

## **REVISED EXPLANATORY NOTES**

### **Clause 7**

#### **Fiscal Period**

ITA  
25(1)

Section 25 of the Act provides that, where an individual who is a resident of Canada disposes of a business carried on as a sole proprietorship, the individual may elect to extend the fiscal year-end of the business to the date on which it would have ended if the business had not been disposed of. Subsection 25(1) is amended to provide that no election may be made by an individual to extend a fiscal period of a terminated proprietorship if the "alternative-fiscal-period rule" in new subsection 249.1(4) applies to the proprietorship's fiscal period.

This amendment applies to fiscal periods that begin after 1994.

### **Clause 8**

#### **Deemed December 31, 1995 Income**

ITA  
34.1(6)

New subsection 34.1(6) applies to an individual where

- at the end of 1995 the individual carries on a business as a member of a partnership no fiscal period of which ended at the end of 1994,
- the business was carried on by a professional corporation as a member of the partnership at the end of 1994,
- the professional corporation transferred its interest in the partnership to the individual before the end of 1995,
- the individual is a practising member of the professional body under the authority of which the professional corporation practised the profession,
- the individual was a specified shareholder of the professional corporation immediately before the time of transfer,

- the professional corporation does not have a share of the income or loss of the partnership for the first fiscal period of the partnership that ends after the end of 1995, and
- an amount is included under subsection 34.1(2) in computing the individual's income for the 1995 taxation year in respect of the business (discussed above in commentary on new subsection 34.1(2)).

If applicable, the December 31, 1995 income of an individual in respect of a business is deemed to be the amount that would have been determined under new subsection 34.1(2) if descriptions A and B in that subsection were read with three changes. First, the description of A is to be read as if the individual's income from the business for the straddle fiscal period of the business ending in 1996 were determined using the rules in new subsection 34.2(2) (e.g., by maximizing deductible reserves and CCA). Second, subparagraph (ii) of the description of B is to be read as if "deducted" were "deductible" (i.e., as if the maximum available capital gains exemption were claimed under section 110.6 for the 1996 taxation year). Third, for the purpose of computing the values C and D in new paragraph 34.1(2)(d), an individual is considered to carry on the business on the days on which the professional corporation carried on the business.

New subsection 34.1(6) applies after 1994.

## **Definitions**

ITA  
34.2(1)

### **"qualifying fiscal period"**

The definition of "qualifying fiscal period" is relevant for determining the "December 31, 1995 income" in respect of a business carried on by a taxpayer.

Paragraph (a) of the definition provides that a fiscal period of a business of a taxpayer is a qualifying fiscal period where

1. the taxpayer carried on the business at the end of 1994,
2. a fiscal period of the business did not end at the end of 1994,

3. the particular fiscal period begins after the beginning of the taxpayer's taxation year that includes the end of 1995, and
4. the fiscal period ends at the end of 1995 because of the definition of "fiscal period" in new paragraph 249.1(1)(b) of the Act.

The first and second conditions ensure that taxpayers have a qualifying fiscal period only if they carry on the business for more than 12 months as of December 31, 1995.

The third condition is of relevance to corporations and testamentary trusts that have taxation years which do not coincide with the calendar year and that are members of a partnership that is required to have a fiscal period that coincides with the calendar year. In this case, a fiscal period of the partnership ending at the end of 1995 is not a qualifying fiscal period of such a taxpayer unless the period began after the beginning of the taxpayer's taxation year that includes the end of 1995.

Where certain conditions are met, paragraph (b) of the definition of "qualifying fiscal period" applies to a other fiscal periods of businesses that end at the end of 1995 because of the definition of "fiscal period" in new paragraph 249.1(1)(b). The conditions are that:

- the taxpayer is an individual who carries on the business as a member of a partnership at the end of 1995,
- the individual acquired the individual's interest in the partnership in 1995 from a professional corporation,
- the professional corporation carried on the business at the end of 1994 as a member of the partnership and does not have a share of the income or loss of the partnership for the fiscal period of the partnership that ends at the end of 1995,
- the individual is a practising member of the professional body under the authority of which the professional corporation practised the profession, and
- the individual was a specified shareholder of the professional corporation immediately before acquiring the interest.

Where certain conditions are met, paragraph (c) of the definition treats as a qualifying fiscal period any fiscal period of a business that ends in the taxation year of a professional corporation that ends at the end of 1995 because of the new definition of "fiscal period" in new paragraph 249.1(1)(b). In particular, at the end of 1994, the

business must be carried on by the corporation as a member of a partnership, or by an individual

- who transferred an interest in the partnership to the corporation before the end of 1995,
- who is a practising member of the professional body under the authority of which the corporation practises the profession,
- who was a specified shareholder of the corporation immediately after the transfer, and
- who does not have a share of the income or loss of the partnership for the first fiscal period of the partnership that ends in 1995.

In such circumstances, each fiscal period of the partnership that ends in the professional corporation's shortened taxation year ending at the end of 1995 is considered to be a qualifying fiscal period for the purposes of new section 34.2. (New paragraph 249.1(1)(b) requires professional corporations that are members of a partnership to have fiscal periods that coincide with the calendar year.)

The example contained in the December 1995 explanatory notes is unchanged.

For descriptions of the definition of "professional corporation" in subsection 248(1) and new section 249.1, see the commentary accompanying those provisions.

## **Clause 17.1**

### **Fiscal Period of Terminated Partnership**

ITA  
99(2)

Subsection 99(1) of the Act provides that, generally, a fiscal period of a partnership is considered to end immediately before the partnership ceases to exist.

Subsection 99(1) does not, however, apply in computing the income of an individual who has made an election under subsection 99(2) of the Act. In this case, for the purpose of computing the individual's income the fiscal period of a partnership is considered to end immediately before the time when the fiscal period of the partnership would have ended if the partnership had not ceased to exist. Subsection 99(2) is amended to provide that no election may be made by an individual to extend a

fiscal period of a terminated partnership if the "alternative-fiscal-period rule" in new subsection 249.1(4) applies to the partnership's fiscal period.

This amendment applies to fiscal periods that begin after 1994.

## **Clause 28**

### **Definitions**

ITA

125.4(1)

#### **"qualified labour expenditure"**

The definition of "qualified labour expenditure" is the portion of a qualified corporation's labour expenditures upon which it can claim a 25% investment tax credit in respect of a Canadian film or video production. A qualified labour expenditure is defined as the lesser of two amounts.

Paragraph (a) of the definition of "qualified labour expenditure" describes the first of these two amounts and is, generally, the amount, if any, by which the total of

(A) the corporation's "labour expenditure" in respect of the film for the taxation year, and

(B) the amount by which

◦ the corporation's "labour expenditure" in respect of the production for a preceding taxation year

exceeds

◦ the corporation's "qualified labour expenditure" in respect of the production for a preceding year and before the end of which principal photography of the film began

exceeds the total of

◦ any amounts transferred to a subsidiary of the corporation that claims the amount as a "labour expenditure" in respect of the production (see paragraph (c) of the definition of "labour expenditure").

The effect of clause 125.4(1)(a)(i)(B) is to add back to the definition of "qualified labour expenditure" a "labour expenditure" that was not a "qualified labour expenditure" in the corporation's preceding taxation year due to the application of the 48% cap discussed below.

Subparagraph 125.4(1)(a)(ii) ensures that certain types of reimbursements are not included in a corporation's "qualified labour expenditure".

As stated above, a "qualified labour expenditure" is the lesser of two amounts. The second amount is determined under the formula in paragraph (b) of the definition. The formula limits a corporation's Canadian film or video production tax credit to 48% of the cost of the production at the end of the year net of assistance. The description B in the formula ensures that tax credits are claimed only once in respect of "qualified labour expenditures". Given the 25% rate of the credit, a corporation's Canadian film or video production tax credit cannot exceed 12% of the cost of production net of assistance.

## **Rules Governing Labour Expenditure**

ITA

125.4(2)

New subsection 125.4(2) of the Act provides special rules that apply for the purpose of the definition of "labour expenditure" in subsection 125.4(1). Paragraph 125.4(2)(a) provides that remuneration does not include remuneration determined by reference to profits or revenues.

New paragraph 125.4(2)(b) provides that the services referred to in paragraph (b) of the definition of "labour expenditure", that relate to the post-production stage of the production, include only the services that are rendered at that stage of production by persons who perform particular specified duties.

This subsection applies to 1995 and subsequent taxation years.

## Tax Credit

ITA  
125.4(3)

New subsection 125.4(3) of the Act provides the Canadian film or video production tax credit. Where the conditions set out in the subsection are met, a qualifying corporation is considered to have paid an amount, on account of its tax payable under Part I of the Act for the year, equal to 25% of its qualified labour expenditure for the year. Thus, to the extent that the production has no tax otherwise payable, the credit is refundable.

*Example:*

*Assume:*

*A qualified corporation is a private corporation that has a taxation year that coincides with the calendar year and it begins the principal photography of a Canadian film or video production in its 1995 taxation year.*

*The total cost of the production is \$3,600,000 and the corporation can reasonably be expected to receive \$600,000 in assistance in respect of the production. The corporation incurs in 1995, \$2,000,000 of the total budgeted cost of \$3,600,000. The remaining \$1,600,000 is incurred in 1996. All of the amounts are directly attributable to the production and are paid for by the corporation within 60 days after the end of its applicable taxation year.*

*The corporation pays \$1,000,000 in salary or wages in each of 1995 and 1996 in respect of the production and the production is completed before the end of 1996. The \$1,000,000 of corporate salary or wages paid meets the definition of "labour expenditure" in subsection 125.4(1).*

*The assistance payable to the corporation is as follows: provincial assistance of \$300,000 and federal assistance of \$300,000 to produce the film.*

*The Minister of Canadian Heritage issues a Canadian film or video production certificate in respect of the production and the corporation files all of the required information with its returns of income for the 1995 and 1996 taxation years.*

***Canadian Film or Video Production Tax Credit for the corporation's 1995 taxation year is \$168,000, which is computed as follows:***

25% x \$672,000 (*qualified labour expenditure*)

where

"qualified labour expenditure" for the taxation year 1995 is:

the lesser of:

(a) \$1,000,000

which is the amount, if any, by which

- |             |                                 |
|-------------|---------------------------------|
| \$1,000,000 | labour expenditure for the year |
| <u>nil</u>  | capped labour expenditure       |
| \$1,000,000 |                                 |

exceeds

- the total of

<u>Nil</u>	parent/sub reimbursement agreement
Nil	

(b) \$672,000

which is the amount, if, any by which

- \$ 672,000 (48% of film cost (\$2m) net of assistance (\$.6m))

exceeds

Nil	No prior "QLE"
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Note: the capital cost of the film for capital cost allowance purposes at the end of the corporation's 1995 taxation year is:



\$1,000,000 labour expenditure  
\$1,000,000 other costs  
(\$600,000) assistance  
(\$168,000) 1995 film credit  
\$1,232,000

**Canadian Film or Video Production Tax Credit for the corporation's 1996 taxation year is \$192,000, which computed as follows:**

25% x \$768,000 (qualified labour expenditure)

where

"qualified labour expenditure" for the taxation year 1996 is:

the lesser of:

(a) \$1,328,000

◦ which is the amount, if any, by which

\$1,000,000 labour expenditure for the year  
\$ 328,000 excess labour expenditure in 1995  
\$1,328,000

exceeds

Nil parent/sub reimbursement agreement  
Nil

(b) \$768,000

◦ which is the amount, if any, by which

\$1,440,000 (48% of film cost (\$3.6m) net of assistance (\$.6m))

*exceeds*

\$672,000                      1995 qualifying labour expenditure

*Note: the capital cost of the film for capital cost allowance purposes at the end of the corporation's 1996 taxation year is (assuming no CCA was claimed by the corporation at the end of its 1995 taxation year):*

\$2,000,000    labour expenditure  
\$1,600,000    other costs  
(\$600,000)    assistance  
(\$168,000)    1995 film credit  
(\$192,000)    1996 film credit  
\$2,640,000

Accordingly, the total Canadian film or video production credit permitted in the above example is \$360,000: \$168,000 + \$192,000 or 25% x (672,000 + \$768,000).

This subsection applies to the 1995 and subsequent taxation years.

### **Clause 38**

#### **Tax Returns**

ITA

150(1)(b) and (d)

Section 150 of the Act requires taxpayers to file their income tax returns on or before certain dates. Under paragraph 150(1)(b) where a taxpayer has died after October 31 in a taxation year and before May 1 in the following year, the taxpayer's legal representative is permitted to file the return for the taxation year up to 6 months after the date of death. Paragraph 150(1)(b) is amended, in the case of an individual who dies after October in a taxation year and before the individual's filing due date for the year had the individual not died, to extend the date on which a deceased individual's return of income is required to be filed to the later of 6 months after the individual dies and the day on which the return would otherwise be required to be filed. The latter time limit corresponds to the extended time limit for filing returns for individuals (other than trusts) under amended paragraph 150(1)(d).

Paragraph 150(1)(d) is amended to extend the due date for filing a return of income to June 15 of the calendar year following a taxation year for an individual (other than a

trust) who earns income from a business in the taxation year, or the spouse of such an individual. (This rule does not, however, apply where an individual's business is a tax shelter.)

These amendments apply to the 1995 and subsequent taxation years.

## **Clause 40**

### **Payment of Tax**

ITA  
153(3.1)

The addition of subsection 153(3.1) to the Act which was contained in the Notice of Ways and Means Motion tabled in December 1995 is not included in this bill. Therefore, the explanatory notes which accompanied proposed subsection 153(3.1) are deleted.

## **Clause 40.1**

### **Instalment Payments - "net tax owing"**

ITA  
156.1(1)

Subsection 156.1(1) of the Act sets out definitions that are relevant in determining whether an individual will be required to make instalment payments of taxes. The definition of "net tax owing" deals with amounts of tax payable and amounts of tax withheld for a taxation year.

The amendments to the definition of "net tax owing" are consequential on the amendments to Part I.2 of the Act dealing with the recovery of Old Age Security benefits contained in this bill. The amendments ensure that both taxes payable under Part I.2 and amounts withheld under that Part will be taken into account in the calculation of an individual's instalment base for a year.

These amendments apply to 1996 and subsequent taxation years, except that, for the 1996 year, the definition is modified to take into account the fact that tax will begin to be withheld under Part I.2 of the Act only after June 1996.

## **Clause 51**

### **Tax in Respect of Over-Contributions to Deferred Income Plans**

ITA

Part X.1

Several references in the December 1995 explanatory notes to the amounts in subsections 204.2(1.1), (1.3), and (1.5) are incorrect. The proper references are listed below.

#### **Subclause 51(1)**

##### **Cumulative excess amount in respect of RRSPs**

ITA

204.2(1.1)(b)

The references to amounts R and T should be references to amounts D and E, respectively. The explanatory notes to this paragraph should also be read to indicate that the reference to the overcontribution margin as amount M is changed to new amount C.

#### **Subclause 51(3)**

##### **Group RRSP amount**

ITA

204.2(1.3)

The references to amounts L, E, and F should be references to amounts A, B, and C, respectively.

#### **Subclause 51(4)**

##### **Transitional amount**

ITA

204.2(1.5)

The references to amounts U and V should be references to amounts A and B, respectively.

**Clause 57**

ITA  
227

The December 1995 explanatory notes which related to proposed subsections 227(5.2) to (5.4) of the Act are deleted because those provisions have not been included in this bill. Accordingly, the notes for what was previously referred to as subsection 227(5.5) is replaced by the following:

ITA  
227(5.2)

New subsection 227(5.2) of the Act clarifies that a partnership is considered to be a person for the purposes of new subsections 227(5) and (5.1).

**Clause 60**

ITA  
248(1)

**Subclause 60(2)**

"scientific research and experimental development"

The new definition of "scientific research and experimental development" replaces the definition found in existing subsection 37(7) of the Act and generally applies to work performed after February 27, 1995. For the purposes of paragraphs 149(1)(j) and (8)(b) of the Act, however, the new definition does not apply to work performed pursuant to an agreement in writing entered into before February 28, 1995.

**Clause 61**

**Subsequent Fiscal Periods**

ITA  
249.1(3)

New subsection 249.1(3) of the Act provides that, where a fiscal period of a business or property of a person or partnership ends at any time, the subsequent fiscal period, if

any, of the business or property of the person or partnership is deemed to begin immediately after that time. Where a business of a person or partnership is disposed of to another person or partnership, the fiscal period of the business may change consistent with the application of new subsection 249.1(1) to the purchaser.

This amendment applies to fiscal periods that begin after 1994.

### **PART III**

#### **Excise Tax Act**

ETA  
323.1

The addition of section 323.1 to the *Excise Tax Act* which was contained in the Notice of Ways and Means Motion tabled in December 1995 is not included in this bill. Therefore, the explanatory notes which accompanied proposed section 323.1 are deleted.

#### **Clauses 68 to 70**

#### **Transitional Provisions**

Several clauses in the December 1995 Notice of Ways and Means Motion have been renumbered in this bill. Clause 69 is now clause 68; subclause 70(1) is now clause 69; and subclause 70(2) is now clause 70.