Legislative Proposals and Explanatory Notes on Taxation of Non-Resident Trusts and Foreign Investment Entities

Published by
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Legislative Proposals

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1. (1) Paragraph 12(1)(*k*) of the *Income Tax Act* is replaced by the following:

Foreign corporations, trusts and investment entities

(*k*) any amount required by subdivision i to be included in computing the taxpayer's income for the year;

(2) Subsection (1) applies to taxation years that begin after 2002.

2. (1) The definition "controlled foreign affiliate" in subsection 17(15) of the Act is replaced by the following:

"controlled foreign affiliate" « société étrangère affiliée contrôlée »

"controlled foreign affiliate" has the meaning that would be assigned by the definition "controlled foreign affiliate" in subsection 95(1) if this Act were read without reference to paragraph 94.1(2)(*h*) and if paragraphs (*d*) and (*e*) of that definition were read as follows:

"(*d*) one or more persons resident in Canada with whom the taxpayer does not deal at arm's length, or

(*e*) the taxpayer and one or more persons resident in Canada with whom the taxpayer does not deal at arm's length;"

(2) Subsection (1) applies after 2002.

3. (1) Paragraph 39(1)(*a*) of the Act is amended by adding the following after subparagraph (ii.2):

(ii.3) a property in respect of which subsection 94.2(3) applies to the taxpayer immediately before the time of the disposition,

(2) Subsection (1) applies to dispositions that occur after 2002.

4. (1) Paragraph 51(1)(*a*) of the French version of the Act is replaced by the following:

a) sauf pour l'application du paragraphe 20(21) et de l'alinéa 94(2)*m*), l'échange est réputé ne pas constituer une disposition du bien convertible;

(2) Paragraph 51(1)(*c*) of the English version of the Act is replaced by the following:

(*c*) except for the purposes of subsection 20(21) and paragraph 94(2)(*m*), the exchange shall be deemed not to be a disposition of the convertible property,

(2) Subsections (1) and (2) apply to

(*a*) taxation years that begin after 2002;

(*b*) taxation years of a taxpayer that begin after 2000 if a trust, to which the taxpayer, directly or indirectly, transferred property in 2001 (or would have so transferred property if section 94 of the Act, as enacted by subsection 10(1) of this Act, applied in 2001), makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*c*) taxation years of a taxpayer that begin after 2001 if a trust, to which the taxpayer, directly or indirectly, transferred property in 2002 (or would have so transferred property if section 94 of the Act, as enacted by subsection 10(1) of this Act, applied in 2002), makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

5. (1) Paragraph 53(1)(*d*.1) of the Act is replaced by the following:

(*d*.1) where the property is a capital interest of the taxpayer in a trust to which paragraph 94(1)(*d*) applied (as that paragraph read in its application to taxation years that began before 2003), any amount required by paragraph 94(5)(*a*) (as that paragraph read in its application to taxation years that began before 2003) to be added in computing the adjusted cost base to the taxpayer of the interest;

(2) Paragraph 53(1)(*m*) of the Act is replaced by the following:

(*m*) where the property is an offshore investment fund property (within the meaning assigned by subsection 94.1(1) as that subsection read in its application to taxation years that began before 2003),

(i) any amount included in respect of the property under subsection 94.1(1) (as that subsection read in its application to taxation years that began before 2003) in computing the taxpayer's income for a taxation year that began both before that time and before 2003, and

(ii) where the taxpayer is a controlled foreign affiliate of a person resident in Canada, any amount included in respect of the property in computing the foreign accrual property income of the controlled foreign affiliate because of the description of C in the definition "foreign accrual property income" in subsection 95(1) for a taxation year of the controlled foreign affiliate that began both before that time and before 2003;

(*m*.1) any amount required by subsection 94.2(12) to be added at or before that time in computing the adjusted cost base to the taxpayer of the property;

(*m*.2) where the property is a participating interest (within the meaning assigned by subsection 94.1(1)) in a foreign investment entity (within the meaning assigned by subsection 94.1(1)), any amount included in respect of the property under subsection 94.1(4) computing the taxpayer's income for a taxation year that began before that time;

(3) Paragraph 53(2)(*b*.1) of the Act is replaced by the following:

(*b*.1) where the property is a capital interest of the taxpayer in a trust to which paragraph 94(1)(*d*) applied (as that paragraph read in its application to taxation years that began before 2003), any amount required by paragraph 94(5)(*b*) (as that paragraph read in its application to taxation years that began before 2003) to be deducted in computing the adjusted cost base to the taxpayer of the interest;

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

(*w*) any amount required by subsection 94.2(12) or 94.3(2) to be deducted at or before that time in computing the adjusted cost base to the taxpayer of the property.

(5) Subsections (1) to (4) apply to taxation years that begin after 2002. Subsections (1) and (3) also apply to

(*a*) taxation years of a taxpayer that begin after 2000 if a trust, in which the taxpayer had a capital interest at any time in 2001, makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) taxation years of a taxpayer that begin after 2001 if a trust, in which the taxpayer had a capital interest at any time in 2002, makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

6. (1) Subsection 70(3.1) of the Act is replaced by the following:

Exception

(3.1) In this section, "rights or things" in respect of an individual do not include an interest in a life insurance policy (other than an annuity contract where the payment for the contract was deductible in computing the individual's income under paragraph 60(*l*) or was made in circumstances in which subsection 146(21) applied), eligible capital property, land included in the inventory of a business, a Canadian resource property, a foreign resource property or property in respect of which subsection 94.2(3) applied to the individual immediately before the individual's death.

(2) Subsection 70(5.2) of the Act is amended by striking out the word "and" at the end of paragraph (*c*), by adding the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*e*) if subsection 94.2(3) applies to the taxpayer in respect of a property at a time that is immediately before the taxpayer's death,

(i) the taxpayer is deemed to have, at that time, disposed of the property for proceeds of disposition equal to its fair market value at that time, and

(ii) any person who, as a consequence of the taxpayer's death, acquires the property is deemed to have acquired the property at that time at a cost equal to its fair market value at that time.

(3) Subsections (1) and (2) apply to taxation years that begin after 2002.

7. (1) That portion of subsection 75(2) after paragraph (*b*) is replaced by the following:

any income or loss from the property or from property substituted for the property, and any taxable capital gain or allowable capital loss from the disposition of the property or of property substituted for the property, is, during the existence of the person while the person is resident in Canada (other than while the person is resident in Canada solely because of subsection 94(3)), deemed to be income or a loss, as the case may be, or a taxable capital gain or allowable capital loss, as the case may be, of the person.

(2) Subsection 75(3) of the Act is amended by striking out the word "or" at the end of paragraph (*c*.1) and by adding the following after paragraph (*c*.1):

(*c*.2) by a trust that is non-resident, for the purpose of computing its income for the year, because a contributor (within the meaning assigned by subsection 94(1)) to the trust is an individual (other than a trust) who is, at the end of the year, resident in Canada and has, at the end of the year, been resident in Canada for a period of, or for periods the total of which is, not more than 60 months; or

(3) Subsection (1) applies to taxation years that begin after 2000.

(4) Subsection (2) applies to trust taxation years that begin after 2000 except that, for trust taxation years that begin in 2001 or 2002 paragraph 75(3)(*c*.2) of the Act, as enacted by subsection (2), shall be read as follows:

(*c*.2) by a trust that is non-resident, for the purpose of computing its income for the year, because a contributor (within the meaning assigned by subsection 94(1) as it reads in its application to taxation years that begin after 2002) to the trust is an individual (other than a trust) who is, at the end of the year, resident in Canada and has, at the end of the year, been resident in Canada for a period of, or for periods the total of which is, not more than 60 months; or

8. (1) Paragraph 85(1.1)(*g*) of the French version of the Act is replaced by the following:

g) d'un bien — valeur ou titre de créance — qui est utilisé ou détenu par le contribuable pendant l'année dans le cadre de l'exploitation d'une entreprise d'assurance ou de prêt d'argent, à l'exception des biens suivants :

(i) les immobilisations,

(ii) les biens à porter à l'inventaire,

(ii.1) les biens détenus par le contribuable, si le paragraphe 94.2(3) s'applique à lui au titre des biens,

(iii) si le contribuable est une institution financière au cours de l'année, les biens évalués à la valeur du marché pour l'année;

(2) Paragraph 85(1.1)(*g*) of the English version of the Act is amended by striking out the word "or" at the end of subparagraph (ii) and by adding the following after subparagraph (ii):

(ii.1) a property held by the taxpayer if subsection 94.2(3) applies to the taxpayer in respect of the property, or

(2) Subsections (1) and (2) apply to taxation years that begin after 2002.

9. (1) Subsection 87(2) of the Act is amended by adding the following after paragraph (*j*.94):

Non-resident trusts and foreign investment entities

(*j*.95) for the purposes of sections 94 to 94.3, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(2) Subsection (1) applies to taxation years that begin after 2000.

10. (1) Subsection 91(1) of the Act is replaced by the following:

Amounts to be included in respect of share of foreign affiliate

91. (1) In computing the income for a taxation year of a taxpayer resident in Canada, there shall be included, in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer, as income from the share, the percentage of the foreign accrual property income of any controlled foreign affiliate of the taxpayer, for each taxation year of the affiliate that ends in the taxation year of the taxpayer, equal to the amount that would be that share's participating percentage in respect of the affiliate, determined at the end of each such taxation year of the affiliate if paragraph (*a*) of the definition "equity percentage" in subsection 95(4) did not take into account each share that would be subject to subsection 94.2(9) in respect of the taxpayer for the year if the taxpayer held the share throughout the year.

(2) Subparagraph 91(4)(*a*)(ii) of the Act is replaced by the following:

(ii) the taxpayer's relevant tax factor for the year, and

(3) Subsection (1) applies to taxation years that begin after 2002.

(4) Subsection (2) applies to the 2002 and subsequent taxation years.

11. (1) Section 94 of the Act is replaced by the following:

Definitions

94. (1) The definitions in this subsection apply in this section.

"arm's length transfer"
« transfert sans lien de dépendance »

"arm's length transfer", at any time by an entity (referred to in this definition as the "transferor") means a loan or transfer (which loan or transfer is referred to in this definition as the "transfer") of property (other than a restricted property) that is made at that time (referred to in this definition as the "transfer time") by the transferor to a particular entity (referred to in this definition as the "recipient") where

(*a*) it is reasonable to conclude that none of the reasons (determined by reference to all the circumstances including the terms of a trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the transfer is the acquisition at any time by any entity of an interest as a beneficiary under a non-resident trust; and

(*b*) the transfer

(i) is a payment of interest, of a dividend, of rent, of a royalty or of any other return on investment, or any substitute for such a return on investment, in respect of a particular property held by the recipient, if

(A) the transfer is not a transfer described in paragraph 94(2)(*g*), or the transfer is a transfer described in paragraph 94(2)(*g*) that is an acquisition by the recipient of

(I) a unit of a mutual fund trust,

(II) a share of the capital stock of a mutual fund corporation, or

(III) a particular share of the capital stock of a corporation (other than a closely-held corporation) which particular share is identical to a share that is, at the transfer time, of a class that is listed on a prescribed stock exchange, and

(B) the fair market value of the property, at the transfer time, is not more than the amount that the transferor would have transferred at the transfer time in respect of the particular property to the recipient if the transferor dealt at arm's length with the recipient,

(ii) is a payment made by a corporation on a reduction of the paid-up capital in respect of shares of a class of its capital stock held by the recipient, if

(A) the transfer is not a transfer described in paragraph 94(2)(*g*), and

(B) the amount of the payment is not more than the lesser of the amount of the reduction and the consideration for which the shares were issued,

(iii) is a refund in whole or in part of a gift that the recipient made to the transferor, if the recipient is a trust and the transferor is at the transfer time a specified charity in respect of the recipient,

(iv) is a transfer

(A) in exchange for which, the recipient transfers or loans property (other than a restricted property) to the transferor, or becomes obligated to so transfer or loan such property, and

(B) for which it is reasonable to conclude

(I) having regard only to the transfer and the exchange that the transferor would have been willing to make the transfer if the transferor dealt at arm's length with the recipient, and

(II) that the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor if the transferor dealt at arm's length with the recipient,

(v) is made in satisfaction of an obligation that arose because of a transfer to which subparagraph (iv) applied, if

(A) the transfer is not a transfer described in paragraph 94(2)(*g*),

(B) the transferor would have been willing to make the transfer if the transferor dealt at arm's length with the recipient, and

(C) the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor if the transferor dealt at arm's length with the recipient,

(vi) is a payment of an amount owing by the transferor under a written agreement the terms and conditions of which, when entered into, were terms and conditions that, having regard only to the amount owing and the agreement, persons dealing at arm's length would have entered into, if the transfer is not a transfer described in paragraph 94(2)(*g*),

(vii) is a payment made before 2002 to a trust (or to a corporation controlled by the trust or to a partnership of which the trust is a majority interest partner, together referred to in this subparagraph as "the specified person or partnership") in repayment of or otherwise in respect of a particular loan made by the trust (or by the specified person or partnership, as the case may be) to the transferor, or

(viii) is a payment made after 2001 to a trust (or to a corporation controlled by the trust or to a partnership of which the trust is a majority interest partner, together referred to in this subparagraph as "the specified person or partnership") in repayment of or otherwise in respect of a particular loan made by the trust (or by the specified person or partnership, as the case may be) to the transferor and either

(A) they would have been willing to enter the particular loan if they dealt at arm's length with each other and the payment is not a transfer described in paragraph 94(2)(*g*), or

(B) the payment is made before 2005 in accordance with fixed repayment terms agreed to before June 23, 2000.

"beneficiary"
« bénéficiare »

"beneficiary", under a trust, includes

(*a*) an entity that is beneficially interested in the trust; and

(*b*) an entity that would be beneficially interested in the trust if

(i) the entity were a person, and

(ii) the reference in subparagraph 248(25)(*b*)(ii) to

(A) "any arrangement in respect of the particular trust" were read as a reference to "any arrangement (including the terms or conditions of a share, or any arrangement in respect of a share, of the capital stock of a corporation that is beneficially interested in the particular trust) in respect of the particular trust", and

(B) "the particular person or partnership might" were read as a reference to "the particular person or partnership becomes (or could become on the exercise of any discretion by any entity), directly or indirectly, entitled to any amount derived, directly or indirectly, from the income or capital of the particular trust or might".

"closely-held corporation"
« société à peu d'actionnaires »

"closely-held corporation", at any time, means a corporation, other than a corporation shares of a class of the capital stock of which are, at that time, widely held and actively traded (as determined by paragraph 94.1(2)(*f*) with any modifications that the circumstances require).

"connected contributor"
« contribuant rattaché »

"connected contributor", to a trust at a particular time, means an entity (including an entity that has ceased to exist) that is a contributor to the trust at the particular time, other than

(*a*) an individual (other than a trust) who was, at or before the particular time, resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including an individual who, before the particular time, was never non-resident); and

(*b*) an entity whose only contributions to the trust are contributions made at a non-resident time of the entity.

“contribution”
« apport »

“contribution”, at any time to a trust by a particular entity, means,

(*a*) a transfer or loan made at that time of property (other than an arm’s length transfer) to the trust by the particular entity;

(*b*) if a particular transfer or loan of property (other than an arm’s length transfer) is made by the particular entity as part of a series of transactions or events that includes another transfer or loan of property that is made at that time to the trust by another entity, that other transfer or loan to the extent that it can reasonably be considered to have been made in respect of the particular transfer or loan; and

(*c*) if the particular entity becomes obligated to make a particular transfer or loan of property (other than an arm’s length transfer) as part of a series of transactions or events that includes another transfer or loan of property that is made at that time to the trust by another entity, that other transfer or loan to the extent that it can reasonably be considered to have been made in respect of the obligation.

“contributor”
« contribuant »

“contributor”, to a trust at any time, means an entity (including an entity that has ceased to exist) that, at or before that time, has made a contribution to the trust.

“entity”
« entité »

“entity” includes an association, a corporation, a fund, a natural person, a joint venture, an organization, a partnership, a syndicate and a trust.

“exempt foreign trust”
« fiducie étrangère exempte »

“exempt foreign trust”, at a particular time, means

(*a*) a non-resident trust, if

(i) each beneficiary under the trust at the particular time is

(A) an individual who, at the time that the trust was created, was, because of mental or physical infirmity, dependent on an individual who is a contributor to the trust or on an individual related to such a contributor (which beneficiary is referred to in this paragraph as an "infirm beneficiary"), or

(B) a person who is entitled, only after the particular time, to receive or otherwise obtain the use of any of the trust's income or capital,

(ii) at the particular time there is at least one infirm beneficiary who suffers from a mental or physical infirmity that causes the beneficiary to be dependent on any person,

(iii) each infirm beneficiary is non-resident at any time in the trust's taxation year that includes the particular time (referred to in this definition as the trust's "current year"), and

(iv) each contribution to the trust made at or before the particular time can reasonably be considered to have been, at the time that the contribution was made, made to provide for the maintenance of an infirm beneficiary during the expected period of the beneficiary's infirmity;

(*b*) a non-resident trust, if

(i) the trust was created after the breakdown of a marriage or common-law partnership of two individuals to provide for the maintenance of a beneficiary under the trust who is a child of one of those individuals (which beneficiary is referred to in this paragraph as a "child beneficiary"),

(ii) each beneficiary under the trust at the particular time is

(A) a child beneficiary under 21 years of age at the particular time,

(B) a child beneficiary under 31 years of age at the particular time who is enrolled at any time in the trust's current year at an educational institution that is described in clause (v)(A) or (B), or

(C) a person who is entitled, only after the particular time, to receive or otherwise obtain the use of any of the trust's income or capital,

(iii) each child beneficiary is non-resident at any time in the trust's current year,

(iv) each contributor to the trust at the particular time was one of those individuals or a person related to one of those individuals, and

(v) each contribution to the trust, at the time that the contribution was made, was made to provide for the maintenance of a child beneficiary, while the child was either under 21 years of age, or was under 31 years of age and enrolled at an educational institution located outside Canada that is

(A) a university, college or other educational institution that provides courses at a post-secondary school level, or

(B) an educational institution that provides courses that furnish a person with skills for, or improve a person's skills in, an occupation;

(*c*) a non-resident trust, if

(i) at the particular time, the trust is an agency of the United Nations,

(ii) at the particular time, the trust owns and administers a university described in paragraph (*f*) of the definition "total charitable gifts" in subsection 118.1(1), or

(iii) at any time in the trust's current year or at any time in the preceding calendar year, Her Majesty in right of Canada has made a gift to the trust;

(*d*) a non-resident trust

(i) that, at all times at or before the particular time, would be non-resident if this Act were read without reference to subsection 94(1) as that subsection read in its application to taxation years that began before 2003,

(ii) that was created exclusively for charitable purposes and has been operated, throughout the period that began at the time it was created and ends at the particular time, exclusively for charitable purposes,

(iii) in respect of which, there is a group of at least 20 persons (other than trusts) at the particular time who are all

contributors to the trust and who all deal with each other at arm's length, if the particular time is more than 24 months after the day on which the trust was created,

(iv) the income of which (determined in accordance with the laws described in subparagraph (v)) for each of its taxation years that end at or before the particular time would, if the income were not distributed and the laws described in subparagraph (v) did not apply, be subject to an income or profits tax in the country in which it was resident in each of those taxation years, and

(v) that was, for each of those taxation years, exempt under the laws of the country in which it was resident from the payment of income or profits tax to the government of that country in recognition of the charitable purposes for which the trust is operated;

(*e*) a non-resident trust that, throughout the trust's current year, is a trust governed by an employees profit sharing plan, a retirement compensation arrangement or a foreign retirement arrangement;

(*f*) a non-resident trust, if throughout the trust's current year

(i) the trust is a trust governed by an employee benefit plan or is a trust (referred to in this paragraph as the "specified trust") described in paragraph (*a*.1) of the definition "trust" in subsection 108(1),

(ii) the plan or the specified trust is maintained primarily for the benefit of non-resident individuals,

(iii) the trust holds no restricted property, and

(iv) the plan or the specified trust provides no benefits, other than benefits in respect of

(A) services rendered for an employer by an employee, of the employer, who was non-resident throughout the period during which the services were rendered,

(B) services rendered primarily outside Canada for an employer by an employee of the employer,

(C) services rendered for an employer by an employee of the employer in connection with a business carried on by the employer outside Canada,

(D) services rendered for an employer by an employee, of the employer, in a particular calendar month where

(I) the employee was resident in Canada throughout no more than 60 of the 72 calendar months ending with the particular month, and

(II) the employee became a member of, or a beneficiary under, the plan or the specified trust (or a similar plan or specified trust for which the plan or the specified trust was substituted) before the end of the calendar month following the month in which the employee became resident in Canada, or

(E) any combination of services described in clauses (A) to (D); and

(*g*) a non-resident trust that has, at all times since it was created, been

(i) operated exclusively for the purpose of administering or providing superannuation, pension, retirement or employee benefits,

(ii) maintained for the benefit of persons all or substantially all of whom are non-resident individuals,

(iii) resident in a country (other than Canada) the laws of which impose an income or profits tax, and

(iv) exempt, under the laws of that country, from the payment of income tax and profits tax to the government of that country in recognition of the purposes for which the trust is operated;

(*h*) a non-resident trust (other than a trust created or maintained for charitable purposes, a trust governed by an employee benefit plan, a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1), a salary deferral arrangement, a trust operated for the purpose of administering or providing superannuation, pension, retirement or employee benefits and a personal trust)

(i) that is, at the particular time, a trust described in paragraph (*c*) of the definition "exempt trust" in subsection 233.2(1), and

(ii) the interest of each beneficiary under which is, throughout the trust's taxation year that includes the particular time, vested indefeasibly;

(*i*) a non-resident trust (other than a trust to which paragraph (*h*) applies, a trust created or maintained for charitable purposes, a trust governed by an employee benefit plan, a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1), a salary deferral arrangement, a trust operated for the purpose of administering or providing superannuation, pension, retirement or employee benefits, a personal trust and a trust that has elected in writing filed with the Minister, on or before the trust's filing-due date for the particular taxation year of the trust that includes the particular time (or for an earlier taxation year that ended before the particular time), that this paragraph not apply to it for the particular taxation year (or for the earlier taxation year) and for all of its subsequent taxation years), if

(i) the trust has, on or before its filing due date for its taxation year that includes the particular time, filed with the Minister a prescribed form with a copy of the trust indenture that applies at the particular time,

(ii) throughout the trust's taxation year that includes the particular time

(A) the interest of each beneficiary under the trust

(I) was described by reference to units, and

(II) was vested indefeasibly,

(B) the trust held no restricted property,

(C) the trust's only undertakings were activities described in any of subparagraphs 132(6)(*b*)(i) to (iii), and

(D) all of the issued units of the trust carried identical rights, and

(iii) at the particular time, it is reasonable to conclude that, with respect to each particular contribution made by a particular contributor to the trust,

(A) no consideration was received (other than property received by the particular contributor that is the particular contributor's interest as a beneficiary under the trust),

(B) none of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement)

for the contribution is the acquisition at any time by any entity (other than the particular contributor) of an interest as a beneficiary under the trust, and

(C) if the particular contributor is resident in Canada at the time of that particular contribution, the fair market value of the particular contribution is equal to the amount that it would be if the particular contributor had dealt at arm's length with the trust; or

(*j*) a trust that is, at the particular time, a prescribed trust or included in a prescribed class of trusts.

"exempt service"
«service exempté »

"exempt service" means a service rendered at any time by an entity (referred to in this definition as the "service provider") to, for or on behalf of, another entity (referred to in this definition as a "recipient") if

(*a*) the recipient is at that time a trust and the service relates to the administration of the trust; or

(*b*) the following conditions apply in respect of the service, namely

(i) the service is rendered in the service provider's capacity at that time as an employee or agent of the recipient,

(ii) in exchange for the service the recipient transfers or loans property, or becomes obligated to transfer or loan property, and

(iii) it is reasonable to conclude

(A) having regard only to the service and the exchange that the service provider would have been willing to carry out the service if the service provider had dealt at arm's length with the recipient, and

(B) that the terms and conditions, and circumstances, under which the service was provided would have been acceptable to the service provider if the service provider had dealt at arm's length with the recipient.

“non-resident time”
« moment de non-résidence »

“non-resident time”, of an entity in respect of a particular time, means a time (referred to in this definition as the “contribution time”) at which the entity made a contribution to a trust that is before the particular time and at which the entity was non-resident, where the entity was non-resident or not in existence throughout the period that began 60 months before the contribution time (or, if the entity is an individual and the trust arose on and as a consequence of the death of the individual, 18 months before the contribution time) and ends at the earliest of

(*a*) the time that is 60 months after the contribution time;

(*b*) if the entity is an individual, the date of death of the individual; and

(*c*) subject to subsection (10), the particular time.

“promoter”
« promoteur »

“promoter” of a trust at any time, means an entity that on or before that time establishes, organizes or substantially reorganizes the undertakings of the trust.

“resident beneficiary”
« bénéficiaire résidant »

“resident beneficiary”, at any time under a particular trust, means an entity (other than an entity that is at that time a specified charity, or a testamentary beneficiary, in respect of the particular trust) that is, at that time, a beneficiary under the particular trust where, at that time

(*a*) the entity is resident in Canada; and

(*b*) there is a connected contributor to the particular trust.

“resident contributor”
« contribuant résidant »

“resident contributor”, to a particular trust at a particular time, means an entity that is, at that time, resident in Canada and a contributor to the particular trust, but does not include

(*a*) an individual (other than a trust) who has not, at that time, been resident in Canada for a period of, or periods the total of which is, more than 60 months (other than an individual who, before that time, was never non-resident); or

(*b*) an individual (other than a trust), if

(i) the particular trust is an *inter vivos* trust that was created before 1960 by a person who was non-resident when the trust was created, and

(ii) the individual has not, after 1959, made a contribution to the particular trust.

“restricted property”
« bien d’exception »

“restricted property” means

(*a*) a particular share (or a right to acquire a share) of the capital stock of a particular closely-held corporation if the particular share (or right), or a property for which the particular share (or right) was substituted, was at any time acquired as part of a transaction or series of transactions or events under which a specified share of the capital stock of a closely-held corporation was acquired by any entity in exchange for, as consideration for, or upon conversion of any property;

(*b*) an indebtedness (or a right to acquire indebtedness) owing by another entity if

(i) the other entity is a closely-held corporation,

(ii) the indebtedness (or right), or a property for which the indebtedness (or right) was substituted, was at any time acquired as part of a transaction or series of transactions or events under which a specified share of the capital stock of a closely-held corporation was acquired by any entity in

exchange for, as consideration for, or upon conversion of any property, and

(iii) the entitlement to receive, in any manner whatever and from any entity, payments in respect of the indebtedness is, directly or indirectly, determined primarily by reference to any one or more of the following criteria in respect of property of the other entity:

(A) production from the property, use of the property, gains from the disposition of the property, profits from the disposition of the property, fair market value of the property,

(B) income from the property, profits from the property, revenue from the property, cash flow from the property, or

(C) any other criterion similar to a criterion referred to in any of clause (A) or (B); and

(*c*) any property the fair market value of which is derived in whole or in part, directly or indirectly, from a particular share, indebtedness or right described in paragraph (*a*) or (*b*).

"specified charity"
« organisme de bienfaisance déterminé »

"specified charity", in respect of a trust at any particular time, is any person (referred to in this definition as the "charity") that at the particular time is a person described in any of paragraphs (*a*) to (*e*) and (*g*.1) of the definition "total charitable gifts" in subsection 118.1(1) other than

(*a*) a charity that does not, at the particular time, deal at arm's length with a specified entity in respect of the trust, and

(*b*) a charity that did not, at any specified prior time, deal at arm's length with a specified entity in respect of the trust,

where

(*c*) "specified prior time" in respect of a charity means any time, before the particular time, at which

(i) an amount was payable to the charity as a beneficiary under the trust,

(ii) an amount was received by the charity on the disposition of all or part of its interest as a beneficiary under the trust, or

(iii) a benefit was received or enjoyed by the charity from or under the trust, and

(*d*) "specified entity" in respect of a trust at any time means

(i) an entity that is at that time

(A) a beneficiary under the trust,

(B) a contributor to the trust,

(C) a person related to a contributor to the trust,

(D) a trustee of the trust,

(E) an entity that could reasonably be considered to have influence over the operation of the trust or the enforcement of its terms, or

(F) an entity that could reasonably be considered to have influence over the selection or appointment of an entity referred to in any of clauses (A), (D) and (E), or

(ii) any group of entities at least one of which is described in subparagraph (i).

"specified controlled foreign affiliate"
« société étrangère affiliée contrôlée déterminée »

"specified controlled foreign affiliate", of a particular entity at any time, means an entity that would, at that time, be a controlled foreign affiliate of the particular entity if the particular entity were resident in Canada at that time.

"specified party"
« tiers déterminé »

"specified party", in respect of a particular entity at any time, means an entity that is at that time

(*a*) an individual who is a spouse or common-law partner of the particular entity;

(*b*) a specified controlled foreign affiliate of

(i) the particular entity, or

(ii) if the particular entity is an individual, a spouse or common-law partner of the individual;

(*c*) an entity for which it is reasonable to conclude that the benefit referred to in subparagraph (8)(*a*)(iii) was conferred

(i) in contemplation of the entity becoming after that time a specified controlled foreign affiliate of an entity referred to in subparagraph (*b*)(i) or (ii), or

(ii) to avoid or minimize a liability under this Part that arose, or that would otherwise have arisen, because of the application of subsection (3) with respect to the particular entity; or

(*d*) a corporation in which the particular entity is a shareholder, if

(i) the corporation is on or before that time beneficially interested in a trust, and

(ii) the particular entity is a beneficiary under the trust solely because of the application of paragraph (*b*) of the definition "beneficiary" in this subsection to the particular entity in respect of the corporation.

"specified property"
« bien déterminé »

"specified property" means

(*a*) a share of the capital stock of a corporation;

(*b*) an interest as a beneficiary under a trust;

(*c*) an interest in a partnership;

(*d*) an interest in any other entity;

(*e*) a right to acquire property described in any of paragraphs (*a*) to (*d*); and

(*f*) any other property deriving its value primarily from property described in any of paragraphs (*a*) to (*e*).

“specified share”
« action déterminée »

“specified share” means a share of the capital stock of a corporation other than a share that is prescribed for the purpose of paragraph 110(1)(*d*).

“testamentary beneficiary”
« bénéficiaire testamentaire »

“testamentary beneficiary”, at any time in respect of a trust, means an entity that is a beneficiary under the trust solely because of a right of the beneficiary to enjoy or possess income or capital of the trust on or after the death after that time of an individual who, at that time, is alive and

(*a*) is a contributor to the trust;

(*b*) is related to a contributor to the trust; or

(*c*) would have been related to a contributor to the trust if every individual who was alive before that time were alive at that time.

“treasury interest”
« participation de trésorerie »

“treasury interest”, in a trust at any time, means an interest (including, for greater certainty, a right acquired from the trust to acquire an interest as a beneficiary under the trust) of an entity as a beneficiary under the trust if

(*a*) the interest was issued by the trust for consideration given to the trust;

(*b*) the trust is not at that time a personal trust; and

(*c*) the trust is not at that time an exempt foreign trust, but would be at that time an exempt foreign trust if it had not made an election under paragraph (*i*) of the definition “exempt foreign trust”.

“trust”
« fiducie »

“trust” includes, for greater certainty, a testamentary trust.

Rules of application

(2) In this section,

(*a*) except where paragraph (*c*) applies, an entity is deemed to have transferred property to a trust when it transfers or loans property (other than by way of an arm's length transfer) to another entity if because of that transfer or loan

(i) the fair market value of one or more properties held by the trust increases at the time of the transfer, or

(ii) a liability or potential liability of the trust decreases at the time of the transfer;

(*b*) the fair market value of a property deemed by paragraph (*a*) to be transferred is deemed to be the total of all amounts each of which is the absolute value of an increase or a decrease referred to in paragraph (*a*) in respect of the property;

(*c*) an entity (referred to in this paragraph as the “transferor”) is deemed to have transferred property to a trust when it transfers or loans property (other than by way of an arm's length transfer) to another entity (referred to in this paragraph as the “recipient”) if

(i) at or after the time of the transfer, the trust holds property the fair market value of which is derived in whole or in part, directly or indirectly, from property held by the recipient, and

(ii) it is reasonable to conclude that one of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the transfer or loan was to permit or facilitate, directly or indirectly, the conferral at any time of a benefit (for greater certainty, including an interest as a beneficiary under a trust) on

(A) the transferor,

(B) a descendant of the transferor, or

(C) an entity with whom the transferor or descendant does not deal at arm's length;

(*d*) the fair market value of a property deemed by paragraph (*c*) to be transferred is deemed to be the fair market value of the property referred to in that paragraph that was actually transferred or loaned;

(*e*) if, at any time, an entity has given a guarantee on behalf of, or has provided any other financial assistance to, another entity, the entity is deemed to have transferred, at that time, property to that other entity;

(*f*) if, at any time after June 22, 2000, an entity (referred to in this paragraph as a "service provider") renders any service (other than an exempt service) to, for or on behalf of, another entity (referred to in this paragraph as a "recipient"), the service provider is deemed to have transferred, at that time, property to the recipient;

(*g*) each of the following acquisitions of property by a particular entity is deemed to be a transfer of the property, at the time of the acquisition of the property, to the particular entity from the entity from which the property was acquired, namely the acquisition by the particular entity of

(i) a share of the capital stock of a corporation from the corporation,

(ii) an interest as a beneficiary under a trust (otherwise than as a consequence of a disposition of the interest by a beneficiary under the trust),

(iii) an interest in a partnership (otherwise than as a consequence of a disposition of the interest by a member of the partnership),

(iv) an interest in an entity that is not a corporation, partnership or trust (otherwise than as a consequence of a disposition of the interest by an entity having an interest in the entity),

(v) a debt owing by an entity from the entity, and

(vi) a right (granted after June 22, 2000 by the entity from which the right was acquired) to acquire or to be loaned property;

(*h*) the fair market value of property deemed by paragraph (*e*) or (*f*) to have been transferred is deemed to be the fair market value, at the time of the transfer, of the assistance, service or right to which the property relates;

(*i*) a particular entity that at any time becomes obligated to do an act that would constitute the transfer of a property to another entity if the act occurred is deemed to have become obligated at that time to transfer property to that other entity;

(*j*) for the purpose of applying at any time the definition "non-resident time" in subsection (1), if a trust acquires property of an individual as a consequence of the death of the individual, the individual is deemed to have transferred the property to the trust immediately before the individual's death;

(*k*) a transfer or loan of property at any time is deemed to be made at that time jointly by a particular entity and another entity (referred to in this paragraph as the "specified entity") if

(i) the particular entity transfers or loans property at that time to another entity,

(ii) the transfer or loan is made at the direction, or with the acquiescence, of the specified entity, and

(iii) it is reasonable to conclude that one of the reasons the transfer or loan is made is to avoid or minimize the liability, of any entity, under this Part that arose, or that would otherwise have arisen, because of the application of subsection (3);

(*l*) a transfer or loan of property at any time is deemed to be made at that time jointly by a particular entity and another entity (referred to in this paragraph as the "specified entity") if

(i) the particular entity transfers or loans property at that time to another entity,

(ii) the transfer or loan is made at the direction, or with the acquiescence, of the specified entity,

(iii) that time is not, or would not be, if the transfer or loan were a contribution of the specified entity, a non-resident time of the specified entity, and

(iv) either

(A) the particular entity is, at that time, an entity that is a controlled foreign affiliate of the specified entity, or would at that time be a controlled foreign affiliate of the specified entity if the specified entity were at that time resident in Canada, or

(B) it is reasonable to conclude that the transfer or loan was made in contemplation of the particular entity becoming after that time a particular entity described in clause (A);

(*m*) for greater certainty, a taxpayer is deemed to have transferred, at a particular time, property to a corporation if

(i) at that time

(A) the taxpayer holds a share of the capital stock of the corporation, and

(B) the terms or conditions of the share change, or

(ii) as consideration for the disposition at or before the particular time of any property, the taxpayer received or became entitled to receive from the corporation a share of the capital stock of the corporation;

(*n*) a contribution made at any time by a particular trust to another trust is deemed to have been made at that time jointly by the particular trust and by each entity that is at that time a contributor to the particular trust;

(*o*) a contribution made at any time by a particular partnership to a trust is deemed to have been made at that time jointly by the particular partnership and by each entity that is at that time a member of the particular partnership (other than a member of the particular partnership where the liability of the member as a member of the particular partnership is limited by operation of any law governing the partnership arrangement);

(*p*) subject to subsection (9), the amount of a contribution to a trust at the time it was made is deemed to be the fair market value, at that time, of the property that was the subject of the contribution;

(*q*) an entity that at any time acquires a treasury interest in a trust from another entity (other than the trust that issued the treasury interest) is deemed to have made at that time a contribution to the trust and the amount of the contribution is deemed to be equal to the fair market value at that time of the treasury interest;

(*r*) a particular entity that has made a particular contribution to a trust as a consequence of having acquired a treasury interest in the trust is, for the purpose of applying this section at any time after the time another entity acquires the treasury interest from the particular entity, deemed not to have made the particular contribution if

(i) in exchange for the transfer, the other entity transfers or loans property, or becomes obligated to transfer or loan property, to the particular entity, and

(ii) it is reasonable to conclude, having regard only to the transfer (or the obligation, as the case may be) and the property, that

(A) the exchange is one that entities dealing at arm's length with one another would have been willing to carry out, and

(B) the terms and conditions made or imposed in respect of the exchange are terms and conditions that would have been acceptable to entities dealing at arm's length with one another;

(*s*) a transfer to a trust by a particular entity is, at a particular time, deemed not to be a contribution to the trust if

(i) the particular entity has transferred, at or before the particular time and in the ordinary course of business of the particular entity, property to the trust,

(ii) the transfer is not an arm's length transfer, but would be an arm's length transfer if the definition "arm's length transfer" in subsection (1) were read without reference to paragraph (*a*), and subparagraphs (*b*)(i) to (iii) and (v) to (viii), of that definition,

(iii) it is reasonable to conclude that the particular entity was the only entity that acquired, in respect of the transfer, an interest as a beneficiary under the trust,

(iv) the particular entity was required, under the securities law of a country or of a political subdivision of the country in respect of the issuance by the trust of interests as a beneficiary under the trust, to acquire an interest because of the particular entity's status at the time of the transfer as a manager or promoter of the trust,

(v) at the particular time the trust is not an exempt foreign trust, but would be at that time an exempt foreign trust if it had not made an election under paragraph (*i*) of the definition "exempt foreign trust", and

(vi) the particular time is before the earliest of

(A) the first time at which the trust becomes an exempt foreign trust,

(B) the first time at which the particular entity ceases to be a manager or promoter of the trust, and

(C) the time that is 24 months after the first time at which the total fair market value of consideration received by the trust in exchange for interests as a beneficiary (other than the particular entity's interest referred to in subparagraph (iii)) under the trust is greater than $500,000;

(*t*) a transfer to a trust by a Canadian corporation of a particular share of the capital stock of the Canadian corporation is, after a particular time, deemed not to be a contribution by the Canadian corporation to the trust if

(i) the trust acquired the particular share before the particular time from the Canadian corporation in circumstances described in paragraph 94(2)(*g*),

(ii) the trust transfers the particular share (referred to in this paragraph as the "sale") at the particular time to another entity,

(iii) in exchange for the sale, the other entity transfers or becomes obligated to transfer property (referred to in this paragraph as the "consideration"), to the trust, and

(iv) it is reasonable to conclude

(A) having regard only to the sale and the consideration that the trust would have been willing to make the sale if the trust dealt at arm's length with the other entity,

(B) that the terms and conditions made or imposed in respect of the exchange are terms and conditions that would have been acceptable to the trust if the trust dealt at arm's length with the other entity, and

(C) that the value of the consideration is not, at or after the particular time, determined in whole or in part, directly or indirectly, by reference to the particular share; and

(*u*) a transfer, before Announcement Date, to a personal trust by an individual (other than a trust) of particular property is deemed not to be a contribution of the particular property by the individual to the trust if

(i) the individual identifies the trust in prescribed form filed with the Minister on or before the individual's filing-due date for the individual's 2003 taxation year (or a later date that is acceptable to the Minister), and

(ii) the Minister is satisfied that

(A) the trust has never acquired, directly or indirectly from the individual or from any entity not dealing at any time at arm's length with the individual, restricted property,

(B) in respect of each contribution (determined without reference to this paragraph) made before Announcement Date by the individual to the trust, none of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the contribution was to permit or facilitate, directly or indirectly, the conferral at any time of a benefit (for greater certainty, including an interest as a beneficiary under the trust) on

(I) the individual,

(II) a descendant of the individual, or

(III) any entity with whom the individual or descendant does not, at any time, deal at arm's length, and

(C) the total of all amounts each of which is the amount of a contribution (determined without reference to this paragraph) made before Announcement Date by the individual to the trust does not exceed the greater of

(I) 1% of the total of all amounts each of which is the amount of a contribution (determined without reference to this paragraph) made to the trust before Announcement Date, and

(II) $500.

Liabilities of non-resident trusts and others

(3) Where at the end of a particular taxation year of a trust (other than a trust that is, at that time, an exempt foreign trust) the trust is non-resident (determined without reference to this subsection) and, at that time, there is a resident contributor to the trust or a resident beneficiary under the trust,

(*a*) subject to subsection (4), the trust is deemed to be resident in Canada throughout the particular taxation year for the purposes of

(i) section 2,

(ii) computing the trust's income for the particular taxation year,

(iii) applying subsections 104(13.1) to (29) and 107(2.1) and (5), in respect of the trust and a beneficiary under the trust,

(iv) applying clause 53(2)(*h*)(i.1)(B), the definition "non-resident entity" in subsection 94.1(1), subsection 107(2.002) and section 115, in respect of a beneficiary under the trust,

(v) determining an obligation of the trust to file a return under section 233.3 or 233.4,

(vi) determining the rights and obligations of the trust under Divisions I and J, and

(vii) determining the liability of the trust for tax under Part I, and under Part XIII on amounts paid or credited to the trust;

(*b*) if the trust elects, by notifying the Minister in writing in its return of income for the particular taxation year, to have this paragraph apply, the trust's income for the particular taxation year (other than the portion of the income that is from sources inside Canada or that is from a source, outside Canada, that is a business carried on by the trust outside Canada) is deemed, for the purposes of subsections 20(11) and (12) and section 126,

(i) to be income of the trust from sources (other than a business carried on by the trust) in a particular country (other than Canada) in which the trust is resident (determined without reference to this subsection), and

(ii) not to be from any other source;

(*c*) for the purpose of subsection 128.1(1), the trust is deemed to have become resident in Canada immediately after the end of its taxation year (referred to in this paragraph as the "preceding year") immediately preceding the particular taxation year if the trust was non-resident throughout the preceding year for the purpose of Part I or of computing its income for the preceding year;

(*d*) subject to subsection (7), each entity that at any time in the particular taxation year is a resident contributor to the trust or a resident beneficiary under the trust

(i) has jointly and severally, or solidarily, with the trust and with each other such entity, the rights and obligations of the trust in respect of the particular taxation year under Divisions I and J, and

(ii) is subject to Part XV in respect of those rights and obligations; and

(*e*) each entity that at any time in the particular taxation year is a beneficiary under the trust and was a person from whom an amount would be recoverable at the end of 2002 under subsection 94(2) (as it read in its application to taxation years that began before 2003) in respect of the trust if the entity had received before 2003 amounts described under paragraphs 94(2)(*a*) or (*b*) in respect of the trust (as those paragraphs read in their application to taxation years that began before 2003)

(i) has, to the extent of the entity's recovery limit for the year, jointly and severally, or solidarily, with the trust and with each other such entity, the rights and obligations of the trust in respect of the taxation years, of the trust, that began before 2003 under Divisions I and J, and

(ii) is, to the extent of the entity's recovery limit for the year, subject to Part XV in respect of those rights and obligations.

Excluded provisions

(4) Paragraph (3)(*a*) does not apply for the purposes of

(*a*) subsection 73(1), paragraph 107.4(1)(*c*) (other than subparagraph 107.4(1)(*c*)(i)), paragraph (*a*) of the definition "mutual fund trust" in subsection 132(6), and subparagraph (*f*)(ii) of the definition "disposition" in subsection 248(1);

(*b*) determining the liability of a person that arises under section 215; and

(*c*) the definitions "arm's length transfer" and "exempt foreign trust" in subsection (1).

Deemed cessation of residence

(5) A trust is deemed to cease to be resident in Canada at the earliest time at which there is neither a resident contributor to the trust nor a resident beneficiary under the trust in a period that would, if this Act were read without reference to this subsection and subsection 128.1(4), be a taxation year of the trust

(*a*) that immediately follows a taxation year of the trust throughout which it was resident in Canada;

(*b*) at the beginning of which there was a resident contributor to the trust, or a resident beneficiary under the trust; and

(*c*) at the end of which the trust is non-resident.

Becoming or ceasing to be an exempt foreign trust

(6) Where at any time a trust becomes or ceases to be an exempt foreign trust (otherwise than because of becoming resident in Canada),

(*a*) its taxation year that would otherwise include that time is deemed to have ended immediately before that time and a new taxation year of the trust is deemed to begin at that time; and

(*b*) for the purpose of determining the trust's fiscal period after that time, the trust is deemed not to have established a fiscal period before that time.

Limit to amount recoverable

(7) The maximum amount recoverable under the provisions referred to in paragraph (3)(*d*) at any time from an entity in respect of a trust (other than an entity that is deemed, by subsection (12) or (13), to be a contributor or a resident contributor to the trust) and a particular taxation year of the trust is the entity's recovery limit at that time in respect of the trust and the particular year if

(*a*) either

(i) the entity is liable under a provision referred to in paragraph (3)(*d*) in respect of the trust and the particular year solely because the entity was a resident beneficiary under the trust at the end of the particular year, or

(ii) at the end of the particular year, the total of all amounts each of which is the amount, at the time it was made, of a contribution to the trust made before the end of the particular year by the entity, or by another entity not dealing at arm's length with the entity, is not more than the greater of

(A) $10,000 and

(B) 10% of the total of all amounts each of which was the amount, at the time it was made, of a contribution made to the trust before the end of the particular year;

(*b*) except where the total determined in subparagraph (*a*)(ii) in respect of the entity and all entities not dealing at arm's length with it is $10,000 or less, the entity has filed on a timely basis under section 233.2 all information returns required to be filed by it before that time in respect of the trust (or on any later day that is acceptable to the Minister); and

(*c*) it is reasonable to conclude that each transaction or event that occurred before the end of the particular year at the direction of, or with the acquiescence of, the entity satisfied the following conditions:

(i) none of the purposes of the transaction or event was to enable the entity to avoid or minimize any liability under a provision referred to in paragraph (3)(*d*) in respect of the trust, and

(ii) the transaction or event was not part of a series of transactions or events any of the purposes of which was to enable the entity to avoid or minimize any liability under a provision referred to in paragraph (3)(*d*) in respect of the trust.

Recovery limit

(8) The recovery limit referred to in paragraph (3)(*e*) and subsection (7) at a particular time of a particular entity in respect of a trust and a particular taxation year of the trust is the amount, if any, by which the greater of

(*a*) the total of all amounts each of which is

(i) an amount received or receivable after 2000 and before the particular time

(A) by the particular entity on the disposition of all or part of the particular entity's interest as a beneficiary under the trust, or

(B) by another entity (that was, at the time the amount became receivable, a specified party in respect of the particular entity) on the disposition of all or part of the specified party's interest as a beneficiary under the trust,

(ii) an amount (other than an amount described in subparagraph (i)) made payable by the trust after 2000 and before the particular time to

(A) the particular entity because of the interest of the particular entity as a beneficiary under the trust, or

(B) another entity (that was, at the time the amount became payable, a specified party in respect of the particular entity) because of the interest of the specified party as a beneficiary under the trust,

(iii) an amount (other than an amount described in subparagraph (i) or (ii)) that is the fair market value of a benefit received or enjoyed, after 2000 and before the particular time, from or under the trust by

(A) the particular entity, or

(B) another entity that was, at the time the benefit was received or enjoyed, a specified party in respect of the particular entity, or

(iv) the maximum amount that would be recoverable from the particular entity at the end of 2002 under subsection 94(2) (as it read in its application to taxation years that began before 2003) if the trust had tax payable under this Part at the end of 2002 in excess of the total of the amounts described in respect of the entity under paragraphs 94(2)(*a*) and (*b*) (as they read in their application to taxation years that began before 2003), except to the extent that the amount so recoverable is in respect of an amount that is included in the particular entity's recovery limit because of subparagraph (i) or (ii), and

(*b*) the total of all amounts each of which is the amount, when made, of a contribution to the trust before the particular time by the particular entity,

exceeds the total of all amounts each of which is

(*c*) an amount recovered before the particular time from the particular entity in connection with a liability of the particular entity (in respect of the trust and the particular year or a preceding taxation year of the trust) that arose because of the application of subsection (3) (or the application of section 94 as it read in its application to taxation years that began before 2003),

(*d*) an amount (other than an amount in respect of which this paragraph has applied in respect of any other entity) recovered before the particular time from a specified party in respect of the particular entity in connection with a liability of the particular entity (in respect of the trust and the particular year or a preceding taxation year of the trust) that arose because of the application of subsection (3) (or the application of section 94 as it read in its application to taxation years that began before 2003), or

(*e*) the amount, if any, by which the particular entity's tax payable under this Part for any taxation year in which an amount described in any of subparagraphs (*a*)(i) to (iv) was paid, became payable, was received, became receivable or was enjoyed by the particular entity exceeds the amount that would have been the particular entity's tax payable under this Part for that taxation year if no such amount were paid, became payable, were received, became receivable or were enjoyed by the particular entity in that taxation year.

Determination of contribution amount – special case

(9) If a contribution is made at any time by an entity to a trust as a consequence of a transaction that is, or as a consequence of a series of transactions or events that includes, the transfer at that time to the trust of a specified property, the amount of the contribution at the time it is made, is deemed, for the purposes of clause 94(2)(*u*)(ii)(C), subparagraph (7)(*a*)(ii) and subsection (8), to be the greater of

(*a*) the amount, determined without reference to this subsection, of the contribution at that time; and

(*b*) the amount that is the greatest fair market value of the specified property, or property substituted for it, in the period that

(i) begins immediately after that time, and

(ii) ends at the end of the third calendar year that ends after that time.

Where contributor becomes resident in Canada within 60 months after contributing

(10) In applying the definition "connected contributor" at the end of each taxation year of a trust that ends before the particular time at which a contributor to the trust becomes resident in Canada within 60 months after making a contribution to the trust, the contribution is deemed to have been made at a time other than a non-resident time of the contributor if

(*a*) in applying the definition "non-resident time" as of the end of each of those taxation years, the contribution was made at a non-resident time of the contributor; and

(*b*) in applying the definition "non-resident time" immediately after the particular time, the contribution is made at a time other than a non-resident time of the contributor.

Application of subsection (12) and (13)

(11) Subsections (12) and (13) apply to a trust or an entity in respect of a trust if

(*a*) at any time property of a trust (referred to in this subsection and subsections (12) and (13) as the "original trust") is transferred or loaned, directly or indirectly, in any manner, to another trust (referred to in this subsection and subsections (12) and (13) as the "transferee trust");

(*b*) the original trust is deemed because of paragraph (3)(*a*) (or was deemed because of subsection (1) as it read in its application to taxation years that began before 2003) to be resident in Canada immediately before that time; and

(*c*) it is reasonable to conclude that one of the reasons the transfer or loan is made is to avoid or minimize a liability under this Part that arose, or that would otherwise have arisen, because of the application of subsection (3) (or because of subsection (1) as it read in its application to taxation years that began before 2003).

Deemed resident contributor

(12) The original trust described in subsection (11) (including a trust that has ceased to exist) is deemed to be, at and after the time of the transfer or loan referred to in subsection (11), a resident contributor to the transferee trust for the purpose of applying this section in respect of the transferee trust.

Deemed contributor

(13) An entity (including any entity that has ceased to exist) that is, at the time of the transfer or loan referred to in subsection (11), a contributor to the original trust, is deemed to be at and after that time

(*a*) a contributor to the transferee trust; and

(*b*) a connected contributor to the transferee trust, if at that time the entity is a connected contributor to the original trust.

(2) Subsection (1) applies to trust taxation years that begin after 2002, except that

(*a*) it also applies to taxation years that begin in 2001 and 2002 of a trust if the trust was created in 2001 and elects, in writing, to have section 94 of the Act, as enacted by subsection (1), apply to those taxation years by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which this Act is assented to;

(*b*) it also applies to taxation years that begin in 2002 of a trust if the trust was created in 2002 and elects, in writing, to have section 94 of the Act, as enacted by subsection (1), apply to those taxation years by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which this Act is assented to;

(*c*) an election referred to in paragraph (*i*) of the definition "exempt foreign trust" in subsection 94(1) of the Act, as enacted by subsection (1), made by a trust in respect of a taxation year that ends before this Act is assented to is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the trust's filing-due date for the taxation year of the trust that includes the day on which this Act is assented to;

(*d*) the phrase "if the entity is an individual and the trust arose as a consequence of the death of the individual, 18 months before the contribution time" in the definition "non-resident time" in subsection 94(1) of the Act, as enacted by subsection (1), shall, in respect of contributions made before June 23, 2000 be read as "if the contribution time is before June 23, 2000, 18 months before the end of the trust's taxation year that includes the contribution time"; and

(*e*) if a trust elects, by notifying the Minister of National Revenue in writing on or before its filing-due date for its taxation year that includes the day on which this Act is assented to, in applying section 94 of the Act, as enacted by subsection (1), in respect of the trust the definition "arm's length transfer" in subsection 94(1) of the Act, as enacted by subsection (1), does not include a loan or other transfer of property that is identified in the election and that is made in a taxation year that begins before 2003.

12. (1) Section 94.1 of the Act is replaced by the following:

Foreign Investment Entities – Accrual Treatment

Definitions

94.1(1) The definitions in this subsection apply in this section and sections 94.2 and 94.3.

"beneficiary"
« bénéficiare »

"beneficiary" has, except for the purpose of paragraph 94.2(11)(*f*), the meaning assigned by subsection 94(1).

"carrying value"
« valeur comptable »

"carrying value", at any time of property of an entity, means

(*a*) the fair market value at that time of the property, if

(i) the taxpayer elects, by notifying the Minister in writing in the taxpayer's return of income for the taxpayer's taxation year that includes that time, to have this paragraph apply to all of the property of the entity, and

(ii) the property is property that would be valued for the purpose of the entity's balance sheet if paragraph (*b*) applied at that time; and

(*b*) in any other case, the amount at which the property would be valued for the purpose of the entity's balance sheet as of that time if that balance sheet

(i) were prepared in accordance with generally accepted accounting principles used in Canada at that time or in accordance with accounting principles substantially similar to generally accepted accounting principles used in Canada at that time, and

(ii) included property that is deemed by paragraph (2)(*j*) to be owned at that time by the entity.

“designated cost”
« coût designé »

“designated cost”, to a taxpayer at any time of a participating interest held, at that time, by the taxpayer in a foreign investment entity, is the amount determined by the formula

$$A + B + C + D + E + F$$

where

A is the cost amount to the taxpayer of the participating interest at that time (determined without reference to paragraphs 53(1)(*m*), (*m*.2) and (*q*) and 53(2)(*g*) and (*g*.1) and section 143.2),

B is an amount included in respect of the participating interest because of this section in computing the taxpayer’s income for a taxation year that ends after 2002 and before that time,

C is, if the participating interest was an offshore investment fund property (as defined in subsection 94.1(1) as it read in its application to taxation years that began before 2003) of the taxpayer at the end of the taxpayer’s last taxation year that began before 2003, the total of all amounts each of which is the amount determined, in respect of the offshore investment fund property for that last taxation year, under variable B, C or D of the definition “designated cost” in subsection 94.1(2) (as it reads in its application to that last taxation year),

D is, if the participating interest was acquired by the taxpayer before 2003, and was not an offshore investment fund property (as defined in subsection 94.1(1) as it read in its application to taxation years that began before 2003) of the taxpayer at the end of the taxpayer’s last taxation year that began before 2003, the amount, if any, by which the fair market value of the participating interest at the end of that last taxation year exceeds the cost amount to the taxpayer of the participating interest at the end of that last taxation year,

E is, if one or more particular amounts has been made available by a person to another person after the last 2002 taxation year of the foreign investment entity and before that time (whether by way of gift, loan, payment for a share, transfer of property at less than its fair market value or otherwise) in circumstances in which it can reasonably be concluded that one of the main reasons for making the particular amount available to the other person was to increase the value of the participating interest, the total of all amounts each

of which is the amount, if any, by which each particular amount exceeds any increase in the cost amount to the taxpayer of the participating interest because of that particular amount, and

F is, if the participating interest is acquired by the taxpayer after 2002, the amount, if any, by which the fair market value of the participating interest at the time it was so acquired exceeds the cost amount to the taxpayer of the participating interest at the time it was so acquired.

"entity"
« entité »

"entity" includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust, but does not include a natural person.

"exempt business"
« enterprise exempte»

"exempt business", of an entity, means a business (other than any business conducted principally with entities with whom the entity does not deal at arm's length or a business carried on by a trust that is an exempt foreign trust because of paragraph (*i*) of the definition "exempt foreign trust" in subsection 94(1)) that, throughout the part of the period during which the business was carried on by the entity (other than as a member of a partnership that is not a qualifying member of the partnership, or that would not be a qualifying member if the entity were a person), is

(*a*) carried on by the entity as a foreign bank, a trust company, a credit union, an insurance corporation or, if the entity is controlled by a taxpayer resident in Canada that is described in subparagraph 95(2.1)(*a*)(i), a trader or dealer in securities or commodities, the activities of which business are regulated under the laws

(i) of each country in which the business is carried on, and the country under whose laws the entity

(A) is governed, and

(B) exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued,

(ii) of the country in which the business is principally carried on, or

(iii) if the entity is a corporation that is related to another corporation and the regulating laws are recognized under the laws of the country (that is a member of the European Union) in which the business is principally carried on, the country (that is a member of the European Union) under whose laws the other corporation

(A) is governed, and

(B) exists, was (unless the other corporation was continued in any jurisdiction) formed or organized, or was last continued; or

(*b*) a business the principal purpose of which is to derive income from

(i) the development and exploitation of Canadian resource property, of foreign resource property, of timber resource property or of any combination of them,

(ii) the leasing or licensing of property that the entity or another entity related to the entity manufactured, produced, developed or purchased and developed,

(iii) the leasing of machinery or equipment that is owned by the entity and that is used by the lessee principally for the purpose of manufacturing or processing goods,

(iv) the sale of real estate developed by the entity, an entity related to the entity, or a partnership of which the entity or the related entity is a qualifying member (or would be a qualifying member if the entity were a person),

(v) the rental of real estate held by the entity or a partnership of which the entity is a qualifying member (or would be a qualifying member if the entity were a person), if the management, maintenance, and other services in respect of the real estate are provided primarily by the employees of

(A) the entity,

(B) a corporation related to the entity,

(C) the partnership,

(D) a qualifying member (or an entity that would be a qualifying member if the entity were a person) of the partnership, or

(E) or any combination of employers described in clauses (A) to (D), or

(vi) a combination of businesses described in subparagraphs (iv) and (v).

"exempt interest"
« participation exempte »

"exempt interest", of a taxpayer in a foreign investment entity at any time, means a participating interest held, at that time, by the taxpayer, in the foreign investment entity, if

(*a*) the foreign investment entity is throughout the period, in the taxpayer's taxation year that includes that time, during which the participating interest was held by the taxpayer, either

(i) a controlled foreign affiliate of the taxpayer, or

(ii) a qualifying entity;

(*b*) the participating interest is, at that time, a mark-to-market property (within the meaning assigned by subsection 142.2(1)) and the taxpayer is, throughout its taxation year that includes that time, a financial institution (within the meaning assigned by subsection 142.2(1));

(*c*) the participating interest is a right (including, for greater certainty, a right that replaces another right)

(i) under an employee stock option plan, or similar agreement, to acquire a share of the capital stock of the foreign investment entity,

(ii) granted by the foreign investment entity, or another entity with which the foreign investment entity does not deal at arm's length,

(iii) acquired by the taxpayer at a time when the taxpayer dealt at arm's length with the entity that granted the right, and

(iv) the taxpayer's entitlement to which arises solely because the taxpayer was an employee of an entity referred to in subparagraph (ii);

(*d*) the foreign investment entity is an entity all or substantially all of the carrying value of the property of which is attributable to

properties that are participating interests in another entity (that is not a foreign investment entity) that is, or is related to, an entity that employs the taxpayer, and an amount that is all or substantially all of the foreign investment entity's income, profits and gains for its taxation year that includes that time becomes payable

(i) by it to its interest holders and the taxpayer's share of that amount is included in computing the taxpayer's income for the taxpayer's taxation year in which that taxation year of the foreign investment entity ends, or

(ii) by it to its interest holders within 120 days after the end of that taxation year, and the taxpayer's share of that amount is included in computing the taxpayer's income for the taxpayer's taxation year that includes the time at which it became payable; or

(*e*) it is reasonable to conclude that the taxpayer had no tax avoidance motive for the acquisition of the participating interest, and the foreign investment entity

(i) is resident in a country in which there is a prescribed stock exchange and participating interests in the foreign investment entity that are identical to the participating interest are widely held and actively traded and listed on a prescribed stock exchange throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest, or

(ii) is governed by, and exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued under the laws of, a particular country (other than a prescribed country) with which Canada has entered into a tax treaty, is, throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest, resident under that treaty in the particular country, and

(A) participating interests that are identical to the participating interest in the foreign investment entity are widely held and actively traded, or

(B) if the particular country is the United States of America, the taxpayer is resident in Canada throughout that period, and the taxpayer is liable for and subjected to income tax in the particular country for that taxation year because the taxpayer is a citizen of the particular country.

“exempt property”
« bien exempt »

“exempt property”, of a particular entity at any time, means, in determining whether a particular taxpayer’s interest in the particular entity is a participating interest in a foreign investment entity,

(*a*) a property, of the particular entity, that is at that time used or held principally in a business (other than a business that is at that time an investment business carried on by the particular entity or by another entity related, otherwise than by reason of a right referred to in paragraph 251(5)(*b*), to the particular entity) carried on by the particular entity or another entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity;

(*b*) indebtedness owing by another entity (referred to in this paragraph as the “indebted entity”), if

(i) each of the particular entity and the indebted entity is, at that time,

(A) a foreign affiliate

(I) of the particular taxpayer, and

(II) in respect of which the particular taxpayer has a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)), or

(B) a foreign affiliate

(I) of another entity that is resident in Canada and of which the particular taxpayer is a controlled foreign affiliate, and

(II) in respect of which the other entity referred to in subclause (I) has a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)), and

(ii) the indebtedness would be excluded property (within the meaning of the definition “excluded property” in subsection 95(1)) of the particular entity, if

(A) the taxpayer referred to in that definition were the particular taxpayer and the foreign affiliate of the taxpayer referred to in that definition were the particular entity, or

(B) the taxpayer referred to in that definition were the other entity described in subclause (i)(B)(I) and the foreign affiliate of the taxpayer referred to in that definition were the particular entity; and

(*c*) a particular property, if

(i) the particular property (or other property for which the particular property is substituted) was acquired by the particular entity at any time within the 36-month period that ends at the particular time (or within any longer period that ends at the particular time that the Minister considers reasonable if the particular entity applies, in writing, to the Minister within 36 months after the property was acquired by the particular entity) because the particular entity

(A) issued a debt or a participating interest in the particular entity,

(B) disposed of property used principally in a business, other than an investment business, carried on by the particular entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity,

(C) disposed of a participating interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business, other than an investment business, carried on by the other entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the other entity, or

(D) accumulated income of the particular entity derived from a business, other than an investment business, carried on by the particular entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity, and

(ii) the issuance, disposition or accumulation referred to in subparagraph (i) was made or amassed for the purpose of

(A) acquiring property to be used principally in, or making expenditures for the purpose of earning income from, a business, other than an investment business, carried on by the particular entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity, or

(B) acquiring a participating interest that is a significant interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business, other than an investment business, carried on by the other entity.

"exempt taxpayer"
« contribuable exempté »

"exempt taxpayer", for a taxation year, means

(*a*) an individual (other than a trust) who, before the end of the year, was resident in Canada for a period of, or periods the total of which is, not more than 60 months, but not including an individual who, before the end of the year, was never non-resident; and

(*b*) a person the taxable income of which for a period any part of which occurs in the year is exempt from tax under this Part because of subsection 149(1) (otherwise than because of paragraph 149(1)(*q*.1), (*t*) or (*z*)).

"foreign bank"
« banque étrangère »

"foreign bank" has the same meaning as in subsection 95(1).

"foreign investment entity"
« entité de placement étrangère »

"foreign investment entity", at any time, means an entity that is, at that time, a non-resident entity unless, at the end of its taxation year that includes that time

(*a*) it is a partnership;

(*b*) it is an exempt foreign trust (in this paragraph having the meaning assigned by the definition "exempt foreign trust" in subsection 94(1)) other than a trust that is an exempt foreign trust because of paragraph (*h*) or (*i*) of that definition;

(*c*) the carrying value of all of its investment property is not greater than one-half of the carrying value of all of its property; or

(*d*) its principal business is not an investment business.

"investment business"
« entreprise de placement »

"investment business", of an entity in a period, means a business (other than an exempt business) carried on by the entity (including, for greater certainty, a business carried on by the entity as a member of a partnership) at any time in the period, the principal purpose of which is to derive income or profits described in any of the following paragraphs:

(*a*) income (including interest, dividends, rents, royalties or any similar return on investment or any substitute for such a return) from property;

(*b*) income from the insurance or reinsurance of risks;

(*c*) income from the factoring of trade accounts receivable; or

(*d*) profits from the disposition of investment property.

"investment property"
« bien de placement »

"investment property", of a particular entity at any time, does not (except for the purpose of applying the definition "investment business" in this subsection or the definition "tracking entity" in subsection 94.2(1)) include exempt property of the particular entity, but does include property of the particular entity that is at that time

(*a*) a share of the capital stock of a corporation (other than a share of the particular entity, a share of a corporation that is a qualifying entity in which the particular entity has a significant interest or a share of a corporation that is a qualifying entity that has a significant interest in the particular entity);

(*b*) an interest as a member of a partnership (other than an interest in a partnership that is a qualifying entity in which the particular entity has a significant interest or an interest in a partnership that

is a qualifying entity that has a significant interest in the particular entity);

(*c*) an interest as a beneficiary under a trust;

(*d*) an interest in any other entity;

(*e*) indebtedness (other than indebtedness owing by a qualifying entity in which the particular entity has a significant interest or indebtedness owing by a qualifying entity that has a significant interest in the particular entity);

(*f*) an annuity;

(*g*) a commodity (other than a commodity, referred to in this definition as an "exempt commodity", that is manufactured, produced, grown, extracted or processed by the particular entity or a person related to the particular entity, otherwise than because of a right referred to in paragraph 251(5)(*b*)) or commodity future (other than a commodity future in respect of an exempt commodity) purchased or sold, directly or indirectly in any manner whatever, on a commodities or commodities futures exchange);

(*h*) real estate;

(*i*) a Canadian resource property or a foreign resource property;

(*j*) currency;

(*k*) a derivative financial product (other than a commodity future in respect of an exempt commodity); or

(*l*) an interest, an option, or a right in respect of property that is investment property because of any of paragraphs (*a*) to (*k*).

"net accounting income"
« résultat comptable net »

"net accounting income", of an entity for a taxation year of the entity, means the amount that would be its net income, before income taxes and extraordinary items, for the year in its financial statements for the year if those financial statements were prepared in accordance with generally accepted accounting principles used in Canada at the end of the year or in accordance with generally accepted accounting

principles substantially similar to generally accepted accounting principals used in Canada at the end of the year.

“non-resident entity”
« entité non-résidente »

“non-resident entity”, at any time, means

(*a*) a corporation or trust that is non-resident at that time; and

(*b*) any entity (other than a corporation or trust) that

(i) exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued under the laws of a country or a political subdivision of a country other than Canada, and

(ii) is governed at that time under the laws of that country or political subdivision.

“participating interest”
« participation déterminée »

“participating interest”, of a particular entity or individual in a non-resident entity, means

(*a*) if the non-resident entity is a corporation, a share of the capital stock of the corporation;

(*b*) if the non-resident entity is a trust, an indefeasibly vested interest as a beneficiary under the trust;

(*c*) if the non-resident entity is not a corporation or trust, an interest in the non-resident entity; and

(*d*) a property that is convertible into, exchangeable for, or confers a right to acquire, directly or indirectly,

(i) an interest, described in any of paragraphs (*a*) to (*c*), in the non-resident entity; or

(ii) a property the fair market value of which is determined primarily by reference to the fair market value of an interest, described in any of paragraphs (*a*) to (*c*), in the non-resident entity.

"qualifying entity"
« entité admissible »

"qualifying entity", in a period, means a particular entity that is a corporation or partnership all or substantially all of the carrying value of the property of which is, throughout the period, attributable to the carrying value of particular property that is, throughout the portion of the period that the particular property is property of the particular entity,

(*a*) property other than investment property;

(*b*) investment property that is a participating interest in or debt issued by another entity if, throughout the portion of the period that the participating interest or debt is property of the particular entity,

(i) the principal business of the other entity is not an investment business, and

(ii) either

(A) the particular entity has a significant interest in the other entity, or

(B) the particular entity

(I) actively participates in or exercises significant influence over the governance or the management of that other entity, directly or indirectly, by reason of its status as a holder of a significant number of participating interests in that other entity (when compared to the number of participating interests held by each other holder of interests in the corporation) or by reason of an agreement in writing between the particular entity and one or more other holders of a significant number of participating interests in that other entity, or

(II) carries out a plan of action that it has established for the purpose of obtaining its objective of actively participating in or exercising significant influence over the governance or the management of that other entity, directly or indirectly, by reason of its status as a holder of a significant number of participating interests in that other entity (when compared to the number of participating interests held by each other holder of interests in the particular entity) or by reason of an agreement in writing between the particular entity and

one or more other holders of a significant number of participating interests in that other entity;

(*c*) investment property in respect of which the particular entity establishes that the property or proceeds from the disposition of the property is to be used by the particular entity for the purpose of acquiring property described in paragraph (*a*) or (*b*); or

(*d*) investment property that is, at a particular time, a particular property held by the particular entity if

(i) the particular property (or other property for which the particular property is substituted property) was last acquired by the particular entity at any time within the 36-month period ending at the particular time (or within any longer period ending at the particular time that the Minister considers reasonable if the particular entity applies, in writing, to the Minister within 36 months after the property was acquired by the particular entity),

(ii) the particular property was acquired because the particular entity

(A) issued a debt, or a participating interest in it,

(B) disposed of property described in any of paragraphs (*a*) to (*c*), or

(C) accumulated its income, and

(iii) the issuance, disposition or accumulation referred to in subparagraph (ii) was made or amassed for the purpose of acquiring property that, if owned by the particular entity, would be property described in any of paragraphs (*a*) to (*c*).

"significant interest"
« participation notable »

"significant interest", of a particular entity in another entity at any time, means

(*a*) if the other entity is a corporation, a share of the capital stock of the corporation, if at that time the particular entity or the particular entity together with entities related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity holds shares of the capital stock of the corporation

(i) that would give the particular entity, or the particular entity together with entities related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity, 25% or more of the votes that could be cast under all circumstances at an annual meeting of shareholders of the corporation, and

(ii) that have a fair market value of 25% or more of the fair market value of all of the issued and outstanding shares of the corporation;

(*b*) if the other entity is a partnership, an interest of the particular entity as a member of the partnership, if at that time the particular entity, or the particular entity together with entities related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity, holds interests as a member of the partnership that have a fair market value of 25% or more of the fair market value of all membership interests in the partnership; and

(*c*) if the other entity is a non-discretionary trust, an interest as a beneficiary under the trust, if at that time the particular entity, or the particular entity together with entities related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity, holds such interests under the trust that have a fair market value of 25% or more of the fair market value of all the interests as beneficiaries under the trust.

"specified party"
« tiers déterminé »

"specified party" in respect of a particular individual or particular entity, as the case may be, means another individual or other entity that does not deal at arm's length with the particular individual or the particular entity, as the case may be.

"taxation year"
« année d'imposition »

"taxation year", of a non-resident entity that is not a corporation or an individual, means

(*a*) in respect of a business or property of the non-resident entity for which the accounts of the non-resident entity are ordinarily made up, the period that would be determined under section 249.1 in respect of the non-resident entity if the non-resident entity were a corporation; and

(*b*) in any other case, a calendar year.

Rules of Application

(2) For the purposes of applying this section and section 94.2 in respect of a particular participating interest in a particular non-resident entity (and in respect of any other participating interests in the particular non-resident entity that are identical to the participating interest) held by a taxpayer in a particular taxation year of the taxpayer,

(*a*) subject to paragraph (*b*),

(i) a consolidated balance sheet and statement of income (both of which are referred to in this paragraph as the "consolidated financial statements") of the particular non-resident entity that are prepared for a taxation year of the particular non-resident entity (referred to in this paragraph and paragraph (*b*) as the "specified year") are deemed to be the balance sheet and statement of income of the particular non-resident entity for the specified year, if they are prepared in accordance with generally accepted accounting principles used for the specified year in Canada or in accordance with generally accepted accounting principles that are substantially similar to those used for the specified year in Canada, and

(ii) the business and non-business activities, the net accounting income derived from those activities, and the assets and liabilities of each other entity (the assets, liabilities and income or loss of which are reflected in those consolidated financial statements) for the specified year are deemed to be those of the particular non-resident entity to the same extent as the particular non-resident entity's proportional interest in the retained earnings at the end of the specified year and income for the specified year of those other entities;

(*b*) if the taxpayer has, by notifying the Minister in writing in the taxpayer's return of income for the particular taxation year, elected to use for the particular taxation year, in respect of the particular participating interest, an unconsolidated balance sheet and an unconsolidated statement of income of the particular non-resident entity that are prepared for the specified year,

(i) paragraph (*a*) does not apply in respect of the particular participating interest (and any participating interests of the taxpayer in the particular non-resident entity that are identical to the particular participating interest) for the particular taxation year, and

(ii) the unconsolidated balance sheet and the unconsolidated statement of income are deemed to be the balance sheet and statement of income of the particular non-resident entity for the specified year of the particular non-resident entity, if they are prepared in accordance with generally accepted accounting principles used in Canada for the specified year or in accordance with generally accepted accounting principles that are substantially similar to those used in Canada for the specified year or would be so prepared if those principles did not require consolidation;

(*c*) generally accepted accounting principles used, for a taxation year, in the United States of America or in countries that are members of the European Union are, for greater certainty, considered to be substantially similar to those used in Canada in respect of that period;

(*d*) if there are at any particular time participating interests in the particular non-resident entity that can at or after the particular time be exchanged for or converted into participating interests in a non-resident entity (referred to in this paragraph as the "specified non-resident entity"),

(i) each of those exchangeable or convertible participating interests is deemed

(A) to have been immediately before the particular time exchanged for or converted into the number and types of participating interests (referred to in this paragraph as the "exchanged or converted participating interests") in the specified non-resident entity for which the exchangeable or convertible participating interests of the particular non-resident entity are exchangeable for or convertible into, and

(B) except in applying this paragraph, not to exist at the particular time, and

(ii) each entity that held, at the time immediately before the time that is immediately before the particular time, an exchangeable or convertible participating interest in the particular non-resident entity is deemed to have acquired immediately before the particular time the number and types of exchanged or converted participating interests in the specified non-resident entity for which the exchangeable or convertible participating interests of the particular non-resident entity are exchangeable for or convertible into;

(*e*) in determining whether the principal business of an entity is, in a taxation year of the entity, an investment business,

(i) subject to subparagraphs (ii) and (iii), the principal business of the entity is to be determined by reference to the facts and circumstances including the carrying value of assets used in the activities carried on, during the entity's taxation year, by the entity, the amount of time spent by the entity's employees in carrying out those activities, the amount of expenditures incurred by the entity in respect of those activities and the net accounting income derived by the entity from those activities,

(ii) subject to subparagraph (iii), if the taxpayer has, by notifying the Minister in writing in the taxpayer's return of income for the particular taxation year, elected to have this subparagraph apply in respect of the particular participating interest, the principal business of the entity for the taxation year of the entity is deemed

(A) to be an investment business if the total net accounting income of the entity, for the entity's taxation year, derived from investment property (other than investment property used or held in the course of carrying on an investment business) and from investment businesses is equal to or greater than the total net accounting income of the entity for the entity's taxation year derived from businesses (other than investment businesses), and

(B) not to be an investment business if the total net accounting income of the entity for the entity's taxation year derived from investment property (other than investment property used or held in the course of carrying on an investment business) and from investment businesses is less than the total net accounting income of the entity for the entity's taxation year derived from businesses (other than investment businesses) carried on by the entity in the entity's taxation year, and

(iii) if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether the principal business of the entity is in the entity's taxation year an investment business, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand, the principal business of the entity is deemed to be an investment business;

(*f*) participating interests in the particular non-resident entity that are identical to the particular participating interest of the taxpayer in the particular non-resident entity are not, at any particular time, widely held and actively traded unless, at the particular time

(i) there are at least 150 persons each of which holds participating interests in the particular non-resident entity that, at that time,

(A) are identical to the particular participating interest, and

(B) have a total fair market value of at least $500,

(ii) the total of all amounts each of which is the fair market value, at that time, of the particular participating interest or of a participating interest in the non-resident entity that is identical to the particular participating interest and that is held, at that time, by the taxpayer or an entity with whom the taxpayer does not deal at arm's length does not exceed 10% of the total of all amounts each of which is the fair market value, at that time, of a participating interest in the non-resident entity that is held, at that time, by any entity and that is identical to the particular participating interest, and

(iii) the participating interests in the non-resident entity that are identical to the particular participating interest

(A) are qualified for distribution to the general public under the securities law of the country or of a political subdivision of the country under the laws of which the particular non-resident entity

(I) is governed, and

(II) exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued, and

(B) can be purchased and sold by any member of the general public in the open market or can be purchased from and sold to the particular non-resident entity by any member of the general public;

(*g*) in applying subparagraph (*e*)(i) of the definition "exempt interest" in subsection (1), if the particular non-resident entity is not a corporation, a partnership or a trust, it is deemed not to be resident in a particular country, unless

(i) the particular country is a country other than a prescribed country,

(ii) the particular non-resident entity is governed, and exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued under the laws of, the particular country, and

(iii) the particular non-resident entity is liable, under the laws of the particular country, to pay an income or profits tax imposed by the government of the particular country on all of the particular non-resident entity's income, profits or gains;

(*h*) subject to paragraph (*i*), the particular non-resident entity is deemed to be a controlled foreign affiliate of the taxpayer throughout the period that begins at the earliest time in a taxation year (referred to in this paragraph as the "first CFA taxation year") of the taxpayer at which the non-resident entity is a foreign affiliate of the taxpayer and ends at the earliest subsequent time at which it is not a foreign affiliate of the taxpayer, if

(i) at any time in the first CFA taxation year, the taxpayer, or a controlled foreign affiliate of the taxpayer, holds a participating interest in the particular non-resident entity,

(ii) a taxation year of the particular non-resident entity ends in the first CFA taxation year,

(iii) the particular non-resident entity is, at the end of the first CFA taxation year, a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest within the meaning assigned by paragraph 95(2)(*m*),

(iv) the taxpayer elects in prescribed form in the taxpayer's return of income for the first CFA taxation year to treat the particular non-resident entity as a controlled foreign affiliate of the taxpayer, and

(v) the taxpayer has not made an election referred to in subparagraph (iv) in respect of the particular non-resident entity for any taxation year other than the first CFA taxation year;

(*i*) an election made by the taxpayer under subparagraph (*h*)(iv) is, other than for the purposes of applying this paragraph and subparagraph (*h*)(v), deemed never to have been made, if

(i) the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine an amount that would, if this Act were read without reference to this paragraph, be required to be added or deducted (otherwise than under subsection 104(13)) in computing the taxpayer's income for the year because of the application of section 91 and an election under subparagraph (*h*)(iv) in respect of a foreign affiliate, and

(ii) information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand;

(*j*) if the taxpayer has made for the particular taxation year a valid election under paragraph (*b*) in respect of the particular participating interest of the taxpayer, a particular entity (referred to in this paragraph as the "specified entity") has a significant interest in another entity that is a corporation, partnership or non-discretionary trust, and the significant interest is relevant in determining whether the particular non-resident entity is a foreign investment entity

(i) each of the following is deemed to be nil:

(A) the carrying value of each

(I) participating interest held, at the time (referred to in this paragraph as the "specified time") that is the end of the particular non-resident entity's last taxation year that ends in the particular taxation year, by the specified entity in the other entity, and

(II) debt owing at the specified time to the specified entity by the other entity (other than a debt acquired in the ordinary course of a business that is not at the specified time an investment business carried on by the specified entity), and

(B) the net accounting income of the specified entity at the specified time derived from property of the specified entity the carrying value of which is deemed to be nil under clause (A),

(ii) each property owned (or that is deemed by this subparagraph to be owned) at the specified time by the other entity (other than a debt owing to the other entity by the specified entity where the other entity and the specified entity are related to each other at the specified time) and that would be valued for the purpose of the balance sheet of the other entity at the specified time is deemed to be owned at the specified time by the specified entity and is deemed to have a carrying value at the specified time equal to the amount determined by the formula

$$A \times B/C$$

where

A is

(A) if the taxpayer has made an election under paragraph (*a*) of the definition "carrying value" in subsection (1) to value the property of the particular non-resident entity at its fair market value at the specified time, the fair market value of the property of the other entity at the specified time, or

(B) in any other case, the amount that would be the carrying value of the property of the other entity at the specified time if that definition were read without reference to paragraph (*a*),

B is the total of all amounts each of which is

(A) the fair market value at the specified time of a participating interest in the other entity owned at the specified time by the specified entity, and

(B) the fair market value at the specified time of a debt (other than a debt acquired in the ordinary course of a business that is not an investment business carried on by the specified entity) that the other entity owes at the specified time to the specified entity, and

C is the total of all amounts each of which is

(A) the fair market value at the specified time of a participating interest in the other entity owned at the specified time by an individual or an entity, and

(B) the fair market value at the specified time of a debt owing at the specified time by the other entity to a holder of a participating interest in the other entity (other than a debt acquired in the ordinary course of a business that is not an investment business carried on by a holder of a participating interest in the other entity), and

(iii) the specified entity is (to the extent of the proportion obtained when that the specified entity's interest at the specified time in the carrying value of the property of the other entity at the specified time as determined under subparagraph (ii) is divided by the total carrying value of the property of the other entity at the specified time as determined under subparagraph (ii)) deemed

(A) to have carried on the activities carried on at the specified time by the other entity in which it used the property referred to in subparagraph (ii), and

(B) to have the net accounting income of the other entity for the period in the taxation year of the other entity ending at the specified time that was derived from the activities referred to in clause (A);

(*k*) subject to paragraphs (*m*) and (*n*), the taxpayer has a tax avoidance motive in respect of the particular participating interest (and any participating interests of the taxpayer in the particular non-resident entity that are identical to the particular participating interest), if it is reasonable to conclude that the main reasons that the taxpayer acquired the particular participating interest include

(i) the derivation of a benefit the value of which can reasonably be attributed principally, directly or indirectly, to income derived from investment property, to profits or gains from the disposition of investment property, or to an increase in value of investment property, and

(ii) the deferral or reduction of the amount of tax that would have been payable by the taxpayer under this Part had the taxpayer earned the income, or realized the profits or gains, from the investment property at the time the income was earned, or the profits or gains were realized, by the entities that owned or held the investment property;

(*l*) in applying paragraph (*k*), the factors to be considered in determining the existence of a tax avoidance motive include

(i) the nature, organization and operation of

(A) the particular non-resident entity,

(B) any foreign investment entity in which the particular non-resident entity or a specified party in respect of the particular non-resident entity has a direct or indirect interest, and

(C) any foreign investment entity in which the taxpayer or a specified party in respect of the taxpayer has a direct or indirect interest,

(ii) the form of, and the terms and the conditions governing, the direct or indirect interests referred to in subparagraph (i),

(iii) the extent to which and the time at which an entity, in which a direct or indirect interest referred to in subparagraph (i) is held, is subject to an income or profits tax on its income, profits and gains, and

(iv) the extent to which and the time at which an entity that holds a direct or indirect interest referred to in subparagraph (i) is subject to an income or profits tax on the entity's share of the income, profits and gains of the entity in which the direct or indirect interest is held;

(*m*) the taxpayer does not have a tax avoidance motive in respect of the particular participating interest held by the taxpayer at any time in the particular taxation year if an amount that is all or substantially all of the income, profits and gains

(i) of the particular non-resident entity for its taxation year that ends in the particular taxation year becomes payable by it to its interest holders within 120 days after the end of its taxation year, and the taxpayer's share of that amount is included in computing the taxpayer's income for the taxpayer's taxation year that includes the time at which the amount became payable, and

(ii) of each other foreign investment entity, in which the particular non-resident entity has a direct or indirect interest, for the other entity's taxation year that ends at any time becomes payable by the other entity to its interest holders within 120 days after the end of the other entity's taxation year, and the particular non-resident entity's share of that amount is included in computing the income, profit or gains for its taxation year that includes the time at which the amount became payable;

(*n*) the taxpayer does not have a tax avoidance motive in respect of the particular participating interest, if throughout the period, in the particular taxation year, during which the taxpayer held the participating interest the particular non-resident entity was a "Regulated Investment Company" for the purposes of sections 851(b) and 852(a) of the United States *Internal Revenue Code of 1986* or a "Real Estate Investment Trust" for the purposes of sections 856(c) and 857(b) of that Code and the taxpayer includes, in computing the taxpayer's income for the particular taxation year, the amount of income that became payable by the particular non-resident entity to the taxpayer in the particular taxation year;

(*o*) an amount is deemed not to have become payable to an entity in a taxation year of the entity unless it was paid in that taxation year to the entity or the entity was entitled in that taxation year to enforce payment of it;

(*p*) the definition "exempt property" in subsection (1) does not apply in respect of a property of the particular non-resident entity if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine

whether property is an exempt property, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand;

(*q*) paragraphs (*a*) to (*d*) of the definition "foreign investment entity" in subsection (1) do not apply in respect of the particular non-resident entity if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether the particular non-resident entity is a foreign investment entity, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand;

(*r*) the definition "qualifying entity" in subsection (1) does not apply if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether an entity is a qualifying entity, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand; and

(*s*) if at any time a taxpayer has a participating interest in a particular foreign investment entity and the taxpayer has at that time a participating interest (referred to in this paragraph as the "indirect participating interest") in another non-resident entity solely because the particular foreign investment entity has at that time a participating interest in that other non-resident entity, then the indirect participating interest is deemed (other than in applying this paragraph) not to be a participating interest of the taxpayer at that time.

Conditions for application of tax regime for foreign investment entities

(3) This subsection applies to a taxpayer for a particular taxation year of the taxpayer in respect of a participating interest in a non-resident entity if

(*a*) the taxpayer is not an exempt taxpayer;

(*b*) the participating interest is held by the taxpayer at the end of a taxation year of the non-resident entity that ends in the particular taxation year;

(*c*) at the end of that taxation year of the non-resident entity it is a foreign investment entity; and

(*d*) at the end of that taxation year of the non-resident entity the taxpayer's participating interest is not an exempt interest of the taxpayer.

Income inclusion

(4) If subsection (3) applies to a taxpayer resident in Canada for a taxation year of the taxpayer in respect of a participating interest in a non-resident entity and subsection 94.2(3) does not apply to the taxpayer for the taxation year in respect of the participating interest, there shall be included (as income from a property that is the participating interest) in computing the taxpayer's income for that taxation year the total of all amounts each of which is the amount, in respect of each month in that taxation year, at the end of which month the taxpayer holds the participating interest, determined by the formula

A x B

where

A is the designated cost, to the taxpayer of the participating interest, at the end of the month, and

B is the quotient obtained when the rate of interest prescribed, in respect of amounts required by this Act to be paid by the Receiver General, for the quarterly period that includes that month is divided by 12.

Foreign Investment Entities – Mark-to-market

Definitions

94.2 (1) The definitions in this subsection and in subsection 94.1(1) apply in this section.

"deferral amount"
« montant de report »

"deferral amount", of a taxpayer in respect of a participating interest in an entity, means, subject to subsections (6) and (14) to (18), the positive or negative amount determined by the formula

A x (B - C)

where

A is

(*a*) if, immediately before the beginning of the taxpayer's first taxation year that began after 2002, the interest was capital property held by the taxpayer, 1/2; and

(*b*) in any other case, 1,

B is

(*a*) the fair market value of the interest at the first time in a particular taxation year of the taxpayer at which the taxpayer was resident in Canada where

(i) the taxpayer held the interest at the end of the preceding taxation year,

(ii) at the end of that preceding year, the taxpayer was resident in Canada or the interest was taxable Canadian property,

(iii) subsection (4) did not apply to the taxpayer for the purpose of computing the taxpayer's income in respect of the interest for any preceding taxation year, and

(iv) subsection (4) applies to the taxpayer for the purpose of computing the taxpayer's income in respect of the interest for the particular year; and

(*b*) nil in any other case, and

C is

(*a*) if paragraph (*a*) of the description of B applies in respect of the interest, the cost amount of the property immediately before the first time in the particular year at which the taxpayer was resident in Canada; and

(*b*) nil in any other case.

"gross-up factor"
« facteur de majoration »

"gross-up factor", for a particular deferral amount, means

(*a*) if the amount determined under variable "A" of the definition "deferral amount" in respect of the particular amount is 1/2, 2; and

(*b*) in any other case, 1.

"readily obtainable fair market value"
« juste valeur marchande vérifiable »

"readily obtainable fair market value", at any time in respect of a particular participating interest in a non-resident entity held at that time by a taxpayer, means

(*a*) if participating interests in the non-resident entity that are identical to the particular participating interest are widely held and actively traded and listed on a prescribed stock exchange throughout the particular period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the particular participating interest, the amount that is the average of the published price at which the participating interests last traded on that stock exchange on the day that includes that time and on the 5 immediately preceding days on which the participating interests traded on that prescribed stock exchange; and

(*b*) the amount that is the price that is payable at that time at the demand of the holders of the participating interests in the non-resident entity that are identical to the particular participating interest (or at the demand of the non-resident entity) for the surrender in whole or in part of the participating interests if

(i) paragraph (*a*) does not apply,

(ii) the participating interests have, throughout the particular period, conditions attached that require the non-resident entity to accept at the demand of the holders of the participating interests (or that require the holders of participating interests to accept, at the demand of the non-resident entity), at prices determined and payable in accordance with the conditions, the surrender in whole or in part of the participating interests, and

(iii) that price

(A) is determined by reference to the fair market value at that time of the property of the non-resident entity, and

(B) would have been acceptable to entities dealing at arm's length with one another.

"tracking entity"
« entité de référence »

"tracking entity", in respect of a particular participating interest of a taxpayer in a particular non-resident entity at a particular time, means the particular non-resident entity if

(*a*) the tracked property described in paragraph (9)(*d*) in respect of the participating interest is at that time owned by the particular non-resident entity, and

(i) the total carrying value at that time of the tracked property is less than 90% of the total carrying value at that time of all property owned at that time by the particular non-resident entity, and

(ii) the total of all amounts each of which is the carrying value at that time of tracked property that is at that time investment property of the particular non-resident entity exceeds 50% of the total of all amounts of each of which is the carrying value at that time of a tracked property owned at that time by the particular non-resident entity;

(*b*) paragraph 94.1(2)(*j*) applies at that time to the particular non-resident entity (because it has a significant interest in another entity), the tracked property is at that time owned (determined without reference to subparagraph 94.1(2)(*j*)(ii)) by the particular non-resident entity, and

(i) the total carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of the tracked property is less than 90% of the total carrying value at that time of all property owned (determined without reference to subparagraph 94.1(2)(*j*)(ii)) at that time by the particular non-resident entity, and

(ii) the total of all amounts each of which is the carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of tracked property that is at that time investment property (determined without reference to subparagraph 94.1(2)(*j*)(ii)) of the particular non-resident entity exceeds 50% of the total of all amounts each of which is the carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of a tracked property owned (determined without

reference to subparagraph 94.1(2)(*j*)(ii)) at that time by the particular non-resident entity; or

(*c*) any of the tracked property is not at that time owned by the particular non-resident entity, the particular non-resident entity owns property that is at that time investment property, and it is reasonable to conclude that the investment property (or property that may be substituted for the investment property) may be used to satisfy, directly or indirectly, the entitlement referred to in paragraph (9)(*d*) in respect of the particular participating interest.

Rules of application

(2) In this section,

(*a*) identical participating interests held by a taxpayer are deemed to be disposed of in the order in which they were acquired by the taxpayer, determined without reference to any other provision of this Act;

(*b*) subsection 94.1(2) applies;

(*c*) where a taxpayer acquires shares (referred to in this paragraph as the "new shares") of the capital stock of a corporation resident in a country other than Canada in exchange for shares of another corporation resident in a country other than Canada (referred to in this paragraph as the "exchanged shares") and subsection 85.1(5) applied to the taxpayer in respect of the new shares, the new shares are deemed to have been owned by the taxpayer throughout the period that the exchanged shares were owned by the taxpayer;

(*d*) in applying paragraph (*a*) of the definition "readily obtainable fair market value" in subsection (1) in respect of a particular participating interest in a non-resident entity held by a taxpayer in a taxation year, where participating interests in the non-resident entity that are identical to the particular participating interest are listed on more than one prescribed stock exchange, the references in that paragraph to a prescribed stock exchange shall be read as a reference to

(i) if the taxpayer so elects, by notifying the Minister in writing in the taxpayer's return of income for that taxation year or a preceding taxation year, the prescribed stock exchange identified by the taxpayer in that election, and

(ii) if the taxpayer has not filed an election in accordance with subparagraph (i) or if participating interests that are identical to the particular participating interest are no longer listed on the stock exchange identified in the election referred to in

subparagraph (i), the prescribed stock exchange chosen by the Minister;

(*e*) paragraph (3)(*b*) does not apply to a taxpayer for a particular taxation year in respect of a participating interest (and in respect of any other participating interests in the non-resident entity that are identical to the participating interest) held in the particular taxation year by the taxpayer in a non-resident entity if

(i) subsection (3) applied, because of an election under paragraph (3)(*b*), for a taxation year (referred to in this paragraph as the "preceding taxation year") that ended before the particular taxation year, of the taxpayer in respect of the participating interest (or in respect of any other participating interests that were held in the preceding taxation year by the taxpayer in the non-resident entity and that are identical to the participating interest), and

(ii) subsection (3) did not apply for a taxation year of the taxpayer that was after the preceding taxation year and before the particular taxation year;

(*f*) paragraph (3)(*b*) does not apply to a taxpayer for a particular taxation year in respect of a participating interest (and in respect of any other participating interests in the non-resident entity that are identical to the participating interest) held in the particular taxation year by the taxpayer in a non-resident entity if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether the participating interest has a readily obtainable fair market value and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand;

(*g*) in applying paragraph (4)(*a*) to a taxpayer, that is a trust, for a particular taxation year of the taxpayer and in respect of a participating interest of the taxpayer in a non-resident entity, the reference in that paragraph to "as income from property that is the participating interest" shall be read as a reference to "as income from property that is a source outside Canada that is the participating interest", if the portion of the net accounting income of the non-resident entity, from sources outside Canada, for its last taxation year that ends in the particular taxation year exceeds 90% of the total net accounting income of the non-resident entity for that last taxation year; and

(*h*) in applying paragraph (21)(*a*) to a taxpayer, that is a trust, for a particular taxation year of the taxpayer and in respect of a

participating interest of the taxpayer in a non-resident entity, the reference in that paragraph to "a capital gain for the year" shall be read as a reference to "a capital gain for the year from a source outside Canada and", if the portion of the net accounting income of the non-resident entity, from sources outside Canada, for its last taxation year that ends in the particular taxation year exceeds 90% of the total net accounting income of the non-resident entity for that last taxation year.

Where mark-to-market method applies

(3) Subject to paragraphs (2)(*e*) and (*f*) and (5)(*b*), this subsection applies to a taxpayer for a taxation year of the taxpayer in respect of a participating interest in a non-resident entity (and in respect of any other participating interests in the non-resident entity that are identical to the participating interest) held in the year by the taxpayer

(*a*) if subsection (9) or paragraph (11)(*a*) applies to the taxpayer for the year in respect of the participating interest (or in respect of any other participating interests that are held in the year by the taxpayer in the non-resident entity and that are identical to the participating interest); or

(*b*) if

(i) subsection 94.1(3) applies to the taxpayer for the year in respect of the participating interest (or in respect of any other participating interests that are held in the year by the taxpayer in the non-resident entity and that are identical to the participating interest),

(ii) the participating interest has a readily obtainable fair market value, and

(iii) the taxpayer has elected that this subsection apply in respect of the participating interest (or in respect of any other participating interests in the non-resident entity that are identical to the participating interest), by notifying the Minister in writing in the taxpayer's return of income

(A) for the taxation year of the taxpayer in which the taxpayer first acquired the participating interest (or first acquired any other participating interest in the non-resident entity that is identical to the participating interest), or

(B) a taxation year for which subsections (9) and (10) do not apply that immediately follows a taxation year for which subsection (9) or (10) applied.

Mark-to-market

(4) Subject to subsection (20), if subsection (3) applies to a taxpayer for a taxation year of the taxpayer in respect of a participating interest in a non-resident entity, in computing the taxpayer's income for the taxation year in respect of the participating interest

(*a*) there shall be added, as income from property that is the participating interest, the positive amount, if any, determined by the formula

$$(A + B + C + D) - (E + F + G)$$

where

A is the total of all amounts each of which is the taxpayer's proceeds from a disposition of the participating interest in the taxation year (other than a disposition deemed to arise because of subsection 128.1(4) or 149(10)),

B is

(i) if the taxpayer held the participating interest at the end of the taxation year, the fair market value (determined before taking into account any amount payable at the end of the taxation year from the non-resident entity in respect of the participating interest) at that time of the participating interest, and

(ii) in any other case, nil,

C is the total of all amounts (other than an amount to which the description of A applies) received by the taxpayer in the taxation year from the non-resident entity in respect of the participating interest,

D is

(i) the taxpayer's deferral amount in respect of the participating interest, if

(A) the deferral amount is a positive amount,

(B) the participating interest was not disposed of by the taxpayer in the taxation year, and

(C) the taxpayer so elects in respect of the participating interest in prescribed form filed with the Minister not later than the taxpayer's filing-due date for the taxation year,

(ii) the taxpayer's deferral amount in respect of the participating interest if

(A) the taxpayer disposed of the participating interest in the taxation year, and

(B) no election was made under subparagraph (i) in respect of the participating interest by the taxpayer for a preceding taxation year, and

(iii) in any other case, nil,

E is the total of all amounts each of which is the cost at which the taxpayer acquired the participating interest in the taxation year (otherwise than because of an acquisition deemed to arise because of subsection 128.1(4) or 149(10)),

F is

(i) if the taxpayer held the participating interest at the beginning of the taxation year, the fair market value at that time of the participating interest (determined before taking into account any amount payable at that time from the non-resident entity in respect of the participating interest), and

(ii) in any other case, nil, and

G is

(i) if the participating interest was deemed by paragraph (11)(*a*) to be a participating interest in an entity for the preceding taxation year of the taxpayer, the amount that would be deductible under paragraph (*b*) in computing the taxpayer's income for that preceding taxation year in respect of the interest if this subsection were read without reference to subparagraph (*b*)(i), and

(ii) in any other case, nil; and

(*b*) there may be deducted, as a loss from property,

(i) if the participating interest was deemed by paragraph (11)(*a*) to be a participating interest in an entity for the year, nil, and

(ii) in any other case, the absolute value of the negative amount, if any, determined by the formula in paragraph (*a*).

Non-resident periods excluded

(5) If a taxpayer is non-resident at any time in a taxation year of the taxpayer

(*a*) for the purpose of subsection (4) (other than the description of D in paragraph (4)(*a*)), the taxation year is deemed to be the period, if any, that begins at the first time in the taxation year at which the taxpayer is resident in Canada and ends at the last time in the taxation year at which the taxpayer is resident in Canada;

(*b*) except for the purposes of subsection (4) and paragraph (*c*), subsection (3) does not apply to the taxpayer at that time; and

(*c*) where the taxpayer is an individual (other than a trust) who was non-resident throughout a particular period that is within a taxation year (determined under paragraph (*a*)) of the taxpayer, at any time in the particular period the individual holds a participating interest in a non-resident entity, and subsection (3) applies to the individual throughout the particular period in respect of the participating interest,

(i) for the purpose of section 114, the income or loss of the individual in respect of the participating interest for the particular period shall be determined without reference to this section, and

(ii) in computing the amount determined under paragraph 114(*a*) in respect of the individual for the year

(A) there shall be deducted any amount that would be included under paragraph (4)(*a*) in computing the individual's income in respect of the participating interest for the particular period if

(I) the value of D in paragraph (4)(*a*) were nil, and

(II) the particular period were a taxation year, and

(B) there shall be added any amount that would be deductible under paragraph (4)(*b*) in computing the individual's income in respect of the participating interest for the particular period if

(I) the value of D in paragraph (4)(*a*) were nil, and

(II) the particular period were a taxation year.

Foreign partnership – member becoming resident

(6) If, at a particular time in a fiscal period of a partnership, a person resident in Canada becomes a member of the partnership, or a person who is a member of the partnership becomes resident in Canada, and immediately before the particular time no member of the partnership is resident in Canada,

(*a*) all amounts determined under this section shall be determined as if that fiscal period began at the first time in that fiscal period (determined without reference to this paragraph) at which a member of the partnership was resident in Canada;

(*b*) for the purpose of the definition "deferral amount" in subsection (1), as it applies in respect of dispositions that occur after the particular time and before the first subsequent time to which this subsection applies in respect of the partnership, subsection (4) is deemed not to have applied to the partnership for any preceding fiscal period; and

(*c*) where a negative deferral amount would, if this Act were read without reference to this paragraph, be determined in respect of a participating interest held by the partnership immediately before the particular time, the deferral amount in respect of the interest is deemed to be nil.

Foreign partnership – members ceasing to be resident

(7) If, at a particular time in a fiscal period of a partnership, a person resident in Canada ceases to be a member of the partnership, or a person who is a member of the partnership ceases to be resident in Canada and immediately after the particular time no member of the partnership is resident in Canada, all amounts determined under this section shall be determined as if that fiscal period ended at the last time in that fiscal period (determined without reference to this subsection) at which a member of the partnership was resident in Canada.

Application of subsections (6) and (7)

(8) In subsections (6) and (7) and this subsection,

(*a*) if it can reasonably be considered that one of the main reasons that a member of a partnership is resident in Canada is to avoid the application of subsection (6) or (7), the member is deemed not to be resident in Canada; and

(*b*) if a particular partnership is a member of another partnership at any time,

(i) each person or partnership that is at that time a member of the particular partnership is deemed to be at that time a member of the other partnership,

(ii) each person or partnership that becomes at that time a member of the particular partnership is deemed to become at that time a member of the other partnership, and

(iii) each person or partnership that ceases at that time to be a member of the particular partnership is deemed to cease at that time to be a member of the other partnership.

Tracking interests

(9) This subsection applies to a taxpayer for a particular taxation year of the taxpayer in respect of a particular participating interest of the taxpayer in a non-resident entity (and any participating interests of the taxpayer in the non-resident entity that are identical to the particular participating interest) if

(*a*) the taxpayer is not an exempt taxpayer for the particular taxation year;

(*b*) the particular participating interest is, at the end of a taxation year of the non-resident entity that ends in the particular taxation year,

(i) held by the taxpayer, and

(ii) not a participating interest described in paragraph (*b*) of the definition "exempt interest" in subsection 94.1(1) or subparagraph (*e*)(i) or (ii) of that definition;

(*c*) the non-resident entity is, at the end of that taxation year of the non-resident entity, a tracking entity in respect of the particular participating interest;

(*d*) at any time in the particular taxation year, the entitlement to receive, in any manner whatever and from any entity, payments in respect of the particular participating interest is, directly or indirectly, determined primarily by reference to any one or more of the following criteria in respect of one or more properties (such property or properties together referred to, in this subsection and the definition "tracking entity" in subsection (1), as "tracked property"):

(i) production from the property, use of the property, gains from the disposition of the property, profits from the disposition of the property, fair market value of the property,

(ii) income from the property, profits from the property, revenue from the property, cash flow from the property, or

(iii) any other criterion similar to a criterion referred to in any of subparagraphs (i) or (ii); and

(*e*) throughout each taxation year of the non-resident entity that ends in the particular taxation year, all or substantially all of the fair market value of the tracked property cannot be attributed, either directly or indirectly, to the fair market value of property

(i) that is a share or shares of the capital stock of a corporation that is at that time a particular foreign affiliate of the taxpayer that if held at that time by the taxpayer would be

(A) a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) of the taxpayer in the particular foreign affiliate of the taxpayer, and

(B) a participating interest of the taxpayer in a qualifying entity, and

(ii) that is not at that time tracked property in respect of a participating interest in a non-resident entity of an entity that is not related to the taxpayer.

Treatment of foreign insurance policies

(10) This subsection applies to a taxpayer for a particular taxation year of the taxpayer in respect of an interest in an insurance policy, if

(*a*) the taxpayer is not an exempt taxpayer for the particular taxation year;

(*b*) the taxpayer holds, at any time in the particular taxation year, an interest in the insurance policy; and

(*c*) the insurance policy is not an insurance policy issued by an insurer in the course of carrying on an insurance business in Canada, the income from which is subject to tax under this Part.

Treatment of foreign insurance policies

(11) If subsection (10) applies to a taxpayer for a particular taxation year of the taxpayer in respect of an interest in an insurance policy

(*a*) in applying subsections (3) and (4) and paragraph (*d*.1) of the definition "specified foreign property" in subsection 233.3(1) to the taxpayer in respect of the interest for the particular taxation year,

(i) the interest is deemed at each time in the particular taxation year that it is held by the taxpayer to be a participating interest in a non-resident entity, and

(ii) the value of D in paragraph (4)(*a*) is deemed to be nil;

(*b*) section 12.2, paragraphs 56(1)(*d*) and (*j*) and 60(*a*) and (*s*) and sections 138.1 and 148 do not apply in respect of the interest for the purpose of computing the taxpayer's income for the particular taxation year;

(*c*) paragraphs (*a*) and (*b*) do not apply to a taxpayer for a taxation year in respect of an insurance policy if

(i) the taxpayer is an individual and the interest in the policy was acquired by the individual more than 60 months before the individual became resident in Canada unless, after the day that is 60 months before the day that the individual became resident in Canada, the individual paid premiums in respect of the policy that are in excess of the level that can reasonably be considered to have been contemplated at the time the first interest in the policy was acquired,

(ii) under the terms and conditions of the insurance policy, the taxpayer is entitled to receive only benefits payable as a consequence of the occurrence of risks insured under the policy, an experience rated refund of premiums for a year or a return of

premiums previously paid upon the surrender, cancellation or termination of the insurance policy, or

(iii) the taxpayer can establish to the satisfaction of the Minister that the taxpayer has included in computing the taxpayer's income for the particular year the amount required under section 12.2 to be included in computing the taxpayer's income for that year in respect of the interest;

(*d*) for the purpose of subsection (4), an interest in an insurance policy held by a taxpayer at the end of a particular taxation year is deemed to have been acquired by the taxpayer at the beginning of the following taxation year at a cost equal to the fair market value at the end of the particular taxation year of the interest if

(i) paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular year, and

(ii) paragraphs (*a*) and (*b*) apply to the taxpayer in respect of the interest for the taxpayer's following taxation year;

(*e*) for the purpose of subsection (4), an interest in an insurance policy held by a taxpayer at the beginning of a particular taxation year is deemed to have been disposed of by the taxpayer at end of the taxpayer's preceding taxation year for proceeds of disposition equal to its fair market value at the end of that preceding taxation year if

(i) paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular taxation year, and

(ii) paragraphs (*a*) and (*b*) applied to the taxpayer in respect of the interest for the taxpayer's preceding taxation year;

(*f*) for the purposes of this subsection and subsection (4), the fair market value of an interest in an insurance policy, the proceeds of disposition of an interest in an insurance policy and amounts paid to a beneficiary in respect of an interest in an insurance policy are each determined without reference to benefits paid, payable or anticipated to be payable, under the insurance policy as a consequence only of the occurrence of the risks insured under the insurance policy;

(*g*) for the purposes of this subsection and subsection (4),

(i) an interest in an insurance policy is deemed to have been acquired by the taxpayer in a particular taxation year (notwithstanding that the interest was held by the taxpayer at the end of the preceding taxation year), where the taxpayer made a

payment described in subparagraph (ii) in respect of a premium or a loan under the policy in the particular taxation year,

(ii) the cost to the taxpayer of an interest in an insurance policy acquired in a particular taxation year is the total of all amounts each of which is

(A) the amount of a premium paid by the taxpayer in the particular taxation year under the insurance policy to the extent that it cannot be refunded (otherwise than on termination or cancellation of the policy) and is not a payment in respect of a benefit described in subparagraphs (*c*)(i) to (vii) of the definition "premium" in subsection 148(9), and

(B) the amount of a payment made by the taxpayer in the particular taxation year in respect of the principal amount of a loan made under the insurance policy in any taxation year to the extent that the loan was included in determining the value of C in the formula in subsection (4) for the taxation year in which the loan was made;

(*h*) if, under paragraph (*d*), a taxpayer is deemed to have acquired an interest in an insurance policy at the beginning of a taxation year (referred to in this paragraph as the "acquisition year"), the taxpayer may add to the cost of that interest, the amount, if any, by which

(i) the total amount of premiums paid by the taxpayer before the beginning of the acquisition year in respect of that interest at a time at which the taxpayer was resident in Canada and not an exempt taxpayer for the year in respect of the interest (to the extent that the premiums paid cannot be refunded otherwise than on termination or cancellation of the policy and are not premiums paid in respect of a benefit described in subparagraphs (*c*)(*i*) to (*vii*) of the definition "premium" in subsection 148(9))

exceeds

(ii) the total of the fair market value, at the beginning of the acquisition year, of that interest and the total of the amounts received by the taxpayer before the beginning of the acquisition year under the policy at a time at which the taxpayer was resident in Canada and not an exempt taxpayer for the year in respect of the interest;

(*i*) for the purpose of subsection (4), if the amount determined under subparagraph (*h*)(ii) exceeds the amount determined under subparagraph (*h*)(i) in respect of an interest in an insurance policy of a taxpayer described in paragraph (*h*), the amount of the excess shall

be added in computing the taxpayer's proceeds of disposition of that interest for the taxation year in which the taxpayer disposes of the interest otherwise than because of paragraph (*e*); and

(*j*) where an interest in an insurance policy is held by a taxpayer at the beginning of a particular taxation year, paragraphs (*a*) and (*b*) do not apply to the taxpayer in respect of the interest for the particular taxation year, and paragraphs (*a*) and (*b*) applied to the taxpayer in respect of the interest for the taxpayer's preceding taxation year, the interest is deemed to have been acquired by the taxpayer at the beginning of the particular taxation year at a cost equal to the amount, if any, by which

(i) the total of the fair market value, at the end of the taxpayer's preceding taxation year, of the interest and the amount that would be determined under paragraph (4)(*b*) in respect of the interest in respect of the taxpayer for the taxpayer's preceding taxation year if this Act were read without reference to subparagraph (4)(*b*)(i),

exceeds

(ii) the amount determined under paragraph (*i*) in respect of the interest in respect of the taxpayer.

Change of status

(12) If a participating interest in a non-resident entity is held by a taxpayer at the beginning of a taxation year, subsection (4) applied for the purpose of computing the taxpayer’s income in respect of the interest for the preceding taxation year and that subsection does not apply for the purpose of computing the taxpayer’s income in respect of the interest for the taxation year (otherwise than because the taxpayer became an exempt taxpayer or ceased to reside in Canada),

(*a*) subject to paragraph (*c*), the taxpayer is deemed to have acquired the participating interest at the beginning of the taxation year at a cost equal to its fair market value at that time;

(*b*) if the participating interest is capital property at the beginning of the taxation year, in computing the adjusted cost base after that time to the taxpayer of the interest

(i) except where the taxpayer has made an election in respect of the participating interest under clause (i)(C) of the description of D in paragraph (4)(*a*), there shall be deducted the product of any positive deferral amount in respect of the participating interest and the gross-up factor for the deferral amount, and

(ii) there shall be added the product of the absolute value of any negative deferral amount in respect of the participating interest and the gross-up factor for the deferral amount; and

(*c*) where paragraph (*b*) does not apply,

(i) except where the taxpayer has made an election in respect of the participating interest under clause (i)(C) of the description of D in paragraph (4)(*a*), there shall be deducted in computing the cost to the taxpayer of the participating interest the lesser of

(A) the product of any positive deferral amount in respect of the participating interest and the gross-up factor for the deferral amount, and

(B) the cost to the taxpayer of the participating interest, determined without reference to this subparagraph,

(ii) there shall be included in computing the taxpayer's income for the taxation year in respect of the participating interest the amount, if any, by which

(A) the amount determined under clause (i)(A) in respect of the participating interest

exceeds

(B) the amount determined under clause (i)(B) in respect of the participating interest, and

(iii) there shall be added in computing the cost to the taxpayer of the participating interest the product of the absolute value of any negative deferral amount in respect of the participating interest and the gross-up factor for the deferral amount.

Cost of participating interest

(13) If a taxpayer's participating interest in a non-resident entity is disposed of by the taxpayer at a particular time in a taxation year and subsection (4) applies for the purpose of computing the taxpayer's income for the taxation year in respect of the participating interest, in determining the taxpayer's cost of the participating interest immediately before the particular time

(*a*) if the participating interest was held by the taxpayer at the beginning of the taxation year, its cost to the taxpayer immediately before the particular time is deemed to be equal to the fair market

value at the beginning of the taxation year of the participating interest; and

(*b*) in any other case, its cost to the taxpayer immediately before the particular time is deemed to be equal to the amount that would be its cost to the taxpayer at the particular time if this Act were read without reference to this section (other than subsection (2)).

Deferral amount where same interest reacquired

(14) Subject to subsections (15) to (18), if a taxpayer disposes of a participating interest in an entity at any time in a taxation year of the taxpayer and subsection (4) applies for the purpose of computing the taxpayer's income for the year in respect of the participating interest, in applying subsection (4) to dispositions after that time the deferral amount of the taxpayer in respect of the interest is nil.

Fresh-start re change of status of entity

(15) If a participating interest is deemed by paragraph (12)(*a*) to have been acquired at a particular time by a taxpayer, for the purpose of applying subsection (4) to a subsequent disposition of the participating interest and a subsequent election in respect of the participating interest under clause (i)(C) of the description of D in paragraph (4)(*a*), the deferral amount of the taxpayer in respect of the participating interest shall

(*a*) for the purpose of subparagraph (*a*)(iii) of the description of B in the definition "deferral amount" in subsection (1), be determined as if subsection (4) had not applied to the taxpayer in respect of the participating interest for taxation years that began before the particular time; and

(*b*) be determined without reference to the application of subsection (14) with regard to dispositions that occurred before the particular time.

Fresh-start after emigration of taxpayer

(16) If a taxpayer ceases at a particular time to be resident in Canada, for the purpose of applying subsection (4) to dispositions, and elections under clause (i)(C) of the description of D in paragraph (4)(*a*), that

occur or that are made after the particular time, the deferral amount in respect of the taxpayer's participating interests shall

(*a*) for the purpose of subparagraph (*a*)(iii) of the description of B in the definition "deferral amount" in subsection (1), be determined as if subsection (4) had not applied to the taxpayer in respect of participating interests for taxation years that began before the particular time; and

(*b*) be determined without reference to the application of subsection (14) with regard to dispositions that occurred before the particular time.

Fresh-start re change of status of tax-exempt entity

(17) If, a taxpayer was not an exempt taxpayer for a particular taxation year, and the taxpayer is an exempt taxpayer for the following taxation year because of the application of paragraph (*b*) of the definition "exempt taxpayer" in subsection 94.1(1), in applying subsection (4) to dispositions, and elections under clause (i)(C) of the description of D in paragraph (4)(*a*), that occur or that are made after that following taxation year, the deferral amount in respect of the taxpayer's participating interests are

(*a*) for the purpose of subparagraph (*a*)(iii) of the description of B in the definition "deferral amount" in subsection (1), determined as if subsection (4) had not applied to the taxpayer in respect of participating interests for taxation years that ended before that following year; and

(*b*) determined without reference to the application of subsection (14) with regard to dispositions that occurred before that following year.

Superficial dispositions

(18) If a taxpayer disposes of a particular participating interest in an entity, the deferral amount in respect of the particular participating interest would otherwise be a negative amount and the disposition would, if the particular participating interest were a capital property and a loss arose on the disposition, give rise to a superficial loss (within the meaning that would be assigned by section 54 if the definition "superficial loss" in that section were read without the reference to subsection 40(3.4) in paragraph (*h*) of that definition)

(*a*) except for the purpose of applying paragraph (*b*) in respect of the disposition, the deferral amount of the taxpayer in respect of the particular participating interest is deemed to be nil; and

(*b*) the deferral amount of the taxpayer in respect of the property that would be the substituted property referred to in that definition if the assumptions described in this subsection applied is deemed to be equal to the deferral amount of the taxpayer in respect of the particular participating interest.

Determination of capital dividend account

(19) If an amount (other than an amount determined under subsection (20)) has been included or deducted under subsection (4) in computing the income of a corporation resident in Canada for a particular taxation year in respect of a particular participating interest in a foreign investment entity, in computing the capital dividend account of the corporation

(*a*) the corporation is deemed to have

(i) a capital gain from a disposition at the end of the particular taxation year of property equal to twice the amount of the taxable capital gain determined under subparagraph (ii), and

(ii) a taxable capital gain from the disposition at the end of the particular taxation year of property equal to the lesser of

(A) the positive amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of the particular participating interest for the particular taxation year (if the gross-up factor in respect of the deferral amount is 2), and

(B) the amount included in computing the income of the corporation for the particular taxation year under subsection (4); and

(*b*) the corporation is deemed to have

(i) a capital loss from a disposition at the end of the particular taxation year of property equal to twice the amount of the allowable capital loss determined under subparagraph (ii), and

(ii) an allowable capital loss from the disposition at the end of the particular taxation year of property equal to the lesser of

(A) the absolute value of the negative amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of the particular participating interest for the particular taxation year (if the gross-up factor in respect of the deferral amount is 2), and

(B) the amount deducted in computing the income of the corporation for the particular taxation year under subsection (4).

Non-application of subsection (4)

(20) No amount shall be included or deducted under subsection (4) in computing a taxpayer's income for a taxation year in respect of a participating interest in a foreign investment entity, if all or substantially all of the amount, that would if this Act were read without reference to this subsection be required to be so included or deducted, can be attributed to

(*a*) capital gains or capital losses of the foreign investment entity from the disposition of capital property;

(*b*) increases or decreases in the fair market value of capital property of the foreign investment entity; or

(*c*) a combination of the factors described in paragraphs (*a*) and (*b*).

Deemed capital gain or loss

(21) If subsection (20) applies in computing a taxpayer's income for a taxation year in respect of a participating interest in a foreign investment entity,

(*a*) the taxpayer is deemed to have a capital gain for the year from the disposition of capital property in the taxation year equal to the amount by which the total of

(i) the amount that would, if this Act were read without reference to subsection (20), be included under subsection (4) in computing the taxpayer's income for the taxation year in respect of the participating interest, and

(ii) the positive amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of that participating interest for the taxation year (where the gross-up factor in respect of the deferral amount is 2)

exceeds

(iii) the absolute value of the negative amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of that participating interest for the taxation year (where the gross-up factor in respect of the deferral amount is 2); and

(*b*) the taxpayer is deemed to have a capital loss for the taxation year from the disposition of capital property in the taxation year equal to the amount by which the total of

(i) the amount that would, if this Act were read without reference to subsection (20), be deducted under subsection (4) in computing the taxpayer's income for the taxation year in respect of the participating interest, and

(ii) the absolute value of the negative amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of that participating interest for the taxation year (where the gross-up factor in respect of the deferral amount is 2)

exceeds

(iii) the positive amount that is the value of D in the formula in subsection (4) in respect of the deferral amount in respect of that participating interest for the taxation year (where the gross-up factor in respect of the deferral amount is 2).

Definitions and rules of application

94.3 (1) The definitions in subsection 94.1(1), and paragraphs 94.1(2)(*o*) and 94.2(2)(*a*), apply in this section.

Prevention of double taxation

(2) If an amount becomes, at a particular time in a particular taxation year of a taxpayer that begins after 2002 or in a preceding taxation year of the taxpayer that begins after 2002, payable to a taxpayer resident in Canada from a particular entity or another entity in respect of a participating interest in the particular entity,

(*a*) there may be deducted in computing the taxpayer’s income for the particular taxation year the lesser of

(i) the amount, if any, by which

(A) the total of all amounts each of which is an amount that is in respect of any of those amounts payable and that is included (otherwise than because of subsection 94.2(4)) in computing the taxpayer's income for any of those years

exceeds the total of

(B) the total of all amounts each of which is an amount that is in respect of any of those amounts payable and that is deductible

(I) under subsection 91(5) in computing the taxpayer's income for any of those years, or

(II) under section 113 in computing the taxpayer's taxable income for any of those years, and

(C) the total of all amounts each of which is an amount that is in respect of the participating interest and that is deducted under this paragraph in computing the taxpayer's income for any of those preceding taxation years, and

(ii) the amount, if any, by which

(A) the total of all amounts each of which is an amount, in respect of the participating interest, that is included, or that would if this Act were read without reference to subsection 94.2(20) have been included, under subsection 94.1(4) or 94.2(4) in computing the taxpayer's income for any of those years,

exceeds the total of all amounts each of which is an amount, in respect of the participating interest,

(B) that is deducted, or that would if this Act were read without reference to subsection 94.2(20) have been deducted, under subsection 94.2(4) in computing the taxpayer's income for any of those taxation years, and

(C) that is deducted under this paragraph in computing the taxpayer's income for any of those preceding taxation years; and

(*b*) if the participating interest is capital property at the particular time, in computing the adjusted cost base to the taxpayer of the interest after the particular time there shall be deducted the amount deducted under paragraph (*a*) in computing the taxpayer's income.

Foreign taxes paid

(3) If an amount received by a taxpayer is included in computing the amount determined under subparagraph (2)(*a*)(i) in respect of the taxpayer in respect of a participating interest for a taxation year, the taxpayer may deduct in computing the taxpayer's income for the taxation year the product obtained when the taxpayer's relevant tax factor (within the meaning assigned by subsection 95(1)) for the taxation year is multiplied by the lesser of

(*a*) the amount of the non-business income tax (as defined in subsection 126(7)) paid by the taxpayer for the taxation year in respect of the amount received; and

(*b*) 15% of the amount determined under subparagraph (2)(*a*)(i) in respect of the taxpayer in respect of the participating interest for the taxation year.

(2) Subsection (1) applies to taxation years that begin after 2002, except that any election referred to in section 94.1 or 94.2 of the Act, as enacted by subsection (1), made by a taxpayer is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the taxpayer's filing-due date for the taxpayer's taxation year that includes the day on which this Act is assented to.

13. (1) The portion of subsection 95(1) of the Act before the definition "active business" is replaced by the following:

Definitions re foreign affiliates

95. (1) In this subdivision (other than sections 94 to 94.3),

(2) The portion of the definition "controlled foreign affiliate" in subsection 95(1) of the Act before paragraph (*a*) is replaced by the following:

"controlled foreign affiliate"
« société étrangère affiliée contrôlée »

"controlled foreign affiliate", at any time, of a taxpayer resident in Canada means a foreign affiliate of the taxpayer that is, at that time, a controlled foreign affiliate of the taxpayer because of paragraph 94.1(2)(*h*) or that is, at that time, controlled by

(3) The description of C in the definition "foreign accrual property income" in subsection 95(1) of the Act is replaced by the following:

C is, where the affiliate is a controlled foreign affiliate of the taxpayer, the amount that is required because of paragraph 95(2)(*g*.3) to be included in computing the foreign accrual property income of the affiliate for the year except to the extent that an amount included in computing that amount so required is otherwise included in computing that foreign accrual property income,

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

(*g*.3) in computing the foreign accrual property income of a particular foreign affiliate of a particular taxpayer for a particular taxation year of the particular affiliate, sections 94.1 to 94.3 apply to the particular affiliate as if

(i) the particular affiliate were a taxpayer resident in Canada throughout the particular taxation year (other than for the purposes of determining if the particular affiliate is a foreign affiliate of a taxpayer or if the particular affiliate is a foreign investment entity and a participating interest in the particular affiliate is an exempt interest of a taxpayer in a foreign investment entity),

(ii) the words "controlled foreign affiliate of the taxpayer" in paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1) referred to a controlled foreign affiliate of the particular taxpayer and not to a controlled foreign affiliate of the particular affiliate,

(iii) for the purpose of applying sections 94.1 and 94.2 in computing the income of a foreign investment entity in which the particular affiliate holds a participating interest, the words "controlled foreign affiliate of the taxpayer" in paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1) referred to a controlled foreign affiliate of the particular taxpayer and not to a controlled foreign affiliate of the entity,

(iv) an election under paragraph 94.1(2)(*b*) or 94.2(3)(*b*) or clause (i)(C) of the description of D in paragraph 94.2(4)(*a*) for the particular taxation year were required to be filed under that provision in respect of the particular affiliate, by, and only by, the particular taxpayer, with the Minister on or before the filing-due date of the particular taxpayer for the particular taxpayer's taxation year in which the particular taxation year ends,

(v) the amount determined under the definition "deferral amount" in subsection 94.2(1) did not include the portion of that amount that can reasonably be considered to have accrued during the period that the particular affiliate was not a foreign affiliate of any person described in any of subparagraphs (*f*)(iii) to (vii), and

(vi) the reference in subsection 94.2(19) to the expression "in computing the capital dividend account of the corporation" were read in respect of the particular affiliate as a reference to the expression "in computing the amount prescribed to be the particular affiliate's exempt surplus and taxable surplus in respect of the taxpayer";

(5) Subsections (1) to (4) apply to taxation years of foreign affiliates of taxpayers that begin after 2002.

14. (1) Section 96 of the Act is amended by adding the following after subsection (1.8):

Application of sections 94.1 and 94.2

(1.9) If an exempt taxpayer (as defined in subsection 94.1(1)) for a taxation year is a member of a partnership at any time in the year, in applying paragraphs (1)(*f*) and (*g*) and 53(1)(*e*) and (2)(*c*) to the taxpayer for a fiscal period of the partnership that ends in the year this Act shall be read without reference to sections 94.1 and 94.2.

(2) The portion of subsection 96(3) of the Act before paragraph (*a*) is replaced by the following:

Agreement or election of partnership members

(3) If a taxpayer who was a member of a partnership at any time in 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, designation or election under or in respect of the application of any of subsections 13(4), (4.2) and (16) and 14(1.01) and (6), section 15.2, subsections 20(9) and 21(1) to (4), section 22, subsection 29(1), section 34, clause 37(8)(*a*)(ii)(B), subsections 44(1) and (6), 50(1) and 80(5), (9), (10) and (11), section 80.04, subsection 86.1(2), section 94.1 or 94.2, and paragraph 95(2)(*g*.2) and subsections 97(2), 139.1(16) and (17) and 249.1(4) and (6) that, if this

Act were read without reference to this subsection, would be a valid agreement, designation or election,

(3) Subsection 96(9) of the Act is replaced by the following:

Application of foreign partnership rule

(9) For the purposes of applying subsection (8) and this subsection,

(*a*) where it can reasonably be considered that one of the main reasons that a member of a partnership is resident in Canada is to avoid the application of subsection (8), the member is deemed not to be resident in Canada; and

(*b*) where at any time a particular partnership is a member of another partnership,

(i) each person or partnership that is, at that time, a member of the particular partnership is deemed to be a member of the other partnership at that time,

(ii) each person or partnership that becomes a member of the particular partnership at that time is deemed to become a member of the other partnership at that time, and

(iii) each person or partnership that ceases to be a member of the particular partnership at that time is deemed to cease to be a member of the other partnership at that time.

(4) Subsections (1) and (2) apply to fiscal periods that begin after 2002.

(5) Subsection (3) applies to fiscal periods that begin after June 22, 2000.

15. (1) Subsection 104(4) of the Act is amended by adding the following after paragraph (*a*.4):

(*a*.5) where the trust is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust's income for the year, the day (in that taxation year) that is immediately before the particular day on which, because a contributor (in this paragraph having the meaning assigned by subsection 94(1)) either ceases to be resident in Canada or ceases to be a contributor to the trust because of the application at any time of paragraph 94(2)(*t*), there is no resident contributor (in this paragraph having the meaning assigned by

subsection 94(1)) to the trust (or the only resident contributors to the trust are entities (in this paragraph having the meaning assigned by subsection 94(1)) each of which is an entity the maximum amount recoverable from which under the provisions referred to in paragraph 94(3)(*d*) is limited to the entities' recovery limits determined under subsection 94(8)), unless subsection 94(5) applies in respect of the contributor ceasing on the particular day to be a resident contributor of the trust;

(2) Paragraph 104(4)(*c*) of the Act is replaced by the following:

(*c*) the day that is 21 years after any day (other than a day determined under any of paragraphs (*a*) to (*a*.5)) that is, because of this subsection, a day on which the trust is deemed to have disposed of each such property.

(3) Section 104 of the Act is amended by adding the following after subsection (4):

Mark-to-market property

(4.1) In determining whether property is capital property for the purpose of subsection (4), this Act shall be read without reference to subparagraph 39(1)(*a*)(ii.3) and section 94.2.

(4) The portion of subsection 104(6) of the Act before paragraph (*a*) is replaced by the following:

Deduction in computing income of trust

(6) Subject to subsections (7) and (7.01), for the purposes of this Part, there may be deducted in computing the income of a trust for a taxation year

(5) Section 104 of the Act is amended by adding the following after subsection (7):

Trusts deemed to be resident in Canada

(7.01) If a trust is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust’s income for the year, the maximum amount deductible under subsection (6) in computing its income for the year is the amount, if any, by which

(*a*) the maximum amount that, if this Act were read without reference to this subsection, would be deductible under subsection (6) in computing its income for the year,

exceeds

(*b*) the total of

(i) the trust's designated income for the year (within the meaning assigned by subsection 210.2(2)) payable in the year to a non-resident beneficiary under the trust, and

(ii) all amounts each of which is determined by the formula

A x B

where

A is an amount (other than an amount described in subparagraph (i)) that

(A) is paid or credited in the year to the trust,

(B) would, if this Act were read without reference to subparagraph 94(3)(*a*)(v) and sections 216 and 217, be an amount as a consequence of the payment or crediting of which the trust would have been liable to tax under Part XIII, and

(C) is payable in the year by the trust to a non-resident beneficiary under the trust, and

B is

(A) 0.35, if the trust can establish to the satisfaction of the Minister that the non-resident beneficiary to whom the amount described in A is payable is resident in a country with which Canada has a tax treaty under which the income tax that Canada may impose on the beneficiary in respect of the amount is limited, and

(B) 0.6, in any other case.

(6) Paragraph 104(21.3)(*a*) of the Act is replaced by the following:

(*a*) the total of all amounts each of which is an allowable capital loss (other than an allowable business investment loss) of the trust for the year from the disposition of a capital property, and

(7) Subsection 104(24) of the Act is replaced by the following:

Amount payable

(24) For the purposes of subparagraph 53(2)(*h*)(i.1), paragraph (*c*) of the definition "specified charity" in subsection 94(1), subsection 94(8) and subsections (6), (7), (7.01), (13) and (20), an amount is deemed not to have become payable to a beneficiary in a taxation year unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of it.

(8) Subsections (1) to (5) and (7) apply to trust taxation years that begin after 2002. Subsections (1), (2), (4), (5) and (7) also apply to trust taxation years that begin

(*a*) after 2000, if the trust makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the trust makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

(9) Subsection (6) applies to trust taxation years that begin after 2000.

16. (1) Paragraph (*a*.1) of the definition "trust" in subsection 108(1) of the Act is replaced by the following:

(*a*.1) a trust (other than a trust described in paragraph (*a*) or (*d*), a trust to which subsection 7(2) or (6) applies or a trust prescribed for the purpose of subsection 107(2)) all or substantially all of the property of which is held for the purpose of providing benefits to individuals each of whom is provided with benefits in respect of, or because of, an office or employment or former office or employment of any individual,

(2) The portion of subsection 108(3) of the Act before paragraph (*a*) is replaced by the following:

Income of a trust in certain provisions

(3) For the purposes of the definition "income interest" in subsection (1) and the definition "exempt foreign trust" in subsection 94(1), the income of a trust is its income computed without reference to the provisions of this Act and, for the purposes of the definition "pre-1972 spousal trust" in subsection (1) and paragraphs 70(6)(*b*) and (6.1)(*b*), 73(1.01)(*c*) and 104(4)(*a*), the income of a trust is its income computed

without reference to the provisions of this Act, minus any dividends included in that income

(2) Subsections (1) and (2) apply to trust taxation years that begin after 2002. Subsections (1) and (2) also apply to trust taxation years that begin

(*a*) after 2000, if the trust makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the trust makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

17. (1) Clause 113(1)(*b*)(i)(A) of the Act is replaced by the following:

(A) the corporation's relevant tax factor for the year

(2) Clause 113(1)(*c*)(i)(B) of the Act is replaced by the following:

(B) the corporation's relevant tax factor for the year, and

(3) Subsections (1) and (2) apply after 2000.

18. (1) The portion of section 114 of the Act before paragraph (*a*) is replaced by the following:

Individual resident in Canada for only part of year

114. Notwithstanding subsection 2(2) and subject to subsection 94.2(5), the taxable income for a taxation year of an individual who is resident in Canada throughout part of the year and non-resident throughout another part of the year is the amount, if any, by which

(2) Subsection (1) applies to taxation years that begin after 2002.

19. (1) Subsection 122(2) of the Act is amended by striking out the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*d*.1) was not a trust to which a contribution, within the meaning assigned by section 94, was made after June 22, 2000; and

(2) Subsection (1) applies to trust taxation years that begin after 2002. Subsection (1) also applies to trust taxation years that begin

(*a*) after 2000, if the trust makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the trust makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

20. (1) Paragraph 126(1)(*a*) of the Act is replaced by the following:

(*a*) the part of any non-business income tax paid by the taxpayer for the year to the government of a country other than Canada that the taxpayer claims,

(2) Section 126 of the Act is amended by adding the following after subsection (1.1):

Exception

(1.2) Subsection (1)

(*a*) does not apply to non-business income tax paid by a taxpayer in respect of an amount received by the taxpayer in respect of a participating interest (as defined in subsection 94.1(1)) of the taxpayer in a foreign investment entity (as defined in subsection 94.1(1)); and

(*b*) does not apply to non-business income tax paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation.

(3) Subsection (1) and (2) applies to taxation years that begin after 2002.

21. (1) Paragraph 149(10)(*c*) of the Act is replaced by the following:

(*c*) for the purposes of applying sections 37, 65 to 66.4, 66.7, 94.1 to 94.3, 111 and 126, subsections 127(5) to (35) and section 127.3 to the corporation, the corporation is deemed to be a new corporation the first taxation year of which began at that time; and

(2) Subsection (1) applies to each corporation that, after 2002, becomes or ceases to be exempt from tax on its taxable income under Part I of the Act.

22. (1) Subparagraph 152(4)(*b*)(vi) of the Act is replaced by the following:

(vi) is made in order to give effect to the application of subsection 94(9) or (10) or 118.1(15) or (16).

(2) Subsection (1) applies after 2002.

23. (1) Section 160 of the Act is amended by adding the following after subsection (2)

Assessment

(2.1) The Minister may at any time assess a taxpayer in respect of any amount payable because of paragraph 94(3)(*d*) or (*e*) and the provisions of this Division (including, for greater certainty, the provisions in respect of interest payable) apply, with any modifications that the circumstances require, in respect of an assessment made under this section as though it had been made under section 152 in respect of taxes payable under this Part.

(2) The portion of subsection 160(3) of the Act before paragraph (*a*) is replaced by the following:

Discharge of liability

(3) Where a particular taxpayer has become jointly and severally, or solidarily, liable with another taxpayer under this section or because of paragraph 94(3)(*d*) or (*e*) in respect of part or all of a liability under this Act of the other taxpayer,

(3) Subsections (1) and (2) apply to assessments made after 2002.

24. (1) Paragraph (*c*) of the description of A in subsection 162(10.1) of the French version of the Act is replaced by the following:

c) si la déclaration est à produire en application de l'article 233.2 à l'égard d'une fiducie, 5 % du total des montants représentant chacun la juste valeur marchande, au moment où il a été fait, d'un apport que la personne ou la société de personnes a fait à la fiducie avant la fin de la dernière année d'imposition de celle-ci pour laquelle la déclaration doit être produite,

(2) Paragraph (*d*) of the description of A in subsection 162(10.1) of the English version of the Act is replaced by the following:

(*d*) where the return is required to be filed under section 233.2 in respect of a trust, 5% of the total of all amounts each of which is the fair market value, at the time it was made, of a contribution of the

person or partnership made to the trust before the end of the last taxation year of the trust in respect of which the return is required,

(3) Section 162 of the Act is amended by adding the following after subsection (10.1):

Application to trust contributions

(10.11) In paragraph (*d*) of the description of A in subsection (10.1), subsections 94(1) and (2) apply, except that the references to "(other than a restricted property)" in the definition "arm's length transfer" in subsection 94(1) are to be read as references to "(other than property that is not described in any of subclauses (*b*)(i)(A)(I) to (III) but to which paragraph 94(2)(*g*) applies)".

(4) The portion of subsection 162(10.3) of the Act before paragraph (*a*) is replaced by the following:

Application to partnerships

(10.3) For the purposes of paragraph (*f*) of the description of A in subsection (10.1) and subsection (10.2), in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a partnership,

(5) Subsection 162(10.4) of the Act is repealed.

(6) Subsections (1) to (5) apply to returns in respect of taxation years that begin after 2002. Subsections (1) to (5) also apply to returns in respect of taxation years that begin

(*a*) after 2000, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

25. (1) Paragraph 163(2.4)(*b*) of the Act is replaced by the following:

(*b*) where the return is required to be filed under section 233.2 in respect of a trust, the greater of

(i) $24,000, and

(ii) 5% of the total of all amounts each of which is the fair market value, at the time it was made, of a contribution of the person or partnership made to the trust before the end of the last taxation year of the trust in respect of which the return is required;

(2) Section 163 of the Act is amended by adding the following after subsection (2.4):

Application to trust contributions

(2.41) In subparagraph (2.4)(*b*)(ii), subsections 94(1) and (2) apply, except that the references to "(other than a restricted property)" in the definition "arm's length transfer" in subsection 94(1) are to be read as references to "(other than property that is not described in any of subclauses (*b*)(i)(A)(I) to (III) but to which paragraph 94(2)(*g*) applies)".

(3) The portion of subsection 163(2.6) of the Act before paragraph (*a*) is replaced by the following:

Application to partnerships

(2.6) For the purposes of paragraph (2.4)(*d*) and subsection (2.5), in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a partnership,

(4) Subsection 163(2.91) of the Act is repealed.

(5) Subsections (1) to (4) apply to returns in respect of taxation years that begin after 2002. Subsections (1) to (4) also apply to returns in respect of taxation years that begin

(*a*) after 2000, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

26. (1) Section 216 of the Act is amended by adding the following after subsection (4):

Optional method of payment

(4.1) If a trust is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust's income for the year, a person who is otherwise required by subsection 215(3) to

remit in the year, in respect of the trust, an amount to the Receiver General in payment of tax on rent on real property or on a timber royalty may elect in prescribed form filed with the Minister under this subsection not to remit under subsection 215(3) in respect of amounts received after the election is made, and if that election is made, the elector shall,

(*a*) when any amount is available out of the rent or royalty received for remittance to the trust, deduct 25% of the amount available and remit the amount deducted to the Receiver General on behalf of the trust on account of the trust's tax under Part I; and

(*b*) if the trust does not file a return for the year as required by section 150, or does not pay the tax that the trust is liable to pay under Part I for the year within the time required by that Part, on the expiration of the time for filing or payment, as the case may be, pay to the Receiver General, on account of the trust's tax under Part I, the amount by which the full amount that the elector would otherwise have been required to remit in the year in respect of the rent or royalty exceeds the amounts that the elector has remitted in the year under paragraph (*a*) in respect of the rent or royalty.

(2) Subsection (1) applies to trust taxation years that begin after 2002, except that an election referred to in subsection 216(4.1) of the Act, as enacted by subsection (1), is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the trust's filing-due date for the taxation year of the trust that includes the day on which this Act is assented to.

27. (1) The definitions "specified beneficiary" and "specified foreign trust" in subsection 233.2(1) of the Act are repealed.

(2) Subsections 233.2(2) and (3) of the Act are replaced by the following:

Rule of application

(2) In this section and paragraph 233.5(*c*.1), subsections 94(1) and (2) apply, except that the references to "(other than a restricted property)" in the definition "arm's length transfer" in subsection 94(1) are to be read as references to "(other than property that is not described in any of subclauses (*b*)(i)(A)(I) to (III) but to which paragraph 94(2)(*g*) applies)".

(3) Subsection 233.2(4) of the Act is replaced by the following:

Filing information on foreign trusts

(4) A person shall file an information return in prescribed form, in respect of a taxation year of a particular trust (other than an exempt trust or a trust described in any of paragraphs (*c*) to (*j*) of the definition "exempt foreign trust" in subsection 94(1)), with the Minister on or before the person's filing-due date for the person's taxation year in which the particular trust's taxation year ends if

(*a*) the particular trust is non-resident at the end of that taxation year of the trust;

(*b*) a contribution has been made by the person to the particular trust at any time in that taxation year of the particular trust or in a preceding taxation year of the particular trust; and

(*c*) the person

(i) is resident in Canada at the end of the particular trust's taxation year, and

(ii) is not, at the end of the year,

(A) a mutual fund corporation,

(B) a non-resident-owned investment corporation,

(C) a person (other than a trust) all of whose taxable income for the person's taxation year that includes that time is exempt from tax under Part I,

(D) a trust all of the taxable income of which for its taxation year that includes that time is exempt from tax under Part I,

(E) a mutual fund trust,

(F) a trust described in any of paragraphs (*a*) to (*e*.1) of the definition "trust" in subsection 108(1),

(G) a registered investment,

(H) a trust in which all persons beneficially interested are persons described in clauses (A) to (G), or

(I) a person who is a contributor to the particular trust by reason only of being a contributor to a trust described in any of clauses (D) to (H).

Similar arrangements

(4.1) In this section and sections 162, 163 and 233.5, a person's obligations under subsection (4) (except to the extent that they are waived in writing by the Minister) are to be determined as if a transfer or loan were a contribution to which paragraph (4)(*b*) applied, an arrangement or entity were a non-resident trust throughout the calendar year that includes the time referred to in paragraph (*a*) and a taxation year of the arrangement or entity were that calendar year, if

(*a*) the person at any time, directly or indirectly, transferred or loaned the property to be held

(i) under the arrangement and the arrangement is governed by laws that are not laws of Canada or a province, or

(ii) by the entity and the entity is a non-resident entity (within the meaning assigned by subsection 94.1(1));

(*b*) the transfer or loan is not an arm's length transfer;

(*c*) the transfer or loan is not solely in exchange for property that would be described in paragraphs (*a*) to (*i*) of the definition "specified foreign property" in subsection 233.3(1) if that definition were read without reference to paragraphs (*j*) to (*q*);

(*d*) the arrangement or entity is not a trust in respect of which the person would, if this Act were read without reference to this subsection, be required to file an information return for a taxation year that includes that time; and

(*e*) the arrangement or entity is, for a taxation year or fiscal period of the arrangement or entity that includes that time, not

(i) an exempt foreign trust,

(ii) a foreign affiliate in respect of which the person is a reporting entity (within the meaning assigned by subsection 233.4(1)), or

(iii) an exempt trust.

(4) Subsections (1) to (3) apply to returns in respect of trust taxation years that begin after 2002. Subsections (1) to (3) also apply to returns in respect of trust taxation years that begin

(*a*) after 2000, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

A return required to be filed because of this subsection is deemed to have been filed with the Minister of National Revenue on a timely basis if it is filed with the Minister of National Revenue on or before the trust's filing-due date for the taxation year of the trust that includes the day on which this Act is assented to.

28. (1) Subparagraph (*a*)(iv) of the definition "bien étranger déterminé" in subsection 233.3(1) of the French version of the Act is replaced by the following:

(iv) la participation dans une fiducie non-résidente ou dans une fiducie qui serait un non-résident en l'absence du sous-alinéa 94(3)*a*)(v),

(2) Paragraph (*a*) of the definition "bien étranger déterminé" in subsection 233.3(1) of the French version of the Act is amended by adding the following after subparagraph (iv):

(iv.1) l'intérêt dans une police d'assurance qui est réputé, par le paragraphe 94.2(11), être une participation déterminée dans une entité non-résidente,

(3) Subparagraph (*b*)(iii) of the definition "bien étranger déterminé" in subsection 233.3(1) of the French version of the Act is repealed.

(4) Subparagraph (*b*)(iv) of the definition "bien étranger déterminé" in subsection 233.3(1) of the French version of the Act is replaced by the following:

(iv) la participation dans une fiducie non-résidente (ou dans une fiducie qui serait un non-résident en l'absence du sous-alinéa 94(3)*a*)(v)) qui n'a pas été acquise pour une contrepartie par la personne ou la société de personnes ou par une personne qui lui est liée,

(5) Paragraph (*d*) of the definition "specified foreign property" in subsection 233.3(1) of the English version of the Act is replaced by the following:

(*d*) an interest in a non-resident trust or in a trust that, if this Act were read without reference to subparagraph 94(3)(*a*)(v), would be non-resident,

(6) The definition "specified foreign property" in subsection 233.3(1) of the English version of the Act is amended by adding the following after paragraph (*d*):

(*d*.1) an interest in an insurance policy that is deemed by subsection 94.2(11) to be a participating interest in a non-resident entity,

(7) Paragraph (*l*) of the definition "specified foreign property" in subsection 233.3(1) of the English version of the Act is repealed.

(8) Paragraph (*m*) of the definition "specified foreign property" in subsection 233.3(1) of the Act is replaced by the following:

(*m*) an interest in a non-resident trust (or in a trust that, if this Act were read without reference to subparagraph 94(3)(*a*)(v), would be non-resident) that was not acquired for consideration by the person or partnership or by a person related to the person or partnership,

(9) Subsections (1), (3) to (5), (7) and (8) apply to returns in respect of trust taxation years that begin after 2002. Subsections (1), (3) to (5), (7) and (8) also apply to returns in respect of trust taxation years that begin

(*a*) after 2000, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the return relates to a trust that makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

(10) Subsections (2) and (6) apply to returns for taxation years that begin after 2002.

29. (1) Subsection 233.4(1) of the Act is amended by adding the word "and" at the end of paragraph (*a*) and by repealing paragraph (*b*).

(2) Subparagraph 233.4(1)(*c*)(ii) of the Act is replaced by the following:

(ii) of which a non-resident corporation is a foreign affiliate at any time in the fiscal period.

(3) The portion of subsection 233.4(2) of the Act before paragraph (*a*) is replaced by the following:

Rules of application

(2) For the purpose of this section, in determining whether a non-resident corporation is a foreign affiliate or a controlled foreign affiliate of a taxpayer resident in Canada or of a partnership

(4) Subsections (1) to (3) apply to taxation years and fiscal periods that begin after 2002. Subsections (1) to (3) also apply to taxation years and fiscal periods that begin

(*a*) after 2000, if the taxation year or fiscal period relates to a trust the taxation year of which begins in 2001 or 2002 and the trust makes a valid election under paragraph 11(2)(*a*) of this Act; and

(*b*) after 2001, if the taxation year or fiscal period relates to a trust the taxation year of which begins in 2002 and the trust makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act.

30. (1) Paragraph 233.5(*c*) of the Act is replaced by the following:

(*c*) if the return is required to be filed under section 233.2 in respect of a trust, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 and before June 23, 2000 that gave rise to the requirement to file a return for a taxation year of the trust that began before 2003 or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2 in respect of each taxation year of the trust that began before 2003;

(*c*.1) if the return is required to be filed under section 233.2, at the time of each contribution (determined with reference to subsection 233.2(2)) made by the person or partnership after June 22, 2000 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.2;

(*c*.2) if the return is required to be filed under section 233.4 by a person or partnership in respect of a corporation that is a controlled foreign affiliate for the purpose of that section of the person or partnership, at the time of each transaction, if any, entered into by the person or partnership after March 5, 1996 that gives rise to the requirement to file the return or that affects the information to be reported in the return, it was reasonable to expect that sufficient information would be available to the person or partnership to comply with section 233.4; and

(2) Subsection (1) applies to returns in respect of taxation years that begin after 2002. Subsection (1) also applies in respect of taxation years that begin

(*a*) in 2001 or 2002, if the trust makes a valid election under paragraph 11(2)(*a*) of this Act, in which case section 233.5 of the Act shall be read, in respect of the trust, without reference to paragraph 233.5(*c*), as enacted by subsection (1); and

(*b*) in 2002, if the trust makes a valid election under paragraph 11(2)(*a*) or (*b*) of this Act, in which case section 233.5 of the Act shall be read, in respect of the trust, without reference to paragraph 233.5(*c*), as enacted by subsection (1).

31. (1) The definition "controlled foreign affiliate" in subsection 248(1) of the Act is replaced by the following:

"controlled foreign affiliate"
«société étrangère affiliée contrôlée»

"controlled foreign affiliate" has, except as expressly otherwise provided in this Act, the meaning assigned by subsection 95(1);

(2) The definition "cost amount" in subsection 248(1) of the Act is amended by adding the following after paragraph (*c*.1):

(*c*.2) where the cost at that time to the taxpayer of the property is determined under subsection 94.2(13), the cost so determined,

(3) The definition "inventory" in subsection 248(1) of the Act is replaced by the following:

"inventory"
« inventaire »

"inventory" means a description of property (other than property to which subsection 94.2(3) applies) the cost or value of which is relevant in computing a taxpayer's income from a business for a taxation year or would have been so relevant if the income from the business had not been computed in accordance with the cash method and, with respect to a farming business, includes all of the livestock held in the course of carrying on the business;

(4) The definition "share" in subsection 248(1) of the Act is replaced by the following:

"share"
« action »

"share", except as the context otherwise requires, means a share or a fraction of a share of the capital stock of a corporation and, for greater certainty, a share of the capital stock of a corporation includes a share of the capital stock of a cooperative corporation (within the meaning assigned by subsection 136(2)) and a share of the capital of a credit union;

(5) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"foreign accrual property income"
« revenu étranger accumulé, tiré de biens »

"foreign accrual property income" has the meaning assigned by section 95;

"non-discretionary trust"
« fiducie non discrétionnaire »

"non-discretionary trust" has the meaning assigned by subsection 17(15);

(6) Subsections (1), (2), (4) and (5) apply to taxation years that begin after 2002.

(7) Subsection (3) applies to fiscal periods that begin after 2002.

PART II

INCOME TAX AMENDMENTS ACT, 2000

32. (1) Paragraph 53(2)(a) of the *Income Tax Amendments Act, 2000* is replaced by the following:

(*a*) in respect of transfers that occur in 2000, 2001 or 2002, for the purpose of subsection 73(1) of the Act, as enacted by subsection (1), the residence of a transferee trust shall be determined without reference to section 94 of the Act, as it reads in its application to taxation years that began before 2003;

(2) Subsection (1) is deemed to come into force on June 14, 2001.

33. (1) Subsection 80(19) of the Act is replaced by the following:

(19) Subsections (1) to (4) apply to the 2000 and subsequent taxation years except that, in respect of transfers in 2000, 2001 or 2002, for the purposes of subsection 107(1) of the Act, as enacted by this section, the residence of a transferee trust shall be determined without reference to section 94 of the Act, as it read in its application to taxation years that began before 2003.

(2) Subsection (1) is deemed to come into force on June 14, 2001.

Explanatory Notes

PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act* and a related Act. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable John Manley, P.C., M.P.
Deputy Prime Minister and Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act* and a related 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

Income from Business or Property

ITA
12(1)(*k*)

Section 12 of the *Income Tax Act* provides for the inclusion of various amounts in computing a taxpayer's income for a taxation year from business or property. Paragraph 12(1)(*k*) refers to certain dividends required by existing sections 90 to 95 to be so added.

Paragraph 12(1)(*k*) is amended so that it refers to all amounts required to be added in computing income under amended sections 90 to 95, including new sections 94.1 and 94.2 relating to foreign investment entities. For more information, see the commentary on those sections.

This amendment generally applies to taxation years that begin after 2002.

Clause 2

Loan to Non-resident – Controlled Foreign Affiliate

ITA
17(15)

Subsection 17(15) of the Act defines expressions that apply for the purposes of section 17, which provides rules under which imputed interest, in connection with debt owing to a taxpayer from a non-resident person, is included in computing the taxpayer's income. The expression "controlled foreign affiliate" is defined to have the same meaning as it does under subsection 95(1) of the Act, except that for the purpose of section 17, a non-resident corporation must be controlled by Canadian residents in order to be treated as a controlled foreign affiliate of a taxpayer resident in Canada.

The definition "controlled foreign affiliate" in subsection 17(15) is amended so that new paragraph 94.1(2)(*h*) does not apply for the purposes of section 17. Under that paragraph, an election is available under which a foreign affiliate of a taxpayer is generally treated as a controlled foreign affiliate of the taxpayer.

This amendment applies after 2002.

Clause 3

Capital Gain from Disposition of Property

ITA
39(1)(*a*)(ii.3)

Paragraph 39(1)(*a*) of the Act describes a taxpayer's capital gain for a taxation year from the disposition of property. This paragraph provides that gains from dispositions of specified properties are to be excluded in determining a capital gain. Under subparagraph 39(1)(*a*)(ii.2), the specified properties include specified debt obligations, where subsection 142.4(4) or (5) applies to the disposition, and mark-to-market properties where subsection 142.5(1) applies to the disposition. Under subparagraph 39(1)(*b*)(ii), the same exclusion generally applies with regard to a taxpayer's capital loss.

New subparagraph 39(1)(*a*)(ii.3) provides a similar exclusion for property in respect of which subsection 94.2(3) applies to a taxpayer immediately before the time of the disposition. Subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities. Because of paragraph 94.2(5)(*b*), this exclusion does not apply in the case of a taxpayer who is not resident in Canada immediately before the time of the disposition.

This amendment applies to dispositions that occur after 2002.

Clause 4

Convertible Property

ITA
51

Section 51 of the Act generally permits a tax-deferred transfer of property where a taxpayer, pursuant to a right of conversion, exchanges capital property (referred to in the commentary on this section as the "convertible property") that is a share, bond, debenture or note of a corporation for capital property that is another share of the capital stock of the corporation.

ITA
51(1)(c)

Paragraph 51(1)(*c*) of the Act provides that an exchange described in paragraph 51(1)(*a*) or (*b*) is deemed not to be to be a disposition of the convertible property.

Paragraph 51(1)(*c*) is amended to ensure that an exchange of convertible property will be considered to be a disposition for the purpose of paragraph 94(2)(*m*) of the Act.

This amendment applies to taxation years that begin after 2002. It also applies to taxation years of a taxpayer that begin

- after 2000 if a trust, to which the taxpayer, directly or indirectly, transferred property in 2001 (or would have so transferred property if new section 94 of the Act applied in 2001), makes a valid election under the coming-into-force provision of new section 94, and

- after 2001 if a trust, to which the taxpayer, directly or indirectly, transferred property in 2002 (or would have so transferred property if new section 94 of the Act applied in 2002), makes a valid election under the coming-into-force provision of new secion 94.

Clause 5

Adjustments to Cost Base

ITA
53

Section 53 of the Act sets out rules for determining the adjusted cost base (ACB) of property. Certain adjustments are made under this section. Subsection 53(1) provides for additions in computing the ACB of a property, and subsection 53(2) for deductions in computing the ACB of a property.

ITA
53(1)(*d*.1)

Paragraph 53(1)(*d*.1) of the Act, applied together with existing paragraph 94(5)(*a*), provides for an addition in computing the adjusted cost base (ACB) to a taxpayer of the taxpayer's capital interest in a trust to which existing paragraph 94(1)(*d*) applies. Paragraph 53(1)(*d*.1) is amended to ensure that historical ACB

additions are maintained, notwithstanding the replacement of the rules in existing section 94.

This amendment applies to taxation years that begin after 2002.

It also applies to taxation years of a taxpayer that begin

- after 2000 if a trust, in which the taxpayer had a capital interest at any time in 2001, makes a valid election under the coming-into-force provision for new section 94, and

- after 2001 if a trust, in which the taxpayer had a capital interest at any time in 2002, makes a valid election under the coming-into-force provision for new section 94.

ITA
53(1)(*m*) and (*m*.1)

Paragraph 53(1)(*m*) of the Act provides for an addition in computing the ACB to a taxpayer of "offshore investment fund property" to which existing section 94.1 applies. Paragraph 53(1)(*m*) is amended to ensure that the historical ACB additions are maintained, notwithstanding the replacement of the rules in existing section 94.1.

Paragraph 53(1)(*m*.1) is introduced to provide for the ACB additions contemplated by new subsection 94.2(12). For more information, see the commentary on that subsection.

Paragraph 53(1)(*m*.2) is introduced to provide for an ACB addition in computing the ACB to a taxpayer of a participating interest, in a foreign investment entity, in respect of which new subsection 94.1(4) applies in computing the taxpayer's income for a taxation year. For more information, see the commentary on section 94.1.

These amendments apply to taxation years that begin after 2002.

ITA
53(2)(*b*.1)

Paragraph 53(2)(*b*.1) of the Act, applied together with existing paragraph 94(5)(*b*), provides for a deduction in computing the ACB to a taxpayer of the taxpayer's capital interest in a trust to which existing paragraph 94(1)(*d*) applies. Paragraph 53(1)(*b*.1) is amended to ensure that historical ACB deductions are maintained, notwithstanding the replacement of the rules in existing section 94.

This amendment applies to taxation years that begin after 2002. It also applies to taxation years of a taxpayer that begin

- after 2000 if a trust, in which the taxpayer had a capital interest at any time in 2001, makes a valid election under the coming-into-force provision for new section 94, and

- after 2001 if a trust, in which the taxpayer had a capital interest at any time in 2002, makes a valid election under the coming-into-force provision for new section 94.

ITA
53(2)(*w*)

Paragraph 53(2)(*w*) of the Act is introduced to provide for the ACB reductions contemplated by new subsections 94.2(12) and 94.3(2). For more information, see the commentary on those subsections.

New paragraph 53(2)(*w*) applies to taxation years that begin after 2002.

Clause 6

Death of a Taxpayer

ITA
70(3.1)

Under subsection 70(2) of the Act, the value of certain "rights or things" owned by an individual at the time of the individual's death is required to be included in the individual's income for the year of death. Subsection 70(3) provides that this rule does not apply in connection with "rights or things" transferred to beneficiaries of the deceased within a specified period of time. Subsection 70(3.1) provides that certain property does not constitute a "right or thing" for this purpose.

Subsection 70(3.1) is amended so that a "right or thing" does not include property in respect of which new subsection 94.2(3) applied to the individual immediately before the individual's death. New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.

This amendment applies to taxation years that begin after 2002.

ITA
70(5.2)(*e*)

Subsection 70(5.2) of the Act provides rules with respect to the disposition of resource properties and land inventories on death.

Paragraph 70(5.2)(*e*) is introduced to provide for a deemed disposition, immediately before the death of an individual, of an interest in a foreign investment entity held by the individual. Paragraph 70(5.2)(*e*) applies only to an interest in a foreign investment entity in respect of which new subsection 94.2(3) applied to the deceased immediately before death. New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.

A disposition under paragraph 70(5.2)(*e*) is deemed to occur for proceeds of disposition equal to the fair market value, at the time of the deemed disposition, of the interest in the foreign investment entity. That paragraph also provides that the acquisition by another person of the interest as a consequence of the individual's death is deemed to be at a cost equal to that fair market value. The proceeds of disposition are included in the value of A in the formula in paragraph 94.2(4)(*a*) in computing the deceased's income under subsection 94.2(4) for the taxation year of death. The deceased is treated as not having held the interest after death.

This amendment applies to taxation years that begin after 2002.

Clause 7

Trusts – Attribution

ITA
75(2) and (3)

Subsection 75(2) generally provides for the attribution of income derived from certain trust property to a person resident in Canada where the property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person). Subsection 75(3) exempts certain trusts from this attribution rule.

Subsection 75(2) is amended to ensure that, if the person to whom income from a particular property would otherwise be attributed under that subsection is an otherwise non-resident trust that is deemed

by new subsection 94(3) to be resident in Canada, the income from that property will not be attributed back to the person.

Amended subsection 75(2) generally applies to trust taxation years that begin after 2000.

Subsection 75(3) is amended by adding new paragraph 75(3)(*c*.2). New paragraph 75(3)(*c*.2) ensures that subsection 75(2) does not apply to trusts in respect of which the contributors are recent immigrants to Canada (i.e., resident in Canada for not more than 60 months). The exception is consistent with similar 60-month exemptions in:

- section 94 (see subsection 94(3) and the definitions "connected contributor" and "resident contributor" in subsection 94(1)),
- section 94.1 (see subsection 94.1(3) and the definition "exempt taxpayer" in subsection 94.1(1)), and
- section 94.2 (see subparagraph 94.2(3)(*b*)(*i*)).

New paragraph 75(3)(*c*.2) applies to trust taxation years that begin after 2000 except that, for trust taxation years that begin in 2001 or 2002, paragraph 75(3)(*c*.2) applies with reference to subsection 94(1) as it reads in its application to taxation years that begin after 2002.

Clause 8

Definition of "Eligible Property"

ITA
85(1.1)(*g*)

Subsection 85(1.1) of the Act describes the types of property (referred to as "eligible property") that may be transferred to a corporation under subsection 85(1). Eligible property includes certain capital property described in the subsection, as well as additional property.

Subsection 85(1.1) is amended so that eligible property for a taxpayer, in all cases, excludes property in respect of which new subsection 94.2(3) applies to the taxpayer. New subsection 94.2(3) sets out the conditions for the application of the mark-to-market taxation regime under subsection 94.2(4) for participating interests in foreign investment entities.

This amendment applies to taxation years that begin after 2002.

Clause 9

Amalgamations – Non-resident Trusts and Foreign Investment Entities

ITA
87(2)(*j*.95)

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

New paragraph 87(2)(*j*.95) provides that, where there has been an amalgamation of two or more taxable Canadian corporations, the amalgamated corporation is deemed to be a continuation of its predecessor corporations for the purposes of sections 94 to 94.3, which relate to foreign trusts and foreign investment entities. Thus, for example, an amalgamated corporation will be considered to be a "contributor" (as defined in subsection 94(1)) to a trust if any predecessor corporation was a contributor to the trust. In addition, the new corporation's "deferral amount" (as defined in subsection 94.2(1)) in respect of an interest in a foreign investment entity will be determined in the same manner as a predecessor's "deferral amount" in respect of the same interest.

Because of the operation of paragraph 88(1)(*e*.2), new paragraph 87(2)(*j*.95) also applies to windings-up to which section 88 applies.

This amendment applies to taxation years that begin after 2000.

Clause 10

Amounts to be Included in Respect of Share of a Foreign Affiliate

ITA
91

Section 91 of the Act sets out rules for determining amounts that a taxpayer resident in Canada is to include in computing its income for a particular year as income from a share of a controlled foreign affiliate of the taxpayer.

ITA
91(1)

Subsection 91(1) of the Act provides that a taxpayer that is resident in Canada must include in computing income an amount in respect of each share owned by the taxpayer of the capital stock of a controlled foreign affiliate of the taxpayer.

Subsection 91(1) is amended so that it does not result in additional income for a taxpayer arising because of the ownership by the taxpayer (or by a controlled foreign affiliate of the taxpayer) of shares that are participating interests in a "tracking entity" to which the mark-to-market regime under subsection 94.2(4) applies by reason of the application of subsections 94.2(3) and (9). Note that, because of paragraph 94.1(3)(*d*), subparagraph 94.2(3)(*b*)(i) and paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1), a share of the capital stock of a controlled foreign affiliate is otherwise not subject to the regime for foreign investment entities in new sections 94.1 and 94.2.

This amendment applies to taxation years that begin after 2002.

ITA
91(4)

Subsection 91(4) of the Act provides for a deduction in computing the income of a taxpayer resident in Canada. The deduction is available where the taxpayer has included an amount under subsection 91(1) in computing income in respect of a share of the capital stock of a controlled foreign affiliate of the taxpayer. The deduction is generally determined with reference to foreign taxes payable by the affiliate and a "relevant tax factor". The "relevant tax factor" for a resident taxpayer is designed to permit a deduction for the resident taxpayer that will result in tax relief that is a proxy for a foreign tax credit in respect of foreign taxes payable by a controlled foreign affiliate of the resident taxpayer.

Subsection 91(4) is amended to explicitly link the "relevant tax factor" to the resident taxpayer and the taxation year for which the deduction under subsection 91(4) is claimed.

This amendment applies to the 2002 and subsequent taxation years.

Clause 11

Non-resident Trusts

ITA
94

OVERVIEW

Existing Rules

Section 94 of the Act sets out rules that tax the passive income earned by certain non-resident trusts. Section 94 generally applies if a person resident in Canada has transferred or loaned property to a non-resident trust that has one or more beneficiaries that are resident in Canada.

Section 94 uses two different methods to impose tax, depending on whether the trust is a discretionary trust. A discretionary trust is a trust under which a person has a discretionary power to determine the amount of the income or capital of the trust that one or more beneficiaries will receive.

If the non-resident trust is a discretionary trust, paragraph 94(1)(*c*) deems the trust to be resident in Canada for the purposes of Part I of the Act and deems its income for tax purposes to be the total of its Canadian source income and its foreign accrual property income, if any. Each beneficiary is jointly and severally liable to pay the Canadian tax of the trust. However, the liability can be enforced against a particular beneficiary only to the extent that the beneficiary has received a distribution from the trust or proceeds from the sale of an interest in the trust.

If the non-resident trust is not a discretionary trust, paragraph 94(1)(*d*) provides that it is to be treated in much the same manner that a non-resident corporation is treated. If a Canadian resident beneficiary holds an interest in the trust with a fair market value equal to 10% or more of the total fair market value of all beneficial interests in the trust, the trust is deemed to be a controlled foreign affiliate of the beneficiary. Consequently, the foreign accrual property income rules apply to the trust and the beneficiary, requiring the beneficiary to include a portion of the foreign accrual property income of the trust in income. On the other hand, beneficiaries whose beneficial interests are less than 10% of the total fair market value of all interests in the trust may be subject to tax under the offshore investment fund rules in section 94.1. If section 94.1 does not apply, such beneficiaries are taxed only if trust income becomes payable to them in the year in which it arises.

New Rules

New section 94 of the Act takes a different approach to the taxation of non-resident trusts (NRTs). In general, if a Canadian resident contributes property to a NRT, the contributor, the NRT and certain Canadian resident beneficiaries of the trust may all become jointly and severally and solidarily liable to pay Canadian tax on the world-wide income of the trust. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Except as indicated otherwise, the amendments to section 94 apply to trust taxation years that begin after 2002. In addition,

- a trust created in 2001 may elect in writing (by filing the election with the Minister on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001 and 2002, and

- a trust created in 2002 may elect in writing (by filing the election with the Minister on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2002.

The table below briefly summarizes section 94 and related rules.

Issue	Summary	References
1. Which trusts are subject to the new NRT rules?	A. In general, a trust (other than an exempt foreign trust) will be subject to tax for a taxation year as a trust resident in Canada if a contribution was made to the trust by an entity that is resident in Canada at the end of the year (other than a recent immigrant to Canada) - i.e. a resident contributor	S. 94(3) "entity" – s. 94(1) "exempt foreign trust" – s. 94(1) "contribution" – s. 94(1) and (2) "resident contributor" – s. 94(1) As to 60-month test for new immigrants, see definition "resident contributor" in s. 94(1).
	B. In addition, a trust (other than an exempt foreign trust) will generally be subject to Canadian tax for a taxation year if there is a resident beneficiary under the trust. More specifically if: • the contribution was made by an entity when the entity was resident in Canada (or generally within a 60-month period before the entity became resident in Canada or within a 60-month period after the entity ceased to be resident in Canada),	S. 94(3) and (10) "beneficiary" – s. 94(1) "contribution" – s. 94(1) and (2) "connected contributor" – s. 94(1) "entity" – s. 94(1) "non-resident time" - 94(1) "resident beneficiary" – s. 94(1) "specified charity" – s. 94(1) "testamentary beneficiary" – s. 94(1)

Issue	Summary	References
	• where the contributing entity is an individual (other than a trust), by the end of the year the individual had been resident in Canada for more than 60 months, and • at the end of the year there is an entity (other than a specified charity or testamentary beneficiary) that is resident in Canada and is a beneficiary under the trust.	
2. Who is responsible for the tax payable by an NRT?	The trust is required to pay tax. If it fails to do so, each contributor referred to in 1(A) and/or each beneficiary referred to in 1(B) is jointly and severally and solidarily liable with the trust for the tax. However, the amount recoverable from an entity that is simply a beneficiary is limited to the beneficiary's recovery limit. Relief is also available in some cases for a contributor whose contribution to the trust is insignificant relative to other contributions made to the trust.	Jointly and severally, and solidarily, liable: paragraph 94(3)(*d*) Limit to amount recoverable - 94(7) Recovery limit - 94(8) Determination of fair market value - 94(9) Definitions - 94(1)
3. Where the NRT rules apply to a trust for a taxation year, how will the trust's tax liabilities be calculated?	A. Canadian rules generally apply to the trust as if the trust were resident in Canada throughout the year for the purpose of computing the trust's income.	s. 94(3)

Issue	Summary	References
	B. Explicit rule treats the trust as becoming resident in Canada, with resulting adjustment to cost amount of property under section 128.1.	s. 94(3)(*c*)
	C. Parts XII.2 and XIII do not apply to the trust. Explicit exemption from Part XIII tax on amounts distributed to the trust, although payer must still withhold.	s. 94(3)(*a*)(v) and (4)(*b*) (see also s.216(4.1)
	D. Flow-through of income to resident and non-resident beneficiaries permitted, subject to special rules in the event that Canadian-source income is distributed to non-residents.	s. 104(7.01) - special rules

Definitions

ITA
94(1)

New subsection 94(1) of the Act defines a number of expressions that apply for the purpose of section 94.

“arm’s length transfer”

A loan or transfer of property by an “entity” in respect of a trust will generally not be considered a “contribution” to the trust where the loan or transfer is an “arm’s length transfer”. In these circumstances, the transferor entity will not be considered to be a “contributor” to the trust. Accordingly, subsection 94(3) does not apply to a non-resident trust as a consequence only of an “arm’s length transfer” in respect of the trust. (For more information on the definitions “contribution”, “contributor” and “entity” in subsection 94(1), see the commentary on those definitions.)

The definition “arm’s length transfer” also is relevant in applying the rules in new paragraphs 94(2)(*a*) and (*c*). Under those rules, a loan or transfer of property made to an entity other than a particular trust may, in specified circumstances, result in a transfer of property being considered to have been made to the particular trust. (For more information, see the commentary on new subsection 94(2).)

If property transferred or loaned is “restricted property”, the transfer or loan will not be an arm's length transfer. (For more information on the definition “restricted property”, see the commentary on that definition.)

Under paragraph (*a*) of the definition, a transfer or loan will be an arm's length transfer only if it is reasonable to conclude that none of the reasons (determined by reference to all the circumstances including the terms of a trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the transfer is the acquisition at any time by any entity of an interest as a beneficiary under a non-resident trust.

Under subparagraphs (*b*)(i) and (ii) of the definition, an arm’s length transfer includes, in general terms, an arm’s length return on investment (conferred by the entity in which the investment is made) and certain payments made by a corporation on a reduction of the paid up capital in respect of shares of a class of the corporation’s capital stock.

Under subparagraph (*b*)(iii) of the definition, an arm’s length transfer includes a transfer to a trust by a “specified charity” (as defined in new subsection 94(1)) in respect of the trust that is made by the specified charity for the purpose of refunding in whole or in part a gift previously made to the specified charity entity by the trust. For more information on the definition “specified charity”, see the commentary on that definition.

Under subparagraph (*b*)(iv) of the definition, an arm’s length transfer includes a transfer in exchange for which, the recipient transfers or loans property (other than a restricted property) to the transferor, or becomes obligated to so transfer or loan such property, and for which it is reasonable to conclude

- having regard only to the transfer and the exchange that the transferor would have been willing to make the transfer if the transferor dealt at arm’s length with the recipient, and

- that the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor if the transferor dealt at arm’s length with the recipient,

Under subparagraph (*b*)(v) of the definition, an arm’s length transfer includes a transfer that is made in satisfaction of an obligation that arose because of a transfer to which subparagraph (*b*)(iv) applied, if

- the transfer is not a transfer described in paragraph 94(2)(*g*),

- the transferor would have been willing to make the transfer if the transferor dealt at arm's length with the recipient, and

- the terms and conditions, and circumstances, under which the transfer was made would have been acceptable to the transferor if the transferor dealt at arm's length with the recipient.

Under subparagraph (*b*)(vi) of the definition, an arm's length transfer includes a transfer that is a payment of an amount owing by the transferor under a written agreement the terms and conditions of which, when entered into, were terms and conditions that, having regard only to the amount owing and the agreement, persons dealing at arm's length would have entered into, if the transfer is not a transfer described in paragraph 94(2)(*g*).

Under subparagraph (*b*)(vii) of the definition, an arm's length transfer includes a transfer that is a payment made before 2002 to a trust (or to a corporation controlled by the trust or to a partnership of which the trust is a majority interest partner, together referred to in this subparagraph as "the specified person or partnership") in repayment of or otherwise in respect of a particular loan made by the trust (or by the specified person or partnership, as the case may be) to the transferor.

Finally, under subparagraph (*b*)(viii) of the definition, an arm's length transfer includes a transfer that is a payment made after 2001 to a trust (or to a corporation controlled by the trust or to a partnership of which the trust is a majority interest partner, together referred to in this subparagraph as "the specified person or partnership") in repayment of or otherwise in respect of a particular loan made by the trust (or by the specified person or partnership, as the case may be) to the transferor in circumstances where either

- they would have been willing to enter the particular loan if they dealt at arm's length with each other and the payment is not a transfer described in paragraph 94(2)(*g*), or

- the payment is made before 2005 in accordance with fixed repayment terms agreed to before June 23, 2000.

The definition "arm's length transfer" generally applies to trust taxation years that begin after 2002. However, where a trust elects, by notifying the Minister in writing on or before its filing-due date for its taxation year that includes the day on which this Act is assented to, the definition "arm's length transfer" will be read without reference to a loan or transfer of property that is made before 2003

and identified in the election. This electing provision recognizes that the definition “arm’s length transfer” in the new rules does not have an equivalent under existing subsection 94(1) of the Act. In particular, a non-resident trust now considered resident by reason of existing subsection 94(1) might not be described in new subsection 94(3) and would no longer be considered resident, which would result in the emigration rules in section 128.1 applying. The election, which is found in the coming-into-force provision of the amending legislation, effectively permits a trust to continue to be deemed resident.

“beneficiary”

Under paragraph (*a*) of the new definition “beneficiary” in subsection 94(1), a beneficiary of or under a trust includes an entity beneficially interested in the trust.

Under paragraph (*b*) of that definition, a beneficiary of or under a trust also includes an entity that would be beneficially interested in the trust if

- the entity were a person, and
- the reference in subparagraph 248(25)(*b*)(ii) to

    (A) “any arrangement in respect of the particular trust” were read as a reference to “any arrangement (including the terms or conditions of a share, or any arrangement in respect of a share, of the capital stock of a corporation that is beneficially interested in the particular trust) in respect of the particular trust”, and

    (B) “the particular person or partnership might” were read as a reference to “the particular person or partnership becomes (or could become on the exercise of any discretion by any entity), directly or indirectly, entitled to any amount derived, directly or indirectly, from the income or capital of the particular trust or might”.

For the purposes of the Act, the expression “beneficially interested” has the meaning assigned by subsection 248(25) of the Act.

“closely-held corporation”

The definition “closely-held corporation” is relevant in applying subparagraph (*b*)(i) of the definition “arm's length transfer” and the definition “restricted property”. (For more information on the

definitions " arm's length transfer " and " restricted property " in subsection 94(1), see the commentary on those definitions.)

A closely-held corporation at any time, means a corporation, other than a corporation shares of a class of the capital stock of which are, at that time, widely held and actively traded. In order for shares to be widely held and actively traded for this purpose, the conditions described in paragraph 94.1(2)(*f*) of the Act must be met with any modifications that the circumstances require.

"connected contributor"

The definition "connected contributor" is relevant in determining whether a beneficiary is, at a particular time, a "resident beneficiary" (as defined in new subsection 94(1)) under a non-resident trust. Under new paragraph 94(3)(*d*) of the Act, such a resident beneficiary can, to an extent, be liable for the trust's income tax. For more information, see the commentary on subsections 94(3) and (7) to (10), subparagraph 152(4)(*b*)(vi) and subsections 160(2.1) and (3).

A connected contributor at a particular time is any entity, including an entity that has ceased to exist, that is a "contributor" (as defined in new subsection 94(1)) to the trust at that time, other than

- an individual who was resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including a trust or an individual who before that time was never non-resident), and

- an entity that is a contributor only because of one or more transactions that occurred at a "non-resident time" (as defined in new subsection 94(1)) of the entity.

For more information on the definitions "contributor", "resident beneficiary" and "non-resident time" in subsection 94(1), see the commentary on those definitions.

In the context of the definition "connected contributor", reference should also be made to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94), new paragraphs 94(2)(*n*) to (*q*) and subsections 94(11) to (13) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94) and paragraphs 94(2)(*r*) to (*u*) (which generally narrow the circumstances in which a contribution is considered to be made for the purposes of section 94). Reference should also be made to new subsection 94(10), which applies where a contributor becomes

resident in Canada within 60 months after making a contribution to a trust.

"contribution"

Where a "contribution" is made at or before a particular time to a non-resident trust by an entity, that entity will be considered to be a "contributor" at the particular time and, in certain cases, will be jointly and severally and solidarily liable under subsection 94(3) for the trust's income taxes. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.) For more information on subsection 94(3), see the commentary on that subsection.

Under paragraph (*a*) of the definition, a "contribution" to a trust by a particular entity means a loan or transfer of property (in this commentary referred to as a "transfer") by the entity to the trust (other than an "arm's length transfer", as defined in new subsection 94(1)).

Under paragraphs (*b*) and (*c*) of the definition "contribution", a contribution is also considered to have been made by a particular entity where

- the particular entity makes a particular transfer (other than an "arm's length transfer") as part of a series of transactions or events that includes another transfer, to the trust, by another entity; or

- the particular entity becomes obligated to make a particular transfer (other than an "arm's length transfer") as part of a series of transactions or events that includes another transfer, to the trust, by another entity.

In these circumstances, the other transfer is considered to be a contribution to the trust by the particular entity only to the extent that the other transfer can reasonably be considered to have been made in respect of the particular transfer or the particular entity's obligation to make the particular transfer, as the case may be. In either case, a contribution is considered to be made at the time of the other transfer.

There are a number of rules that have the effect of applying the definition "contribution" more broadly than would otherwise be the case. See the commentary on new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94), new paragraphs 94(2)(*n*) to (*q*) and subsections 94(11) to (13) (which generally extend the circumstances

in which a contribution is considered to be made for the purposes of section 94) and paragraphs 94(2)(*r*) to (*u*) (which generally narrow the circumstances in which a contribution is considered to be made for the purposes of section 94).

The definition "contribution" applies to all loans and transfers, irrespective of when made.

"contributor"

A "contributor" to a trust at any time means an "entity" (as defined in new subsection 94(1)), including an entity that has ceased to exist, that at or before that time has made a "contribution" (as defined in new subsection 94(1)) to the trust. The definition "contributor" is significant primarily for the purposes of the definitions "resident contributor" and "connected contributor" in new subsection 94(1). For more information, see the commentary on those definitions.

Reference should be made in this context to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94), new paragraphs 94(2)(*n*) to (*q*) and subsections 94(11) to (13) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94) and paragraphs 94(2)(*r*) to (*u*) (which generally narrow the circumstances in which a contribution is considered to be made for the purposes of section 94).

"entity"

The expression "entity" is defined to include an association, a corporation, a fund, a natural person, a joint venture, an organization, a partnership, a syndicate and, for greater certainty, a trust.

"exempt foreign trust"

An "exempt foreign trust" includes a number of different types of non-resident trusts that are exempt from the application of new subsection 94(3). The expression refers to the following types of non-resident trusts:

> (*a*) a non-resident trust the current income (determined with reference to amended subsection 108(3)) or capital from which can be provided only to one or more physically or mentally infirm dependent individuals, provided that these individuals are non-resident and that any property settled on the trust could reasonably be considered, at the time it was settled, to be necessary for the maintenance of those individuals;

(*b*) a non-resident trust created after the breakdown of a marriage or common-law partnership of two individuals, the current income (determined with reference to amended subsection 108(3)) or capital from which can be provided only to non-resident children of one of the individuals, if the children are under 21 years of age (or under 31 years of age and enrolled in a specified educational institution) and each "contribution" to the trust (as defined in subsection 94(1)) was to provide for the maintenance of those children;

(*c*) certain non-resident trusts that own or administer a university described in paragraph (*f*) of the definition "total charitable gifts" in subsection 118.1(1) and that could qualify under that definition as a recipient permitted for the purposes of the tax credit for charitable gifts;

(*d*) certain non-resident trusts established exclusively for charitable purposes (as those purposes are defined in the laws of Canada);

(*e*) a non-resident trust that thoughout the trust's current year is governed by an employee profit sharing plan (as defined in subsection 248(1)), by a retirement compensation arrangement (as defined in subsection 248(1), or by a foreign retirement arrangement (as defined in subsection 248(1));

(*f*) a non-resident trust if throughout the trust's current year

(i) it is governed by an employee benefit plan (as defined in subsection 248(1)) or a trust described in paragraph (*a*.1) of the definition trust in subsection 108(1),

(ii) it is maintained primarily for the benefit of non-resident individuals,

(iii) it holds no restricted property, and

(iv) it provides no benefits, other than benefits in respect of services described in clauses (iv)(A) to (E) of the definition;

(*g*) a non-resident trust that at all times after it was created has been

(i) resident in a country (other than Canada) under the laws of which an income tax is imposed,

(ii) exempt under the laws referred to in subparagraph (i) from the payment of income or profits tax to the government of that country in recognition of the purposes for which it is operated,

(iii) operated exclusively for the purpose of administering or providing benefits under, one or more superannuation, pension or retirement funds or any funds or plans established to provide employee benefits, and

(iv) maintained for the benefit of persons all or substantially all of whom are non-resident individuals;

(*h*) a non-resident trust (other than a trust created or maintained for charitable purposes, a trust governed by an employee benefit plan, a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1), a salary deferral arrangement, a trust operated for the purpose of administering or providing superannuation, pension, retirement or employee benefits and a personal trust) if

(i) the trust is described in paragraph (*c*) of the definition "exempt trust" in subsection 233.2(1) (i.e., certain foreign unit trusts that meet the conditions described in section 4801.1 of the *Income Tax Regulations*), and

(ii) the interest of each beneficiary under the trust is, throughout the trust's taxation year that includes the particular time, vested indefeasibly; or

(*j*) a prescribed trust or prescribed class of trusts. (At the present time, it is not anticipated that any trust or class of trusts will be prescribed for this purpose.)

In addition, under paragraph (*i*) of the definition, a non-resident trust that meets at a particular time certain specified conditions will be treated as an exempt foreign trust unless it has elected in writing filed with the Minister, on or before the trust's filing-due date for the particular taxation year of the trust that includes the particular time (or for an earlier taxation year that ended before the particular time), that paragraph (*i*) not apply to it for the particular taxation year (or for the earlier taxation year) and for all of its subsequent taxation years. The specified conditions are that

- the trust not be a trust to which paragraph (*h*) of the definition applies, a trust created or maintained for charitable purposes, a trust governed by an employee benefit plan, a trust described in paragraph (*a*.1) of the definition "trust" in subsection 108(1), a salary deferral arrangement, a trust operated for the purpose of administering or providing superannuation, pension, retirement or employee benefits or a personal trust,

- the trust has, on or before its filing due date for its taxation year that includes the particular time, filed with the Minister a

prescribed form with a copy of the trust indenture that applies at the particular time (note that after the initial filing, it is intended that the prescribed form be filed in respect of each taxation year in which the trust indenture is in any way modified or varied);

- at the particular time, it is reasonable to conclude that, with respect to each particular contribution made by a particular contributor to the trust,

  (i) no consideration was received (other than property received by the particular contributor that is the particular contributor's interest as a beneficiary under the trust),

  (ii) none of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the contribution is the acquisition at any time by any entity (other than the particular contributor) of an interest as a beneficiary under the trust, and

  (iii) if the particular contributor is resident in Canada at the time of that particular contribution (note that this condition would apply in respect of individual described in paragraph (*a*) of the definition "resident contributor" in subsection 94(1)), the fair market value of the particular contribution is equal to the amount that it would be if the particular contributor had dealt at arm's length with the trust; and

- throughout the trust's taxation year that includes the particular time

  (i) the interest of each beneficiary under the trust was described by reference to units and was vested indefeasibly,

  (ii) the trust held no restricted property,

  (iii) the trust's only undertakings were activities described in any of subparagraphs 132(6)(*b*)(i) to (iii), and

  (iv) all of the issued units of the trust carried identical rights.

Paragraph (*i*) is intended to apply to non-resident investment trusts that are legitimately commercial - commonly referred to as pooled fund trusts - where the trust has fewer than 150 unitholders. Given the restrictions on the trust's undertakings, such a trust is intended to be treated as a foreign investment entity under sections 94.1 to 94.3.

A Canadian resident unitholder (other than an "exempt taxpayer" within the meaning assigned by subsection 94.1(1)) of the trust would be expected to be a taxpayer to whom subsection 94.1(3) applies for a taxation year of the unitholder.

"exempt service"

The definition "exempt service" is relevant to new paragraph 94(2)(*f*), which deems the provision of certain services (other than exempt services) to be a transfer of property.

An exempt service means a service rendered at any time by an entity (the "service provider") to, for or on behalf of, another entity (a "recipient") if either

- the recipient is at that time a trust and the service relates to the administration of the trust, or

- the following conditions apply in respect of the service, namely

  (i) the service is rendered in the service provider's capacity at that time as an employee or agent of the recipient,

  (ii) in exchange for the service the recipient transfers or loans property, or becomes obligated to transfer or loan property, and

  (iii) it is reasonable to conclude

    (A) having regard only to the service and the exchange that the service provider would have been willing to carry out the service if the service provider had dealt at arm's length with the recipient, and

    (B) that the terms and conditions, and circumstances, under which the service was provided would have been acceptable to the service provider if the service provider had dealt at arm's length with the recipient.

"non-resident time"

The definition "non-resident time" is relevant in determining whether a contributor to a trust is a "connected contributor" and whether the "look-through" rule in paragraph 94(2)(*l*) applies in determining whether an entity has made a contribution (i.e., is a contributor).

The "non-resident time" of an entity in respect of a particular time means a time (referred to in this commentary as the "contribution time") at which the entity made a contribution to a trust, that is

before the particular time and at which the entity was non-resident, provided that the entity was non-resident (or not in existence) throughout a specified period.

As indicated into the coming-into-force provision for new section 94 of the Act, where the contribution time occurs before June 23, 2000, the specified period is the period that begins 18 months before the end of the trust's taxation year that includes the contribution time and ends at the earliest of

- 60 months after the contribution time;
- where the entity is an individual, the date of the individual’s death; and
- subject to subsection 94(10), the particular time.

Where the contribution time occurs after June 22, 2000 and the trust arose as a consequence of the death of an individual, the specified period is the period that begins 18 months before the contribution time and ends at the earliest of

- 60 months after the contribution time;
- where the entity is an individual, the date of the individual’s death; and
- subject to subsection 94(10), the particular time.

Where the contribution time occurs after June 22, 2000 and the trust did not arise as a consequence of the death of an individual, the specified period is the period that begins 60 months before the contribution time and ends at the earliest of

- 60 months after the contribution time;
- where the entity is an individual, the date of the individual’s death; and
- subject to subsection 94(10), the particular time.

The measurement of the specified period by reference to any particular time is to ensure that the contributing entity and the trust may, subject to new subsection 94(10), treat the contribution time as a “non-resident time” for the purposes of applying subsection 94(3) at the end of any particular trust taxation year if at the end of that particular year the contributor still has not become resident in Canada within the 60-month period after the contribution time.

However, as detailed in the commentary on new subsection 94(10), new subsection 94(10) ensures that such a contributor will, for the purposes of the definition "connected contributor", be considered to have made the contribution at a time other than a "non-resident time" if the contributor becomes resident in Canada within the 60-month period after the contribution time. As a result, at the end of each of the trust's taxation years following the contribution, there would be a connected contributor to the trust and, if there were a resident beneficiary under the trust, subsection 94(3) would also apply in respect of those years.

Amended subparagraph 152(4)(*b*)(vi) of the Act ensures that a reassessment of a taxpayer arising out of the application of subsection 94(10) may be undertaken by the Canada Customs and Revenue Agency within 3 years after the end of the taxpayer's normal reassessment period for the taxpayer's relevant taxation year.

For more information on new subsection 94(10) and amended subparagraph 152(4)(*b*)(vi), see the commentary on those provisions.

"promoter"

The definition "promoter" is relevant in applying new paragraph 94(2)(*s*), which provides that a transfer to a trust will not be considered a contribution where certain conditions, described in that paragraph, are met. For this purpose a promoter means an entity that establishes, organizes or substantially reorganizes the undertakings of the trust. For more information on paragraph 94(2)(*s*), see the commentary on that paragraph.

"resident beneficiary"

Under new subsection 94(3), a particular trust is generally treated as resident in Canada for a particular taxation year if there is a "resident beneficiary" under the particular trust at the end of the particular year. Under new paragraph 94(3)(*d*), each "resident beneficiary" can be jointly and severally and solidarily liable with the particular trust for the particular trust's income tax liabilities under the Act for the particular year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.) For more information, see the commentary on subsection 94(3).

A "resident beneficiary" at a particular time under a trust is an entity (other than an entity that is at that time a "specified charity" or a "testamentary beneficiary" in respect of the trust) that, at that time, is a beneficiary under the trust, if, at that time,

- the entity is resident in Canada; and

- there is a "connected contributor" to the trust.

The expressions "connected contributor", "specified charity" and "testamentary beneficiary" are defined in new subsection 94(1). For further information, see the commentary on those definitions.

"resident contributor"

Under new subsection 94(3), a trust is generally treated as resident in Canada for a particular taxation year if there is a "resident contributor" to the trust at the end of the particular year. Under new paragraph 94(3)(*d*), a "resident contributor" can be jointly and severally and solidarily liable with the trust for the trust's income tax liabilities under the Act for the particular year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

A "resident contributor" at any time means an entity that is, at that time, resident in Canada and a "contributor" (as defined in new subsection 94(1)) to the trust. However, an exemption from treatment as a resident contributor is provided for a contributor who is:

- an individual who was resident in Canada for a period of, or periods the total of which is, not more than 60 months (but not including a trust or an individual who before that time was never non-resident); and

- an individual, if the trust is an *inter vivos* trust that was created before 1960 by a person who was non-resident when the trust was created and the individual made no contribution after 1959 to the trust.

In the context of this definition, reference should also be made to new paragraphs 94(2)(*a*) to (*m*) (which extend the circumstances in which a transfer is considered to occur for the purposes of section 94), new paragraphs 94(2)(*n*) to (*q*) and subsections 94(11) to (13) (which generally extend the circumstances in which a contribution is considered to be made for the purposes of section 94) and paragraphs 94(2)(*r*) to (*u*) (which generally narrow the circumstances in which a contribution is considered to be made for the purposes of section 94).

"restricted property"

The expression "restricted property" is relevant in applying a number of provisions in respect of non-resident trusts, including the

definitions in subsection 94(1) of “arm's length transfer” and “exempt foreign trust”. The definition “restricted property” is intended to serve as an anti-avoidance provision.

More specifically, restricted property means

- under paragraph (*a*) of the definition, a particular share (or a right to acquire a share) of the capital stock of a particular closely-held corporation if the particular share (or right), or a property for which the particular share (or right) was substituted, was at any time acquired as part of a transaction or series of transactions under which a specified share of the capital stock of a closely-held corporation was acquired by any entity in exchange for, as consideration for, or upon conversion of any property;

- under paragraph (*b*) of the definition, an indebtedness (or a right to acquire indebtedness) owing by another entity if

  - the other entity is a closely-held corporation,

  - the indebtedness (or right), or a property for which the indebtedness (or right) was substituted, was at any time acquired as part of a transaction or series of transactions under which a specified share of the capital stock of a closely-held corporation was acquired by any entity in exchange for, as consideration for, or upon conversion of any property, and

  - the entitlement to receive, in any manner whatever and from any entity, payments in respect of the indebtedness is, directly or indirectly, determined primarily by reference to any one or more of the criteria identified in any of clauses (*b*)(iii)(A) to (C) of the definition; and

- under paragraph (*c*) of the definition, any property the fair market value of which is derived in whole or in part, directly or indirectly, from a particular share, indebtedness or right described in paragraph (*a*) or (*b*)of the definition.

“specified charity”

The expression “specified charity” is used in the definitions “arm’s length transfer” and “resident beneficiary” in new subsection 94(1). An arm’s length transfer includes a refund, from a specified charity in respect of a trust to the trust, of a gift previously made by the trust to the charity. A resident beneficiary under a trust does not include a specified charity. For more information, see the commentary on those definitions.

A specified charity in respect of a trust at any particular time means a person (in this commentary referred to as a “charity”) that at that time is described in any of paragraphs (*a*) to (*e*) and (*g*.1) of the definition “total charitable gifts” in subsection 118.1(1). However, a specified charity does not include:

- a charity that does not, at a particular time, deal at arm’s length with a “specified entity” in respect of the trust; or

- a charity that did not, at any “specified prior time” in respect of the charity, deal at arm’s length with a specified entity in respect of the trust.

For this purpose, a “specified prior time” in respect of a charity is defined in paragraph (*c*) of the definition “specified charity” as meaning any time, before the particular time, at which

- an amount was payable to the charity as a beneficiary under the trust,

- an amount was received by the charity on the disposition of the charity’s interest in the trust, or

- a benefit was received or enjoyed by the charity from or under the trust.

Paragraph (*d*) of the definition “specified charity” defines a “specified entity” in respect of a trust at any time to mean

- an entity that is at that time beneficially interested in the trust, a contributor to the trust, a person related to a contributor to the trust, a trustee of the trust, an entity that could reasonably be considered to have influence over the operation of the trust or the enforcement of its terms, or an entity that could reasonably be considered to have influence over the selection or appointment of an entity referred to above, or

- any group at least one of the members of which is described immediately above.

“specified controlled foreign affiliate”

A “specified controlled foreign affiliate” of a particular entity at any time means an entity that would, at that time, be a controlled foreign affiliate of the particular entity if the particular entity were resident in Canada at that time. The definition is used for the purpose of the definition “specified party”.

“specified party”

New subsection 94(8) of the Act provides a rule for calculating an entity’s recovery limit for the purpose of determining under subsection 94(7) of the Act the extent of an entity’s limitation on liability arising under a provision referred to in new paragraph 94(3)(*d*). A “specified party” in respect of a particular entity at any time means an entity that is at that time:

- under paragraph (*a*) of the definition, an individual who is a spouse or common-law partner of the particular entity;

- under paragraph (*b*) of the definition, a “specified controlled foreign affiliate” (as described in the commentary immediately above) of the particular entity, or of a spouse or common-law partner of the particular entity;

- under paragraph (*c*) of the definition, an entity for which it is reasonable to conclude that the benefit referred to in subparagraph 94(8)(*a*)(iii) of the Act (i.e., a benefit received or enjoyed under a trust) was conferred either

  (i) in contemplation of the entity becoming after that time a “specified controlled foreign affiliate” of an entity referred to in subparagraph (*b*)(i) or (ii) of the definition, or

  (ii) to avoid or minimize a liability under this Part that arose, or that would otherwise have arisen, because of the application of subsection (3) with respect to the particular entity; or

- under paragraph (*d*) of the definition, a corporation in which the particular entity is a shareholder, if the corporation is or was beneficially interested in a trust, and the particular entity is a beneficiary under the trust solely because of the application of paragraph (*b*) of the definition “beneficiary” in subsection 94(1) to the particular entity in respect of the corporation.

“specified property”

New subsection 94(9) of the Act can affect the calculation of the amount of a “contribution” (as defined in new subsection 94(1)) to a trust of “specified property”. For this purpose, “specified property” means:

- a share of the capital stock of a corporation, an interest as a beneficiary under a trust, an interest in a partnership, or an interest in any other entity;
- a right to acquire any of the above; or
- any other property deriving its value primarily from property described above.

“specified share”

A specified share means a share of the capital stock of a corporation other than a share that is prescribed for the purpose of paragraph 110(1)(*d*). This expression is relevant to the definition “restricted property” in subsection 94(1). For more information, see the commentary on the definition “restricted property”.

“testamentary beneficiary”

The expression “testamentary beneficiary” is used in the definition “resident beneficiary” in new subsection 94(1). A resident beneficiary under a trust does not include a testamentary beneficiary.

A testamentary beneficiary in respect of a trust at a particular time means an entity that is a beneficiary under the trust solely because of a right of the beneficiary to enjoy or possess income or capital, of the trust, on or after the death after that time of a specified individual. For this purpose a specified individual is an individual who is, at that time, alive and a contributor to the trust, an individual related to a contributor to the trust or an individual who would have been related to a contributor to the trust if every individual who was alive before that time were alive at that time.

“treasury interest”

A “treasury interest” in a trust means (including, for greater certainty, a right acquired from the trust to acquire an interest as a beneficiary under the trust) an interest of an entity as a beneficiary under the trust if

(i) the interest was issued by the trust for consideration given to the trust;

(ii) the trust is not at that time a personal trust; and

(iii) the trust is not at that time an exempt foreign trust, but would be at that time an exempt foreign trust if it had not made an election under paragraph (*i*) of the definition "exempt foreign trust".

The expression "treasury interest" is relevant to the application of paragraphs 94(2)(*q*) and (*r*) of the Act, which provide rules for determining whether the acquisition or transfer of such an interest is considered to be a contribution to the trust. For more information, see the commentary on new subsection 94(2) and paragraph (*i*) of the definition "exempt foreign trust" in subsection 94(1).

"trust"

A definition "trust" is provided for the purpose of applying section 94. The definition clarifies that a reference to a trust in that section includes an estate.

Rules of Application

ITA
94(2)

New subsection 94(2) of the Act sets out a number of rules for use in applying section 94. These rules are primarily relevant for the purposes of determining whether a transaction constitutes a "contribution" (as defined in subsection 94(1)) of property to a trust. These rules are also relevant for the purposes of subsections 94(7) to (9) and the amended reporting rules in subsections 162(10.1) and 163(2.4) and section 233.2.

Paragraphs 94(2)(*a*) to (*m*) include rules that deem certain loans or transfers, the granting of options and the provision of services to be transfers of property to an entity. A deemed transfer will be considered to be a contribution to a trust if the transfer falls within the criteria of the definition "contribution" in subsection 94(1). In this regard, it should be noted that a transfer or loan, unless it is deemed to be a contribution under any of paragraphs 94(2)(*n*) to (*q*), will not be considered a contribution if it is an "arm's length transfer" (as defined in new subsection 94(1)). In addition, paragraphs 94(2)(*r*) to (*u*), may apply to deem certain transfers not to be contributions.

The rules in subsection 94(2) generally apply to taxation years of trusts that begin after 2002, but in some cases relief is provided with regard to transactions or events that occur before June 23, 2000 or Announcement Date. In addition, trusts created in 2001 and trusts created in 2002 may elect in writing (by filing the election with the Minister of National Revenue on or before the trust's filing-due date for the trust's taxation year in which the amending legislation is assented to) to have new section 94 of the Act apply to its taxation years that begin in 2001 and 2002, as the case may be.

Deemed transfers

Paragraph 94(2)(*a*) of the Act generally applies to indirect loans or transfers of property to a trust through transfers to other entities. Paragraph (*a*) deems, except where paragraph 94(2)(*c*) applies, a transfer of property (other than an "arm's length transfer", as defined in new subsection 94(1)) to be a direct transfer to a trust if the property is transferred from one entity to another and, as a result of the transfer, the fair market value of the property of the trust increases or the liabilities of the trust decrease. Where paragraph (*a*) applies, paragraph 94(2)(*b*) deems the fair market value of property deemed transferred under paragraph 94(2)(*a*) to be the total of all amounts each of which is the absolute value of an increase in the fair market value of the trust property or a decrease in the liabilities of the trust because of the transfer.

Paragraph 94(2)(*c*) also applies to indirect loans or transfers of property to a trust. Paragraph (*c*) deems a transfer or loan of property (other than an "arm's length transfer") from an entity (in this commentary, "the transferor") to another entity to be a direct transfer to a trust where the trust holds property the fair market value of which is derived from property held by the other entity and it is reasonable to conclude that one of the reasons for the transfer was to confer a benefit (for greater certainty, including an interest as a beneficiary under a trust) on the transferor, a descendant of the transferor or any person with whom the transferor or descendant does not deal at arm's length. Paragraph 94(2)(*d*) deems the fair market value of property deemed transferred under paragraph 94(2)(*c*) to be the fair market value of the property actually transferred.

Paragraph 94(2)(*e*) deems an entity that provides a guarantee or other financial assistance to another entity to have transferred property to that other entity. Under paragraph 94(2)(*h*), the fair market value of the property deemed to have been transferred is deemed to be the fair market value of the assistance.

Paragraph 94(2)(*f*) applies where any service (other than an exempt service, as defined in subsection 94(1)) is rendered after June 22,

2000 by an entity to, for or on behalf of another entity. In these circumstances, the entity rendering the service is deemed to have transferred property to the other entity. For more information on the definition "exempt service", see the commentary on that definition. Under paragraph 94(2)(*h*), the fair market value of the property deemed under paragraph 94(2)(*f*) to have been transferred is deemed to be equal to the fair market value of the services rendered.

For greater certainty, paragraph 94(2)*(g*) provides that a corporation is considered to transfer shares that it issues. Similar rules, also contained in paragraph 94(2)(*g*), apply to interests in a trust issued by the trust, interests in a partnership issued by the partnership or interest in an other entity issued by the entity, as well as to debt issued to an entity by another entity and a right (granted after June 22, 2000 by the entity from which the right was acquired) to acquire or to be loaned property.

As noted above, paragraph 94(2)(*h*) is relevant to determining the fair market value of property deemed under paragraphs 94(2)(*e*) and (*f*) to have been transferred.

Paragraph 94(2)(*i*) deems an entity to have become obligated at a particular time to transfer property to another entity where the entity becomes obligated to do an act (e.g., the rendering of a service) that would constitute the transfer of a property to another entity if the act were to occur. This rule is generally relevant for the purposes of paragraph (*c*) of the definition "contribution" in subsection 94(1).

Paragraph 94(2)(*j*) applies, for the purpose of applying at any time the definition "non-resident time" in subsection (1), if a trust acquires property of an individual as a consequence of the death of the individual. In these circumstances, paragraph 94(2)(*j*) deems the individual to have transferred the property to the trust immediately before the individual's death.

Paragraph 94(2)(*k*) applies where a particular entity loans or transfers property to another entity at the direction or with the acquiescence of another entity (the "specified entity"). In these circumstances, if it reasonable to conclude that one of the reasons for the transfer is to enable the specified entity (or any entity that does not deal at arm's length with the specified entity) to avoid or minimize a liability of any entity under Part I of the Act that arose, or that would otherwise have arisen, because of the application of subsection (3), the transfer is deemed to be a transfer made jointly by the particular entity and the specified entity.

Paragraph 94(2)(*l*) also applies where a particular entity loans or transfers property to another entity at the direction or with the

acquiescence of a specified entity. In these circumstances, the transfer is deemed to be a transfer made jointly by the particular entity and the specified entity if

- the transfer is made at a time that is not, or would not be, if the transfer or loan were a contribution of the specified entity, a "non-resident time" (as defined in new subsection 94(1)) of the specified entity, and

- either

  - the particular entity is at the time of the transfer a controlled foreign affiliate of the specified entity (or would be a controlled foreign affiliate of the specified entity if the specified entity were resident in Canada), or

  - it is reasonable to conclude that the transfer was made in contemplation of the particular entity becoming after the time of the transfer a controlled foreign affiliate of the specified entity (or a controlled foreign affiliate of the specified entity if the specified entity were resident in Canada).

The expression "controlled foreign affiliate" is defined in subsection 248(1) of the Act as having the meaning given in subsection 95(1).

Paragraph 94(2)(*m*) applies for greater certainty. It deems a taxpayer to have transferred, at a particular time, property to a corporation if either

- at that time

  - the taxpayer holds a share of the capital stock of the corporation, and

  - the terms or conditions of the share change, or

- as consideration for the disposition at or before the particular time of any property, the taxpayer received or became entitled to receive from the corporation a share of the capital stock of the corporation.

Deemed contributions

Paragraph 94(2)(*n*) applies where a particular trust makes a contribution to another trust. If this is the case, the contribution is deemed to have been made jointly by the particular trust and each other entity that is a contributor to the particular trust.

Paragraph 94(2)(*o*) applies where a partnership makes a contribution to a trust. Where this is the case, the contribution is deemed to have been made jointly by the partnership and by each entity that is a partnership member (other than a limited partner) at the time of the contribution. However, if a partnership has contributed to a trust, a limited partner of the partnership may also be considered to have made a contribution to the trust in respect of a transfer or loan made by the limited partner or another entity if any of the rules in subsection 94(2) so provide.

Paragraph 94(2)(*p*) provides, subject to subsection 94(9), that the amount of a contribution to a trust at the time it was made is deemed to be the fair market value at that time of the property that was the subject of the contribution. The rule is useful for the purposes of new paragraph 94(2)(*u*), subsections 94(7) and (8), as well as the reporting penalty provisions in amended subsections 162(10.1) and 163(2.4). The rule is relevant because a contribution is defined by reference to a loan or transfer, rather than by reference to the property that was the subject of the transfer or loan.

Paragraphs 94(2)(*q*) and (*r*) apply to dealings in a "treasury interest" (as defined in new subsection 94(1)) in a trust. The rules for treasury interests would be expected to apply in the relatively rare circumstance that a commercial investment trust is deemed resident in Canada because of the application of paragraph 94(3)(*a*). For this purpose, an investment trust that is considered commercial is one that meets all the requirements of paragraph (*i*) of the definition "exempt foreign trust" under subsection 94(1), but that has elected under that paragraph not to be treated as an exempt foreign trust. For more information on the definitions "treasury interest" and "exempt foreign trust", see the commentary on those definitions.

Paragraph 94(2)(*q*) deems an entity, that at any time acquires a treasury interest in a trust from another entity (other than the trust that issued the treasury interest), to have made a contribution to the trust at that time. The amount of the contribution is deemed to be the fair market value at that time of the treasury interest.

Paragraph 94(2)(*r*) generally applies where a particular entity has made a contribution to a trust because of acquiring a treasury interest and at a later time another entity acquires the interest from the particular entity for arm's length consideration. In these circumstances, the particular entity is deemed, for the purpose of applying section 94 at any time after the later time, not to have made the contribution.

Transfers deemed not to be contributions

Paragraph 94(2)(*s*), in very general terms, provides that a transfer of property to a trust by a particular entity that is a manager or sponsor of the trust, in exchange for an interest as a beneficiary under the trust, will not be considered a contribution of the particular entity to the trust while the beneficial interest is acquired and held by the particular entity because of a requirement imposed under securities laws. Paragraph 94(2)(*s*) will be relevant in the relatively rare circumstance that a commercial investment trust cannot rely on the exemption for exempt foreign trusts in order to avoid the application of subsection 94(3). Paragraph 94(2)(*s*) will apply in determining under that subsection whether the trust has a resident contributor or connected contributor (i.e., and hence, a resident beneficiary).

More specifically, under paragraph 94(2)(*s*), a transfer to a trust by a particular entity is, at a particular time, deemed not to be a contribution to the trust if

> (i) the particular entity has transferred, at or before the particular time and in the ordinary course of business of the particular entity, property to the trust,
>
> (ii) the transfer is not an arm's length transfer, but would be an arm's length transfer if the definition “arm's length transfer” in subsection 94(1) were read without reference to paragraph (*a*), and subparagraphs (*b*)(i) to (iii) and (v) to (viii), of that definition,
>
> (iii) it is reasonable to conclude that the particular entity was the only entity that acquired, in respect of the transfer, an interest as a beneficiary under the trust,
>
> (iv) the particular entity was required, under the securities law of a country or of a political subdivision of the country in respect of the issuance of beneficial interests by the trust, to acquire the interest because of the particular entity's status at the time of the transfer as a manager or promoter (as defined in subsection 94(1)) of the trust,
>
> (v) at the particular time the trust is not an exempt foreign trust, but would be at that time an exempt foreign trust if it had not made an election under paragraph (*i*) of the definition “exempt foreign trust”, and
>
> (vi) the particular time is before the earliest of

(A) the first time at which the trust becomes an exempt foreign trust,

(B) the first time at which the particular entity ceases to be a manager or sponsor of the trust, and

(C) the time that is 24 months after the first time at which the total fair market value of consideration received by the trust in exchange for beneficial interests (other than the particular entity's interest referred to in subparagraph 94(2)(*s*)(iii)) in the trust is greater than $500,000;

Paragraph 94(2)(*t*) generally expunges a contribution of shares of a Canadian corporation from the corporation to a trust if the trust acquired the shares in circumstances described in subparagraph 94(2)(g)(i) and the trust later sells the shares in circumstances in which the parties to the sale deal with each other on an arm's length basis. However, the application of 94(2)(*t*) will not effect the application of 94(2)(*g*) in respect of the original transfer by the corporation to the trust: that transfer will continue to be treated as a transfer under section 94. In addition, the application of 94(2)(*t*) will not expunge the status as a contribution to the trust of a transfer made by an entity and involving the corporation (e.g., an entity that transferred property to the corporation, and hence the trust, because of the application of paragraph 94(2)(*c*) and (*m*)).

More specifically, a transfer to a trust by a Canadian corporation of a particular share of the capital stock of the Canadian corporation is, after a particular time, deemed by paragraph 94(2)(*t*) not to be a contribution by the Canadian corporation to the trust if

(i) the trust acquired the particular share before the particular time from the Canadian corporation in circumstances described in paragraph 94(2)(*g*),

(ii) the trust sells the particular share at the particular time to another entity,

(iii) in exchange for the sale, the other entity transfers or becomes obligated to transfer property to the trust as consideration for the sale, and

(iv) it is reasonable to conclude

(A) having regard only to the sale and the consideration that the trust would have been willing to make the sale if the trust dealt at arm’s length with the other entity,

(B) that the terms and conditions made or imposed in respect of the exchange are terms and conditions that would have been acceptable to the trust if the trust dealt at arm's length with the other entity, and

(C) that the value of the consideration is not, at or after the particular time, determined in whole or in part, directly or indirectly, by reference to the particular share.

Paragraph 94(2)(*u*) applies to a transfer, before Announcement Date, to a personal trust by an individual (other than a trust) of particular property. Where the conditions in subparagraphs 94(2)(*u*)(i) and (ii) are met, the transfer of the particular property is deemed not to be a contribution of the particular property by the individual to the trust. Paragraph 94(2)(*u*) is intended to provide relief to individuals that have transferred a relatively small amount of property to a trust (e.g., the initial settlement of a coin on the trust) where the individual can reasonably be considered not to have been involved with the use of the trust as part of what is commonly referred to as an estate freeze (i.e., see the condition in clause 94(2)(*u*)(ii)(A) that the trust never have acquired from the individual restricted property).

The conditions in subparagraphs 94(2)(*u*)(i) and (ii) are that

(i) the individual identifies the trust in prescribed form filed with the Minister on or before the individual's filing-due date for the individual's 2003 taxation year (or a later date that is acceptable to the Minister), and

(ii) the Minister is satisfied that

(A) the trust has never acquired, directly or indirectly from the individual or from any entity not dealing at any time at arm's length with the individual, restricted property,

(B) in respect of each contribution (determined without reference to paragraph 94(2)(*u*)) made before Announcement Date by the individual to the trust, none of the reasons (determined by reference to all the circumstances including the terms of the trust, an intention, the laws of a country or the existence of an agreement, a memorandum, a letter of wishes or any other arrangement) for the contribution was to permit or facilitate, directly or indirectly, the conferral at any time of a benefit (for greater certainty, including an interest as a beneficiary under the trust) on

(I) the individual,

(II) a descendant of the individual, or

(III) any entity with whom the individual or descendant does not, at any time, deal at arm's length, and

(C) the total of all amounts each of which is the amount of a contribution (determined without reference to paragraph 94(2)(*u*)) made before Announcement Date by the individual to the trust does not exceed the greater of

(I) 1% of the total of all amounts each of which is the amount of a contribution (determined without reference to paragraph 94(2)(*u*)) made to the trust before Announcement Date, and

(II) $500.

The examples below illustrate the operation of subsection 94(2) and the definition "contribution" in subsection 94(1).

Example 1

Donald is a long-term resident of Canada. In 2003, Donald pays higher than fair market value consideration for a property acquired from a corporation. A non-resident trust holds shares in the corporation. The fair market value of those shares increases because of the transaction.

Results

1. Under paragraph 94(2)(a), Donald is considered to have transferred property to the trust in these circumstances. The exception for arm's length transfers does not apply.

2. As a consequence, Donald is considered to have made a contribution to the trust, which results in Donald being a contributor and a resident contributor to the trust.

Example 2

1. Lucie, a long-term resident of Canada, transfers property to Canco on condition that Canco direct Canco's wholly-owned foreign subsidiary (Foreignco-1) to transfer properties to another corporation (Foreignco-2) for consideration that is less than fair market value.

2. Shares of the capital stock of Foreignco-2 are held by a non-resident trust.

3. The fair market value of the Foreignco-2 shares increases as a result of the increase in the fair market value of the property owned by Foreignco-2.

Results

1. The transfers to Canco and to Foreignco-2 are part of the same series of transactions.

2. Because of paragraph 94(2)(a), the transfer to Foreignco-2 is considered to be a transfer by Foreignco-1 to the trust. Because of paragraph 94(2)(l), the transfer by Foreignco-1 to the trust is considered to be jointly made by Foreignco-1 and Canco. (This would also be the result under paragraph 94(2)(k), if it was intended to avoid or minimize a liability under Part I.) The exception for arm's length transfers does not apply.

3. Canco is considered to have made a contribution to the non-resident trust because of paragraph (a) of the definition "contribution" in new subsection 94(1). Lucie is considered to have made a contribution to the trust under paragraph (b) of that definition. Both Lucie and Canco are therefore contributors and resident contributors to the trust.

4. Foreignco-1 is also a "contributor" to the trust, but this does not have any practical consequences because Foreignco-1 is non-resident.

Liabilities of Non-resident Trusts and Others

ITA
94(3)

New subsection 94(3) of the Act applies to a non-resident trust (other than an "exempt foreign trust", as defined in subsection 94(1)) for a taxation year where, at the end of the year, there is a "resident contributor" to the trust or a "resident beneficiary" under the trust. All of these expressions are explained in detail in the commentary on new subsection 94(1).

Where subsection 94(3) applies to a non-resident trust for a taxation year, the trust is deemed to be resident in Canada throughout the year for the purposes specified in paragraph 94(3)(*a*). Except to the extent otherwise provided by subsection 94(4), a trust is deemed to be resident in Canada for a taxation year under subsection 94(3):

- for the purposes of applying sections 2, computing the trust's income for the year and computing the trust's liability for tax

under Part I – with the result that the trust is subject to tax under that Part on its world-wide income for the year (including, for example, its income determined as a result of deemed dispositions under subsections 104(4) to (5.2) or 128.1(4));

- for the purpose of applying clause 53(2)(*h*)(i.1)(*B*) – with the result that the adjusted cost base to a beneficiary of the beneficiary's interest in a trust to which this clause applies is computed in the same way as for interests in trusts resident in Canada;

- for the purpose of applying the definition "non-resident entity" in subsection 94.1(1) – with the result that a beneficiary's interest in the trust is not treated as an interest of a beneficiary in a foreign investment entity for the purposes of new sections 94.1 and 94.2;

- for the purposes of applying subsections 104(13.1) to (29), 107(2.1), (2.002) and (5) and section 115 – with the result that the tax treatment of beneficiaries under the trust generally accords with the tax treatment available to beneficiaries under trusts that are resident in Canada;

- for the purposes of determining the obligation of the trust to file a return under sections 233.3 and 233.4 – with the result that the trust is required to file information returns under sections 233.3 (information return on foreign property holdings the total cost of which exceeds $100,000) and 233.4 (information return on foreign affiliates);

- for the purpose of determining the liability of the trust for tax under Part XIII – with the result that the trust is exempt from Part XIII tax on amounts paid or credited to it; and

- for the purpose of determining the rights and obligations of the trust under sections 150 to 180 – with the result that various administrative provisions in the Act apply in the same way as to other trusts resident in Canada. (These provisions include those with regard to the filing of returns, assessments, tax payments, arrears interest, refund interest, instalment interest, penalties, refunds and appeals.)

A trust to which subsection 94(3) applies is deemed to be resident in Canada throughout the year for the above purposes, including the computation of its income and its taxable income and section 2 of the Act. Section 2 of the Act imposes on every person resident in

Canada at any time in a taxation year an obligation to pay an income tax on that person's taxable income for the year.

Under paragraph 1 of the resident article in Canada's income tax treaties, a reference in such a treaty to a "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation in that State by reason of the person's domicile, residence, place of management or any other criterion of a similar nature. A person, in this context, would generally include a trust because of the definition "person" in Canada's income tax treaties. Because a trust to which subsection 94(3) applies is deemed to be resident of Canada and is liable to tax in Canada on its worldwide income, it will be considered a resident of Canada under paragraph 1 of the resident article in Canada's income tax treaties, whether it is also considered to be resident, under the applicable treaty, in another country or not.

A trust that is also resident of the other contracting state under a particular treaty would be a dual resident under the treaty. In the event of dual residency under an income tax treaty, the tie-breaker rules in the resident article applicable to individuals would not apply. The Canada Customs and Revenue Agency has expressed the view that in this context, the term "individual" is to be interpreted to mean natural person and not a trust. The Agency has indicated that this interpretation would generally prevail across most if not all of Canada's income tax treaties if the definition "person" in the particular treaty under consideration makes reference to both an "individual" and a "trust". Even if a trust were considered an individual for the purpose of an income tax treaty, it is clear from the context of the tie-breaker rule applicable to individuals that it is intended to apply only to natural persons. This is because expressions such as "personal home", "center of vital interest" and "habitual abode" used in the tie-breaker rules have meaning only in reference to natural persons and would not be of use in clarifying the residence of a trust for the purpose of a treaty.

In general, therefore, under the income tax treaty the competent authorities of each contracting state would have to enter into an agreement to determine in which state the trust would be resident for the purpose of the particular treaty. In the absence of such an agreement Canada would exercise its first right to tax. Canada would grant foreign tax credits for the other State's income taxes paid by the trust and thus any double tax would be expected to be minimized if not altogether eliminated.

In this regard, paragraph 94(3)(*b*) allows a trust to elect for the special rules in that paragraph to apply in determining the trust's eligibility for a foreign tax credit. If the trust elects for a taxation year, the trust's income for the taxation year (other than the portion

of the income that is from sources inside Canada or that is from a source, outside Canada, that is a business carried on by the trust outside Canada) is deemed, for the purposes of subsections 20(11) and (12) and section 126,

- to be income of the trust from sources (other than a business carried on by the trust) in a particular country (other than Canada) in which the trust is resident (determined without reference to this subsection), and

- not to be from any other source;

Paragraph 94(3)(*c*) clarifies that a non-resident trust that becomes subject to subsection 94(3) for a particular taxation year, after not being subject to either new subsection 94(3) or existing paragraph 94(1)(*c*) for the preceding year is deemed, for the purpose of subsection 128.1(1), to become resident in Canada immediately after the end of the preceding year.

As a result, the cost amount of each of the properties (other than taxable Canadian properties) held by the trust at the beginning of the particular year is deemed by subsection 128.1(1) to be the fair market value of the property at the beginning of the particular year. Note, in this regard, that paragraph 94(3)(*c*) complements the rule in subsection 94(6) in the case where a non-resident trust ceases to be an "exempt foreign trust" (as defined in subsection 94(1)). In this case, subsection 94(6) establishes the beginning of a new "stub" taxation year to which subsection 94(3) may apply. If subsection 94(3) does apply for that "stub" year, subsection 128.1(1) would apply with regard to the properties (other than taxable Canadian properties) held by the trust at the beginning of that "stub" year.

Paragraph 94(3)(*d*) imposes liabilities for a taxation year on entities who are "resident contributors" or "resident beneficiaries". Where subsection 94(3) applies to a trust for a taxation year, each of these entities is jointly and severally and solidarily liable with the trust in respect of the trust's obligations under sections 150 to 180. Typically, the most significant obligation in this context is the obligation to pay tax instalments pursuant to section 156. However, the extent of the liability imposed by paragraph 94(3)(*d*) is limited by new subsection 94(7). For more information, see the commentary on subsections 94(7) to (9).

The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.

Paragraph 94(3)(*e*) imposes liabilities for a taxation year on each entity that is a beneficiary under the trust and was a person from whom an amount would be recoverable at the end of 2002 under subsection 94(2) (as it read in its application to taxation years that began before 2003) in respect of the trust if the entity had received before 2003 amounts described under paragraphs 94(2)(*a*) or (*b*) in respect of the trust (as those paragraphs read in their application to taxation years that began before 2003). Where subsection 94(3) applies to the trust for a taxation year, each of these entities is, to the extent of the entity's recovery limit for the year, jointly and severally and solidarily liable with the trust in respect of the trust's obligations under sections 150 to 180.

Note that subsection 94(3) does not result in the creation of any obligations for a trust that is subject to subsection 94(3) to withhold tax on distributions to non-resident beneficiaries under Part XIII or to pay any tax under Part XII.2. As noted above, one of the effects of subsection 94(3) is that the trust is not liable for such tax in connection with distributions of Canadian-source income to the non-resident beneficiaries. However, the rules in new subsection 104(7.01) are designed so that there will be a reasonable level of Part I tax in respect of Canadian-source income received by the trust in the event the trust also distributes income to non-resident beneficiaries. For more information, see the commentary on subsection 104(7.01).

Excluded Provisions

ITA
94(4)

New subsection 94(4) of the Act provides that the rules in paragraph 94(3)(*a*) treating non-resident trusts as resident in Canada do not apply for certain limited purposes:

- the definitions "arm's length transfer" and "exempt foreign trust" in subsection 94(1) – thus ensuring that there is no circularity in applying those definitions due to fact that those definitions impose a requirement that a trust be non-resident;

- subsection 73(1) and paragraph 107.4(1)(*c*) (other than subparagraph 107.4(1)(*c*)(*i*)) and subparagraph (*f*)(ii) of the definition "disposition" in subsection 248(1) – thus ensuring that proposed rules allowing in some cases for a rollover of property on transfers to a trust generally do not apply to transfers to a trust deemed to be resident in Canada by subsection 94(3); and

- paragraph (*a*) of the definition "mutual fund trust" in subsection 132(6) – a reference that makes it clear that a trust deemed to be resident in Canada by subsection 94(3) will not be treated as a mutual fund trust for any purpose.

Furthermore, except as otherwise permitted under subsection 216(4.1) of the Act, paragraph 94(3)(*a*) does not relieve a payer of Canadian-source income from the obligation to withhold amounts under section 215 in connection with amounts paid to a trust deemed to be resident in Canada by subsection 94(3). This is so even though such a trust is not liable for Part XIII tax on amounts paid or credited to it, because of the application of subparagraph 94(3)(*a*)(vii). The trust would be expected to apply for a refund of such tax, which would be given except to the extent that there are any outstanding liabilities of the trust with regard to Part I tax.

Deemed Cessation of Residence

ITA
94(5)

New subsection 94(5) of the Act deems a trust to have ceased to be resident in Canada at the earliest time in a specified period at which there is neither a "resident contributor" to the trust nor a "resident beneficiary" under the trust. For this purpose, the specified period is the period that would (if the Act were read without reference to subsections 94(5) and 128.1(4)) be a taxation year of the trust

- that immediately follows a taxation year of the trust throughout which it was resident in Canada,

- at the beginning of which there was either a resident contributor to the trust or a resident beneficiary under the trust, and

- at the end of which the trust is non-resident.

For more information on the expressions "resident contributor" and "resident beneficiary", as defined in new subsection 94(1), see the commentary on those provisions.

Where subsection 94(5) applies, the cessation of residence in Canada of a trust results in the application of subsection 128.1(4). Under that subsection, a taxation year of the trust is deemed to have ended immediately before the earliest time in the specified period described above. At that deemed taxation year end, the criteria in subsection 94(3) are satisfied. Accordingly, the trust will be subject to tax under Part I on its world-wide income for that year because it is considered under subsection 94(3) to be resident in Canada throughout that year.

Under new paragraph 94(3)(*d*), each "resident beneficiary" or "resident contributor" at the time of that deemed taxation year end can be jointly and severally and solidarily liable with the trust for the trust's income tax liabilities under the Act for that year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Becoming or Ceasing to be an Exempt Foreign Trust

ITA
94(6)

New subsection 94(6) of the Act generally provides that, if a trust becomes or ceases to be an "exempt foreign trust" (as defined in new subsection 94(1)) at any time, the trust's taxation year is deemed to have ended immediately before that time, a new "stub" taxation year is deemed to have begun at that time and the trust is deemed not to have established a fiscal period before that time. However, subsection 94(6) does not apply where a trust ceases to be an exempt foreign trust because it becomes resident in Canada.

Subsection 94(3) may apply in respect of the later "stub" taxation year of the trust if the criteria set out in that subsection are satisfied at the end of that year. Where this is the case, the trust would be subject to tax under Part I on its world-wide income for that later "stub" year because it would be considered under subsection 94(3) to be resident in Canada for that year.

Limit to Amount Recoverable

ITA
94(7) and (8)

New subsection 94(7) of the Act allows for a limitation of the amount that may be recovered from an entity that would otherwise be jointly, severally and solidarily liable for the entire amount of a trust's tax obligations under the Act. Subsection 94(7) applies to an entity (other than an entity that is deemed, by subsection 94(12) or (13), to be a contributor or a resident contributor to the trust) in respect of a particular taxation year of the trust where three conditions are satisfied.

The first condition is satisfied in respect of a particular taxation year of the trust:

- where, under subparagraph 94(7)(*a*)(i), the entity is jointly and severally and solidarily liable with the trust only because the

entity was a “resident beneficiary” (as defined in new subsection 94(1)) under the trust at the end of the particular year, or

- where, under subparagraph 94(7)(*a*)(ii), at the end of the particular year, the total amount (determined with reference to paragraph 94(2)(*b*), (*d*), (*h*), (*p*) and (*q*) and subsection 94(9)) of contributions made to the trust by the entity (or by another entity not dealing at arm’s length with the entity) is not more than the greater of $10,000 and 10% of the total amount of all contributions to the trust.

The second condition, under paragraph 94(7)(*b*), requires that the entity have filed on a timely basis all information returns required to be filed by the entity in respect of the trust under section 233.2 (or on any later day that is acceptable to the Minister of National Revenue). However, the second condition need not be satisfied if the first condition is satisfied because the total determined under subparagraph 94(7)(*a*)(ii) (in respect of the entity and all entities not dealing at arm's length with it) is $10,000 or less.

The third condition, under paragraph 94(7)(*c*), is satisfied in respect of an entity and a particular taxation year of the trust where it is reasonable to conclude that each transaction or event that occurred before the end of the particular year at the direction of, or with the acquiescence of, the entity satisfied the following conditions:

- none of the purposes of the transaction or event was to enable the entity to avoid or minimize any liability under a provision referred to in paragraph 94(3)(*d*) in respect of the trust, and

- the transaction or event was not part of a series of transactions or events any of the purposes of which was to enable the entity to avoid or minimize any liability under a provision referred to in paragraph 94(3)(*d*) in respect of the trust.

There are a number of transactions or events, or series of transactions or events, that may result in a failure to satisfy the third condition (e.g., an artificial dilution of an entity’s relative contribution to the trust (i.e., below the 10% level); or corporate distributions that have the effect of avoiding or minimizing the impact of the three-year rule described in subsection 94(9)).

Reference should be made in this context to the definition “contribution” in subsection 94(1), as well as to related rules in subsection 94(2).

Where subsection 94(7) applies to an entity in respect of a taxation year of a trust, the amount recoverable at any time from the entity in respect of the year is limited to the person's "recovery limit", determined under subsection 94(8), in respect of the trust and the year.

Under subsection 94(8), the amount of the recovery limit that applies to a particular entity at any particular time is calculated as follows:

- ADD amounts received or receivable after 2000 and before the particular time by the particular entity on the disposition of all or part of the particular entity's interest as a beneficiary under the trust, or by another entity that was, at the time the amount became receivable, a specified party (as defined in subsection 94(1)) in respect of the particular entity on the disposition of all or part of the specified party's interest as a beneficiary under the trust;

- ADD an amount (other than an amount described in the paragragh above) made payable by the trust after 2000 and before the particular time to the particular entity because of the interest of the particular entity as a beneficiary under the trust, or another entity (that was, at the time the amount became payable, a specified party in respect of the particular entity) because of the interest of the specified party as a beneficiary under the trust;

- ADD the fair market value of benefits received or enjoyed, after 2000 and before the particular time, under the trust by the particular entity (or an entity that was, at the time the benefit was received or enjoyed, a specified party in respect of the particular entity), not otherwise taken into account above;

- ADD the maximum amount that would be recoverable from the particular entity at the end of 2002 under subsection 94(2) (as it read in its application to taxation years that began before 2003) if the trust had had tax payable under Part I of the Act at the end of 2002 in excess of the total of the amounts described in respect of the entity under paragraphs 94(2)(*a*) and (*b*) (as they read in their application to taxation years that began before 2003), except to the extent that the amount so recoverable is in respect of an amount that is included in the particular entity's recovery limit because of subparagraph 94(8)(*a*)(i) or (ii);

- ADD the total amount (determined with reference to paragraphs 94(2)(*b*), (*d*), (*h*), (*p*) and (*q*) and subsection 94(9)) of contributions made to the trust by the particular entity, to the

extent that this amount exceeds the total of the first three amounts;

- SUBTRACT previous recoveries by the Canada Customs and Revenue Agency ("CCRA") under subsection 94(3) (or under subsection 94(1) as it read in its application to taxation years that began before 2003) from the particular entity in respect of the trust and the year or a preceding taxation year of the trust;

- SUBTRACT previous recoveries by the CCRA under subsection 94(3) (or under subsection 94(1) as it read in its application to taxation years that began before 2003) from a specified party in respect of the particular entity in respect of the trust and the year or a preceding taxation year of the trust; and

- SUBTRACT the amount, if any, by which the particular entity's tax payable under this Part for any taxation year in which an amount described in any of subparagraphs (*a*)(i) to (iv) was paid, became payable, was received, became receivable or was enjoyed by the particular entity exceeds the amount that would have been the particular entity's tax payable under this Part for that taxation year if no such amount were paid, became payable, were received, became receivable or were enjoyed by the particular entity in that taxation year.

For more information on subsections 94(11) to (13), or the expression "specified party" as defined in subsection 94(1), see the commentary on those provisions.

Determination of contribution amount

ITA
94(9)

Subsection 94(9) affects the calculation of the amount of a "contribution" (as defined in new subsection 94(1)) to a trust of "specified property" (as defined in new subsection 94(11)) for the purpose of determining whether the "recovery limit" limitation applies to a contributor to the trust and of determining the amount of that recovery limit.

The amount of a contribution to a trust because of a transfer to the trust of specified property is deemed by subsection 94(9) to be the greater of:

- the amount, otherwise determined, at that time of the contribution; and

- the amount that is the greatest fair market value of the specified property (or of substituted property) in the period that begins immediately after that time and ends at the end of the third calendar year after that time.

For more information on the expression "specified property" as defined in new subsection 94(1), see the commentary on that provision.

Subsection 94(9) allows for a reasonable opportunity for recovery of tax by the CCRA in the context of a transaction or series of transactions involving the transfer of specified property. Consider, for example, an estate freeze under which common shares in the capital stock of a corporation are transferred directly or indirectly to a non-resident trust. Because of the difficulties associated with valuing the common shares at the time of the transfer, it is appropriate to provide for a valuation as described above.

In conjunction with new subsection 94(9), subparagraph 152(4)(*b*)(vi) of the Act is amended to ensure that a reassessment of a taxpayer arising out of the application of subsection 94(9) can be undertaken by the CCRA within 3 years after the normal reassessment period of the taxpayer in respect of the taxpayer's relevant taxation year.

Where Contributor Becomes Resident in Canada Within 60 Months after Contributing

ITA
94(10)

New subsection 94(10) of the Act applies to determine whether there is a "connected contributor" (as defined in new subsection 94(1)) to a trust for the purpose of applying the definition "resident beneficiary" (as defined in new subsection 94(1)). Under new paragraph 94(3)(*d*) of the Act, a resident beneficiary can, to an extent, be liable for the trust's income tax under Part I of the Act. For more information, see the commentary on those definitions and subsections 94(3) and (7) to (9).

A "contribution" (as defined in new subsection 94(1)) to a trust by a contributor is considered to have been made at a time other than a "non-resident time" (as defined in subsection 94(1)) if the contributor becomes resident in Canada at any time within the period (referred to in this commentary as the "60-month post period") 60 months after the time of the contribution. However, to facilitate the administration of the definition "non-resident time", paragraph (*b*) of the definition "connected contributor" and subsection 94(3), the definition "non-resident time" is drafted so that such a contributor and the trust may,

subject to subsection 94(10), treat the time of the contribution as a non-resident time for the purposes of applying the definition "connected contributor" and subsection 94(3) at the end of any particular trust taxation year if at the end of that particular year the contributor still has not become resident in Canada within the 60-month post period.

Subsection 94(10) deems (for the purpose of applying the definition "connected contributor" at the end of each taxation year of the trust that ends before the particular time at which the contributor becomes resident in Canada within the 60-month post period) the contribution to have been made at a time other than a "non-resident time" (as defined in subsection 94(1)) of the contributor if:

- in applying the definition "non-resident time" as of the end of each of those taxation years, the particular contribution was made at a non-resident time of the contributor; and

- in applying the definition "non-resident time" at the particular time, the contribution is made at a time other than a non-resident time of the contributor.

Where subsection 94(10) applies, the contributor will be considered a "connected contributor" to the trust and, if there was a "resident beneficiary" at the end of the relevant prior taxation year of the trust, the trust and the resident beneficiary would, because of subsection 94(3), generally be jointly and severally and solidarily liable for Part I tax on the trust's income for the year. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of Quebec and the law of other provinces.)

Subparagraph 152(4)(*b*)(vi) of the Act is amended to ensure that a reassessment of a taxpayer arising out of the application of subsection 94(10) can be undertaken by the Canada Customs and Revenue Agency within 3 years after the normal reassessment period of the taxpayer in respect of the taxpayer's relevant taxation year.

Deemed Contributor or Resident Contributor

ITA
94(11) to (13)

Subsections 94(11) to (13) of the Act provide a set of related anti-avoidance rules that apply where it is reasonable to conclude that one of the reasons for a loan or transfer of property from a trust (the "original trust"), that is deemed under paragraph 94(3)(*a*) to be resident in Canada (or was deemed because of subsection (1) as it

read in its application to taxation years that began before 2003), to another trust (the "transferee trust") is to avoid or minimize the liability, of any entity under Part I of the Act, that arose, or that would otherwise have arisen, because of the application of subsection (3) (or because of subsection (1) as it read in its application to taxation years that began before 2003).

Where such a loan or transfer is made at a particular time, the original trust is deemed, under subsection 94(12), to be a resident contributor to the transferee trust for the purpose of applying this section in respect of the transferee trust.

Where such a loan or transfer is made at a particular time, an entity that is at that time a contributor to the original trust is deemed, under subsection 94(13), to be a contributor to the transferee trust and a connected contributor to the transferee trust (if at that time the entity is also a connected contributor to the original trust). For more information on the definitions "contributor" and "connected contributor" in subsection 94(1), see the commentary on those definitions.

Subsection 94(7) of the Act, generally provides that the liability of a "resident contributor" is limited by that contributor's recovery limit, as determined by reference to subsections 94(7) to (9). However, subsection 94(7) does not apply to an entity that is deemed, by subsection 94(12) or (13), to be a contributor or a resident contributor to the trust. For more information on the definition "resident contributor" or subsections 94(3) and (7) to (9), see the commentary on those provisions.

Clause 12

Foreign Investment Entities

ITA
94.1

OVERVIEW

Existing Rules

Existing section 94.1 of the Act applies where a taxpayer has invested in an offshore investment fund and one of the main reasons for the investment is to reduce or defer the tax liability that would have applied to the income generated from the underlying assets of the fund if such income had been earned directly by the taxpayer. In these circumstances, existing section 94.1 generally requires an

amount to be included in computing the taxpayer's income from the investment. This amount is determined, in general terms, by multiplying the cost amount of the taxpayer's investment by a factor based on interest rates prescribed under Part XLIII of the *Income Tax Regulations*.

New Rules

Section 94.1 is replaced by provisions in new sections 94.1 to 94.3, which contain rules governing the tax treatment of interests in foreign investment entities (FIEs). In computing a taxpayer's income for a taxation year, new section 94.1 will generally require an amount to be included in computing the taxpayer's income from the investment. This amount will be determined, in general terms, by multiplying the designated cost of the taxpayer's investment by a factor based on interest rates prescribed under paragraph 4301(*b*) of the *Income Tax Regulations*. However, if a taxpayer elects and has sufficient information to comply, or the investment is subject to the special rules for foreign insurance policies or investments in tracking entities, new section 94.2 applies in place of the rules in section 94.1. Under section 94.2, a taxpayer must take into account the annual increase or decrease in the fair market value of the taxpayer's interest in a FIE in computing the taxpayer's income from the FIE. Section 94.3 is designed to prevent double taxation with respect to amounts included in income under sections 94.1 and 94.2.

New sections 94.1 to 94.3 apply to taxation years that begin after 2002.

The table below provides an overview of new sections 94.1 to 94.3 and related provisions.

Issue	Summary	References
1. Who is subject to the new FIE rules?	A. All taxpayers, except exempt taxpayers. Except as indicated in (C), below, FIE rules do not apply to non-resident taxpayers.	S.94.1(3) and (4) and 94.2(3) and (4). "Exempt taxpayer" (s.94.1(1)). Non-resident taxpayers: see also s.94.1(3) and 94.2(5).
	B. Partnerships with members resident in Canada must allocate FIE income to those members.	Existing section 96, including exception in s. 96(1.9). See also s. 94.2(6) for application to cases where partnership members become resident in Canada.
	C. Controlled foreign affiliates.	New s. 95(2)(*g*.3).

2. What property is subject to the new FIE rules?	A. Participating interests (other than exempt interests) in foreign investment entities. However, if no taxation year of a FIE has ended in the taxpayer's taxation year, the FIE rules do not apply to the taxpayer for the taxpayer's year in respect of the FIE.	S. 94.1(2). The following definitions in s. 94.1(1): "entity", "non-resident entity", "foreign investment entity", "exempt interest" and "participating interest".
	B. Interests in non-resident entities, where the return on those interests tracks returns in respect of investment property. This property is subject only to s. 94.2, not to s. 94.1.	S. 94.2(3) and (9). The definition "tracking entity" in 94.2(1) See also amended s. 91(1).

Issue	Summary	References
	C. Interests in certain foreign insurance policies. This property is subject only to s. 94.2, not s. 94.1.	S. 94.2(3), (10) and (11).
3. What is the difference in the tax treatment of FIE interests between s. 94.1 and s. 94.2?	A. Section 94.1. Taxes investor based on a prescribed rate of return.	S. 94.1(4).
	B. Section 94.2. Full appreciation/decline in fair market value of the investment is recognized on an annual basis.	S. 94.2(4) S. 94.2(20)
4. How will foreign affiliates of taxpayers resident in Canada be treated under new FIE rules?	Subject to s. 94.2(9) (interests in tracking entities), a taxpayer's share of the capital stock of a controlled foreign affiliate is exempt from the new FIE rules. In certain cases, a taxpayer can elect to have a foreign affiliate treated as a controlled foreign affiliate.	Paragraph (*a*) of the definition "exempt interest". Paragraphs 94.1(2)(*h*) and (*i*).
5. If a non-resident corporation that is a FIE pays out dividends, how are these dividends taxed?	A. General principle: existing rules apply.	Existing s. 90 and 113.
	B. Relief provided to prevent double taxation. This relief extends to taxable distribution from other FIEs (e.g., trusts).	S. 94.3.
6. In what circumstances is a taxpayer subject to sections 94.1 and 94.2, respectively?	A Requirement to use s. 94.1 where insufficient information to use s. 94.2.	S. 94.1(3) and 94.2(3)

Issue	Summary	References
	B. Election to use s. 94.2 available – interest must have readily ascertainable fair market value.	S. 94.2(3)
	C. Requirement to use s. 94.2 in the case of properties described in 2(B) and (C), above.	See references in 2(B) and (C).

Definitions

ITA
94.1(1)

New subsection 94.1(1) of the Act defines a number of expressions for the purpose of section 94.1. These definitions are also relevant for the purposes of sections 94.2 and 94.3.

"beneficiary"

A reference in sections 94.1 to 94.3 to a "beneficiary" carries, except for the purpose of paragraph 94.2(11)(*f*) (i.e., a beneficiary in respect of an interest in an insurance policy), the meaning assigned by subsection 94(1). For more information, see the commentary on the definition "beneficiary" in subsection 94(1).

"carrying value"

The "carrying value" of a property held by an entity at any time means:

- the fair market value of the property at that time, if the taxpayer so elects in respect of all the property of the entity and the property is property that would be valued for the purpose of the entity's balance sheet at that time, or

- the amount at which the property would be valued at that time for the purpose of the entity's balance sheet, if the balance sheet were prepared in accordance with generally accepted accounting principles used in Canada or accounting principles substantially similar to generally accepted accounting principles used in Canada and included the property that is deemed under paragraph 94.1(2)(*j*) (i.e. property held by certain entities in which the entity has a significant interest) to be owned by the entity at that time.

Subsection 94.1(2) also provides a series of rules that relate to the determination of the carrying values of assets of the entity. For more information, see the commentary to subsection 94.1(2).

The carrying value of property is relevant primarily for the purpose of determining whether a non-resident entity is a FIE. Under paragraph 94(3)(*c*), this determination is made at the end of the entity's taxation year. For more information, see the commentary on that paragraphs and the definition "foreign investment entity".

It should also be noted that paragraph 94.1(2)(*j*) provides a "look-through" rule that can affect the properties considered to be owned by an entity and the carrying values of the entity's properties. In particular, the rule in paragraph 94.1(2)(*j*) can impute to an entity both ownership of property otherwise owned by certain other entities in which the entity has a significant interest and the "net accounting income" (as defined in subsection 94.1(1)) of such other entities derived from such property. For the purposes of the look-through rule, the time at which the determination of carrying value is made is the end of the "taxation year" (as defined in subsection 94.1(1)) of the first tier non-resident entity (whether lower tier entities share the same taxation year or not). For more information, see the commentary to new paragraph 94.1(2)(*j*) and the definition "taxation year".

"designated cost"

In computing a taxpayer's income for a taxation year from a participating interest of the taxpayer in a FIE, where subsection 94.1(4) applies, the taxpayer will be required to include the amount, determined under that subsection, in computing the taxpayer's income from the investment. That amount is determined by multiplying the "designated cost" of the taxpayer's investment by a factor based on the interest rate prescribed under paragraph 4301(*b*) of the *Income Tax Regulations*.

The designated cost to a taxpayer at any time of a participating interest held at that time by the taxpayer in a foreign investment entity, is determined, in general terms, as follows:

- ADD the cost amount to the taxpayer of the participating interest at that time (determined without reference to certain provisions of the Act),

- ADD the amount of any previous income inclusions, of the taxpayer in respect of the participating interest, arising because of the application of subsection 94.1(4) for a previous taxation year that ends after 2002,

- ADD, if the participating interest was an offshore investment fund property (as defined in subsection 94.1(1) of the Act as it read in its application to taxation years that began before the 2003) of the taxpayer at the end of the taxpayer's last taxation year that began before 2003, certain amounts required to be included in computing the designated cost under "old" subsection 94.1(2),

- ADD, if the participating interest was acquired by the taxpayer before 2003, and was not an offshore investment fund property of the taxpayer at the end of the taxpayer's last taxation year that began before 2003, the amount, if any, by which the fair market value of the participating interest at the end of that last taxation year exceeds the cost amount to the taxpayer of the participating interest at the end of that last taxation year,

- ADD, if one or more particular amounts has been made available by a person to another person after the last 2002 taxation year of the foreign investment entity and before that time for the main purpose of increasing the value of the taxpayer's participating interest, the total of all amounts each of which is the amount, if any, by which each particular amount exceeds any increase in the cost amount to the taxpayer of the participating interest because of that particular amount, and

- ADD, if the participating interest is acquired by the taxpayer after 2002, the amount, if any, by which the fair market value of the participating interest at the time it was so acquired exceeds the cost amount to the taxpayer of the participating interest at the time it was so acquired.

"entity"

An entity includes an association, a corporation, a fund, a joint venture, an organization, a partnership, a syndicate and a trust. It does not include a natural person.

"exempt business"

The definition "exempt business" is relevant in determining whether a "non-resident entity" (as defined in subsection 94.1(1)) carrying on an "investment business" (as defined in subsection 94.1(1)) and whether the non-resident is a FIE. An investment business does not include an exempt business.

An exempt business of an entity, in general terms, is a business (other than any business conducted principally with entities with whom the entity does not deal at arm's length or a business carried on by a trust

that is an “exempt foreign trust” because of paragraph (*i*) of the definition “exempt foreign trust” in subsection 94(1)) that throughout the period it is carried on by the entity (other than as a member of a partnership that is not a qualifying member of the partnership, or that would not be a qualifying member if the entity were a person) is

- carried on by the entity as a foreign bank, a trust company, a credit union, an insurance corporation or, if the entity is controlled by a taxpayer resident in Canada that is described in subparagraph 95(2.1)(*a*)(i), a trader or dealer in securities or commodities, the activities of which business are regulated under the laws of a specified country, or

- a business the principal purpose of which is to derive income from certain real estate businesses, certain leasing or licensing businesses, or businesses involved in the development of foreign and Canadian resource properties and timber resources.

For more information, see the commentaries on the definitions “foreign investment entity” and “investment business” in subsection 94.1(1).

“exempt interest”

The FIE income inclusion rules under subsection 94.1(4) or 94.2(4) apply to a taxpayer for a year generally only where subsection 94.1(3) applies to the taxpayer. Subsection 94.1(3) will not apply to a taxpayer for a particular taxation year of the taxpayer in respect of a participating interest of the taxpayer in a non-resident entity if at the end of a taxation year of the non-resident entity that ends in the particular taxation year the taxpayer's participating interest is an “exempt interest”. An exempt interest of a taxpayer in a FIE is defined to mean a particular participating interest held by the taxpayer in the FIE if any of the following applies:

- The FIE is either a controlled foreign affiliate of the taxpayer (including an affiliate that is a controlled foreign affiliate because of an election under new paragraph 94.1(2)(*h*)) or a “qualifying entity” (as defined in subsection 94.1(1);

- The participating interest is a mark-to-market property (as defined in subsection 142.2(1)) and the taxpayer is a financial institution (as defined in that same subsection);

- The participating interest is a right under an employee stock option or similar agreement to acquire a share of the capital stock in the FIE and

1. the right was granted by the FIE or another entity with which it does not deal at arm's length,

2. the taxpayer acquired the right at a time when the taxpayer dealt at arm's length with the entity that granted the right, and

3. the taxpayer was entitled to acquire the right solely because the taxpayer was employed by the FIE or the other entity referred to in 1. above;

- All or substantially all of the carrying value of the FIE's property can be attributed to participating interests in an entity (other than a FIE) that is, or is related to, the employer of the taxpayer, and an amount that is all or substantially all of the FIE's income, profits and gains for its taxation year that includes that time becomes payable (as determined under paragraph 94.1(2)(*o*))

  1. by the FIE to its interest holders (and the taxpayer's share of that amount is included in computing the taxpayer's income for the taxpayer's taxation year in which that taxation year of the FIE ends), or

  2. by the FIE to its interest holders within 120 days after the end of that taxation year (and the taxpayer's share of that amount is included in computing the taxpayer's income for the taxpayer's taxation year that includes the time at which it became payable); or

- It is reasonable to conclude that the taxpayer had no tax avoidance motive (determined by reference to paragraphs 94.1(2)(*k*) to (*n*)) for the acquisition of the participating interest, and the FIE

  1. is resident (determined by reference to paragraph 94.1(2)(*g*)) in a country in which there is a prescribed stock exchange and participating interests in the FIE that are identical to the participating interest are widely held and actively traded (determined by reference to paragraph 94.1(2)(*f*)) and listed on a prescribed stock exchange throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest, or

  2. is governed by, and exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued under the laws of, a particular country (other than a prescribed country) with which Canada has entered

into a tax treaty, is, throughout the period, in the taxpayer's taxation year that includes that time, during which the taxpayer held the participating interest, resident under that treaty in the particular country, and

(A) participating interests that are identical to the participating interest in the foreign investment entity are widely held and actively traded, or

(B) if the particular country is the United States of America, the taxpayer is resident in Canada throughout that period, and the taxpayer is liable for and subjected to income tax in the particular country for that taxation year because the taxpayer is a citizen of the particular country.

As noted above, a number of the application rules in subsection 94.1(2) are relevant in determining whether an interest in a foreign investment entity is an exempt interest. For more information, see the commentary on those provisions.

The rules in subsection 94.1 and 94.2 (subject to the rules in subsections 94.2(9) and (10) dealing with tracking interests and insurance policies) do not apply to a taxpayer in respect of an exempt interest in a foreign investment entity.

“exempt property”

The definition “exempt property” is relevant in determining whether aproperty is an “investment property”(as defined in subsection 94.1(1)) and whether a “non-resident entity” (as defined in subsection 94.1(1)) is a FIE. Except for the purposes of applying the definitions “investment business” in subsection 94.1(1) and “tracking entity” in subsection 94.2(1), investment property does not include exempt property.

In general terms, exempt property of a particular entity means at any time, in determining whether a particular taxpayer’s interest in the particular entity is a participating interest in a FIE,

- under paragraph (*a*) of the definition, a property, of the particular entity, that is at that time used or held principally in a a business (other than an investment business) carried on by the particular entity or a related entity,

- under paragraph (*b*) of the definition, indebtedness (that would be “excluded property”, as defined in subsection 95(1), of the particular entity if certain assumptions applied) owing by a debtor to the particular entity, where the

> particular entity and the debtor are foreign affiliates of the taxpayer or of another entity of which the taxpayer is a controlled foreign affiliate and in respect of which the taxpayer or the other entity, as the case may be, has a qualifying interest (as defined in subsection 95(2)(*m*)).

In addition, under paragraph (*c*) of the definition, exempt property means a property acquired by the particular entity within the 36 months preceding that time (or where written application has been made to the Minister of National Revenue by the taxpayer within 36 months of having acquired the property, within such longer period as the Minister considers reasonable in the circumstances) as a result of qualified activities. Those activities are

- the issuance of a debt or a participating interest in the particular entity;

- the disposition of property used in a business (other than an investment business) carried on by the particular entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity;

- the disposition of a participating interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used principally in a business (other than an investment business) carried on by the other entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the other entity; and

- the accumulation of income of the particular entity derived from a business (other than an investment business) carried on by the particular entity or an entity related (otherwise than by reason of a right referred to in paragraph 251(5)(*b*)) to the particular entity,

The qualified activities also must have been undertaken for the purpose of

- acquiring property to be used principally in or making expenditures for the purpose of earning income from a business (other than an investment business) carried on by the entity or an entity related to the entity, or

- acquiring a participating interest that is a significant interest in another entity all or substantially all of the fair market value of the property of which is attributable to property used or held principally in the course of earning income from a business, other than an investment business, carried on by the other entity.

“exempt taxpayer”

The rules in new sections 94.1 and 94.2 do not apply in respect of periods during which a taxpayer is an exempt taxpayer. For more information, see the commentary on paragraph 94.1(3)(*a*) and subsections 94.2(9) and (10).

An individual is an “exempt taxpayer” for a taxation year where the individual, before the end of the year, was a resident of Canada for a period of, or periods the total of which is, 60 months or less. (Individuals who have never been non-resident cannot fall within the 60-month exception.) This 60-month exemption for new immigrants to Canada is similar to an exemption in the rules for non-resident trusts in existing section 94.

Except as indicated below, tax-exempt entities to which subsection 149(1) applies are also exempt taxpayers. Retirement compensation arrangements and qualifying environmental trusts for which alternative income tax rules are provided under Parts XI.3 and XII.4 and insurers to which paragraph 149(1)(*t*) applies are not exempt taxpayers.

The express reference to tax-exempt entities is generally of significance for the purposes of calculating Part I tax only in the context of the narrow circumstances to which new subsection 94.2(17) applies. That subsection contemplates a case where a taxpayer ceases to be an “exempt taxpayer” and subsequently becomes an “exempt taxpayer”. However, the reference to tax-exempt entities may also be of significance in the context of Part XI (foreign property limits), given that the application of sections 94.1 and 94.2 has an impact on the cost amount of participating interests in FIEs.

“foreign bank”

The definition “foreign bank” has the same meaning as in subsection 95(1). The expression is used in the definition “exempt business”.

“foreign investment entity”

The new tax regime for FIEs in sections 94.1 and 94.2 generally applies only to participating interests in a “foreign investment entity” as defined in subsection 94.1(1).

A non-resident entity (as defined in subsection 94.1(1)) will be a FIE, unless any one of the following exceptions applies to the non-resident entity:

- it is an “exempt foreign trust” (as defined in new subsection 94(1)) other than a trust that is an exempt foreign trust because of paragraph (*h*) or (*i*) of that definition,

- the carrying value of all of its investment property is not greater than one-half of the carrying value of all of its property,

- it is a partnership, or

- its principal business is not an investment business.

The new rules are designed so that, in the case of partnerships, members’ shares of incomes and losses are allocated in accordance with section 96 (including new subsection 96(1.9), described in the commentary below).

For more information, see the commentary on the definitions “entity”, “non-resident entity”, “investment property” and “carrying value” in subsection 94.1(1) and “exempt foreign trust” in subsection 94(1).

Special rules apply to determine if a non-resident entity is a FIE. For more information, see in particular the commentary on paragraphs 94.1(2)(*a*) to (*e*) and (*h*) to (*j*).

“investment business”

The expression “investment business” is relevant in determining whether a non-resident entity is a FIE or a “qualifying entity”, as defined in subsection 94.1(1) . An “investment business“ of an entity in a period means a business (other than an exempt business) carried on by the entity (including, for greater certainty, a business carried on by the entity as a member of a partnership) at any time in the period, if the principal purpose of the business is to derive any of the following income or profits:

- income (including interest, dividends, rents, royalties or any similar return on investment or any substitute for such a return) from property,

- income from the insurance or reinsurance of risks,

- income from the factoring of trade accounts receivable,

- profits from the disposition of investment property.

“investment property”

The expression “investment property” includes a list of specified properties. Most of the specified properties (e.g., shares, partnership interests, real estate and resource properties) are also specified in the definition of the same expression in subsection 95(1). In addition to the properties also specified in the definition in subsection 95(1), “investment property” held by a particular entity includes:

- an interest in an organization, fund or other entity;
- most derivative financial products; and
- interests, options and rights in respect of the above properties.

It should be noted, however, that investment property of an entity does not include, generally, an “exempt property” (as defined in subsection 94.1(1)) and:

- a “significant interest” (as defined in subsection 94.1(1)) in a “qualifying entity” (as defined in subsection 94.1(1));
- an interest in a qualifying entity that has a significant interest in the entity; and
- debt owing by qualifying entities in which the entity has a significant interest or by a qualifying entity that has a significant interest in the entity.

The definition is relevant for the purpose of the determining whether a non-resident entity is a FIE. For more information, see the commentary on the definitions “qualifying entity”, “significant interest”, and “exempt property” in subsection 94.1(1).

“net accounting income”

The net accounting income of an entity for a taxation year means the amount that would be its net income before extraordinary items and income taxes as shown in its financial statements for the year prepared in accordance with accounting principles that are, or that are substantially similar to, generally accepted accounting principles used in Canada at the end of the year (determined by reference to paragraph 94.1(2)(*c*)). For more information paragraph 94.1(2)(*c*), see the commentary on that provision.

“non-resident entity”

One of the requirements for an entity to be a FIE to which sections 94.1 and 94.2 apply is that the entity must be a “non-resident entity”. In this regard, it should be noted that, under proposed subparagraph 94(3)(*a*)(iv), certain trusts that would otherwise be non-resident are deemed (for certain limited purposes including the definition “non-resident entity”) to be resident in Canada for taxation years in which the trust has a resident contributor or a resident beneficiary. For more information, see the commentary to new subsection 94(3).

In addition to non-resident corporations and trusts, a “non-resident entity” includes any other type of entity that

- exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued under the laws of a country or a political subdivision of a country other than Canada, and

- is governed at that time under the laws of that country or political subdivision.

“participating interest”

A “participating interest” in an entity means a share of the capital stock of corporation, an indefeasibly vested interest as a beneficiary (as defined in subsection 94.1(1)) under a trust and an interest in any other type of entity.

It also includes a property that is convertible into or exchangeable for or confers a right to acquire

- such a share, interest as a beneficiary or other interest, or

- a property the fair market value of which is determined primarily by reference to the fair market value of such a share, interest as a beneficiary or other interest in an entity.

For a related rule that applies in determining whether an interest is a participating interest, see the commentary on paragraph 94.1(2)(*s*).

“qualifying entity”

A “qualifying entity” in a period means a particular entity that is a partnership or a corporation all or substantially all of the “carrying value” (as defined in subsection 94.1(1)) of the property of which is, throughout the period, attributable to the carrying value of property that is:

- property other than “investment property” (as defined in subsection 94.1(1)),

- investment property that is a participating interest in or debt of another entity if the other entity is an entity whose principal business is not an investment business and the particular entity has either a significant interest in the other entity or a strategic interest in the other entity,

- investment property in respect of which the particular entity establishes that the property or proceeds from the disposition of the property is to be used by the particular entity for the purpose of acquiring property described in the two paragraphs above,

- investment property that is held at a particular time by the particular entity and acquired within the 36 months preceding that time (or, where applicable conditions are met, within such longer period as the Minister considers reasonable in the circumstances), as a result of qualifying activities.

For this purpose, qualifying activities are

- the issuance of a debt or a participating interest in the entity,

- the disposition of property described in any of paragraphs (*a*) to (*c*) of the definition “qualifying entity”, and

- the accumulation of income of the entity.

The qualifying activities must also have been made for the purpose of acquiring property that, if owned by the entity, would be property described in paragraph (*a*) to (*c*) of the definition of “qualifying entity”.

For the purpose of applying this definition, an entity will be considered to have a strategic interest in another entity where the entity participates in or has established a plan of action for participating in the management and control of the other entity by reason of its status as a holder of a significant number (not to be confused with the “significant interest” definition) of participating interests in the other entity (in comparison with the number of participating interests held by each holder of interests in the entity) or an agreement with other such significant interest holders.

In establishing if an entity actively participates in or exercises a significant influence over the governance or the management of an other entity the following facts (among others) will be considered:

- whether the entity, alone or in alliance with others, appoints members of the board of directors and management;

- whether the entity, alone or in alliance with others, significantly influences the appointment of members of the board of directors and management; and

- whether the entity, alone or in alliance with others, is actively involved in the strategic planning for the entity.

In determining if an entity is carrying out a plan of action for the purpose of obtaining its objective of actively participating in or exercising significant influence over the governance or the management of another entity, all factors will be considered. For example, an entity's board-approved plan of action, board minutes, investment studies and other material relating to the strategic investment will be considered. As well, evidence that increasing numbers of shares of the other entity are being bought or that property is being sold in order to raise money to acquire such shares will be considered important factors. The entity's investment history and patterns will also be considered.

Finally, it should be noted that under paragraph 94.1(2)(*r*), the definition "qualifying entity" in subsection (1) does not apply in determining whether a taxpayer has a participating interest in a FIE, if the Minister sends a written demand to a taxpayer requesting additional information for the purpose of enabling the Minister to determine whether an entity is a qualifying entity, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand.

For more information, see the commentary on paragraph 94.1(2)(*r*) and on the definitions "carrying value", "significant interest" and "investment property" in subsection 94.1(1).

"significant interest"

An entity is considered to have a significant interest in a corporation, partnership, or non-discretionary trust if the entity or a group of entities comprised of the entity and entities related to the entity holds shares or interests in the corporation, partnership or trust that have a fair market value equal to 25% or more of the fair market value of all the shares or interests in the corporation, partnership or trust and, in the case of a corporation, the entity or the group of entities comprised of the entity and the entities related to the entity has shares entitling the entity to cast at least 25% of votes at an annual shareholders' meeting of the corporation.

In these circumstances, the entity's significant interest will be its share of the capital stock of the corporation, its interest as a member of the partnership or its interest as a beneficiary under the trust, as the case may be.

“specified party”

The definition “specified party” is relevant in determining whether a taxpayer has an avoidance motive in respect of a participating interest in a FIE. This determination is relevant to applying the definition “exempt interest” in subsection 94.1(1). For more information, see the commentary on the definition “exempt interest”.

A specified party in respect of a particular individual or particular entity, as the case may be, means another individual or other entity that does not deal at arm's length with the particular individual or the particular entity, as the case may be.

“taxation year”

The “taxation year” of a non-resident entity that is a corporation or an individual is generally determined in accordance with subsection 249(1) and paragraph 250.1(*a*). Where the non-resident entity is not an individual or a corporation, this definition provides that the entity's taxation year means:

- in respect of a business or property of the non-resident entity for which the accounts of the non-resident entity are ordinarily made up, the period that would be determined under section 249.1 in respect of the non-resident entity if the non-resident entity were a corporation, and

- in any other case, a calendar year.

Rules of Application

ITA
94.1(2)

Subsection 94.1(2) sets out a number of rules for the purposes of applying sections 94.1 and 94.2 in respect of a particular participating interest in a particular non-resident entity (and in respect of any other participating interests in the particular non-resident entity that are identical to the participating interest) held by a taxpayer in a particular taxation year of the taxpayer. These rules are relevant, for example, in determining whether the particular non-resident entity is a FIE and whether the particular participating interest is an “exempt interest”.

Methods for Determining Whether Entity is a FIE

New paragraphs 94.1(2)(*a*) and (*b*) contain rules that apply to determine the financial statements and assets and income to which a taxpayer must refer to determine whether the particular non-resident entity, in which the taxpayer holds a particular participating interest, is a FIE.

Under paragraph 94.2(2)(*a*), the particular non-resident entity's consolidated financial statements for a taxation year are deemed to be the balance sheet and statement of income of the particular non-resident entity for that taxation year if those statements are prepared in accordance with generally accepted accounting principles used in Canada ("Canadian GAAP") or in accordance with generally accepted accounting principles that are substantially similar to that Canadian GAAP). In addition, the business and non-business activities, the net accounting income derived from those activities, and the assets and liabilities of each other entity (the assets, liabilities and income or loss of which are reflected in those consolidated financial statements) are deemed to be those of the non-resident entity to the same extent as the non-resident entity's proportional interest in the retained earnings and income of those other entities for that taxation year.

It should be noted that if paragraph 94.1(2)(*a*) applies in respect of the taxpayer's participating interest in the non-resident entity, the special look-through rule in paragraph 94.1(2)(*j*) will not apply in respect of that participating interest. For more information, see the commentary on paragraph 94.1(2)(*j*). Paragraph 94.1(2)(*a*) is relevant in applying, for example, the definition "carrying value" in subsection 94.1(1), when determining whether the non-resident entity is a FIE because of the carrying value of its investment property.

If the consolidated financial statements of the non-resident entity are not available or are not prepared as required by paragraph 94.2(1)(*a*), or they are available but the taxpayer would prefer to rely on non-consolidated financial statements for that taxation year, the taxpayer must make a valid election for that year in accordance with paragraph 94.1(2)(*b*). If this election is made, paragraph 94.1(2)(*a*) does not apply for that year in respect of the taxpayer's participating interest in the non-resident entity. In addition, the non-consolidated financial statements are deemed to be the balance sheet and statement of income of the non-resident entity if they are prepared in accordance with Canadian GAAP or generally accepted accounting principles that are substantially similar to Canadian GAAP.

If a valid election is made by the taxpayer under paragraph 94.1(2)(*b*), the special look-through for significant interests of more than 25% in underlying entities will be available to the taxpayer in

applying sections 94.1 and 94.2 in respect of the taxpayer's participating interest in the non-resident entity.

For more information, see the commentary on the definitions "carrying value", "foreign investment entity" and "investment property" in subsection 94.1(1). See also, the commentary on paragraph 94.1(2)(*c*), for more information on determining whether accounting principles are substantially similar to Canadian GAAP, and the commentary on paragraph 94.1(2)(*j*), for more information on the look-through rule for significant interests.

GAAP substantially similar to Canadian GAAP

Paragraph 94.2(2)(*c*) provides that generally accepted accounting principles used for a taxation year in the United States of America or in countries that are members of the European Union are, for greater certainty, considered to be substantially similar to those used in Canada for that taxation year.

Exhangeable/Convertible Participating Interests

Under paragraph 94.1(2)(*d*), exchangeable or convertible participating interests in a non-resident entity are deemed to have been exchanged or converted in accordance with their terms.

In addition, each entity that held an exchangeable or convertible participating interest in the non-resident entity is deemed to have acquired immediately before the deemed exchange or conversion time the number and types of exchanged or converted participating interests in the specified entity for which the exchangeable or convertible participating interests of the non-resident entity are exchangeable for or convertible into.

Investment business

Under paragraph 94.1(2)(*e*), a determination of whether the principal business of an entity for a taxation year of the entity is an investment business is made by reference to:

- subject to the rules below, the relevant facts and circumstances, including the utilization of assets and employees, expenditures made and the net income of the entity, or

- if the taxpayer elects, by reference to the entity's "net accounting income" (as defined in subsection 94.1(1)) from investment property and investment businesses,

Under subparagraph 94.1(2)(*e*)(iii), if the Minister of National Revenue sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether the principal business of the entity is in that taxation year an investment business, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand, the principal business of the entity for that taxation year is deemed to be an investment business.

Widely Held and Actively Traded

Under paragraph 94.1(2)(*f*), participating interests in a particular non-resident entity that are identical to a particular participating interest of a taxpayer in the particular non-resident entity are not, at any particular time, widely held and actively traded unless, at the particular time

- there are at least 150 persons each of which holds participating interests in the particular non-resident entity that, at that time, are identical to the particular participating interest, and have a total fair market value of at least $500,

- the total of all amounts each of which is the fair market value, at that time, of the particular participating interest or of a participating interest in the non-resident entity that is identical to the particular participating interest and that is held, at that time, by the taxpayer or an entity with whom the taxpayer does not deal at arm's length does not exceed 10% of the total of all amounts each of which is the fair market value, at that time, of a participating interest in the non-resident entity that is held, at that time, by any entity and that is identical to the particular participating interest, and

- the participating interests in the non-resident entity that are identical to the particular participating interest are

  - qualified for distribution to the general public under the securities law of the country or of a political subdivision of the country under the laws of which the particular non-resident entity is governed, and exists, was (unless the entity was continued in any jurisdiction) formed or organized, or was last continued, and

  - can be purchased and sold by any member of the general public in the open market or can be purchased from and sold to the particular non-resident entity by any member of the general public.

This rule is relevant in determining whether the taxpayer's particular participating interest is, under paragraph (*e*) of the definition "exempt interest" in subsection 94.1(1), an exempt interest. For more information on exempt interests, see the commentary on that expression.

Residency of an Entity - Special Case

New paragraph 94.1(2)(*g*) of the Act applies in determining whether a taxpayer's participating interest (as defined in subsection 94.1(1)) in a FIE is an "exempt interest"(as defined in subsection 94.1(1)). Paragraph 94.1(2)(*g*) provides that in applying subparagraph (*e*)(i) of the definition "exempt interest", if the FIE is not a corporation, a partnership or a trust, it is deemed not to be resident in a particular country, unless

- the particular country is a country other than a prescribed country,
- the FIE is governed, and exists, was (unless the FIE was continued in any jurisdiction) formed or organized, or was last continued under the laws of, the particular country and,
- the FIE is liable, under the laws of the particular country, to pay an income or profits tax imposed by the government of the particular country on all of its income, profits or gains.

If the paragraph 94.1(2)(*g*) applies so that the FIE is not considered resident in a particular country for the purpose of subparagraph (*e*)(i) of the definition "exempt interest", then the taxpayer would not be able to rely upon that paragraph in order to qualify the participating interest as an exempt interest.

Entity Treated as Controlled Foreign Affiliate

New paragraph 94.1(2)(*h*) of the Act permits a taxpayer to make an irrevocable election to treat its foreign affiliate (including an affiliate the shares which are held by the taxpayer's controlled foreign affiliate) as a controlled foreign affiliate for a particular taxation year and subsequent taxation years. This one-time election is available only if:

- a taxation year of the affiliate ends at or before the end of the particular year, and
- the taxpayer has a "qualifying interest" (as defined in paragraph 95(2)(*m*)) in the affiliate.

The election must be made in prescribed form in the taxpayer's tax return for the year. However, under paragraph 94.1(2)(*i*), described in the commentary below, the election may be rendered invalid in the event that the taxpayer cannot provide sufficient information to the Minister of National Revenue for the Minister to be able to determine amounts required to be included in the taxpayer's income under section 91. In addition, the election ceases to have effect if the corporation ceases to be a foreign affiliate of the taxpayer.

In the period during which an election under paragraph 94.1(2)(*h*) is effective, a foreign affiliate of a taxpayer is deemed to be a controlled foreign affiliate of the taxpayer. As a result, a share issued by the affiliate to the taxpayer would be an "exempt interest" under the definition in subsection 94.1(1). Sections 94.1 and 94.2 generally would not apply to the taxpayer's participating interest in the affiliate. However, the foreign accrual property income (FAPI) rules would apply and the taxpayer would be required to include in income under section 91 a percentage of any FAPI derived by the affiliate in the year. Notwithstanding an election under paragraph 94.1(2)(*h*), section 94.2 may still apply in the event that a taxpayer's interest in a controlled foreign affiliate is a tracked interest to which subsection 94.2(9) applies.

Demand for Information – CFA election

Under paragraph 94.1(2)(*i*), an election made by a taxpayer under subparagraph 94.1(2)(*h*)(iv) is, other than for the purposes of applying paragraph 94.1(2)(*i*) and that subparagraph, deemed never to have been made, if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to make a determination referred to in one of those paragraphs, and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand.

The determination referred to in paragraph 94.1(2)(*i*) concerns an amount that would, if the Act were read without reference to that paragraph, be required to be added or deducted (otherwise than under subsection 104(13)) in computing the taxpayer's income for the year because of the application of section 91 and an election under paragraph 94.1(2)(*h*) in respect of a foreign affiliate.

Look-through Rule – Significant Interests

A particular non-resident entity is a FIE at any time if the carrying value of all of the entity's "investment property" is more than 50% of the "carrying value" of all its property at the end of the entity's taxation year that includes that time and none of the other exceptions in the definition "foreign investment entity" applies.

New paragraph 94.1(2)(*j*) is relevant in determining whether a taxpayer's participating interest in the particular non-resident entity is a participating interest in a FIE. The paragraph applies if the taxpayer has made a valid election under 94.1(2)(*b*) in respect of the participating interest of the taxpayer, a specified entity (i.e., the particular non-resident entity or another entity) has a significant interest in another entity ("the investee"), that is a corporation, partnership or non-discretionary trust, and the significant interest is relevant in determining whether the particular non-resident entity is a foreign investment entity.

In these circumstances, in determining the carrying value of the specified entity's property, the carrying values of its participating interests in the investee are deemed to be nil. Debt that owing to the specified entity by the investee (other than debt acquired in the ordinary course of a business other than an investment business of the specified entity) is also deemed to have a carrying value to the specified entity of nil, and the net accounting income of the specified entity is also deemed to be nil to the extent that it is derived from debt or participating interests of the specified entity that are deemed to be nil.

Instead, the specified entity is deemed to own the property of the investee. Each such deemed owned property is deemed to have a carrying value to the specified entity based on the product obtained by multiplying the property's carrying value to the investee by the specified entity's proportional ownership of the investee's property. In general terms, this proportional ownership is the quotient obtained by dividing:

- the amount that is the fair market value of the specified entity's shares and certain debt issued by the investee, by

- the amount that is the total fair market value of shares and certain debt issued by the investee entity.

If the taxpayer notifies the Minister of National Revenue in writing of its intention to value the specified entity's property at its fair market value in accordance with paragraph (*a*) of the definition "carrying

value" in subsection 94.1(1), the property of the investee must also be valued on that basis.

If there are tiers of entities each of which has a significant interest in the other, paragraph 94.1(2)(*j*) operates to deem each higher tier entity to own properties of the immediately lower tier entities on an iterative basis. For example, assume a non-resident entity (Foreignco-1) owns 100% of the shares in Foreignco-2, which in turn owns 100% of shares in Foreignco-3 and that Foreignco-1, Foreignco-2 and Foreignco-3 have identical taxation year ends. The carrying values from properties in Foreignco-3 would, under paragraph 94.1(2)(*j*), become the carrying values of properties in Foreignco-2. Because paragraph 94.1(2)(*j*) operates on an iterative basis, the carrying value of those properties would be considered to be the carrying values of properties held by Foreignco-1.

As well, the activities carried on by the investee using the property deemed to be owned by the specified entity and the investee's net accounting income derived from those activities are deemed to be those of the specified entity.

The example below illustrates the operation of paragraph 94.1(2)(*j*).

Example

1. *Jean, who resides in Canada, holds shares in Foreignco, a non-resident corporation that is not a controlled foreign affiliate of Jean. Foreignco's principal activity is the carrying on of investment activities on behalf of its shareholders. Foreignco prepares its financial statements in accordance with accounting principles substantially similar to generally accepted accounting principles used in Canada.*

2. *The carrying values of Foreignco's assets at the end of its taxation year ending in Jean's year are as follows:*

guaranteed investment certificate	*$10,000*
shares of XYZ Inc. in which Foreignco has a significant interest	*$20,000*
shares of ABC Inc. in which Foreignco does not have a significant interest	*$ 5,000*
cash	*$ 4,000*
Total assets	*$39,000*

3. *XYZ Inc. owns assets at that time that are used in the course of carrying on an active business, with a carrying value of $80,000. It also has investment property with a carrying value of $15,000.*

4. *The fair market value of the shares of XYZ Inc. held by Foreignco is $40,000 while the fair market value of all the issued and outstanding shares of XYZ Inc. is $100,000 at that time.*

Results

1. *The guaranteed investment certificate, cash, and the shares of XYZ Inc. and ABC Inc. are all investment property by virtue of the definition "investment property" in subsection 94.1(1).*

2. *However, since Foreignco owns a significant interest in XYZ Inc., the special look-through rule in new paragraph 94.1(2)(j) applies. Under this look-through rule the carrying value of Foreignco's shares in XYZ Inc. is deemed to be nil. Instead, Foreignco is deemed to own a portion of the property that XYZ Inc. owns.*

3. *The carrying value of the XYZ property deemed to be owned by Foreignco is 40% of its carrying value to XYZ, since Foreignco's percentage ownership of shares is 40%.*

4. *Consequently, the carrying values of the investment property of Foreignco are:*

guaranteed investment certificate	*$10,000*
shares of XYZ Inc.	*nil*
shares of ABC Inc.	*$ 5,000*
cash	*$ 4,000*
investment property of XYZ Inc. (40% of $15,000)	*$ 6,000*
Total	*$25,000*

5. *The total carrying value of the assets of Foreignco is:*

Investment property (see above)	*$ 25,000*
assets of XYZ Inc. (other than investment property) (40% of $80,000)	*$ 32,000*
Total	*$ 57,000*

6. *As a result, Foreignco is not a FIE because less than 50% of the carrying value of its property is investment property.*

Tax Avoidance Motive

New paragraph 94.1(2)(*k*) of the Act sets out the conditions under which a taxpayer will be considered to have a tax avoidance motive in respect of a participating interest in a FIE. Subject to new paragraphs 94.1(2)(*m*) and (*n*) (described in the commentary below), a tax avoidance motive will be considered to exist where one of the main reasons for acquiring a participating interest in a FIE was to permit the taxpayer to achieve the following two objectives:

- to derive a benefit the value of which can be attributed principally, directly or indirectly, to income derived from investment property, to profits or gains from the disposition of investment property, or to an increase in value of investment property, and

- to defer or reduce the amount of tax that would have been payable by the taxpayer if the taxpayer had earned or realised such income, profits or gains from the investment property at the time they were earned or realised by the holders of the investment property.

Factors Considered in Tax Avoidance Motive

New paragraph 94.1(2)(*l*) of the Act sets out factors to be considered in determining whether there is a tax avoidance motive for a taxpayer acquiring an interest in a FIE. Those factors are similar to the ones in existing subsection 94.1(1). However, the form and the terms and conditions governing the taxpayer's interest in a FIE are to be taken into account as well. Note that a tax avoidance motive may exist whether the FIE is resident in a “tax haven” or not. The factors are as follows:

- the nature, organization and operation of the FIE and any other FIE in which it or a specified party (as defined in subsection 94.1(1)) in respect of it has a direct or indirect interest,

- the nature, organization and operation of any FIE in which the taxpayer or a specified party in respect of the taxpayer has a direct or indirect interest,

- the form of and the terms and the conditions governing the direct or indirect interests described above,

- the extent to which and the time at which an entity in which an direct or indirect interest described above is held is subject to income tax or profits tax on its income, profits and gains, and

- the extent to which and the time at which an entity that holds a direct or indirect interest described above is subject to an income tax or profits tax on the entity's share of the income, profits and gains of the entity in which the direct or indirect interest is held.

No Tax Avoidance Motive

New paragraphs 94.1(2)(*m*) and (*n*) provide two situations where a taxpayer will not be considered to have a tax avoidance motive in respect of a participating interest in a non-resident entity held by the taxpayer in a taxation year:

- if the non-resident entity (and each other foreign investment entity, in which the non-resident entity has a direct or indirect interest) flows through all or substantially all of its income for its taxation year that ends in the particular taxation to its interest holders within 120 days after the end of its taxation year, and the taxpayer's share of that amount is included in computing the taxpayer's income, profit or gains for the taxpayer's taxation year that includes the time at which the amount became payable, and

- if the non-resident entity is a "Regulated Investment Company" for the purposes of sections 851(b) and 852(a) of the United States *Internal Revenue Code* or a "Real Estate Investment Trust" for the purposes of sections 856(c) and 857(b) of that Code, and the taxpayer includes, in computing the taxpayer's income for that taxation year of the taxpayer, the amount of income that became payable by the particular non-resident entity to the taxpayer in that taxation year of the taxpayer.

Amounts Payable

Under paragraph 94.1(2)(*o*), an amount is deemed not to have become payable to an entity in a taxation year of the entity unless it was paid in the year to the entity or the entity was entitled in the taxation year of the entity to enforce payment of it.

Demands for Information

Under paragraphs 94.1(2)(*p*) to (*r*) a number of provisions in section 94.1 will not apply in respect of a taxpayer's participating interest in a non-resident entity, if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to make a determination referred to in one of those paragraphs, and information satisfactory to the Minister to make the

determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand.

The determinations referred to in paragraph 94.1(2)(*p*) to (*r*) are in respect of the definitions "exempt property", "foreign investment entity" and "qualifying entity" in subsection 94.1(1), respectively.

Participating Interests – Special Case

Paragraph 94.1(2)(*s*) applies in determining whether an interest is a participating interest. Under that paragraph, if at any time a taxpayer has a participating interest in a particular foreign investment entity and the taxpayer has at that time a participating interest (referred to in that paragraph and this commentary as the "indirect participating interest") in another non-resident entity solely because the particular foreign investment entity has at that time a participating interest in that other non-resident entity, then the indirect participating interest is deemed not to be a participating interest of the taxpayer at that time.

Paragraph 94.1(2)(*s*) provides relief only where the conditions attached to a taxpayer's participating interest in a FIE are such that the interest may also be a participating interest in another non-resident entity in which the FIE holds an interest and in which the taxpayer does not directly hold an interest. Paragraph 94.1(2)(*s*) would not apply to a participating interest where the taxpayer holds the participating interest directly in the other non-resident entity – in these circumstances, the taxpayer would be required to determine whether the participating interest in the other non-resident entity is a participating interest in a FIE.

Conditions for Application of Tax Regime for Foreign Investment Entities

ITA
94.1(3)

New subsection 94.1(3) of the Act sets out the common conditions for the application of the FIE rules in section 94.1(3) (prescribed rate of return regime) and 94.2(4) (mark-to-market regime). For the prescribed rate of return or mark-to-market regimes to apply to a taxpayer for a particular taxation year of the taxpayer in respect of a participating interest held in the particular year by the taxpayer in a non-resident entity (other than a tracking interest or a foreign insurance product – for more information see the commentary on subsection 94.2(3)), all of the following conditions set out in subsection 94.1(3) must be satisfied:

- the taxpayer is not an “exempt taxpayer” for the taxpayer's particular taxation year;

- the taxpayer held the participating interest at the end of a taxation year of the non-resident entity that ends in the taxpayer's particular taxation year; and

- at the end of that taxation year of the non-resident entity, the interest was a participating interest in a FIE and was not an exempt interest.

Income Inclusion – Prescribed Rate of Return Regime

ITA
94.1(4) and (5)

If subsection 94.1(3) applies (and subsection 94.2(3) does not apply) to a taxpayer resident in Canada for a taxation year of the taxpayer in respect of a participating interest in a non-resident entity, the taxpayer is required to include (as income from a property that is the participating interest) in computing the taxpayer’s income for that taxation year the total of all amounts each of which, is in respect of each month in that taxation year, at the end of which month the taxpayer holds the participating interest, the product obtained by multiplying

- the designated cost (as defined in subsection 94.1(1)), to the taxpayer of the participating interest, at the end of the month,

by

- the quotient obtained when the rate of interest prescribed, in respect of amounts required by this Act to be paid by the Receiver General, for the quarterly period that includes that month is divided by 12.

For this purpose, the rate of interest will be that determined under paragraph 4301(*b*) of the Regulations. That rate, in very general terms, is the 3-month average Treasury bill rate + 2 percentage points.

For more information on the definition “designated cost” in subsection 94.1(1), see the commentary on that definition. For more information on subsection 94.2(3), see the commentary on that subsection.

Foreign Investment Entities – Mark-to-market

ITA
94.2

New section 94.2 of the Act sets out new rules for the taxation of interests in FIEs where subsection 94.1 does not apply.

Except as otherwise indicated, section 94.2 applies to taxation years that begin after 2002.

Definitions

ITA
94.2(1)

New subsection 94.2(1) of the Act sets out a number definitions and provides that those definitions and the definitions in subsection 94.1(1) apply for the purposes of section 94.2.

"deferral amount"

The deferral amount of a taxpayer generally represents the gain or loss (in the event that the interest was capital property, one half of the gain or loss) in respect of the interest accrued to the time when the interest first became subject to the rules in section 94.2. The expression "deferral amount " in respect of a participating interest in an entity applies principally for the purpose of determining the value of D in the formula set out in subsection 94.2(4). Subsection 94.2(4) generally provides for the recognition of a deferral amount in respect of a participating interest on the disposition of the interest. Because of paragraph 94.2(2)(*a*), identical participating interests are considered to be disposed of in the order in which they were acquired.

For a participating interest, in a FIE, acquired after the beginning of the taxpayer's first taxation year that began after 2002, the deferral amount will be nil in the typical cases where the rules in section 94.2 apply to the interest for the year in which the interests were acquired.

The deferral amount is calculated, in conjunction with subsections 94.2(5) and subsection 128.1(4), so that gains and losses accruing while a taxpayer is not resident in Canada are ignored for the purposes of section 94.2, except in the unusual case where an interest in a FIE is taxable Canadian property.

Additional rules affecting the calculation of the deferral amount are contained in subsections 94.2(6) and (14) to (18), as described in the commentary below.

“gross-up factor”

The definition “gross-up factor” for a particular deferral amount is 1, except where the 1/2 factor is relevant in computing the deferral amount because the property is capital property. In the latter case, the “gross-up factor” is 2 (i.e., the reciprocal of the 1/2 factor). For more information on the relevance of this definition, see the commentary on subsection 94.2(12).

“readily obtainable fair market value”

The definition “readily obtainable fair market value” is relevant in determining whether a taxpayer may elect to have section 94.2 apply in respect of a particular participating interest (as defined in subsection 94.1(1)) of the taxpayer in a non-resident entity (as defined in subsection 94.1(1)). In general terms, the particular participating interest will have a readily obtainable fair market value if one of two sets of conditions is met. The first set of conditions is that participating interests identical to the particular interest be widely held and actively traded (determined by reference to paragraph 94.1(2)(*f*)) and listed on a prescribed stock exchange. In these circumstances, the readily obtainable fair market value of the particular interest is the amount that is the average of the published price at which the identical participating interests last traded on the prescribed stock exchange on the day that includes that time and on the 5 immediately preceding days on which the participating interests traded on that stock exchange.

Note that, under paragraph 94.2(2)(*d*), where the identical participating interests are listed on more than one prescribed stock exchange, the taxpayer may generally elect which of the exchanges will be used in applying the definition “readily obtainable fair market value”. For more information, see the commentary on paragraph 94.2(2)(*d*).

Where the first set of conditions is not met, the second set of conditions requires that the identical participating interests have conditions attached that require the non-resident entity to accept at the demand of the holders of the participating interests (or that require the holders of participating interests to accept, at the demand of the non-resident entity) and at a price (“the redemption price”) determined and payable in accordance with the conditions, the surrender in whole or in part of the participating interests. In addition, the conditions require that the redemption price be determined by reference to the fair market value of the property of the non-resident entity, and be a price that would have been acceptable to entities dealing at arm’s length with one another.

If this second set of conditions is met, the particular interest's readily obtainable fair market value will be the amount that is the redemption price.

“tracking entity”

The definition “tracking entity” is relevant in determining whether section 94.2 will apply for a taxation year of a taxpayer in respect of a participating interest, held by the taxpayer at the end of the year, in a non-resident entity. If the non-resident entity is, at the end of a taxation year of the non-resident entity that ends in the taxpayer's year, a tracking entity, and the other conditions described in subsection 94.2(9) are met, such that subsection 94.2(9) applies, then section 94.2 would generally apply for the year.

A particular non-resident entity is a tracking entity in respect of a particular participating interest of a taxpayer in the non-resident entity if any of paragraphs (*a*) to (*c*) of the definition applies.

Under paragraph (*a*) of the definition, the particular non-resident entity is a tracking entity if

- the tracked property described in paragraph 94.2(9)(*d*) in respect of the particular participating interest is at that time owned by the particular non-resident entity,

- the total carrying value at that time of the tracked property is less than 90% of the total carrying value at that time of all property owned at that time by the particular non-resident entity, and

- the total of all amounts each of which is the carrying value at that time of tracked property that is at that time investment property of the particular non-resident entity exceeds 50% of the total of all amounts of each of which is the carrying value at that time of a tracked property owned at that time by the particular non-resident entity.

Where the particular non-resident entity is a specified entity described in paragraph 94.1(2)(*j*), that paragraph would be relevant in applying paragraph (*a*) of the definition “tracking entity”.

Under paragraph (*b*) of the definition, the particular non-resident entity will be a tracking entity if

- paragraph 94.1(2)(*j*) applies at that time to the particular non-resident entity (because it has a significant interest in another entity),

- the tracked property described in paragraph 94.2(9)(*d*) in respect of the participating interest is at that time owned (determined without reference to subparagraph 94.1(2)(*j*)(ii)) by the particular non-resident entity,

- the total carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of the tracked property is less than 90% of the total carrying value at that time of all property owned (determined without reference to subparagraph 94.1(2)(*j*)(ii)) at that time by the particular non-resident entity, and

- the total of all amounts each of which is the carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of tracked property that is at that time investment property (determined without reference to subparagraph 94.1(2)(*j*)(ii)) of the particular non-resident entity exceeds 50% of the total of all amounts each of which is the carrying value (determined without reference to subparagraph 94.1(2)(*j*)(i)) at that time of a tracked property owned (determined without reference to subparagraph 94.1(2)(*j*)(ii)) at that time by the particular non-resident entity.

Paragraph (*b*) of the definition ensures that if tracked property held by the particular non-resident entity includes its participating interest in another entity, then, notwithstanding paragraph 94.1(2)(*j*), the carrying value of the participating interest is included in determining whether the particular non-resident entity is a tracking entity.

Under paragraph (*c*) of the definition, the particular non-resident entity will be a tracking entity if

- any of the tracked property described in paragraph 94.2(9)(*d*) in respect of the participating interest is not at that time owned by the particular non-resident entity,

- the particular non-resident entity owns property that is at that time investment property, and

- it is reasonable to conclude that the investment property (or property that may be substituted for the investment property) may be used to satisfy, directly or indirectly, the entitlement referred to in paragraph 94.2(9)(*d*) in respect of the particular participating interest.

For more information on the application of this definition see the commentary on subsection 94.2(3) and (9). For more information on paragraph 94.2(1)(*j*), see the commentary on that provision.

Rules of application

ITA
94.2(2)

New subsection 94.2(2) of the Act provides rules of application for the purpose of section 94.2.

Paragraph 94.2(2)(*a*) provides that identical properties that were held and are disposed of by a taxpayer will be treated as having been disposed of in the order in which they were acquired by the taxpayer. For this purpose, paragraph 94.2(2)(*a*) makes it clear that the various acquisitions that are deemed to occur under the Act (e.g., section 47) are not to be taken into account. This measure is relevant primarily for the purpose of determining the amount to be added or deducted from a taxpayer's income under subsection 94.2(4), especially with reference to the "deferral amount" referred to in the description of D in paragraph 94.2(4)(*a*).

Paragraph 94.2(2)(*b*) provides that the rules in subsection 94.1(2) also apply for the purposes of section 94.2.

Paragraph 94.2(2)(*c*) provides that a taxpayer who acquires shares (referred to in this paragraph as the "new shares") of the capital stock of a corporation resident in a country other than Canada in exchange for shares of another corporation resident in a country other than Canada (referred to in this paragraph as the "exchanged shares") in circumstances in which subsection 85.1(5) applied to the taxpayer in respect of the new shares, the new shares are deemed to have been owned by the taxpayer throughout the period that the exchanged shares were owned by the taxpayer.

Paragraph 94.2(2)(*d*) applies for the purpose of paragraph (*a*) of the definition "readily obtainable fair market value" in subsection 94.2(1), referred to in the commentary above, in respect of a particular participating interest in a non-resident entity held by a taxpayer in a taxation year. Where participating interests in the non-resident entity that are identical to the particular participating interest are listed on more than one prescribed stock exchange, the references in that definition to a prescribed stock exchange shall be read as a reference to the prescribed stock exchange in respect of which the taxpayer files an election with the Minister of National Revenue.

If the taxpayer does not so elect or participating interests that are identical to the particular participating interest are no longer listed on the stock exchange identified in the taxpayer's election referred, the references in that definition to a prescribed stock exchange shall be

read as a reference to the prescribed stock exchange chosen by the Minister of National Revenue.

Paragraph 94.2(2)(*e*) provides that the mark-to-market regime in section 94.2 will not apply to a taxpayer in respect of certain participating interests of the taxpayer. The rule applies if the taxpayer has been subject to section 94.2 in respect of a participating interest because of paragraph 94.2(3)(*b*) (i.e., an election in respect of the interest where the interest has a readily obtainable fair market value) and subsection 94.2(3) ceases to apply. For example, paragraph 94.2(2)(*e*) would apply where the interest is not an interest in a tracking entity or a foreign insurance policy and the interest ceases to have a readily obtainable fair market value or the Minister fails to receive, in response to a demand under paragraph 94.2(2)(*f*), information satisfactory to make a determination of whether the interest has a readily obtainable fair market value.

Where paragraph 94.2(2)(*e*) applies the taxpayer will become subject to 94.1(4) in respect of the participating interest if 94.1(3) continues to apply to the taxpayer in respect of the participating interest.

Note that if, because of paragraph 94.2(3)(*a*), section 94.2 applies to a taxpayer for a taxation year in respect of a participating interest (i.e., the interest is an interest in a tracking entity or a foreign insurance policy), in the immediately following year the interest ceases to be an interest in a tracking entity or a foreign insurance policy, and paragraph 94.2(3)(*b*) has never applied in respect of the participating interest (i.e., the taxpayer has not previously elected in respect of the participating interest under paragraph 94.2(3)(*b*)), then the taxpayer may elect, under paragraph 94.2(3)(*b*) to be subject to section 94.2 for that immediately following year. In this regard, see the commentary on clause 94.2(3)(*b*)(ii)(B).

Paragraph 94.2(2)(*f*) provides that paragraph (3)(*b*) does not apply to a taxpayer for a particular taxation year in respect of a participating interest held in the particular taxation year by the taxpayer in a non-resident entity if the Minister sends a written demand to the taxpayer requesting additional information for the purpose of enabling the Minister to determine whether the participating interest has a readily obtainable fair market value and information satisfactory to the Minister to make the determination is not received by the Minister within 60 days (or within such longer period as is acceptable to the Minister) after the Minister sends the demand.

Paragraphs 94.2(2)(*g*) and (*h*) provide special rules for determining whether a taxpayer's income for a taxation year from the application of subsection 94.2(4) will be treated as income from a source outside Canada. Paragraph 94.2(2)(*g*) provides that in applying paragraph

94.2(4)(*a*) to a taxpayer (that is a trust) for a particular taxation year of the taxpayer and in respect of a participating interest of the taxpayer in a non-resident entity, the reference in that paragraph to "as income from property that is the participating interest" shall be read as a reference to "as income from property that is a source outside Canada that is the participating interest". However, this special rule applies only if the portion of the net accounting income of the non-resident entity, from sources outside Canada, for its last taxation year that ends in the particular taxation exceeds 90% of the total net accounting income of the non-resident entity for that last taxation year.

Paragraph 94.2(2)(*h*) provides that in applying paragraph 94.2(21)(*a*) to a taxpayer (that is a trust) for a particular taxation year of the taxpayer and in respect of a participating interest of the taxpayer in a non-resident entity, the reference in that paragraph to "a capital gain for the year" shall be read as a reference to "a capital gain for the year from a source outside Canada and". However, this special rule applies only if the portion of the net accounting income of the non-resident entity, from sources outside Canada, for its last taxation year that ends in the particular taxation year exceeds 90% of the total net accounting income of the non-resident entity for that last taxation year.

The application of paragraphs 94.2(2)(*g*) and (*h*) in respect of a participating interest of a taxpayer will not be relevant in determining a taxpayer's eligibility for a foreign tax credit under section 126 of the Act. In this regard, see the commentary below on subsections 94.3(2) and 126(1.1). Rather, paragraph 94.2(2)(*g*) and (*h*) provide relief to trusts resident in Canada that hold participating interests in a FIE and that make payable to their non-resident beneficiaries all or part of the trusts' incomes arising under subsection 94.2(4) or (21). Where paragraph 94.2(2)(*g*) or (*h*) applies and the trust indenture permits amounts of deemed income of the trust to be made payable to beneficiaries, the amounts of such trust income arising under subsection 94.2(4) or (21) and made payable to non-resident beneficiaries of the trust may qualify for reduced withholding if the non-resident beneficiary is resident in a country with which Canada has entered a tax treaty and the tax treaty contains a provision permitting such a reduction in withholding.

Where paragraphs 94.2(2)(*g*) and (*h*) does not apply, income arising under subsection 94.2(4) or (21) is income from a source inside Canada.

Mark-to-market

ITA
94.2(3) and (4)

Subsection 94.2(3) of the Act sets out those circumstances where, subject to paragraphs 94.2(2)(*e*) and (*f*) and 94.2(5)(*b*), subsection 94.2(3) applies to a taxpayer in respect of a participating interest in a non-resident entity. For the mark-to-market regime in subsection 94.2(4) to apply for a taxation year, subsection 94.2(3) must apply for the year.

Except as described above, subsection 94.2(3) will apply to a taxpayer for a taxation year in respect of a participating interest in a non-resident entity (and in respect of any other participating interests in the non-resident entity that are identical to the participating interest) if either:

- Subsection 94.2(9) (interests in tracking entities) or paragraph 94.2(11)(*a*) (foreign insurance policies) applies to the taxpayer for the year in respect of the interest; or

- Subsection 94.1(3) applies to the taxpayer in respect of the interest, the interest has a readily obtainable fair market value (as defined in subsection 94.2(1)) and the taxpayer elects, generally in the taxation year of the taxpayer in which the taxpayer first acquired the participating interest or an identical interest, that subsection 94.3(3) apply.

Note that under clause 94.2(3)(*b*)(ii)(B) a taxpayer may elect, to have subsection 94.3(3) apply, in a year other than the taxation year in which the taxpayer first acquired the participating interest or an identical interest if the election is made in the taxpayer's return of income for a taxation year if

- the taxation year is one for in which the interest is neither an interest in a tracking entity nor a foreign insurance policy, and

- the taxation year immediately follows a taxation year for which the interest is either an interest in a tracking entity or a foreign insurance product that a taxation year for which subsection.

Where subsection 94.2(3) applies to a participating interest in a FIE, subject to subsection 94.2(20), paragraph 94.2(4)(*a*) requires a taxpayer to include in computing income as income from property (in this regard, see the commentary on paragraph 94.2(2)(*g*)), in respect of the interest, any positive amount resulting from the operation of the formula set out in paragraph 94.2(4)(*a*). Under paragraph

94.2(4)(*b*), the absolute value of any negative amount resulting from the operation of the same formula may be deducted in computing the taxpayer's income as a loss from property. (Note, however, that losses in respect of foreign insurance polices are denied because of subparagraph 94.2(4)(*b*)(i). Instead, as described below, the denied losses are carried forward to offset later income inclusions.)

The amount determined under the formula for a taxpayer's taxation year in respect of a participating interest in a FIE to be treated as an income or a loss from property is computed as follows:

- [A] ADD the proceeds of disposition in the year from any disposition by the taxpayer in the year of the interest (other than a disposition arising from the application of subsection 128.1(4) or 149(10), given that the value of B would take into account the fair market value of the interest at the time of such deemed dispositions);

- [B] ADD, where the taxpayer held the interest at the end of the year, the fair market value of the interest at that time (determined before taking into account the FIE's liability in respect of any amount payable from the FIE in respect of the interest);

- [C] ADD the total payments received by the taxpayer in the year from the FIE, other than payments included in the value of A;

- [D] ADD, where the taxpayer so elects for a year during which the taxpayer did not dispose of the interest, any positive deferral amount in respect of the interest;

- [D] ADD, where the taxpayer disposed of the interest in the year and the election referred to above has not been previously made, the deferral amount in respect of the interest - the value of D will reduce the amount determined under the formula in the event that the deferral amount is a negative amount;

- [E] SUBTRACT the cost of the interest on any acquisition in the year of the interest (disregarding acquisitions arising because of the application of subsection 128.1(4) or 149(10), given that these acquisitions are taken into account in the value of F);

- [F] SUBTRACT, where the taxpayer held the interest at the beginning of the year, the fair market value of the interest at the beginning of the year; and

- [G] SUBTRACT, in the case of a foreign insurance policy to which subsection 94.2(3) applies because of the operation of new subsections 94.2(10) and (11), any loss denied for the preceding year because of the operation of subparagraph 94.2(4)(*b*)(*i*).

Ignoring the descriptions of D and G, the formula in paragraph 94.2(4)(*a*) in effect determines the net increase or decrease in the fair market value of a taxpayer's participating interest in a FIE for a taxation year.

The value of D represents a taxpayer's accrued gain or loss when a participating interest first becomes subject to section 94.2. The amount of this accrued gain or loss (or one half of it, in the event so provided in the definition "deferral amount" in paragraph 94.2(1)(*b*)) is included in computing income under the description of D, but only for the taxation year in which the interest is disposed of unless the taxpayer elects for earlier recognition of a positive deferral amount. (An earlier recognition of a positive deferral amount may be beneficial for a taxpayer, particularly where section 94.3 applies.) Where the taxpayer is a trust, a disposition may occur as a consequence of the application of the 21-year deemed disposition rule. See, in this regard, new subsection 104(4.1).

The example below illustrates the operation of subsection 94.2(4).

Example

1. *Leonard acquires a 1% interest in ABC Inc. in 1999 for $500. On December 31, 2000, it is capital property to Leonard. ABC Inc. is not a FIE in respect of the taxpayer at any time before 2004.*

2. *ABC Inc. becomes a FIE during 2004 and Leonard elects under subparagraph 94.2(3)(b)(iii) to have the rules in section 94.2 apply. Leonard's interest in ABC Inc. does not qualify as an "exempt interest".*

3. *The fair market values of Leonard's participating interest at the beginning and at the end of 2004 are $800 and $1,000 respectively.*

4. *Leonard disposes of his shares just before the end of 2005 for $1,200. ABC Inc. does not make any distributions to Leonard during his period of ownership.*

Results

1. *No amount is included in Leonard's income for 2003 under either section 94.1 or 94.2. For 2004, Leonard is required to include $200 in income under the formula in paragraph 94.2(4)(a).*

2. *The $200 inclusion is determined as follows:*

   - *"A" is nil, since no participating interest in ABC Inc. is disposed of in 2004,*
   - *"B" is $1,000, the fair market value of the participating interest at the end of 2004,*
   - *"C" is nil since no payments are received in 2004,*
   - *"D" is nil since no participating interest is disposed of in 2004 and no election was otherwise made,*
   - *"E" is nil since no participating interest in ABC Inc. is acquired in 2004, and*
   - *"F" is $800, the fair market value of the participating interest at the beginning of 2004.*

3. *Although Leonard's participating interest has appreciated by $500 since the time of its acquisition, only $200 is required to be included in income under section 94.2 for 2004.*

4. *For 2005, the amount included in income under subsection 94.2(4) is $350, computed as follows:*

   - *"A" is $1,200, the proceeds of disposition of the participating interest,*
   - *"B" is nil since Leonard does not own any participating interest in ABC Inc. at the end of 2005,*
   - *"C" is nil since no payments or distributions were received in 2005,*
   - *"D" is $150, the deferral amount in respect of the interest – the "deferral amount" is one half (the one-half factor applies because Leonard's interest in ABC Inc. is capital property held by Leonard on June 22nd 2000) of the amount by which $800 (the fair market value of the interest at the beginning of 2004 which is the first year in*

respect of which section 94.2 applies to the interest) exceeds $500 (the cost amount of the interest),

- *"E" is nil since no participating interest in ABC Inc. is acquired in 2005, and*
- *"F" is $1,000, the fair market value of the participating interest at the beginning of 2005.*

Non-resident Periods Excluded

ITA
94.2(5)

New subsection 94.2(5) of the Act provides special rules dealing with the application of section 94.2 for a taxation year to persons who are not resident in Canada throughout the year.

Under paragraph 94.2(5)(*a*), the amounts determined under section 94.2 are generally determined as if the taxation year of the taxpayer excludes the period in the year during which the taxpayer is not resident in Canada. This rule, in conjunction with section 128.1, generally ensures that the increases and decreases in fair market values that are relevant in determining income inclusions and deductions under section 94.2 are the increases and decreases occurring while the taxpayer is resident in Canada. However, this rule does not affect the calculation of the taxpayer's deferral amount: paragraph 94.2(1)(*b*) (in conjunction with subsection 128.1(1)) already ensures that gains or losses accruing prior to becoming resident in Canada are not taken into account for the purposes of computing a taxpayer's deferral amount in respect of a participating interest in a FIE, except in the unusual case where the FIE interest is taxable Canadian property.

Paragraph 94.2(5)(*a*) also ensures that subsection 94.2(4) does not apply to a taxpayer for a taxation year throughout which the taxpayer is not resident in Canada.

Under paragraph 94.2(5)(*b*), subsection 94.2(3) generally does not apply to a taxpayer at a particular time if the taxpayer is not resident in Canada at the particular time. This has relevance for the purposes of a number of new provisions, including subparagraph 39(1)(*a*)(ii.3). This subparagraph has the effect of excluding, from a taxpayer's capital property, a property in respect of which subsection 94.2(3) applies and is intended to ensure that there is no double taxation with respect to the same economic gain. Paragraph 94.2(5)(*b*) thus ensures that a non-resident taxpayer cannot claim that a taxable Canadian property consisting of a FIE interest is not capital property on the

basis of subparagraph 39(1)(*a*)(ii.3). (Note: non-resident taxpayers are generally subject to tax on taxable capital gains from their dispositions of taxable Canadian properties.)

Paragraph 94.2(5)(*c*) applies in the unusual case where an individual changes his or her Canadian residence status more than once in the same calendar year. For example, an individual might leave Canada near the beginning of a calendar year but return later in the same year. In the event that such an individual is considered not to reside in Canada during a period in the calendar year, the individual's period of non-residence would be included within the individual's taxation year and the rule in paragraph 94.2(5)(*a*) would have no effect. In order to not tax gains accrued while an individual was non-resident and to not provide relief for losses accrued during the same period, paragraph 94.2(5)(*c*) provides that:

- for the purposes of section 114, the individual's income or loss from the individual's period of non-residence is determined without reference to section 94.2, and

- in computing the individual's taxable income under section 114,

  - there is to be deducted the increase in the fair market value of an interest in a FIE to which subsection 94.2(4) applies during the non-resident period (this fair market value appreciation would be reflected in the amount determined under subsection 94.2(4) in computing the taxpayer's income), and

  - there is to be added the decline in the fair market value of an interest in a FIE to which subsection 94.2(4) applies that accrued during the non-resident period (this fair market value decline would be reflected in the amount determined under subsection 94.2(4) in computing the taxpayer's income).

The example below illustrates the operation of paragraph 94.2(5)(*c*).

Example

Bernard emigrates from Canada on February 1, 2003 in order to start permanent employment elsewhere. Due to unexpected changes in circumstances, he returns to Canada on December 1, 2003. Bernard owns an interest in a FIE to which section 94.2 applies. The fair market value of the interest in 2003 increases from $100 (January 1, 2003), to $105 (February 1, 2003), to $108 (December 1, 2003) and to $107 (December 31, 2003). It is assumed that Bernard establishes

that he did not reside in Canada from February 1, 2003 to December 1, 2003.

Results

1. *Under section 94.2(4), the amount included in computing Bernard's income for 2003 is equal to $7 (B = 107, F = 100).*

2. *Paragraph 94.2(5)(c) permits a deduction for the purposes of paragraph 114(a) equal to $3 (i.e., $108 - $105) equal to the appreciation in the fair market value of the interest while Bernard was not resident in Canada. As a consequence, Bernard's taxable income in respect of the FIE interest for 2003 is $4 (i.e., $7 minus $3).*

Foreign Partnerships – Change of Residence of Member

ITA
94.2(6) to (8)

New subsections 94.2(6) to (8) of the Act provide special rules for partnerships having non-resident members. These subsections are analogous to rules in existing subsections 96(8) and (9) and are designed, in general terms, to prevent partnership losses that accrue while no partnership member is resident in Canada from being used in Canada. A further rule for partnership members is set out in new subsection 96(1.9).

More specifically, subsection 94.2(6) applies where a partnership begins to have members who reside in Canada. Under subsection 94.2(7), a corresponding rule applies in a similar fashion where a partnership ceases to have members who reside in Canada. In either case, for the purposes of determining amounts under section 94.2 portions of the fiscal period of the partnership in which no member is resident in Canada will generally be disregarded.

Where subsection 94.2(6) applies to a partnership at any time, the deferral amount for a FIE interest held by the partnership immediately before that time is computed with reference to the fair market value and the cost amount of the interest. However, if a negative deferral amount is otherwise determined with respect to the interest, the deferral amount is deemed to be nil.

As a consequence of subsections 94.2(6) and (7), amounts added or deductible under subsection 94.2(4) for a partnership in respect of a FIE interest will generally reflect increases or decreases in fair market value while the partnership has members resident in Canada.

However, once the interest is disposed of, an amount reflecting gains accruing before any member became resident in Canada will be recognized because of the application of subsection 94.2(4).

Subsection 94.2(8) contains an anti-avoidance rule, which is aimed at preventing the insertion of nominal Canadian resident partners for tax planning purposes. This rule is parallel to the rule in existing subsection 96(9).

Subsection 94.2(8) also contains a "look-through" rule. It allows for the "look-through" of one or more tiers of partnerships for the purposes of determining whether a person is a member of a partnership.

Participating Interests in a Tracking Entity

ITA
94.2(9)

New subsection 94.2(9) of the Act is an anti-avoidance rule intended to prevent the circumvention of sections 94.1 and 94.2 through the use of a participating interest, in a "tracking entity" (as defined in subsection 94.1(1)), where the tracking entity is not a FIE or the entity is a FIE, but the interest is an "exempt interest". Where subsection 94.2(9) applies with regard to an interest in a tracking entity for a taxation year, the mark-to-market regime in section 94.2 applies to a taxpayer for that year.

Subsection 94.2(9) applies to a taxpayer (other than an exempt taxpayer, as defined in subsection 94.1(1)) for a particular taxation year of the taxpayer in respect of a particular participating interest of the taxpayer in a non-resident entity (and any participating interests of the taxpayer in the non-resident entity that are identical to the particular participating interest) if

- the particular participating interest is, at the end of a taxation year of the non-resident entity that ends in the particular taxation year, held by the taxpayer, and not a participating interest described in paragraph (*b*) of the definition "exempt interest" in subsection 94.1(1) or subparagraph (*e*)(i) or (ii) of that definition,

- the non-resident entity is, at the end of that taxation year of the non-resident entity, a "tracking entity" (as defined in subsection 94.2(1)) in respect of the particular participating interest,

- at any time in the particular taxation year, the entitlement to receive, in any manner whatever and from any entity, payments in respect of the particular participating interest is, directly or indirectly, determined primarily by reference to any one or more of the following criteria in respect of one or more properties (such property or properties together referred to, as "tracked property" in subsection 94.2(9) and the definition "tracking entity" in subsection 94.2(1)):

    - production from the property, use of the property, gains from the disposition of the property, profits from the disposition of the property, fair market value of the property,

    - income from the property, profits from the property, revenue from the property, cash flow from the property, or

    - any other criterion similar to a criterion referred to in any of subparagraphs (i) or (ii), and

- throughout each taxation year of the non-resident entity that ends in the particular taxation year, all or substantially all of the fair market value of the tracked property cannot be attributed, either directly or indirectly, to the fair market value of property:

    - that is a share or shares of the capital stock of a corporation that is at that time a particular foreign affiliate of the taxpayer that if held at that time by the taxpayer would be a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) of the taxpayer in the particular foreign affiliate of the taxpayer, and a participating interest of the taxpayer in a qualifying entity, and

    - that is not at that time tracked property in respect of a participating interest in a non-resident entity of an entity that is not related to the taxpayer.

It should be noted that tracked properties can include any property, whether owned by the non-resident entity or not. For example, if the fair market value of shares issued by a non-resident entity is tracked to the world-wide price of gold bullion, the tracked properties in question would be the world-wide supply of gold bullion. Whether subsection 94.2(9) applies or not in this case would typically depend on whether the non-resident entity is a tracking entity, as defined in subsection 94.2(1).

It should also be noted that, except as provided by subparagraph 94.2(9)(*b*)(ii), there is no exemption under subsection 94.2(9) with regard to an "exempt interest" (as defined in subsection 94.1(1)) in a non-resident entity. Thus, the mark-to-market rules can apply to a taxpayer in respect of shares of the capital stock of a controlled foreign affiliate of the taxpayer.

Treatment of Foreign Insurance Policies

ITA
94.2(10) and (11)

New subsection 94.2(10) of the Act applies if a taxpayer (other than an exempt taxpayer, as defined in subsection 94.1(1)) holds, at any time in a particular taxation year of the taxpayer, an interest in a foreign insurance policy. For this purpose, a foreign insurance policy is one that is not issued by an insurer in the course of carrying on business in Canada the income from which is subject to tax under Part I.

Where subsection 94.2(10) applies, new subsections 94.2(11) sets out the treatment under section 94.2 of an interest in the foreign insurance policy.

Paragraphs 94.2(11)(*a*) and (*b*) generally provide that, where a taxpayer (other than an exempt taxpayer) holds an interest in a foreign insurance policy, for the purposes of subsections 94.2(3) and (4) (and a corresponding foreign property reporting rule in subsection 233.3(1)) the particular interest is deemed to be a participating interest in a non-resident entity to which the mark-to-market rules in subsection 94.2(4) apply. However, the mark-to-market regime under subsection 94.2(4) applies differently to insurance policies in two respects. First, no deferral amount is calculated with regard to insurance policies. Second, losses are not deductible, but instead can be used to offset future income amounts otherwise arising under subsection 94.2(4). (As to the treatment of losses, see the commentary on subsection 94.2(4)). Those paragraphs also provide that, where the mark-to-market rules apply to an insurance policy, the other rules in the Act with regard to the taxation of insurance products do not apply.

Paragraph 94.2(11)(*c*) provides that paragraphs 94.2(11)(*a*) and (*b*) do not apply to a taxpayer in respect of an insurance policy in the following situations:

- The taxpayer is an individual and the interest in the policy was acquired more than five years before the taxpayer became resident in Canada. However, this exception does not apply if

premiums in excess of the level originally contemplated under the policy have been paid within 5 years of the policyholder becoming resident in Canada or while the policyholder was resident in Canada.

- Under the terms and conditions of the policy, the policyholder is entitled to receive only benefits payable as a consequence of the occurrence of the risks insured under the policy, an experience rated refund of premiums for a year and a return of premiums previously paid upon the surrender, cancellation or termination of the policy.

- The taxpayer can establish to the satisfaction of the Minister of National Revenue that an appropriate amount of income has been included in the taxpayer's income under section 12.2 in respect of the policy or that the interest in the policy is an interest in an exempt policy for the purpose of that section.

In the event that new paragraphs 94.2(11)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy in a particular year but apply to that taxpayer in respect of that interest in the following year, paragraph 94.2(11)(*d*) provides that the taxpayer is deemed to have acquired the interest in the insurance policy, at its fair market value at the end of the particular year (determined with reference to paragraph 94.2(11)(*f*)), immediately after the beginning of the following taxation year.

In the event that paragraphs 94.2(11)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy for a taxation year but did apply in the preceding taxation year, paragraph 94.2(11)(*e*) provides that the taxpayer is deemed to have disposed of the interest in the insurance policy immediately before the end of the preceding taxation year for proceeds equal to its fair market value at that time.

Paragraph 94.2(11)(*f*) provides that the fair market value of an interest in an insurance policy and amounts of proceeds of disposition of an interest in an insurance policy and payments in respect of interests in insurance policy are determined without reference to benefits paid, payable or anticipated to be payable under the policy only as a consequence of the occurrence of the risks insured under the policy.

Paragraph 94.2(11)(*g*) provides that, where a taxpayer makes a premium or a policy loan payment in respect of an insurance policy in a taxation year, an interest in the insurance policy is deemed to have been acquired in the year. The cost of the interest is the total of the premiums paid and the payments of the principal amount of

policy loans to the extent the loans were included in proceeds of disposition of the interest in prior years.

Paragraph 94.2(11)(*h*) provides rules permitting additions to the deemed cost of an interest in a policy otherwise determined for a year where the actual costs exceed the fair market value of interest at the beginning of the first taxation year in which subsection 94.2(4) applies to the taxpayer in respect of these interests. The amount that may be added is the amount, if any, by which the qualifying premiums paid at or before that time in respect of the interest in the policy exceeds the fair market value of the interest at that time.

Paragraph 94(11)(*i*) provides rules adding to a taxpayer's proceeds of disposition otherwise determined of an interest in an insurance policy for the year in which it is disposed of, the amount by which the fair market value of the interest at the beginning of the first taxation year in which subsection 94.2(4) applies to the taxpayer in respect of the interest exceeds the cost of the interest at that time.

In the event that paragraphs 94.2(11)(*a*) and (*b*) do not apply to a taxpayer in respect of an interest in an insurance policy for one taxation year and did apply in the preceding year, paragraph 94.2(11)(*j*) deems the taxpayer to have acquired the interest at the beginning of the taxation year and provides that the cost of the interest is equal to the amount if any by which is the total of the fair market value and the amount that would be determined under subparagraph 94.2(4)(*b*)(ii) in respect of the interest at the end of the preceding taxation year if that subparagraph applied to the interest exceeds the amount determined under subparagraph 94.2(4)(*b*)(*i*) in respect of the interest in respect of the taxpayer.

Subsections 94.1(10) and (11) apply for taxation years that begin after 2003.

Example

Assume that David, a long-term resident of Canada, pays premiums of $10,000 to an offshore insurer for a life insurance policy in 2000. The policy's fair market value is $9,000 and $10,700 at the end of 2003 and 2004 (respectively).

Results

1. *For 2003, no income amount is determined under paragraph 94.2(4)(a) because the cost of the policy exceeds the fair market value at the end of 2003. The cost to David of the policy is deemed to be $10,000 ($9000 + $1000).*

2. *The loss for the year 2003 is $1000. ($9000 – $10,000). No claim in respect of the loss is permitted under paragraph 94.2(4)(b) of the Act. The amount of the denied loss is equal to $1,000 and is included under G in the formula in paragraph 94.2(4)(a) in year 2004.*

3. *For 2004, the amount included in income under paragraph 94.2(4)(a) is $700 (= $10,700 ("B"), minus $9,000 ("F"), minus $1,000 ("G")).*

It is possible that the cash surrender value of a policy may be less than its fair market value.

Change of Status

ITA
94.2(12)

New subsection 94.2(12) of the Act sets out rules that apply where a taxpayer holding a participating interest in a non-resident entity was subject to subsection 94.2(4) for a taxation year but is not subject, in respect of the interest, to subsection 94.2(4) for the following taxation year (otherwise than because the taxpayer ceased to reside in Canada or became an "exempt taxpayer", as defined in subsection 94.1(1)).

Where subsection 94.2(12) applies, the taxpayer is deemed to have acquired the particular interest at the beginning of the following taxation year at a cost equal to the fair market value of the particular interest at that time.

This subsection could apply, for example, where a taxpayer's interest in a foreign investment entity ceases to have a readily obtainable fair market value, as defined in subsection 94.2(1).

Since the taxpayer is deemed to have acquired the property at its fair market value at the beginning of the following year, all increases and decreases in the value of the interest from the time of its acquisition are reflected in the taxpayer's cost of the interest for tax purposes. However, only the gain or loss accruing while it was subject to subsection 94.2(4) has been brought into income. The gain or loss in value for the period from the time of acquisition to the time it became subject to subsection 94.2(4) has not been taken into consideration for tax purposes.

Accordingly, paragraph 94.2(12)(*b*) provides for a negative or positive adjustment to the adjusted cost base (ACB) of a participating interest held as capital property. Any positive "deferral amount" (as defined in subsection 94.2(1)) in respect of the interest is deducted in

computing the ACB of the interest, but the deduction is grossed-up by a factor of two in the event that the deferral amount was calculated with reference to one-half of the accrued gains. The ACB deduction does not, however, apply in the event that a positive deferral amount has already been taken into account because of an election under the description of D in paragraph 94.2(4)(*a*). The absolute value of any negative deferral amount (or twice the amount if the 1/2 factor was used in computing the negative deferral amount) is added in computing the ACB of the interest. Where capital property is not involved, a corresponding decrease or increase in cost (rather than adjusted cost basis) is provided under paragraph 94.2(12)(*c*). To the extent that the decrease would otherwise result in a negative cost, the decrease is brought into the taxpayer's income under paragraph 94.2(12)(*c*).

Cost of Participating Interest

ITA
94.2(13)

New subsection 94.2(13) of the Act provides a rule for determining the cost at a particular time of a participating interest in an entity for a taxation year in the event that the interest is disposed of by the taxpayer in the year.

The cost to the taxpayer immediately before the disposition of the property is deemed to be its fair market value at the beginning of the taxpayer's taxation year. In the event that the property was not held by the taxpayer at that time, its cost immediately before the disposition is its cost determined without reference to section 94.2 (other than subsection 94.2(2)). In identifying property for these purposes, identical properties of a taxpayer are considered to be disposed of on a "first in, first out" basis, as a consequence of the application of paragraph 94.2(2)(*a*).

Under new paragraph (*c*.2) of the definition "cost amount" in subsection 248(1), the cost determined at a particular time for a property under subsection 94.2 (13) is also the "cost amount" of the property at the particular time.

Deferral Amount where Same Interest Reacquired

ITA
94.2(14)

New subsection 94.2(14) of the Act generally provides that a "deferral amount" in respect of a property of a taxpayer is deemed to be nil, after the property has been disposed of by the taxpayer at a time when the mark-to-market rules in subsection 94.2(4) applied to the property. This is of relevance to property that is reacquired by a taxpayer. However, subsection 94.2(14) is subject to the rules in subsections 94.2(15) to (18).

It should be noted that identical properties of a taxpayer are considered to be disposed of on a "first in, first out" basis as a consequence of the application of paragraph 94.2(2)(*a*).

Fresh-start re Change of Status of Entity

ITA
94.2(15)

New subsection 94.2(15) of the Act applies where a taxpayer's participating interest in an entity was initially subject to the rules in subsection 94.2(4) and ceases to be subject to those rules (otherwise than because of the taxpayer having become an "exempt taxpayer"). For example, subsection 94.2(15) could apply where an entity ceases to be a FIE.

In these circumstances, the deferral amount in respect of the participating interest is determined without reference to previous applications of subsections 94.2(4) and (14). This rule is relevant only in the event that the same participating interest of the taxpayer again becomes subject to the rules in subsection 94.2(4).

Parallel "fresh-start" rules are contained in subsection 94.2(16) and (17). All of these "fresh-start" rules are expected to be only rarely involved, given that more than one change in status of an investment or a taxpayer is required for the rules to become relevant. For more information on the "deferral amount" defined in subsection 94.2(1), see the commentary on that definition.

Fresh-start after Emigration of Taxpayer

ITA
94.2(16)

New subsection 94.2(16) of the Act affects the calculation of the "deferral amount" in respect of a participating interest in an entity for a taxpayer who has ceased to reside in Canada. It is relevant in the event that, at a subsequent time, the taxpayer becomes resident in Canada again.

In these circumstances, the deferral amounts in respect of the taxpayer's FIE interests are determined without reference to previous application of subsections 94.2(4) and (14).

For further context, see the commentary on the related fresh-start rule in subsection 94.2(15).

Fresh-start re Change of Status of Tax-exempt Entity

ITA
94.2(17)

New subsection 94.2(17) of the Act affects the calculation of the "deferral amount" in respect of an interest in an entity for a taxpayer that initially was not an "exempt taxpayer" under paragraph (*b*) of that definition in subsection 94.1(1) and then subsequently obtains that status.

In these circumstances, the deferral amounts in respect of the FIE interests of the taxpayer are determined without reference to previous applications of subsections 94.2(4) and (14).

For further context, see the commentary on the related fresh-start rule in subsection 94.2(15). In addition, it should be noted that amended subsection 149(10) applies to changes of tax-exempt status for taxpayers that are corporations. Where subsection 149(10) applies, the rules in subsection 94.2(17) do not apply.

Superficial Dispositions

ITA
94.2(18)

New subsection 94.2(18) of the Act applies where a taxpayer disposes of a participating interest in an entity in respect of which a negative amount is determined under the description of D in the formula in subsection 94.2(4). This would be the case where there is a negative deferral amount associated with the interest. In these circumstances, the deferral amount is instead generally deemed to be nil if, during the period beginning 30 days before the disposition and ending 30 days after the disposition, identical property is acquired by the taxpayer or certain related persons.

Subsection 94.2(18) operates in a manner similar to the "superficial loss" rules for capital properties and is intended to prevent the premature realization of losses in respect of a property in which a taxpayer effectively retains an economic interest. "Superficial loss" has the same meaning as assigned in section 54, except that the definition for the purposes of subsection 94.2(18) does not contain the exception for transactions covered by subsection 40(3.4).

Property substituted for the particular property is, in these circumstances, considered to have the deferral amount associated with the property disposed of.

Determination of Capital Dividend Account

ITA
94.2(19)

New subsection 94.2(19) provides rules that deem a positive or negative deferral amount in respect of a disposition of what would, but for sections 94.1 and 94.2, be a capital property to be a taxable capital gain or an allowable capital loss, as the case may be, and twice such an amount to be a capital gain or capital loss of the corporation, as the case may be, for the purposes of computing the capital dividend account of the corporation. This rule ensures that 1/2 of a capital gain or a capital loss that is attributable to a deferral amount is reflected in the capital dividend account of a corporation.

Non-application of Subsection (4)

ITA
94.2(20)

New subsection 94.2(20) provides a special rule that requires a taxpayer to report, in certain circumstances, amounts determined under subsection 94.2(4) for a particular year in respect of a participating interest in a foreign investment entity as capital gains and losses rather than as income from property.

This rule applies where all or substantially all the amount required to be added or deducted in computing the taxpayer's income for the particular year under subsection 94.2(4) in respect of a participating interest can be attributed to

- capital gains and losses of the foreign investment entity from dispositions of capital property of the foreign investment entity,

- increases or decreases in the fair market value of capital property of the foreign investment entity during the year, or

- a combination of such gains and losses and increase or decreases in fair market value.

In such a case, no amount is included or deducted in computing the taxpayer's income for the year in respect of the participating interest under subsection 94.2(4).

Deemed Capital gain or Loss

ITA
94.2(21)

New subsection 94.2(21) provides that where new subsection 94.2(20) applies to a taxpayer’s interest in a FIE for a taxation year, the taxpayer is treated as having

- realized capital gains in the year equal to the total of the positive amount determined under subsection 94.2(4) in respect of the taxpayer in respect of the participating interest plus or minus the positive or negative deferral amount included in “D” in the formula in subsection 94.2(4) in respect of the taxpayer in respect of the participating interest for the year, or

- realized capital losses in the year equal to the total of the negative amount determined under subsection 94.2(4) in respect of the taxpayer in respect of the participating interest plus or

minus the negative or positive deferral amount included in "D" in the formula in subsection 94.2(4) in respect of the taxpayer in respect of the participating interest for the year.

Prevention of Double Taxation

ITA
94.3

New section 94.3 provides rules to eliminate double taxation of income where a FIE, in respect of which section 94.1 or 94.2 has applied in calculating the income for a year of a holder of an interest in the FIE, makes payable an amount of income to that interestholder. The definitions in subsections 94.1(1) and the rules of application in paragraphs 94.1(2)(*o*) and 94.2(2)(*a*) apply in section 94.3

Under subsection 94.3(2), where an amount becomes payable (at a particular time in a particular taxation year of a taxpayer that begins after 2002 or in a preceding taxation year of the taxpayer that begins after 2002) to a taxpayer resident in Canada from a FIE in respect of a participating interest in the entity held by the taxpayer (otherwise than as consideration for the disposition of the interest), new section 94.3 of the Act permits a deduction designed to offset any net income inclusion resulting from the amount payable. For this purpose, paragraph 94.1(2)(*o*) provides that an amount is deemed not to have become payable to the taxpayer unless it was paid in the year to the taxpayer or the taxpayer was entitled to enforce payment of it.

The permitted deduction for the taxpayer's taxation year is equal to the lesser of:

- the amount, if any, by which the total of those amounts payable that are included (otherwise than because of subsection 94.2(4)) in computing the taxpayer's income for any of those years, exceeds the total of all amounts deductible in any of those years under subsection 91(5) or section 113 in respect of those amounts payable and deductible in respect of the participating interest in any of those preceding years under paragraph 94.3(2)(*a*), and

- the amount, if any, by which the total of

  – the amounts included (or that, but for subsection 94.2(20), would have been included) in respect of the participating interest under subsections 94.1(4) or 94.2(4) in computing the taxpayer's income for the taxation year or a preceding taxation year

exceeds the total of all amounts each of which is an amount, in respect of the participating interest,

- that is deducted (or that, but for subsection 94.2(20), would have been deducted) under subsection 94.2(4) in computing the taxpayer's income for any of those taxation years, or

- that is deducted under paragraph 94.3(2)(*a*) in computing the taxpayer's income for any of those preceding taxation years.

The amount deducted from income under paragraph 94.3(2)(*a*) in respect of the interest is also required to be deducted in computing the adjusted cost base of the interest.

The example below illustrates the operation of subsection 94.3(2).

Example

1. *A taxpayer resident in Canada, Canco, purchases a 20% interest in Foreignco, a non-resident corporation. Foreignco is a FIE. Participating interests in Foreignco do not qualify as "exempt interests". Both Canco and Foreignco have taxation years that coincide with calendar years. Subsection 94.1(4) applies to Canco in respect of the interest.*

2. *Canco's income under subsection 94.1(4) in respect of its participating interest in Foreignco for 2003 is $100,000. Foreignco pays a dividend of $50,000 to Canco in 2003. Canco includes the dividend in income pursuant to section 90 and claims a deduction of $20,000 in computing its taxable income pursuant to subsection 113(1). No foreign withholding taxes were paid by Canco on the $50,000 dividend.*

Results

1. *Canco's deduction from income under section 94.3 is equal to $30,000, being the lesser of the net income inclusion as a result of the payment (= $50,000 minus $20,000) and the amount of the income inclusion under subsection 94.1(4) ($100,000).*

2. *The result would generally be the same if the $50,000 dividend were instead paid in a subsequent year.*

Under subsection 94.3(3), if a taxpayer receives in a taxation year an amount from a FIE in respect of a participating interest in the FIE

held in the taxation year by the taxpayer and the amount is included in computing the amount determined under subparagraph 94.3(2)(*a*)(i) in respect of that participating interest of the taxpayer for the taxation year, the taxpayer may deduct in computing the taxpayer's income for the taxation year the product obtained when the taxpayer's relevant tax factor (as defined in subsection 95(1)) for the year is multiplied by the lesser of

- the amount of non-business income tax (as defined in subsection 126(7)) paid by the taxpayer for the taxation year in respect of the amount received, and

- 15% of the amount determined under subparagraph 94.3(2)(*a*)(i) in respect of the participating interest of the taxpayer for the taxation year.

Subsection 94.3(3) is relevant where a FIE distribution is made in respect of a taxpayer's participating interest and the distribution is subject to non-business income tax imposed by the government of a country in which the FIE is resident. Because of new subsection 126(1.1) of the Act, described in the commentary below, a taxpayer is not entitled to a tax credit under subsection 126(1) in respect of non-business income tax paid by a taxpayer in respect of the distribution. Instead, subsection 94.3(3) would be expected to apply to provide a level of relief from the potential incidence of double taxation.

Clause 13

Foreign Affiliates

ITA
95

Section 95 of the Act defines a number of terms and provides certain rules relating to the taxation of resident shareholders of foreign affiliates.

Definitions

ITA
95(1)

Subsection 95(1) of the Act sets out definitions that are relevant for the purposes of sections 90 to 95.

Subsection 95(1) is amended so that these definitions do not apply for the purposes of sections 94 to 94.3, except where the definition

applies for the purposes of the Act as a whole because of subsection 248(1). This amendment applies to taxation years that begin after 2002.

As set out below, various definitions in subsection 95(1) are also being amended.

“controlled foreign affiliate”

The income for a taxation year of a taxpayer resident in Canada includes, under subsection 91(1) of the Act, a specified percentage of the foreign accrual property income (FAPI) of any controlled foreign affiliate of the taxpayer. In order to eliminate overlap between the FAPI rules and the rules for foreign investment entities in sections 94.1 and 94.2, the latter rules generally do not apply in respect of a taxpayer’s interest in a controlled foreign affiliate of a taxpayer resident in Canada. An election is provided under new paragraph 94.1(2)(*h*) under which a foreign affiliate of a taxpayer can be treated as the taxpayer's controlled foreign affiliate.

The definition “controlled foreign affiliate” is amended to refer to foreign affiliates that are deemed by paragraph 94.1(2)(*h*) to be controlled foreign affiliates.

This amendment applies to taxation years that begin after 2002.

“foreign accrual property income”

The FAPI of a controlled foreign affiliate of a taxpayer resident in Canada is allocated to the taxpayer in accordance with subsection 91(1) of the Act. Under its definition in subsection 95(1), FAPI includes certain amounts that would be included in the affiliate’s income under existing subsection 94.1(1) if that subsection were read in the manner specified in the description of C of the definition.

The description of C in the definition “foreign accrual property income” is being amended to reflect new section 94.1. Under the amended description of C, FAPI includes the amount that is required by new paragraph 95(2)(*g*.3) to be included in computing FAPI of the affiliate for the year, except to the extent that an amount in computing that amount so required is otherwise included in computing FAPI. For detail on paragraph 95(2)(*g*.3), see the commentary on that paragraph.

This amendment applies to taxation years that begin after 2002.

Foreign Investment Entities

ITA
95(2)

Subsection 95(2) of the Act provides rules for determining the income of a foreign affiliate of a taxpayer resident in Canada. These rules apply for the purposes of sections 90 to 95.

The rules in new paragraph 95(2)(*g*.3) set out the manner in which sections 94.1 to 94.3 apply for the purpose of computing income from property that is to be included in computing the FAPI of a particular foreign affiliate of a Canadian taxpayer for a particular taxation year of the affiliate. They are to be applied as if

- The particular affiliate were a taxpayer resident in Canada throughout the particular year (other than for the purposes of determining if the particular affiliate is a foreign affiliate of a taxpayer, if the particular affiliate is a foreign investment entity or if a particular interest in the foreign affiliate is an exempt interest in a foreign investment entity);

- The exemption in paragraph (*a*) of the definition "exempt interest" for controlled foreign affiliates is treated as if it referred only to controlled foreign affiliates of the Canadian taxpayer (not of the particular affiliate);

- In the event that the particular affiliate has a participating interest in a particular foreign investment entity and the particular entity has a participating interest in another non-resident entity, the application of sections 94.1 and 94.2 to the particular entity is determined as if the exclusion from the application of those sections for controlled foreign affiliates referred to in paragraph (*a*) of the definition "exempt interest" in subsection 94.1(1) were for controlled foreign affiliates of the Canadian taxpayer (not controlled foreign affiliates of the particular entity). This rule applies instead of the rule in paragraph 94.1(5)A(*i*);

- The Canadian taxpayer (rather than the particular affiliate) is required to make an election under paragraph 94.1(2)(*a*) or 94.2(3)(*b*) or subparagraph (i) of the description of D in paragraph 94.2(4)(*a*) in connection with the particular affiliate's participating interests in foreign investment entities;

- The particular affiliate's "deferral amount" determined under the definition of that expression in subsection 94.2(1) does not include the portion of the amount that can reasonably be

considered to have accrued during the period that the particular affiliate was not a foreign affiliate of the Canadian taxpayer and certain other specified persons; and

- The reference in subsection 94.2(19) to the expression “in computing the capital dividend account of the corporation” were read in respect of the affiliate as a reference to the expression “in computing the amount prescribed to be the particular affiliate's exempt surplus and taxable surplus in respect of the taxpayer”.

This amendment applies to taxation years that begin after 2002.

Clause 14

Partnerships and their Members

ITA
96

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

Application of sections 94.1 and 94.2

ITA
96(1.9)

New subsection 96(1.9) of the Act is relevant where an “exempt taxpayer” (in general, an individual who has been resident in Canada for fewer than 60 months) is a member of a partnership and the partnership invests in a foreign investment entity. In these circumstances, the exempt taxpayer’s share of the partnership’s income or loss is computed without regard to sections 94.1 and 94.2. For further details on the application of section 94.2 to partnerships, see the commentary on new subsections 94.2(6) to (8).

This amendment applies to fiscal periods of partnerships that begin after 2002.

Agreement or Election of Partnership Members

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership.

Subsection 96(3) is amended so that it applies for the purposes of elections under

- new sections 94.1 and 94.2; and
- paragraph 95(2)(*g*.2).

This amendment applies to fiscal periods of partnerships that begin after 2002.

Application of Foreign Partnership Rule

ITA
96(9)

Subsection 96(8) of the Act provides rules that apply where, at a particular time, a Canadian resident becomes a member of a partnership, or a person who is a member of such a partnership becomes a resident of Canada. Where, immediately before the particular time no member of the partnership was resident in Canada, these rules apply in computing the income of the partnership for fiscal periods ending after the particular time. In general terms, the rules in subsection 96(8) are designed to prevent losses accrued while a partnership had no Canadian resident partners from being used to reduce Canadian income tax liabilities.

Subsection 96(9) provides that, where one of the main reasons that there is a member of the partnership who is resident in Canada is to avoid the application of subsection 96(8), that member will, for the purpose of applying subsection 96(8), be considered not to be resident in Canada.

Subsection 96(9) is amended to provide an explicit look-through rule for the purposes of subsection 96(8) so that members of partnerships may be identified through one or more tiers of partnerships which are

members of other partnerships. Amended subsection 96(9) is consistent with new subsection 94.2(8).

This amendment applies to partnership fiscal periods that begin after June 22, 2000.

Clause 15

Trusts and their Beneficiaries

ITA
104

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

ITA
104(4)(*a*.5) and (*c*)

Subsection 104(4) of the Act sets out what is generally referred to as the "21-year deemed realization rule" for trusts. The purpose of subsection 104(4) is to prevent the use of trusts to defer indefinitely the recognition for tax purposes of gains accruing on capital property. Subsection 104(4) generally treats capital property of a trust (other than certain trusts for the benefit of a spouse or common-law partner) as having been disposed of and reacquired by the trust every 21 years at the property's fair market value.

Paragraph 104(4)(*a*.5) is introduced to provide for a deemed disposition day for a trust that is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust's income for the year. The deemed disposition day is the day (in that taxation year) that is immediately before the particular day on which, because a "contributor" (as defined in subsection 94(1) of the Act) to the trust either ceases to be resident in Canada or ceases to be a contributor to the trust because of the application at any time of paragraph 94(2)(*t*), there is no resident contributor to the trust (or the only resident contributors to the trust are entities each of which is an entity the maximum amount recoverable from which under the provisions referred to in paragraph 94(3)(*d*) is limited to the entities' recovery limits determined under subsection 94(8)). However, no deemed disposition will occur under paragraph 104(4)(*a*.5) if subsection 94(5) applies in respect of the contributor ceasing on the particular day to be a resident contributor of the trust. For more information on section 94, see the commentary on that section.

Paragraph 104(4)(*c*) is amended so that there is not a deemed disposition day for a trust 21 years after any day determined under new paragraph 104(4)(*a*.5).

These amendments apply to trust taxation years that begin after 2002. They also apply to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

ITA
104(4.1)

New subsection 104(4.1) of the Act provides that, for the purposes of the deemed disposition rule in subsection 104(4), a property's status as capital property is determined without reference to new subparagraph 39(1)(*a*)(ii.3) and new section 94.2. As a result, if subsection 94.2(3) applies to a taxpayer that is a trust in respect of a participating interest of the trust and the trust is deemed to have disposed of the interest because of the application of subsection 104(4), there is a recognition of the "deferral amount" in applying subsection 94.2(4).

This amendment applies to trust taxation years that begin after 2002.

ITA
104(6)

Subsection 104(6) of the Act generally permits a trust to deduct, in computing income for a taxation year, any income payable to a beneficiary under the trust.

Subsection 104(6) is amended so that it is expressly subject to subsections 104(7) and 104(7.01).

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

ITA
104(7.01)

Subsection 104(6) generally permits a trust to deduct, in computing income for a taxation year, an amount not exceeding the portion of its income for the year that becomes payable in the year to a beneficiary. Because of subsection 104(24), trust income is deemed not to have become payable in the year to a beneficiary unless it is paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of the amount.

New subsection 104(7.01) of the Act restricts the amount that a trust, that is deemed by subsection 94(3) to be resident in Canada (referred to in this commentary as a "subsection 94(3) trust"), can deduct under subsection 104(6) in computing its income in the event that the trust has Canadian-source income and makes distributions to beneficiaries not resident in Canada.

In effect, subsection 104(7.01) acts as a proxy for taxes under Parts XII.2 and XIII of the Act in connection with Canadian-source income that has become payable by a subsection 94(3) trust to its non-resident beneficiaries.

New subsection 94(3) deems a trust to which it applies to be resident in Canada for certain purposes, not including Part XII.2. Accordingly, a trust that is resident in Canada solely because of the deeming provision in subsection 94(3), would generally be non-resident for purposes of Part XII.2. Because of an existing exemption for non-resident trusts in Part XII.2, a tax under that Part does not apply to such a trust.

A subsection 94(3) trust is also exempt from Part XIII withholding obligations on Canadian-source income that becomes payable in the year by a resident of Canada to non-resident persons because these subsection 94(3) trusts are not treated by new subsection 94(3) as resident in Canada for the purpose of Part XIII tax.

However, to ensure that subsection 94(3) trusts are not inappropriately used to distribute Canadian-source income free of tax to non-resident beneficiaries, subsection 104(7.01) limits the amount of any trust deduction under subsection 104(6) for such distributions, thereby ensuring the income is subject to Part I tax in the trust.

(It should also be noted that Canadian residents that pay an amount to a subsection 94(3) trust are still liable for a withholding obligation under section 215 of the Act notwithstanding that the trust itself is exempt from Part XIII tax. This is because new paragraph 94(4)(*b*) provides that the deemed Canadian residence under subsection 94(3)

does not apply for the purposes of determining withholding tax under section 215. The Canada Customs and Revenue Agency will hold the withholding taxes paid and apply them on account of the trust's Part I tax liability. The existing provisions of the Act do not expressly give a Part XIII exemption in this regard to trusts that are subject to existing subsection 94(1). Instead, existing subparagraph 94(1)(*c*)(ii) allows a tax credit to be claimed by those trusts under section 126 in connection with Part XIII tax on payments made to those trusts.)

As mentioned above, subsection 104(7.01) reduces the maximum deduction under subsection 104(6). More specifically, the amount by which the maximum deduction under subsection 104(6) for a taxation year is reduced under subsection 104(7.01) is equal to the total of:

- the trust's "designated income" for the year (as defined in Part XII.2) payable in the year to a non-resident beneficiary under the trust, and

- all amounts each of which is the product obtained by multiplying a specified factor by each particular amount that is paid or credited in the year to the trust that would, disregarding express provisions to the contrary in the Act, be subject to Part XIII tax and that is payable in the year to a non-resident beneficiary under the trust.

The specified factor in respect of each particular amount described in the second paragraph above is 0.35, if the trust can establish to the satisfaction of the Minister of National Revenue that the non-resident beneficiary to whom the particular amount is payable is resident in a country with which Canada has a tax treaty under which the income tax that Canada may impose on the beneficiary in respect of the amount is limited. In any other case, the specified factor is 0.6.

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.
The example below illustrates the operation of new subsection 104(7.01).

Example

1. *Trust X is an offshore trust established by Stefan, a long-term resident of Canada. The primary beneficiaries under the trust are Linda (a resident of Canada), Tim (a resident of non-Treatyland) and Bart (a resident of the United States).*

2. *Trust X receives $1,600 of income in its 2003 taxation year. This income consists of $400 of taxable dividends received from a taxable Canadian corporation. The remaining $1,200 of income is from other sources, none of which is "designated income" (as defined in Part XII.2) of the trust.*

3. *$1,050 of Trust X's income for 2003 is made payable in the year to Bart. Of this amount, $100 represents the taxable dividends. Trust X makes payable $200 of its income to Tim. Of this amount, $200 represents the taxable dividends. The remaining $350 of the trust's income is made payable in the year to Linda. Of this amount, $100 represents the taxable dividends.*

4. *Trust X is assumed to have designated the $400 of taxable dividends under subsection 104(19). (Where a designation under subsection 104(19) is available and the designation is made, the designated portion of the dividend income of the trust will, for the purposes of the Act (other than Part XIII), maintain its character, as dividend income, in the hands of the beneficiary.)*

Results

1. *Because Trust X has a resident contributor at the end of its 2003 taxation year, the trust is deemed by new subsection 94(3) to be resident in Canada for the purposes of computing its income.*

2. *Before taking into account any deduction under subsection 104(6), Trust X's income is $1,600. Note that the $400 in dividends are included in computing the trust's income.*

3. *Before taking into account new subsection 104(7.01), the maximum deduction under subsection 104(6) is also $1,600.*

4. *Because of subsection 104(7.01), the maximum deduction under subsection 104(6) is reduced to $1,445 (i.e., $1,600 minus the total of: (nil + ((.60 x $200)) and (0.35 x $100)).*

5. *Assuming that the trust claims a deduction of $1,445 under subsection 104(6), the trust would consequently have income of $155. If a tax rate of 48% were assumed, the trust would be liable for Canadian income tax of $74. Note that the trust is exempt from having to collect a Part XIII tax in respect of the amounts made payable to Bart and Tim, because the trust is not treated by new subsection 94(3) as resident in Canada for this purpose. Disregarding this*

exemption, the Part XIII tax that would have had to have been collected by the trust in respect of the amounts made payable to Bart and Tim would have been $75 (i.e., 25% of $200 at 15% of $100).

ITA
104(21.3)

Subsection 104(21.3) of the Act defines the expression "net taxable capital gains". The expression is used in subsections 104(21) and (21.2), which permit a trust to flow through its taxable capital gains realized in a year to a beneficiary to whom an amount of the trust's income for the year has been made payable. The trust can flow through its taxable capital gains to beneficiaries only to the extent of its net taxable capital gains for the year.

Under subsection 104(21.3), the amount of a trust's net taxable capital gains for a taxation year equals the amount, if any, by which its total taxable capital gains for the year exceeds the total of two amounts:

- its total allowable capital losses for the year, and
- the amount deducted by it under paragraph 111(1)(*b*) in computing its taxable income for the year (i.e., deduction of carried-over net capital losses for preceding years and for the three following years).

Subsection 104(21.3) is amended so that allowable business investment losses (ABILs) are disregarded for the purpose of the first of the two amounts. Accordingly, ABILs will not result in a reduction of taxable capital gains that may be flowed through to beneficiaries under trusts and against which allowable capital losses can be claimed.

This amendment applies to trust taxation years that begin after 2000.

ITA
104(24)

The determination of when an amount becomes payable in a taxation year is relevant for a number of purposes, including the determination of the amount deductible under subsection 104(6) of the Act. Under subsection 104(24), an amount (e.g., income allocated to a beneficiary) is deemed not to have become payable in the year to a beneficiary unless it was paid in the year to the beneficiary or the beneficiary was entitled in the year to enforce payment of the amount.

Subsection 104(24) is amended so that it also applies for the purposes of paragraph (*c*) of the definition "specified charity" in subsection 94(1), subsection 94(8) and subsection 104(7.01). For more information, see the commentary on those provisions.

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 16

ITA
108

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

Definitions

ITA
108(1)

"trust"

Subsection 108(1) of the Act defines "trust", for the purposes of the 21-year deemed disposition rule and other specified measures, to exclude certain listed trusts.

Paragraph (*a*.1) of that definition is amended to clarify that its intended application should be limited to health and welfare trusts.

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Income of a Trust in Certain Provisions

ITA
108(3)

Subsection 108(3) of the Act provides that, for the purposes of the definition "income interest" in subsection 108(1), the income of a trust is its income computed without reference to the provisions of the Act.

Subsection 108(3) is amended so that the rule described above also applies for the purposes of the definition “exempt foreign trust” in new subsection 94(1).

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 17

Deduction in Respect of Dividend Received from Foreign Affiliate

ITA
113

Subsection 113(1) of the Act permits a resident corporation to deduct specified amounts in respect of dividends received from a foreign affiliate out of the exempt, taxable and pre-acquisition surplus of the foreign affiliate. The amounts so deductible are determined largely with reference to Part LIX of the *Income Tax Regulations*. The deductions under paragraphs 113(1)(*b*) and (*c*) with regard to dividends out of taxable surplus are also determined with reference to the resident corporation’s “relevant tax factor”.

Subsection 113(1) is amended to explicitly link the “relevant tax factor” to the resident corporation receiving the dividends and the taxation year in which the dividends are received.

This amendment applies after 2000.

Clause 18

Part-year Residents

ITA
114

Section 114 of the Act provides rules for computing the taxable income of an individual who is resident in Canada for a period or periods in a taxation year, and is non-resident for the rest of the year.

Section 114 is amended so that it is subject to paragraph 94.2(5)(*c*), a rule that applies in connection with a participating interest, in a foreign investment entity, in respect of which the mark-to-market regime under section 94.2 applies to a taxpayer. Paragraph 94.2(5)(*c*)

is, however, only relevant to an individual who ceases to be, and later becomes, resident in Canada in the same taxation year. For further information, see the commentary on new subsection 94.2(5).

This amendment applies to taxation years that begin after 2002.

Clause 19

Tax Payable by *Inter Vivos* Trust

ITA
122(2)(*d*.1)

Subsection 122(1) of the Act provides that, instead of graduated income tax rates, *inter vivos* trusts are generally subject to top marginal rates of income tax on their undistributed income. Subsection 122(2) permits graduated income tax rates for certain *inter vivos* trusts established before June 18, 1971. One of the conditions for an *inter vivos* trust continuing to qualify for graduated income tax rates is that it not receive any gifts after June 18, 1971.

Paragraph 122(2)(*d*.1) is introduced so that the graduated income tax rates cease to apply to a trust in the event that, after June 22, 2000, a "contribution" is made to the trust. For this purpose, the expression "contribution" is defined in new section 94.

This amendment applies to trust taxation years that begin after 2002. It also applies to trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 20

Foreign Tax Credit

ITA
126

Section 126 of the Act provides rules under which taxpayers may deduct, from tax otherwise payable, amounts they have paid in respect of foreign taxes.

ITA
126(1)(*a*) and (1.1)

Subsection 126(1) of the Act provides a tax credit to a taxpayer in respect of foreign non-business income tax – that is, foreign taxes levied on investment and other non-business income of the taxpayer. However, paragraph 126(1)(*a*) provides an exception to the effect that no tax credit is available if the taxpayer is a corporation and the foreign taxes paid by the taxpayer are in respect of income from a share of the capital stock of a foreign affiliate of the taxpayer.

Paragraph 126(1)(*a*) is amended to remove the reference to the exception for taxes paid in respect of income from a share of a foreign affiliate. This exception is now found in subsection 126(1.1).

New subsection 126(1.1) describes circumstances in which subsection 126(1) does not apply. More specifically, it provides that subsection 126(1):

- does not apply to non-business income tax paid by a taxpayer in respect of an amount received by the taxpayer in respect of a participating interest (as defined in subsection 94.1(1)) of the taxpayer in a foreign investment entity (as defined in subsection 94.1(1)) – in this regard, see the commentary on the related rule found in new subsection 94.3(2), and

- does not apply to non-business income tax paid by a corporation in respect of income from a share of the capital stock of a foreign affiliate of the corporation.

These amendments apply to taxation years that begin after 2002.

Clause 21

Exempt Corporations

ITA
149(10)(*c*)

Subsection 149(10) of the Act applies where, at a particular time, a corporation becomes or ceases to be exempt from tax under Part I on its taxable income (otherwise than by reason of the exemption for certain insurers in paragraph 149(1)(*t*)). A new taxation year is considered to start at the particular time and the corporation's properties are deemed to have been disposed of at fair market value and reacquired at the particular time for the same amount.

Paragraph 149(10)(*c*) provides that the corporation is, for specified purposes in the Act, treated as a new corporation. One of the specified purposes is with regard to the investment tax credit regime set out in subsections 127(5) to (26).

Paragraph 149(10)(*c*) is amended so that it is also relevant in applying

- additional rules for the investment tax credit that are set out in subsections 127(27) to (35) (this amendment is consequential on the earlier enactment of those subsections), and

- sections 94.1 to 94.3. (For example, a corporation's "deferral amount" (as defined in subsection 94.2(1)) in respect of any interest it holds in a foreign investment entity is determined without reference to taxation years that occurred before the corporation's change of status. This will typically result in a nil deferral amount for the corporation.)

These amendments apply to corporations that, after 2002, become or cease to be exempt from tax on their taxable income under Part I of the Act.

Clause 22

Assessment and Reassessment

ITA
152(4)(*b*)(vi)

In general terms, subsection 152(4) of the Act provides that the Minister of National Revenue may not reassess tax payable by a taxpayer for a taxation year after the normal reassessment period for the taxpayer in respect of the year unless certain conditions described in paragraph 152(4)(*a*) or (*b*) have been met. Subparagraph 152(4)(*b*)(vi) allows the Minister to reassess a taxpayer within 3 years after the end of the normal reassessment period for the taxpayer in respect of the year where the reassessment is made in order to give effect to the application of subsection 118.1(15) or (16) of the Act.

Subparagraph 152(4)(*b*)(vi) is amended to also allow the Minister to reassess a taxpayer within three years after the end of the normal reassessment period where the reassessment is made in order to give effect to the application of subsection 94(9) or (10). For more information on subsections 94(9) and (10), see the commentary on those subsections.

This amendment applies after 2002.

Clause 23

Tax Liability – Non-arm's Length Transfers of Property

ITA
160

Section 160 contains rules regarding the joint and several liability of a taxpayer for the income tax liability of another person who, when not dealing at arm's length with the taxpayer, transferred property to the taxpayer for consideration less than its fair market value.

Assessment

ITA
160(2.1)

New subsection 160(2.1) of the Act allows the Minister of National Revenue to assess a taxpayer at any time in respect of any amount payable because of paragraph 94(3)(*d*) or (*e*). Such an assessment has the same effect as if it had been made under section 152 of the Act and is subject to interest. For more information on paragraphs 94(3)(*d*) and (*e*), see the commentary on those provisions.

This amendment applies to assessments made after 2002.

Discharge of liability

ITA
160(3)

Subsection 160(3) of the Act provides that, where a taxpayer becomes jointly and severally liable with another taxpayer under subsection 160(1) or (1.1) with respect to a tax liability of the other person, a payment by the particular taxpayer on account of the particular taxpayer's tax liability will discharge the joint liability to the extent of the payment.

Subsection 160(3) is amended so that it also applies where the particular taxpayer has become jointly and severally, and solidarily, liable with another taxpayer under because of paragraph 94(3)(*d*) or (*e*) in respect of part or all of a liability under this Act of the other taxpayer. (The expression "solidarily liable" is added to ensure that the Act appropriately reflects both the civil law of the province of

Quebec and the law of other provinces.) For more information on paragraphs 94(3)(*d*) and (*e*), see the commentary on those provisions.

This amendment applies to assessments made after 2002.

Clauses 24 and 25

Penalties

ITA
162 and 163

Subsections 162 and 163 of the Act impose penalties for infractions such as failing to provide certain information on a return, failing to file a return for a taxation year, and making false statements on a return.

ITA
162(10.1) and (10.11)

Subsection 162(10.1) of the Act imposes a penalty on any person or partnership that is more than 24 months late in filing an information return that the person or partnership was required to file under any of sections 233.1 to 233.4. (This penalty applies in addition to the penalties imposed under subsections 162(7) and (10).)

The penalty imposed under subsection 162(10.1) with respect to a particular information return is equal to a specified amount less the amount of the penalties imposed under subsections 162(7) and (10) with respect to the return. The specified amount with respect to an information return for a trust required to be filed by a person or partnership under section 233.2 is equal to 5% of the total fair market value of any property transferred or loaned to the trust that, if no other loan or transfer were taken into account, would have imposed an obligation on the person or partnership to file the return.

Subsection 162(10.1) is amended, as a consequence of amendments made to section 233.2, by changing the manner in which the specified amount is determined. The specified amount is now to be determined with reference to the fair market value of "contributions" made by the person or partnership to the trust.

New subsection 162(10.11) provides that, for the purpose of the calculation in subsection 162(10.1), the definitions and rules in subsections 94(1) and (2) generally apply. Subsection 162(10.11) is similar to amended subsection 233.2(2), described in greater detail in the commentary below.

These amendments apply to returns in respect of taxation years that begin after 2002. They also apply to returns in respect of taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

ITA
162(10.3), 162(10.4), 163(2.6) and 163(2.91)

Existing paragraph 94(1)(*d*) of the Act provides for non-resident trusts to be treated as foreign affiliates. It is being repealed as a consequence of the introduction of new rules for non-resident trusts in section 94. Subsections 162(10.3) and (10.4) are rules that affect the calculation of penalty tax in respect of a person's or partnership's failure to file a return in respect of a foreign affiliate.

Subsections 163(2.6) and (2.91) are similar provisions that affect the calculation of penalty tax in respect of false statements and omissions in such a return.

Subsections 162(10.3) and 163(2.6) are amended to reflect the changes to section 94 under which non-resident trusts are no longer treated as foreign affiliates. Subsections 162(10.4) and 163(2.91) are repealed for the same reason.

These amendments apply to returns in respect of taxation years that begin after 2002. They also apply to returns in respect of taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

ITA
163(2.4)(*b*) and (2.41)

Subsection 163(2.4) of the Act imposes a penalty on any person or partnership that, knowingly or under circumstances amounting to gross negligence, has made or has participated in, assented to, or acquiesced in, the making of a false statement or omission in a return required to be filed under any of sections 233.1 to 233.6. The penalty under paragraph 163(2.4)(*b*) relates to a return required to be filed under section 233.2. The existing penalty is the greater of $24,000 and 5% of the total fair market value of the property that the person or partnership loaned or transferred to the trust that gave rise to the obligation to file.

Paragraph 163(2.4)(*b*) is amended as a consequence of changes made to the non-resident trust rules in section 94 and the annual reporting requirement in respect of non-resident trusts under section 233.2.

Under amended section 233.2, a person is subject to the annual reporting requirement where the person makes a "contribution" to the trust.

Accordingly, amended paragraph 163(2.4)(*b*) provides for a penalty for a person equal the greater of $24,000 and a specified amount in respect of the return. The specified amount for a person is essentially equal to 5% of the fair market value of "contributions" made by the person. The specified amount is calculated in the same way as the specified amount under amended subsection 162(10.1) in respect of late-filed returns. Under new subsection 163(2.41), the definitions and rules in subsections 94(1) and (2) generally apply. Subsection 163(2.41) is similar to amended subsection 233.2(2), described in greater detail in the commentary below.

These amendments apply to returns in respect of taxation years that begin after 2002. They also apply to returns in respect of taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 26

Deduction and Payment of Tax

ITA
216

Section 216

Section 216 of the Act provides certain rules relating to non-residents who elect to be taxed under Part I in respect of certain rental and timber royalty income rather than under Part XIII, which would normally apply in such circumstances.

Rents and timber royalties –optional method of payment

ITA
216(4.1)

In general, Part XIII of the Act imposes a withholding tax of 25% on rental payments made by Canadians to non-resident owners of Canadian real property. An exception to this general rule exists where a non-resident chooses, under subsection 216(4) of the Act, to file a Canadian income tax return in respect of the rental income and timber royalty income and pay tax on the net amount of such income.

Where the conditions of subsection 216(4) are satisfied, the rule requiring a Canadian payer (or agent of the payee pursuant to s. 215(3)) to remit 25% of the gross payment to the CCRA does not apply; instead, only 25% of the net amount of income received by the non-resident's agent need be remitted.

However, an otherwise non-resident trust to which paragraph 94(3)(*a*) of the Act would apply is deemed resident in Canada for the purposes of determining the liability under Part XIII on amounts paid to the trust. Therefore, the trust would not be able to rely on subsection 216(4), despite the liability, because of paragraph 94(4)(*b*) and section 215, of a Canadian payer for amounts paid or credited to the trust that would, but for proposed paragraph 94(3)(*a*), generally have been subject to a tax under Part XIII.

Subsection 216(4.1) is introduced to provide a measure of relief in these circumstances. Under that subsection, if a trust is deemed by subsection 94(3) to be resident in Canada for a taxation year for the purpose of computing the trust's income for the year, a person who is otherwise required by subsection 215(3) to remit in the year, in respect of the trust, an amount to the Receiver General in payment of tax on rent on real property or on a timber royalty may elect in prescribed form filed with the Minister under this subsection not to remit under subsection 215(3) in respect of amounts received after the election is made. Under paragraphs 216(4.1)(*a*) and (*b*), if that election is made, the elector shall,

- when any amount is available out of the rent or royalty received for remittance to the trust, deduct 25% of the amount available and remit the amount deducted to the Receiver General on behalf of the trust on account of the trust's tax under Part I; and

- if the trust does not file a return for the year as required by section 150, or does not pay the tax that the trust is liable to pay under Part I for the year within the time required by that Part, on the expiration of the later of the time for filing or payment, as the case may be, pay to the Receiver General, on account of the trust's tax under Part I, the amount by which the full amount that the elector would otherwise have been required to remit in the year in respect of the rent or royalty exceeds the amounts that the elector has remitted in the year under paragraph 216(4.1)(*a*) in respect of the rent or royalty.

This amendment applies to trust taxation years that begin after 2002.

Clause 27

Foreign Reporting Requirements

ITA
233.2

Existing section 233.2 of the Act requires certain persons who have made transfers or loans to a "specified foreign trust", or to a non-resident corporation that is a controlled foreign affiliate of such a trust, to file annual information returns with respect to the trust. A "specified foreign trust", as defined in subsection 233.2, includes a trust with a "specified beneficiary" resident in Canada. As defined in subsection 233.2(1), a "specified beneficiary" is generally any beneficiary under the trust with the exception of persons listed in subparagraphs (*a*)(i) to (x) of the definition. For a return to be required to be filed as a consequence of a transfer or loan, it is necessary to have a "non-arm's length indicator", as set out in subsection 233.2(2), apply in respect of the transfer or loan. One of the cases where a "non-arm's length indicator" applies in respect of a transfer to a trust is where the transferor is a "specified beneficiary" under the trust. Subsection 233.2(3) provides a look-through rule so that, where a partnership transfers property, it is considered to have been transferred by members of the partnership.

New section 94 sets out new rules governing the taxation of non-resident trusts. In order to be consistent with the new rules:

- the definitions "specified beneficiary" and "specified foreign trust" in section 233.2 are repealed,

- there is no longer a requirement for a "non-arm's length indicator", so the existing rule in subsection 233.2(2) is repealed,

- except as described below, the definitions and rules of application in subsections 94(1) and (2) apply because of amended subsection 233.2(2), and

- there is no longer a requirement for an explicit look-through rule for partnerships in section 233.2, given that the rule in paragraph 94(2)(*o*) applies because of amended subsection 233.2(2). Consequently, subsection 233.2(3) is repealed.

Under amended subsection 233.2(4), reporting will generally be required for a taxation year whenever a "contribution" has been made by a person resident in Canada to a non-resident trust at or before the end of the year. Because of amended subsection 233.2(2), the

expression "contribution" generally carries the same meaning as in new section 94 with most of the same exceptions for "arm's length transfers" contained in the definition of that expression in subsection 94(1). However, the exception in that definition against transfer of "restricted property" (as defined in subsection 94(1)) is extended to apply to most transfers described in paragraph 94(2)(*g*) (unless the transfer involves, generally, an issuance of a unit or share from a mutual fund trust, a mutual fund corporation or a corporation other than a closely-held corporation, as the case may be), with the result that such transfers do not give rise to an exception to the obligations for reporting under subsection 233.2(4). It should be noted that amended subsection 233.2(2) also applies for the purpose of new paragraph 233.5(*c*.1).

New subparagraph 233.2(4)(*c*)(ii) sets out a list of persons for whom reporting obligations are not imposed. This list is consistent with the list of beneficiaries who are not treated as "specified beneficiaries" under the existing rules in section 233.2.

Amended subsection 233.2(4) of the Act also exempts contributors from filing information returns with regard to trusts described in paragraphs (*c*) to (*i*) of the new definition "exempt foreign trust" in subsection 94(1). For more information in this regard, see the commentary on that definition.

These amendments apply to returns in respect of trust taxation years that begin after 2002. They also apply to returns in respect of trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

ITA
233.2(4.1)

New subsection 94(3) of the Act provides that, where a non-resident trust has a resident contributor or resident beneficiary at the end of the trust's taxation year, the trust is generally taxed on its income in Canada for the year as if the trust were resident in Canada. However, the deeming provisions in subsection 94(3) apply only to arrangements that are considered to be trusts for Canadian income tax purposes. In some cases, there may be doubt as to whether a given arrangement is a trust for Canadian income tax purposes.

New subsection 233.2(4.1), in combination with subsection 233.2(4), imposes a filing obligation on contributors to certain entities or arrangements in respect of which reporting is not otherwise required. One of the key objectives of subsection 233.2(4.1) is to ensure that claims that section 94 does not apply can be reviewed by the CCRA.

More specifically, new subsection 233.2(4.1) applies where property has, directly or indirectly, been transferred or loaned by a person to be held

- under an arrangement governed by laws that are not laws of Canada or a province, or

- by a non-resident entity (as defined in subsection 94.1(1)).

The person must, where certain additional conditions are satisfied, file the information return referred to in amended subsection 233.2(4).

New subsection 233.2(4.1) provides that, except as the Minister of National Revenue otherwise permits in writing, the person has obligations under amended subsection 233.2(4) if all of the following conditions are satisfied:

- the transfer or loan is not an arm's length transfer (within the meaning that would be assigned by the definition "arm's length transfer" in subsection 94(1) as amended by subsection 233.2(2));

- the transfer or loan is not solely in exchange for property that would be described in paragraphs (*a*) to (*i*) of the definition "specified foreign property" in subsection 233.3(1) if that definition were read without reference to paragraphs (*j*) to (*q*) of that definition;

- the entity or arrangement is not a trust in respect of which the person would, without reference to subsection 233.2(4.1) and the explicit exemptions for filing returns contained in subsection 233.2(4), be required to file an information return for a taxation year that includes that time; and

- the entity or arrangement is, for a taxation year or fiscal period that includes that time, not

  (i) an exempt foreign trust (as defined in subsection 94(1)),

  (ii) foreign affiliate in respect of which the person is a reporting entity (as defined in subsection 233.4(1)), or

  (iii) an exempt trust (as defined in subsection 233.2(1)).

Where the above conditions are satisfied, the person's obligations under subsection 233.2(4) and related provisions are determined as if:

- the transfer were a contribution to which paragraph 233.2(4)(*a*) applied;

- the entity or arrangement were a trust not resident in Canada throughout the calendar year that includes the time of the transfer or loan; and

- the taxation year of the entity or arrangement were that calendar year.

These amendments apply to returns in respect of trust taxation years that begin after 2002. They also apply to returns in respect of trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 28

Returns in Respect of Foreign property

ITA
233.3

Section 233.3 of the Act provides reporting requirements in respect of foreign property. In general terms, it provides that certain taxpayers resident in Canada and certain partnerships must file an information return with respect to their "specified foreign property" if the total cost amount of such property exceeds $100,000. For this purpose, "specified foreign property" (as defined in subsection 233.3(1)) includes an interest in a non-resident trust or a trust that would be non-resident were it not for section 94. It does not include an interest in a non-resident trust that was not acquired for consideration by the person or partnership.

Paragraph (*d*) of the definition "specified foreign property" is amended by changing a cross-reference to section 94 to a cross-reference to new subparagraph 94(3)(*a*)(v). This amendment is consequential on amendments to section 94. As a result, interests in trusts deemed to be resident of Canada because of section 94 are "specified foreign property" unless otherwise expressly excluded.

Paragraph (*d*.1) of the definition is introduced so that specified foreign property includes an interest in an insurance policy issued by a non-resident insurer, if the mark-to-market regime in section 94.2 applies in respect of the interest. New paragraph (*d*.1) of the definition applies to returns for taxation years that begin after 2002.

For further information in this regard, see the commentary on new subsection 94.2(11).

Paragraph (*l*) of the definition is repealed to eliminate a reference to trusts that are treated as foreign affiliates. This reference is no longer necessary in light of new subsection 94(1), under which non-resident trusts are no longer treated as foreign affiliates.

Paragraph (*m*) of the definition is amended so that the exclusion for non-resident trusts that applies with regard to interests not acquired for consideration also applies to trusts that are deemed by subsection 94(3) to be resident in Canada. This amendment is made for consistency.

Except as indicated above, these amendments generally apply to returns in respect of trust taxation years that begin after 2002. In addition, amended paragraphs (*d*) and (*m*) of the definition "specified foreign property" and the repeal of paragraph (*l*) of that definition apply to returns in respect of trust taxation years that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 29

Returns Respecting Foreign Affiliates

ITA
233.4(1) and (2)

Section 233.4 of the Act provides reporting requirements in respect of foreign affiliates. In general terms, it provides that taxpayers resident in Canada (or certain partnerships) of which a non-resident corporation or non-resident trust is a foreign affiliate must file an information return in respect of the affiliate.

Subsections 233.4(1) and (2) are amended to eliminate references to foreign affiliates that are non-resident trusts. These references are no longer necessary in light of new subsection 94(1), under which non-resident trusts are no longer treated as foreign affiliates.

These amendments apply to taxation years and fiscal periods that begin after 2002. They apply to taxation years and fiscal periods that begin after 2000, or after 2001, if the trust makes the appropriate election under the coming-into-force provision for new section 94 of the Act.

Clause 30

Due Diligence Exception

ITA
233.5

Section 233.5 of the Act provides that, where specified conditions set out in paragraphs 233.5(*a*) to (*d*) are met, information required in a return filed under section 233.2 or 233.4 does not include information that is not available to the person or partnership required to file the return. In the case of a return required to be filed by a person or partnership under section 233.2, paragraph 233.5(*c*) provides that it must be reasonable for the person or partnership to expect, at the time of each transaction entered into by the person or partnership after March 5, 1996 that either gives rise to the requirement to file the return or that affects the information to be reported in the return, that sufficient information would be available to the person or partnership to comply with section 233.2.

Paragraph 233.5(*c*) is amended so that it applies only in connection with transactions entered into before June 23, 2000 that gave rise to the requirement to file a return for a taxation year of the trust that began before 2003. In connection with trust returns required to be filed for trust taxation years that began before 2003, it must be reasonable for the person or partnership to expect that sufficient information would have been available to the person or partnership to comply with section 233.2 if the proposed amendments to section 94 were not taken into account.

Paragraph 223.5(*c*) is also amended so that it does not apply to returns required to be filed under section 233.4. It is replaced in this respect by new paragraph 233.5(*c*.2), without any change in the specified conditions for such returns.

Paragraph 233.5(*c*.1) is introduced in connection with returns required to be filed under section 233.2 by a person or partnership for a taxation year of the trust that begins after 2002. Where "contributions" (determined with reference to subsection 233.2(2), referred to in the commentary above) are made after June 22, 2000, relief under section 233.5 is available only if it was reasonable for the person or partnership to expect, at the time of each such contribution that either gives rise to the requirement to file the return or that affects the information to be reported in the return, that sufficient information would be available to the person or partnership to comply with section 233.2.

This amendment applies to returns in respect of taxation years that begin after 2002. It also applies to returns in respect of taxation years that begin

- in 2001 or 2002, if the trust makes a valid election under the coming-into-force provision for new section 94 of the Act, in which case section 233.5 of the Act shall be read, in respect of the trust, without reference to paragraph 233.5(*c*), and

- in 2002, if the trust makes a valid election under the coming-into-force provision of new section 94 Act, in which case section 233.5 of the Act shall be read, in respect of the trust, without reference to paragraph 233.5(*c*).

Clause 31

Definitions

ITA
248(1)

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

"controlled foreign affiliate"

The expression "controlled foreign affiliate" is defined to have the meaning assigned by subsection 95(1).

This definition is amended so that it applies except as expressly otherwise provided in the Act. See, for example, the definition "controlled foreign affiliate" in subsection 17(15).

This amendment applies to taxation years that begin after 2002.

"cost amount"

This definition is used throughout the Act, particularly in provisions relating to the transfer of properties to and from corporations, trusts and partnerships.

New paragraph (*c*.2) of the definition provides that, where a cost of property to a taxpayer is determined as of any time under new subsection 94.2(13), that cost is also the "cost amount", under subsection 248(1), of the property to the taxpayer at that time.

This amendment applies to taxation years that begin after 2002.

“inventory”

A taxpayer’s “inventory” is generally described in subsection 248(1) of the Act as a description of property the cost or value of which is relevant in computing a taxpayer’s income from a business for a taxation year. Rules for “inventory” in section 10 and elsewhere in the Act affect the calculation of a taxpayer’s income from business.

The definition “inventory” is amended to exclude descriptions of property the disposition of which is subject to the application of subsection 94.2(3) of the Act.

This amendment applies to fiscal periods that begin after 2002.

“share”

The definition “share” is amended so that it applies except as the context otherwise requires. For example, if the context requires that the expression “share” refer to a portion of an amount or thing, then it would not carry the meaning otherwise assigned by subsection 248(1).

This amendment applies to taxation years that begin after 2002.

“foreign accrual property income”

The definition “foreign accrual property income” is included in subsection 248(1) so that the definition of this expression in section 95 of the Act applies for the purposes of the Act.

This amendment applies to taxation years that begin after 2002.

“non-discretionary trust”

The definition “non-discretionary trust” is included in subsection 248(1) so that the existing definition of the expression in subsection 17(15) applies for the purposes of the Act. The expression is used in the definition “foreign investment entity” in new subsection 94.1(1).

This amendment applies to taxation years that begin after 2002.

Part 2

Technical Amendments to the *Income Tax Amendments Act,* 2000

Clause 32

S.C. 2001, C.17
53(2)(*a*)

Income Tax Act
73(1)

Subsection 73(1) of the *Income Tax Act* generally provides for a tax-free disposition of capital property if it is transferred by an individual to the individual's spouse, common-law partner or a trust for the exclusive benefit of the spouse or common-law partner during the lifetime of the spouse or common-law partner. For subsection 73(1) to apply, the transferor and transferee must both be resident in Canada at the time of the transfer. Where the transferee is a trust, in respect of transfers that occur in 2000 or 2001, the residency requirement is determined without reference to subsection 94(1) as it read before 2002.

This amendment to the *Income Tax Amendments Act*, 2000, ensures that, in applying subsection 73(1) in respect of transfers that occur in 2000, 2001 or 2002, the residence of a transferee will be determined without reference to section 94 of the Act, as it reads in its application to taxation years that began before 2003.

This amendment is deemed to come into force on June 14, 2001.

S.C. 2001, C.17
80(19)

Income Tax Act
107(1)

Paragraph 107(1)(*a*) of the *Income Tax Act* applies for the purpose of computing a taxpayer's taxable capital gain from the disposition of a capital interest in a personal trust (or a prescribed trust described in section 4800.1 of the *Income Tax Regulations*), except where the interest was an interest in a non-resident *inter vivos* trust purchased by the taxpayer and the disposition was not by way of a distribution to which subsection 107(2) applies. For this purpose the residency of the trust is to be determined without reference to section 94 as it read before 2002.

This amendment to the *Income Tax Amendments Act*, 2000, ensures that, in applying subsection 107(1) in respect of transfers that occur in 2000, 2001 or 2002, the residence of a transferee trust will be determined without reference to section 94 of the Act, as it reads in its application to taxation years that began before 2003.

This amendment is deemed to come into force on June 14, 2001.