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# Revised Draft Amendments to the Income Tax Act

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Debt Forgiveness and  
Foreclosures

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

December 1994

Canada 

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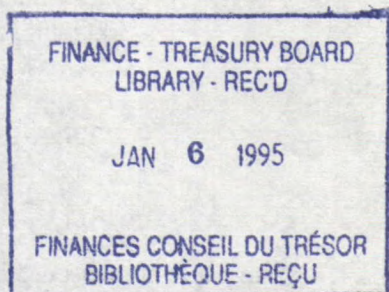
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Department of Finance  
Canada

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# Revised Draft Legislation on Debt Forgiveness and Foreclosures

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**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

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

Forgiven amount

(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

(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;

(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

(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.**

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

Debt forgiveness

(z.3) any amount required because of subsection 80(13) or (17) to be included in computing the taxpayer's income for the year.

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

**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**

5

(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

10

**(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

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**(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):**

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(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.

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

25

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

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

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

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**(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), 5

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

**4.(1) The second formula in the definition "cumulative eligible capital" in subsection 14(5) of the Act is replaced by the following:** 10

$$(P + \underline{P.1} + Q) - R$$

**(2) The definition "cumulative eligible capital" in subsection 14(5) of the Act is amended by adding the following after the description of P:** 15

- P.1 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); 20

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

Deemed eligible capital expenditure 25

(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 30

(a) that eligible capital expenditure, determined without reference to this subsection, and 35

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

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

(ii) that time

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

exceeds

(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.

5

#### 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 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.

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

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**(5) Subsection (3) applies to assistance that a taxpayer receives or becomes entitled to receive after February 21, 1994 and repayments of such assistance.**

25

**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.

30

#### 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

35

(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 (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

(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.**

**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

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

(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

(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.

(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

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(a) before February 22, 1994,

(b) after February 21, 1994

(i) under the terms of an agreement in writing entered into on or before that date, or

10

(ii) under the terms of any amendment to such an agreement, where that amendment was entered into in writing before July 12, 1994 and the amount of the settlement or extinguishment was not substantially greater than the settlement or extinguishment provided under the terms of the agreement,

15

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

20

(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*, or similar legislation of a country other than Canada, 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.

25

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, all or part of 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;

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35

**(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; 5

**(3) Subsection 20(1) of the Act is amended by striking out the word "and" at the end of paragraph (ss), by adding the word "and" at the end of paragraph (tt) and by adding the following after paragraph (tt):** 10

**Debt forgiveness**

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

**(4) Subsections (1) and (3) apply to taxation years that end after February 21, 1994.** 20

**(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 subsection 13(1), 14(1), 80(13) or (17) or 80.3(3) or (5), 25

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

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

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

**9.(1) The portion of subsection 31(1) of the Act following subparagraph (b)(i) is replaced by the following:** 35

exceeds

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

#### 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

5

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

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.

10

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

**10.(1) Subsection 37(1) of the Act is amended by adding the following after paragraph (f):**

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**(f.1)** the total of all amounts each of which is the lesser of

(i) the amount deducted under section 61.3 in computing the taxpayer's income for a preceding taxation year, and

20

(ii) the amount, if any, by which the amount that the taxpayer was entitled to deduct under this subsection in computing the taxpayer's income for that preceding year exceeds the amount claimed by the taxpayer under this subsection in computing the taxpayer's income for that preceding year,

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

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**11.(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.

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

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

(C) a reasonable amount as a reserve in respect of such of the proceeds of disposition of the property as are payable to the taxpayer after the end of the year as can reasonably be regarded as a portion of the amount determined under subparagraph (i) in respect of the property, and

5

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**(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;

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20

(e.2) a taxpayer's loss on the settlement or extinguishment of a particular commercial obligation (in this paragraph having the meaning assigned by subsection 80(1)) issued by a person or partnership and payable to the taxpayer shall, where any part of the consideration given by the person or partnership for the settlement or extinguishment of the particular obligation consists of one or more other commercial obligations issued by the person or partnership to the taxpayer, be deemed to be the amount determined by the formula

25

$$A \times (B-C)/B$$

30

where

A is the amount, if any, that would be the taxpayer's loss from the disposition of the particular obligation if this Act were read without reference to this paragraph,

35

B is the total fair market value of all the consideration given by the person or partnership for the settlement or extinguishment of the particular obligation, and

40

C is the total fair market value of the other obligations;

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

**(4) Paragraph 40(2)(e.1) of the Act, as enacted by subsection (2), applies to dispositions that occur after July 12, 1994, other than dispositions pursuant to agreements in writing entered into on or before July 12, 1994.** 5

**(5) Paragraph 40(2)(e.2) of the Act, as enacted by subsection (2), applies to dispositions after Announcement Date, other than dispositions pursuant to agreements in writing entered into on or before Announcement Date.** 10

**13.(1) Clause 44(1)(e)(iii)(C) of the Act is replaced by the following:** 15

(C) a reasonable amount as a reserve in respect of such of the proceeds of disposition of the former property as are payable to the taxpayer after the end of the particular year as can reasonably be regarded as a portion of the amount determined under subparagraph (i) in respect of the property, and 20

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

**14.(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):** 25

(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

A/B 30

where

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

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 35

(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.**

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**15.(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,

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(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

15

(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.**

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**16.(1) 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,

25

(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

30

and the taxpayer elects in the taxpayer's return of income for the year to have this subsection apply in respect of the debt 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. 5

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

**17.(1) Subsection 51(1) of the Act is amended by adding the following after paragraph (d):** 10

(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 15

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 20

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, 25

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

**18.(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 (f.2) 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; 30 35

(f.11) where the property was disposed of by a person (other than a non-resident person or a person exempt from tax under this Part on the person's taxable 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) or (f.2) 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) or 85(4)(a) to be nil, the amount that would otherwise be the capital loss from the disposition;

(f.12) where the property is a particular commercial obligation (in this paragraph having the meaning assigned by subsection 80(1)) payable to the taxpayer as consideration for the settlement or extinguishment of another commercial obligation payable to the taxpayer and the taxpayer's loss from the disposition of the other obligation was reduced because of paragraph 40(2)(e.2), the proportion of the reduction that the principal amount of the particular obligation is of the total of all amounts each of which is the principal amount of a commercial obligation payable to the taxpayer as consideration for the settlement or extinguishment of that other obligation;

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

(q) 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):**

## 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,

(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

(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,

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

(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.

## 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 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

(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

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 5

(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. 10

#### 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,

(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 15 20

(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.

**(5) Subsections (1) to (4) apply to taxation years that end after February 21, 1994. 25**

**19.(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 30

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

**"specified property"**  
**«bien déterminé»**

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

- (a) a share,
- (b) a capital interest in a trust,
- (c) an interest in a partnership, or
- (d) an option to acquire specified property of the taxpayer;

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

Reserve claimed for debt forgiveness

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.

Reserve claimed for debt forgiveness

56.3 There shall be included in computing a taxpayer's income for a taxation year during which the taxpayer was not a bankrupt the amount, if any, deducted under section 61.4 in computing the taxpayer's income for the preceding taxation year.

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

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

**Reserve for debt forgiveness for resident individuals**

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 not exceeding the amount determined by the formula

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

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 (or a partnership of which the individual was a member) was included under subsection 80(13) in computing the income of the individual for the year or of the partnership for a fiscal period that ends in the year (to the extent that, where the amount was included in computing income of a partnership, it relates to the individual's share of that income)

exceeds

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

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

C is the greater of \$40,000 and the income of the individual for the year, determined without reference to this section, section 56.2, paragraph 60(w), subsection 80(13) and paragraph 80(15)(a).

**Deduction for insolvency with respect to resident corporations**

61.3(1) There shall be deducted in computing the income for a taxation year of a corporation resident in Canada throughout the year that is not exempt from tax under this Part on its taxable income, the lesser of

(a) the amount, if any, by which

(i) the total of all amounts each of which is an amount that, because of the application of section 80 to a commercial obligation (in this section having the meaning assigned by subsection 80(1)) issued by the corporation (or a partnership of which the corporation was a member) was included under subsection 80(13) in computing the corporation's income for the year or of the partnership for a fiscal period that ends in the year (to the extent that the amount, where it was included in computing income of a partnership, relates to the corporation's share of that income) 5 10

exceeds

(ii) the total of all amounts deducted because of paragraph 80(15)(a) in computing the corporation's income for the year; and 15

(b) the amount determined by the formula 20

$$A - 2(B - C - D - E)$$

where

A is the amount determined under paragraph (a) in respect of the corporation for the year, 25

B is the total of

(i) the fair market value of the assets of the corporation at the end of the year, 30

(ii) the amounts paid before the end of the year on account of the corporation's tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or on account of a similar tax payable for the year under an Act of a province, and 35

(iii) the total of all amounts paid in the 12-month period preceding the end of the year by the corporation to a corporation with whom the corporation does not deal at arm's length 40

(A) as a dividend (other than a stock dividend),

(B) on a reduction of paid-up capital in respect of any class of shares of its capital stock,

5

(C) on a redemption, acquisition or cancellation of its shares, or

(D) as a distribution or appropriation in any manner whatever to or for the benefit of the shareholders of any class of its capital stock, to the extent that the distribution or appropriation cannot reasonably be considered to have resulted in a reduction in the amount otherwise determined for C in respect of the corporation for the year;

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15

C is the total liabilities of the corporation at end of the year (determined without reference to the corporation's liabilities for tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or for a similar tax payable for the year under an Act of a province) and, for this purpose,

20

(i) the equity and consolidation methods of accounting shall not be used, and

(ii) subject to subparagraph (i) and except as otherwise provided above, the total liabilities of the corporation shall

25

(A) where the corporation is not an insurance corporation or a bank to which clause (B) or (C) applies and the balance sheet as of the end of the year was presented to the shareholders of the corporation and was prepared in accordance with generally accepted accounting principles, be considered to be the total liabilities shown on that balance sheet,

30

35

(B) where the corporation is a bank or an insurance corporation that is required to report to the Superintendent of Financial Institutions and the balance sheet as of the end of the year was accepted by the Superintendent, be considered to be the total liabilities shown on that balance sheet,

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(C) where the corporation is an insurance corporation that is required to report to the superintendent of insurance or other similar officer or authority of the province under whose laws the corporation is incorporated and the balance sheet as of the end of the year was accepted by that officer

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or authority, be considered to be the total liabilities shown on that balance sheet, and

(D) in any other case, be considered to be the amount that would be shown as total liabilities of the corporation at the end of the year on a balance sheet prepared in accordance with generally accepted accounting principles; 5

D is the total of all amounts each of which is the principal amount at the end of the year of a distress preferred share (within the meaning assigned by subsection 80(1)) issued by the corporation; and 10

E is the greater of 15

(i) 50% of the amount, if any, by which the amount that would be corporation's income for the year if that amount were determined without reference to this section, section 61.4 and subsection 80(17) exceeds the amount determined under paragraph (a) in respect of the corporation for the year, and 20

(ii) the total of amounts paid before the end of the year on account of the corporation's tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or on account of a similar tax payable for the year under an Act of a province. 25

#### Reserve for insolvency with respect to non-resident corporations

(2) There shall be deducted in computing the income for a taxation year of a corporation which is non-resident at any time in the year, the lesser of 30

(a) the amount, if any, by which

(i) the total of all amounts each of which is an amount that, because of the application of section 80 to a commercial obligation issued by the corporation (or a partnership of which the corporation was a member) was included under subsection 80(13) in computing the corporation's taxable income or taxable income earned in Canada for the year or the income of the partnership for a fiscal period that ends in the year (to the extent that, where the amount was included in computing income of a partnership, it relates to the corporation's share of the partnership's income added in computing the corporation's taxable income or taxable income earned in Canada for the year) 35 40 45

exceeds

(ii) the total of all amounts deducted because of paragraph 80(15)(a) in computing the corporation's taxable income or taxable income earned in Canada for the year; and

5

(b) the amount determined by the formula

$$A - 2(B - C - D - E)$$

10

where

A is the amount determined under paragraph (a) in respect of the corporation for the year,

15

B is the total of

(i) the fair market value of the assets of the corporation at the end of the year,

20

(ii) the amounts paid before the end of the year on account of the corporation's tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or on account of a similar tax payable for the year under an Act of a province, and

25

(iii) the total of all amounts paid in the 12-month period preceding the end of the year by the corporation to a corporation with whom the corporation does not deal at arm's length

30

(A) as a dividend (other than a stock dividend),

(B) on a reduction of paid-up capital in respect of any class of shares of its capital stock,

35

(C) on a redemption, acquisition or cancellation of its shares, or

(D) as a distribution or appropriation in any manner whatever to or for the benefit of the shareholders of any class of its capital stock, to the extent that the distribution or appropriation cannot reasonably be considered to have resulted in a reduction of the amount otherwise determined for C in respect of the corporation for the year;

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45

C is the total liabilities of the corporation at end of the year (determined without reference to the corporation's liabilities for tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or for a similar tax payable for the year under an Act of a province), determined in the manner described in the description of C in subsection (1); 5

D is the total of all amounts each of which is the principal amount at the end of the year of a distress preferred share (within the meaning assigned by subsection 80(1)) issued by the corporation; and 10

E is the greater of

(i) 50% of the amount, if any, by which the amount that would be the corporation's taxable income or taxable income earned in Canada for the year if that amount were determined without reference to this section, section 61.4 and subsection 80(17) exceeds the amount determined under paragraph (a) in respect of the corporation for the year, and 15  
20

(ii) the total of amounts paid before the end of the year on account of the corporation's tax payable under this Part or any of Parts I.3, II, VI and XIV for the year or on account of a similar tax payable for the year under the Act of a province. 25

#### Anti-avoidance

(3) Subsections (1) and (2) do not apply to a corporation for a taxation year where property was transferred in the 12-month period preceding the end of the year or the corporation became indebted in that period and it can reasonably be considered that one of the reasons for the transfer or the indebtedness was to increase the amount that the corporation would, but for this subsection, be entitled to deduct under subsection (1) or (2). 30  
35

#### Reserve for debt forgiveness for corporations and others

61.4 There may be deducted as a reserve in computing the income for a taxation year of a taxpayer that is a corporation or trust resident in Canada throughout the year or a non-resident person who carried on business through a fixed place of business in Canada at the end of the year such amount as the taxpayer claims not exceeding the least of 40

(a) the amount determined by the formula

$$A - B$$

where

5

A is the amount, if any, by which

(i) the total of all amounts each of which is an amount that, because of the application of section 80 to a commercial obligation (within the meaning assigned by subsection 80(1)) issued by the taxpayer (or a partnership of which the taxpayer was a member) was included under subsection 80(13) in computing the income of the taxpayer for the year or a preceding taxation year or of the partnership for a fiscal period that ends in that year or preceding year (to the extent that, where the amount was included in computing income of a partnership, it relates to the taxpayer's share of that income)

10

15

exceeds the total of

20

(ii) all amounts each of which is an amount deducted under paragraph 80(15)(a) in computing the taxpayer's income for the year or a preceding taxation year, and

25

(iii) all amounts deducted under section 61.3 in computing the taxpayer's income for the year or a preceding taxation year; and

B is the amount, if any, by which the amount determined for A in respect of the taxpayer for the year exceeds the total of

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(i) the amount that would be determined for A in respect of the taxpayer for the year if that value did not take into account amounts included or deducted in computing the taxpayer's income for any preceding taxation year, and

35

(ii) the amount, if any, included under section 56.3 in computing the taxpayer's income for the year;

40

(b) the total of

(i) 4/5 of the amount that would be determined for A in paragraph (a) in respect of the taxpayer for the year if that value did not take into account amounts included or deducted in computing the taxpayer's income for any preceding taxation year,

45

(ii)  $\frac{3}{5}$  of the amount that would be determined for A in paragraph (a) in respect of the taxpayer for the year if that value did not take into account amounts included or deducted in computing the taxpayer's income for the year or any preceding taxation year (other than the last preceding taxation year), 5

(iii)  $\frac{2}{5}$  of the amount that would be determined for A in paragraph (a) in respect of the taxpayer for the year if that value did not take into account amounts included or deducted in computing the taxpayer's income for the year or any preceding taxation year (other than the second last preceding taxation year), and 10

(iv)  $\frac{1}{5}$  of the amount that would be determined for A in paragraph (a) in respect of the taxpayer for the year if that value did not take into account amounts included or deducted in computing the taxpayer's income for the year or any preceding taxation year (other than the third last preceding taxation year), and 15

(c) where the taxpayer is a corporation that commences to wind up in the year (otherwise than in circumstances to which the rules in subsection 88(1) apply), nil. 20

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

**22.(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 30

exceeds the total of

(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 35

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

23.(1) The formula in the definition "cumulative Canadian exploration expense" in subsection 66.1(6) of the Act is replaced by the following:

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

(2) The definition "cumulative Canadian exploration expense" in subsection 66.1(6) of the Act is amended by adding the following after the description of J:

10

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

15

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

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

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

25

(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):

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(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):

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(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.**

**25.(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):**

**(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 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):**

**(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):**

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

(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):

5

(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:

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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.

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26.(1) The portion of paragraph 66.7(1)(b) of the Act after subparagraph (i) is replaced by the following:

exceeds the total of

20

(ii) all other amounts deducted under subsection 29(25) of the *Income Tax Application Rules*, this subsection and subsections (3),(4) and (5) for the year that can reasonably be regarded as attributable to the part of its income for the year described in subparagraph (i) in respect of the particular property, and

25

(iii) except where the amount determined under paragraph (a) arose as a consequence of the acquisition of control of the successor by a person or group of persons, the successor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the successor by way of an amalgamation or merger, all amounts added because of subsection 80(13) or (17) in computing the amount determined under subparagraph (i).

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(2) 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

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

**(3) The portion of paragraph 66.7(2)(b) of the Act after subparagraph (ii) is replaced by the following:**

exceeds the total of

(iii) all other amounts deducted under this subsection for the year that can reasonably be regarded as attributable to

(A) the part of its income for the year described in subparagraph (i) in respect of the particular property, or

(B) a part of its income for the year described in clause (ii)(A) in respect of which an amount is designated by the successor under clause (ii)(A), and

(iv) except where the amount determined under subparagraph (a)(i) arose as a consequence of the acquisition of control of the successor by a person or group of persons, the successor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the successor by way of an amalgamation or merger, all amounts added because of subsection 80(13) or (17) in computing the amount determined under subparagraph (i),

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

(a) the amount, if any, by which

(i) the total of

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

5

(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,

10

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

(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,

15

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

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

20

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

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

25

**(5) The portion of paragraph 66.7(3)(b) of the Act after subparagraph (i) is replaced by the following:**

30

exceeds the total of

(ii) all other amounts deducted under subsection 29(25) of the *Income Tax Application Rules*, this subsection and subsections (1), (4) and (5) for the year that can reasonably be regarded as attributable to the part of its income for the year described in subparagraph (i) in respect of the particular property, and

35

(iii) except where the amount determined under clause (a)(i)(A) arose as a consequence of the acquisition of control of the successor by a person or group of persons, the successor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the successor by way of an amalgamation or merger, all amounts added because of subsection 80(13) or (17) in computing the amount determined under subparagraph (i).

**(6) 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

**(7) The portion of paragraph 66.7(4)(b) of the Act after subparagraph (i) is replaced by the following:**

exceeds the total of

(ii) all other amounts deducted under subsection 29(25) of the *Income Tax Application Rules*, this subsection and subsections (1), (3) and (5) for the year that can reasonably be regarded as attributable to the part of its income for the year described in subparagraph (i) in respect of the particular property, and

(iii) except where the amount determined under clause (a)(i)(A) arose as a consequence of the acquisition of control of the successor by a person or group of persons, the successor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the successor by way of an amalgamation or merger, all amounts added because of subsection 80(13) or (17) in computing the amount determined under subparagraph (i).

**(8) The portion of paragraph 66.7(5)(a) of the Act after subparagraph (i) and before subparagraph (ii) is replaced by the following:**

exceeds the total of

**(9) 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

**(10) The portion of paragraph 66.7(5)(b) of the Act after paragraph (ii) is replaced by the following:** 5

exceeds the total of

(ii) all other amounts deducted under subsection 29(25) of the *Income Tax Application Rules*, this subsection and subsections (1),(3) and (4) for the year that can reasonably be regarded as attributable to the part of its income for the year described in subparagraph (i) in respect of the particular property, and 10 15

(iii) except where the amount determined under subparagraph (a)(i) arose as a consequence of the acquisition of control of the successor by a person or group of persons, the successor ceasing to be exempt from tax under this Part on its taxable income or the acquisition of properties by the successor by way of an amalgamation or merger, all amounts added because of subsection 80(13) or (17) in computing the amount determined under subparagraph (i). 20

**(11) Paragraph 66.7(9)(f) of the Act is replaced by the following:** 25

(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).

**(12) Subsections (1) to (11) apply to taxation years that end after February 21, 1994.** 30

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

Surrender of property by debtor

79.(1) In this section,

"creditor"  
«créancier»

35

"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 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;

**"person"**

*«personne»*

"person" includes a partnership;

10

**"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;

15

**"specified amount"**

*«montant déterminé»*

"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

20

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

#### Application of section 79

(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.

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## 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

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;

10

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;

15

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

20

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

(i) the particular debt, and

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

25

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

D is

(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

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(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

(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 5

(b) in any other case, nil; 10

E is

(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 15

(b) in any other case, nil;

F is the total of all amounts each of which is the lesser of 20

(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

(b) the total of

(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, 25

(ii) all amounts renounced under subsection 66(10), (10.1), (10.2) or (10.3) by the debtor in respect of the particular debt, 30

(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, 35

(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

(A) the unpaid interest accrued to that time on the particular debt, and 5

(B) the total of

(I) 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, and 10  
15

(II) such portion of that unpaid interest as would, if it were paid, be included in the amount determined under paragraph 28(1)(e) in respect of the debtor;

G is the fair market value at that time of the particular property; and 20

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

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

(a) subsection 39(13) applies, where the property was capital property (other than depreciable property) of the person immediately before its surrender, 30

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

(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 5

(d) paragraph 20(1)(hh) applies, in any other case. 10

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. 15

Surrender of property does not constitute payment or repayment by debtor 20

(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. 25

Foreign exchange 30

(7) Where a debt is denominated in a currency (other than Canadian currency), any amount determined for A, B, C or D under subsection (3) in respect of the debt shall be determined with reference to the relative value of that currency and Canadian currency at the time the debt was issued. 35

## Seizure of property by creditor

79.1(1) In this section,

**"creditor"**

«*créancier*»

"creditor has the meaning assigned by subsection 79(1);

5

**"debt"**

«*dette*»

"debt" has the meaning assigned by subsection 79(1);

**"person"**

«*personne*»

10

"person" has the meaning assigned by subsection 79(1);

**"property"**

«*bien*»

"property" has the meaning assigned by subsection 79(1);

**"specified amount"**

«*montant déterminé*»

15

"specified amount" has the meaning assigned by subsection 79(1);

**"specified cost"**

«*coût déterminé*»

20

"specified cost" to a person of a debt owing to the person means

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

25

(b) in any other case, the amount, if any, by which

(i) the cost amount to the person of the debt

exceeds

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(ii) such portion of that cost amount as would be deductible in computing the person's income (otherwise than in respect of the principal amount of the debt) if the debt were established by the person to have become a bad debt or to have become uncollectable.

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## 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. 5

## 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 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. 10 15

## 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. 20 25

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

(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 30 35

(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

(b) the cost amount to the creditor of the property immediately before the previous time. 5

#### 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 10

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

(i) the fair market value of the particular property immediately before that time 15

is of

(ii) the fair market value of all properties immediately before that time that were seized by the creditor at 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 20

(i) was included in the cost to the creditor of property other than the particular property, 25

(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 30

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. 5

#### Treatment of debt

(7) Where a property is seized at any time in a taxation year by a creditor in respect of a particular debt, 10

(a) the creditor shall be deemed to have disposed of the particular debt at that time;

(b) the amount received on account of the particular debt as a consequence of the seizure shall be deemed 15

(i) to be received at that time, and

(ii) to be equal to 20

(A) where the particular debt is capital property, the adjusted cost base to the creditor of the particular debt, and

(B) in any other case, the cost amount to the creditor of the particular debt; 25

(c) where any portion of the particular debt is outstanding immediately after that time, the creditor shall be deemed to have reacquired that portion immediately after that time at a cost equal to 30

(i) where the particular debt is capital property, nil, and

(ii) in any other case, the amount, if any, by which 35

(A) the cost amount to the creditor of the particular debt

exceeds.

(B) the specified cost to the creditor of the particular debt; and 40

(d) where no portion of the particular debt is outstanding immediately after that time and the particular debt is not capital property, the creditor may deduct as a bad debt in computing the creditor's income for the year the amount described in subparagraph (c)(ii) in respect of the seizure.

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#### 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 10

(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.

**(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.** 15

**(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:** 20

(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 25

(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 30

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

(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 35

of disposition of the property are reduced because of paragraph (e.1), as the case may be;

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

Debtor's gain on settlement of debts

80.(1) In this section,

5

"commercial debt obligation"

«*créance commerciale*»

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

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

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

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;

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"commercial obligation"

«*dette commerciale*»

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"commercial obligation" issued by a debtor means

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

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

"debtor"

«*débiteur*»

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

"directed person"

«*personne désignée*»

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

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(a) a taxable Canadian corporation or an eligible Canadian partnership by which the debtor is controlled at that time, or

(b) a taxable Canadian corporation or an eligible Canadian partnership that is controlled at that time by

(i) the debtor,

(ii) the debtor and one or more persons related to the debtor, or

(iii) a person or group of persons by which the debtor is controlled at that time;

5

**"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);

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**"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,

(a) a non-resident owned investment corporation,

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

(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;

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**"excluded obligation"**

*«dette exclue»*

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

(a) the proceeds from the issue of the obligation

(i) were included in computing the debtor's income or, but for the expression "other than a prescribed amount" in paragraph 12(1)(x), would have been so included,

(ii) were deducted in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts, or 5

(iii) were deducted in computing the capital cost or cost amount to the debtor of any property of the debtor,

(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, 10

(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; 15

**"excluded property"**

**«bien exclu»**

"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; 20

**"excluded security"**

**«valeur mobilière exclue»**

"excluded security" issued by a corporation to a person as consideration for the settlement of a debt means 25

(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 30

(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;

"forgiven amount"  
«montant remis»

"forgiven amount" at any time in respect of a commercial obligation issued by a debtor is the amount determined by the formula 5

$$A - B$$

where

A is the lesser of the amount for which the obligation was issued and the principal amount of the obligation, and 10

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, 15

(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,

(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, 20

(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, 25

(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,

(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, 30

(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,

(i) where the debtor is a bankrupt at that time, the principal amount of the obligation, 5

(j) such portion of the principal amount of the obligation as represents the principal amount of an excluded obligation,

(k) where the debtor is a partnership and the obligation was, since the later of the creation of the partnership or the issue of the obligation, always payable to a member of the partnership actively engaged, on a regular, continuous and substantial basis, in those activities of the partnership that are other than the financing of the partnership business, the principal amount of the obligation, and 10 15

(l) the amount, if any, given at or before that time by the debtor to another person as consideration for the assumption by the other person of the obligation;

"person" 20  
«*personne*»

"person" includes a partnership;

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

"relevant loss balance" at a particular time for a commercial obligation and in respect of 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 25 30

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

(b) subsections (3) and (4) did not apply to reduce such loss at or after that time, and 35

(c) paragraph 111(4)(a) and subsection 111(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 for the obligation and in respect of such loss for the particular year shall be deemed to be nil unless

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

(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;

**"successor pool"**

*«compte de société remplaçante»*

"successor pool" at any time for a commercial obligation and in respect of 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

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

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

(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 for the obligation shall be deemed to be nil unless

(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

(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*»

5

"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 at or 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

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(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.

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#### 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 or as consideration for the issue of a share described in paragraph (c) of the definition "excluded security" in subsection (1));

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(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

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(i) has a principal amount, and

(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,  $\frac{3}{4}$ ,

(ii) in respect of loss for a taxation year that ended before 1988,  $\frac{1}{2}$ , and 10

(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 total of 30

(i) the fair market value of the share at the time it was issued, and

(ii) the amount that can reasonably be considered as the increase, as a consequence of the settlement of the debt, in the fair market value of other shares issued by corporation and owned by the person; 35

(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 a new commercial debt obligation issued by the debtor to the other person

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

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(ii) the new obligation shall be deemed to have been issued for an amount equal the amount, if any, by which

(A) the principal amount of the new obligation

15

exceeds

(B) the amount, if any, by which the principal amount of the new obligation exceeds the amount for which the particular obligation was issued;

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(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;

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(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

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(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,

(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

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(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

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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

(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 5

(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 10

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

(k) where an obligation is denominated in a currency (other than 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 Canadian currency at the time the obligation was issued; 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 25

(m) for greater certainty, the amount that can be applied under this section to reduce another amount may not exceed that other amount;

(n) except for the purposes of this paragraph, where 30

(i) a commercial debt obligation issued by a debtor is settled at any time,

(ii) the debtor is at that time a member of a partnership, and 35

(iii) the obligation was, under the agreement governing the obligation, treated immediately before that time as a debt owed by the partnership,

the obligation shall be considered to have been issued by the partnership and not by the debtor;

(o) notwithstanding paragraph (n), where a commercial debt obligation for which a particular person is jointly liable with one or more other persons is settled at any time in respect of the particular person but not in respect of all of the other persons, the portion of the obligation that can reasonably be considered to be the particular person's share of the obligation shall be considered to have been issued by the particular person and settled at that time and not at any subsequent time; 5 10

(p) a commercial debt obligation issued by an individual that is outstanding at the time of the individual's death and settled at a subsequent time shall, if the estate of the individual was liable for the obligation immediately before the subsequent time, be deemed to have been issued by the estate at the same time and in the same circumstances as the obligation was issued by the individual; and 15

(q) where a commercial debt obligation issued by an individual would, but for this paragraph, be settled at any time in the period ending 6 months after the death of an individual (or within such longer period as is acceptable to the Minister and the estate of the individual) and the estate of the individual was liable immediately before that time for the obligation 20

(i) the obligation shall be deemed to have been settled at the beginning of the day on which the individual died and not at that time, 25

(ii) any amount paid at that time by the estate in satisfaction of the principal amount of the obligation shall be deemed to have been paid at the beginning of the day on which the individual died, 30

(iii) any amount given by the estate at or before that time to another person as consideration for assumption by the other person of the obligation shall be deemed to have been given at the beginning of the day on which the individual died, and

(iv) paragraph (b) shall not apply in respect of the settlement to interest that accrues within that period. 35

## 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:

(a) the debtor's non-capital loss for each taxation year that ends before that time to the extent that the amount so applied 5

(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 for the obligation and in respect of 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 10

(ii) does not, because of this subsection, reduce the debtor's non-capital loss for a preceding taxation year; 15

(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 for the obligation and in respect of the debtor's farm loss for the year, and 20

(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 25

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

(ii) does not, because of this subsection, reduce the debtor's restricted farm loss for a preceding taxation year. 30

## Reductions of capital losses

(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:

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(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, if any, by which

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

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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

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(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 for the obligation and in respect of the debtor's net capital loss for the year, and

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

#### 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:

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

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

#### Restriction with respect to depreciable property

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(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

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(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

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(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

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

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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

(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).

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#### Reductions of resource expenditures

(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:

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(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 for the obligation and in respect of the particular amount; 5 10

(b) the cumulative Canadian exploration expense (within the meaning assigned by subsection 66.1(6)) of the debtor;

(c) the cumulative Canadian development expense (within the meaning assigned by subsection 66.2(5)) of the debtor; 15

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

(e) 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 20

(ii) the amount so applied does not exceed such portion of the total 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. 25

#### 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, subject to subsection (18) 30

(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 35

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;

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(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)

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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

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(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.

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

(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, subject to subsection (18) 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).

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

(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, subject to subsection (18) 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

- (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
- (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.

## 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,

(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

(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

(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,

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 5

(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. 10

#### 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 15

$$(A + B - C - D) \times E$$

where 20

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

B is the lesser of

(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 25

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

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, 30

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

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(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

exceeds

(ii)  $\frac{4}{3}$  of 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

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(b) in any other case, nil, and

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E is

(a) where the debtor is a partnership, 1, and

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(b) in any other case, .75.

Residual balance

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

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(a) 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 directed persons at that time in respect of the debtor if

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(i) those obligations were issued at that time by those directed persons and were settled immediately after that time,

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(ii) an amount equal to 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,

(iii) amounts were designated by 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

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(iv) no amounts were designated by any of those directed persons under subsection (11) in respect of the settlement of any of those obligations, and

(b) where the debtor is a partnership, all amounts each of which is 1/4 of an amount deducted because of paragraph (c) or (d) in computing the residual balance at that time in respect of the settlement of the particular obligation,

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exceeds the total of

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(c) all amounts each of which is 4/3 of the amount that would be included under subsection (13) in computing the debtor's income for the year in respect of the settlement at or before that time of a commercial obligation issued by the debtor if the amounts determined for B and D in subsection (13) were nil,

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(d) all amounts each of which is 4/3 of 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 an 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 at or before that time and in the year of a commercial obligation issued by the debtor,

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(e) 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 at or before that time and in the year of a commercial obligation issued by the debtor, and

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(f) all amounts each of which is the lesser of

(i) the total of all amounts designated under subsection (11) in respect of the settlement before that time and in the year of another commercial obligation issued by the debtor, and

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(ii) the residual balance of the debtor at that previous time.

## 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,

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(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 and if income arising from the application of subsection (13) were from a source of income separate from any other sources of partnership income, 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

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(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,

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(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),

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(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,

(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,

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(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

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(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

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(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.

#### Designations by Minister

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(16) Where a commercial obligation issued by a debtor is settled at any time in a taxation year and, as a consequence of the settlement an amount would, but for this subsection, be deducted under section 61.2 or 61.3 in computing the debtor's income for the year and the debtor has not designated amounts under subsections (5) to (11) to the maximum extent possible in respect of the settlement,

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(a) the Minister may designate amounts under subsections (5) to (11) to the extent that the debtor would have been permitted to designate those amounts; and

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(b) the amounts designated by the Minister shall, except for the purpose of this subsection, be deemed to have been designated by the debtor as required by subsections (5) to (11).

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#### Income inclusion where residual balance a positive amount

(17) Where a commercial obligation issued by a corporation is settled at any time in a taxation year and, as a consequence of the settlement an amount is deducted under section 61.3 in computing the corporation's income for the year, unless the corporation has commenced to wind up on or before the day that is 12 months after the end of the year there shall be added in computing the corporation's income for the year from the source in connection with which the obligation was issued 50% of the lesser of

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

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(b) the amount, if any, by which the lesser of

(i) the residual balance (within the meaning assigned by subsection (14)) of the corporation at that time in respect of the settlement of the obligation, and

(ii) the amount, if any, by which the amount deducted under section 61.3 in computing the corporation's income for the year exceeds the amount, if any, deducted because of paragraph 37(1)(f.1) in determining the balance determined under subsection 37(1) in respect of the corporation after the year because of an amount deducted under section 61.3 in computing the corporation's income for the year 5 10

exceeds the total of all amounts included because of this subsection in computing the corporation's income for the year in respect of a settlement before that time of a commercial obligation issued by the corporation. 15

#### Partnership designations

(18) Where a commercial obligation issued by a partnership is settled at any time after Announcement Date, the amount designated under subsection (9), (10) or (11) in respect of the settlement by the partnership to reduce the adjusted cost base of a capital property acquired shall not exceed the amount, if any, by which the adjusted cost base at that time to the partnership of the property exceeds the fair market value at that time of the property. 20 25

#### Deemed settlement of debts

80.01(1) In this section,

**"commercial debt obligation"**

*«créance commerciale»*

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

**"commercial obligation"**

*«dette commerciale»*

"commercial obligation" has the meaning assigned by subsection 80(1); 35

**"debtor"**

*«débiteur»*

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

**"distress preferred share"****«action privilégiée de renflouement»**

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

**"forgiven amount"****«montant remis»**

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"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;

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**"person"****«personne»**

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

**"specified cost"****«coût déterminé»**

"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 obligation, and

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

**Application**

(2) For the purposes of this section,

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(a) paragraphs 80(2)(a), (b), (j), (l) and (n) apply; and

(b) a person has a significant interest in a corporation at any time if the person owned at that time

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

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

and, for the purposes of this paragraph, a person shall be deemed to own at any time each share of the capital stock of a corporation that is owned, otherwise than because of this paragraph, at that time by another person with whom the person does not deal at arm's length. 5

#### 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 10 15

(a) the definition "cost amount" in subsection 248(1) were read without reference to paragraph (e) of that definition, and 20

(b) that cost amount included amounts added in computing the creditor's income in respect of the portion of the indebtedness representing unpaid interest, to the extent those amounts have not been deducted in computing the creditor's income as bad debts in respect of that unpaid interest. 25

#### Deemed settlement on winding-up

(4) Where there is a winding-up of a subsidiary to which the rules in subsection 88(1) apply and 30

(a) a debt or other obligation (in this subsection referred to as the "subsidiary's obligation") of the subsidiary to pay an amount to the parent, or 35

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

is, as a consequence of the winding-up, settled at a particular time without any payment of an amount or by the payment of an amount that is less than the principal amount of the subsidiary's obligation or the parent's obligation, as the case may be, the following rules apply: 40

(c) where that payment is less 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 the particular time if the definition "cost amount" in subsection 248(1) were read without reference to paragraph (e) of that definition and the parent so elects 5  
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 the particular 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 10  
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 particular time if

(i) the definition "cost amount" in subsection 248(1) were read 15  
without reference to paragraph (e) of that definition, and

(ii) that cost amount included amounts added in computing the parent's income or the subsidiary's income in respect of the portion of the indebtedness representing unpaid interest, to the 20  
extent that the parent or the subsidiary has not deducted any amounts as bad debts in respect of that unpaid interest; and

(d) for the purposes of applying section 80 to the subsidiary's obligation, where property is distributed at any time in circumstances to which paragraph 88(1)(a) or (b) applies and the subsidiary's obligation is settled as a consequence of the distribution, the subsidiary's obligation shall be deemed to have been settled immediately before the time that is immediately before the time of the distribution and not at any later time. 25  
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#### 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 the 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 principal amount of the share, the following rules apply: 35

(a) where the payment was less than the adjusted cost base of the share 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; and 40  
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(b) for the purposes of applying section 80 to the share, where property is distributed at any time in circumstances to which paragraph 88(1)(a) or (b) applies and the share is settled as a consequence of the distribution, the share shall be deemed to have been settled immediately before the time that is immediately before the time of the distribution and not at any later time.

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#### 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),

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(i) a person who owned the obligation

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

(B) where the debtor is a corporation, did not have a significant interest in the debtor, or

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(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

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

#### Parked obligation

(7) For the purposes of this subsection and subsections (6), (8) and (10),

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

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

(ii) the holder of the obligation

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

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(B) where the debtor is a corporation and the holder acquired the obligation after July 12, 1994 (otherwise than pursuant to an agreement in writing entered into on or before July 12, 1994), has a significant interest in the debtor; and

(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.

#### 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 because of a statutory limitation period 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, at a subsequent time a payment is made by the debtor of an amount in satisfaction of the principal amount of the obligation and it cannot reasonably be considered that one of the reasons the obligation became a parked obligation or became unenforceable, as the case may be, before the subsequent time was to have this subsection apply to the payment, in computing the debtor's income for the taxation year (in this subsection referred to as the "subsequent 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

$$.75(A - B) - C$$

where

A is the amount of the payment,

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

(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

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, and

C is the amount, if any, by which the total of

(a) all amounts deducted under section 61.3 in computing the debtor's income for the subsequent year or a preceding taxation year,

(b) all amounts added because of subsection 80(13) in computing the debtor's income for the subsequent year or a preceding taxation year in respect of a settlement under subsection (8) or (9) in a period during which the debtor was exempt from tax under this Part on its taxable income, and

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(c) all amounts added because of subsection 80(13) in computing the debtor's income for the subsequent year or a preceding taxation year in respect of a settlement under subsection (8) or (9) in a period during which the debtor was non-resident (other than any of those amounts added in computing the debtor's taxable income or taxable income earned in Canada)

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exceeds the total of

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(d) the amount, if any, deducted because of paragraph 37(1)(f.1) in determining the balance determined under subsection 37(1) in respect of the debtor immediately after the subsequent year, and

(e) all amounts by which the amount deductible under this subsection in respect of a payment made by the debtor before the subsequent time in computing the debtor's income for the subsequent year or a preceding year has been reduced because of this description.

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Foreign currency gains and losses

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(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.

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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).

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General rules

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

(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;

(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

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(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

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(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

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(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).

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#### 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,

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(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

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(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.

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#### 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

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(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

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

#### 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

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(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

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(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.

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

(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 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. 5 10

#### Deemed settlement on expiry of term

(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 15

(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.

#### Gains on subsequent dispositions 20

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)). 25

#### 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 30

(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 35

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

(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. 5

Surrender of capital property 10

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

(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 15

(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; 20

(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). 25

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 30 35

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

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(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

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(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

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(A) the share of a taxable dividend relating to the interest that was received after July 12, 1994 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

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(B) the share of a capital dividend relating to the interest that was received after July 12, 1994 and in a fiscal period of the partnership ending in the specified period relating to the disposition of the interest,

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(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

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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

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(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.

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#### 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

(a) beginning at or on the later of July 12, 1994 and the last time before the particular time that the person acquired the property, and

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(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.

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#### Alternative treatment

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(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,

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(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), 5

(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 10

(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. 15

#### 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. 20 25

#### Transfers of forgiven amounts

80.04(1) In this section, "commercial debt obligation", "commercial obligation", "debtor", "directed person", "eligible Canadian partnership", "forgiven amount" and "person" have the meanings assigned by subsection 80(1). 30

#### Eligible transferee

(2) For the purpose of this section, an "eligible transferee" of a debtor at any time is a directed person of the debtor or 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. 35

## Application

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

### Agreement respecting transfer of forgiven amount

(4) Where 5

(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,

(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, 10

(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 15

the following rules apply:

(e) except for the purposes of subsection 80(11), the transferee shall be deemed to have issued a commercial debt obligation that was settled at the particular time,

(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), 20

(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, 25

(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, 30

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

(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,

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(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, and

(j) for the purposes of sections 61.3 and 61.4, the amount included under subsection 80(13) in computing the income of the eligible transferee in respect of the settlement of the obligation referred to in paragraph (e) or deducted under paragraph 80(15)(a) in respect of such income shall be deemed to be nil.

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#### Consideration for agreement

(5) For the purposes of this Part, where property is acquired at any time by an eligible transferee as consideration for entering into an agreement with a debtor that is filed under this section

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(a) where the property was owned by the debtor immediately before that time,

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(i) the debtor shall be deemed to have disposed of the property at that time for proceeds equal to the fair market value of the property at that time, and

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(ii) no amount may be deducted in computing the debtor's income as a consequence of the transfer of the property, except any amount arising as a consequence of the application of subparagraph (i);

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(b) the cost at which the property was acquired by the eligible transferee at that time shall be deemed to be equal to the fair market value of the property at that time;

(c) the eligible transferee shall not be required to add an amount in computing income only because of the acquisition at that time of the property; and

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

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## Manner of filing agreement

(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

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

(i) on or before the later of

(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

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(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

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(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;

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(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,

(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,

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(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

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(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

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(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.

#### 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 5

(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 10

(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. 15

#### 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). 20 25

#### 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. 30

#### 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 issued by the debtor that was settled at any time, the debtor is, to the extent of 30% of the amount specified in the agreement, liable to pay 35

(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,

(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

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(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

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

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#### Joint liability

(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.

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#### 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,

(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

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(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

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(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.

**Idem**

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

**Partnership members**

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(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.

(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

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

(i) before February 22, 1994,

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(ii) after February 21, 1994

(A) under the terms of an agreement in writing entered into on or before that date, or

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(B) under the terms of any amendment to such an agreement, where that amendment was entered into in writing before July 12, 1994 and the amount of the settlement or extinguishment was not substantially greater than the settlement or extinguishment provided under the terms of the agreement,

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(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*, or similar legislation of a country other than Canada, before February 22, 1994, or

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(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

(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:

(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)(i) 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

(2) Subsection (1) applies to property disposed of after July 12, 1994, other than property disposed of pursuant to an agreement in writing entered into on or before July 12, 1994.

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

Computation of adjusted cost base of property

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

(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

$$A \times B/C$$

where

A is the amount, if any, by which

(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,

exceeds

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(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,

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 10

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 15

(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.

**(2) Subsection (1) applies to taxation years that end after February 21, 1994.** 20

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

Idem

(h.1) for the purposes of section 61.4, 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) Subsection 87(2) of the Act is amended by adding the following after paragraph (I.2):** 30

Forgiven amount

(l.21) for the purposes of section 61.3 and subsection 80.01(10), the new corporation shall be deemed to be the same corporation as, and a continuation of, each predecessor corporation;

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

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**Adjusted cost base of option**

(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 10

(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. 15

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

**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, 20

(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 25

(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. 30

**(5) Subsections (1) to (4) 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:**

(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.** 5

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

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

**(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:** 10

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 15

**(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:**

| A.1 is 4/3 of 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), 20

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:** 25

G is amount, if any, by which 30

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

exceeds

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

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

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

(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

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(ii) without reference to subsections 80(3) to (12), (15) and (17), 80.01(5) to (11) and sections 80.02 to 80.04;

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

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**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, a designation 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), subsections 80(5), (9), (10) and (11), section 80.04 and subsection 97(2) that, but for this subsection, would be a valid agreement, designation or election, the following rules apply:

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(a) the agreement, designation or election is not valid unless

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(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, designation 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, designation or election; and

(c) notwithstanding paragraph (a), any agreement, designation or election deemed by paragraph (b) to have been made or executed by any person shall be deemed to be a valid agreement, designation 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)(i) 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 July 12, 1994, other than property disposed of pursuant to an agreement in writing entered into on or before July 12, 1994.**

**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

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

(ii) the amount, if any, by which

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

exceeds

(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;

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

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

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

(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:

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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:

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"net capital loss"

*«perte en capital nette»*

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

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

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where

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,

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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

(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

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;

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

$$(A + B) - (C + D + D.1 + D.2)$$

(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:

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.

38.(1) Paragraph 114(a) of the Act is replaced by the following:

(a) the individual's income for the period or periods in the year throughout which the individual is resident in Canada, computed without regard to section 61.2 and as though that period or those periods were the whole taxation year, and

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

39.(1) Paragraph 115(1)(a) of the Act is amended by added the following immediately after subparagraph (iii.2):

(iii.21) the amount, if any, included under section 56.3 in computing the non-resident person's income for the year,

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

40.(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:

(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;

(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;

(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.

**(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.**

**41.(1) The Act is amended by adding the following after section 160.3:**

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#### **Liability in respect of transfers by insolvent corporations**

160.4 (1) Where property is transferred at any time by a corporation to a taxpayer with whom the corporation does not deal at arm's length at that time and the corporation is not entitled because of subsection 61.3(3) to deduct an amount under section 61.3 in computing income for a taxation year because of the transfer or because of the transfer and one or more other transactions, the taxpayer is jointly and severally liable with the corporation to pay an amount of the corporation's tax under this Part for the year equal to amount, if any, by which the fair market value of the property at that time exceeds the fair market value at that time of the consideration given for the property, but nothing in this subsection shall be deemed to limit the liability of the corporation under any other provision of this Act.

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#### **Indirect transfers**

##### **(2) Where**

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(a) property is transferred at any time from a taxpayer (in this subsection referred to as the "transferor") to another taxpayer (in this subsection referred to as the "transferee") with whom the transferor does not deal at arm's length,

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(b) the transferor is liable because of subsection (1) or this subsection to pay an amount of the tax of another person (in this subsection referred to as the "debtor") under this Part, and

(c) it can reasonably be considered that one of the reasons of the transfer would, but for this subsection, be to prevent the enforcement of this section,

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the transferee is jointly and severally liable with the transferor and the debtor to pay an amount of the debtor's tax under this Part equal to the lesser of the amount of such tax that the transferor was liable to pay at that time and the amount, if any, by which the fair market value of the property at that time exceeds the fair market value at that time of the consideration given for the property, but nothing in this subsection shall be deemed to limit the liability of the debtor or the transferor under any provision of this Act.

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## Minister may assess recipient

(3) The Minister may at any time assess a person in respect of any amount payable by the person because of this section and the provisions of this Division apply, with such modifications as the circumstances require, in respect of an assessment made under this section, as though it had been made under section 152. 5

## Rules applicable

(4) Where a corporation and another person have, because of subsection (1) or (2), become jointly and severally liable in respect of part or all of a liability of the corporation under this Act, the following rules apply: 10

(a) a payment by the other person on account of that person's liability shall to the extent thereof discharge the joint liability; but 15

(b) a payment by the corporation on account of the corporation's liability discharges the other person's liability only to the extent that the payment operates to reduce the corporation's liability to an amount less than the amount in respect of which the other person was, by subsection (1) or (2), as the case may be, made liable. 20

**(2) Subsection (1) applies to transfers after Announcement Date.** 25

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

## Consideration for agreement

(1.1) For the purposes of Part I of the Act, where property is acquired at any time by a transferee corporation as consideration for entering into an agreement with a transferor corporation that is filed under this section 30

(a) where the property was owned by the transferor corporation immediately before that time, 35

(i) the transferor corporation shall be deemed to have disposed of the property at that time for proceeds equal to the fair market value of the property at that time, and

(ii) the transferor corporation shall not be entitled to deduct any amount in computing the transferor corporation's income as a consequence of the transfer of the property, except any amount arising as a consequence of subparagraph (i); 40

(b) the cost at which the property was acquired by the transferee corporation at that time shall be deemed to be equal to the fair market value of the property at that time;

(c) the transferee corporation shall not be required to add an amount in computing income only because of the acquisition at that time of the property; and

(d) 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.

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

**43. Section 220 of the Act is amended by adding the following after subsection (3.2):**

Designations under section 80 and subsection 80.03(7)

(3.21) For the purposes of subsection (3.2), a designation in any form prescribed for the purpose of paragraph 80(2)(i) or any of subsections 80(2) to (11) or 80.03(7) shall be deemed to be an election under a prescribed provision of the Act.

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

"bankrupt"  
«failli»

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

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

"restricted farm loss"  
«perte agricole restreinte»

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

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

(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.

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## Parts of debt obligations

(27) For greater certainty,

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(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;

(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

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(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.**

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**45.(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),

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

**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),

(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

(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), 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.**

**46.(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

**(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), (e.1) or (e.2) 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

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

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Explanatory Notes to  
Revised Draft Legislation  
on Debt Forgiveness  
and Foreclosures

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## **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. A earlier draft of the legislation and these notes was released on July 12, 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.

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## 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)(z.3)**

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)(z.3) provides that income of a taxpayer arising from the application of new subsection 80(13) or (17) 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 relating to forgiveness of debt, described below.

This amendment applies 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) and (2)

ITA

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.

The definition "cumulative eligible capital" in subsection 14(5) is amended to provide that a new amount (P.1) is added in computing that excess. The amount determined for P.1 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). Under that provision, a taxpayer is allowed to apply a portion of any amount forgiven on the settlement of a debt issued by the taxpayer to reduce the cumulative eligible capital in respect of a business of the taxpayer.

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

#### Subclause 4(3)

#### 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. These amendments apply 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. (Unless the property is land, there is an additional requirement that all or part of the amount not be due until more than two years after the sale.) 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 all or part of 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.

**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)(uu)**

New paragraph 20(1)(uu) of the Act provides a deduction in computing a taxpayer's income 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. Subsection 80.01(10) concerns payments made in satisfaction of a debt after it is considered to have become "parked" for the purposes of the debt forgiveness rules in section 80. 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 income inclusions under subsections 80(13) and (17) (net of any deduction under new paragraph 20(1)(uu)) are 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). The non-recognition for cash-basis taxpayers of interest payable until it is actually paid also minimizes the effect of the rules in both sections 79 and 80. (See subparagraph (b)(v) of the description of F in subsection 79(2) and paragraph 80(2)(b).)

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

### Scientific research and experimental development

ITA

37(1)(f.1)

Section 37 of the Act sets out the rules for the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR & ED).

New paragraph 37(1)(f.1) provides that a taxpayer's SR & ED balance for a taxation year must be reduced to take into account each deduction claimed by the taxpayer under new section 61.3 for a preceding taxation year. That section provides a deduction to corporations and non-residents in certain circumstances to offset amounts included in income under section 80 as a result of the forgiveness of debt issued those persons. The amount of the reduction under paragraph 37(1)(f.1) is equal to the lesser of:

- the amount deducted under section 61.3 in computing the taxpayer's income for that preceding year, and
- any amount that the taxpayer was entitled to deduct, but did not claim, under subsection 37(1) for that preceding taxation year.

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

## Clause 11

### 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 12**

### **Capital gains - special rules**

#### **Subclause 12(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).

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

#### Subclause 12(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 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 this rule.

The purpose of new paragraph 40(2)(e.1) (in conjunction with amended subsections 85(4) and 97(3)) is to provide balanced treatment for debtors and creditors under the debt parking rule in subsection 80.01(8) and the stop-loss rules in subsections 40(2), 85(4) and 97(3). For further details, see the commentary on the amendment to subsection 85(4).

This amendment applies to dispositions after July 12, 1994, other than dispositions pursuant to agreements in writing entered into on or before July 12, 1994.

##### ITA 40(2)(e.2)

New paragraph 40(2)(e.2) of the Act applies where a taxpayer disposes of one commercial obligation (as defined by subsection 80(1)) issued by a person or partnership in exchange for another commercial obligation issued by the same person or partnership. In these circumstances, any loss from the disposition is reduced and the amount of the reduction is added under new paragraph 53(1)(f.12) in computing the adjusted cost base of the new obligation. More specifically, the loss determined under new paragraph 40(2)(e.2) from the disposition of a particular commercial obligation is equal to the loss otherwise determined multiplied by a proration factor. The proration factor is equal to the fair market

value of the consideration that is not a commercial obligation divided by the fair market value of the total consideration received for the obligation disposed of.

### EXAMPLE

Assume a \$100,000 commercial debt obligation issued by Debtco to a taxpayer is now worth only \$10,000. As part of a restructuring, the taxpayer accepts two commercial debt obligations issued by Debtco (having principal amounts of \$45,000 and \$15,000) and \$4,000 of cash in settlement of the \$100,000 obligation. The total value of this consideration is \$10,000.

#### Results:

1. As a consequence of new paragraph 80(2)(h), the full principal amount of the new obligations is considered to have been paid in satisfaction of the first debt. The "forgiven amount" in respect of the first obligation is therefore equal to \$36,000 ( $\$100,000 - 60,000 - 4,000$ ).
2. The capital loss otherwise determined is equal to \$90,000 ( $\$100,000 - 10,000$ ). As a consequence of paragraph 40(2)(e.2), the capital loss is also equal to \$36,000 ( $\$90,000 \times (4,000/10,000)$ ).
3. The \$54,000 reduction in the capital loss is added under new paragraph 53(1)(f.12) in computing the adjusted cost base of the new obligations in proportion to the principal amounts of those obligations. Consequently, \$40,500 (three-quarters of the \$54,000 reduction) is allocated to the \$45,000 obligation and \$13,500 (one-quarter of the \$54,000 reduction) is allocated to the \$15,000 obligation.

This amendment applies to dispositions after Announcement Date, other than dispositions pursuant to agreements in writing entered into on or before Announcement Date.

## **Clause 13**

### **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 amendment to the latter clause is described in the commentary above.

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

## **Clause 14**

### **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 15**

### **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 16**

### **Bad debts and shares of bankrupt corporations**

#### **ITA 50(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, where the taxpayer so elects.

Subsection 50(1) is amended to provide that it also only applies, in the case of a debt payable to a taxpayer, where the taxpayer so elects. 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 in which the taxpayer has a "significant interest" (as defined under subsection 80.01(2)). 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 17****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 18

### Adjustments to cost of property

#### Subclause 18(1)

##### ITA

##### 53(1)(f.1) to (f.12)

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)).

New paragraph 53(1)(f.12) is introduced so that the amount by which a capital loss has been reduced under paragraph 40(2)(e.2) on the exchange of one commercial obligation for one or more other commercial obligations is added in computing the adjusted cost base of the other obligation or obligations. For further detail, see the commentary on new paragraph 40(2)(e.2) and the definition "commercial obligation" in subsection 80(1).

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

## Subclause 18(2)

ITA  
53(1)(q)

New paragraph 53(1)(q) 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 18(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 18(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 from 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 from 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 19**

### **Definitions**

#### **Subclause 19(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 19(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 19(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 20**

### **Add back of reserves for debt forgiveness**

ITA

56.2 and 56.3

New section 56.2 of the Act is discussed in the commentary on new section 61.2.

New section 56.3 provides that a reserve deducted by a taxpayer under new section 61.4 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 section 61.4. Section 61.4, in conjunction with section 56.3, permits non-residents carrying on business in Canada and resident corporations and trusts to have amounts included in income under section 80 (debt forgiveness) spread over a five-year period. It should be noted, however, that section 56.3 does not apply to require an income inclusion in a taxation year during which a taxpayer is a bankrupt.

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

## **Clause 21**

### **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 an individual whose indebtedness has been forgiven. A related amendment, discussed in the commentary on section 61.4, applies to non-residents, corporations and trusts. It should be noted, however, that the Minister of National Revenue is authorized under new subsection 80(16) to reduce an individual's tax attributes and, as a consequence, the income inclusion of the individual under subsection 80(13), in the event that the individual has failed under

section 80 to apply forgiven amounts of debts to the maximum extent possible against those tax attributes.

The deduction under section 61.2 is equal to:

- the total of all such income inclusions for the year (including the individual's share of such income inclusions as a member of a partnership for fiscal periods that end in the year),

MINUS the total of

- deductions claimed under paragraph 80(15)(a) for the year in the individual's capacity as a member of a partnership, and
- if the individual's income for the year exceeds \$40,000, 20% of the excess.

For these purposes, an individual's income is computed without regard to subsection 80(13), new section 56.2, paragraph 60(w) (deduction for tax under Part I.2 on old age security) and section 61.2 itself. The reference to paragraph 60(w) is required to prevent a circular calculation between section 180.2 (under which Part I.2 tax is computed) and section 61.2. The effect of these references is that a deduction under section 61.2 is claimed before the computation of Part I.2 tax.

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 the individual has sufficient other income to support the inclusion of all or part of an income inclusion under subsection 80(13). However, it is intended that a deduction can be claimed under section 61.2 for the taxation year in which an individual dies. There is no requirement that the reserve be added in computing the income of the individual's estate or beneficiaries. In addition, the add-back of a reserve for an individual will not apply 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.

**Deduction for debt forgiveness**

**ITA  
61.3**

New subsection 61.3(1) of the Act provides a deduction for corporations resident in Canada (other than corporations exempt from tax under Part I of the Act) with respect to amounts included in income under subsection 80(13) because of the application of the debt forgiveness rules. In general terms, section 61.3 requires a debtor corporation to compute the amount of its net assets (i.e., the fair market value of its assets, net of its liabilities) at the end of a taxation year. Subsection 61.3(1) allows an offset against the income inclusion under subsection 80(13) equal to the amount of that income inclusion minus two times the net asset amount. Thus, the effect of the offset is that a corporation will be required to recognize income as a consequence of subsection 80(13) only to the extent of twice the corporation's net assets. As a consequence, on the assumption that the combined federal/provincial income tax rate of a corporation does not exceed 50%, the income inclusion for the corporation under subsection 80(13) will not result in the corporation's liabilities exceeding the fair market value of its assets.

More specifically, the amount deducted under subsection 61.3(1) in respect of a corporation for a taxation year is equal to the lesser of two amounts. The first amount (referred to below as the "net forgiveness amount") is equal to the total of amounts added in computing the corporation's income because of the application of subsection 80(13), net of any deductions in respect of that total under paragraph 80(15)(a).

The second amount in respect of a corporation for a taxation year is determined as follows:

- ADD the corporation's net forgiveness amount;
- SUBTRACT 2 times the total of
  - the fair market value of the corporation's assets at the end of the year,
  - the amounts paid by the corporation before the end of the year on account of federal and provincial taxes for the year that are specified below, and
  - all amounts paid in the 12-month period preceding the end of the year by the corporation to a person with whom the corporation does not deal at arm's length
    - as a dividend (other than a stock dividend),
    - on a reduction of paid-up capital,
    - on a redemption, acquisition or cancellation of its shares, or
    - as a distribution or appropriation in any manner whatever to or for the benefit of the shareholders of any class of its capital stock (to the extent that the distribution or appropriation cannot reasonably be considered to have resulted in a reduction in the corporation's liabilities);
- ADD 2 times the corporation's liabilities at the end of the year, determined in the manner specified below;
- ADD 2 times the total of the principal amounts of all distress preferred shares issued by the corporation as of the end of the year, as determined under new section 80.02; and
- ADD the greater of
  - the amount, if any, by which the income of the corporation for the year (determined without reference to sections 61.3 and 61.4 and subsection 80(17)) exceeds the corporation's net forgiveness amount, and

- two times the total amounts paid by the corporation before the end of the year on account of its tax payable on its specified federal and provincial taxes for the year.

For the purposes of subsection 61.3(1), the liabilities of a corporation at the end of a taxation year are determined without regard to specified federal and provincial taxes payable for the year.

Otherwise, generally accepted accounting principles must be used for the purposes of determining such liabilities. In the event that a balance sheet reflecting the liabilities of a corporate debtor has been shown to its shareholders or, in the case of a bank or insurance corporation, to the appropriate federal or provincial regulator, the liabilities will generally be those reflected on the balance sheet with an adjustment for the specified federal and provincial taxes. (For this purpose, the specified federal taxes for a taxation year are the taxes payable for the year under Part I or any of Parts I.3, II, VI and XIV of the Act. Specified provincial taxes are any corresponding provincial taxes.)

Subsection 61.3(2) provides for a deduction, parallel to the deduction referred to above, for a non-resident corporation in computing the non-resident corporation's income.

Subsection 61.3(3) provides that the deductions under subsections 61.3(1) and (2) are not available to a corporation for a taxation year if property was transferred (or the corporation became indebted) in 12-month period preceding the end of the year and one of the reasons for the transaction was to increase the amount that the corporation would be entitled to deduct under subsection 61.3(1) or (2). Reference should also be made in this context to the joint liability rule in new section 160.4.

The Minister of National Revenue is authorized under new subsection 80(16) to increase the amount of a corporation's forgiven amounts that are applied under subsections 80(5) to (11) against the corporation's tax attributes, in the event that there is a deduction under section 61.3 in computing the corporation's income. In addition, a deduction under section 61.3 by a corporation can result in a recapture of up to 50% of the deduction under new subsection 80(17) and an adjustment under new paragraph 37(1)(f.1) with respect to the corporation's balance of scientific research expenditures. An adjustment with respect to a deduction under section 61.3 is also provided with respect to payments of debts deemed to be settled under subsection 80.01(8) (debt parking) or (9) (statutory limitation periods).

The following example illustrates the operation of subsection 61.3(1).

**EXAMPLE**

The following information applies to Debtco at the end of the 1994 taxation year:

Net forgiveness amount .....	\$100,000
Fair market value of assets at end of year .....	\$ 70,000
Liabilities at the end of year, determined without regard to specified tax liabilities for the year .....	\$ 67,000
Income for the year, determined without reference to sections 61.3 and 61.4 and subsection 80(17) .....	\$101,000
Payments on account of specified tax liabilities for the year .....	\$ nil

**Results:**

1. The deduction that Debtco claims under section 61.3 for the taxation year is equal to \$95,000, which is the lesser of

- \$100,000, and
- $\$95,000 (\$100,000 - 2(70,000) + 2(67,000) + (101,000 - 100,000))$ .

2. Under section 61.4, the \$5,000 remaining income inclusion can be spread over 5 years.

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

**Reserve for debt forgiveness****ITA  
61.4**

New section 61.4 of the Act allows a taxpayer to deduct an amount as a reserve with respect to an income inclusion under new subsection 80(13) on the settlement of a commercial obligation (within the meaning assigned by subsection 80(1)) issued by the taxpayer. In conjunction with new section 56.3, section 61.4 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). A reserve is also not allowed under section 61.4 for corporations that are winding-up in circumstances to which subsection 88(1) does not apply. (Individuals resident in Canada are allowed to claim a reserve under new section 61.2. Corporations are also permitted, in certain cases, to claim a deduction under new section 61.3.)

More specifically, where an income inclusion under subsection 80(13) arises for a qualifying taxpayer, up to  $\frac{4}{5}$  of the income inclusion may be deducted under section 61.4 in computing the taxpayer's income for the year. The amount deducted by a taxpayer under section 61.4 for a taxation year is added back under section 56.3 in computing the taxpayer's income for the following year. For the following year, a taxpayer may deduct up to  $\frac{3}{5}$  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 section 61.4 for the preceding year in respect of that income inclusion). For the next two years, up to  $\frac{2}{5}$  and  $\frac{1}{5}$  of the original income inclusion may be deducted, subject to the same limit.

Section 61.4 is structured so that it takes into account debts settled in different taxation years. However, the effect of section 61.4 is to group debts according to the taxation year in which they were settled so that the income inclusion with respect to such debts can be determined in the manner described above.

For the purposes of section 61.4, the original income inclusion referred to above is determined net of deductions claimed by the taxpayer under new paragraph 80(15)(a) and section 61.3 in respect of the income inclusion. The reference to paragraph 80(15)(a) 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.

**Clause 22****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 23****Canadian exploration expenses**

ITA  
66.1(6)

Subsection 66.1(6) of the Act sets out the definition of "cumulative Canadian exploration expense" (CCEE). 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 new description of J.1 in that definition provides that the computation of CCEE takes into account reductions required by new subsection 80(8).

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

**Clause 24****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 25****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 26**

### **Successor rules**

#### **ITA**

66.7(1) to (5) and (9)(f)

Subsections 66.7(1) to (5) of the Act allow a corporation to claim deductions with respect to Canadian exploration and development expenses, 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. The deductions claimed under these subsections are limited to specified resource income (commonly called "streamed income") from the property to which the expenses relate. New subsection 80(8) requires a taxpayer's resource expenditure pools to be reduced in certain cases where a commercial obligation (within the meaning assigned by subsection 80(1)) issued by the taxpayer is settled. In certain cases, new subsections 80(13) and (17) require a taxpayer to include in computing income certain amounts arising in respect of the settlement of a commercial obligation (as defined in subsection 80(1)).

Paragraphs 66.7(1)(b), (2)(b), (3)(b), (4)(b) and (5)(b) are amended to ensure that amounts included in computing income under subsections 80(13) or (17) are excluded from a taxpayer's streamed income for the purposes of these rules. This exclusion does not, however, apply to a taxpayer where the successor pool arose as a consequence of the acquisition of control of the taxpayer by a person

or group of persons, the taxpayer ceasing to be exempt from tax under Part I of the Act or the acquisition of properties by the taxpayer by way of an amalgamation or merger.

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 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.

If property is surrendered to a creditor as a consequence of the failure to pay a debt while other property remains as security for the same debt, it is intended that a reasonable portion of that debt be included in the amount determined under A and that the portion of the debt so included not be included in the event that further property is surrendered by the debtor with respect to the same debt. One method of making such a reasonable allocation would be to base it on the fair market value of the surrendered property compared to the fair market value of all property that was security for the debt immediately before the surrender of the property.

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 to take into account accrued interest on the debtor's debt, if the debtor would be entitled to deduct such interest in computing income on a cash basis if it were actually paid. The proceeds under section 79 are further 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.

ITA  
79(7)

New subsection 79(7) of the Act provides that, where a debt is denominated in a foreign currency, the proceeds of disposition for property surrendered by a debtor are determined with reference to the historical foreign exchange rate at the time the debt was issued. This is consistent with the rule provided for debt forgiveness under paragraph 80(2)(k).

## 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.

In the event that the same debt is secured by more than one property and these properties are seized at different times by a creditor, it is intended that a reasonable portion of the debt be considered to relate to a particular property. The reasonable portion of the debt can be determined with reference to the fair market value of properties seized.

### 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 a debt is, if 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 amount minus such portion of the cost amount that represents unpaid interest and that would be deductible in computing the creditor's income if the debt became a bad debt or became uncollectible. 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.

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.

In the event that further costs are incurred by a creditor with respect to a property after its acquisition, subsection 79(6) is not intended to preclude such costs from being taken into account. For example, a creditor may make payments to a security holder with respect to seized property without having legally assumed the responsibility to make such payments.

#### ITA 79.1(7)

New subsection 79.1(7) of the Act provides that, if 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 adjusted cost base to the creditor of the debt or, if the debt is not capital property, its cost amount. The debt is considered to have been disposed of at the time of seizure and, if any portion of it is still outstanding, it is deemed to have been reacquired. The cost of the reacquired debt is considered to be nil for capital property or, if the debt is not capital property, its cost amount minus its "specified cost" (as described in the commentary to subsection 79.1(6)). In the event that no part of a debt remains outstanding after a seizure by a

creditor, this excess may be deducted by the creditor as a bad debt in computing the creditor's income.

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. The amount received as a consequence of the seizure is considered to be received at the time of the seizure. Any further recovered amounts would be income or a capital gain of the creditor, depending on whether or not the debt is capital property of the creditor.

### EXAMPLE

A creditor acquires debt from another person at a cost of \$100,000. The debt is capital property. Part of the debt consists of unpaid interest of \$15,000. Subsequently, the creditor seizes land from the debtor in circumstances to which section 79.1 applies. The debt is still outstanding and the creditor collects a further \$7,000 on account of the unpaid interest.

Results:

1. The creditor is considered to acquire the land for \$100,000.
2. The debt is deemed to have been reacquired by the creditor for nil under subsection 79.1(7).
3. The further \$7,000 collected is included in computing the creditor's income under paragraph 12(1)(c). However, the creditor is entitled to a corresponding deduction under paragraph 20(14)(b).
4. As a consequence of the deduction under paragraph 20(14)(b) and the application of subsection 40(3) and paragraph 53(2)(i), the creditor has a capital gain of \$7,000. This capital gain is added to the adjusted cost base under paragraph 53(1)(a) so that no further capital gain is realized.

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 (18).
- 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 apply to the settlement of a debt to the extent that section 78 applies in respect of the debt, because of paragraph (c) of the definition of "excluded obligation" in subsection 80(1). The effect of section 79 is reduced 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 following, 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,
- after February 21, 1994, under the terms of any amendment to a written agreement entered into on or before February 21, 1994, where that amendment was entered into in writing before July 12, 1994 and the amount of the settlement or extinguishment was not substantially greater than the settlement or extinguishment provided under the terms of the agreement,
- 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*, or similar legislation under a foreign country, 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.

These exceptions do not apply to cases of deemed settlements under subsections 80.01(8) and (9), for which separate grandfathering provisions are provided.

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 paragraphs 80(2)(h), (n) to (q), 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.

A "commercial debt obligation" does not include an obligation to pay interest, except to the extent that new paragraph 80(2)(b) applies. For further detail, see the commentary on that paragraph.

"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 and any partnership.

"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 (or a part of 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 would have been so recognized if it were not for the exclusion of prescribed amounts under paragraph 12(1)(x). It also includes amounts payable that have been otherwise included in computing the debtor's income (e.g., subsection 15(2)) or amounts payable that resulted in a deduction in computing the adjusted cost base of property (e.g., subparagraph 53(2)(c)(i.3)). In addition, an "excluded obligation" 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., certain 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 paragraphs 80(2)(a) and (g). For discussion, see the commentary on those paragraphs.

"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). In general,  $\frac{3}{4}$  of any remaining unapplied amount is added in computing the debtor's income under 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,
- consideration previously given by the debtor to another person for the assumption by the other person of the obligation, and

- any portion of the principal amount of the obligation representing accrued interest that was included under section 80.4 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 reduced to the extent that 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.

The "forgiven amount" definition is also nullified in the event that a debtor is an "active" member of a partnership and the obligation has always been payable to an "active" member of the partnership. For this purpose, an "active" member of a partnership is a member of the partnership actively engaged, on a regular, continuous and substantial basis, in partnership activities (other than the financing of the partnership business).

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 originally issued by the debtor (e.g., the settlement of an obligation still outstanding after amounts have been paid in satisfaction of the original obligation).

"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 or as consideration for the issue of a share described in paragraph (c) of the definition "excluded security" in subsection 80(1)).

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 a debt issued by the corporation. Where this is the case, the debt is considered to be settled for an amount equal to the total of the fair market value of the share and the increase, resulting from the settlement of the debt, in the value of other shares of the capital stock of the corporation owned by that person. 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.

Note that new paragraph 80(2)(a) provides that the issue of a publicly-traded share described above will not give rise to the application of section 80. In the case of the issue of other "excluded securities" that are not distress preferred shares, it is intended that Revenue Canada's existing administrative practices continue to apply.

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 a new 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 new obligation is deemed to be paid by the debtor at that time, because of the issue of the new obligation, in satisfaction of the principal amount of the particular obligation, and
- the new obligation is considered to have been issued for an amount equal to the amount, if any, by which the principal amount of the new obligation exceeds the amount, if any, by which
  - the principal amount of the new obligation exceeds
  - the amount for which the particular obligation was issued.

In applying paragraph 80(2)(h), consideration must be given to the existing definition of "principal amount" in subsection 248(1). In particular, the principal amount of an obligation issued by a debtor does not include amounts that are considered to be payable on account of interest.

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 issued. In addition, the nature of any income inclusion under subsection 80(13) or (17) 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 Corporation A2.
3. As a consequence of the application of section 251, 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 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 ( $10,000 - 3,000$ ).

Further rules dealing with fluctuations in foreign currency are provided under new subsections 79(7) and 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(2)(m)

Paragraph 80(2)(m) of the Act ensures that, if a "forgiven amount" is applied under section 80 to reduce another amount, the amount of the reduction cannot exceed that other amount. As a consequence, the

application of the forgiven amount will not result in negative amounts.

#### ITA

##### 80(2)(n) and (o)

Paragraph 80(2)(n) of the Act applies where a commercial debt obligation issued by a partner is settled and the debt was treated as debt owed by the partnership. Paragraph 80(2)(n) ensures that, in these circumstances, the obligation is considered, for the purposes of section 80, to have been issued by the partnership and not by the debtor.

Paragraph 80(2)(o) applies, within or outside the partnership context, where a commercial debt obligation for which a debtor is jointly liable is settled at any time in respect of the debtor but not in respect of all the other persons jointly liable to pay the debt. In these circumstances, notwithstanding paragraph 80(2)(n), a reasonable share of the obligation is considered to have been issued by the debtor and to have been settled at such time and not at any subsequent time.

#### ITA

##### 80(2)(p) and (q)

Paragraphs 80(2)(p) and (q) apply in the event that a commercial debt obligation issued by an individual is settled after the individual's death. Paragraph 80(2)(p) clarifies that the obligation is considered to have been issued by the estate of the individual at the same time and in the same circumstances as the obligation was issued by the individual, assuming that the estate was liable for the obligation immediately before it was settled. However, paragraph 80(2)(q) provides that the obligation is considered to have been settled at the beginning of the day of the individual's death where it is settled within the period ending 6 months after the death (or a longer period acceptable to the Minister of National Revenue and the deceased's legal representatives). Any amount paid by the estate on the settlement of the obligation is, together with any consideration given by the estate for the assumption by another person of the obligation, likewise considered to have been paid or given at the beginning of the day of the individual's death. Paragraph 80(2)(q) also provides that, in these circumstances, interest accruing after the individual's death is ignored for the purposes of computing the forgiven amount in respect of the obligation that is deemed to have been settled.

The purpose of paragraph 80(2)(q) is to allow forgiven amounts in respect of commercial debt obligations issued by a deceased individual to be applied against the individual's tax attributes under subsections 80(3) to (12). In the event that an income inclusion

arises under subsection 80(13), a deduction can be claimed under new section 61.2 in the terminal return of the deceased.

ITA

80(3) and (4)

New subsections 80(3) and (4) of the Act provide 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. As under the existing rules, there is no requirement that the debt settled was used in generating such losses.

The forgiven amount in respect of a commercial obligation is applied under subsection 80(3) 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 a 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" for the relevant obligation and in respect of that loss. The "relevant loss balance" of a debtor for an obligation and in respect of 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 for an obligation and in respect of 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, and
- 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" for the relevant obligation and in respect of that loss.

Under paragraph 80(2)(e), the portion of the forgiven amount applied under subsection 80(4) 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" in respect 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 X 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 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 exploration expense, 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 any of subsections 66.7(2) to (5) as a consequence of the settlement of an obligation at any time is limited to the "successor pool" immediately after that time for the obligation, as defined under subsection 80(1).

The "successor pool" at any time for an obligation is the balance of an amount determined under any of those subsections 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 for 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.

New subsection 80(18) restricts the designations that may be made under subsection 80(9) by a partnership. For further detail, see the commentary below.

#### 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.

New subsection 80(18) restricts the designations that may be made under subsection 80(10) by a partnership. For further detail, see the commentary below.

#### 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 or interests in related partnerships and that are not 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.

New subsection 80(18) restricts the designations that may be made under subsection 80(11) by a partnership. For further detail, see the commentary below.

#### 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 for 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)

Where a commercial obligation issued by a debtor is settled, 75% (or, where the debtor is a partnership, 100%) of the portion of 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 sections 56.2, 56.3, 61.2 and 61.4, 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. Finally, new section 61.3 provides for a deduction with respect to insolvent corporations where there is an income inclusion under subsection 80(13).

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 cumulative Canadian development expense 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 multiplied by  $\frac{3}{4}$ . The product (\$1,500) 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 an incentive for debtors to enter into agreements with related parties under new section 80.04 to reduce the tax attributes of related parties to nil, before the debtor designates amounts under subsection 80(11) to reduce the adjusted cost base of certain property owned by the debtor. In general, the debtor is provided with an incentive to reduce the amount otherwise designated under subsection 80(11) by an amount up to the specified tax attributes of specified persons related to the debtor. The amount stipulated in such an agreement is deducted in computing the income inclusion otherwise arising for a debtor 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 in the commentary on subsection 80(14)),

#### 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 the calculation of the debtor's income inclusion 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. For further commentary on the first adjustment, see the commentary on subsection 80(14).

The second adjustment (equal to minus "D") in the calculation of a debtor's income inclusion applies in the event that the debtor has 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 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(14)

Subsection 80(14) of the Act defines the expression "residual balance". In general terms, it is defined as the total of income tax attributes (other than those described in subsection 80(11)) of certain corporations and partnerships related to a debtor (referred to as "directed persons") remaining after the settlement of an obligation, after taking into account the application of section 80.04 in respect of that settlement. Where a commercial debt obligation issued by a debtor (other than a partnership) is settled at any time, the debtor is required under subsection 80(13) to add in computing income an amount equal to 75% of the lesser of the residual balance at that time and total amounts applied at that time under subsection 80(11) of the Act to reduce the adjusted cost base of the debtor's capital property.

More specifically, the residual balance at any time in a taxation year 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 each "directed person" at that time in respect of the debtor if
  - those notional obligations were issued at that time by those directed persons and were settled immediately after that time,
  - an amount equal to 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 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 any of those directed persons under subsection 80(11) in respect of the settlement of any of those notional obligations

exceeds the total of

- 4/3 of the total amount that would be included under subsection 80(13) in computing the debtor's income for the year in respect of settlements at or before that time of commercial obligations issued by the debtor if the residual balance and the second adjustment in the income inclusion calculation under subsection 80(13) (described in the commentary on that subsection) were nil at the times of those settlements,
- 4/3 of the total amount 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 settlements of the obligations that are 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 settlements at or before that time and in the year of commercial obligations issued by the debtor,
- all amounts specified in an agreement (other than an agreement with any of those directed persons) filed under section 80.04 in

respect of settlements at or before that time and in the year of commercial obligations issued by the debtor, and

- the total of all amounts designated under subsection 80(11) in respect of a settlement before that time and in the year of a commercial obligation issued by the debtor, to the extent of the residual balance of the debtor at that previous time.

Where the debtor is a partnership, an amount is added under paragraph 80(14)(b) in computing the residual balance of the partnership. The effect of this adjustment is that the references to "4/3 of" in the above description are ignored, reflecting the different treatment of partnerships under subsection 80(13).

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 by which the debtor is controlled, or
- a taxable Canadian corporation or an eligible Canadian partnership that is controlled at that time by
  - the debtor,
  - the debtor and one or more persons related to the debtor, or
  - a person or group of persons by which the debtor is controlled.

Under subsection 102(1), a "Canadian partnership" is defined as 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 tax under Part I of the Act 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 described immediately above are beneficially interested (within the meaning assigned by subsection 248(25)).

Several points may be helpful in understanding the residual balance definition:

- As mentioned above, the residual balance does take into account agreements under section 80.04 that have the effect of reducing the tax attributes of a directed person. The technical basis for this is that a notional obligation referred to above is deemed by subparagraph 80(14)(a)(i) to have been settled immediately after an agreement under section 80.04 is effective. As a consequence, the reduction of tax attributes because of section 80.04 is taken into account for the purposes of determining the residual balance.
- In some cases, a directed person may rather have an income inclusion than reduce tax attributes pursuant to an agreement under section 80.04. Where this is the case, the residual balance is still reduced under paragraph 80(14)(d).
- In the event that a debtor chooses to apply any amount under subsection 80(11), it will generally be to the debtor's advantage to arrange to have a residual balance of nil in order to avoid the double counting of a portion of the forgiven amount among the debtor and directed persons of the debtor. The residual balance can be reduced either by entering into agreements under section 80.04 with persons related to the debtor or reducing the amount that is applied under subsection 80(11). A reduction of the amount applied under subsection 80(11) will reduce the residual balance under paragraph 80(14)(c).

The examples below illustrate the operation of subsections 80(13) and (14) and section 80.04.

### **EXAMPLE 1**

Debtco issued a commercial obligation to a bank for \$21,000. 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 \$21,000 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. Assuming that Opco uses the \$16,000 specified in the agreement to reduce its UCC, the residual balance is nil because Opco has no relevant tax attributes as a consequence of the agreement under section 80.04. (Even if Opco does not use the \$16,000 to grind its tax attributes, the residual balance would still be reduced to nil because of paragraph 80(14)(d).)

3. To the extent that Opco does not reduce its UCC to nil under subsection 80(5), subsection 80(13) would require that \$12,000 (3/4 of \$16,000) be included in computing Opco's income. Opco would not be permitted to claim any reserve under section 61.3 or 61.4 because of paragraph 80.04(4)(j).

4. Typically, Debtco will wish to reduce the adjusted cost base of the Opco shares by \$5,000 under subsection 80(11). Debtco's income inclusion under subsection 80(13) is nil as a result of the \$16,000 transfer. This amount is computed as follows:

- add \$16,000 under the description of A in subsection 80(13), which is the remaining unapplied amount (\$21,000-5,000),
- add nil under the description of B in subsection 80(13), which is the lesser of the residual balance (\$0) and the designation under subsection 80(11) (\$5,000), and
- subtract \$16,000 under the description of C in subsection 80(13), which is the amount specified in agreement under section 80.04.

## EXAMPLE 2

Debtco issued a commercial obligation to a bank for \$150,000. 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 \$120,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of \$70,000. The full \$150,000 of debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is \$20,000 and designates \$80,000 under subsection 80(11) as a reduction in the ACB of the Opco shares. Opco uses the \$20,000 to reduce its UCC from \$70,000 to \$50,000.

### Results:

1. The residual balance at the time of the settlement is nil, determined as follows:

- Add \$50,000, which is the \$70,000 UCC minus the \$20,000 amount specified in the agreement under section 80.04, and
- Subtract \$50,000 under paragraph 80(14)(c), which is the \$150,000 forgiven amount, minus the \$80,000 designated under subsection 80(11) and the \$20,000 specified in the agreement under section 80.04.

2. As a consequence, the amount included under subsection 80(13) in computing Debtco's income is equal to \$37,500, determined as follows:

- Add \$70,000 under the description of A in subsection 80(13), which is the remaining unapplied forgiven amount (\$150,000-80,000),
- Add nil under the description of B in subsection 80(13), as the residual balance is nil,
- Subtract the \$20,000 specified amount under the description of C in subsection 80(13), and
- Multiply the remainder (\$50,000) by 3/4.

### EXAMPLE 3

Same as example 2, except that the amount designated under subsection 80(11) is \$100,000 rather than \$80,000.

Results:

1. The residual balance at the time of the settlement is \$20,000, determined as follows:

- Add \$50,000, which is the \$70,000 UCC minus the \$20,000 amount specified in the agreement under section 80.04, and
- Subtract \$30,000 under paragraph 80(14)(c), which is the \$150,000 forgiven amount, minus the \$100,000 designated under subsection 80(11) and the \$20,000 specified in the agreement under section 80.04.

2. As a consequence, the amount included under subsection 80(13) in computing Debtco's income is equal to \$37,500, determined as follows:

- Add \$50,000 under the description of A in subsection 80(13), which is the remaining unapplied forgiven amount (\$150,000-100,000),
- Add the \$20,000 residual balance under the description of B in subsection 80(13),
- Subtract the \$20,000 specified amount under the description of C in subsection 80(13), and
- Multiply the remainder (\$50,000) by 3/4.

#### EXAMPLE 4

Debtco issued two commercial obligations to a bank for \$90,000 and \$60,000. 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 \$120,000. Opco's only asset is depreciable property of a prescribed class having an undepreciated capital cost (UCC) of \$70,000. The \$90,000 debt is fully forgiven. Subsequently, in the same taxation year, the \$60,000 debt is forgiven. Debtco enters into an agreement with Opco under section 80.04 in which the amount specified is \$20,000 with respect to the first settlement. In addition, an amount of \$20,000 is designated under subsection 80(11) with respect to the first settlement. Subsequently, an amount of \$60,000 is designated under subsection 80(11) with respect to the second settlement. (Note: this example is, in substance, the same as example 2.)

#### Results:

1. As in example 2, the residual balance at the time of the first settlement is nil. This is computed as follows:
  - Add \$50,000, which is the \$70,000 UCC minus the \$20,000 amount specified in the agreement under section 80.04, and
  - Subtract \$50,000 under paragraph 80(14)(c), which is the \$90,000 forgiven amount, minus the \$20,000 designated under subsection 80(11) and the \$20,000 specified in the agreement under section 80.04.
2. The residual balance at the time of the second settlement is also nil, as there are no further additions to the residual balance set out in the facts.

3. Given the residual balance in each case is equal to nil, the income inclusion under subsection 80(13) is equal to \$37,500 with respect to the first settlement ( $\frac{3}{4} \times (\$90,000 - \$20,000 - \$20,000)$ ) and \$0 with respect to the second settlement. This is consistent with example 2. In the event that a higher total amount is designated under subsection 80(11), the results will be consistent with example 3.

#### 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). For this purpose, income resulting from subsection 80(13) is considered to arise from a separate source so that current year partnership expenses do not have any impact on the computation of the deduction.

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. Further relief with respect to certain partnership obligations is provided under paragraph (k) of the description of B in the definition "forgiven amount" in subsection 80(1). In addition, special rules are provided with respect to partnership obligations under new paragraphs 80(2)(n) and (o) and subsection 80(18).

### 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). An amount of \$6,000 ( $\frac{3}{4} \times \$8,000$ ) 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 section 61.2 or 61.4 or may be entitled to a deduction under new section 61.3.

#### ITA 80(16)

New subsection 80(16) of the Act allows the Minister of National Revenue to designate amounts under any of subsections 80(5) to (11), to the extent that the debtor would have been permitted to have designated those amounts. However, this authority is provided only in the event that an amount would otherwise be deducted under new section 61.2 or 61.3. It should be noted that, in these circumstances, the Minister can designate an amount under new subsection 80(11) even where that increase also results in an increase in the amount added in computing the debtor's income under subsection 80(13) and, as a consequence, an increase in an offsetting amount deducted under section 61.3.

#### ITA 80(17)

New subsection 80(17) of the Act applies only if a deduction is claimed under new section 61.3 in computing the income of a corporation. New subsection 80(17) is designed to provide an insolvent corporation with an incentive to enter into agreements with related corporations and partnerships under section 80.04 in order to have the tax attributes of those corporations or partnerships reduced.

New subsection 80(17) provides that, if a commercial obligation issued by a corporation is settled at any time in a taxation year and the corporation claims a deduction under section 61.3 in computing income for that year, there is added in computing the corporation's income for that year from the source in connection with which the obligation was issued 50% of the lesser of:

- the total amounts designated under subsection 80(11) by the corporation in respect of the settlement of the obligation, and
- the amount, if any, by which the lesser of
  - the residual balance (within the meaning assigned by subsection 80(14)) at that time in respect of the settlement of the obligation, and
  - the amount deducted under section 61.3 in computing the debtor's income for the year (net of any part of that deduction applied to reduce the corporation's balance of scientific research expenditures under new paragraph 37(1)(f.1))

exceeds the total of all other amounts included because of subsection 80(17) in computing the debtor's income for the year in respect of a settlement before that time of a commercial obligation issued by the corporation.

Subsection 80(17) does not, however, apply to a corporation for a taxation year if it begins to wind up on or before the day that is 12 months after the end of the year.

#### EXAMPLE

A commercial obligation issued by Debtco is settled. Assume the following facts apply to Debtco:

Amounts designated under subsection 80(11) .....	\$10,000
Deduction claimed under section 61.3 .....	\$25,000
Residual balance at the time of settlement .....	\$ 4,000

#### Result:

As a consequence of subsection 80(17), \$2,000 (i.e. 50% of \$4,000) is added in computing Debtco's income.

#### ITA 80(18)

New subsection 80(18) of the Act applies only where a commercial obligation issued by a partnership is settled at any time after Announcement Date. Where this is the case, a partnership cannot

designate amounts under subsection 80(9), (10) or (11) so that the adjusted cost base of a property at the time of the settlement becomes less than its fair market value at that time.

The purpose of this measure is to prevent partnerships from acquiring capital properties in order to minimize the impact of section 80. The measure is limited to partnerships because many tax attributes (e.g. loss carryforwards and resource expenditures) are allocated to partnership members and the forgiveness of a commercial obligation that is considered to have been issued by a partnership does not result in a reduction of those attributes, subject to the application of subsection 80(15). For further detail on the treatment of partnerships and their members, see the commentary on subsection 80(15).

### **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 new 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 for the purposes of 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),
- paragraph 80(2)(j) (which provides assumptions relevant for the purposes of determining whether two or more persons are related to each other),
- 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), and
- paragraph 80(2)(n) (which ensures that debt of a partnership is treated as having been issued by the partnership).

Subsection 80.01(2) also provides that, for the purposes of section 80.01, a person has a "significant interest" in a debtor corporation if the person (and other non-arm's length persons) own shares of the capital stock of the debtor corporation to which 25% or more of the votes or value are attributable. The expression "significant interest" is relevant for the purposes of new subsections 80.01(6) to (8), described below.

The rule in new 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. The main 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. In addition, new subsection 80.01(3) provides that amounts of unpaid interest in respect of the debt that have been added in computing the creditor's income are likewise added, for the purposes of subsection 80.01(3), in computing the cost amount of the debt to the extent that those amounts have not been deducted as bad debts in computing the creditor's income.

The rule in new subsection 80.01(4) was contained in existing subsection 80(3). Under existing subsection 80(3) and new subsection 80.01(4), 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).

New subsection 80.01(4) also provides that unpaid interest is treated in the same manner as described above in the commentary on subsection 80.01(3).

New paragraph 80.01(4)(d) also provides a rule that applies whenever a subsidiary's obligation is settled on a distribution of property in the course of a winding-up to which subsection 88(1) applies. Where this is the case, the time at which the debt is settled is deemed to be the time that is immediately before the time that is immediately before the time of the distribution. This rule ensures that there is an appropriate reduction under section 80 in the cost amount of distributed property. It is consequential on the new rules in section 80 providing for the reductions of tax attributes under subsections 80(5) to (11) immediately after the settlement of an obligation and only with respect to property that is owned after the settlement.

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 an amount equal to 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.

New subsection 80.01(5), like subsection 80.01(4), also provides a rule that applies whenever a distress preferred share issued by a subsidiary is settled on a distribution of property in the course of a winding-up to which subsection 88(1) applies. Where this is the case, the time at which the share is settled is deemed to be the time that is immediately before the time that is immediately before the time of the distribution.

Subsections 80.01(6) to (8) contain provisions that are designed to counter the "parking" of a commercial debt obligation. In general terms, they can apply where an obligation issued by a debtor to one creditor is transferred, directly or indirectly to another creditor who is related to the debtor or has a "significant interest" (as defined in subsection 80.01(2)) in the debtor. They can also apply after an obligation owed to a creditor is deemed to have been reacquired by the creditor under amended subsection 50(1).

In order for the "debt parking" rules to apply at any time to a debt, subject to transitional rules each of the following conditions (referred to below as the "debt parking conditions") must apply:

- under subsection 80.01(6), the debt must be a "specified obligation" (as described below),
- under subsection 80.01(7), the specified obligation must be a "parked obligation" (i.e., the current holder of the debt does not deal at arm's length with the debtor or, where the debtor is a corporation, the current holder of the corporation has a "significant interest" in the corporation (as defined by new subsection 80.01(2))),
- under subsection 80.01(8), but subject to paragraph 80.01(7)(b), the "parked obligation" must become a "parked obligation at that time" (i.e., either of the above debt parking conditions did not apply immediately before that time), and
- under subsection 80.01(8), the specified cost (as defined in subsection 80.01(1)) to the current creditor of the obligation is less than 80% of its principal amount.

These conditions are described more fully below.

Under subsection 80.01(6), a "specified obligation" of a debtor is, at a particular time, an obligation issued by the debtor where any of the following three tests are satisfied:

- at any previous time
  - a person who owned the obligation dealt at arm's length with the debtor and, where the debtor is a corporation, did not have a "significant interest" (as defined in subsection 80.01(2)) in the debtor, 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.

Note, however, that an obligation is not considered to become a "specified obligation" at any time because either of the first two tests above was satisfied before any previous time that the obligation became a "parked obligation". Consequently, once debt has become

to the debt parking rules, any previous arm's length relationship or sale is irrelevant for the purposes of determining whether the debt is subject to a further application of the debt parking rules.

The second debt parking condition is satisfied under paragraph 80.01(7)(a) where the current holder of a "specified obligation" does not deal at arm's length with the debtor. In addition, where the debtor is a corporation and the current holder has a "significant interest" in debtor (as defined in subsection 80.01(2)), the second condition is also satisfied unless the current holder acquired the obligation on or before July 12, 1994 or pursuant to an agreement in writing entered into before that date.

The third debt parking condition necessary for the debt parking rules to apply to an obligation at any time is that an obligation must become a "parked obligation" at that time. In other words, the debt parking rules under subsection 80.01(8) will only apply once there is a change of status with respect to the debt. However, for this purpose, 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 under paragraph 80.01(7)(b) 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.

Paragraph 80.01(7)(b) applies in relatively narrow circumstances. For example, assume that a commercial debt obligation issued by a corporation is acquired at time 1 by a related corporation from a financial institution and, as a consequence, becomes a parked obligation at time 1. Further assume that the debt purchaser disposes of the obligation and all the shares of the capital stock of the debtor at time 2 to a corporation that is unrelated to the debt purchaser. In these circumstances, paragraph 80.01(7)(b) provides that the obligation is considered to become a parked obligation at time 2 even though it was also a parked obligation immediately before time 2.

Subject to a transitional rule described below, where all four debt parking conditions apply in respect of a commercial debt obligation, 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 amount) to the current holder of the obligation.

These consequences do not, however, apply with respect to debt that becomes a parked obligation after February 21, 1994 (otherwise than pursuant to an agreement in writing entered into before February 22, 1994). In applying the income tax law to acquisitions of debt to which subsection 80.01(8) does not apply, one of the issues that will be considered is the application of the general anti-avoidance rule.

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 in 1995 for \$12,000 by a corporation (C2) related to Debtco. 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 related to 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).

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 generally 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 deduction under subsection 80.01(10) for a payment in satisfaction of an obligation is, however, denied if it can reasonably

be considered that one of the reasons for the obligation becoming a parked obligation or becoming unenforceable, as the case may be, before the time of the payment was to have subsection 80.01(10) apply to the payment. In addition, any deduction under subsection 80.01(10) is reduced to reflect any deductions claimed by a debtor under new section 61.3 that have not resulted in a reduction of the debtor's scientific research expenditure balance pursuant to new paragraph 37(1)(f.1). A deduction under subsection 80.01(10) is also reduced to reflect income inclusions for a debtor under subsection 80(13) in respect of deemed settlements occurring when the debtor is non-resident or exempt from tax under Part I of the Act, except the portion of those income inclusions added in computing a non-resident's taxable income or taxable income earned in Canada.

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 of 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 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 from 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 July 12, 1994 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 July 12, 1994 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 subsections 80(13) and (17). 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 is a "directed person" of the debtor (as described in the commentary to subsection 80(14)) or a taxable Canadian corporation or eligible Canadian partnership related to the debtor. For this purpose, 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 subsection 80(11), 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;
- 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; and
- the transferee is, however, not entitled to claim any amount under section 61.3 or 61.4 with respect to the deemed obligation.

Subsection 80.04(5) provides rules that apply where property is acquired by an eligible transferee as consideration for entering into an agreement that is filed under section 80.04. If the property is owned by the debtor immediately before the transfer, the debtor is deemed to have disposed of the property at its fair market value but is not entitled to deduct any amount in respect of the transfer except any loss resulting from the deemed disposition. The cost at which the property was acquired by the eligible transferee is considered to be equal to its fair market value. Neither the eligible transferee nor the debtor is required to add any amount or benefit in computing income only because of the acquisition of the property or because of the entering into of the agreement under section 80.04.

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 30% 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 corporations 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 balance between the rules in subsection 85(4) for creditors and the debt parking rules for debtors in new section 80.01.

**EXAMPLE**

Assume that Purchaseco is planning to acquire all the assets of Holdco, a corporation with which it deals at arm's length. Holdco's assets consist of shares of the capital stock of Opco 1 and debt owed to Holdco by a corporation (Opco 2) which is a wholly-owned subsidiary of Opco 1. The fair market value of the debt is well below its principal amount.

**Results:**

1. If Purchaseco acquires the debt and the shares, the debt parking rules will apply and reduce Opco 2's tax attributes. Conversely, Holdco should be able to realize a loss for income tax purposes.
2. In the absence of this amendment, a transfer of the debt to Opco 1 would increase the adjusted cost base of the shares of the

capital stock of Opco 1. A loss would be realized on the disposition of shares, with no corresponding reduction of tax attributes.

3. As a consequence of this amendment, no loss is realized by Holdco.

This amendment applies to property disposed of after July 12, 1994, other than property disposed of pursuant to an agreement in writing entered into on or before July 12, 1994.

## 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. Because of the reference to paragraph 87(2)(h.1) in paragraph 88(1)(e.2), the new measure also applies to windings-up to which subsection 88(1) applies. The provisions specified are:

- section 61.4 (which allows an amalgamated corporation to claim a reserve under section 61.4 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 section 56.3 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 reserves under section 61.4) 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(2)(1.21)

New paragraph 87(2)(1.21) of the Act provides that section 61.3 and subsection 80.01(10) apply to an amalgamated corporation as if the amalgamated corporation were the same corporation as, and a continuation of, each of the predecessor corporations. For further detail on these provisions, see the commentary above.

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

#### Subclause 31(3)

##### 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(4)

#### 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 proceeds for a subsidiary and the cost to the parent corporation of property owned by its subsidiary before the winding-up are 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 paragraph 80(1)(b). This amendment is consequential on the amendments to section 80 that are described above.

This amendment applies to windings-up beginning after July 13, 1990.

**Clause 33****Foreign accrual property income**

Subclauses 33(1) to (4)

ITA

95(1)

"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  $\frac{4}{3}$  of 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 (i.e.,  $\frac{4}{3} \times \$3,600 \times .75$ ). 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), (15) and (17), 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.

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

**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 so that designations under subsections 80(5) and (9) to (11) in respect of a partnership are treated in the same way as an election referred to in subsection 96(3).

Subsection 96(3) is also 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.

These amendments apply 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 circumstances, 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 balance between the rules in subsection 97(3) for creditors and the debt parking rules for debtors in new section 80. For further detail, see the commentary on a related amendment to subsection 85(4).

This amendment applies to property disposed of after July 12, 1994, other than property disposed of pursuant to an agreement in writing entered into on or before July 12, 1994.

## **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**

**Part-year residents**

ITA

114(a)

Section 114 of the Act provides the rules with respect to deductions allowed in computing the taxable income of an individual residing in Canada during only part of a taxation year.

Paragraph 114(a) is amended to ensure that, in these cases, any individual cannot claim a deduction under new section 61.2 in computing the individual's income for a taxation year.

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

**Clause 39**

**Taxable income earned in Canada**

ITA

115(1)(a)(iii.21)

Subsection 115(1) of the Act determines the taxable income earned in Canada on which a non-resident is subject to taxation under Part I of the Act.

New subparagraph 115(1)(a)(iii.21) provides that amounts required to be included in computing a non-resident corporation's income under section 56.3 of the Act are included in computing the corporation's taxable income earned in Canada.

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

## **Clause 40**

### **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 section 79.

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.

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 41**

#### **Liability in respect of transfers by insolvent corporations**

ITA

160.4

New section 160.4 of the Act applies where a transfer of property has been made by a corporation and, as a consequence of the transfer (or the transfer combined with other transactions), the corporation is precluded under subsection 61.3(3) from deducting an amount under section 61.3. Where this is the case, the transferee is jointly liable with the transferor under subsection 160.4(1) for the transferor's tax under Part I of the Act for the first taxation year of the transferor ending after the time of the transfer and for preceding taxation years. The liability of the transferee applies up to the amount, if any, by which the fair market value of the property at the time of the transfer exceeds the fair market value of the consideration given for the property transferred.

In addition, should a transferee make a further non-arm's length transfer and one of the reasons that the transfer was made was to prevent the enforcement of section 160.4, subsection 160.4(2) provides for joint liability on the part of subsequent non-arm's length transferees for the original transferor's Part I tax referred to above. The liability is limited to the lesser of the outstanding amount of the original transferor's tax liability remaining at the time of the subsequent transfer and the amount, if any, by which the fair market value of the property transferred exceeds the fair market value of the consideration given for the property.

This amendment applies to transfers made after Announcement Date.

## Clause 42

### Part VI.1 tax

ITA

191.3(1.1)

Section 191.3 of the Act, relating to the special Part VI.1 tax on corporations paying dividends on taxable preferred shares, allows a transferor corporation to transfer its liability for this tax to a related transferee corporation.

New subsection 191.3(1.1) provides rules that apply where property is acquired by a transferee corporation as consideration for entering into an agreement that is filed under section 191.3. If the property is owned by the transferor corporation immediately before the transfer, the corporation is deemed to have disposed of the property at its fair market value but is not entitled to deduct any amount in respect of the transfer except any loss resulting from the deemed disposition. The cost at which the property was acquired by the transferee corporation is considered to be equal to its fair market value. Neither the transferor corporation nor the transferee corporation is required to add any amount or benefit in computing income only because of the acquisition of the property or because of the entering into of the agreement under section 191.3. 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 43

### Minister's duty

ITA

220

Subsections 220(3.2) to (3.7) of the Act allow for the late filing, amendment and revocation of certain elections made by taxpayers or partnerships.

Subsection 220(3.21) is introduced so that these measures apply to designations in forms prescribed for the purposes of section 80 and subsection 80.03(7).

This amendment applies on Royal Assent.

## Clause 44

### Interpretation

#### Subclause 43(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 43(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 43(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 becomes 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 45**

**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 46

### 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 rules under paragraphs 40(2)(e.1) and (e.2) of the Act, which correspond to the adjusted cost base increase provided under new paragraphs 53(1)(f.11) and (f.12) of the Act, are treated in the same way.

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

## **Appendix**

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# **Revised Draft Income Tax Regulations and Explanatory Notes on Debt Forgiveness**

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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), (15) and (17) 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), (15) and (17), 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.

