible capital property**

Subclauses 4(1) to (4)

ITA

14(1)

14(5) (definition of "cumulative eligible capital")

Subsection 14(1) of the Act provides that where, at the end of a taxation year, the amounts required to be deducted in computing a taxpayer's "cumulative eligible capital" (as defined under subsection 14(5)) exceed the amounts required to be added in computing that amount, the excess must be included in computing the taxpayer's income for the year as business income or as a taxable capital gain.

Subsection 14(1) is amended to provide that the new amount determined for G in the formula used to determine "cumulative eligible capital" in subsection 14(5) is to be added in computing that excess.

Under the amended definition of "cumulative eligible capital" in subsection 14(5), the amount determined for G in respect of a business of a taxpayer is the total of all reductions of the taxpayer's cumulative eligible capital in respect of that business that are required under new subsection 80(7).

These amendments apply to taxation years ending after February 21, 1994.

Subclause 4(5)

ITA

14(9) and (10)

Subsection 14(5) of the Act defines the expression "eligible capital expenditure" for the purposes of determining income inclusions and deductions with respect to eligible capital property. Under the existing law, there are no specific rules dealing with government



assistance received or repaid with respect to eligible capital property. To the extent that government assistance with respect to such property does not reduce the eligible capital expenditure with respect to such property, the existing rules provide for an income inclusion under paragraph 12(1)(x).

New subsections 14(9) and (10) provide that government assistance for eligible capital property in respect of a business carried on by a taxpayer, or a repayment of such assistance, results in a decrease or increase, as the case may be, in the eligible capital expenditure in respect of that property. This rule applies only to the extent that the entitlement to the assistance arises, or the repayment thereof is made, before the taxpayer ceases to carry on that business. (A deduction in computing income for repayments made after the taxpayer ceases to carry on business is provided under new paragraph 20(1)(hh.1).) Subsections 14(9) and (10) are similar to the rules with respect to depreciable property in subsections 13(7.1) and (7.2).

The new rules in subsections 14(9) and (10) are relevant not only for government assistance, but also for other amounts treated as government assistance for the purposes of the Act. In this regard reference may be made to new subsection 79(4), under which certain amounts are treated as payments or repayments of government assistance, and subsection 248(16) under which input tax credits with respect to the Goods and Services Tax are likewise treated as government assistance.

These amendments apply to assistance that a taxpayer receives or becomes entitled to receive after February 21, 1994 and repayments of such assistance.

## **Clause 5**

### **Shareholder benefits**

#### **ITA**

#### **15(1.2) and (1.21)**

Subsection 15(1.2) of the Act provides that the value of the benefit considered to be conferred on a shareholder in consequence of the settlement or extinguishment of a loan or other obligation is the

amount of the outstanding obligation that was settled or extinguished, minus the sum of the amount paid by the shareholder on the settlement or extinguishment of the obligation and the amount included in the shareholder's income at the time the obligation arose. The value of such a benefit conferred on a shareholder by a corporation is included in computing the shareholder's income under subsection 15(1).

Subsection 15(1.2) is amended to provide that the value of a benefit in connection with an obligation issued by a debtor that is settled or extinguished is the "forgiven amount" in respect of the obligation, as defined by new subsection 15(1.21). Reference in this context should be made to new subsections 248(26) and (27), which clarify the circumstances in which an obligation is considered to be issued by a debtor and affect partial settlements of obligations.

Under subsection 80(1), the "forgiven amount" in respect of an obligation is essentially the lesser of the principal amount of the obligation and the amount for which it was issued minus any amount paid in satisfaction of the principal amount of the obligation and other adjustments which reflect the extent to which the unpaid amount of the obligation has otherwise been recognized for income tax purposes. Subsection 15(1.21) defines this expression in the same way, except that

- ° any amount included in computing income because of the obligation being settled or extinguished is not taken into account, except to the extent that the amount is included in income under paragraph 6(1)(a),
- ° the forgiven amount is not reduced to reflect the extent to which the obligation is taken into account under new subsection 79(3) in determining the proceeds of disposition of any property, and
- ° interest payable on the principal amount of the obligation is not taken into account.

In the event an obligation with respect to interest payable on an obligation is settled, subsection 15(1.2) does not have any effect because of paragraph 15(1.21)(d). Instead, the rules in section 79 or 80 will apply in the event that the obligation is a "commercial obligation" (as defined under amended subsection 80(1)).

A discussion of the interaction between subsections 6(15) and 15(1.2) and sections 78 to 80 is contained in the commentary on the amendments to section 80. In addition, new section 80.01 is relevant in determining whether an obligation is settled for the purposes of subsection 15(1).

These amendments apply to taxation years ending after February 21, 1994.

## **Clause 6**

### **Prohibited deductions-business and property income**

ITA

18(9.3)

Subsection 18(9.3) of the Act applies in the event that a debtor prepaid interest in respect of a debt obligation and the amount that the debtor has deducted in respect of the prepayment is limited because of subsection 18(9.2). In these circumstances, the prepaid interest not deductible because of subsection 18(9.2) is effectively treated as a payment in satisfaction of the principal amount of the debt obligation, in the event that the debt obligation is settled or extinguished in circumstances to which section 79 or 80 applies. As a consequence, the impact of those sections on the debtor is reduced.

Subsection 18(9.3) is amended to provide that it applies in the event that section 79 applies to a debtor, whether or not the debt owed by the debtor is settled or extinguished. In addition, a reference to paragraph 79(c) is changed to section 79 in order that both the existing rules and the new rules in section 79 are referred to. This amendment applies to 1992 and subsequent taxation years.

Paragraph 18(9.3)(f) is amended to provide that the prepaid interest described above is to be deducted in computing the forgiven amount in respect of a debt at the time it is settled or extinguished. This deduction is provided in paragraph (c) of the description of B in the definition "forgiven amount" in amended subsection 80(1). This amendment applies to taxation years ending after February 21, 1994, with respect to debts settled or extinguished in circumstances to which the new rules in section 80 apply.

## **Clause 7**

### **Deductions in computing income from business or property**

#### **Subclause 7(1)**

ITA

20(1)(n)

Paragraph 20(1)(n) of the Act allows a taxpayer to claim a reserve in respect of the taxpayer's profit from the sale of property. The reserve may be claimed by a taxpayer for a taxation year only with respect to an amount that was included in computing the taxpayer's income from a business for the year or a preceding taxation year and that is not due until after the end of the year and more than two years after the day on which the property was sold. (Where the property is land, the requirement that the amount not be due within two years of the sale does not apply.) However, subsection 20(8) provides that no reserve may be claimed under paragraph 20(1)(n) for a taxation year in respect of the sale of property if the sale occurred more than 36 months before the end of the year.

Paragraph 20(1)(n) is amended to provide that, in the case of real property, a reserve in respect of a taxpayer's profit from the sale of property may be claimed by the taxpayer for a taxation year to the extent that proceeds from the sale of the property are payable after the end of the year. In the case of property other than real property, a reserve may be claimed on the same basis provided that the amount payable at the end of the year was, at the time of the sale, due at least two years after the time of the sale. The reserve is subject to the 36-month limit in subsection 20(8).

The purpose of this amendment is to avoid penalizing creditors who exercise "acceleration" clauses pursuant to an agreement under which the creditor sold property and received, as part of the consideration, a note payable by the purchaser of the property. The acceleration clause would typically only be exercised where the purchaser defaulted on its obligations to a creditor. Similar amendments are proposed to subsections 40(1) and 44(1).

This amendment applies to taxation years ending after February 21, 1994.

ITA

20(1)(n.1)

New paragraph 20(1)(n.1) of the Act provides relief with respect to an income inclusion under new subsection 80(13) which may apply on the settlement of a commercial obligation issued by a taxpayer. In conjunction with amended paragraph 12(1)(e.1), paragraph 20(1)(n.1) allows such an income inclusion for a taxpayer to be spread over 5 years if the taxpayer is a non-resident person that carries on business through a fixed place of business in Canada or a corporation or trust resident in Canada. No reserve is allowed for partnerships because of the special rules for members of partnerships described in the commentary to new subsection 80(15). Individuals resident in Canada are allowed to claim a reserve under new section 61.2.

More specifically, where an income inclusion under subsection 80(13) arises for a qualifying taxpayer in connection with arm's length debt, up to 4/5 of the income inclusion may be deducted under paragraph 20(1)(n.1) in computing the taxpayer's income for the year. The deduction is claimed in a prescribed form filed with the taxpayer's income tax return. The amount deducted by a taxpayer under paragraph 20(1)(n.1) for a taxation year is added back under paragraph 12(1)(e.1) in computing the taxpayer's income for the following year. For the following year, a taxpayer may deduct up to 3/5 of the original income inclusion for the year (subject to a limit equal to the original income inclusion minus the amount by which the original inclusion exceeds the amount deducted under paragraph 20(1)(n.1) for the preceding year in respect of that income inclusion). For the next two years, up to 2/5 and 1/5 of the original income inclusion may be deducted, subject to the same limit.

For the purposes of paragraph 20(1)(n.1), the original income inclusion referred to above is determined net of any deduction claimed by the taxpayer under new paragraph 80(15)(a) in respect of the income inclusion. This is relevant only where a taxpayer is a member of a partnership to which section 80 applied.

This amendment applies to taxation years ending after February 21, 1994. However, the prescribed form referred to above is considered to have been filed as required if it is filed with the Minister of National Revenue before 1996.

Subclause 7(2)

ITA

20(1)(hh.1)

New paragraph 20(1)(hh.1) of the Act allows a deduction for the repayment, after February 21, 1994, of assistance received by a taxpayer in respect of eligible capital property related to a business carried on by the taxpayer. The deduction (equal to 3/4 of the amount so repaid) applies only where the taxpayer ceases to carry on the business prior to the repayment. Repayments of assistance prior to that time are added under new paragraph 14(9)(b) in computing the eligible capital expenditure of the taxpayer.

Subclause 7(3)

ITA

20(1)(ss)

New paragraph 20(1)(ss) of the Act provides for a deduction for a taxpayer in certain cases where the debt forgiveness rules under subsection 80(15) apply to a partnership of which the taxpayer is a member. A deduction is also provided for up to 3/4 of any payment to which subsection 80.01(10) applies. For further discussion, see the commentary on those subsections.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 8****Farming or fishing business**

ITA

28(1)(d) and (g)

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

Paragraphs 28(1)(d) and (g) are amended so that an income inclusion under new paragraph 12(1)(e.1) or subsection 80(13) (net of any reserve claimed with respect to the income inclusion under paragraph 20(1)(n.1) and any deduction under new paragraph 20(1)(ss)) is recognized as income from a farming or fishing business, in the event that an obligation in respect of the business is settled or extinguished in circumstances to which section 80 applies. Many obligations in respect of such businesses will, however, not be subject to sections 79 and 80 because of paragraph (b) of the definition of "excluded obligation" in subsection 80(1). This definition is used in the definition of "forgiven amount" in subsection 80(1) and in the description of F in subsection 79(3).

These amendments apply to taxation years ending after February 21, 1994.

**Clause 9****Loss from farming**

ITA

31(1) and (1.1)

Subsection 31(1) of the Act restricts the losses from farming deductible against other sources of income by farmers whose chief source of income is neither farming nor a combination of farming and some other source of income. The unrestricted portion of such losses is limited to \$2,500 plus one-half of the next \$12,500 of losses. The remainder of such a loss is defined, for the purposes of the Act, as a

"restricted farm loss". A restricted farm loss for a taxation year is deductible under paragraph 111(1)(c) in computing taxable income for the 3 preceding taxation years or the 10 following taxation years to the extent of the taxpayer's income from farming in those years.

Section 31 is amended so that the definition of "restricted farm loss" is provided under new subsection 31(1.1) rather than subsection 31(1).

New subsection 31(1.1) expressly provides that a "restricted farm loss" is reduced as required by section 80.

These amendments apply to taxation years ending after February 21, 1994.

## **Clause 10**

### **Capital gains and losses**

#### **ITA 39(3)**

Subsection 39(3) of the Act provides rules that apply where a taxpayer purchases in the open market any obligation earlier issued by the taxpayer. In these circumstances, the taxpayer will be considered to have realized a capital gain to the extent that the amount for which the obligation was issued by the taxpayer exceeds the purchase price for the obligation. A capital loss arises to the extent that the purchase price exceeds the greater of the principal amount of the obligation and the amount for which it was issued. However, these provisions do not apply to the extent that the gain or loss is otherwise recognized under the Act as income or a loss.

Subsection 39(3) is amended to ensure that a capital gain may arise pursuant to paragraph 39(3)(a), notwithstanding that the application of new subsection 80(12) or (13) could result in an income inclusion for the taxpayer if subsection 39(3) did not apply. Paragraph (d) of the description of B in the definition "forgiven amount" in subsection 80(1) ensures that an obligation extinguished in circumstances to which subsection 39(3) applies does not give rise to the application of section 80.



Reference should also be made to new subsection 248(27), which clarifies that the open market purchase of any portion of an obligation under subsection 39(3) is treated on the same basis as the purchase of the entire obligation.

This amendment applies to taxation years ending after February 21, 1994.

## **Clause 11**

### **Capital gains - special rules**

#### **Subclause 11(1)**

ITA

40(1)(a)(iii)(C)

Where a taxpayer disposes of capital property in a taxation year, the gain otherwise determined may be reduced under subparagraph 40(1)(a)(iii) of the Act by a reasonable reserve in respect of proceeds of disposition that are not due to the taxpayer until after the end of the year. However, the gain from the disposition is fully recognized over the first five (or, in some cases, ten) taxation years of the taxpayer ending after the time of disposition.

Clause 40(1)(a)(iii)(C) is amended to provide that a reserve for a taxation year is based on amounts that are payable to the creditor after the end of the year, whether or not the amounts became due to the creditor before the end of the year. The purpose of this amendment is to avoid penalizing creditors who exercise "acceleration" clauses pursuant to an agreement under which the creditor sold capital property and received as part of the consideration a note payable by the purchaser of the property. The acceleration clause would typically be exercised only if the purchaser defaulted on its obligations to a creditor. Similar amendments are proposed to paragraph 20(1)(n) and subsection 44(1).

Clause 40(1)(a)(iii)(C) is also amended to provide that the amount of the reserve in respect of the sale of property cannot exceed the gain from the sale of the property (determined without reference to

reserves) multiplied by a proration factor. The proration factor for a taxation year is equal to the portion of the proceeds of disposition with respect to a property that is payable after the end of the year divided by the full proceeds of disposition with respect to the property. However, the reserve is still subject to the 5-year (or 10-year) limit referred to above.

These amendments apply to taxation years ending after February 21, 1994.

#### Subclause 11(2)

#### ITA 40(2)(e.1)

New paragraph 40(2)(e.1) of the Act (in conjunction with amended subsections 85(4) and 97(3)) provides that the loss from the disposition by a taxpayer of certain indebtedness is considered to be nil. Instead, the transferee is generally entitled to increase its adjusted cost base of the property under amended paragraph 53(1)(f.1) or new paragraph 53(1)(f.11).

New paragraph 40(2)(e.1) applies where the transferor and the transferee of the indebtedness and the debtor are all related to each other. New paragraph 80(2)(j), described in the commentary below, may apply in determining whether or not a transferor, a transferee and a debtor are related to each other for the purpose of paragraph 40(2)(e.1).

The purpose of new paragraph 40(2)(e.1) (in conjunction with amended subsections 85(4) and 97(3)) is to provide for consistency between the debt parking rule in subsection 80.01(8) and the stop-loss rules in subsections 40(2), 85(4) and 97(3).

This amendment applies to dispositions after Announcement Date, other than dispositions pursuant to agreements in writing entered into on or before Announcement Date.

**Clause 12****Replacement property**

ITA

44(1)(e)(iii)(C)

Paragraph 44(1)(e) of the Act governs the computation of a taxpayer's gain from the disposition of a capital property when another capital property is acquired by the taxpayer as a replacement property. Under subparagraph 44(1)(e)(iii), a reserve may be claimed with respect to the computed gain on the same basis as a reserve may be claimed under subparagraph 40(1)(c)(iii) (described in the commentary above).

Clause 44(1)(e)(iii)(C) is amended in the same manner as clause 40(1)(a)(iii)(C). The amendments to the latter clause are described in the commentary above.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 13****Identical properties**

ITA

47(1)

Section 47 of the Act requires a taxpayer to average the cost of identical properties acquired after 1971. Where a taxpayer acquires a property identical to a property or properties already owned by the taxpayer, the taxpayer is considered under subsection 47(1) to have disposed of each of the previously-acquired properties for proceeds equal to its adjusted cost base to the taxpayer and to have acquired each of the identical properties for a cost equal to

- the total of the adjusted cost bases to the taxpayer of all of the previously-acquired identical properties and the cost to the taxpayer of the newly-acquired identical property

divided by

- the number of identical properties owned by the taxpayer after the acquisition of the newly-acquired identical property.

Subsection 47(1) is designed so that the cost of each identical property of a taxpayer is the same after the acquisition of a new identical property by the taxpayer. As a consequence, the order of any subsequent dispositions of such properties by a taxpayer generally does not need to be identified.

Subsection 47(1) is amended to provide that, where previously-acquired identical properties have been subject to a deduction in computing their adjusted cost bases under new paragraph 53(2)(g.1), the adjusted cost base of each identical property after a new acquisition of such property is reduced pro-rata under that paragraph. The amendment effectively preserves the history of deductions in computing the adjusted cost base of property under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of the amendment is with respect to the potential future application of new section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 49(3.01), 51(1), 53(4) to (6), 86(4) and 87(5.1) and (6.1).

The amount deducted under paragraph 47(1)(c) in computing the adjusted cost base of a property to a taxpayer is added in computing that adjusted cost base under paragraph 47(1)(d) so that these provisions will maintain the same net amount as the adjusted cost base to the taxpayer of the property.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 14****Options**

ITA

49(3.01)

Subsection 49(3) of the Act applies when an option to acquire property is exercised by a taxpayer. In computing the adjusted cost base to the taxpayer of such property, there is generally added the adjusted cost base to the taxpayer of the related option.

New subsection 49(3.01) provides that, where the adjusted cost base of an option to acquire "specified property" has been subject to a deduction in computing its adjusted cost base under new paragraph 53(2)(g.1), the adjusted cost base of the specified property acquired on the exercise of the option will also be reduced under that paragraph. A corresponding increase in the adjusted cost base is also provided, so that there is no net effect on the amount of the adjusted cost base of the specified property. For this purpose, "specified property" is defined under section 54 as a capital property of a taxpayer that is a share, a capital interest in a trust, a partnership interest or an option to acquire such property.

Subsection 49(3.01) effectively preserves the history of deductions in computing the adjusted cost base of an option under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of subsection 49(3.01) is with respect to the potential future application of new section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 47(1), 51(1), 53(4) to (6), 86(4) and 87(5.1) and (6.1).

This amendment applies to taxation years ending after February 21, 1994.

## Clause 15

### Bad debts and shares of bankrupt corporations

ITA

50(1) and (1.1)

Subsection 50(1) of the Act provides that certain debt owed to a taxpayer is deemed to be disposed of by the taxpayer for no proceeds and to have been reacquired by the taxpayer at a cost of nil. This rule applies to debts established to have become bad debts by a taxpayer. Subsection 50(1) also applies to certain shares owned by a taxpayer.

Subsection 50(1) is amended so that it applies, for the purposes of sections 79.1 and 80.01, to a debt owed to a taxpayer, whether or not the debt is capital property of the taxpayer.

Subsection 50(1) is also amended to ensure that it applies to debts in respect of which the creditor claims a deduction in computing income (e.g., paragraph 20(1)(p) or subsections 20(4) to (4.2)). In certain cases, the claim for a deduction under paragraph 20(1)(p) may arise because of the operation of subsection 111(5.3) where the creditor is a corporation whose control has been acquired. In addition, the amendment ensures the application of this rule to bad debts added in computing a creditor's resource expenditure pools under subsection 66.1(6), 66.2(5) or 66.4(5).

Amended subsection 50(1) applies to a debt owed to a taxpayer (other than a debt in respect of which a deduction or resource pool adjustment is claimed) only where the taxpayer so elects in the taxpayer's income tax return. A similar elective rule already applies in respect of shares owned by a taxpayer. As a result of this amendment, subsection 50(1.1) is amended to modify a cross-reference to subsection 50(1).

A taxpayer may decide not to elect under subsection 50(1) if that election would result in the application of new subsection 80.01(8) to a debtor with whom the taxpayer does not deal at arm's length or of which the taxpayer is a specified shareholder. For further discussion, see the commentary on new subsections 80.01(6) to (8).

These amendments apply to taxation years ending after February 21, 1994.

## **Clause 16**

### **Convertible property**

#### **ITA**

#### **51(1)(d.1) and (d.2)**

Subsection 51(1) of the Act applies where a share of the capital stock of a corporation is acquired under the terms of certain convertible securities issued by the corporation. In these circumstances, the convertible security is treated as if it had not been disposed of. The cost of the new share is determined with reference to the adjusted cost base of the convertible security.

New paragraphs 51(1)(d.1) and (d.2) provide that, where the adjusted cost base of a convertible security has been subject to a deduction in computing its adjusted cost base under new paragraph 53(2)(g.1), the adjusted cost base of the new share is likewise reduced under paragraph 53(2)(g.1). This measure effectively preserves the history of deductions in computing the adjusted cost base of a convertible security under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of paragraphs 51(1)(d.1) and (d.2) is with respect to the potential future application of new section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 47(1), 49(3.01), 53(4) to (6), 86(4) and 87(5.1) and (6.1).

More specifically, paragraph 51(1)(d.1) provides for a deduction in computing the adjusted cost base of a share acquired in exchange for a convertible security. The deduction, which is taken into account at the time of the exchange, is equal to a specified proportion of the total amounts previously deducted under paragraph 53(2)(g.1) in computing the adjusted cost base of the convertible property. The specified proportion is equal to the fair market value of the new share acquired by a taxpayer divided by the fair market value of all new shares acquired by the taxpayer on the exchange.

Under paragraph 51(1)(d.2), the amount determined under paragraph 51(1)(d.1) in respect of a new share acquired by a taxpayer is added in computing the adjusted cost base to the taxpayer of the share so that there is no net effect on the amount of its adjusted cost base.

This amendment applies to taxation years ending after February 21, 1994.

## **Clause 17**

### **Adjustments to cost of property**

#### **Subclause 17(1)**

ITA

53(1)(f.1) and (f.11)

Paragraph 53(1)(f.1) of the Act provides for an increase in computing the adjusted cost base to a taxable Canadian corporation of property transferred to the corporation, equal to a capital loss denied to the transferor because of paragraph 40(2)(e) or subsection 85(4). It applies only where:

- ° the transferor was another taxable Canadian corporation, and
- ° the transferor was not allowed under paragraph 85(4)(b) to increase the adjusted cost base of shares owned by it as a consequence of the transfer of the property.

Paragraph 53(1)(f.1) is amended to provide that capital losses denied under new paragraph 40(2)(e.1) are, for the purposes of paragraph 53(1)(f.1), treated in the same way as capital losses denied under paragraph 40(2)(e).

New paragraph 53(1)(f.11) is introduced so that a capital loss denied under paragraph 40(2)(e.1) (to the extent not reflected under amended paragraph 53(1)(f.1)) on the transfer of a property is similarly added to the adjusted cost base to the transferee of the property. This measure does not apply where the transferor is non-resident or



tax-exempt or is a partnership (other than an eligible Canadian partnership, within the meaning assigned by subsection 80(1)).

These amendments apply to taxation years ending after Announcement Date.

#### Subclause 17(2)

ITA

53(1)(p)

New paragraph 53(1)(p) of the Act provides for an increase in the adjusted cost base to a taxpayer of property, to the extent allowed by any of new paragraphs 47(1)(d), 49(3.01)(b), 51(1)(d.2), 53(4)(b), (5)(b) and (6)(b), 86(4)(b) and 87(5.1)(b) and (6.1)(b). For further detail, see the commentary on those provisions and new section 80.03.

This amendment applies to taxation years ending after February 21, 1994.

#### Subclause 17(3)

ITA

53(2)(g.1)

New paragraph 53(2)(g.1) of the Act provides for deductions in computing the adjusted cost base to a taxpayer of property, to the extent required by any of new subsections 80(9) to (11) and paragraphs 47(1)(c), 49(3.01)(a), 51(1)(d.1), 53(4)(a), (5)(a) and (6)(a), 86(4)(a) and 87(5.1)(a) and (6.1)(a). For further detail, see the commentary on those provisions and new section 80.03.

This amendment applies to taxation years ending after February 21, 1994.

## Subclause 17(4)

### ITA

#### 53(4) to (6)

New subsections 53(4) to (6) of the Act provide rules that affect the computation of the adjusted cost base to a taxpayer of any "specified property".

The only significance of subsections 53(4) to (6) is with respect to the potential application of new section 80.03, which recognizes all or a portion of the reduction in the adjusted cost base of specified property under paragraph 53(2)(g.1), on certain dispositions of such property. Paragraph 53(2)(g.1) provides reductions in the adjusted cost bases of property which result, directly or indirectly, from the operation of the debt forgiveness rules in section 80. Similar amendments are provided under subsections 47(1), 49(3.01), 51(1), 86(4) and 87(5.1) and (6.1). As defined under section 54, "specified property" is capital property that is a share, a capital interest in a trust, a partnership interest or an option to acquire such property.

Subsection 53(4) of the Act applies only where the proceeds of disposition of a specified property are determined under any one of a number of provisions in the Act. Where this is the case, and the adjusted cost base of the specified property was reduced under paragraph 53(2)(g.1), subsection 53(4) provides for the adjusted cost base to continue to be reduced under that paragraph.

The provisions set out in subsection 53(4) are as follows:

- paragraph 48.1(1)(c) (which provides for the deemed disposition and reacquisition of a share of the capital stock of a small business corporation that becomes a public corporation),
- sections 70 and 73 (which provide for the deemed disposition of certain property on the death of an individual and, in certain cases, for rollovers of property to qualifying recipients),
- subsection 85(1) (under which is determined proceeds of disposition of property transferred to a corporation in exchange for a share issued by the corporation),

- paragraph 85.1(1)(a) (under which is determined proceeds of disposition of shares of the capital stock of a corporation that are exchanged by a taxpayer for shares of the capital stock of another corporation),
- paragraphs 87(4)(a) and (c) (under each of which is determined the proceeds of disposition of shares of the capital stock of a corporation on the amalgamation of that corporation with another corporation),
- paragraph 88(1)(a) (under which is determined the proceeds of disposition for a subsidiary of assets transferred to a parent on a winding-up),
- subsection 97(2) (under which is determined proceeds of disposition of property transferred to a partnership in exchange for an interest in the partnership),
- subsection 98(2) and paragraphs 98(3)(f) and (5)(f) (under each of which is determined proceeds of disposition for a partnership of partnership assets distributed to members of the partnership),
- subsection 104(4) (which provides for the deemed disposition by a trust of capital property),
- paragraphs 107(2)(a), (2.1)(a), (4)(d) and (5)(a) (under each of which is determined proceeds of disposition for a trust of trust assets distributed to beneficiaries under the trust),
- paragraph 111(4)(e) (under which is determined the proceeds of disposition of certain capital property of a corporation on an acquisition of control of the corporation), and
- section 128.1 (which provides for the deemed disposition and reacquisition of property where taxpayers immigrate to, or emigrate from, Canada).

Where the proceeds of disposition at any time for a specified property are determined under any one of the above provisions, there is deducted under paragraph 53(4)(a) in computing the adjusted cost base to a transferee (including a person or partnership deemed to

reacquire such property under that provision), the amount, if any, by which

- the total of amounts previously deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the person who actually disposed of, or is deemed by any of the provisions to have disposed of, that property

exceeds

- the capital gain on the disposition of that property, determined without reference to subsection 100(2) (dealing with dispositions of partnership interests which have "negative" adjusted cost bases) and any reserves claimed by that person.

Any amount deducted under paragraph 53(4)(a) in computing the adjusted cost base of a property is also added at the same time under paragraph 53(4)(b) in computing that adjusted cost base so that there is no net effect on the amount of the adjusted cost base of the property.

Subsection 53(5) applies where specified property is disposed of by a person (referred to below as the "vendor") to another person or partnership with whom the vendor does not deal at arm's length, or with whom the vendor would not deal at arm's length if the assumptions set out in new paragraph 80(2)(j) were made. Where this is the case, and subsection 53(4) does not apply to the disposition, there is deducted under paragraph 53(5)(a) in computing the adjusted cost base to the other person or partnership, the amount, if any, by which

- the total of amounts previously deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the vendor of that property

exceeds

- the capital gain on the disposition of that property, determined without reference to subsection 100(2) and any reserves claimed by the vendor.

Any amount deducted under paragraph 53(5)(a) in computing the adjusted cost base of a property is also added at the same time under paragraph 53(5)(b) in computing that adjusted cost base.

Subsection 53(6) applies where 2 or more corporations amalgamate or merge to form a new corporate entity and specified property is acquired on the formation of the new entity. Where this is the case, any amount previously deducted by a predecessor corporation under paragraph 53(2)(g.1) in computing its adjusted cost base of such property is deducted under paragraph 53(6)(a) after the time of the acquisition, unless those amounts are otherwise deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the new entity of the specified property.

Any amount deducted under paragraph 53(6)(a) in computing the adjusted cost base of a property is also added at the same time under paragraph 53(6)(b) in computing that adjusted cost base.

These amendments apply to taxation years ending after February 21, 1994.

## **Clause 18**

### **Definitions**

#### **Subclause 18(1)**

ITA

54

"proceeds of disposition"

The expression "proceeds of disposition", which is relevant for the purposes of determining a taxpayer's capital gain or loss from the disposition of property, is contained in section 54 of the Act. Included in the "proceeds of disposition" of property under existing paragraph (h) of the definition are proceeds deemed to arise in consequence of paragraph 79(c).

Paragraph (h) of the definition is amended to refer to section 79, rather than paragraph 79(c). This amendment is consequential on the amendments to section 79, described in the commentary below,

under which proceeds of disposition for a debtor are determined under new subsection 79(3).

This amendment applies to taxation years ending after February 21, 1994.

#### Subclause 18(2)

ITA

54

"specified property"

The new definition "specified property" is described in the commentary to new subsections 53(4) to (6) of the Act. It is used in those subsections, as well as in new subsection 49(3.01).

This amendment applies to taxation years ending after February 21, 1994.

#### Subclause 18(3)

ITA

54

"superficial loss"

Section 54 of the Act defines "superficial loss". Pursuant to paragraph 40(2)(g), a taxpayer's loss from the disposition of property is nil, if the loss is a superficial loss. The loss denied to a transferor may be added in computing the adjusted cost base to the transferee of the property, to the extent provided under paragraph 53(1)(f).

The definition of "superficial loss" is amended to provide that it does not apply in respect of losses deemed to be nil by new paragraph 40(2)(e.1). Thus, a loss denied under paragraph 40(2)(e.1) is added under amended paragraph 53(1)(f.1) or new paragraph 53(1)(f.11), rather than paragraph 53(1)(f), in computing the adjusted cost base to the transferee of the property.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 19****Add back of reserve for debt forgiveness**

ITA

56.2

New section 56.2 of the Act is discussed in the commentary on new section 61.2.

**Clause 20****Reserve for debt forgiveness**

ITA

61.2

New section 61.2 of the Act provides relief to individuals resident in Canada who might otherwise face financial hardship as a consequence of an income inclusion under new subsection 80(13), which in certain circumstances includes an amount in the income of a debtor whose obligation has been forgiven. The relief applies in respect of the settlement of any debt owing by an individual to an arm's length creditor where, as a consequence of the settlement of the debt, an amount is included under subsection 80(13) in computing the individual's income. A related amendment, discussed in the commentary on paragraph 20(1)(n.1), applies to non-residents, corporations and trusts.

In these circumstances, an individual is allowed to deduct an amount by filing a form with the individual's income tax return. This deduction is equal to:

- the total of all such income inclusions for the year,

MINUS the total of

- deductions in respect of that total claimed under paragraph 80(15)(a) because the individual is a member of a partnership,

- any part of that total that could have been reduced by the individual designating greater amounts under subsection 80(5) to (10), and
- 20% of the individual's income for the year that is over \$40,000.

For these purposes, an individual's income is computed without regard to subsection 80(13), new section 56.2 (described below), paragraph 60(w) (deduction for tax under Part I.2 on old age security) and section 61.2. The reference to paragraph 60(w) is required to prevent circularity between section 180.2 (under which Part I.2 tax is computed) and section 61.2.

The amount deducted under section 61.2 in computing an individual's income for a taxation year is added back under section 56.2 in computing the individual's income for the following year, but a deduction in respect of the resulting income inclusion is available under section 61.2 on the same basis for the following year. As a consequence, the income inclusion for an individual resulting from section 80 is, in effect, deferred until a later taxation year in which it is reasonable to consider that the individual should have sufficient funds to pay the income tax resulting from the income inclusion. In addition, the add back of a reserve for an individual does not apply with respect to any taxation year during which the individual is a bankrupt.

The operation of sections 56.2 and 61.2 in these circumstances is illustrated in the examples below.

### **EXAMPLE 1**

In 1995, individual A included \$20,000 in income under subsection 80(13) as a result of a forgiveness of debt. The individual's income, determined without reference to subsection 80(13) and sections 56.2 and 61.2, is \$30,000 in 1995 and 1996 and \$50,000 in 1997. Assume A claims deductions under section 61.2 to the maximum extent possible.

#### **Results:**

1. The amount included in income for 1995 under subsection 80(13) will be completely offset by a deduction



under section 61.2 of \$20,000 so that A's income for tax purposes for 1995 will remain \$30,000.

2. For 1996, A will be required under section 56.2 to bring into income the \$20,000 claimed in 1995 under section 61.2. This inclusion will be completely offset by a deduction under section 61.2 of \$20,000 so that A's income for tax purposes for 1996 will remain \$30,000.

3. For 1997, A will be required under section 56.2 to bring into income the \$20,000 claimed in 1996 under section 61.2. Because A's income otherwise determined for 1997 exceeds \$40,000, A is not entitled to completely offset the \$20,000 income inclusion with a further claim under section 61.2. Rather, the potential reserve is reduced by 20% of A's income in excess of \$40,000, i.e., \$2,000 ( $.2 \times (\$50,000 - 40,000)$ ). Thus, A may claim a deduction of \$18,000 under section 61.2 and A's income for tax purposes for 1997 will be \$52,000 ( $\$50,000 + \$20,000 - \$18,000$ ).

4. The \$18,000 reserve claimed for 1997 will be added to A's income for 1998. A reserve for that year and subsequent years may be available, depending on the amount of A's income in those years.

## EXAMPLE 2

In 1995, individual B included an amount in income under subsection 80(13) of \$10,000 in respect of one debt, against which the individual was able to claim a reserve under section 61.2 of \$3,000. In 1996, a further amount of \$6,000 is included in computing the individual's income under subsection 80(13) in respect of another debt. The individual's income for 1996, without taking into account subsection 80(13) and sections 56.2 and 61.2, is \$62,000.

### Results:

1. The deduction that may be claimed under section 61.2 for 1996 is \$4,600. This is equal to \$6,000 (forgiven amount in respect of the other debt), plus \$3,000 (income inclusion under section 56.2) minus 20% of ( $\$62,000 - \$40,000$ ).

2. To the extent that a deduction is claimed for 1996 under section 61.2, it is added back under section 56.2 in computing the individual's income for 1997.

This amendment applies to taxation years ending after February 21, 1994. However, the form referred to above is considered to have been filed as required if it is filed with the Minister of National Revenue before 1996.

## **Clause 21**

### **Resource expenditures**

ITA  
66(4)

Subsection 66(4) of the Act sets out the deduction that may be claimed for foreign exploration and development expenses (FEDE). Under paragraph 66(4)(a), the amount that may be deducted by a taxpayer for a taxation year is determined with reference to the portion of the total of those expenses incurred before the end of the year that was not deductible in computing the taxpayer's income for a preceding taxation year.

Paragraph 66(4)(a) is amended to provide that the deduction for FEDE takes into account reductions in the FEDE balance required by new subsection 80(8), which applies in certain circumstances when debt is forgiven.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 22****Canadian development expenses**

ITA

66.2(5)

**"cumulative Canadian development expense"**

Subsection 66.2(5) of the Act sets out the definition of "cumulative Canadian development expense" (CCDE). Under the description of F in that definition, a taxpayer's CCDE is reduced to take into account proceeds from the dispositions of Canadian mining properties to the extent that those proceeds have not reduced the taxpayer's pools arising as a consequence of a transaction to which the successor rules in section 66.7 apply. New subsection 80(8) requires a taxpayer's resource expenditure pools to be reduced in certain cases where debt issued by the taxpayer is settled.

The description of F in that definition is amended to provide that, in determining the amount of successor pools against which such proceeds of disposition have been applied, no reduction under subsection 80(8) at or after the time of the disposition is taken into account.

The new description of M.1 in that definition provides that the computation of CCDE takes into account reductions required by new subsection 80(8).

These amendments apply to taxation years ending after February 21, 1994.

## Clause 23

### Canadian oil and gas property expenses

ITA

66.4(5)

"cumulative Canadian oil and gas property expense"

Subsection 66.4(5) of the Act sets out the definition of "cumulative Canadian oil and gas property expense" (CCOGPE). Under the description of F in that definition, a taxpayer's CCOGPE is reduced to take into account proceeds from the dispositions of Canadian oil and gas properties to the extent that those proceeds have not reduced the taxpayer's pools arising as a consequence of a transaction to which the successor rules in section 66.7 apply. New subsection 80(8) requires a taxpayer's resource expenditure pools to be reduced in certain cases where debt issued by the taxpayer is settled.

The description of F in that definition is amended to provide that, in determining the amount of successor pools against which such proceeds of disposition have been applied, no reduction under subsection 80(8) at or after the time of the disposition is taken into account.

The new description of I.1 in that definition provides that the computation of CCOGPE takes into account reductions required by subsection 80(8).

These amendments apply to taxation years ending after February 21, 1994.

**Clause 24****Successor rules****ITA**

66.7(2)(a), (3)(a), (4)(a), (5)(a) and (9)(f)

Subsections 66.7(2), (3), (4) and (5) of the Act allow a corporation to claim deductions with respect to foreign exploration and development expenses, Canadian exploration expenses, Canadian development expenses and Canadian oil and gas property expenses incurred by one or more other taxpayers, where property has been acquired by the corporation in circumstances to which the successor rules apply. New subsection 80(8) requires a taxpayer's resource expenditure pools to be reduced in certain cases where debt issued by the taxpayer is settled.

Paragraphs 66.7(2)(a), (3)(a), (4)(a) and (5)(a) are amended to provide that the successor pools thereunder are reduced as required by new subsection 80(8).

A cross reference in paragraph 66.7(9)(f) is changed to reflect amended paragraph 66.7(3)(a).

These amendments apply to taxation years ending after February 21, 1994.

**Clause 25****Death of a taxpayer****ITA**

70(5.1)(c)(ii)

Subsection 70(5.1) of the Act provides for a rollover of eligible capital property in respect of a business that was acquired by an eligible person as a consequence of the death of an individual. The property is deemed to have been disposed of by the deceased individual for an amount equal to  $\frac{4}{3}$  of the deceased's cumulative eligible capital in respect of the business, multiplied by a proration

factor reflecting the fair market value of the property relative to the fair market value of all eligible capital property in respect of the business. Except as described below, the eligible person is deemed to have acquired the property for the same amount.

Where the eligible person continues to carry on the business, the eligible person is deemed by paragraph 70(5.1)(c) to have made an eligible capital expenditure in respect of the property equal to the deceased's deemed proceeds for the property plus an additional amount equal to  $\frac{4}{3}$  of the deceased's deductions in respect of the business under paragraph 20(1)(b) multiplied by the proration fraction referred to above. However, the eligible person is, in effect, treated as having previously claimed the additional amount as a deduction under paragraph 20(1)(b). This measure allows the tax treatment of an eligible person with respect to such property to be consistent with the tax treatment for the deceased.

Subparagraph 70(5.1)(c)(ii) is amended to add a reference to the description of G in the formula determining a eligible person's cumulative eligible capital. Under the description of G, an individual's cumulative eligible capital is reduced by amounts determined pursuant to new subsection 80(7) on the settlement of debt issued by the individual. As a result, such reductions in respect of an individual are treated in the same manner as deductions under paragraph 20(1)(b) described above.

This amendment applies to transfers of property occurring after February 21, 1994.

## **Clause 26**

### ***Inter vivos* transfer of property**

ITA

73(3)(d.1)(ii)

Subsection 73(3) of the Act provides for the *inter vivos* transfer of farm property by a farmer to the farmer's child. In the case of eligible capital property, the rules providing for the rollover of such

property are similar to the rules in subsection 70(5.1) described above.

Subparagraph 73(3)(d.1)(ii) is amended to add a reference to the description of G in the formula determining a taxpayer's cumulative eligible capital. Under the description of G, a taxpayer's cumulative eligible capital is reduced by amounts determined pursuant to new subsection 80(7). Subsection 80(7) applies in certain circumstances when a taxpayer's indebtedness is forgiven. The effect of this reference is to treat such reductions in respect of a taxpayer in the same manner as deductions under paragraph 20(1)(b).

This amendment applies to acquisitions of property occurring after February 21, 1994.

## **Clause 27**

### **Surrender of property by debtor**

ITA

79

Section 79 of the Act sets out rules governing the tax consequences for a debtor and creditor where the creditor has acquired property held by the debtor in consequence of the debtor's failure to pay an amount to the creditor. The existing rules are intended principally to ensure that such amounts, as well as other debt related to the acquired property, are recognized in computing the debtor's proceeds of disposition with respect to the property. In addition, the existing rules generally provide that a creditor acquires such property at a cost equal to the cost to the creditor of the creditor's claim with respect to such property and that the creditor may not subsequently claim any loss or deduction in respect of the creditor's claim.

The existing rules are structured so that income tax consequences do not depend on the fair market value (at the time of an acquisition or reacquisition) of such property, although if the property consists of more than one type of property for income tax purposes, the fair market value of a particular property may be relevant in determining the proceeds of disposition of the particular property for the debtor and the cost to the creditor of the same property. Where the creditor

reacquires such property, the rules allow a gain of the creditor from the previous disposition of the property not to be recognized until the seized property is subsequently disposed of by the creditor, to the extent that the creditor claimed a reserve in respect of the gain for the taxation year preceding the year in which the seized property is reacquired by the creditor.

More specifically, the income tax consequences under the existing rules for a debtor and a creditor where the creditor acquires a property held by the debtor in consequence of the debtor's failure to pay an amount to the creditor may be summarized as follows:

- the debtor's proceeds of disposition of the property include the sum of the principal amounts of the creditor's claim plus the principal amounts of other debts extinguished by reason of the acquisition (paragraph 79(c));
- a loss may be claimed by the debtor in the event that any amounts are subsequently paid by the debtor in satisfaction of an obligation to pay any of the creditor's claim (paragraph 79(d));
- where the property has been reacquired by the creditor after a disposition of the property in a previous year by the creditor, a reserve claimed by the creditor under paragraph 20(1)(n) or subparagraph 40(1)(a)(iii) or 44(1)(e)(iii) for the first taxation year ending before the reacquisition is not added back for the purposes of determining the creditor's income or capital gain for the year of reacquisition (paragraph 79(e));
- the property is considered to have been acquired or reacquired by the creditor at a cost equal to the cost to the creditor of the creditor's claim, minus the reserve described above (paragraph 79(f));
- the creditor's adjusted cost base of the creditor's claim is nil, which prevents the creditor from subsequently claiming a capital loss in respect of the claim (paragraph 79(g)); and
- the creditor is not subsequently entitled to deduct any amount in respect of the creditor's claim as a doubtful or bad debt under paragraph 20(1)(l) or (p).



The commentary below discusses the amendments to section 79 and new section 79.1. Amended section 79 deals only with debtors. New section 79.1 deals with creditors. For an overview of the interaction between subsections 6(15) and 15(1.2) and sections 78 to 80, see the commentary on the amendments to section 80.

The new rules in sections 79 and 79.1 apply with respect to property acquired after February 21, 1994, other than property acquired or reacquired pursuant to a court order made before February 22, 1994.

#### ITA 79(1)

Amended section 79 of the Act provides the income tax consequences for debtors in connection with foreclosures, conditional sale reposessions and similar transactions. Definitions are provided in this respect under subsection 79(1). Under subsection 79.1(1), these definitions also apply for the purposes of new section 79.1.

The definition of "creditor" ensures that a mortgagee of property is considered to be a "creditor", irrespective of the applicable law governing mortgages. The definition also provides that the seller under a conditional sales agreement (and any assignee with respect to the agreement) is considered to be a creditor with respect to the property that is subject to the agreement. This definition is consistent with the existing law and ensures that the rules in sections 79 and 79.1 operate with respect to mortgage foreclosures and conditional sale reposessions.

"Debt" is defined to include an obligation to pay an amount under a mortgage or similar obligation or under a conditional sales agreement.

The definition of "person" ensures that sections 79 and 79.1 apply where the creditor or debtor is a partnership.

The definition of "property" ensures that sections 79 and 79.1 do not apply by reason of the acquisition of money or government debt (including government-guaranteed debt) by a creditor.

A "specified amount" of a debt owed or assumed by a person means the unpaid principal amount of the debt and unpaid interest that has

accrued with respect to the debt. The reference to unpaid interest allows unpaid interest to be taken into account in determining a debtor's proceeds of disposition of property that is acquired by a creditor. The reference to debt that is assumed is relevant, under new subsection 79.1(6), only for the purposes of determining the cost to a creditor of property acquired from the debtor.

ITA  
79(2)

New subsection 79(2) of the Act sets out the circumstances in which property is considered to be "surrendered" by a person to another person. The operative rules in section 79 only apply in the event that property is surrendered by a debtor to a creditor.

Property is surrendered by a debtor to a creditor where the beneficial ownership of the property is acquired or reacquired from the debtor by the creditor and the acquisition or reacquisition was in consequence of the debtor's failure to pay debt owing by the debtor to the creditor. Thus, where a creditor acquires or reacquires property from a third party to whom property was previously transferred by a debtor of the creditor, section 79 will not apply unless the third party has become liable directly to the creditor and the property is acquired or reacquired in consequence of the third party's failure to pay an amount to the creditor.

ITA  
79(3)

Where a particular property is surrendered at any time (referred to below as the "surrender time") by a debtor to a creditor, the debtor's proceeds of disposition of the particular property are determined under new subsection 79(3) of the Act by the formula:

$$(A + B + C + D + E - F) \times G/H$$

The amount determined for A is the total of all debts owing by a debtor to a creditor in connection with the surrender of properties by the debtor to the creditor. The only difference from the existing rules in this respect is the inclusion of unpaid interest.

The amount determined for B is the total of all debts owing immediately before the surrender time by a debtor to someone other than the creditor to whom properties are surrendered, to the extent that such amounts cease to be owing by the debtor as a consequence of that surrender. Unlike the existing rules, the amount determined for B includes unpaid interest. In addition, the amount determined for B includes debt that ceases to be owed by the debtor (whether or not the debt is actually extinguished) as a consequence of a surrender of property by the debtor.

The amount determined for C is the total of all debts owing by a debtor immediately before the surrender time that is not included in the amount determined for A or B, where any property surrendered by the debtor was security for such debt and such property was also security for a subordinate debt owing by the debtor immediately before the surrender time to the creditor to whom such property was surrendered. The description of C (in conjunction with the description of B) ensures, for example, that a debt under a first mortgage in respect of property is included in computing a debtor's proceeds of disposition if a debtor surrenders the property to the second mortgagee in respect of the property.

An amount is determined for D only if a debt is owing by the debtor immediately before the surrender time to a creditor (other than the creditor to whom property is surrendered) and, as a consequence of the surrender, the debt ceases to be secured by all the debtor's properties. Where this is the case, the portion of the total amount of such unsecured debts that is not taken into account in the amount determined for B or C is added in computing the debtor's proceeds of disposition of property that is surrendered. However, the amount determined for D is limited to the amount by which the total cost amount of all surrendered properties exceeds the proceeds for those properties (determined without reference to the amounts determined for D and F).

The description of D recognizes that, in some cases, a debtor may be insulated from liability from either a legal or practical perspective with respect to a debt formerly secured by a surrendered property. The new provision is designed to prevent an overall loss for a debtor that would otherwise result from not taking into account such debt in determining proceeds of disposition with respect to surrendered properties. In the event that payment is subsequently made by a

debtor in satisfaction of a debt included in the amount determined for D, new subsection 79(4) provides for recognition of such a payment.

The description of E applies where a creditor and a debtor do not deal with each other at arm's length and the total fair market value of a surrendered property exceeds the total amounts of debts added in computing the proceeds of disposition determined on the surrender. In these circumstances, the excess is also taken into account in determining the debtor's proceeds of disposition. This measure is consistent with the existing wording in section 79.

The description of F results in a reduction of a debtor's proceeds of disposition of surrendered property to reflect the extent to which the obligations taken into account in determining the proceeds are, or have already been, taken into account under other provisions of the Act. This will occur where such an obligation is an "excluded obligation" (defined under subsection 80(1)), which includes a forgivable loan that is treated as assistance for income tax purposes. In addition, the proceeds under section 79 are reduced to reflect income arising from the settlement, or deemed settlement, of employee or shareholder indebtedness to which paragraph 6(1)(a) or subsection 15(1) applies and accrued interest payable that has been included under section 80.4 in computing the debtor's income. The proceeds under section 79 are also reduced, where a debtor is a joint exploration corporation, to reflect renunciations of resource expenditures under section 66 in respect of debt that is taken into account in determining proceeds of surrendered property for the debtor. Finally, the proceeds under section 79 are also reduced to reflect deemed settlements of obligations under subsection 80.01(8) before the year in which a debtor surrenders property in circumstances to which section 79 applies.

The descriptions of G and H in subsection 79(3) provide for the pro-ration of a debtor's proceeds of disposition with respect to surrendered property, in the event that the surrendered property consists of more than one type of property for income tax purposes. The proration factor is equal to the fair market value of the relevant part of the surrendered property divided by the fair market value of all the surrendered property.

ITA  
79(4)

New subsection 79(4) of the Act provides a new rule in the event that a debtor subsequently pays a debt included in the debtor's proceeds of disposition of surrendered property. The existing rule in paragraph 79(d) provides that such amounts were considered to be losses from the disposition of property, but did not expressly characterize the nature of such a loss.

Under subsection 79(4), such a payment is treated as a capital loss under subsection 39(13) to the extent that it relates to non-depreciable capital property. To the extent that the payment relates to property the cost of which to the debtor was a Canadian exploration expense, Canadian development expense or Canadian oil and gas property expense, the amount of the payment is added to the resource pool to which such expense relates. In all other cases, the amount of the payment (or three-quarters of the payment where it relates to eligible capital property) is deductible under paragraph 20(1)(hh) or (hh.1).

ITA  
79(5)

New subsection 79(5) of the Act is a special rule which applies in the event that an employee or shareholder indebtedness is settled or extinguished in a taxation year after having been recognized in computing a taxpayer's proceeds of disposition of property surrendered in a preceding year. In these circumstances, an amount equal to the employee's or shareholder's income inclusion (determined with reference to amended subsections 6(15) or 15(1.2)) is treated as a repayment of assistance to which subsection 79(4) applies.

Subsection 79(5), in conjunction with the description of F in subsection 79(3), ensures that the rules in subsection 6(15) and 15(1.2) have priority over the rules in section 79.

ITA  
79(6)

New subsection 79(6) of the Act ensures that a debtor is not considered to have paid or repaid any amount as a consequence of the acquisition or reacquisition of surrendered properties. This measure is relevant, for example, where a surrender of property by a debtor relates to a forgivable loan that was considered to be assistance for the purposes of subsection 13(7.1). Such assistance is not considered to be repaid in these circumstances. Instead, the amount of such assistance is recognized under the description of F in subsection 79(3) as a deduction in computing the debtor's proceeds of disposition of surrendered properties.

**Seizure of property by creditor**

ITA  
79.1(1)

New section 79.1 of the Act provides the income tax consequences for creditors in connection with acquisitions and reacquisitions of property from debtors. Definitions used in this section are provided under subsection 79.1(1).

Subsection 79.1(1) defines "creditor", "debt", "person", "property" and "specified amount" in the same manner as those expressions are defined under subsection 79(1). The expression "specified cost" is also defined. This definition is discussed in the commentary on subsection 79.1(6).

ITA  
79.1(2)

New subsection 79.1(2) of the Act sets out the circumstances in which property is considered to be "seized" by a person in respect of a debt. The operative rules in section 79.1 only apply where property is seized by a creditor in respect of a debt.

Property is seized by a creditor in respect of a debt where the beneficial ownership of the property is acquired or reacquired by the creditor and the acquisition or reacquisition was in consequence of another person's failure to pay to the creditor all or part of the debt. It should be noted that, unlike subsection 79(2), subsection 79.1(2) can apply to a creditor where the original debtor transfers secured property to a third party and there is no debtor/creditor relationship between the third party and the creditor.

#### ITA

##### 79.1(3) and (4)

Subsections 79.1(3) and (4) of the Act, which are similar to existing rules in paragraph 79(e), provide that a reserve claimed in the first taxation year ending before a reacquisition of a creditor's seized property is not added back in computing the creditor's income for the year of the seizure. Instead, the cost to the creditor of the seized property is reduced in a corresponding manner under subsection 79.1(6). However, if the prior year reserve in respect of a seized property exceeds its cost (determined under subsection 79.1(6), without reference to the reserve), the excess is added back into income for the year of the seizure.

#### ITA

##### 79.1(5)

New subsection 79.1(5) of the Act provides relief for a creditor who seizes capital property during a taxation year in which it was previously disposed of by the creditor. Under subsection 79.1(5), a creditor's proceeds of disposition with respect to such a previous disposition are generally reduced by the unpaid portion of those proceeds at the time of the reacquisition of the property by the creditor. The amount of such reduction is taken into account by a reduction under subsection 79.1(6) in the cost to the creditor of the seized property. More specifically, the redetermined proceeds of disposition in respect of a previous disposition by the creditor of the seized property in these circumstances are considered to be equal to the lesser of the actual proceeds of disposition of the property to the creditor and the amount that is the greater of:

- the amount, if any, by which the actual proceeds of disposition of the property to the creditor exceed the portion of those proceeds represented by unpaid principal amounts of debt immediately before the time of the seizure, and
- the cost amount to the creditor of the property immediately before the previous disposition.

A special transitional rule allows this relief to apply retroactively where a taxpayer elects in writing filed with the Minister of National Revenue. This transitional rule applies to property that is reacquired by a creditor after 1991.

ITA

79.1(6)

New subsection 79.1(6) of the Act provides that the cost of a particular seized property to a creditor that is acquired in consequence of the failure to pay debt is treated as being the sum of two amounts minus a third amount.

The first amount added is the "specified cost" of the debt, multiplied by a proration factor (described below). The second amount added is the total outlays and expenses made or incurred by the creditor before the acquisition or reacquisition, or the amount of debt assumed by the creditor, to protect the creditor's interest in that property, other than amounts otherwise taken into account for income tax purposes. The third amount, which is subtracted, is any reserve claimed for the preceding taxation year with respect to that property, or the proceeds reduction determined under subsection 79.1(5), in the event that the property is being reacquired by the creditor.

As defined under subsection 79.1(1), the "specified cost" of debt is, where the debt is capital property of a creditor, its adjusted cost base to the creditor. In other cases, the specified cost of the debt is simply its cost. The reference to adjusted cost base (rather than cost) is of relevance, for example, where a corporate creditor has undergone an acquisition of control to which subsection 111(4) applies or where the adjusted cost base to the creditor of the debt is increased under paragraph 53(1)(f.1) or (f.11) on an acquisition of the debt from a person related to the creditor. It should be noted that amended



subsection 50(1) (described in the commentary above) is also relevant for the purposes of computing the specified cost of debt, whether the debt is capital property or inventory.

The proration factor, with respect to a particular property seized by a creditor, is its fair market value at the time of its acquisition or reacquisition by the creditor divided by the fair market value at that time of all the property seized by the creditor.

#### ITA

##### 79.1(7)

New subsection 79.1(7) of the Act provides that, where a creditor seizes property in respect of a debt, the amount received on account of the debt as a consequence of the seizure is deemed to be equal to the specified cost to the creditor of the debt. This measure replaces the existing rule in paragraph 79(g) and ensures that there will be no income or loss resulting from any recovery in respect of a debt where a creditor seizes property in respect of the debt, unless the creditor recovers further amounts in respect of the debt. Any further recovered amounts would be income or a capital gain of the creditor, depending on whether the debt is inventory or capital property of the creditor.

#### ITA

##### 79.1(8)

New subsection 79.1(8) of the Act prohibits any deductions by a creditor in respect of the principal amount of a debtor's debt on account of bad or doubtful debts, where property was seized by the creditor in respect of that debt in circumstances to which section 79.1 applies.

The prohibition extends to bad debt expenses claimed directly (e.g., paragraph 20(1)(p) and subsections 20(4) to (4.2)) or claimed indirectly through an addition to a resource expenditure pool under subsection 66.1(6), 66.2(5) or 66.4(5).

Subsection 79.1(8) does not, however, prevent a creditor from claiming a bad or doubtful debt with respect to unpaid interest.

## Clause 28

### Forgiveness of debt

ITA

80

Section 80 of the Act (in conjunction with Part LIV of the *Income Tax Regulations*) sets out the existing rules that apply where an obligation of a debtor to pay an amount is settled or extinguished for less than its principal amount and the amount for which it was issued. In most circumstances, the current rules provide that the resulting economic gain is not immediately taxable but rather reduces, in turn, the amount of the debtor's deductible loss carry forwards from preceding taxation years, the capital cost of the debtor's depreciable property and the adjusted cost base of any other capital property.

There are a number of circumstances set out in existing paragraphs 80(1)(c) to (h) in which section 80 does not apply in respect of an obligation issued by a debtor. These exemptions from the application of section 80, which are also provided under the new provisions noted, apply where:

- the debtor is a bankrupt (paragraph (i) of the description of B in the definition of "forgiven amount" in subsection 80(1)),
- the obligation is one on which any interest payable may neither be deducted nor capitalized for tax purposes (definition of "commercial debt obligation" in subsection 80(1)),
- section 79 applies in respect of the obligation (paragraph (f) of the description of B in the definition of "forgiven amount" in subsection 80(1)),
- the amount of the obligation settled or extinguished is already recognized for tax purposes as income, a reduction in the capital cost or adjusted cost base of property or a capital gain under subsection 39(3) (paragraph (d) of the description of B in the definition of "forgiven amount" and the definition of "excluded obligation" in subsection 80(1)), or

- the obligation is settled or extinguished by way of bequest or inheritance (paragraph 80(2)(a)).

As described in detail below, the rules in existing section 80 are being substantially modified. The amendments to section 80 and related new provisions are organized as follows:

- Amended subsection 80(1) sets out a number of definitions relevant for the purposes of the new rules, including the key definition of "forgiven amount" that is referred to above.
- Amended subsection 80(2) contains a number of rules of application, including the rule contained in existing subsection 80(4) concerning the forgiveness of interest owing on a debt.
- The operative rules are now provided under new subsections 80(3) to (15).
- Rules for the deemed settlement of debt (including rules formerly contained in subsections 80(2) and (3)) are contained in new section 80.01.
- New section 80.02 provides special rules dealing with distress preferred shares.
- New section 80.03 provides for the recognition of a capital gain (or a forgiven amount) in certain cases after the adjusted cost base of a share, convertible debt, partnership interest, trust interest or option is reduced under new subsection 80(9), (10) or (11) and the property (or related property) is subsequently disposed of.
- New section 80.04 is a mechanism whereby unapplied portions of forgiven amounts may, in effect, be transferred by a debtor to eligible corporations and partnerships.

The new rules for debt forgiveness are entirely contained in the Act. As a consequence, Part LIV of the Regulations is no longer relevant, except in the cases where grandfathering applies.

The amendments to subsections 6(15) and 15(1.2) and sections 79 and 80 have been structured to provide that the income tax provisions

for a debtor with respect to debt forgiveness and unpaid amounts apply in the following order:

- section 78, as per note 1,
- subsections 6(1) and (15), as per note 2,
- subsections 15(1) and (1.2), as per note 2,
- section 9, to the extent that a debt settlement results in an income inclusion apart from an express statutory rule, as per note 3,
- section 79, as per note 4, and
- section 80, as per note 5.

**Notes:**

<sup>1</sup>Section 80 does not have any application in respect of the settlement of a debt where section 78 applies in respect of the debt, because of paragraph (c) of the definition of "excluded obligation" in subsection 80(1). Section 79 has no application in this respect because of the description of F in subsection 79(3).

<sup>2</sup>In the event that subsection 79(3) applies to a debt in a taxation year preceding, or coinciding with, a taxation year in which subsection 6(15) or 15(1.2) applies to the same debt, the amount determined for F in subsection 79(3) limits the application of section 79. In the event that subsection 6(15) or 15(1.2) applies to a debt in a taxation year after the year for which subsection 79(3) applies to the same debt, subsection 79(5) effectively provides for a reversal of the application of section 79. Section 80 cannot apply concurrently with subsection 6(15) or 15(1.2) because of paragraph (b) of the description of B in the definition of "forgiven amount" in subsection 80(1).

<sup>3</sup>To the extent that income is recognized on the settlement of an obligation (e.g., a trade account payable) apart from sections 79 and 80, sections 79 and 80 will not apply. (See the amount determined for F in subsection 79(3) and the definition of "excluded obligation" in subsection 80(1).) In the event that section 78 has previously applied with respect to such an

obligation, subsection 4(4) will ensure that there is no further income inclusion.

<sup>4</sup>Notwithstanding the general rule, the rules in section 80 rather than section 79 prevail in the event that subsection 80.01(8) (deemed settlement on debt parking) had applied to a debt in a taxation year before the taxation year in which section 79 applies to the debt. The amount determined for F in subsection 79(3) reflects the income tax consequences of a deemed settlement from the earlier taxation year. In the event that a surrender of property under section 79 occurs in the same year as a deemed settlement of debt under subsection 80.01(8), the rules in section 79 prevail because of paragraph (f) of the description of B in the definition of "forgiven amount" in subsection 80(1).

<sup>5</sup>In the event that subsection 80.01(8) or (9) applies on a deemed settlement of debt before the subsequent operation of section 80, paragraph (g) of the description of B in the definition of "forgiven amount" in subsection 80(1) will result in the subsequent operation of section 80 being limited.

The amendments to section 80 generally apply to taxation years ending after February 21, 1994. However, except for the purposes of the employee and shareholder indebtedness provisions and section 79, these amendments do not apply to any obligation settled or extinguished

- ° before February 22, 1994,
- ° after February 21, 1994, under the terms of a written agreement entered into on or before that date,
- ° before 1996, pursuant to a restructuring of debt in connection with a proceeding commenced in a court in Canada before February 22, 1994,
- ° before 1996, in connection with a proposal (or notice of intention to make a proposal) that was filed under the *Bankruptcy and Insolvency Act* before February 22, 1994, or

- before 1996, in connection with a written offer that was made by, or communicated to, the holder of the obligation before February 22, 1994.

In addition, paragraph 80(2)(i) and subsections 80(5), (7), (8), (9), (10) and (11) refer to designations filed in prescribed forms with the income tax return of the debtor. A designation referred to in any of those provisions will be considered to have been filed, as required under those provisions, if it is filed with the Minister of National Revenue before 1996.

#### ITA 80(1)

The new definitions in subsection 80(1) of the Act are set out below.

#### "commercial debt obligation"

A "commercial debt obligation" includes an obligation on which interest payable is deductible in computing income or would, if interest had been payable in respect of the obligation and certain assumptions were made, have been so deductible. As is the case with the existing rules, the limitations on interest deductibility under subsections 18(2) and (3.1) (interest on debt related to building construction and land acquisition or ownership), subsection 18(4) (thin capitalization) and section 21 (capitalization of interest) are assumed not to apply for the purposes of the definition.

In determining whether an obligation is a "commercial debt obligation", the limitations on the deduction of interest under subsection 15.1(2) (small business development bonds), subsection 15.2(2) (small business bonds) and paragraph 18(1)(g) (income bonds) are also ignored. Under these provisions, interest paid by debtors is not deductible and is treated by the creditor as a dividend.

An obligation may also be a "commercial debt obligation" if interest on it is deductible in computing the debtor's taxable income earned in Canada or taxable income. The reference to "taxable income earned in Canada" and "taxable income" apply to businesses carried on by a

debtor in a taxation year, where the debtor was not resident in Canada during all or part of that year. (For a discussion of the application of section 80 in connection with the computation of foreign accrual property income and surplus pools of foreign affiliates, see the commentary on the amendments to section 95 and to draft clause 5907(1)(a)(i)(C) of the Regulations.)

The expression "commercial debt obligation" is used in the definition "commercial obligation", described below, and in new paragraph 80(2)(h), subsection 80(15) and sections 80.01 to 80.04. Reference in this context should be made to new subsections 248(26) and (27), which clarify the circumstances in which an obligation is considered to be issued by a debtor and affect partial settlements of obligations.

#### "commercial obligation"

A "commercial obligation" issued by a debtor is a "commercial debt obligation" or "distress preferred share" issued by the debtor. For the rules in amended section 80 to apply, it is required that a "commercial obligation" be settled or extinguished. The application of these rules to distress preferred shares is an extension of the existing rules. Special rules for distress preferred shares are contained in new section 80.02.

#### "debtor"

A debtor is defined to include any corporation that has issued a distress preferred share.

#### "directed person"

This expression is discussed in the commentary to new subsection 80(14).

#### "distress preferred share"

A "distress preferred share" issued by a corporation is defined as a share issued by the corporation after February 21, 1994 (other than a share issued pursuant to an agreement in writing entered into on or before that date) that is described in paragraph (e) of the definition of

"term preferred share" in subsection 248(1) and would be a "term preferred share" under that subsection if that definition were read without reference to paragraphs (e) and (f) of the definition. The definition of "distress preferred share" is used in the expressions "commercial obligation", "debtor" and "excluded security", in the special rules for distress preferred shares contained in section 80.02 and for the purposes of new sections 80.01 and 80.03. Once a share ceases to be a distress preferred share, subsection 80.02(7) provides for a deemed settlement for the purposes of section 80.

### "eligible Canadian partnership"

This definition is discussed in the commentary to new subsection 80(14).

### "excluded obligation"

An "excluded obligation" is essentially an obligation not taken into account for the purposes of applying section 80 because it is taken into account for the purposes of the Act, apart from the rules in section 79 and 80.

An "excluded obligation" includes a loan that has been recognized as assistance for income tax purposes under any one of a number of provisions (e.g., paragraph 12(1)(x) or subsection 13(7.1)) or was included in computing the debtor's income (e.g., subsection 15(2)). It also includes an obligation related to an amount unpaid by a cash basis taxpayer that is recognized for income tax purposes only when it is paid.

An "excluded obligation" also includes an obligation to which the rules in section 78 apply and obligations (e.g., trade payables) the settlement of which result in income to a debtor, apart from the application of sections 79 and 80.

### "excluded property"

An "excluded property" at any time in respect of a non-resident debtor is property that would not qualify as "taxable Canadian property" under paragraph 115(1)(b) if it were disposed of at that time.



The adjusted cost base of excluded property, as well as capital losses from the disposition of such property, are not taken into account under subsections 80(9) to (11). This is consistent with existing subsection 111(9), which provides that capital losses and business investment losses from the disposition by a non-resident taxpayer of such property are not taken into account in determining the taxpayer's non-capital loss or net capital loss for a taxation year.

"excluded security"

This expression is used only in paragraph 80(2)(g). For discussion, see the commentary on that paragraph.

"forgiven amount"

The key definition in section 80 is "forgiven amount". The forgiven amount in respect of a commercial obligation issued by a debtor is required to be applied as provided under subsections 80(3) to (12). Any remaining unapplied amount is added in computing the debtor's income, to the extent provided by subsection 80(13).

The "forgiven amount" at any time in respect of a commercial obligation issued by a debtor is defined as the lesser of the principal amount of the obligation and the amount for which it was issued minus the total of the following amounts:

- any amount paid at that time in satisfaction of the principal amount of the obligation,
- any amount included in respect of employee or shareholder indebtedness in computing the income of any person because of the settlement of the obligation at that time,
- any amount reducing the forgiven amount in respect of the obligation at that time under amended paragraph 18(9.3)(f),
- any capital gain recognized under subsection 39(3) on the open market purchase by a debtor of the obligation,
- such portion of the principal amount of the obligation as relates to an amount renounced under subsection 66(10), (10.1), (10.2) or (10.3) by the debtor,

- any portion of the principal amount of the obligation that has been included in computing a debtor's proceeds of disposition under subsection 79(3) with respect to property surrendered by the debtor,
- all forgiven amounts determined in respect of the obligation at previous times at which the obligation was deemed by subsection 80.01(8) or (9) to have been settled, and
- any portion of the principal amount of the obligation representing accrued interest that was included under section 80.04 in computing the debtor's income. (This measure is relevant only to the extent that unpaid amounts of interest are considered to represent a principal amount of debt because of paragraph 80(2)(b).)

In addition, the forgiven amount is nullified in the event that a debtor is a bankrupt or the obligation in connection with which the forgiven amount is determined is an "excluded obligation". The expression "excluded obligation" is defined in subsection 80(1) and discussed in the commentary above.

Reference in this context should also be made to new subsections 248(26) and (27), which clarify the circumstances in which an obligation is considered to be issued by a debtor and affect partial settlements of obligations.

"person"

A "person" is defined to include a partnership.

"relevant loss balance"

This expression is discussed in the commentary to new subsections 80(3) and (4).

"successor pool"

This expression is discussed in the commentary to new subsection 80(8).

"unrecognized loss"

This expression is discussed in the commentary to new subsection 80(13).

ITA  
80(2)

New subsection 80(2) of the Act provides a number of rules of application for the purposes of section 80. Broader rules of application for the purposes of section 80 and other provisions in the Act are provided under new subsections 248(26) and (27). Rules relating to distress preferred shares are provided under new section 80.02.

ITA  
80(2)(a) to (i)

New paragraph 80(2)(a) of the Act provides that an obligation issued by a debtor is considered to be settled when the obligation is settled or extinguished (otherwise than by way of a bequest or inheritance).

New paragraph 80(2)(b) treats interest payable by a debtor as having a principal amount equal to the portion of the interest that is deductible or that may be capitalized for income tax purposes. It also provides that such interest is also considered to be an obligation issued by the debtor for the same amount. This provision is a restatement of the rule contained in existing subsection 80(4).

New paragraph 80(2)(c) provides that subsections 80(3) to (13) apply in numerical order to the forgiven amount in respect of a commercial obligation.

New paragraphs 80(2)(d) and (e) provide rules that take into account the fraction of capital losses (including business investment losses) for a taxation year that are included in determining net capital losses and non-capital losses for the year. For taxation years ending after 1989, the applicable fraction is  $\frac{3}{4}$ . For taxation years ending before 1988, the applicable fraction is  $\frac{1}{2}$ . For taxation years ending in 1988 or 1989, the applicable fraction is between  $\frac{1}{2}$  and  $\frac{3}{4}$ , as determined under section 38. Only the applicable fraction for a

taxation year of the unapplied portion of the forgiven amount is applied under subsection 80(4) to reduce a loss for that year. However, the portion of the forgiven amount so applied under subsection 80(4) is considered to have been the amount of the reduction of a loss for a year divided by the applicable fraction for the year.

### EXAMPLE

The forgiven amount at a relevant time in respect of an obligation issued by a debtor is \$100. The debtor's undeducted net capital loss carryforward from the 1990 taxation year is \$60.

#### Results:

1. As a consequence of subsection 80(4) and paragraph 80(2)(d), no more than  $\frac{3}{4}$  of the forgiven amount (i.e.  $\frac{3}{4} \times 100$ ) will be applied to reduce a net capital loss for 1990.
2. While the amount required to eliminate the loss is \$60, as a consequence of paragraph 80(2)(e), the portion of the forgiven amount considered to have been applied in these circumstances is \$80 (i.e.  $\frac{4}{3} \times 60$ ). Thus, the remaining unapplied portion of the forgiven amount is \$20.

New paragraph 80(2)(f) is a rule that takes into account the fact that only  $\frac{3}{4}$  of a debtor's eligible capital expenditures are added in computing a debtor's cumulative eligible capital. As a consequence, under new subsection 80(7), only  $\frac{3}{4}$  of the unapplied forgiven amount in respect of an obligation is applied to reduce cumulative eligible capital. Under paragraph 80(2)(f), the portion of the forgiven amount applied in this respect is considered to be  $\frac{4}{3}$  of the reduction of the cumulative eligible capital. This rule is parallel to the rule for capital losses, illustrated in the example above.

New paragraph 80(2)(g) applies where a share of the capital stock of a corporation (other than an excluded security) is issued by the corporation to a person in consideration for the cancellation of debt issued by the corporation. Where this is the case, the debt is considered to be settled for an amount equal to the fair market value of the share. For this purpose, an "excluded security" issued by a

corporation to a person in consideration for the cancellation of a debt is defined under subsection 80(1) as:

- a distress preferred share issued by the corporation to the person,
- a share issued by the corporation to the person under terms of the debt, where the debt was a bond, debenture or note and the terms were in effect before February 22, 1994, or
- a share issued by the corporation to the person under the terms of the debt, where the debt was a bond, debenture or note listed on a prescribed stock exchange in Canada and the terms for the conversion to the share were not established or substantially modified after the later of February 22, 1994 and the time that the bond, debenture or note was issued.

New paragraph 80(2)(h) applies where any part of the consideration given by a debtor to another person for the settlement at any time of a particular commercial debt obligation issued by the debtor and payable to the other person consists of another commercial debt obligation issued by the debtor to the other person. Where this is the case,

- an amount equal to the principal amount of the other obligation is deemed to be paid by the debtor at that time, because of the issue of the other obligation, in satisfaction of the principal amount of the particular obligation, and
- the other obligation is deemed to have been issued at the same percentage premium or discount at which the particular obligation was issued.

New paragraph 80(2)(i) is a rule that clarifies the application of the debt forgiveness rules where the rules would otherwise apply simultaneously to obligations issued by a debtor that are settled at the same time. Where this is the case, the obligations are treated as having been settled at different times, in whatever order designated by the debtor in a prescribed form filed with the debtor's income tax return. If the debtor fails to designate an order, the order is designated by the Minister of National Revenue.

## EXAMPLE

A debtor has two outstanding commercial debt obligations, owing to C1 (principal amount of \$1,000) and C2 (principal amount of \$5,000). The obligations are settled at the same time on the payment of \$2,400 (of which \$400 is for the obligation owing to C1 and \$2,000 is for the obligation owing to C2). The debt owing to C1 is designated as having been settled before the debt owing to C2.

### Result:

1. The forgiven amount determined with respect to the obligation owed to C1 is \$600. This amount is applied, as required under subsections 80(3) to (12), immediately before the time at which it is actually settled.
2. The forgiven amount determined with respect to the obligation owed to C2 is \$3,000, which is applied at the time of the actual settlement.

In many cases, the order in which obligations are settled as a consequence of new paragraph 80(2)(i) should not make any difference to the tax treatment of debtors. However, if two obligations were issued in different circumstances, the operation of the rules in subsections 80(3) to (12) is affected in certain cases. For example, the loss carryforwards and resource expenditure pools against which a forgiven amount can be applied under subsections 80(3) and (8) depend, in part, on when an obligation was incurred. In addition, the nature of any income inclusion under subsection 80(13) depends on the source in connection with which an obligation was issued.

### ITA 80(2)(j)

Paragraph 80(2)(j) of the Act introduces a number of assumptions that are relevant for the purposes of determining whether two or more persons (including partnerships and trusts) are related to each other. The assumptions are also relevant for the purposes of determining whether any person controls another person.

Paragraph 80(2)(j) provides that each partnership and trust is, for the purposes of section 80, treated as a corporation having a single class of capital of 100 voting shares. The members of the partnership, or the beneficiaries under the trust, are treated as owning such shares in accordance with their proportionate interests in the partnership or trust. The proportionate interest of a partner or a beneficiary is based on the fair market value of the partner's or beneficiary's interest in the partnership or trust.

In the case of a discretionary trust, the fair market value of a beneficiary's interest is treated as nil if the beneficiary is not entitled to any of the income or capital of the trust until after the death of one or more other beneficiaries under the trust. (Other beneficiaries under a discretionary trust will, in effect, each be considered to own the 100 voting shares jointly because the fair market value of their interest is considered to be the fair market value of all interests in the trust.)

The example below illustrates the operation of paragraph 80(2)(j).

#### **EXAMPLE**

Assume that individual A owns all the shares of the capital stock of Corporation A1. Corporation A1 is a 70% partner in Partnership A. Partnership A owns 60% of the shares in Corporation A2. Partnership A is the debtor to which the rules in section 80 apply.

Results:

1. Corporation A1 controls Partnership A, as Corporation A1 is deemed to own over 50% of the voting shares with respect to Partnership A.
2. Partnership A controls Corporation A2, as Partnership A is deemed to own over 50% of the voting shares with respect to Partnership A.
3. As a consequence of the application of section 252, the individual is related to the partnership and the two corporations. In addition, the two corporations and the partnership are all related to each other.

ITA  
80(2)(k)

Paragraph 80(2)(k) of the Act clarifies the treatment under section 80 of an obligation that is settled in the event that the obligation is denominated in a foreign currency. It provides that foreign currency fluctuations after the time an obligation is issued are ignored for the purposes of section 80 and that forgiven amounts are determined with reference to the exchange rate at the time that a debt was issued.

**EXAMPLE**

A debtor borrowed U.S. \$10,000 on a long-term basis, at a time when the Canadian dollar and the U.S. dollar are trading at par. Subsequently, the creditor forgives the obligation on payment of the U.S. \$3,000. At the subsequent time, the exchange rate is Cdn. \$1 = U.S.\$80. The foreign currency gains and losses for the debtor and creditor are assumed to be on account of capital.

Results:

1. At the subsequent time, the capital loss sustained by the debtor because of the depreciation of the Canadian dollar is Cdn. \$750 ( $\$3,000 / .8 - \$3,000$ ). (The lender has a corresponding gain.)
2. Under new paragraph 80(2)(k), the forgiven amount is determined with reference to the exchange rate at the time the debt was issued. As a consequence, the forgiven amount is equal to Cdn. \$7,000 ( $10,000 - 3,000$ ).

A further rule dealing with fluctuations in foreign currency is provided under new subsection 80.01(11).

ITA  
80(2)(l)

Paragraph 80(2)(l) of the Act applies where an amount is paid in satisfaction of the principal amount of a particular commercial obligation issued by a debtor and, as a consequence of the payment, the debtor is legally obliged to pay that amount to another person.



Typically, this would arise where a guarantor is obliged to make payments under the terms of a guarantee to a creditor.

Where this is the case, the obligation to pay that amount to the other person is considered to be a commercial obligation that was issued by the debtor at the same time and in the same circumstances as the particular obligation. This amendment should be read with new subsection 248(27), which clarifies the circumstances in which a person will be regarded as having issued an obligation.

#### ITA

#### 80(3) and (4)

New subsection 80(3) of the Act provides that a forgiven amount in respect of debt issued by a debtor is applied at the time that the debt is settled to reduce the debtor's loss carryforwards, as described in greater detail below.

The forgiven amount in respect of a commercial obligation is applied to reduce, in the following order:

- ° the debtor's non-capital loss carryforwards (apart from allowable business investment losses, which are provided more generous treatment under subsection 80(4)),
- ° the debtor's farm loss carryforwards, and
- ° the debtor's restricted farm loss carryforwards.

Within each of the above categories of losses, a loss for an earlier taxation year is reduced before the loss for a later taxation year. In addition, the amount by which a loss for a year may be reduced is limited to the "relevant loss balance" in respect of the relevant obligation that relates to that loss. The "relevant loss balance" of a debtor in respect of an obligation that relates to a loss for a previous taxation year is defined in subsection 80(1) as the amount of such loss that would be deductible in computing the debtor's taxable income or taxable income earned in Canada if:

- ° the debtor had sufficient income and taxable capital gains,

- the amount of such loss were not reduced under subsection 80(3) or (4) at or after the time that the obligation was settled, and
- there were no restrictions under subsections 111(4) and (5) after the acquisition of control of the debtor with respect to the deduction of losses.

The relevant loss balance of a corporate debtor in respect of an obligation that relates to a net capital loss, non-capital loss, farm loss or restricted farm loss for a previous year is deemed to be nil after an acquisition of control of the debtor that occurred after that previous year unless

- the obligation was issued before, and not in contemplation of, that acquisition of control, or
- all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance an obligation that is described immediately above.

Under subsection 80(4), the remaining unapplied portion of a debtor's forgiven amount is multiplied by the applicable fraction for a taxation year (as described in the commentary to subsection 80(2)) and applied to reduce, subject to the same restrictions as described above, in the following order:

- the debtor's non-capital losses, to the extent that they are allowable business investment losses, of each previous year,
- the debtor's net capital losses of each previous year.

Within each of these categories of losses, a loss for an earlier taxation year is reduced before the loss for a later taxation year. In addition, the amount by which a loss for a year may be reduced is limited to the "relevant loss balance" in respect of the relevant obligation that relates to that loss.

Under paragraph 80(2)(e), the portion of the forgiven amount applied in respect of a loss for a taxation year is considered to be equal to the reduction of the loss for that year multiplied by the reciprocal of the applicable fraction for that year. For further discussion, see the commentary on that paragraph.

The example below illustrates the operation of subsections 80(3) and (4).

### EXAMPLE

Debtco has \$10,000 of non-capital losses from the 1992 taxation year. This amount consists of \$4,800 of allowable business investment losses and \$5,200 of other losses. Debtco deducted \$2,000 in respect of these losses in computing its 1993 income. In 1995, \$20,000 of commercial debt issued by Debtco is settled without any payment being made by Debtco.

#### Results:

1. Under subsection 80(3), the "ordinary non-capital loss" is \$3,200 ( $\$10,000 - 2,000 - 4,800$ ). As a consequence, the non-capital loss for the 1992 year is reduced under subsection 80(3) by \$3,200. The remaining unapplied portion of the forgiven amount is \$16,800.
2. Under subsection 80(4), the portion of the forgiven amount that is applied is \$4,800, which is the "relevant loss balance" of the non-capital loss of \$8,000 ( $\$10,000 - 2,000$ ) minus the "ordinary non-capital loss" balance of \$3,200.
3. As a consequence the non-capital loss for the 1992 year is reduced to \$2,000 ( $10,000 - 3,200 - 4,800$ ). However, the remaining \$2,000 cannot be deducted because it was previously claimed as a deduction.
4. The remaining unapplied forgiven amount is \$10,400 ( $\$20,000 - 3,200 - (4/3 \times 4,800)$ ).

#### ITA 80(5) and (6)

New subsection 80(5) of the Act (which, in conjunction with subsection 80(6), effectively replaces the rules in Part LIV of the Regulations) provides that the remaining unapplied portion of a debtor's forgiven amount in respect of an obligation settled at any

time may, to the extent designated by the debtor in a prescribed form filed with the debtor's income tax return, be applied to reduce immediately after that time the following amounts:

- ° capital costs of depreciable properties of a prescribed class that are owned by the debtor immediately after that time,
- ° capital costs of other depreciable properties that are owned by the debtor immediately after that time, and
- ° the undepreciated capital costs to the debtor of a prescribed class of depreciable property immediately after that time.

Subsection 80(6) provides that an amount may be applied under subsection 80(5) to reduce the capital cost to the debtor of a depreciable property of a prescribed class only to the extent that the undepreciated capital cost to the debtor of the depreciable property exceeds the total of all other reductions at that time to that undepreciated capital cost. In other words, a reduction under subsection 80(5) to the capital cost of a property in a prescribed class cannot be made to the extent that it would result in a negative balance in the undepreciated capital cost of the class.

Subsection 80(6) also provides that an amount may be applied under subsection 80(5) to reduce the capital cost to a debtor of a depreciable property that is not in a prescribed class, to the extent that the capital cost to the debtor of that property exceeds the amount that was allowed to the debtor under Part XVII of the Regulations in respect of the property. This measure is relevant only for property acquired before 1972 to which Part XVII of the Regulations applies.

#### ITA 80(7)

New subsection 80(7) of the Act provides that the remaining unapplied portion of a debtor's forgiven amount is multiplied by  $\frac{3}{4}$  and then applied, to the extent designated by the debtor in a prescribed form filed with the debtor's income tax return, to reduce the debtor's cumulative eligible capital. As noted in the commentary on paragraph 80(2)(f), the portion of a forgiven amount that is

considered to have been applied under subsection 80(7) is equal to  $\frac{4}{3}$  of the reduction.

## ITA 80(8)

New subsection 80(8) of the Act provides that the remaining unapplied portion of a debtor's forgiven amount in respect of an obligation settled at any time may, to the extent designated by the debtor in a prescribed form filed with the debtor's income tax return, be applied to reduce immediately after that time the following amounts:

- undeducted resource expenditure balances that are deductible or potentially deductible under subsection 66.7(2), (3), (4) or (5) as a consequence of the acquisition of control of the debtor by a person or group of persons, the debtor ceasing to be exempt from tax under Part I on its taxable income or the acquisition of properties by the debtor by way of an amalgamation or merger, subject to the limitation described below,
- the debtor's cumulative Canadian development expense and cumulative Canadian oil and gas property expense, and
- where the debtor is resident in Canada, the portion of the debtor's foreign exploration and development expenses that would be deductible in computing the debtor's income for the year if the debtor had sufficient foreign resource income and if the year ended at that time.

The reduction in a resource expenditure balance under subsection 66.7(2), (3), (4) or (5) as a consequence of the settlement of an obligation at any time is limited to the "successor pool" immediately after that time in respect of the obligation, as defined under subsection 80(1). The "successor pool" at any time in respect of an obligation is the balance of an amount determined under subsection 66.7(2), (3), (4) or (5) that would be deductible in computing the debtor's income for the taxation year that includes that time if

- the debtor had sufficient "streamed" income from resource properties,
- the balance were not reduced as a consequence of the application of subsection 80(8) at that time,
- the year ended immediately after that time (i.e. there were no future transactions or events that reduced the balance), and
- there were no annual percentage limits with respect to the deduction of "successor" Canadian development expenses or "successor" Canadian oil and gas property expenses.

However, the successor pool at any time in respect of an obligation is deemed to be nil unless

- the obligation was issued before, and not in contemplation of, the event (e.g., acquisition of control) that gave rise to the deduction of the resource expenditure balance under subsection 66.7(2), (3), (4), or (5), or
- all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance an obligation described immediately above.

## ITA 80(9)

New subsection 80(9) of the Act provides that the remaining unapplied portion of a debtor's forgiven amount in respect of an obligation settled at any time may, to the extent designated by the debtor in a prescribed form filed with the debtor's income tax return, be applied to reduce immediately after that time the adjusted cost bases to the debtor of capital properties, other than the following properties:

- depreciable properties, except to the extent provided under paragraph 80(9)(b) (described below),
- excluded properties (as defined under subsection 80(1)),

- ° personal-use properties (as defined under section 54),
- ° shares of the capital stock of corporations of which the debtor is a "specified shareholder" (as defined under subsection 248(1)),
- ° debt issued by corporations of which the debtor is a "specified shareholder" (as defined under subsection 248(1)), and
- ° interests in partnerships that are related to the debtor (as determined with reference to the assumptions in paragraph 80(2)(j)).

In order to take advantage of subsection 80(9) with respect to a settlement of an obligation, a debtor must designate to the maximum extent permitted under subsections 80(5), (7) and (8) in respect of the settlement. Subsections 80(10) and (11) provide for reductions in the adjusted cost base of shares, debts and partnership interests, in the event that a forgiven amount is not fully applied after the operation of subsection 80(9).

In the majority of cases, the application of a forgiven amount in respect of depreciable properties is dealt with exclusively under subsection 80(5). Paragraph 80(9)(b) applies only where the capital cost of depreciable property of a prescribed class is, for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and regulations under paragraph 20(1)(a), less than its capital cost for other purposes. This difference can arise because special rules for changes of use and non-arm's length transfers are provided under subsection 13(7) to determine the capital cost of a depreciable property only for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and regulations under paragraph 20(1)(a). In these circumstances, a debtor is allowed under subsection 80(9) to reduce the capital cost of depreciable property only to the extent that the capital cost is not reflected in the undepreciated capital cost of a prescribed class of depreciable property.

Paragraph 80(9)(c) provides that the reduction of the capital cost of depreciable property under subsection 80(9) is not relevant for the purposes of paragraphs 8(1)(j) and (p), sections 13 and 20 and regulations under paragraph 20(1)(a). The reduction would, for example, be relevant for the purposes of computing any capital gain from the disposition of the property.

In some cases, reductions under subsection 80(9) to the adjusted cost bases of shares, convertible debts, partnership interests, trust interests and options with respect to such property may ultimately be relevant for the purposes of new section 80.03. For further detail, see the commentary on that section.

## ITA 80(10)

New subsection 80(10) of the Act provides that the remaining unapplied portion of a debtor's forgiven amount in respect of an obligation may be applied to reduce the adjusted cost bases to the debtor of capital properties that are shares of the capital stock of corporations of which the debtor is a specified shareholder or debts issued by such corporations, other than the following properties:

- shares of the capital stock of corporations related to the debtor,
- debts issued by corporations related to the debtor, and
- excluded properties (as defined under subsection 80(1)).

In order to take advantage of subsection 80(10) with respect to a settlement of an obligation, a debtor must designate to the maximum extent permitted under subsections 80(5) to (9) in respect of the settlement. Subsection 80(11) provides for reductions in the adjusted cost base of shares and debts, in the event that a forgiven amount is not fully applied after the operation of subsection 80(10).

In some cases, reductions under subsection 80(10) to the adjusted cost bases of shares or convertible debts may ultimately be relevant for the purposes of new section 80.03. For further detail, see the commentary on that section.

## ITA 80(11)

New subsection 80(11) of the Act provides that the remaining unapplied portion of a debtor's forgiven amount in respect of an obligation may, to the extent designated by the debtor in a prescribed



form filed with the debtor's income tax return, be applied to reduce the adjusted cost bases to the debtor of capital properties that are shares of the capital stock of related corporations, debts issued by related corporations and interests in related partnerships, (other than excluded properties (as defined under subsection 80(1))). For this purpose, paragraph 80(2)(j) may assist in determining whether a debtor is related to a corporation or partnership.

In order to take advantage of subsection 80(11) with respect to a settlement of an obligation, a debtor must designate to the maximum extent permitted under subsections 80(5) to (10) in respect of the settlement. As discussed in the commentary below, the amount designated by a debtor under subsection 80(11) may be constrained because of the new income inclusion rule in subsection 80(13). Excessive reductions in the adjusted cost base of property under subsection 80(11) can result in an income inclusion under subsection 80(13).

In some cases, reductions under subsection 80(11) to the adjusted cost bases of shares, convertible debts and partnership interests may ultimately be relevant for the purposes of new section 80.03. For further detail, see the commentary on that section.

#### ITA 80(12)

New subsection 80(12) of the Act provides a mechanism whereby a debtor can effectively apply a forgiven amount against current year capital losses or, where the debtor is a corporation, any net capital losses of its former subsidiary that are potentially deductible in computing the debtor's taxable income as a consequence of the application of subsection 88(1.2). In the absence of this provision, the unapplied forgiven amount would be included in computing the debtor's income to the extent provided under subsection 80(13) and such capital losses could not be used to offset the resulting income.

Subsection 80(12) applies where amounts have been designated by a debtor under subsections 80(5) to (9) in respect of the settlement of an obligation to the maximum extent permitted. Where this is the case, the lesser of two amounts is treated as a capital gain of the debtor. The forgiven amount in respect of an obligation is considered

to have been applied to the extent of the capital gain created by the debtor under subsection 80(12).

The first amount relevant for the purposes of determining a debtor's capital gain is the portion of the forgiven amount that remains unapplied after the application of subsections 80(3) to (11).

The second amount is, in general terms, the debtor's capital losses for the taxation year that includes the time of the settlement, net of the debtor's capital gains for the year. More specifically, the second amount (determined in respect of any obligation settled at any time) is the amount, if any, by which the total of

- the total capital losses for the year that includes that time from the disposition of properties (other than excluded properties, as defined under subsection 80(1), and listed personal properties), and
- where the debtor is a corporation into which a subsidiary has been wound-up under subsection 88(1), 4/3 of the amount, if any, that would be deductible under paragraph 111(1)(b) as a net capital loss for the year with respect to the subsidiary's capital losses, as a consequence of the application of subsection 88(1.2), if the debtor had sufficient income and taxable capital gains for the year

exceeds the total of

- the debtor's total capital gains for the year (determined without reference to the application of subsection 80(12)), and
- all amounts deemed by subsection 80(12) to be a capital gain of the debtor for the year as a consequence of the application of subsection 80(12) to obligations settled before that time.

ITA

80(13) and (14)

Where a commercial obligation issued by a debtor is settled, the debtor's forgiven amount that remains unapplied after the application of subsections 80(3) to (12) of the Act, is added in computing the debtor's income. The source of that income is deemed to be the source in connection with which the obligation was issued. However,

as discussed below, two adjustments apply for the purposes of calculating the income inclusion under subsection 80(13).

Under new paragraphs 12(1)(e.1) and 20(1)(n.1) and sections 56.2 and 61.2, any income inclusion under subsection 80(13) can be spread over a number of years, depending on the circumstances of the debtor. Reference should be made to the commentary on those provisions. A special rule is also provided under new subsection 80(15) to deal with cases where debtors are partnerships.

The example below illustrates the effect of subsections 80(3) to (13), without reference to the two adjustments referred to above.

### **EXAMPLE**

A debt issued by Debtco for \$50,000 has a principal amount equal to the same amount and is settled in 1995 with no payment by Debtco in satisfaction of the principal amount. At the time the debt is settled, Debtco has a cumulative Canadian development expense of \$1,200, cumulative eligible capital in respect of a business of \$600 and an undepreciated capital cost of a prescribed class of \$30,000. (The properties currently owned by the debtor in the prescribed class are Asset A, which has a capital cost of \$8,000 and Asset B, which has a capital cost of \$12,000.) Debtco also has land with an adjusted cost base of \$16,000. Debtco has no loss carryforwards. What are the tax consequences to Debtco assuming that the forgiven amount of \$50,000 is applied to the maximum extent permitted under subsections 80(5) to (9)?

Results:

1. The forgiven amount of \$50,000 may first be applied under subsection 80(5) to reduce the capital costs of Assets A and B to nil. The unapplied balance of the forgiven amount is thus \$30,000 (\$50,000 - \$8,000 - \$12,000). The \$30,000 balance may then be applied against the undepreciated capital cost of the prescribed class, which is \$10,000 (\$30,000 net of the reductions thereto caused by the reduction of the capital costs of Assets A and B). After the undepreciated capital cost is reduced to nil the unapplied balance of the forgiven amount is \$20,000.

2. The \$20,000 balance is then multiplied under subsection 80(7) by  $\frac{3}{4}$ . The resulting product (\$15,000) may be applied under that subsection to reduce the cumulative eligible capital to nil. By reason of paragraph 80(2)(f), the balance of the forgiven amount after the application of subsection 80(7) is \$19,200 (\$20,000 minus  $\frac{4}{3}$  (\$600)).
3. The \$19,200 balance may then be applied under subsection 80(8) to reduce the resource expenditure pools to nil. The resulting balance is \$18,000 (\$19,200 - 1,200).
4. The \$18,000 balance may then be applied under subsection 80(9) to reduce the adjusted cost base of the land to nil. The resulting balance is \$2,000 (\$18,000 - 16,000).
5. The \$2,000 still remaining is included under subsection 80(13) in computing the debtor's income.

As mentioned above, two adjustments are made in calculating the income inclusion under subsection 80(13). The purpose of the first adjustment is to provide (in conjunction with section 80.04) a mechanism for tax attributes, other than those described in subsection 80(11), of certain related corporations and partnerships to be reduced rather than the debtor designating an amount under subsection 80(11) or including an amount in income under subsection 80(13).

The first adjustment (equal to "B" minus "C") under subsection 80(13) can occur where a debtor has applied any amount under subsection 80(11) to reduce the adjusted cost base of a share of the capital stock of a related corporation, debt issued by a related corporation or an interest in a related partnership. This adjustment can also occur where a debtor has filed one or more agreements under section 80.04 that, in effect, transfer some or all of the remaining unapplied forgiven amount, to related corporations or partnerships. (For the purposes of section 80, the relatedness of corporations and partnerships is determined with reference to new paragraph 80(2)(j)).

In each case, the amount of this adjustment in respect of the settlement of an obligation at any time is equal to

- the lesser of
  - the total of all amounts designated under subsection 80(11) by the debtor in respect of that settlement, and
  - the "residual balance" at that time in respect of that settlement (as described below),

## MINUS

- the total of all amounts specified in an agreement filed under section 80.04 in respect of that settlement (for further detail see the commentary on that section).

If the amount of this adjustment is a positive number, it is added in computing a debtor's income under subsection 80(13) because of the amounts determined for B and C in subsection 80(13). Where the amount of the adjustment is negative, the debtor's income under subsection 80(13) is reduced accordingly.

The "residual balance" (as determined under subsection 80(14)) is, in general terms, the total of income tax attributes (other than those described in subsection 80(11)) of the debtor and certain related corporations and partnerships (referred to as "directed persons") remaining after the settlement of an obligation, after taking into account the application of sections 80 and 80.04 in respect of that settlement. More specifically, the residual balance at any time in respect of the settlement of a particular obligation issued by a debtor is the amount, if any, by which

- the total of all amounts that would be applied under any of subsections 80(3) to (10) and (12) in respect of the settlements of notional separate commercial obligations issued by the debtor (and by each "directed person" at that time in respect of the debtor) if
  - those notional obligations were issued at that time by the debtor and by those directed persons and were settled immediately after that time,
  - an amount equal to the remaining unapplied portion of the forgiven amount at that time in respect of the actual settled

obligation were the forgiven amount immediately after that time in respect of each of those notional obligations,

- amounts were designated by the debtor and those directed persons under subsections 80(5) to (10) to the maximum extent permitted in respect of the settlement of each of those notional obligations, and
- no amounts were designated by the debtor or any of those directed persons under subsection 80(11) in respect of the settlement of any of those obligations

exceeds the total of

- the amount that would be included under subsection 80(13) in computing the debtor's income for the year in respect of the settlement of the particular obligation at that time if the residual balance and the second adjustment (described below) were each nil,
- all amounts that would, without regard to the second adjustment, be included under subsection 80(13) in computing the income of any of those directed persons in respect of the settlement of the obligation that is deemed by paragraph 80.04(4)(e) to have been issued by the directed person because of the filing of an agreement under section 80.04 in respect of the settlement of the particular obligation, and
- all amounts specified in an agreement (other than an agreement with any of those directed persons) filed under section 80.04 in respect of the settlement of the particular obligation.

For the purposes of computing the "residual balance", a "directed person" in respect of a debtor is defined under subsection 80(1) as:

- a taxable Canadian corporation or an eligible Canadian partnership (described below) by which the debtor is, directly or indirectly controlled (determined with reference to paragraph 80(2)(j)), or
- a taxable Canadian corporation or an eligible Canadian partnership that is, directly or indirectly, controlled by a person described immediately above.

Under subsection 102(1), a "Canadian partnership" is a partnership all the members of which are resident in Canada. An "eligible Canadian partnership" is defined under subsection 80(1) as a Canadian partnership none of the members of which are:

- ° non-resident owned investment corporations,
- ° persons exempt because of subsection 149(1) from Part I tax on their taxable income,
- ° other partnerships, other than eligible Canadian partnerships, or
- ° trusts, other than trusts in which no non-resident persons and no persons referred to above are beneficially interested (within the meaning assigned by subsection 248(25)).

The example below illustrates the first adjustment and the operation of subsection 80(13) and section 80.04.

### EXAMPLE

Debtco issued a commercial obligation to a bank for \$20,000. Debtco's only asset is the shares of the capital stock of Opco (a wholly-owned subsidiary that is a taxable Canadian corporation), which have an adjusted cost base (ACB) to Debtco of \$22,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of \$16,000. The full \$20,000 of debt is forgiven.

#### Results:

1. The effect of subsection 80(13) in this case is that Debtco will have an income inclusion, unless at least \$16,000 is transferred under section 80.04 to Opco. Assume, for the purposes below, that \$16,000 is specified in an agreement filed under section 80.04 between Debtco and Opco.
2. The \$16,000 is treated as a forgiven amount of an obligation issued by Opco. To the extent that Opco does not reduce its UCC to nil under subsection 80(5), subsection 80(13) would require that the \$16,000 be included in computing Opco's income. (Opco

would not be permitted to claim any reserve under paragraph 20(1)(n.1).)

3. Typically, Debtco will wish to reduce the adjusted cost base of the Opco shares by \$4,000 under subsection 80(11). Debtco's income inclusion under subsection 80(13) is nil as a result of the \$16,000 transfer. This is because the "residual amount" (described above), as a consequence of the operation of section 80.04, is nil.

The second adjustment (equal to minus "D") in the income inclusion of a debtor applies in the event that the debtor previously disposed of a debt owing to the debtor or another right to receive an amount, but a capital loss was denied with respect to the disposition because of subparagraph 40(2)(g)(ii). In these circumstances, the debtor's income inclusion under subsection 80(13) can generally be reduced to reflect the amount of portion of such loss (which is defined in subsection 80(1) as the debtor's "unrecognized loss") that has not already reduced the income inclusion of the debtor under subsection 80(13) in respect of previous settlements of obligations issued by the debtor. This adjustment is, however, not available unless the debtor has designated to the maximum extent permitted under subsections 80(5) to (10). Moreover, in the event that the debtor is a corporation the control of which was acquired after the unrecognized loss was realized, the unrecognized loss at any subsequent time is deemed to be nil unless

- the obligation settled at the subsequent time was issued by the debtor before, and not in contemplation of, the acquisition of control, or
- all or substantially all of the proceeds from issuing that obligation were (directly or indirectly) used to refinance an obligation described immediately above.

#### ITA 80(15)

Under new subsection 80(15) of the Act a member of a partnership is allowed a deduction not exceeding the amount that would, if the partnership had designated amounts to the maximum extent permitted



under subsections 80(5) to (10) in respect of the forgiven amount of an obligation issued by it, have been included as the member's share of any income resulting from the application of subsection 80(13).

However, where a member of a partnership does deduct such an amount, the member is deemed to have issued a commercial obligation that was settled at the end of the fiscal period of the partnership in which the partnership's obligation was settled. The amount of such deduction claimed by the partner is treated as if it were the forgiven amount in respect of the deemed obligation. Under subsection 80(15), a deemed obligation is generally treated as having been issued at the same time and in the same circumstances as the partnership obligation that gives rise to the application of subsection 80(13). (This is relevant for the purposes of applying the definitions "relevant loss balance", "successor pool" and "unrecognized loss", which are discussed in the commentary on subsections 80(3), (8) and (13).) In addition, for the purposes of applying subsection 80(13) in respect of the deemed obligation, the source in connection with which the deemed obligation was issued is deemed to be the source in connection with which the partnership obligation was issued.

Where a member of a partnership is a corporation the control of which was acquired after the time that an obligation is deemed by subsection 80(15) to be issued and before the corporation became a member of the partnership, the obligation will be considered under paragraph 80(15)(c) to have been issued after the time of the acquisition of control (or after a later acquisition of control, where relevant). As a consequence, the corporation will not be able to apply the deemed forgiven amount under subsection 80(15) against losses arising before an acquisition of control in these circumstances.

The purpose of subsection 80(15) is to provide for relief for members of a partnership, in recognition of the fact that a partner may well have undeducted loss carryforwards and resource expenditure pools that are attributable to activities of the partnership. The forgiveness of an obligation that is deemed to arise for a partner is treated in the same manner as a forgiven amount in respect of an obligation issued by the debtor would be treated.

## EXAMPLE

A and B are members of a partnership. The adjusted cost base of A's interest in the partnership on October 1, 1994 is \$10,000. The adjusted cost base of B's interest in the partnership on that date is "negative" \$8,000. Debt of \$30,000 owing by the partnership is settled for nil, with a resulting \$30,000 forgiven amount. There are no relevant expenditures or costs against which the forgiven amount may be applied. A and B are 50/50 partners. The fiscal period of the partnership, as well as the taxation years of A and B, are all based on the calendar year.

### Results:

1. As a consequence of section 96, A and B each have a share of partnership income equal to \$15,000. As a result, the adjusted cost base of A's interest in the partnership on January 1, 1995 is \$25,000. The adjusted cost base of B's interest in the partnership on that date is \$7,000.
2. Under paragraph 80(15)(a), A and B may each deduct up to \$15,000 in computing their income. This completely offsets the income inclusion referred to above, but does not have any effect on the adjusted cost base of their partnership interests.
3. If A deducts \$15,000 under paragraph 80(15)(a), the amount is treated as a forgiven amount for A. If A does not have any tax attributes that can be reduced under subsections 80(3) to (8), A may apply the \$15,000 to reduce the adjusted cost base of its partnership interest from \$25,000 to \$10,000 under subsection 80(9). (Note: If A were related to the partnership for the purposes of section 80, the adjusted cost base of the partnership interest could only be reduced in accordance with subsections 80(11) and (13).)
4. If B deducts \$15,000 under paragraph 80(15)(a), the amount is likewise treated as a forgiven amount for B. If B does not have any tax attributes that can be reduced under subsections 80(3) to (8), B may apply \$7,000 of the forgiven amount to reduce the adjusted cost base of its partnership interest from \$7,000 to nil under subsection 80(9). The remaining \$8,000 would be included under subsection 80(13) in computing B's income for the 1994

taxation year. However, B would generally be allowed to claim a reserve under paragraph 20(1)(n.1) or section 61.2.

## **Deemed settlement of debt**

ITA

80.01

New section 80.01 of the Act provides that obligations issued by debtors are deemed to be settled in a number of cases.

Subsection 80.01(1) defines "commercial debt obligation", "commercial obligation", "debtor", "distress preferred share" and "person", for the purposes of section 80.01, as those terms are defined under subsection 80(1).

Subsection 80.01(1) also provides that "forgiven amount" is generally defined in the same way as it is defined under subsection 80(1). However, in the event that employee or shareholder indebtedness has been forgiven in circumstances to which subsection 6(1) or 15(1) applies, the "forgiven amount" in respect of such indebtedness is given the meaning assigned by new subsection 6(15.1) or 15(1.21), as the case may be. This definition is relevant for the purposes of subsections 80.01(8) and (10), described in the commentary below.

Subsection 80.01(1) also defines the "specified cost" of an obligation, an expression that is used only in new subsection 80.01(8). For further detail, see the commentary below.

Subsection 80.01(2) provides that the following provisions apply for the purposes of section 80.01:

- paragraph 80(2)(a) (which sets out the circumstances in which debt is considered to be settled),
- paragraph 80(2)(b) (which provides that interest payable by a debtor is considered to be an obligation issued by the debtor, but which does not apply for the purposes of subsection 80.01(3),

- ° paragraph 80(2)(j) (which provides assumptions relevant for the purposes of determining whether two or more persons are related to each other), and
- ° paragraph 80(2)(l) (which ensures that an obligation created on a payment on account of an obligation by a guarantor is treated as if it were the guaranteed obligation).

The rule in subsection 80.01(3) was contained in existing subsection 80(2). Under either provision, a debt settled on the amalgamation or merger of a debtor corporation and a creditor corporation is deemed to have been settled for its cost amount. Cost amount, for this purpose, is the adjusted cost base of a debt that is capital property or the value of a debt that is inventory, as determined for the purpose of computing the creditor's income. The only substantive difference between existing subsection 80(2) and new subsection 80.01(3) is that subsection 80.01(3) applies to distress preferred shares "settled" on an amalgamation or merger. Under paragraph 80.02(2)(c), a distress preferred share is considered to be settled when it is redeemed, acquired or cancelled by its issuer.

The rule in subsection 80.01(4) was contained in existing subsection 80(3). Under either provision, where a debt owed between a parent corporation and its subsidiary is settled on the winding-up of the subsidiary under 88(1) for less than both the principal amount of the debt and its cost amount to the creditor, an election may be filed by the parent corporation to treat the debt as having been settled for its cost amount (as determined above). There are no changes of substance between existing subsection 80(3) and subsection 80.01(4).

Subsection 80.01(5) applies where a subsidiary is wound-up into a parent corporation in circumstances to which subsection 88(1) applies and, as a consequence, distress preferred shares issued by the subsidiary and owned by the parent are "settled" (i.e., redeemed, acquired or cancelled, as provided under paragraph 80.02(2)(c)) by the subsidiary. Subsection 80.01(5) provides that, for the purposes of applying the provisions of the Act only to the subsidiary, the share is considered to have been settled for its adjusted cost base. (The proceeds of disposition for the parent corporation of the share are determined under paragraph 88(1)(b).) Subsection 80.01(5) applies in the same manner in the unusual case of distress preferred shares of

the capital stock of a parent that are owned by the parent's subsidiary.

Subsection 80.01(8) contains a rule that is designed to counter the "parking" of a commercial debt obligation. In general terms, it can apply where an obligation originally issued by a debtor to one creditor is transferred, directly or indirectly, to another creditor who is related to the debtor or is a specified shareholder of the debtor. It can also apply after an obligation owed to a creditor is deemed to have been reacquired by the creditor under amended subsection 50(1).

More specifically, subsection 80.01(6) defines a "specified obligation" in relation to debt parking. Under subsection 80.01(7), only a "specified obligation" of a debtor will be treated as a "parked obligation". A "specified obligation" of a debtor is, at a particular time, an obligation issued by the debtor where

- ° at any previous time (except, where relevant, a time before any previous time at which the obligation became a "parked obligation"),
  - a person who owned the obligation dealt at arm's length with the debtor and, where the debtor is a corporation, was not a specified shareholder of the debtor (as defined in subsection 248(1)), or
  - the obligation was acquired by the holder of the obligation from another person who was, at the time of that acquisition, not related to the holder or related to the holder only because of paragraph 251(5)(b), or
- ° the obligation is a bad debt that is deemed by subsection 50(1) to be reacquired at the particular time.

Under paragraph 80.01(7)(a), a "specified obligation" of a debtor at any time is considered to be a "parked obligation" at that time in the event that the current holder of the obligation does not deal at arm's length with the debtor. A "specified obligation" is also considered to be a "parked obligation" in the event that the current holder is a "specified shareholder" of the debtor (as defined in subsection 248(1)), unless the current holder acquired the obligation

on or before Announcement Date or pursuant to an agreement in writing entered into on or before that date.

Under paragraph 80.01(7)(b), an obligation acquired or reacquired in circumstances to which subparagraph 80.01(6)(a)(ii) (acquisition from unrelated person) or paragraph 80.01(6)(b) (deemed reacquisition under subsection 50(1)) applies is, if the obligation is a parked obligation immediately after the acquisition or reacquisition, considered to have become a parked obligation at the time of the acquisition or reacquisition. This rule applies whether or not the obligation was a parked obligation immediately before the acquisition or reacquisition.

Where, at any time after February 21, 1994, a commercial debt obligation that was issued by a debtor becomes a parked obligation (otherwise than pursuant to an agreement in writing entered into before February 22, 1994), paragraphs 80.01(8)(a) and (b) provide that:

- for the purposes of applying the provisions of the Act to the debtor, the obligation is considered to have been settled at that time, and
- the forgiven amount at that time in respect of the obligation shall be determined as if the debtor had paid an amount at that time in satisfaction of the obligation equal to its "specified cost" (i.e. as defined in subsection 80.01(1), its adjusted cost base or, where the debt is not capital property, its cost) to the current holder of the obligation.

However, subsection 80.01(8) provides a *de minimis* rule which provides that the above rules do not apply to an obligation issued by a debtor unless the specified cost to the current creditor of the obligation is less than 80% of its principal amount. It should also be noted that amended subsection 50(1) is relevant for the purposes of computing the specified cost of an obligation, whether or not the obligation is capital property.

The examples below illustrate the effect of subsections 80.01(6) to (8).

**EXAMPLE 1**

The relevant obligation (having a principal amount of \$16,000) was issued by Debtco to a financial institution. The debt was acquired for \$12,000 by a specified shareholder (C2) of Debtco in 1995. Subsequently, the debt was disposed of by C2 to another corporation (C3) related to C2.

**Results:**

1. At the time of the acquisition by C2, the obligation becomes a parked obligation. This is because C2 is a specified shareholder of Debtco and because the obligation is a specified obligation, as described above. Consequently, the obligation is deemed to have been settled for \$12,000. This generally results in a forgiven amount to Debtco of \$4,000.
2. At the time of the acquisition by C3, the obligation does not become a parked obligation, since the obligation has been a "parked obligation" since the time of the acquisition by C2.

**EXAMPLE 2**

In June 1994, Purchaseco acquires, from a financial institution, debt that was issued by Debtco. The adjusted cost base of the debt is \$10,000 and the principal amount of the debt (as well as the amount for which it was issued) is \$40,000. In 1995, Purchaseco acquires all the shares of the capital stock of Debtco.

**Result:**

In 1995 the obligation becomes a parked obligation since it is held by a non-arm's length person and it is a specified obligation. The forgiven amount is equal to \$30,000 (40,000 - 10,000), which is applied as described in the commentary to section 80.

**EXAMPLE 3**

Same as example 2, except that the adjusted cost base of the debt is \$33,000.

## Result:

There are no income tax consequences under subsection 80.01(8) at the time of the acquisition of the Debtco shares because of the *de minimis* rule in subsection 80.01(8). This rule allows debt to be acquired at a 20% discount (or less) without the application of subsection 80.01(8).

While new subsection 80.01(8) applies only to acquisitions of debt occurring after February 21, 1994, Revenue Canada will continue to review acquisitions occurring before that date. One of the issues that will be considered in this context is the applicability of the general anti-avoidance rule to particular transactions that involve the parking of debt.

Subsection 80.01(9) applies where a commercial debt obligation issued by a debtor that is payable at any time to an unrelated creditor becomes unenforceable after February 21, 1994 because of a statutory limitation period. Where this is the case, the obligation is deemed to have been settled at that time. The treatment of subsequent payments with respect to the liability are dealt with in subsection 80.01(10).

Subsection 80.01(10) applies in the event that a recovery is made on account of the principal amount of a commercial debt obligation in excess of the amount for which the obligation was considered to be settled under subsection 80.01(8) or (9). Where this is the case, the debtor is permitted to deduct 3/4 of the amount, if any, by which the payment exceeds the amount, if any, by which

- the principal amount of the obligation

exceeds the total of

- all forgiven amounts previously determined in respect of the portions of the obligation at times such portions were previously deemed to be settled, and
- all previous payments made in satisfaction of the principal amount of the obligation.

The following examples illustrate the operation of subsection 80.01(10).



**EXAMPLE 4**

Same as example 2, except that Debtco repays \$18,000 of the debt in 1997.

Results:

1. As described in example 2, the forgiven amount in 1995 is equal to \$30,000.
2. Debtco may deduct \$6,000 ( $\frac{3}{4} \times (18,000 - (40,000 - 30,000))$ ) in computing its income for the 1997 taxation year.

**EXAMPLE 5**

In July 1994, Purchaseco acquires debt that was issued by Debtco from a financial institution and, in 1995, acquires all the shares in the capital stock of Debtco. The adjusted cost base of the debt was \$60,000 and the principal amount of the debt (as well as the amount for which it was issued) is \$100,000. In 1996, all the shares and one-half of the debt are acquired by an arm's length purchaser. The adjusted cost base to the arm's length purchaser (Newco) of the one-half of the debt is \$12,000. In 1997, Debtco pays Purchaseco \$44,000 in full satisfaction of the outstanding debt to Purchaseco. In 1998, Debtco pays Newco \$30,000 in full satisfaction of the debt payable to Newco.

Results:

1. The forgiven amount for 1995 in respect of the whole obligation is \$40,000 ( $\$100,000 - 60,000$ ), which is applied as described in commentary to section 80.
2. The forgiven amount for 1996 in respect of the acquired half of the obligation is \$18,000. ( $\$50,000 - 12,000 - (.5 \times 40,000)$ ), which is also applied as described in the commentary to section 80.
3. The deduction for Debtco with respect to the \$44,000 payment is equal to \$1,500. This is  $\frac{3}{4} \times (\$44,000 - (\$100,000 - 40,000 - 18,000 - 0))$ . The zero in the computation reflects the fact that

nothing was previously paid in satisfaction of the principal amount of the obligation.

4. The deduction for Debtco with respect to the \$30,000 payment is equal to \$22,500. This is  $\frac{3}{4} \times (\$30,000 - (\$100,000 - 40,000 - 18,000 - 44,000))$ . Note: the negative number determined in the interior brackets is considered to be zero.

Subsection 80.01(11) provides that the deemed settlement of an obligation under subsection 80.01(8) or (9) will not trigger the recognition of any foreign currency gain or loss. Instead, any such gains or losses would typically arise on the actual settlement of the obligation in accordance with subsection 39(2). For further discussion on foreign currency gains and losses, see the commentary on paragraph 80(2)(k).

Section 80.01 applies to taxation years ending after February 21, 1994.

## **Rules for distress preferred shares**

### **ITA 80.02**

New section 80.02 of the Act sets out special rules dealing with distress preferred shares. Some of the rules have the effect of confirming Revenue Canada's existing interpretations of the law in this context.

Subsection 80.02(1) defines "commercial debt obligation", "commercial obligation", "distress preferred share" and "person" as those expressions are defined under subsection 80(1).

Subsection 80.02(2) sets out a number of rules that apply for the purposes of applying the provisions of the Act to issuers of distress preferred shares.

Paragraph 80.02(2)(a) provides that the "principal amount" of a distress preferred share is considered to be the amount for which it was issued.

Paragraph 80.02(2)(b) provides that the amount for which a distress preferred share is considered to be issued is, at any time, equal to the total of

- the amount for which the share was issued (otherwise determined), and
- any increase in the paid-up capital of the share before that time

#### MINUS

- any amounts paid before that time on a reduction of the paid-up capital of the share, except to the extent that the amount is deemed by section 84 to have been paid as a dividend.

Paragraph 80.02(2)(c) provides that a distress preferred share is considered to be settled when it is redeemed, acquired or cancelled by its issuer.

Paragraph 80.02(2)(d) provides that a payment in satisfaction of the principal amount of a distress preferred share is any payment made on a reduction of the paid-up capital in respect of the share, to the extent that the payment would constitute proceeds of disposition of the share if the exclusion for deemed dividends under paragraph (j) of the definition of "proceeds of disposition" in section 54 were ignored.

Subsection 80.02(3) applies where a commercial debt obligation issued by a corporation is settled and there is a direct substitution of a distress preferred share for the obligation. If there is a direct transfer of this nature, there is essentially a "rollover" of the principal amount of the obligation for the purposes of section 80. More specifically, an obligation directly substituted by distress preferred shares is deemed to have been settled for the lesser of:

- the principal amount of the obligation, and
- the amount by which the paid-up capital of shares of that class increases because of the issue of those shares.

Under paragraph 80.02(3)(b), the distress preferred share is considered to have been issued for the same amount, subject to

subsequent reductions in respect of the issued amount that are determined under paragraph 80.02(2)(b).

Subsection 80.02(4) applies where a distress preferred share issued by a corporation is settled and there is a direct substitution of the share by a commercial debt obligation issued by the corporation. Where this is the case, the share is deemed to have been settled for an amount equal to the principal amount of the obligation. The substitute obligation is considered to have been issued for the same amount. Under subsection 80.02(5), a similar rule applies in the unusual case that the substitute obligation is another distress preferred share. However, in this case, the amount paid in satisfaction of the original distress preferred share is considered to be the increase in paid-up capital associated with the issue of the substitute share.

Subsections 80.02(3) to (5) do not apply to arrangements where exchanges involving distress preferred shares are made on a more indirect basis. If similar income tax results are achieved by such transactions as are achieved with direct substitutions and exchanges described in those subsections, such transactions will not be viewed as offensive in tax policy terms.

Subsection 80.02(6) applies where a distress preferred share issued by a corporation is settled and there is a direct substitution of the share by another share (other than another distress preferred share) or by an obligation (other than a commercial debt obligation) that is issued by the corporation. Where this is the case, the amount paid in satisfaction of the principal amount of the distress preferred share on its settlement is considered to be the fair market value of the other share or the obligation.

Subsection 80.02(7) applies where a share no longer qualifies as a distress preferred share. Where this is the case, the share is deemed to have been settled immediately before the time it ceases to qualify. A payment equal to the fair market value of the share at that time is deemed to have been made immediately before that time in satisfaction of the principal amount of the share. Pursuant to the definition of "distress preferred share" in subsection 80(1), a share ceases to be a distress preferred share 5 years after its date of issue.

Section 80.02 applies to taxation years ending after February 21, 1994.

## Gains on subsequent dispositions

ITA

80.03

New section 80.03 of the Act sets out rules that are designed to preserve the effectiveness of the debt forgiveness rules under section 80, in the event that section 80 has resulted in a reduction of the adjusted cost base of a share, partnership interest or trust interest. The operative rules in section 80.03 are contained in subsections 80.03(2) and (4).

Subsection 80.03(1) defines a number of expressions used in the section. "Commercial debt obligation", "commercial obligation", "distress preferred share", "forgiven amount" and "person" have the meanings assigned by subsection 80(1). In addition, as is the case under subsection 112(6), "taxable dividend" does not include a capital gains dividend that is issued by a mutual fund corporation.

Subsection 80.03(2) applies where capital property that is a share (other than a distress preferred share), partnership interest or trust interest is "surrendered" (as determined under subsection 80.03(3)). In general terms, such property is surrendered when it is cancelled, redeemed or extinguished and the underlying property of the corporation, partnership or trust that is acquired on such a surrender is based on the cost to the corporation, partnership or trust. More specifically, the surrender of a share, a partnership interest or a trust interest, as the case may be, by a person occurs where:

- the share is of the capital stock of a subsidiary and the share is disposed of in the course of a winding-up to which subsection 88(1) applies,
- the person is a corporation and the share is of the capital stock of another corporation with which the corporation amalgamates or merges,
- the trust interest is disposed of on a rollover basis under subsection 107(2), or

- the partnership interest is disposed of on a rollover basis under subsection 98(3) or (5).

Where such property is surrendered by a person, subsection 80.03(2) provides that the person is treated as having realized a capital gain from the disposition of another notional property. The amount of this capital gain is equal to the amount, by which

- the total reductions in the adjusted cost base of the surrendered property resulting directly from the application of any of subsections 80(9) to (11) or that, as a consequence of the application of subsection 47(1), 49(3.01), 51(1), 53(4) to (6), 86(4) or 87(5.1) or (6.1) (referred to below as the "history preservation rules"), resulted indirectly from the application of subsections 80(9) to (11)

exceeds the total of

- the person's capital gain from the disposition of the surrendered property (determined without reference to the capital gain arising under subsection 100(2) from the disposition of a partnership interest with a "negative" adjusted cost base), and
- where, at the end of the taxation year that included the time of the surrender of the property, the person is resident in Canada or is a non-resident person who carries on business in Canada through a fixed place of business, the amount designated under subsection 80.03(7) by the person in respect of the surrendered property.

The history preservation rules effectively maintain the record of deductions in computing the adjusted cost base of property resulting from the application of subsections 80(9) to (11), in the event that such property is

- transferred or deemed to have been acquired or reacquired under subsection 47(1) (identical properties) or a number of the provisions referred to in subsection 53(4),
- transferred to any person on a non-arm's length basis in circumstances to which subsection 53(5) applies,

- acquired on an amalgamation or merger, or
- substituted for other property in circumstances to which subsection 49(3.01), 51(1), 86(4) or 87(5.1) or (6.1) applies.

Subsection 80.03(4) applies where a corporation disposes of capital property that is a share or a partnership or trust interest. Where this is the case, and neither subsection 80.03(2) nor the history preservation rules apply, the corporation is deemed to have a capital gain from the disposition of another capital property. The capital gain determined as a consequence of a disposition at any time of a share or a partnership or trust interest is equal to the amount by which the lesser of

- the total of all amounts deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the transferor of that property immediately before that time, and
- where that property is a share, the total of taxable dividends on the share (to the extent deductible in computing taxable income) in the specified period relating to the disposition, as described below, and capital dividends received on the share in the same period

exceeds the sum of the capital gain recognized by the transferor on the disposition of that property and any amount designated in respect of the disposition under subsection 80.03(7). Subsection 80.03(4) also applies where such property is transferred to an individual or a partnership in circumstances to which subsection 53(5) applies or where the property is transferred by a corporation to a partnership in circumstances to which subsection 97(2) applies.

Where the property is an interest in a partnership or a trust, the second amount referred to above is equal to the total of

- the partner's share of taxable dividends relating to the partnership interest (to the extent deductible in computing taxable income) that were received by the partnership after Announcement Date and in a fiscal period ending in the specified period relating to the disposition of the partnership interest, and
- the partner's share of capital dividends received by the partnership in respect of that interest in such a fiscal period.

Where the property is a capital interest in a trust, the second amount referred to above is equal to the amounts deemed by subsection 104(19) to have been received as taxable dividends in respect of the capital interest (to the extent deductible in computing taxable income) in the specified period in respect of the disposition of the capital interest.

For the purposes of subsection 80.03(4), the specified period relating to a disposition of property by a person is generally the period during which the property is held by the person. More specifically, a specified period relating to a property disposed of by a person at any time is defined under subsection 80.03(5) as the period

- beginning at or on the later of Announcement Date and the last previous time the person acquired the property, and
- ending at the time of the disposition.

Subsection 80.03(6) provides a special rule for determining the "specified period" relating to the disposition of a property, in the event that any of the history preservation rules applied on acquisition of the property. Where this is the case, the beginning of the specified period is determined with respect to the first preceding acquisition to which none of the history preservation rules applied.

Subsection 80.03(7) allows a person to treat a capital gain that would otherwise arise under subsection 80.03(2) or (4) as a forgiven amount for the purposes of section 80, to the extent that the person so designates. The designation is made in a prescribed form filed with a person's income tax return for the taxation year that includes the time of the disposition that gave rise to the application of subsection 80.03(2) or (4). Where a person makes a designation, for the purposes of section 80

- the person is considered to have issued a commercial debt obligation at that time that is settled immediately after that time,
- the amount designated (to the extent of the deemed capital gain otherwise determined) is treated as if it were the forgiven amount immediately after that time in respect of the deemed obligation,



- the source in connection with which the deemed obligation was issued is any business carried on by the person at the end of the year, and
- if the person does not carry on a business at the end of the year, the person is deemed to carry on an active business at the end of the year and the source in connection with which the obligation was issued shall be deemed to be the business deemed to be carried on.

Subsection 80.03(8) applies where, as a consequence of the disposition by an individual of property that qualifies for the lifetime capital gains exemption, the individual realizes a capital gain under subsection 80.03(2). Where this is the case, the capital gain so determined will be eligible for the lifetime capital gains exemption under section 110.6.

Section 80.03 applies to taxation years ending after February 21, 1994. However, the prescribed form referred to in subsection 80.03(7) is considered to have been filed on a timely basis if it is filed with the Minister of National Revenue before 1996.

## **Transfers of forgiven amounts**

### **ITA 80.04**

New section 80.04 of the Act contains a mechanism which applies where a commercial obligation issued by a debtor has been settled, but the forgiven amount is not fully applied under subsections 80(3) to (12). Where this is the case, and the debtor has designated amounts to the maximum extent permitted under subsection 80(5) to (10), the debtor may transfer the unapplied portion of the forgiven amount to certain corporations and partnerships to which the debtor is related. The transferee is then permitted to apply the transferred amount under subsection 80(3) to (10) and (12) and include any unapplied portion of the transferred amount in its income. The advantage to the debtor is that the transferred amount, as described in the commentary to subsections 80(13) and (14), reduces the amount otherwise included in computing the debtor's income under subsection 80(13). The mechanism provided under section 80.04 is

similar to existing section 191.3 of the Act, which allows for the transfer of liability under Part VI.1 of the Act from one corporation to another.

Subsection 80.04(1) defines "commercial debt obligation", "commercial obligation", "debtor", "eligible Canadian partnership", "forgiven amount" and "person" in the same manner as those expressions are defined under subsection 80(1).

Subsection 80.04(2) defines an "eligible transferee" of a debtor at any time as a corporation or partnership that throughout

- the taxation year or fiscal period of the debtor that includes that time, and
- the taxation year or fiscal period of the corporation or the partnership that includes that time

was a taxable Canadian corporation or eligible Canadian partnership related to the debtor. Unapplied portions of a debtor's forgiven amount can be transferred under section 80.04 only to eligible transferees of the debtor. For these purposes, relatedness arising because of a right referred to in paragraph 251(5)(b) is ignored.

Subsection 80.04(3) provides that the rules of application under subsection 80(2) apply, to the extent relevant, for the purposes of section 80.04. For example, paragraph 80(2)(j) provides rules which are relevant for the purposes of determining whether a debtor is related to a partnership.

Subsection 80.04(4) sets out the detail of the circumstances in which the mechanism in section 80.04 applies. The mechanism applies where:

- a commercial obligation issued by a debtor (other than an obligation deemed by section 80.04 itself to have been issued) is settled,
- amounts were designated by the debtor under subsections 80(5) to (10) to the maximum extent permitted in respect of the settlement of the obligation time,

- the debtor and an eligible transferee of the debtor (described above) file an agreement under section 80.04 between them in respect of that settlement, and
- an amount is specified in that agreement.

Where the above circumstances apply in respect of the settlement at any time of a commercial obligation, the following rules apply:

- except for the purposes of paragraph 20(1)(n.1), subsection 80(11) and section 61.2, the transferee is deemed to have issued a commercial debt obligation that was settled at that time;
- the specified amount under the agreement is treated as the forgiven amount at that time in respect of the deemed obligation;
- the deemed obligation is generally treated as having been issued at the same time (referred to below as the "time of issue") at which, and in the same circumstances in which, the particular obligation was issued,
- where the transferee is a corporation the control of which was acquired after the time of issue and the transferee corporation and the debtor were not related to each other immediately before that acquisition of control, the deemed obligation is treated as having been issued after that acquisition of control so that the transferee will not be able to apply the forgiven amount against losses arising before the acquisition of control, and
- the source in connection with which the deemed obligation was issued is considered to be the source in connection with which the particular obligation was issued.

Subsection 80.04(5) provides that any amount paid or payable by a debtor or received or receivable by an eligible transferee as consideration for entering into an agreement under section 80.04 is deemed, for the purposes of Part I of the Act, to be nil. It also provides that no benefit is considered to have been conferred on a debtor as a consequence of the debtor entering into an agreement under section 80.04. In this context, see also new subsection 191.3(1.1).

Subsection 80.04(6) sets out the mechanics of filing an agreement under section 80.04 that are required for the agreement to be a valid agreement. The agreement is not valid unless it is filed in a prescribed form

- ° by the later of
  - the due date for the debtor's income tax return for the taxation year or fiscal period that includes the time at which the debtor's obligation was settled, and
  - the due date for the transferee's income tax return for the taxation year or fiscal period that includes that time, or
- ° within the period within which the debtor or the transferee may serve a notice of objection to an assessment of Part I tax for either of the two applicable taxation years described above.

For the purposes above, a partnership is treated by subsection 80.04(7) as being required to file an income tax return for its fiscal period that is due by the latest income tax return due date for any of its partners for the taxation year in which that period ends. Likewise, it is assumed a partnership can file a notice of objection for a fiscal period during each period within which any member of the partnership may serve a notice of objection to an assessment of Part I tax payable for a taxation year in which the fiscal period ends. For further detail with respect to agreements by partnerships, see amended subsection 96(3).

Subsection 80.04(6) also provides that, where the debtor or transferee is a corporation, agreement under section 80.04 must be accompanied by the resolution of the corporation's directors, or the document of the corporation's legal administrators, authorizing the agreement to be made.

Subsection 80.04(6) also provides that an agreement between a debtor and an eligible transferee is invalid if it is superseded by a subsequent valid agreement. However, the earlier agreement remains valid for the purposes of section 80.04 if it is one to which subsection 80.04(8) applies.

Subsection 80.04(8) applies where it can reasonably be considered that the main purpose of a corporation becoming related to another corporation was to enable the corporations to file an agreement under section 80.04. If this is the case, the amount specified under that agreement is considered to be nil for the purposes applying subsection 80(13) to the debtor. As a consequence, no relief under subsection 80(13) would be available in connection with such agreement.

Subsection 80.04(9) requires the Minister of National Revenue to assess or reassess any taxpayers (including partners of the debtor or transferee) to take into account an agreement filed under section 80.04, even where the assessment or reassessment would otherwise be statute-barred.

Subsection 80.04(10) provides that a debtor is liable to pay all or part of its eligible transferee's taxes, interest and penalties for taxation years ending in the 10 calendar years ending after the settlement of the debt that is the subject of an agreement under section 80.04. Where the transferee is a partnership, the liability is based on the total taxes, interest and penalties of the transferee's partners. The liability is limited, however, to 40% of the amount specified in the agreement. Subsection 80.04(11) clarifies that the debtor and the transferee (or, where the transferee is a partnership, the members of the partnership) are jointly and severally liable for such amounts.

Subsections 80.04(12) and (13) permit the Minister to assess a debtor for a liability arising under subsection 80.04(10) in the same manner in which a liability for the debtor's own taxes is assessed. If the debtor is a partnership, the assessments may be made with respect to the members of the partnership. However, the Minister may assess a member of such a partnership only with respect to taxation years of an eligible transferee (or, where the eligible transferee is another partnership, members of the other partnership) that end at or after the time that member entered the debtor partnership. If a person was no longer a member of a partnership at the time an obligation is deemed to be settled under section 80.04, the Minister cannot assess that person in connection with the deemed settlement except if the person re-enters the partnership.

Subsection 80.04(14) provides that, where there are two or more tiers of partnerships, the rules in subsections 80.04(10) and (12) look

through any such tiers. For example, if one partnership is a member of another partnership, the first partnership's members will be treated as members of the other partnership for the purposes of subsections 80.04(10) and (12).

Section 80.04 applies to taxation years ending after February 21, 1994. However, the prescribed form referred to in subsection 80.04(6) is considered to have been filed on a timely basis if it is filed with the Minister before 1996.

## **Clause 29**

### **Transfer of property to corporation by shareholders**

ITA

85(4)

Subsection 85(4) of the Act applies where a taxpayer disposes of capital property or eligible capital property to a transferee corporation controlled by the taxpayer, by the taxpayer's spouse or by a person or group of persons by whom the taxpayer was controlled. In these circumstances, any capital loss (or deduction under paragraph 24(1)(a)) is denied. Instead, where the transferor owns shares of the capital stock of the transferee, all or part of the denied loss is added under paragraph 85(4)(b) in computing the adjusted cost base of those shares.

Paragraph 85(4)(b) is amended to provide that it does not apply in the event that the property disposed of is debt that, after the transfer, is payable to the transferee by another related corporation or a related partnership. In these circumstances, the denied capital loss would be added under paragraph 53(1)(f.1) or (f.11) in computing the adjusted cost base to the transferee corporation of the debt. New paragraph 80(2)(j), described in the commentary above, assists in determining whether or not a transferee is related to a debtor for the purpose of paragraph 85(4)(b).

The purpose of this amendment is to ensure that the rules in subsection 85(4) are consistent with the debt parking rules in new section 80.01.

This amendment applies to property disposed of after Announcement Date, other than property disposed of pursuant to an agreement in writing entered into on or before Announcement Date.

### Clause 30

#### Exchange of shares

ITA

86(4)

Section 86 of the Act applies where a corporation reorganizes its capital structure by issuing shares to a taxpayer as full or partial consideration for the surrender of all the taxpayer's shares in a class of shares of the capital stock of the corporation. Where this is the case, the cost of the new shares is determined with reference to the adjusted cost base of the surrendered shares.

New subsection 86(4) provides that, where the adjusted cost base of a surrendered share has been subject to a deduction in computing its adjusted cost base under paragraph 53(2)(g.1), the adjusted cost base of a new share to which section 86 applies is also reduced under that paragraph. This measure effectively preserves the history of deductions in computing the adjusted cost base of the surrendered share under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of subsection 86(4) is with respect to the potential future application of section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 47(1), 49(3.01), 51(1), 53(4) to (6) and 87(5.1) and (6.1).

More specifically, in computing the adjusted cost base to a taxpayer of any new share acquired in circumstances to which section 86 applies, paragraph 86(4)(a) provides for the deduction in computing the adjusted cost base to the taxpayer of the new share. The deduction is equal to a specified percentage of the amount, if any, by which

- ° the total amounts that were deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to a taxpayer of the old shares

exceeds

- the taxpayer's capital gain from the disposition of the old shares (determined without reference to the capital gains reserve).

The specified percentage for a particular new share is the percentage of the fair market value of all the new shares that is attributable to the particular new share.

Under paragraph 86(4)(b), the amount determined under paragraph 86(4)(a) in respect of a new share is added in computing the adjusted cost base to the taxpayer of the new share. As a consequence, there is no net effect on the amount of its adjusted cost base.

This amendment applies to taxation years ending after February 21, 1994.

## **Clause 31**

### **Amalgamations**

#### **Subclause 31(1)**

ITA

87(2)(h.1)

New paragraph 87(2)(h.1) of the Act provides that specified provisions relating to the settlement of debt apply to an amalgamated corporation as if the amalgamated corporation were the same corporation as, and a continuation of, each of the predecessor corporations. The provisions specified are

- paragraph 20(1)(n.1) (which allows an amalgamated corporation to claim a reserve under paragraph 20(1)(n.1) on the same basis as its predecessor corporations),
- the description of F in subsection 79(3) (which ensures that, if an amalgamated corporation surrenders property on a foreclosure, that the proceeds of disposition of the property do not include amounts



that a predecessor corporation had already recognized for income tax purposes),

- ° the definition of "forgiven amount" in subsection 80(1) (which, in conjunction with subsection 87(7), ensures that any forgiven amount in respect of an obligation issued by a predecessor corporation and settled after the amalgamation is determined in the same manner as if it had been settled before the amalgamation),
- ° subsection 80.03(7) (which ensures that a designation may be made under subsection 80.03(7) by a corporation to reduce a deemed capital gain otherwise arising for a predecessor corporation under section 80.01), and
- ° section 80.04 (which ensures that an agreement to transfer a forgiven amount from a debtor to a transferee under section 80.04 is effective whether or not there has been an amalgamation involving either the debtor or the transferee).

New paragraph 12(1)(e.1) is not referred to in paragraph 87(2)(h.1). This is because existing paragraph 87(2)(g) already provides for reserves claimed by a predecessor corporation (including a reserve under paragraph 20(1)(n.1)) to be added back in computing the income of a corporation formed on the amalgamation of the predecessor corporation and other corporations.

This amendment applies to taxation years ending after February 21, 1994.

Subclause 31(2)

ITA  
87(5.1) -

Subsection 87(5) of the Act applies where a taxpayer has an outstanding option to acquire shares of the capital stock of a corporation at the time the corporation amalgamates with one or more other corporations. In the event that the taxpayer acquires an option to acquire shares of the capital stock of the amalgamated corporation as consideration for the outstanding option, the new option is deemed

to have been acquired at a cost equal to the adjusted cost base of the outstanding option.

New subsection 87(5.1) provides that, where the adjusted cost base of such an outstanding option has been subject to a deduction in computing its adjusted cost base under new paragraph 53(2)(g.1), the adjusted cost base of the new option is likewise reduced under that paragraph. A corresponding increase in the adjusted cost base is also provided, so that there is no net effect on the adjusted cost base of the new option.

Subsection 87(5.1) effectively preserves the history of deductions in computing the adjusted cost base of the option under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of subsection 87(5.1) is with respect to the potential future application of new section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 47(1), 49(3.01), 51(1), 53(4) to (6), 86(4) and 87(6.1).

This amendment applies to taxation years ending after February 21, 1994.

#### Subclause 31(3)

#### ITA 87(6.1)

Subsection 87(6) of the Act applies where a taxpayer owns a capital property that is an outstanding bond, debenture, note or other obligation of a corporation at the time the corporation amalgamates with one or more other corporations. In the event that the taxpayer acquires such an obligation of the amalgamated corporation as consideration for the outstanding obligation, the new obligation is deemed to have been acquired at a cost equal to the adjusted cost base of the outstanding obligation.

New subsection 87(6.1) applies only where such a new obligation is convertible to shares on a rollover basis under subsection 51(1). Where this is the case and the adjusted cost base of the outstanding

obligation for which the new obligation was substituted has been subject to a deduction in computing its adjusted cost base under new paragraph 53(2)(g.1), the adjusted cost base of the new obligation is likewise reduced under that paragraph. A corresponding increase in the adjusted cost base is also provided, so that there is no net effect on the adjusted cost base of the new obligation.

Subsection 87(6.1) effectively preserves the history of deductions in computing the adjusted cost base of the obligation under paragraph 53(2)(g.1), which relates to reductions in the adjusted cost base arising from the operation of the debt forgiveness rules in section 80. The only relevance of subsection 87(6.1) is with respect to the potential future application of new section 80.03, as described in the commentary on that section. Similar amendments are provided under subsections 47(1), 49(3.01), 51(1), 53(4) to (6), 86(4) and 87(5.1).

This amendment applies to taxation years ending after February 21, 1994.

## **Clause 32**

### **Windings-up**

#### **ITA**

#### **88(1)(c)(ii)**

Subsection 88(1) of the Act provides rules which apply where a subsidiary has been wound-up into its parent. The cost to the parent corporation of property owned by its subsidiary before the winding-up is generally equal to the cost amount to the subsidiary immediately before the winding-up. However, under clause 88(1)(c)(ii)(B), the cost of such property also reflects any required reductions under existing paragraph 80(1)(b) to the cost amount of the property on the winding-up brought about by the settlement or extinguishment of an obligation owing to the parent corporation by the subsidiary.

Clause 88(1)(c)(ii)(B) is amended to refer to required reductions under section 80 rather than under paragraph 80(1)(b). This

amendment is consequential on the amendments to section 80 that are described above.

This amendment applies with respect to windings-up beginning after July 13, 1990.

### **Clause 33**

#### **Foreign accrual property income**

Subclauses 33(1) to (4)

ITA

95

"foreign accrual property income"

The foreign accrual property income (FAPI) of a controlled foreign affiliate of a taxpayer resident in Canada is taken into account under section 91 of the Act in computing the taxpayer's income for the year in which it is earned by the affiliate, rather than the year in which it is distributed. Under subsection 95(1), one of the components of FAPI is certain income from property and business, other than active business. However, certain losses and loss carryforwards of the affiliate reduce the affiliate's FAPI.

The description of A in the FAPI definition is amended so that the application of section 80 is ignored for the purposes of the FAPI definition, except to the extent described below. In this connection, also see the commentary on new paragraph 95(2)(g.1).

The new description of A.1 in the FAPI definition requires that an amount be added in computing FAPI. The amount that is added is the amount required to be added because of subsection 80(13). However, in the event that this amount exceeds the losses deductible under the descriptions of D to F in computing FAPI, the excess for a taxation year is deducted under the new description of G in computing FAPI for the year and added under the new description of A.2 in computing FAPI for the subsequent year. In effect, the excess is taken into account only once the affiliate realizes further losses that are relevant for the purposes of computing its FAPI.

Consequential amendments to Part LIX of the Regulations will be made to reflect the new descriptions of A.1, A.2 and G in the FAPI definition.

As illustrated in the example below, the effect of these amendments is to negate an affiliate's losses for the purposes of computing its FAPI.

### EXAMPLE

A foreign affiliate borrows \$20,000 in year 1. It uses the borrowed money to purchase a property the income from which is included in computing the affiliate's FAPI. The affiliate initially has net losses totalling \$2,900 in years 1 and 2, which are carried forward to year 3. In year 3, \$3,600 of the debt is forgiven.

Results:

1. For year 3, the amount added in computing FAPI under the description of A.1 is \$3,600. The amount subtracted under the description of G is \$700 ( $3,600 - 2,900$ ).
2. The amount subtracted under the description of G is added back in computing the FAPI of the affiliate under the description of A.2 for the following year. It will be taken into account only once further losses are realized.

These amendments apply to taxation years ending after February 21, 1994.

Subclause 33(5)

ITA  
95(2)(g.1)

Subsection 95(2) of the Act sets out certain rules that apply in determining components of the foreign accrual property income (FAPI) of a foreign affiliate.

New paragraph 95(2)(g.1) clarifies that, for the purposes of computing FAPI, the rules in section 80 will apply with respect to

obligations settled or extinguished that relate to FAPI. An obligation will be considered to relate to FAPI for this purpose if interest on the obligation is relevant (or would be relevant, if charged) in determining an affiliate's FAPI. However, many of the debt forgiveness rules (specifically, subsections 80(3) to (12) and (15), subsections 80.01(5) to (11) and sections 80.02 to 80.04) are ignored for this purpose. In addition, adjustments are made under the amended FAPI definition in subsection 95(1) so that, in effect, the application of section 80 for FAPI purposes results only in a reduction of FAPI-related losses.

## **Clause 34**

### **Partnership rules**

#### **ITA**

#### **96(3)**

Subsection 96(3) of the Act provides rules that apply where a member of a partnership makes an election under, or in respect of the application of, certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended to treat an agreement filed by a partnership under section 80.04 in the same way as an election referred to in subsection 96(3). For further discussion, see the commentary on that section.

This amendment applies to fiscal periods ending after February 21, 1994.

## **Clause 35**

### **Transfers to partnerships**

ITA

97(3)(b)

Subsection 97(3) of the Act applies where a taxpayer disposes of capital property to a transferee partnership of which the taxpayer is a majority interest partner. In these circumstance, any capital loss from the disposition is denied. Instead, the denied loss is added under paragraph 97(3)(b) in computing the adjusted cost base of the transferor's interest in the transferee partnership.

Paragraph 97(3)(b) is amended to provide that it does not apply in the event that the property disposed of is debt that, after the transfer, is payable to the transferee partnership by a corporation or a partnership related to the transferor. In these circumstances, the denied capital loss would be added under paragraph 53(1)(f.11) in computing the adjusted cost base to the transferee partnership of the debt. New paragraph 80(2)(j), described in the commentary above, assists in determining whether or not a transferor is related to a debtor for the purpose of paragraph 97(3)(b).

The purpose of this amendment is to ensure that the rules in subsection 97(3) are consistent with the debt parking rules in new section 80.01.

This amendment applies to property disposed of after Announcement Date, other than property disposed of pursuant to an agreement in writing entered into on or before Announcement Date.

## **Clause 36**

### **Trust rules**

ITA

107(1)(a)

Paragraph 107(1)(a) of the Act is relevant for the purpose of computing a beneficiary's taxable capital gain from the disposition of

a capital interest in a personal trust. The effect of the provision is that a beneficiary will not realize a gain from the disposition of an interest in a personal trust (or a trust prescribed under section 4800.1 of the Regulations), except to the extent that the proceeds of disposition exceed the greater of two amounts. The first amount is the adjusted cost base to the beneficiary of that interest. The second amount is the "cost amount" of that interest. "Cost amount" for this purpose is, under subsection 108(1), determined with reference to the cost amount to a trust of the trust's assets.

Paragraph 107(1)(a) is amended so that, in computing the second amount, there are deducted amounts that are deducted under paragraph 53(2)(g.1) in computing the adjusted cost base to the beneficiary of the interest in the trust.

This amendment applies to taxation years ending after February 21, 1994.

### **Clause 37**

#### **Losses deductible**

##### **ITA**

##### **111(8)**

"farm loss", "net capital loss" and "non-capital loss"

Subsection 111(8) of the Act defines the "farm loss", "net capital loss" and "non-capital loss" of a taxpayer. The definitions are amended to clarify that such losses are to be reduced as required by section 80. Section 80 requires such reductions under both the existing and new rules.

These amendments apply to taxation years ending after February 21, 1994, including the computation of loss carryforwards from years ending on or before that date.



**Clause 38****Insurance corporations**

ITA

138(11.93)

Subsection 139(11.93) of the Act provides rules, overriding those in section 79, which apply where an insurer acquires or reacquires property as a result of a debtor's failure to pay an amount in respect of a bond, debenture, mortgage, hypothec, agreement of sale or other form of indebtedness. In this case, the insurer is treated as having acquired or reacquired the property at its fair market value and to have disposed of the bond or other form of indebtedness for proceeds equal to that fair market value. In addition, the insurer's unpaid claim is treated as having a cost amount of nil and to be a bond or other form of indebtedness. The insurer is denied any further reserves for doubtful debts in respect of the claim. The debtor, on the other hand, treats the property as having been disposed of for the amount of the insurer's claim and may treat any further payments on the debt as a loss from the disposition of property.

Subsection 138(11.93) is amended to provide that it applies in the circumstances described above only to an insurer and not to a debtor of the insurer. The debtor will be subject to the rules in subsection 79(2).

Subsection 138(11.93) is also amended to clarify the income tax rules that apply in the event that an amount is still owing to an insurer after the acquisition or reacquisition by the insurer of property. In this case,

- ° the remaining right is considered to have been reacquired by the insurer at a cost of nil, and
- ° the remaining right shall continue to be treated as if it is in respect of a bond, debenture, mortgage, hypothec, agreement of sale or other form of indebtedness.

The above treatment is relevant for the purposes of determining the branch tax liability of non-resident insurers.

These amendments apply with respect to property acquired or reacquired after February 21, 1994, other than acquisitions or reacquisitions pursuant to a court order made before February 22, 1994.

## **Clause 39**

### **Part VI.1 tax**

ITA  
191.3

Section 191.3 of the Act, relating to the special Part VI.1 tax on corporations paying dividends on taxable preferred shares, allows a corporation to transfer its liability for this tax to a related corporation.

New subsection 191.3(1.1) of the Act provides that any consideration paid, payable, received or receivable with respect to such a transfer is ignored for the purposes of Part I of the Act. This provision is similar to new subsection 80.04(5), discussed in the commentary above.

This amendment applies to the 1988 and subsequent taxation years.

## **Clause 40**

### **Interpretation**

Subclause 40(1)

ITA  
248(1)  
"bankrupt"  
"estate of the bankrupt"

"Bankrupt" and "estate of the bankrupt" are defined as having the meanings assigned by the *Bankruptcy and Insolvency Act*. This amendment eliminates the need to add cross-references to subsection 128(3) whenever the expressions are used.

This amendment applies to taxation years ending after February 21, 1994.

Subclause 40(2)

"restricted farm loss"

The definition of "restricted farm loss" is amended to change a cross-reference to subsection 31(1) to subsection 31(1.1). This amendment is consequential on the splitting of existing subsection 31(1) into two subsections.

This amendment applies to taxation years ending after February 21, 1994.

Subclause 40(3)

ITA  
248(26)

New subsection 248(26) of the Act clarifies the circumstances in which an obligation of a person will be regarded as having been issued for the purposes of section 80 and other provisions.

Subsection 248(26) applies where a debtor become liable to repay borrowed money. It also applies where a debtor becomes liable to pay an amount (other than interest) as consideration for any property acquired or services rendered or that is deductible in computing the income of the debtor. Subsection 248(26) ensures that such liabilities are treated as obligations issued for a principal amount equal to the amount of the liability. This measure is relevant for the purposes of applying the provisions of the Act relating to the treatment of the debtor in respect of such liabilities.

Subsection 248(26) does not apply to a liability of a person or partnership under a guarantee or similar undertaking given by the person or partnership.

This amendment applies to taxation years ending after February 21, 1994.

ITA  
248(27)

New subsection 248(27) of the Act clarifies the treatment of obligations issued by a debtor that are or were part of a larger obligation issued by the debtor. Unless the context otherwise requires, any portion of that obligation is treated as an obligation in its own right. The principal amount, and the amount for which the obligation is issued, are pro-rated accordingly.

For example, assume a debtor issued an obligation for \$196,000 that had a principal amount of \$200,000 and that the debtor has paid \$100,000 on account of the principal amount of the obligation. The obligation still remaining would be considered to have a principal amount of \$100,000 and to have been issued for \$98,000.

This amendment applies to taxation years ending after February 21, 1994.

**Clause 41**

**Acquisitions of control**

ITA  
256(7) and (8)

Paragraph 256(7)(a) of the Act identifies circumstances in which control of a corporation (or a corporation controlled by that corporation) will not be considered to have been acquired for the purposes of certain provisions in the Act. Paragraph 256(7)(b) provides that a person or group of persons will, in certain circumstances, be considered for the purposes of the same provisions to have acquired control of a corporation immediately before the amalgamation of that corporation with another corporation. Subsection 256(8) extends the circumstances in which control of a corporation is considered to have been acquired for the purposes of many of the same provisions in certain cases where a taxpayer has acquired a right to acquire shares, to control the voting rights of shares or to cause the corporation to redeem, cancel or acquire shares owned by other shareholders.

Subsection 256(7) is amended so that it also applies for the purposes of section 80, in which there are references to acquisitions of control in the definitions of "relevant loss balance", "successor pool" and "unrecognized loss" in subsection 80(1) and in subsection 80(15). It is also amended so that it applies for the purposes of paragraph 80.04(4)(h). For further detail, see the commentary above on those provisions. This amendment applies to acquisitions, redemptions, cancellations and amalgamations occurring after February 21, 1994.

Subsection 256(8) is amended so that control of a corporation is (for the purposes of section 80 and paragraph 80.04(4)(h)) considered to be acquired, in the event that a right referred to above in respect of the corporation is acquired and it can reasonably be concluded that one of the main purposes of the acquisition of the right was to affect the application of section 80. This amendment applies to acquisitions of rights occurring after February 21, 1994.

## **Clause 42**

### **Capital gains**

#### **ITAR**

#### **26(3) and (5)**

Subsections 26(3) and (5) of the *Income Tax Application Rules* are relevant for the purposes of computing the adjusted cost base of certain capital property held by a taxpayer (or a person not dealing at arm's length with the taxpayer) on December 31, 1971. These rules have the effect of ignoring any increases in the adjusted cost base of such property arising because of the operation of the stop-loss rules in paragraph 40(2)(e) and subsection 85(4) of the Act.

Subsections 26(3) and (5) of the Rules are amended so that the new stop-loss rule under paragraph 40(2)(e.1) of the Act, which corresponds to the adjusted cost base increase provided under new paragraph 53(1)(f.11) of the Act, is treated in the same way.

This amendment applies to taxation years ending after February 21, 1994.

## **Appendix**

---

**Draft Income Tax**

**Regulations and Explanatory**

**Notes on Debt Forgiveness**

---

DRAFT *INCOME TAX REGULATIONS* ON  
DEBT FORGIVENESS

**1. Section 1105 of the *Income Tax Regulations* is replaced by the following:**

1105. The classes of property provided in this Part and in Schedule II are hereby prescribed for the purposes of the Act.

**2. Clause 5907(1)(a)(i)(C) of the Regulations is replaced by the following:**

(C) in any other case, the income therefrom for the year computed in accordance with Part I of the Act on the assumption that the business were carried on in Canada, the affiliate were resident in Canada and the Act were read without reference to subsections 80(3) to (12) and (15) and 80.01(5) to (11) and sections 80.02 to 80.04,

**3. Sections 1 and 2 apply to taxation years that end after February 21, 1994.**

EXPLANATORY NOTES ON DRAFT *INCOME TAX*  
*REGULATIONS ON DEBT FORGIVENESS*

ITR  
1105

Section 1105 of the Regulations prescribes classes of depreciable property for the purposes of the Act. It is amended to ensure that the prescription applies for all purposes of the Act, including section 80.

This amendment applies to taxation years ending after  
February 21, 1994.

ITR  
5907(1)(a)(i)(C)

Paragraph 5907(1)(a) of the Regulations defines the "earnings" of a foreign affiliate for the purposes of computing the affiliate's surplus accounts. Generally, such earnings are computed in accordance with the relevant foreign law. In the event that there is no applicable foreign law, such earnings are computed in accordance with Canadian income tax law.

Clause 5907(1)(a)(i)(C) is amended so that, where a foreign affiliate is required to compute such earning in accordance with Canadian income tax law, many of the debt forgiveness rules are ignored. The rules ignored for this purpose are subsections 80(3) to (12) and (15), subsections 80.01(5) to (11) and sections 80.02 to 80.04. A similar amendment is provided under new paragraph 95(2)(g.1), which is relevant for the purposes of computing the affiliate's foreign accrual property income.

This amendment applies to taxation years ending after  
February 21, 1994.



