New subsection 107(2.2) applies to distributions made after 1993; however, new subsection 107(2.2) applies only where property is distributed before 2005. After 2004, paragraph 53(1)(*p*) of the Act increases the adjusted cost base to a beneficiary of an interest in a trust to the extent of any undepleted exempt capital gains balance of the beneficiary in respect of the trust. A prescribed form filed under subsection 107(2.2) before the end of the sixth month after the month that the bill that includes this amendment is assented to is deemed to be filed on time.

Subclause 128(6)

ITA
107(6)

Subsection 107(6) of the Act is an anti-avoidance rule designed to deal with an acquisition of a capital interest in a trust that has a property with an accrued loss. Where the property is distributed to the beneficiary in satisfaction of that interest, any loss on a subsequent disposition of the property will be denied to the extent that it can be considered to have accrued while owned by the trust **and** at a time when neither the beneficiary, a person related to the beneficiary nor a partnership of which the beneficiary or a related person was a majority interest partner, had a capital interest in the trust.

This subsection is amended as a consequence of the introduction of the concept of "affiliated persons" in new section 251.1 of the Act. As amended, subsection 107(6) will limit the recognition of a loss only to the extent that it arose when neither the beneficiary nor a person affiliated with the beneficiary had a capital interest in the trust. For this purpose, the affiliation test set out in new section 251.1 is to be read without reference to the extended definition of "controlled" in subsection 251.1(2) of the Act.

Amended subsection 107(6) applies after April 26, 1995.

Clause 129

Trusts

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.

Subclauses 129(1) and (2)

ITA
108(1)
"excluded property"

The definition of "excluded property" in subsection 108(1) of the Act is amended to replace its reference to property referred to in clauses 115(1)(*b*)(v)(A) to (D) of the Act with a reference to taxable Canadian property. This amendment makes no substantive change to the definition, but simplifies and clarifies it. The amended definition applies after April 26, 1995.

"trust"

A "trust" is defined in subsection 108(1) of the Act, for the purposes of the 21-year deemed disposition rules and other specified measures, to exclude certain listed trusts. Under paragraph (*e*.1) of the definition, trusts governed by eligible funeral arrangements are among the excluded trusts for these purposes.

Paragraph (*e*.1) of the definition is amended so that cemetery care trusts are likewise excluded, in cases where such trusts might not be otherwise be considered to be trusts governed by eligible funeral arrangements. For further detail, see the commentary below on the definition "cemetery care trust" in subsection 148.1(1) of the Act.

This amendment applies to the 1993 and subsequent taxation years.

Subclauses 129(3) to (6)

ITA
108(2)

Subsection 108(2) of the Act defines the expression "unit trust". A trust must qualify as a "unit trust" in order to meet the conditions for qualifying as a "mutual fund trust" under subsection 132(6) of the Act.

Paragraph 108(2)(*b*) of the Act is amended so "interests" in real property, as defined by subsection 248(4) of the Act, are treated in the same manner as real property for the purposes of determining whether a trust is a unit trust. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

Paragraph 108(2)(*b*) is also amended so that share warrants, debentures, notes and other similar obligations are treated in the same manner as shares and bonds, mortgages and marketable securities for the purposes of determining whether a trust is a unit trust.

New paragraph 108(2)(*c*) of the Act allows certain trusts established before 1994 to qualify as "unit trusts". This provision applies to a trust where the following conditions are satisfied:

- the fair market value of the property of the trust at the end of 1993 was primarily attributable to real property (or an interest in real property, as defined by subsection 248(4));

- the trust was a "unit trust" under subsection 108(2) throughout any calendar year that ended before 1994; and

- the current fair market value of the property of the trust is primarily attributable to cash or investments described in paragraph (*a*) or (*b*) of the definition "qualified investment" in section 204 of the Act, real property (or an interest in real property) or any combination of such property.

These amendments apply to the 1994 and subsequent taxation years.

Clause 130

Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act sets out the rules that apply in calculating an individual's entitlement to the lifetime capital gains exemption.

Subclause 130(1)

ITA
110.6(2.1)

Subsection 110.6(2.1) of the Act provides a deduction in respect of net taxable capital gains from the disposition of qualified small business corporation shares. This amendment to paragraph 110.6(2.1)(*d*) of the Act replaces a general reference to "that paragraph" with a specific reference to paragraph 3(*b*), to eliminate any ambiguity that may arise. The amendment applies to the 1996 and subsequent taxation years.

Subclause 130(2)

ITA
110.6(14)(*f*)(iii)

Paragraph 110.6(14)(*f*) of the Act applies for the purposes of the definition of "qualified small business corporation share" in subsection 110.6(1) of the Act and treats shares issued by a corporation to a particular person or partnership, except in certain circumstances, as having been owned immediately before their issue to the particular person or partnership by a person who was not related to the particular person or partnership. Paragraph 110.6(14)(*f*) is amended by adding subparagraph (iii) to provide that shares issued by the corporation as stock dividends on other shares of the capital stock of the corporation will not be subject to this rule.
Paragraph 248(5)(*b*) of the Act provides that a share received in payment of a stock dividend on a particular share of the capital stock of a corporation is deemed to be property substituted for that particular share. Therefore, paragraphs (*e*) and (*f*) of the definition of

"qualified small business corporation share" in subsection 110.6(1) will be applicable to ensure that the holding period and active business asset tests in that definition operate effectively where shares are received as stock dividends on other shares of the capital stock of a corporation.

The effect of the rule in paragraph 110.6(14)(*f*) is to require shares, other than those issued in circumstances provided for in the exceptions in subparagraphs (i), (ii) and (iii), to be owned for the full 24 month holding period by the taxpayer or persons or partnerships related to the taxpayer in order to qualify for the $500,000 lifetime capital gains exemption. This rule ensures that the holding period requirement in the "qualified small business corporation share" definition cannot be circumvented through the issue of shares of a corporation from treasury. For example, a sole shareholder of a small business corporation wishing to sell shares which were acquired from an unrelated person within the 24-month period preceding the expected date of sale could have the corporation issue shares from treasury immediately before the sale. In the absence of the rule in paragraph 110.6(14)(*f*), the shares issued from treasury could meet the holding period requirement for the purposes of the $500,000 lifetime capital gains exemption.

New subparagraph 110.6(14)(*f*)(iii) of the Act applies to dispositions of shares that occur after June 17, 1987.

Subclauses 130(3) and (4)

ITA
110.6(27) and (28)

Subsections 110.6(27) and (28) of the Act deal with amendments to an election made under subsection 110.6(19) in respect of capital gains accrued to February 22, 1994.

Subject to subsection 110.6(28), subsection 110.6(27) permits an election under 110.6(19) of the Act in respect of a property or a business to be amended at any time before 1998 by the filing of an amended election in prescribed form accompanied by payment of an estimate of the penalty in respect of the amended election. This subsection is amended, applicable to the 1994 and subsequent taxation years, to ensure that it only applies for the purposes of

section 110.6 of the Act other than subsection 110.6(29) of the Act which provides for the calculation of the penalty.

Subsection 110.6(28) prohibits the revocation or amendment of an election where the amount designated in the election in respect of the property is greater than 11/10 of its fair market value at the end of February 22, 1994. This subsection is amended, applicable to the 1994 and subsequent taxation years, to provide that an election cannot be revoked or amended where the amount designated in respect of a partnership interest or a business exceeds the greater of $1 and the fair market value of the partnership interest or the eligible capital property in respect of the business, as the case may be, at the end of February 22, 1994.

Clause 131

Taxable Dividends Received by Corporations

ITA
112

Section 112 of the Act is one of the principal provisions of the Act dealing with the treatment of dividends received by taxpayers.

Subclauses 131(1) and (2)

Loss on Share that is Capital Property

ITA
112(3) to (3.32)

Subsection 112(3) of the Act contains a "stop-loss" rule which reduces the loss of a corporation from the disposition of a share held as capital property by the amount of tax-free dividends received by the corporation on the share. The provision applies unless the corporation establishes that it held the share for at least 365 days before the disposition and that the corporation and non-arm’s length persons did not own more than 5 per cent of the shares of any class of the dividend-paying corporation when the dividends were received by the corporation. Subsections 112(3.1) and (3.2) of the Act provide

similar treatment where the share is held by a partnership or trust. These subsections are amended in several respects.

First, the reference to a "capital dividend" is changed to a reference to a dividend in respect of which an election was made under subsection 83(2) of the Act where the dividend is not a taxable dividend because of subsection 83(2.1) of the Act. Subsection 83(2) permits a private corporation to elect to treat a dividend it pays as a capital dividend. Where the election is made, no part of the dividend is included in the shareholder's income even where the dividend exceeds the corporation's capital dividend account. However, where the conditions in subsection 83(2.1) are satisfied, a capital dividend will be treated as a taxable dividend received by the shareholder and paid by the corporation. Subsection 83(2.1) is an anti-avoidance rule which applies where one of the main purposes of an acquisition of a share is to acquire a right to a capital dividend. Accordingly, under the amended provisions, a dividend subject to subsection 83(2.1) is not treated as a dividend in respect of which an election under subsection 83(2) was made. (For the sake of simplicity in the presentation of these notes describing the amendments to section 112 of the Act, reference to the term "capital dividends" will be maintained.)

Second, the rules are restructured so that the dividends which are excluded from the loss reduction are set out in separate subsections from those which require the loss reduction. The dividends which are excluded are those which meet the 365-day and 5-per-cent ownership test and are contained in new subsections 112(3.01), (3.11), (3.31) and (3.32).

Third, the provisions are amended to ensure that only dividends received while the taxpayer and non-arm's length persons held more than 5 per cent of the shares of any class of the dividend-paying corporation are taken into account in reducing a loss from the disposition of a share. Under the existing provisions, a dividend that was received while the taxpayer did not exceed the 5-per-cent threshold may have, nevertheless, been taken into account in reducing a loss if another dividend was received at a time when the taxpayer exceeded the 5-per-cent threshold.

Fourth, the subsections are amended to ensure that the 365-day holding period can only be met where the taxpayer held the

share throughout the 365-day period that ends immediately before its disposition.

Fifth, as a consequence of the amendment to paragraph 112(6)(*a*) of the Act the provisions are amended to remove the reference to an amount on which a corporation was required to pay tax under Part VII of the *Income Tax Act* chapter 148 of the Revised Statutes of Canada, 1952, as it read on March 31, 1977.

Subsection 112(3) is also amended to expand its application to shares held by a natural person with respect to capital dividends. However, under amended subsection 112(3) a loss will be reduced only by the lesser of:

- the capital dividends received by the person on the share, and
- the amount by which the loss exceeds the taxable dividends received by the person on the share.

This change will ensure that a loss is not reduced to the extent that the loss is attributable to the corporation's payment of taxable dividends to the shareholder.

Subsection 112(3.1) is also amended to expand its application to an individual member of a partnership which receives capital dividends. In a manner akin to the amendment to subsection 112(3), these capital dividends will reduce an individual's share of a partnership loss only where they exceed the individual's share of the loss minus the taxable dividends received by the individual on the share. With respect to members of a partnership that are trusts, the amended provision also applies to taxable dividends and life insurance capital dividends received on a share and designated under subsection 104(19) or (20) of the Act by the trust in respect of a beneficiary that is a corporation, partnership or another trust.

Subsection 112(3.1) is further amended to ensure that a taxpayer's share of a partnership loss is subject to reduction in situations involving multi-tier partnerships. Amended subsection 112(3.1) is intended to reduce an individual or corporate partner's share of a loss from one partnership where the share of a corporation was held by another partnership of which the first partnership has a direct or indirect (that is, through one or more other partnership) interest. Since

the partnerships are flow-through entities with respect to any loss arising from the disposition of a share held by one of the partnerships, the stop-loss rule applies only at the individual or corporate partner level: the loss of a partnership that is a member of another partnership is not reduced under the amended provision.

Subsection 112(3.2), which deals with trust losses other than those addressed under new subsection 112(3.3), is amended to expand its application, subject to subsection 112(3.32), to taxable dividends and life insurance capital dividends received on a share and designated by a trust to beneficiaries that are corporations, partnerships or other trusts. Under new subsection 112(3.32) taxable dividends which the trust establishes were received by an individual that is not a trust are not included in the loss reduction under subsection 112(3.2) or (3.3).

Under amended paragraph 112(3.2)(*a*) of the Act a trust's loss will also be reduced by the lesser of the following two amounts:

- capital dividends received by the trust, and

- the trust's loss minus certain taxable dividends paid on the share disposed of. (The taxable dividends which count for this purpose are those received and taxed in the trust's hands, designated by the trust in respect of a beneficiary who is a natural person, or designated to other beneficiaries where the trust establishes that the dividends were received on a share that was held for 365 days or more and received when the trust, the beneficiary and persons non-arm's length with the beneficiary owned less than 5 per cent of any class of the capital stock of the corporation.)

Where the trust is an individual's estate and the share was acquired as a consequence of the individual's death, the amount of the loss reduction otherwise determined above will be reduced under subparagraph 112(3.2)(*a*)(iii) of the Act by 1/4 of the lesser of the loss otherwise determined and the capital gain arising from the deemed disposition of the share on the individual's death. In conjunction with subsection 164(6) of the Act, subparagraph 112(3.2)(*a*)(iii) is intended to enable an individual's estate to ignore, in computing its capital loss in respect of shares of a private corporation, capital dividends up to 1/4 of the deceased's capital gain on the shares, thus promoting integration between the deceased individual and the estate where the deceased's capital gain

on the shares is attributable to the appreciation of capital property held by the corporation.

The exclusion for prescribed trusts has been removed in the amended provision, reflecting the fact that no trusts have been prescribed for the purposes of subsection 112(3.2). In addition, capital losses of mutual fund trusts are not subject to amended subsection 112(3.2).

New subsection 112(3.3) of the Act is a special rule which applies to reduce a trust's loss from the disposition of a share that is considered to have been acquired by the trust because of the application of subsection 104(4) of the Act. At certain times, subsection 104(4) treats property of a trust as having been disposed of and reacquired at its fair market value. Those times are, generally, when the spouse beneficiary of a spousal trust dies and every 21 years thereafter and, in the case of any other trust, every 21 years following the trust's creation. When there is a deemed disposition and reacquisition of shares owned by a trust because of the application of subsection 104(4), the trust is in a position similar to that of an individual's estate: in both cases the capital gain to the trust in respect of a corporation's share may be attributable to the appreciation of capital property held by the corporation, and allowing capital dividends received by the trust after the deemed disposition, of up to 1/4 of the gain triggered by the disposition, to be ignored in computing its loss on a subsequent disposition promotes integration between the corporation and the trust. Therefore, the same provision found in the estate rule in subparagraph 112(3.2)(*a*)(iii) is set out in subparagraph 112(3.3)(*a*)(iii).

The new stop-loss rules in subsections 112(3) to (3.32) generally apply to share dispositions that occur after April 26, 1995. They do not apply, however, to share dispositions taking place after that date where:

1. The shares are owned by a taxpayer on April 26, 1995 and are disposed of pursuant to an agreement in writing made before April 27, 1995.

2. A corporation or a partnership of which a corporation was a member was a beneficiary of a life insurance policy on the life of a taxpayer on April 26, 1995, the proceeds of the policy were intended primarily to be used to redeem the shares owned by the taxpayer on

April 26, 1995, and the redemption occurs pursuant to an agreement in writing made before April 1997. This rule has the following important features:

- The shares owned by the taxpayer on April 26, 1995 need not be shares of the corporation which is the beneficiary of the life insurance policy; it is necessary only to demonstrate that the proceeds of the policy were intended to be used to acquire the taxpayer's shares. For example, the taxpayer may hold an interest in the corporate beneficiary through one or more holding corporations.

- The shares need not be acquired with the proceeds of the life insurance policy that was in place on April 26, 1995. Therefore, policies may be renewed, converted, replaced or entered into after April 26, 1995 without necessarily eliminating the application of these grandfathering rules.

- The life insurance policy may insure the life of the taxpayer or the taxpayer's spouse or both lives. This is intended to accommodate joint life insurance policies and other estate planning arrangements.

Similar rules apply where the taxpayer is a spouse trust and the life insured is the beneficiary spouse.

3. The shares are held by a taxpayer on April 26, 1995, the taxpayer dies on or after that date and the taxpayer's estate disposes of the shares before 1997.

4. On April 26, 1995 a taxpayer's estate owns the shares, the estate's first taxation year ends after April 26, 1995 and the share are disposed of by the estate before 1997.

5. The shares are owned by a spouse trust on April 26, 1995 and are disposed of by the trust after the death of the beneficiary spouse and before 1997.

A share acquired in exchange for another share on a conversion, transfer to a corporation, corporate reorganization or amalgamation to which section 51, 85, 86 or 87 (respectively) of the Act applies is to be treated as being the same as the exchanged share for the purposes of

(i) determining whether a taxpayer owned the share on April 26, 1995; and

(ii) whether it was reasonable to conclude that a life insurance policy was intended to be used primarily to fund a redemption of the share.

Application rule for subsections 112(3) to (3.32) of the Act, as proposed in Bill C-69

Bill C-69 was tabled in the previous Parliament on November 20, 1996. The House of Commons did not pass Bill C-69 before Parliament dissolved in April 1997. In order to take effect, these provisions must be reintroduced in a new bill when the new session of Parliament begins in the fall. The following notes explain changes that are to be made to the provisions of Clause 57 of Bill C-69.

Clause 57 of Bill C-69 provides rules which reduce a taxpayer's loss arising on the disposition of a share of the capital stock of a corporation by the amount of certain dividends received by the taxpayer on the share. These rules generally apply to share dispositions that occur after April 26, 1995. They do not apply, however, to share dispositions that occur in the situations described in clause 57(10) of Bill C-69. That clause is amended in several ways. First, the amendment removes the requirement in clause 57(10)(*b*) that the disposition of a share be made pursuant to a written agreement entered into before April 1997.

Second, the requirement in clause 57(10)(*b*), that it be reasonable to conclude that the proceeds of a life insurance policy be primarily intended to fund a share redemption, will be modified. Under the modified clause 57(10)(*b*), the transitional relief may apply provided that a main purpose of the life insurance policy was to fund a share redemption. This change is intended to expand the types of circumstances which can qualify for transitional relief.

Third, the share ownership requirement in clause 57(10) is modified to include shares owned on April 26, 1995 by a trust under which an individual is a beneficiary. Therefore, the transitional rule in clause 57(10)(*b*) may apply where: the shares are owned by a trust on April 26, 1995; a corporation was a beneficiary of a life insurance policy on the life of an individual beneficiary (or the individual's

spouse) of the trust; a main purpose of the insurance was to fund a redemption of the shares; and the share disposition is made by the individual, the individual's spouse or their estates.

Fourth, modified clause 57(10)(*b*)(i) and new clause 57(10)(*b*)(iv)(C) will ensure that transitional relief is available where

- a share was owned by a spousal trust on April 26, 1995;
- a corporation was a beneficiary of a life insurance policy that insured the life of the beneficiary spouse under the trust;
- a main purpose of the insurance policy was to fund a redemption of the share; and
- the share is disposed of by the spouse trust to the corporation after the spouse's death and before the end of the trust's third taxation year that begins after the spouse's death.

Fifth, the transitional rule will be amended to clarify that the disposition of a share may qualify for transitional relief where the disposition is made by the individual whose life was insured, the individual's spouse or their estates. The transitional rules are also expanded to include certain share dispositions made by inter vivos or testamentary spouse trusts created by the individual whose life (or whose spouse's life) was insured on April 26, 1995.

In addition to these changes, the supporting rule in clause 57(11) of the Bill will be modified. For the purposes of clause 57(10)(*b*), existing clause 57(11) provides that a share acquired in exchange for another share on a conversion, transfer to a corporation, corporate reorganization or amalgamation to which section 51, 85, 86 or 87 (respectively) of the *Income Tax Act* applies is to be treated as being the same as the exchanged share for the purposes of

(i) determining whether a particular taxpayer owned the share on April 26, 1995; and

(ii) determining whether it was reasonable to conclude that a life insurance policy was intended to be used primarily to fund a redemption of the share.

Clause 57(11) will be simplified as a consequence of the changes to clause 57(10). A share acquired in exchange for another share in a transaction to which section 51, 85, 86 or 87 of the Act applies will be considered to be the same share as the exchanged share for all purposes of the rule in clause 57(10)(*b*). The amendment to clause 57(11) will also clarify that the transitional rule will continue to be available where there is a succession of share transfers, conversions, reorganizations or amalgamations.

Loss on Share Not Held as Capital Property

ITA
112(4) to (4.22)

Subsection 112(4) of the Act provides a "stop-loss" rule in respect of losses arising with respect to a share that is not held as capital property. Such losses are reduced by the amount of dividends received by the taxpayer on the share unless the taxpayer owned the share for at least 365 days before the loss was sustained and the taxpayer and non-arm's length persons did not own more than 5 per cent of any class of shares of the dividend-paying corporation at the time a dividend was received.

Subsections 112(4.2) and (4.3) of the Act are similar rules which apply to losses arising from shares held by partnerships and trusts, respectively. Subsection 112(4.1) of the Act is a rule which applies for the purposes of inventory valuation under subsection 10(1) of the Act. Under subsection 112(4.1), a dividend received on a share must be added to the fair market value of the share otherwise determined, unless the taxpayer satisfies the 365-day and 5-per-cent share ownership tests described above.

These subsections are amended so that the dividends which are excluded from the amount of loss reduction, because they meet the 365-day and 5-per-cent share ownership tests, are set out in new subsections 112(4.01), (4.11), (4.21) and (4.22) of the Act. The 5-per-cent ownership tests are also amended to ensure that only dividends received while the taxpayer held more than 5 per cent of the shares of any class of the dividend-paying corporation are taken into account in reducing a loss from a disposition or increasing a fair market value in an inventory valuation. Under the existing provisions, a dividend that was received while the taxpayer and non-arm's length

persons did not hold more than 5 per cent of the shares of the dividend-paying corporation may have, nevertheless, been taken into account in reducing a loss or increasing a fair market value if another dividend was received at a time when the taxpayer exceeded the 5-per-cent threshold.

The 365-day holding period test is also amended to ensure that it can be met only where the taxpayer held the share throughout the 365-day period ending immediately before the disposition or, in the case where section 10 of the Act applies, at the time of inventory valuation.

The subsections are further amended to remove the references to a capital gains dividend as a consequence of the amendment to paragraph 112(6)(*a*) of the Act.

Subsection 112(4) is also amended to expand its application to shares held by a partnership so that any loss reduction is made at the partnership rather than partner level. Accordingly, amended subsection 112(4.2) does not apply to shares held by partnerships.

Subsection 112(4.1) is also amended to expand the purposes for which the provision applies as a consequence of the amendments to section 10 of the Act. New subsection 10(10) of the Act requires a corporation to value its inventory of a business that is an adventure or concern in the nature of trade at the end of the corporation's last taxation year before a change in control. The inventory is valued at the lower of its original cost and its fair market value. Amended subsection 112(4.1) applies for the purposes of determining the fair market value of such inventory.

Lastly, the exclusion for a prescribed trust in these subsections has been removed because no trusts have been prescribed for the purpose of these provisions.

Amended subsections 112(4) and (4.2) and new subsections 112(4.01), (4.21) and (4.22) apply to dispositions that occur after April 26, 1995. Amended subsection 112(4.1) and new subsection 112(4.11) apply to taxation years that end after April 26, 1995.

Subclauses 131(3) to (6)

Adjustment to Proceeds of Disposition

ITA
112(5.1)(*b*) and (5.2)

Subsections 112(5) and (5.1) of the Act set out the criteria for determining when the stop-loss rule in subsection 112(5.2) of the Act applies. Subsection 112(5.2) applies to adjust a taxpayer's proceeds of disposition arising from the disposition of a share in certain circumstances. In general terms, subsection 112(5.2) prevents a taxpayer from obtaining a deduction for the part of a taxpayer's overall loss in respect of a share to the extent that the taxpayer has received dividends on the share.

Subsection 112(5) provides that subsection 112(5.2) applies where a financial institution disposes of a share that is a mark-to-market property and the financial institution and non-arm's length persons held more that 5 per cent of any class of the corporation on which the dividends were paid.

Subsection 112(5.1) provides that subsection 112(5.2) applies where a taxpayer disposes of a share that is held for less than 365 days if the disposition was an actual disposition and the share was a mark-to-market property for any taxation year beginning after October 1994 in which the taxpayer was a financial institution. The 365-day holding period in paragraph 112(5.1)(*b*) of the Act is amended so that the taxpayer must hold the share throughout the 365-day period ending immediately before the disposition. This amendment is consistent with the 365-day tests in amended subsections 112(3.01) to (4.22) of the Act.

Paragraph (*b*) of the description of B in subsection 112(5.2) is amended to remove the reference to capital gains dividends as a consequence of the amendment to paragraph 112(6)(*a*) of the Act.

New subsection 112(5.21) is added to the Act to ensure that only dividends received while the taxpayer and non-arm's length persons held more than 5 per cent of the issued shares of any class of the dividend-paying corporation are included in the total determined under paragraph (*b*) of the description of B in subsection 112(5.2).

Under existing subsections 112(5.1) and (5.2), a dividend that was received while the taxpayer and non-arm's length persons did not hold more than 5 per cent of the shares of the dividend-paying corporation may have, nevertheless, been taken into account in reducing a loss if another dividend was received at a time when the taxpayer exceeded the 5-per-cent threshold. New subsection 112(5.21) also maintains the application of the 365-day holding period contained in subsection 112(5.1).

A consequential amendment is made to paragraph (*b*) of the description of C in subsection 112(5.2) to replace the reference to subsection 112(4.3) of the Act with a reference to subsection 112(4.2) of the Act.

These amendments apply to dispositions that occur after April 26, 1995.

Subclause 131(7)

Stop-Loss Rules not Applicable

ITA
112(5.5)

Subsection 112(5.5) of the Act provides that the stop-loss rules in subsections 112(3) to (4), (4.2) and (4.3) of the Act are not applicable in specified circumstances. The subsection is amended by removing the reference to subsection 112(4.3) of the Act which is being repealed by this Act.

Subclause 131(8)

Stop-Loss Rules Restricted

ITA
112(5.6)

In the case of certain dispositions, subsection 112(5.6) of the Act provides that the holding of a share for less than 365 days does not cause the existing stop-loss rules in subsections 112(3) to (4), (4.2) and (4.3) of the Act to apply. Therefore, those rules will have potential application only where dividends are received on a share of

a corporation of which the shareholder and non-arm's length persons own more than 5 per cent of any class of shares. The amendment to subsection 112(5.6) is consequential on the amendments to those stop-loss rules and merely changes the references to the provisions in which the 365-day share ownership tests are found.

Amended subsection 112(5.6) applies to dispositions that occur after April 26, 1995.

Subclause 131(9)

Meaning of Certain Expressions

ITA
112(6)(*a*)

For the purposes of section 112 of the Act, paragraph 112(6)(*a*) of the Act states that the term "taxable dividend" is not to include a capital gains dividend as defined by subsection 131(1) of the Act. Paragraph 112(6)(*a*) is amended to exclude a capital gains dividend and a dividend received by a taxpayer on which the taxpayer was required to pay tax under Part VII of the Act, as it read on March 31, 1977, from the meaning of "taxable dividend" and "dividend". Part VII of the Act levied a tax of 25 per cent on certain taxable dividends received by either a corporation resident in Canada or an unincorporated trader or dealer in securities. The tax was equal to 25 per cent of the portion of the taxable dividend paid out of the designated surplus of the payer corporation. The stop-loss rules in subsections 112(3) to (4.3) and (5.2) of the Act do not apply to capital gains dividends or dividends subject to the former Part VII tax. Since the amended stop-loss rules in section 112 do not contain references to these dividends, the dividends will be excluded by amended paragraph 112(6)(*a*).

Amended paragraph 112(6)(*a*) applies after April 26, 1995.

Subclause 131(10)

Rules Where Shares Exchanged

ITA
112(7)

Subsection 112(7) of the Act provides rules relating to the application of the "stop-loss" rules in subsections 112(3) to (3.2) of the Act to shares that have been acquired in exchange for other shares (the "old shares") on a conversion, share-for-share exchange, corporate reorganization or amalgamation. Existing subsection 112(7) provides that the loss otherwise determined on the disposition of a new share acquired in such an exchange is reduced by the taxable dividends, capital dividends and life insurance capital dividends received on the new share which are subject to the stop-loss rules in subsection 112(3), (3.1) or (3.2) as well as the same types of dividends received on all the old shares that are attributed to the new share. Where the number of old shares and new shares exchanged is not equal, the dividends received on the old shares are attributed to the new share on a pro rata basis using the adjusted cost bases of the new shares immediately after the exchange. The dividends received on an old share that are attributed to a new share are limited to the adjusted cost base of the old share. Existing subsection 112(7) does not make it clear that a loss from the disposition of a new share should only be reduced by the dividends received on the old shares which do not meet the 365 day and 5-per-cent share ownership tests in subsections 112(3) to (3.2).

Amended subsection 112(7) applies for the purposes of the amended stop-loss rules in subsections 112(3) to (3.32). Rather than adjusting the amount of loss otherwise determined on a disposition of a new share, amended subsection 112(7) treats an old share as being the same as the new share acquired in exchange for the old share and treats the dividends received on the old share as having been received on the new share. Under amended paragraph 112(7)(*a*) of the Act, any dividends received on the old share are considered to have been received on the new share in the proportion that the adjusted cost base of the new share is of the total adjusted cost bases of all the new shares acquired in exchange for that old share. Thus, if the amended stop-loss rules apply to reduce a loss from the disposition of a new share, only the appropriate dividends received on the old shares will

be taken into account. Under amended paragraph 112(7)(*b*) of the Act the amount of loss that can be reduced on a disposition of a new share, due to the dividends that are attributed to the new share because of paragraph 112(7)(*a*), is limited to the adjusted cost base of the old share acquired in exchange for the new share.

This amendment applies to dispositions that occur after April 26, 1995.

Clause 132

Taxable Income Earned in Canada by Non-Residents

ITA
115(1)(*b*), 115(3)

Section 115 of the Act provides rules for calculating a non-resident's taxable income earned in Canada.

Paragraph 115(1)(*b*) of the Act lists the types of property (called "taxable Canadian property") in respect of which taxable capital gains and allowable capital losses figure in the calculation of a non-resident's taxable income earned in Canada. In addition to renumbering its subparagraphs and updating its language, this paragraph is revised in several respects.

First, subparagraph 115(1)(*b*)(ii) of the Act is modified to clarify that a non-resident's ships and aircraft used principally in international traffic, as well as related personal property, are not taxable Canadian property, provided the country in which the non-resident is resident grants substantially similar relief to persons resident in Canada.

Second, paragraph 115(1)(*b*) is amended to modify the basic criterion for determining whether a share of the capital stock of a corporation is taxable Canadian property, replacing a test based on the status of the corporation as a public corporation with a test based on whether or not the share is listed on a prescribed Canadian or foreign stock exchange. Revised subparagraph 115(1)(*b*)(iv) of the Act provides that an unlisted share of a corporation resident in Canada (other than a mutual fund corporation) is taxable Canadian property. Under revised subparagraph 115(1)(*b*)(vi) of the Act, a listed share of a

Canadian-resident corporation, or a share of a mutual fund corporation, is taxable Canadian property if the shareholder, together with all non-arm's length persons, owned 25 per cent or more of the shares of any class of the corporation's stock at any time in the preceding five years.

Third, amended subparagraph 115(1)(*b*)(v) of the Act treats certain unlisted shares of non-resident corporations as taxable Canadian property. Such a share will be taxable Canadian property at a particular time if two criteria are both met. First, at some time in the 12 months preceding the particular time more than half of the fair market value of the corporation's property must be in the form of taxable Canadian property, Canadian resource properties, timber resource properties, income interests in Canadian-resident trusts or interests in or options in respect of these sorts of property. Second, at the same time more than half of the fair market value of the share itself must be derived directly or indirectly from any one or more real properties in Canada, Canadian resource properties or timber resource properties.

A share of a non-resident corporation that meets the tests described above will usually not be taxable Canadian property if it is listed on a prescribed stock exchange. If the shareholder has held 25 per cent or more of the shares of any class of the corporation's stock at any time in the preceding five years, however, subparagraph 115(1)(*b*)(vi) provides that the share is taxable Canadian property even if it is listed on a prescribed exchange.

A fourth change to paragraph 115(1)(*b*) treats as taxable Canadian property certain interests in non-resident trusts. The tests for this treatment, set out in subparagraph 115(1)(*b*)(ix) of the Act, are comparable to those that apply to shares of non-resident corporations.

Another change slightly modifies the description of those partnership interests that are taxable Canadian property. Under existing paragraph 115(1)(*b*)(v), a partnership interest is taxable Canadian property if, at any time in the 12 months before the interest is disposed of, 50 per cent or more of the value of the partnership's property was represented by taxable Canadian property, Canadian resource property, timber resource property and income interests in Canadian resident trusts. New subparagraph (vii) changes the applicable percentage from 50 per cent or more to over 50 per cent,

the same number as in new subparagraphs (v) and (xi). The new subparagraph also clarifies that options in respect of the various sorts of property it describes are treated for this purpose in the same way as the property itself.

Amended paragraph 115(1)(*b*) applies after April 26, 1995, with certain exceptions. The amendments do not apply to a disposition of property before 1996 to a person who was obliged to acquire the property under an agreement in writing made on or before April 26, 1995. (For this purpose a person is not considered to be obliged to acquire property where the obligation can be relieved if there is a change to the Act or an adverse assessment under the Act.) The amendments also do not apply to a disposition before 1996 pursuant to a prospectus or similar document filed with the relevant securities authority before April 27, 1995. And where a property (such as a share of a non-resident corporation, or an unlisted share of a public corporation) has become taxable Canadian property as a result of these amendments, new subsection 40(9) of the Act may reduce a taxpayer's gain or loss on a disposition of the property. For more information on new subsection 40(9), reference should be made to the notes to that provision.

Clause 133

Dispositions of Property by Non-Residents

ITA
116

Section 116 of the Act sets out information reporting and tax collection procedures relating to non-residents' dispositions of taxable Canadian property.

Subclause 133(1)

ITA
116(1)

Subsections 116(1) and (2) of the Act allow a non-resident who plans to dispose of taxable Canadian property to obtain what is commonly known as a "clearance certificate" in respect of the disposition.

Subsection 116(1) is amended, with application after April 26, 1995, to clarify that it does not apply to dispositions to which subsection 116(5.2) of the Act applies.

Subclause 133(2)

Notice to Minister

ITA
116(3)

Subsection 116(3) of the Act requires a non-resident who disposes of taxable Canadian property to provide certain information to the Minister of National Revenue. This provision is amended, with application after April 26, 1995, to clarify that it does not apply to dispositions to which subsection 116(5.2) of the Act applies.

Subclause 133(3)

Certificates for Dispositions

ITA
116(5.2)

Subsection 116(5.2) of the Act provides for "clearance certificates" in respect of dispositions by non-residents of certain sorts of property. The subsection is amended to provide that it does not apply in respect of the disposition of "excluded property," defined for this purpose in subsection 116(6) of the Act. The amendment, which applies to dispositions that occur after 1996, also clarifies that subsection 116(5.2) applies to the disposition of any interest in, or option in respect of, a property to which the subsection applies.

Subclause 133(4)

ITA
116(6)(*a*) and (*b*)

The various rules in section 116 of the Act, which provides a withholding procedure for the purchaser of certain property, do not apply where the property is "excluded property," as defined in subsection 116(6) of the Act. Subsection 116(6) is amended as a

consequence of the restructuring and revision of paragraph 115(1)(*b*) of the Act.

Existing subparagraph 115(1)(*b*)(ix) of the Act refers to any property that is deemed by any provision of the Act to be taxable Canadian property. Amended paragraph 115(1)(*b*) moves this reference to subparagraph 115(1)(*b*)(xii) of the Act. Paragraph 116(1)(*a*)'s cross-reference must therefore be updated as well.

Under subparagraphs 115(1)(*b*)(iii) and (iv) of the Act, a share of a public corporation is taxable Canadian property only if the person disposing of the share (along with persons with whom that person did not deal at arm's length) held a significant interest in the corporation. Since the purchaser of a publicly-traded share will ordinarily not know who the vendor of the share is, let alone the extent of the vendor's interest in the corporation, paragraph 116(6)(*b*) of the Act currently treats a share of the capital stock of a public corporation, or an interest in such a share, as excluded property.

With the amendment of paragraph 115(1)(*b*), the focus of determining if a share of a corporation resident in Canada is taxable Canadian property under that provision has shifted from whether or not the corporation is a public corporation to whether or not the class of shares in question is listed on a prescribed stock exchange. This amendment to paragraph 116(6)(*b*) imports the same test into the definition of excluded property. Under amended paragraph 116(6)(*b*), a share of a class of a corporation's stock, or an interest in a share, will be excluded property if that class is listed on any prescribed exchange. The amendment applies after April 26, 1995, except in respect of certain dispositions before 1996. The excluded dispositions are the same as those to which the amendments to paragraph 115(1)(*b*) do not apply; for more information, readers should consult the notes to that provision.

Clause 134

Age Tax Credit

ITA
118(2)

Subsection 118(2) of the Act provides an age tax credit for individuals who are over 65 years of age or who reach age 65 in the year. The credit is calculated as a percentage (17 per cent for 1994) of an indexed base amount ($3,482 for 1994). The base amount upon which an individual's age tax credit is calculated is reduced by 15 per cent of the amount by which the individual's income for the year exceeds $25,921. For 1994, the reduction is only one-half of the reduction otherwise determined.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which the reduction in the age tax credit is calculated, resulting in certain circumstances in a reduced credit.

Subsection 118(2) is amended, applicable to 1994 and subsequent taxation years, to exclude a capital gain arising by virtue of section 79 of the Act from the income base upon which the reduction in the age tax credit is calculated.

Clause 135

Tuition Tax Credit

ITA
118.5(1)

Subsection 118.5(1) of the Act provides a tax credit in respect of tuition fees paid to certain educational institutions. New subparagraph 118.5(1)(*a*)(v) of the Act is added to ensure that where, under a federal program designed to assist athletes, tuition fees are paid on behalf of an individual or the individual is entitled to a reimbursement, the individual will not be entitled to claim a tuition

tax credit unless the payment or reimbursement is included in computing income.

New subparagraph 118.5(1)(*a*)(v) applies to 1994 and subsequent taxation years.

Clause 136

Credits in Year of Bankruptcy

ITA
118.95

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing non-refundable tax credits in sections 118 to 119 of the Act, an individual may claim full credits in respect of each of these periods, even though this means that the individual may get the benefit of these credits twice in respect of the same calendar year.

New section 118.95 is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, these non-refundable tax credits in respect of each of the two periods in the calendar year will generally be calculated on a pro-rata basis (except for those credits that are based on expenditures or the receipt of certain types of income during the period). The calculation of credits will be similar to the calculation of credits in respect of individuals residing in Canada for only part of a taxation year, which is contained in section 118.91 of the Act. The personal tax credits, the age tax credit, the disability tax credit and the transfers of unused credits will be subject to pro-ration based on the number of days in the period for which the return is filed. The pension tax credit, charitable donations tax credit, medical tax credit and the tuition and education tax credits will be based on the related amounts in respect of each period. In all cases, the total of the amounts claimed in respect of each of these credits for both the pre and post-bankruptcy periods cannot be greater

than the amount that could be claimed in respect of the calendar year.

New section 118.95 applies to bankruptcies that occur after April 26, 1995.

Clause 137

Minimum Tax Carry-Over

ITA
120.2(4)(*a*)

Section 120.2 of the Act provides for the carry-over of additional taxes paid under the minimum tax provisions for previous taxation years.

Where an individual becomes bankrupt, the trustee in bankruptcy for the individual is required under paragraph 128(2)(*e*) of the Act to file income tax returns on behalf of the individual in respect of income arising from the individual's estate and business. Currently, the trustee cannot utilize any minimum tax carry-over of the individual in such a return in computing the tax payable by the individual.

Paragraph 120.2(4)(*a*) of the Act is amended to provide that, for taxation years that begin after April 26, 1995, the trustee may claim under subsection 120.2(1) of the Act any available minimum tax carry-over in an income tax return that is required under paragraph 128(2)(*e*). However, the individual, who is required to file an income tax return under paragraph 128(2)(*f*) of the Act, may not deduct any such amount under that subsection for such years.

Clause 138

Child Tax Credit

ITA
122.2

Before its repeal and replacement by the child tax benefit for 1993 and subsequent years, section 122.2 of the Act provided the rules for

determining the child tax credit for individuals. A taxpayer's total child tax credit in respect of a year was reduced by five cents for each dollar of the individual's family income in excess of an indexed threshold. For this purpose, the individual's family income for the year was the total of the incomes for the year of the taxpayer and a supporting person.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which both the child tax credit and the child tax benefit are calculated, resulting in certain circumstances in a reduced credit.

Section 122.2 is amended, in its application to the 1992 taxation year, to exclude a capital gain arising by virtue of section 79 of the Act from the income base of the child tax credit. Similar amendments are also being made to the child tax benefit.

Clause 139

Goods and Services Tax Credit

ITA
122.5

Section 122.5 of the Act provides the rules for determining the Goods and Services Tax (GST) credit for individuals.

Subclause 139(1)

ITA
122.5(1)
"adjusted income"

A taxpayer's total GST credit in respect of a year is reduced by five cents for each dollar of the taxpayer's adjusted income in excess of an indexed threshold. For this purpose, a taxpayer's "adjusted income" for a year, which is defined in subsection 122.5(1) of the Act, is the total of the incomes for the year of the taxpayer and the taxpayer's cohabiting spouse and the end of that year.

Section 79 of the Act provides special rules where a creditor acquires or reacquires property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from such a transaction is included in the income base upon which the GST tax credit is calculated, resulting in certain circumstances in a reduced credit.

Section 122.5 is amended, applicable to the 1992 and subsequent taxation years, to exclude a capital gain arising by virtue of section 79 of the Act from the income base upon which the GST credit is calculated.

Subclause 139(2)

ITA
122.5(1)
"eligible individual"

An "eligible individual", for purposes of the GST credit, is defined as an individual who is resident in Canada at the end of December and who is married, a parent or at least 19 years old at that time. This amendment to the definition, which is consequential on the addition of new subsection 122.5(7) to the Act, clarifies that an individual must be resident in Canada at the end of December 31 of a year. This amendment applies after April 26, 1995.

Subclause 139(3)

Effect of bankruptcy

ITA
122.5(7)

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing the GST credit, only the income from the post-bankruptcy period is taken into account in future periods for the purposes of determining the "adjusted income" upon which the GST credit is based.

New subsection 122.5(7) is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, the individual's entitlement to the GST credit in subsequent years will be calculated based on income from both the pre and post-bankruptcy periods. By virtue of the wording of this new subsection and the definition "adjusted income" in subsection 122.5(1) of the Act, where a spouse become bankrupt, the spouse's income from both periods will also be taken into consideration.

New subsection 122.5(7) applies to bankruptcies that occur after April 26, 1995.

Clause 140

Child Tax Benefit – Definitions

ITA
122.6

Section 122.6 of the Act contains definitions for the purposes of the child tax benefit (CTB). This benefit is delivered in non-taxable monthly payments based on family earnings, income, number of children and child care expenses.

Subclause 140(1)

ITA
122.6
"adjusted income"

The amount of the monthly CTB is based on a taxpayer's "adjusted income", which is the total of the incomes for a base taxation year of the taxpayer and the taxpayer's cohabiting spouse at the end of that year. For the first 6 months of a year, the base taxation year is the second preceding year, and, for the last 6 months of a year, the base taxation year is the preceding year.

Section 79 of the Act provides special rules where a creditor acquires or reacquires a property in consequence of a debtor's failure to pay any part of a mortgage or other debt. The capital gain arising from

such a transaction is included in the income base upon which the CTB is calculated, resulting in certain circumstances in a reduced benefit payable in a subsequent year.

The definition "adjusted income" in section 122.6 of the Act is amended to exclude a capital gain arising by virtue of section 79 from the income base upon which the CTB is calculated. This amendment is effective with respect to child tax benefit payments arising after June 30, 1993.

Subclause 140(2)

ITA
122.6
"eligible individual"

Paragraph (*e*) of the definition "eligible individual" describes certain residency requirements that must be met in order for an individual to be eligible for the child tax benefit. Subparagraph (*e*)(iii), which provides for the determination of Convention refugee status by the Convention Refugee Determination Division of the Immigration and Refugee Board, is being amended to reflect the fact that individuals may be determined to be Convention refugees not only by this body, but also under other provisions of the *Immigration Act* and Regulations.

This amendment applies after 1992.

Paragraphs (*g*) and (*h*) of the definition "eligible individual" refer to regulations made by the Governor in Council on the recommendation of the Minister of National Health and Welfare. These paragraphs are amended to replace these references with references to prescribed circumstances and prescribed factors. This amendment, which applies after August 27, 1995, reflects the shift in responsibility from the Minister of National Health and Welfare to the Minister of National Revenue.

Clause 141

Child Tax Benefit – Bankrupt Individuals

ITA
122.61(3.1)

Where an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy (the pre-bankruptcy period) and the other that begins on the day of the bankruptcy and runs to December 31 (the post-bankruptcy period). Under the current provisions governing the child tax benefit (CTB), only the income from the post-bankruptcy period is taken into account in future periods for the purposes of determining the income upon which the CTB is based and the earned income upon which the earned income supplement to the CTB is based.

New subsection 122.6(3.1) is added to the Act to ensure that, where an individual becomes bankrupt in a calendar year, the individual's entitlement to the CTB and the earned income supplement in subsequent years will be calculated based on income from both the pre and post-bankruptcy periods. By virtue of the wording of this new subsection and the definitions "adjusted income" and "adjusted earned income" in section 122.6 of the Act, where a spouse becomes bankrupt, the spouse's income from both periods will also be taken into consideration.

New subsection 122.6(3.1) applies to bankruptcies that occur after April 26, 1995.

Clause 142

Child Tax Benefit – Eligible Individuals

ITA
122.62

Section 122.62 of the Act deals with various situations in which a person becomes or ceases to become an eligible individual or a

cohabiting spouse of such an individual for purposes of the child tax benefit (CTB).

Subclause 142(1)

Eligible Individuals

ITA
122.62(1) and (2)

Subsection 122.62(1) of the Act provides that, as a general rule, a person will be entitled to a CTB for a particular month only if the person files the required notice with the Minister of National Health and Welfare before the end of the eleventh month following that month. However, subsection 122.62(2) of the Act provides that the Minister may extend the period to file the notice. These subsections are amended, applicable after August 27, 1995, to require the filing of the notice in prescribed form containing prescribed information with the Minister of National Revenue and to give to this Minister the power to extend the period for filing the notice.

Subclause 142(2)

Person Ceasing to be an Eligible Individual

ITA
122.62(4)

Subsection 122.62(4) of the Act requires a person who ceases to be an eligible individual in respect of a qualified dependant to inform the Minister of National Health and Welfare of that fact before the end of the following month. This subsection is amended to require the person to notify the Minister of National Revenue. The notification need not necessarily be in writing.

This amendment applies after August 27, 1995.

ITA
122.62(5) to (9)

Subsection 122.62(5) of the Act enables the Minister of National Health and Welfare to waive the requirement to file a notice under

subsection 122.62(1) of the Act or the requirement under subsection 122.62(4) of the Act to inform the Minister upon ceasing to be an eligible individual in respect of a qualified dependant.

Paragraph 122.62(5)(*a*) of the Act, which deals with the filing of notices, is deleted as the Minister of National Revenue already has the power, under subsection 220(2.1) of the Act, to waive the requirement to file a notice.

Paragraph 122.62(5)(*b*) of the Act, which deals with notification when ceasing to be an eligible individual, is also deleted as a result of the amendment to subsection 122.62(4) of the Act. Since the requirement to inform the Minister in writing when a person ceases to be an eligible individual has been removed, there is no need to have a provision to waive the requirement to inform the Minister.

Subsections 122.62(6) to (8) of the Act deal with elections filed with the Minister of National Health and Welfare upon the death of a cohabiting spouse or when a person separates from or becomes a cohabiting spouse. The subsections are amended in order that the elections be filed with the Minister of National Revenue. Subsections 122.62(6) to (8) have been renumbered as 122.62(5) to (7) to reflect the fact that old subsection 122.62(5) is no longer required. Previous subsection (9), which dealt with obtaining advice from the Minister of National Health and Welfare, is deleted as the Minister of National Revenue will be responsible for the child tax benefit program.

These amendments apply after August 27, 1995.

Clause 143

Child Tax Benefit – Agreements

ITA
122.63

Section 122.63 of the Act deals with agreements between the federal government and provinces regarding the basic amount of the child tax benefit. The reference to the Minister of National Health and Welfare has been deleted, applicable after August 27, 1995, as that

department will no longer have responsibility in respect of the child tax benefit program.

Clause 144

Child Tax Benefit – Communication of Information

ITA
122.64

Section 122.64 of the Act deals with the treatment of information obtained for the purposes of the child tax benefit.
Subsection 122.64(2) of the Act allows information obtained under the child tax benefit provisions or the *Family Allowances Act* to be provided to an official of the Department of National Health and Welfare for the purposes of certain stated acts.

Subsection 122.64(2) of the Act is amended to remove the reference to the *Children's Special Allowances Act* since the Minister of National Health and Welfare will no longer be responsible for the administration of that Act, and to add a reference to the *Family Allowances Act* to permit the disclosure of information obtained under that Act to the Minister of National Health and Welfare for the purpose of the administration of that Act. This provision is necessary since subsection 122.64(1) of the Act deems the information obtained under the *Family Allowances Act* to be obtained by the Minister of National Revenue, so that such information is protected under the confidentiality provisions of section 241 of the Act.

Subsection 122.64(2) is also amended to incorporate the wording from subsection 122.64(5) of the Act, which defines official as being within the meaning assigned by subsection 241(10) of the Act. As a consequence, subsection 122.64(5) is repealed.

These amendments apply after August 27, 1995.

Clause 145

Small Business Deduction

ITA
125

Section 125 of the Act provides a corporate tax reduction (called the "small business deduction") in respect of income of a Canadian-controlled private corporation (CCPC) from an active business carried on in Canada.

Subclause 145(1)

ITA
125(1)

Subsection 125(1) of the Act provides the basic rules for the calculation of a CCPC's small business deduction. The small business deduction is provided by way of an annual tax credit which is calculated as 16 per cent of the least of:

- a corporation's active business income for a taxation year;
- its taxable income for the year; and
- its business limit for the year (which is generally $200,000).

The small business deduction is intended to apply only to corporations that are CCPCs throughout the taxation year for which they are claiming the deduction. The amendment to subsection 125(1) simply corrects an error which occurred at the time subsection 125(1) was last amended (1988), thereby ensuring that this intention prevails. It is generally applicable to taxation years that end after June 1988.

Subclause 145(2)

ITA
125(7)
"Canadian-controlled private corporation"

Subsection 125(7) of the Act defines "Canadian-controlled private corporation", among other terms. This definition applies not only to the small business deduction under section 125 of the Act but also, through its incorporation by reference into subsection 248(1) of the Act, to the Act as a whole.

Currently, a corporation is a CCPC if it is a private corporation and a Canadian corporation (both of which terms are defined in subsection 89(1) of the Act), and it is not controlled, directly or indirectly in any manner whatever by one or any combination of public corporations (other than prescribed venture capital corporations) or non-resident persons. This amendment ensures that two other types of corporation are not CCPCs. The first type are corporations that, if they are not actually controlled by non-residents, avoid that status only because their shares are widely held. The second type are corporations the shares of which are listed on a foreign stock exchange. The following paragraphs describe in more detail how the amended definition applies to each of these cases.

A corporation the voting shares of which are distributed among a large number of persons is usually not considered to be controlled by any group of its shareholders, provided the shareholders do not act together to exercise control. As a result, it may be argued that a private Canadian corporation that is owned by a number of non-residents or public corporations is not controlled by non-residents or public corporations, and is thus a CCPC. New paragraph (*b*) of the CCPC definition clarifies that this is not the case. Paragraph (*b*) requires non-residents' and public corporations' shareholdings – not only of the corporation in question, but of all corporations – to be notionally attributed to one hypothetical person. If that person would control the corporation, then the corporation is not a CCPC.

Under the definition of "public corporation" in subsection 89(1) of the Act, a corporation the shares of which are listed on a prescribed Canadian exchange will usually be a public corporation, and thus not a CCPC. New paragraph (*c*) of the CCPC definition extends similar

treatment to corporations the shares of which are traded on foreign exchanges. Specifically, the paragraph provides that a corporation is not a CCPC if any of its shares are listed on any prescribed stock exchange (that is, either a Canadian exchange listed in Income Tax Regulation 3200 or a foreign exchange listed in Regulation 3201).

This amendment applies after 1995.

Subclause 145(3)

ITA
125(7)
"specified investment business"

A "specified investment business" carried on by a corporation is defined in subsection 125(7) of the Act in general terms as a business the principal purpose of which is to derive income from property and which does not employ more than five full-time employees.

Income from a "specified investment business" does not qualify for the small business deduction under section 125 of the Act. However, such income from Canadian sources is considered to be "Canadian investment income" under subsection 129(4.1) of the Act. The rules in section 129 of the Act allow for a tax refund for a corporation of up to 20 per cent of Canadian investment income on the payment of dividends by the corporation.

The definition "specified investment business" is amended, applicable to the 1995 and subsequent taxation years, to include a business carried on by a prescribed labour-sponsored venture capital corporation where the main purpose of the business is to derive income from property. This measure applies irrespective of the number of the employees of the corporation or of any corporation associated with it.

Section 6701 of the *Income Tax Regulations*, which provides the meaning of "prescribed labour-sponsored venture capital corporation" for a number of provisions of the Act, will be amended to apply for the purpose of the definition "specified investment business" in subsection 125(7).

Clause 145.1

Film or Video Production Services Tax Credit

ITA
125.5

New section 125.5 of the Act sets out the rules that apply for the purpose of computing a film or video production services tax credit. Generally, this new tax credit is available at a rate of 11 per cent of qualified Canadian labour expenditures incurred after October 1997 by an eligible production corporation for the production of an accredited film or video production. The application of these rules is more fully described in the commentary accompanying the following subsections.

ITA
125.5(1)

New subsection 125.5(1) of the Act provides definitions that apply for the purpose of new section 125.5.

"accredited film or video production certificate"

The term "accredited film or video production certificate" means a certificate issued in respect of a production by the Minister of Canadian Heritage certifying that the production is an accredited production.

An accredited film or video production certificate is required to be filed by an eligible production corporation with its return of income for a taxation year in which it claims a film or video production services tax credit under new subsection 125.5(3) of the Act. Reference should also be made to the commentary accompanying new subsection 125.5(6) of the Act, which provides that an accredited film or video production certificate in respect of a production may be revoked by the Minister of Canadian Heritage in certain circumstances.

"accredited production"

The definition "accredited production" has the meaning assigned by regulation. The regulations are to be amended to reflect that an accredited production is a film or video production the cost of which

- is in excess of $1 million; or

- in the case a production that has is part of a television series that has more than one episode, or is a pilot for such a series, is in excess of $100,000 for a production shorter than 30 minutes or in excess of $200,000 for any other production.

The regulations will also list the types of productions that are not eligible, including any production that is

(i) news, current events or public affairs programming, or a programme that includes weather or market reports,

(ii) a talk show,

(iii) a production in respect of a game, questionnaire or contest,

(iv) a sports event or activity,

(v) a gala presentation or awards show,

(vi) a production that solicits funds,

(vii) reality television,

(viii) pornography,

(ix) advertising, or

(x) a production produced primarily for industrial, corporate or institutional purposes.

Upon application from the owner of the copyright, the Minister of Canadian Heritage will certify those proposed productions that meet these requirements.

"assistance"

The definition "assistance" describes amounts that reduce the cost of a film or the amount of an otherwise "qualifying Canadian labour expenditure." Generally, all government assistance received in respect of an eligible production will reduce the related expenditure base for the film and video production services tax credit in the same manner as is currently the case under the regular investment tax credit program. Also, new subsection 125.5(4) of the Act clarifies that amounts paid as a tax credit under this section are also assistance received by the claimant.

"Canadian labour expenditure"

The definition "Canadian labour expenditure" describes the underlying expenditures of a corporation that will be eligible for the film or video production services tax credit. In the case of a corporation not eligible for the credit, its Canadian labour expenditure is deemed to be nil. In the case of a corporation that is an eligible production corporation for a taxation year, the corporation's Canadian labour expenditure for the taxation year in respect of an accredited production is, subject to new subsection 125.5(2) of the Act discussed below, the total of three amounts (paragraphs (*a*) to (*c*) of that definition), to the extent that they are reasonable in the circumstances.

Paragraph (*a*) of the definition "Canadian labour expenditure" is the total salary or wages (discussed below) directly attributable to the production that are incurred by the eligible production corporation after October 1997, in the taxation year of the corporation and paid by it in the year (or within 60 days after the end of the year) in respect of certain stages of the production. The eligible stages of production are those stages from the end of the final script stage to the end of the post-production stage. The commentary accompanying new paragraph 125.5(2)(*b*) of the Act lists those services that are considered to be post-production services.

Paragraph (*b*) of the definition "Canadian labour expenditure" refers to a portion of amounts paid by the eligible production corporation under contracts for services, i.e. as non-salaried remuneration. The eligible portion is the amount that

- is directly attributable to the accredited production;

- is paid in a taxation year (or within 60 days after the end of the year) by the eligible production corporation;
- is paid to a person or partnership that is carrying on a business in Canada through a permanent establishment; and
- relates to services rendered in Canada to the eligible production corporation after October 1997 and in the year, for the stages of production mentioned above (see the above discussion in respect of paragraph (*a*)).

Furthermore, the service provider must be one of the following persons:

- an individual resident in Canada who is not an employee of the eligible production corporation, to the extent to which the amount paid
  - is attributable to services personally rendered by the individual in Canada in respect of the accredited production, or
  - is attributable to and does not exceed the salary or wages of those of the individual's employees who were resident in Canada for personally rendering services in Canada for the production;
- a taxable Canadian corporation, to the extent the amount paid is attributable to and does not exceed the salary or wages of those of the other corporation's employees who are resident in Canada for personally rendering services in Canada for the production;
- a taxable Canadian corporation, all the shares of which belong to an individual resident in Canada and the activities of which consist principally of the provision of the individual's services, to the extent the amount paid is attributable to services rendered personally in Canada by the individual for the production;
- a partnership, to the extent to which the amount paid
  - is attributable to services personally rendered in Canada by an individual resident in Canada who is a member of the partnership, for the production of the property, or

- is attributable to and does not exceed the salary or wages of the partnership's employees for personally rendering services for the production.

Paragraph (*c*) of the definition "Canadian labour expenditure" provides a mechanism under which a subsidiary wholly-owned corporation can obtain credit for a Canadian labour expenditure by reimbursing its parent for expenditures incurred by the parent in a particular year of the parent in respect of the corporation's production, if certain conditions are met. In particular, the expenditure reimbursed to the parent must be an expenditure that would have otherwise been a Canadian labour expenditure of the eligible production corporation for the particular year if

- the eligible production corporation had such a particular year, and

- the expenditure were incurred by the eligible production corporation for the same purpose as it was by the parent and were paid at the same time and to the same person or partnership as it was by the parent (i.e. those expenditures which previously earned the credit).

"eligible production corporation"

The definition "eligible production corporation" means a corporation that, in the year, carries on through a permanent establishment (as defined by regulation) in Canada a business that is primarily a film or video production business, or production services business.

Specifically excluded are prescribed labour-sponsored venture capital corporations, tax-exempt corporations and corporations controlled by one or more tax-exempt persons. Furthermore, the corporation must either

- own the copyright in the film for which a claim is being made, or

- have contracted directly with the owner of the copyright (where the owner itself is not an eligible production corporation).

"qualified Canadian labour expenditure"

The definition "qualified Canadian labour expenditure" is the portion of an eligible corporation's Canadian labour expenditures upon which it can claim an 11-per-cent investment tax credit in respect of an accredited production (explained above). Generally, the definition "qualified Canadian labour expenditure" means the amount in respect of the accredited production by which the aggregate of Canadian labour expenditures in the current and preceding taxation years exceeds

- the total assistance attributable to those expenditures that the corporation or any other person or partnership has received, is entitled to receive, or can reasonably expect to receive, at the time of filing the corporation's return of income for the year, that has not been repaid before that time pursuant to a legal obligation to do so;

- the total of all such amounts which are, where the eligible production corporation is a parent, subject to an agreement under which a wholly-owned subsidiary claims it as a "Canadian labour expenditure" in respect of the accredited production; and

- the total of qualified Canadian labour expenditures for preceding years which ended after the principle filming or taping began.

"salary or wages"

The definition "salary or wages", which is generally defined in subsection 248(1) of the Act, does not include for the purposes of this credit an amount described in section 7 of the Act (share option benefits) or any amount determined by reference to profits or revenues.

Subsection 125.5(1) applies to taxation years that end after October 1997.

ITA
125.5(2)

New subsection 125.5(2) of the Act provides special rules that apply for the purpose of applying the definition "Canadian labour

expenditure" in subsection 125.5(1) of the Act.
Paragraph 125.5(2)(*a*) of the Act provides that remuneration does not include remuneration determined by reference to profits or revenues. A similar rule is found in the definition "salary or wages", as discussed above.

Paragraph 125.5(2)(*b*) of the Act provides that the services referred to in paragraph (*b*) of the definition "Canadian 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 duties. In particular, these services are the duties of an animation cameraman, assistant colourist, assistant mixer, assistant sound-effects technician, boom operator, colourist, computer graphics designer, cutter, developing technician, dubbing technician, encoding technician, inspection technician – clean up, mixer, optical effects technician, picture editor, printing technician, projectionist, recording technician, senior editor, sound editor, sound-effects technician, special effects editor, subtitle technician, timer, video-film recorder operator, videotape operator or by a person who performs a prescribed duty.

Paragraph 125.5(2)(*c*) of the Act ensures that a film or video production services tax credit will not be claimed in respect of amounts claimed as expenditures in respect of scientific research and experimental development.

Paragraph 125.5(2)(*d*) of the Act clarifies that Canadian labour expenditures do not include amounts that are not production costs, such as costs of marketing, advertising, promotion, market research, or any cost related in any way to some other production.

This subsection applies to taxation years that end after October 1997.

ITA
125.5(3)

New subsection 125.5(3) of the Act provides that, where an eligible production corporation that produces an accredited production has satisfied certain conditions, the 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 11 per cent of its qualified Canadian labour

expenditures for the year in respect of the production. The conditions that an eligible production corporation must satisfy are that

- it files with its return of income for the taxation year
  - an accredited film or video production certificate issued in respect of an accredited production, and
  - a prescribed form containing prescribed information; and
- the principal filming or taping of the production began before the end of the year.

For a description of many of the terms referred to in new subsection 125.5(3), reference may be made to the commentary accompanying new subsection 125.5(1) of the Act.

This subsection applies to taxation years that end after October 1997.

ITA
125.5(4)

New subsection 125.5(4) of the Act provides that a film or video production services tax credit may not be claimed in respect of a Canadian film or video production for which a credit is claimed pursuant to section 125.4 of the Act.

This subsection applies to taxation years that end after October 1997.

ITA
125.5(5)

New subsection 125.5(5) of the Act provides that the amount of tax that a corporation is considered to have paid under subsection 125.5(3) of the Act for a taxation year is considered to be assistance received by the corporation from a government immediately before the end of the year (other than for the purpose of claiming the film production tax credit).

This subsection applies to taxation years that end after October 1997.

ITA
125.5(6)

New subsection 125.5(6) of the Act provides that an accredited film or video production certificate in respect of a production may be revoked by the Minister of Canadian Heritage. A revocation of a certificate may occur in circumstances where an incorrect statement is made for the purposes of obtaining the certificate or the production is not an accredited production. A revoked certificate is considered never to have been issued for the purposes of claiming a film or video production services tax credit under new subsection 125.5(3) of the Act. For additional information on this matter, see the commentary accompanying amended paragraph 152(1)(*b*) of the Act.

This subsection applies to taxation years that end after October 1997.

Clause 146

Investment Tax Credit

ITA
127(9)
"specified percentage"

Subsection 127(9) of the Act provides definitions for terms that are used in the provisions relating to the ITC.

The definition "specified percentage" in subsection 127(9) sets out the relevant rates at which investment tax credits are earned in different circumstances.

Paragraph (*f*) of the definition permits an investment tax credit to be earned by the repayment of government assistance, non-government assistance or contract payments that reduced the cost of property under paragraph (11.1)(*b*), the amount of an expenditure under paragraph (11.1)(*c*) or (*e*), or the prescribed proxy amount of the taxpayer under paragraph (11.1)(*f*).

Paragraph (*f*) of the definition is amended consequential on the repeal of paragraphs (11.1)(*c*), (*e*) and (*f*) effective for taxation years beginning after 1995. Those paragraphs were replaced by

subsections 127(11.5) and (18) to (20) of the Act. The definition is, therefore, further amended by the addition of new paragraph (*f*.1) consequential on the introduction of basis reductions in subsections 127(18) to (20) and the additions to the ITC in respect of repayments of those amounts in paragraphs (*e*.1) and (*e*.2) of the definition "investment tax credit".

For more information on those amendments, please see the Explanatory Notes to the February 27, 1995 budget amendments, which were released in December, 1995.

This amendment applies to taxation years that begin after 1995.

Clause 147

Refundable Investment Tax Credit

ITA
127.1(1)

Subsection 127.1(1) of the Act allows a taxpayer to claim a refundable investment tax credit for a taxation year.

At present, a trustee in bankruptcy required to file an income tax return under paragraph 128(2)(*e*) of the Act may not claim a refundable investment tax credit under subsection 127.1(1) of the Act. Subsection 127.1(1) of the Act provides that a taxpayer's refundable investment tax credit, to the extent so designated by the taxpayer, is deemed to be paid on account of the taxpayer's tax for the year under Part I as of the date of filing the return for the year or a prescribed form amending a prior year's return. This amendment to subsection 127.1(1) provides that the payment will be deemed to have been made on the day that the taxpayer is required to pay the balance of the estimated taxes for the year. This will allow the deemed payment to be taken into account in determining the interest on arrears of taxes payable under other Parts of the Act. This amendment applies to taxation years that end after February 22, 1994.

Paragraph 127.1(1)(*a*) of the Act is amended to add a reference to paragraph 128(2)(*f*) of the Act and to delete the reference to paragraph 128(2)(*e*) of the Act. Accordingly, for taxation years

that begin after April 26, 1995, an individual who is bankrupt during a taxation year and who is required to file an income tax return under 128(2)(*f*) may not claim a refundable investment tax credit under subsection 127.1(1). The trustee in bankruptcy for the individual may, however, make such a claim for those years.

Clause 148

Part XII Tax Credit

ITA
127.41(1)(*a*)

Section 127.41 of the Act provides a refundable tax credit to beneficiaries of a mining reclamation trust, recognizing that trust income is subject to a tax under Part XII.4 of the Act and is also allocated to one or more beneficiaries income under subsection 107.3(1) of the Act. The amount of the tax credit is, under paragraph 127.41(1)(*a*) of the Act, normally based on a beneficiary's pro-rata share of Part XII.4 tax. However, where a beneficiary of a mining reclamation trust is a partnership, under paragraph 127.41(1)(*b*) of the Act members of the partnership are allowed a tax credit equal to a pro-rata share of the Part XII.4 tax credit to which the partnership would be entitled if it were a person.

Paragraph 127.41(1)(*a*) is amended so that partnership losses are, for the purposes of calculating the component of the tax credit under paragraph 127.41(1)(*a*), treated in a parallel fashion to partnership income. Consequently, neither partnership income nor partnership losses have any bearing on the calculation of the portion of the tax credit determined under paragraph 127.41(1)(*a*). The amendment is of relevance only in cases where a taxpayer is a direct beneficiary in one mining reclamation trust and an indirect beneficiary (through a partnership) in another mining reclamation trust.

This amendment applies to taxation years that end after February 22, 1994.

Clause 149

Minimum Tax

ITA
127.5

Section 127.5 of the Act levies the minimum tax payable by an individual under Part I for a taxation year.

Section 127.5 is amended as a consequence of the enactment of new paragraph 127.55(*f*) of the Act. For additional details see the commentary on that paragraph.

This amendment applies to the 1992 and subsequent taxation years.

Clause 150

Minimum Tax – Adjusted Taxable Income

ITA
127.52

Section 127.52 of the Act defines the "adjusted taxable income" of an individual for a taxation year for the purposes of determining any minimum tax liability under Division E.1 of Part I of the Act.

Subclauses 150(2), (3) and (5)

ITA
127.52(1)

Subsection 127.52(1) of the Act defines the "adjusted taxable income" of an individual for a taxation year as the amount that would be the individual's taxable income for that year if the assumptions set out in paragraphs 127.52(1)(*a*) to (*j*) were made. A number of amendments are being made to this subsection.

First, subsection 127.52(1) is amended to extend its application to:

- certain losses deducted by a limited partner, a member of a partnership who has been a specified member since becoming a partner, or a partner for whose interest an identification number is required to be, or has been, obtained under section 237.1. For this purpose, losses allocated from a partnership are netted against gains from the same partnership source – that is allowable capital losses of the partnership against taxable capital gains of the partnership; business losses of the partnership against taxable capital gains of the partnership arising from the disposition of property used in the business; and property losses of the partnership against taxable capital gains of the partnership arising from the disposition of property held to earn income from property;

- losses deducted in respect of investments identified or required to be identified under the tax shelter identification rules; and

- carrying charges in respect of investments described above as well as those described in paragraphs 127.52(1)(*b*), (*c*) and (*e*), which relate to deductible amounts in respect of rental/leasing property, film property and resource-related deductions.

An exception is provided for limited partnership losses incurred in the year in which the partnership is wound up. Subsection 127.52(1) does not apply to any portion of such losses that is allocated to a partner.

These amendments apply to taxation years of an individual that begin after 1994.

Subsection 127.52(1) is also amended, applicable to the 1994 and 1995 taxation years, by adding new paragraph 127.52(1)(*h*.1). This paragraph is consequential on the addition of paragraph 110.6(21)(*a*) to the Act. It ensures that the portion of the gain from the deemed disposition of non-qualifying real property under subsection 110.6(19) that is not eligible for the capital gains exemption will be excluded from the adjusted taxable income computation in subsection 127.52(1). Subsection 110.6(21) ensures that the tax on that portion of the gain that is not so eligible is deferred until a subsequent taxable disposition. Similarly, on such a subsequent

disposition that gain will be included in the adjusted taxable income computation.

Paragraph 127.52(1)(*i*) provides rules that apply to an individual's losses arising in another taxation year that are relevant in the year in which the individual is computing "adjusted taxable income" for minimum tax purposes. Paragraph 127.52(1)(*i*) is amended to ensure that such losses from another taxation year are computed on the basis of the wording of subsection 127.52(1) as it reads for that year. These amendments generally apply to taxation years of an individual that begin after 1994, except that the amendment of paragraph 127.52(l)(*i*) of the Act applies after December 1, 1994 to any taxation year.

Clause 127.52(1)(*i*)(ii)(B) is also amended to include the full amount of net capital losses incurred before 1986 in the calculation of an individual's adjusted taxable income. This amendment generally applies in determining an individual's adjusted taxable income for taxation years that begin after 1994.

Subclause 150(6)

ITA
127.52(2)

Subsection 127.52(2) of the Act provides a special rule that applies where an individual has invested in a partnership that owns a residential building or a certified Canadian film production. For the purpose of computing adjusted taxable income under the minimum tax, the individual is treated as having claimed capital cost allowance claimed by the partnership in the same proportion as the individual's share of the partnership income.

Subsection 127.52(2) is amended to apply to any amount deductible in computing the income or loss of a partnership. Where an amount deductible by a partnership is relevant for the purpose of computing the adjusted taxable income of an individual who is a member of the partnership, the individual is treated as having claimed the partnership's deductible amounts in the same proportion as the individual's share of the partnership income or loss.

This amendment applies to taxation years of an individual that begin after 1994.

Subclause 150(7)

Specified Member of a Partnership

ITA
127.52(2.1)

New subsection 127.52(2.1) of the Act provides an anti-avoidance rule that applies where one of the main reasons that a member of a partnership was not a specified member of the partnership since becoming a member of the partnership is to avoid the application of the "adjusted taxable income" computation under section 127.52 of the Act in respect of determining an individual's minimum tax for a year.

In such cases, the member shall be considered to have been a specified member of the partnership at all times since becoming a member of the partnership. This subsection applies after April 26, 1995.

Subclauses 150(8) and (9)

ITA
127.52(3)

Subsection 127.52(3) of the Act defines the terms "film property" and "residential property" for the purpose of computing an individual's adjusted taxable income under the minimum tax. Subsection 127.52(3) is amended to repeal the definition "residential property" and to add the definitions "limited partner" and "rental or leasing property".

These amendments apply to taxation years of an individual that begin after 1994.

Example of Application of Section 127.52 of the Act

EXAMPLE A:

Regular Part I Computation of Taxable Income		***Section 127.52 Computation of Taxable Income***	
Facts concerning the individual's share of income and losses of the limited partnership.	*Income computation ignoring Minimum Tax*	*Income computation for purposes of Minimum Tax*	*Reason for adjustment*
Business Loss before CCA	*($9,500)*	*($8,000)*	*The 127.52(1)(c.1)(ii) limit on the loss is lesser of:* *A: 9,500 (amount of loss); and B:* ***8,000*** *(amount of 8,000 business tcgs in excess of nil acls)*
Loss calculated as a result of CCA from business of producing a film	*($500)*	*$0*	*127.52(1)(c) eliminates the CCA which is relevant for the purpose of determining the limit imposed by 127.52(1)(c.1)(ii)(B)*
Taxable capital gain from disposition of property used in above-noted business	*$6,000*	*$8,000*	*127.52(1)(d)*
Taxable capital gain from disposition of other partnership (non-business) property	*$9000*	*$12,000*	*127.52(1)(d)*
Individual's Taxable Income	*$5,000*	*$12,000*	*There is a $7,000 adjustment for Minimum Tax purposes*

EXAMPLE B:

Regular Part I Computation of Taxable Income		***Section 127.52 Computation of Taxable Income***	
Facts concerning the individual's share of income and losses of the limited partnership.	*Income computation ignoring Minimum Tax*	*Income computation for purposes of Minimum Tax*	*Reason for adjustment*
Business Loss before CCA	*($9,500)*	*$0*	*The 127.52(1)(c.1)(ii) loss limit is lesser of:* *A: 9,500 (amount of loss);* *B:* ***Nil*** *(amount of 8,000 business tcgs in excess of 8,000 acls)*
Loss calculated as a result of CCA from business of producing a film	*($500)*	*$0*	*127.52(1)(c) eliminates the CCA which is relevant for the purpose of determining the limit imposed by 127.52(1)(c.1)(ii)(B)*
Taxable capital gain from disposition of property used in above-noted business	*$6,000*	*$8,000*	*127.52(1)(d)*
Allowable capital loss from disposition of other partnership (non-business) property	*($6,000)*	*($8,000)*	*127.52(1)(d); the loss limit in 127.52(1)(1c.)(i) is the lesser of:* *A: 20,000 (amount of tcgs:12K+8k);* *B:* ***8,000*** *(amount of loss)*
Taxable capital gain from disposition of other partnership (non-business) property	*$9,000*	*$12,000*	*127.52(1)(d)*
Individual's Taxable Income	*($1,000)*	*$12,000*	*There is a $13,000 adjustment for Minimum Tax purposes*

Clause 151

Minimum Tax – Exceptions

ITA
127.55

Section 127.55 of the Act exempts individuals from the minimum tax in certain limited circumstances.

Section 127.5 of the Act previously exempted certain related segregated fund trusts and mutual fund trusts from the application of the minimum tax. These exemptions are now included in new paragraph 127.55(*f*), which also applies to a trust prescribed to be a master trust under section 5001 of the *Income Tax Regulations*. One of the conditions that a master trust must satisfy is that each of its beneficiaries must be a trust governed by a registered pension plan or a deferred profit sharing plan.

This amendment applies to the 1992 and subsequent taxation years.

Clause 152

Bankrupt Individuals

ITA
128(2)

Subsection 128(2) of the Act contains rules that apply to individuals who become bankrupt.

Under paragraph 128(2)(*d*) of the Act, where an individual becomes bankrupt in a calendar year, a taxation year of the individual is deemed to have ended on the day before the bankruptcy and a new taxation year of the individual is deemed to have begun on the day of the bankruptcy.

In the calendar year in which the individual becomes bankrupt, a number of income tax returns must be filed by, or on behalf of, the individual:

- a return to be filed for the taxation year that ends on the day before the bankruptcy;

- a return to be filed under paragraph 128(2)(*e*) of the Act by the trustee in bankruptcy with respect to certain income of the estate and business of the individual for each taxation year in that calendar year; and

- a separate return to be filed by the individual for the taxation year that begins on the day of bankruptcy.

For each subsequent calendar year during which the individual is bankrupt, the trustee and the individual are each required to file an income tax return in respect of the income of the individual.

A number of the rules set out in subsection 128(2) prevent double reporting of income and double deducting of amounts in computing taxable income and tax payable for a taxation year. In particular, these rules:

- allocate the income of the individual for a year between the returns that are to be filed by the trustee and the individual;

- limit certain deductions that may be made by the trustee and the individual in computing taxable income for the year; and

- limit certain deductions that may be made by the trustee and the individual in determining the tax payable for the year.

Further, paragraph 128(2)(*g*) of the Act sets a restriction on losses that might otherwise be carried forward under section 111 of the Act after the individual is absolutely discharged from bankruptcy.

Subsection 128(2) is amended to expand these rules effective for bankruptcies that occur after April 26, 1995.

The amendments to subsection 128(2) are part of a package of amendments relating to bankruptcies. Other changes include the introduction of new section 118.61 of the Act dealing with the carry-over of unused tuition fee and education tax credits, new section 118.95 of the Act dealing with the proration of personal tax credits, an amendment to section 120.2 of the Act dealing with

minimum tax carry-over, amendments to sections 122.5 and 122.61 of the Act dealing with the Goods and Services Tax Credit and Child Tax Benefit, and an amendment to 127.1 of the Act dealing with the refundable investment tax credit.

Subclause 152(1)

ITA
128(2)(*e*)

A trustee in bankruptcy for a bankrupt individual is currently required under paragraph 128(2)(*e*) of the Act to file an income tax return on behalf of the bankrupt individual as if:

- the only income of the individual for a taxation year were the income for the year arising from dealings in the estate or the carrying on of a business of the bankrupt by the trustee;

- the individual were not entitled to deduct any amount under Division C (computation of taxable income) for the year except under section 111 of the Act (loss carry-overs); and

- the individual were not entitled to deduct any amount under sections 118 to 118.3, 118.5, 118.6, 118.61, 118.8 and 118.9 of the Act (various credits and deductions available to individuals).

Subparagraph 128(2)(*e*)(ii) of the Act is amended to allow the trustee in bankruptcy to deduct amounts under paragraphs 110(1)(*d*), (*d*.1), (*d*.2) and (*d*.3) (stocks options, etc.) and section 110.6 (capital gains exemption) in Division C of the Act in computing taxable income of the individual. Any such deduction must be in respect of an amount that the trustee is required to include in income under subparagraph 128(2)(*e*)(i) of the Act.

Subparagraph 128(2)(*e*)(ii) is further amended to allow the trustee to deduct under section 111 of the Act (loss carry-overs) an amount in respect of losses of the bankrupt, such as capital losses, non-capital losses and limited partnership losses, arising in taxation years that end before the bankrupt is absolutely discharged from bankruptcy. Losses referred to in section 111 for taxation years ending after the bankrupt is absolutely discharged from bankruptcy cannot be carried back to be

applied against the income of the bankrupt for any taxation year that ends before the bankrupt is so discharged.

Subparagraph 128(2)(*e*)(iii) of the Act is amended to allow the trustee to deduct an amount under section 118.1 (charitable gifts) with respect to gifts made by the bankrupt before the individual became bankrupt.

Subparagraph 128(2)(*e*)(iii) is also amended to limit the deduction under subsection 127(5) of the Act (investment tax credits) in computing tax payable. This amendment restricts the carrying back of investment tax credits arising from expenditures incurred or properties acquired in taxation years ending after the bankrupt is absolutely discharged.

The amendments to paragraph 128(2)(*e*) apply to bankruptcies that occur after April 26, 1995.

Subclause 152(2)

ITA
128(2)(*f*)

An individual who is bankrupt at any time in a taxation year is required under paragraph 128(2)(*f*) of the Act to file an income tax return for the year. This return is in addition to the return that is required under paragraph 128(2)(*e*) of the Act to be filed by the trustee in bankruptcy on behalf of the individual for the same taxation year. Paragraph 128(2)(*f*) of the Act is amended to deny the bankrupt individual a deduction under section 118.61 of the Act (carryforward of unused tuition and education tax credits). However, the trustee may claim a deduction under that section in the return filed under paragraph 128(2)(*e*). For further details on the carryforward of unused tuition and education tax credits, reference may be made to the commentary on section 118.61 of the Act.

This amendment applies to the 1997 and subsequent taxation years.

Subclause 152(3)

ITA
128(2)(*g*)

Paragraph 128(2)(*g*) of the existing Act prohibits an individual who is discharged absolutely from bankruptcy from deducting under section 111 of the Act losses carried forward from taxation years that ended before the individual's discharge, as well as certain amounts in computing the individual's tax payable. Paragraph 128(2)(*g*) is amended to restrict the individual from deducting an amount under section 118.61 (carryforward of unused tuition and education tax credits) in respect of the individual's unused tuition and education tax credits at the end of the last taxation year that ended before the bankruptcy. For further details on the carryforward of unused tuition and education tax credits, reference may be made to the commentary on section 118.61 of the Act.

This amendment applies to the 1997 and subsequent taxation years.

Subclause 152(4)

ITA
128(3)

Subsection 128(3) of the Act provides that, in section 128 of the Act, the terms "bankrupt" and "estate of the bankrupt" have the meanings assigned by the *Bankruptcy and Insolvency Act*. As recent amendments to the Act (in Bill C-70) added these same definitions to section 248 of the Act, subsection 128(3) is no longer required, and is therefore repealed. The repeal of subsection 128(3) applies to bankruptcies that occur after April 26, 1995.

Clause 153

Immigration – Paid-Up Capital

ITA
128.1(2)

Subsection 128.1(2) of the Act applies a formula to adjust the paid-up capital of the shares of a corporation that becomes resident in Canada. As a consequence of changes to Part XIV of the Act, a reference (in paragraph (*c*) of the description of the variable C in the formula) to paragraph 219(1)(*h*) of the Act is replaced with a reference to paragraph 219(1)(*j*) of the Act.

This amendment generally applies to taxation years that begin after 1995. Since the existing reference to paragraph 219(1)(*h*) of the Act may remain relevant for taxation years that begin in 1996, a transitional version of the amendment leaves both references in place for such taxation years.

Clause 154

Dividend Refund

ITA
129(1)(*b*)

If a corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "dividend refund" upon issuing the assessment of tax for the year, paragraph 129(1)(*b*) of the Act allows the corporation to make an application for the refund within the period determined under paragraphs 152(4)(*b*) or (*c*) of the Act within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 129(1)(*b*) are strictly consequential on the amendments to subsection 152(4) of the Act and effect no substantive changes to this provision. Amended paragraph 129(1)(*b*) applies after April 27, 1989.

Clause 155

Investment Corporations

ITA
130

Section 130 of the Act sets out special rules relating to the taxation of investment corporations.

Subclause 155(1)

Application of ss. 131(1) to (3.2) and (6)

ITA
130(2)

As a flow-through vehicle, an investment corporation can pass its capital gains on to its shareholders in the form of capital gains dividends. Such dividends are treated as capital gains in the hands of the shareholders, while the corporation receives a refund of the tax it paid on the gains. This special treatment is made available by subsection 130(2) of the Act, which adapts the capital gains dividend rules for mutual fund corporations (subsections 131(1) to (3.2) of the Act) to investment corporations.

In its current form, subsection 130(2) applies to a corporation that was throughout a taxation year an investment corporation other than a mutual fund corporation. As a result, a corporation that is an investment corporation throughout a taxation year, but that becomes a mutual fund corporation part-way through the year, may lose its entitlement to capital gains dividend treatment. This amendment, which applies to the 1993 and subsequent taxation years, prevents that inappropriate result. The amendment also ensures that the relevant definitions in subsection 131(6) of the Act apply for the purposes of subsection 130(2).

Subclause 155(2)

ITA
130(3)(*a*)

Paragraph 130(3)(*a*) of the Act sets out the conditions under which a corporation is considered to be an investment corporation. Among those conditions is, in subparagraph 130(3)(*a*)(vii) of the Act, a requirement that no shareholder hold more than 25 per cent of the shares of the corporation. This amendment expands that rule. In effect, a person will be considered for the purpose of the 25-per-cent test to own not only any shares that person actually owns, but also (1) any shares owned by persons with whom that person does not deal at arm's length, and (2) a proportionate number of any shares held by a trust or partnership of which that person is a beneficiary or member.

More specifically, under new subparagraph 130(3)(*a*)(vii.1) of the Act, a corporation will be an investment corporation only if no person acquiring shares of the corporation after June 20, 1996 would be a specified shareholder of the corporation if the definition "specified shareholder" in subsection 248(1) of the Act were modified in two ways: first, if the references to "not less than 10 per cent" were read as "more than 25 per cent;" and second, if that test applied only in respect of the shares of the corporation itself (rather than also in respect of the shares of corporations related to it).

This amendment applies to taxation years that begin after June 20, 1996. A significant exception applies to corporations that were investment corporations on June 20, 1996 and that had one or more shareholders (called "existing 26-per-cent specified shareholders" in these notes) who would otherwise violate the new 25-per-cent specified shareholding test. In such a case, the application of amended subparagraph 130(3)(*a*)(vii) in respect of the corporation and a given 26-per-cent specified shareholder (as well as persons related to that shareholder) will depend on what happens to the share ownership and capitalization of the corporation after June 20, 1996.

As long as an existing 26-per-cent specified shareholder (and any person who does not deal at arm's length with such a shareholder) does not acquire additional shares of the corporation, or contribute additional capital to it, amended subparagraph 130(3)(*a*)(vii) does not

apply in respect of the shareholder's interest in the corporation. Assuming it meets the Act's other requirements, the corporation can remain an investment corporation.

If, after June 20, 1996 and before the end of a given taxation year, an existing 26-per-cent specified shareholder contributes capital to the corporation or acquires additional shares of the corporation, amended subparagraph 130(3)(*a*)(vii) will apply for that and subsequent taxation years, in respect of the shareholder's investment in the corporation. However, this basic rule, in subclause 155(5) of this bill, is overridden in certain cases by subclause 155(8) of this Act. Those cases are essentially the acquisition of shares that have been held continuously since June 20, 1996 by related persons, and the acquisition of shares as stock dividends. These are described in more detail below.

An existing 26-per-cent specified shareholder who buys a share in the market or from treasury will thus cause the corporation not to be an investment corporation, if the shareholder's direct and indirect interest totals over 25 per cent at any time in the year. On the other hand, if before the end of a given year the shareholder has acquired shares only as stock dividends or from related persons, subclause 155(8) of this bill provides that the amended version of subparagraph (vii) is to be read in a special manner for that year. Instead of limiting the shareholder's shareholding to 25 per cent, it will limit it to the greatest percentage of the shares of any class of the corporation's stock that were held at the end of June 20, 1996 by the existing 26-per-cent specified shareholder and non-arm's length persons.

Subclause 155(6) of this bill provides for situations in which a person becomes related to an existing 26-per-cent specified shareholder after June 20, 1996. Such "newly-related persons" (defined in subclause 155(7) of this bill) will not themselves be existing 26-per-cent specified shareholders, and will thus not be covered by subclauses 155(5) and (8). However, subclause 155(6) applies amended subparagraph 130(3)(*a*)(vii) of the Act to the corporation if a newly-related person either contributes capital to it or holds a share of it (whether directly or indirectly).

Three additional details of these special rules should be noted. First, the class of related persons from whom an existing 26-per-cent specified shareholder may acquire a share under subclause 155(8) of

this bill includes only persons who were related to the shareholder both on June 20, 1996 and at every time (after that date) at which they held the share. This means, for example, that an existing 26-per-cent specified shareholder who marries in 1997 cannot acquire additional shares from her or his new spouse without invoking the ordinary version of subparagraph 130(3)(*a*)(vii), even though the spouse is related to the shareholder when the shares are transferred. It also means, however, that every person who holds a share between June 20, 1996 and the time it is acquired by an existing 26-per-cent specified shareholder need not remain related to the shareholder throughout, as long as they were related on June 20, 1996 and while the person held the share.

Second, subclause 155(8) of this bill includes a special provision with respect to shares that are issued by the corporation to a person related to an existing 26-per-cent specified shareholder, and are then transferred by that person to the shareholder. Such shares are in effect treated in the same way as shares that existed on June 20, 1996.

Finally, subclause 155(9) of this bill makes special provision for partnerships and trusts. Where a trust that existed on June 20, 1996 distributes a share to a person who has been a beneficiary since that date, in satisfaction of that person's capital interest in the trust, the share is deemed for the purposes of these rules to have been owned by the beneficiary during the period from the later of June 20, 1996 and the time the trust last acquired the share, until the time the beneficiary acquires it. This ensures that the beneficiary, who has simply acquired a share in which the beneficiary already had a beneficial interest, will not be treated as having acquired a share that was owned by an unrelated person.

Similar treatment is given in respect of a share (or an interest in a share) that a partnership that ceases to exist distributes to a person who has been a member of the partnership since June 20, 1996.

The definition "specified shareholder" in subsection 248(1) of the Act treats a trust beneficiary as owning some or all of any shares held by the trust, and a member of a partnership as owning a proportionate number of any shares held by the partnership. The final provision in the coming-into-force rules for the amendment to subparagraph 130(3)(*a*)(vii) extends this deeming principle to the

acquisition of the share. That is, a person who is a trust beneficiary or a partner and who is therefore deemed to own a share is also deemed to have acquired the share, at the later of the time the trust or partnership acquired it and the time the person last became a beneficiary of the trust or member of the partnership. This ensures that share acquisitions by the trust or partnership are appropriately included in determining the person's interest in the corporation.

Clause 156

Definition of Mortgage Investment Corporation

ITA
130.1(6)

Section 130.1 of the Act sets out rules that apply to mortgage investment corporations and their shareholders. Subsection 130.1(6) defines "mortgage investment corporation" for these purposes.

Subparagraph 130.1(6)(*f*)(i) of the Act refers to "residential property" as defined in the *Residential Mortgage Financing Act*. That Act, which defined "residential property" by reference to definitions contained in the *National Housing Act*, was repealed in 1993. This amendment to subparagraph 130.1(6)(*f*)(i) therefore replaces the term "residential property" with the corresponding terms in the *National Housing Act*, so that the substance of the paragraph remains unchanged.

This amendment applies as of June 23, 1993, the date on which the *Residential Mortgage Financing Act* was repealed.

Clause 157

Mutual Fund Corporations

ITA
131

Section 131 sets out rules relating to the taxation of mutual fund corporations and their shareholders.

Subclause 157(1)

ITA
131(2)(*b*)

If a mutual fund corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "capital gains refund" upon issuing the assessment of tax for the year, paragraph 131(2)(*b*) of the Act allows the corporation to make an application for the refund within the period determined under paragraph 152(4)(*b*) or (*c*) of the Act within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 131(2)(*b*) are strictly consequential on the amendments to subsection 152(4) of the Act and effect no substantive changes to this provision. Amended paragraph 131(2)(*b*) applies after April 27, 1989.

Subclause 157(2)

Dividend Refund to Mutual Fund Corporation

ITA
131(5)

Subsection 131(5) of the Act treats a mutual fund corporation as a private corporation for the purposes of the refundable tax imposed under Part IV of the Act on private and certain other ("subject") corporations.

This amendment makes two changes to subsection 131(5). First, it simplifies the description of a mutual fund corporation's refundable dividend tax on hand (RDTOH). Second, it restructures the provision to ensure that a mutual fund corporation does not lose access to its RDTOH if it becomes an investment corporation, or if it has ceased to be a subject corporation.

The amendment applies to the 1993 and subsequent taxation years.

Subclause 157(3)

ITA
131(8)

Subsection 131(8) of the Act sets out the definition of "mutual fund corporation".

The definition is amended so that "interests" in real property, as defined by subsection 248(4) of the Act, are treated in the same manner as real property for the purposes of determining whether a corporation is a mutual fund corporation. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

This amendment applies to the 1994 and subsequent taxation years.

Clause 158

Mutual Fund Trusts

ITA
132

Section 132 contains special rules relating to the taxation of mutual fund trusts.

Subclause 158(1)

ITA
132(1)(*b*)

If a mutual fund trust has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid a "capital gains refund" upon issuing the assessment of tax for the year, paragraph 132(1)(*b*) of the Act allows the trust to make an application for the refund within the period determined under paragraph 152(4)(*b*) or (*c*) of the Act within which the Minister can reassess tax payable by the trust for the year. The amendments to paragraph 132(1)(*b*) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes

to this provision. Amended paragraph 132(1)(*b*) applies after April 27, 1989.

Subclauses 158(2) and (3)

Meaning of "Mutual Fund Trust"

ITA
132(6)

Subsection 132(6) of the Act sets out the definition of "mutual fund trust". Under the definition, if a trust becomes a mutual fund trust on or before the day on which it must file its return for its first taxation year, it can elect to be deemed to have been a mutual fund trust from the start of its first taxation year to the day on which it first met the requirements. Consequential to the addition of new subsection 132(6.1) of the Act, the portion of subsection 132(6) providing the election is repealed.

The definition is also amended so that "interests" in real property, as defined by subsection 248(4) of the Act, are treated in the same manner as real property for the purposes of determining whether a trust is a mutual fund trust. Under subsection 248(4), an "interest" in real property includes a leasehold interest in real property.

These amendments apply to the 1994 and subsequent taxation years.

Subclause 158(4)

Election to be Mutual Fund

ITA
132(6.1)

New subsection 132(6.1) of the Act provides that where a trust becomes a mutual fund trust at any time before the 91st day after the end of the calendar year in which it was created and the trust elects in its first return of income under Part I, the trust is treated as having been a mutual fund trust from the day it was created. The subsection replaces the election previously available under subsection 132(6) of the Act which required that a trust make such an

election on or before its balance due date for its first taxation year. The amendment applies to the 1994 and subsequent taxation years.

Clause 159

Mutual Fund Reorganizations

ITA
132.2(1)

Section 132.2 of the Act provides for "qualifying exchanges" between mutual funds. In a qualifying exchange, one mutual fund transfers all or substantially all of its property to another mutual fund, and takes back units of the transferee fund. The transferor fund's investors then exchange their shares or units of the transferor for those units of the transferee fund. Both sets of transactions take place on a tax-deferred or "rollover" basis. The qualifying exchange thus allows two mutual funds to be merged with no immediate tax consequence.

Section 132.2 is amended in three respects. First, a new paragraph is inserted (amended paragraph (*p*)) to ensure the appropriate computation of the transferor and transferee fund's capital gains redemptions under subsection 131(6) or 132(4) of the Act for its taxation year that includes the beginning of the qualifying exchange. A fund's capital gains redemptions are that proportion of both its realized and its latent capital gains that is presumed to have been distributed to investors on redemptions as gains on their investments. Since under the present rules the units of the transferee taken back by the transferor on a qualifying exchange have a cost amount of nil for all purposes, the transferor's latent gain on those units will likely be overstated. Similarly, the transferee's capital gains redemptions for its last taxation year beginning before the exchange occurs could be distorted by the inclusion of the value of the units issued by the transferee to the transferor, or by the inclusion of the assets or liabilities assumed by the transferee, on the exchange.

To prevent those potential distortions, amended paragraph (*p*) treats the transferor's total cost amount of all its property as the total of its proceeds of disposition of property it has transferred on the exchange, and its cost amount of property not transferred. The transferee, meanwhile, is treated as not having acquired any of the property it

received on the exchange. These deeming rules apply only for the purposes of computing the funds' capital gains redemptions for their taxation years that include the transfer time.

A consequential amendment to paragraph 132.2(1)(*h*) of the Act confirms that the special rule in amended paragraph (*p*) overrides the general rule with respect to the cost of the property taken back on the exchange by the transferor.

The second change to section 132.2 confirms that a qualifying exchange does not constitute a deemed dividend to the investors in the transferor fund.

Where the transferor fund is a corporation, its investors' exchange of their shares for units of the transferee may constitute an acquisition of those shares by the transferor. Subsection 84(3) of the Act provides that on the redemption, acquisition or cancellation of its shares, a corporation is treated as having paid a dividend. Subsection 131(4) of the Act, however, prevents section 84 of the Act from applying to mutual fund corporations. If the transferor fund is a mutual fund corporation when its investors exchange their shares for units of the transferee, then the investors will not be treated as having received a dividend.

To ensure that no deemed dividend arises on a qualifying exchange, paragraph 132.2(1)(*o*) of the Act is amended to provide that where, as part of a qualifying exchange, an investor disposes of a share of the transferor, for the purposes of subsection 131(4) the transferor will be treated as being a mutual fund at the time of that disposition.

Existing paragraph 132.2(1)(*p*) of the Act, which precludes the transferor fund from continuing to be treated as a mutual fund, is amended to accommodate the change to paragraph (*o*), and is renamed as paragraph (*q*).

Finally, the definition of "qualifying exchange" in subsection 132.2 is amended to accommodate the exercise of statutory dissent rights by investors in the transferor fund. Despite the general rule in

paragraph (*b*) of that definition, that any person disposing of shares of the transferor within the 60-day period of the exchange may receive only units of the transferee in return, the fact that an investor chooses to exercise dissent rights rather than participating in the exchange will not disqualify the transaction as a qualifying exchange.

These changes apply as of the July 1, 1994 coming-into-force of the qualifying exchange rules, except that funds that have carried out a qualifying exchange before November 1996 may choose not to have new paragraph 132.2(1)(*p*) apply in respect of their exchange. To make this choice, the funds must jointly elect in writing filed with the Minister of National Revenue before the end of the third month following Royal Assent to this legislation.

Clause 160

Non-Resident-Owned Investment Corporations

ITA
133(6)(*b*)

If a non-resident-owned investment corporation has filed its tax return for a taxation year within 3 years from the end of the year and the Minister of National Revenue has not paid an "allowable refund" upon issuing the assessment of tax for the year, paragraph 133(6)(*b*) of the Act allows the corporation to make an application for the refund within the period determined under paragraph 152(4)(*b*) or (*c*) of the Act within which the Minister can reassess tax payable by the corporation for the year. The amendments to paragraph 133(6)(*b*) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 133(6)(*b*) applies after April 27, 1989.

Clause 161

Cooperative Corporations

ITA
136(1)

Subsection 136(1) of the Act provides that cooperative corporations that would otherwise be private corporations are considered not to be private corporations, except for the purposes of certain provisions of the Act listed in that subsection. Subsection 136(1) is amended to add to the list the definition of "mark-to-market property" in subsection 142.2(1) of the Act. Thus, a cooperative that is a private corporation retains its status for the purpose of that definition and any regulations made under the definition. At present, whether a cooperative is a private corporation is relevant only for proposed subsection 9001(1) of the *Income Tax Regulations*, which prescribes certain small business corporation shares for the purpose of paragraph (*e*) of the definition of mark-to-market property.

The amendment to subsection 136(1) applies to taxation years that end after February 22, 1994.

Clause 162

Insurer – Not Private Corporation

ITA
141.1

Section 141.1 of the Act provides that for many purposes an insurance corporation (other than a life insurance corporation) is not treated as a private corporation. The section is amended to include among those the new refundable additional tax on the investment income of Canadian-controlled private corporations, in section 123.2 of the Act.

To coincide with the introduction of section 123.2, this amendment applies to taxation years that end after June 1995.

Clause 163

Definition – "specified debt obligation"

ITA
142.2(1)

A "specified debt obligation" of a taxpayer is the taxpayer's interest in a loan, bond, debenture, mortgage, note, agreement of sale or any other similar indebtedness, or in any debt obligation purchased by the taxpayer. However, it does not include an interest in an income bond, an income debenture, a small business development bond, a small business bond or a prescribed property. The amendment excludes from the definition any instrument issued by or made with a person to whom the taxpayer is related or with whom the taxpayer does not otherwise deal at arm's length, or in which the taxpayer has a significant interest. Such instruments will continue to be dealt with outside the new mark-to-market property rules. The amendment applies to taxation years that end after February 22, 1994.

Clause 164

Income from Specified Debt Obligation

ITA
142.3

Section 142.3 of the Act provides that the amounts included or deducted in respect of a specified debt obligation (as defined in subsection 142.2(1) of the Act) in computing the income of a financial institution are to be determined in accordance with rules set out in the Regulations.

Subclauses 164(1) to (3)

Amounts to be Included and Deducted

ITA
142.3(1)

Three consequential amendments are made to subsection 142.3(1) of the Act:

(i) the reference to subsection 142.3(2) of the Act is changed to subsection 142.3(3) as a consequence of the renumbering of that provision;

(ii) paragraph 142.3(1)(*c*) of the Act is amended so that it allows new subsection 142.3(2) to apply with respect to the determination of amounts to be included or deducted in respect of specified debt obligations; and

(iii) subsection 142.3(1) is amended to make it subject to new subsection 142.3(4) of the Act.

The first two amendments apply to taxation years that end after February 22, 1994, except that they do not apply to a debt obligation disposed of before February 23, 1994. The third amendment is applicable to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayers elects to have new paragraph 20(1)(*l*) of the Act apply to those years.

Subclauses 164(4)

ITA
142.3(2) and (3)

Subsection 142.3(2) of the Act provides that subsection 142.3(1) of the Act does not apply to specified debt obligations that are mark-to-market properties, nor does it apply to indexed debt obligations (as defined in subsection 248(1) of the Act). This subsection is renumbered as subsection 142.3(3) of the Act and is amended so that it also applies for the purpose of new subsection 142.3(2). The latter amendment is made because of the

reference in new subsection 142.3(2) to amounts required by subsection 12(3) of the Act to be included in a taxpayer's income in respect of specified debt obligations.

New subsection 142.3(2) applies where a financial institution has failed to include an amount in income in respect of a specified debt obligation, as required by paragraph 142.3(1)(*a*) of the Act. Subsection 142.3(2) provides that the amount is to be included in computing the financial institution's income for a subsequent taxation year in which it still holds the obligation, except to the extent that the amount has been included in computing income for a preceding taxation year. This rule is similar to the requirement in subsection 12(3) that all interest that has accrued to a taxpayer or was received by the taxpayer to the end of a taxation year be included in computing the taxpayer's income for the year, to the extent that it was not included in computing the taxpayer's income for a preceding taxation year.

Subsection 142.3(2) also applies if a financial institution has not included an amount in income as required by subsection 12(3). This is relevant for specified debt obligations that were acquired before subsection 142.3(1) began to apply to the taxpayer. If a taxpayer failed to report an amount as required by subsection 12(3), that subsection will not apply to later years when the tax treatment of the obligation is governed by subsection 142.3(1).

These amendments apply to taxation years ending after February 22, 1994, except that they do not apply to debt obligations disposed of before February 23, 1994.

Subclause 164(5)

Impaired Specified Debt Obligations

ITA
142.3(4)

New subsection 142.3(4) of the Act provides that subsection 142.3(1) of the Act does not apply to a taxpayer in respect of a specified debt obligation for that part of a taxpayer's taxation year in which the obligation is impaired and an amount in respect thereof is deductible under new subparagraph 20(1)(*l*)(ii) of the Act by the taxpayer for the

year. Therefore no amount will be included in the income of the taxpayer in respect of the obligation under 142.3(1) for the part of the taxation year in which the obligation is impaired. This is consistent with the new accounting rules which provide that recognition of interest income in accordance with the terms of the original debt obligation ceases on the impairment of the obligation. New subsection 142.3(4) applies to taxation years that end after September 1997, and also to taxation years that end after 1995 and before October 1997 where the taxpayer elects to have the reserve provisions in new paragraph 20(1)(*l*) of the Act apply to those years.

Clause 165

Disposition of Specified Debt Obligation

ITA
142.4

Section 142.4 of the Act contains rules for the measurement and treatment of the gain or loss realized by a financial institution on the disposition of a specified debt obligation (other than a mark-to-market property). The amendments to this section apply to taxation years that end after February 22, 1994.

Subclauses 165(1) and (2)

Definition of "tax basis"

ITA
142.4(1)

Subsection 142.4(1) of the Act defines the tax basis of a specified debt obligation. The tax basis, which is analogous to the adjusted cost base of a capital property, is used to measure the gain or loss from a disposition of the obligation. Paragraphs (*b*) and (*j*) of the definition are amended.

Paragraph (*b*) of the definition adds to the tax basis of a specified debt obligation amounts included by several provisions in respect of the obligation in computing the income of the taxpayer. This

paragraph is amended to add a reference to new subsection 142.3(2) of the Act.

Paragraph (*j*) of the definition reduces the tax basis of a specified debt obligation to a taxpayer by the amount of a payment received by the taxpayer under the obligation where the payment is in respect of an amount included in the tax basis by any of paragraphs (*a*) to (*f*) of the definition and is not proceeds of disposition. Paragraph (*j*) is amended to provide that the tax basis of a specified debt obligation is reduced by all payments received by the taxpayer under the obligation, other than a payment that is proceeds of disposition or a fee or similar amount.

Subclause 165(3)

Rules Applicable to Disposition

ITA
142.4(3)

Paragraph 142.4(3)(*a*) of the Act provides that where a taxpayer disposes of a specified debt obligation after February 22, 1994, no amount will be included or deducted in respect of the disposition except as provided by section 142.4 of the Act. Other provisions of the Act do not apply.

Paragraph 142.4(3)(*a*) of the Act is amended to permit paragraph 79.1(7)(*d*) of the Act to apply where a taxpayer disposes of a specified debt obligation. Accordingly, where a financial institution forecloses on the security under a loan, the financial institution will be able to claim a deduction under 79.1(7)(*d*) in respect of any accrued but unpaid interest the financial institution has been required to include in income under paragraph 142.3(1)(*a*) of the Act.

Subclause 165(4)

Inclusions and Deductions Re Disposition

ITA
142.4(4)

Subsection 142.4(4) of the Act applies to the disposition of a specified debt obligation after 1994, except a disposition to which subsection 142.4(5) of the Act applies. It requires the taxpayer to include or deduct amounts in respect of the disposition in computing income.

The amendments to subsection 142.4(4) are consequential on the amendment of the definition of "current amount" in subsection 142.4(7) of the Act. They do not change the net amount required by subsection 142.4(4) to be included or deducted in respect of a disposition in computing income. The definition of "current amount" is amended so that it does not include the transition amount in respect of the disposition. Thus, it is just the credit-related component of a gain or loss.

As amended, paragraph 142.4(4)(*a*) of the Act applies where the transition amount in respect of the disposition of a specified debt obligation is positive. It requires the transition amount to be included in computing the taxpayer's income for the taxation year in which the disposition occurs. Paragraph 142.4(4)(*b*) of the Act provides for an amount equal to the absolute value of the transition amount to be deducted if the transition amount is negative.

Paragraph 142.4(4)(*c*) of the Act, which applies where a taxpayer has a gain from the disposition of a specified debt obligation, requires the current amount of the gain to be included in income in the year of disposition, and requires a prescribed part of the residual portion of the gain (as defined in subsection 142.4(8) of the Act) to be included in income each year, starting in the year of disposition. Proposed Part XCII of the *Income Tax Regulations* will contain the rules for amortizing the residual portion of a gain.

Paragraph 142.4(4)(*d*) of the Act, which is similar to paragraph 142.4(4)(*c*), provides for deductions where a taxpayer has a loss from the disposition of a specified debt obligation.

Gain or Loss Not Amortized

ITA
142.4(5)

Subsection 142.4(5) of the Act provides that the full gain or loss from the disposition after February 22, 1994 of certain specified debt obligations is to be included or deducted in computing income for the taxation year in which the disposition occurs. This subsection is replaced by a new subsection 142.4(5) that differs from the existing subsection in the following respects:

- a new paragraph 142.4(5)(*c*) is added;
- existing paragraph 142.4(5)(*c*) is relabelled as paragraph (*d*); and
- existing paragraphs 142.4(5)(*d*) and (*e*) are replaced by new paragraphs 142.4(5)(*e*) and (*f*).

New paragraph 142.4(5)(*c*) of the Act permits a taxpayer (other than a life insurance corporation) to elect to postpone the commencement of the amortization requirement for gains and losses. If the election is made, subsection 142.4(5) applies to all dispositions of specified debt obligations before 1996. The election must be in writing and filed with the Minister of National Revenue before July 1997.

New paragraph 142.4(5)(*e*) of the Act provides that the amount to be included in a taxpayer's income in respect of the disposition of a specified debt obligation is the amount, if any, by which the taxpayer's proceeds of disposition exceed the tax basis of the obligation. Paragraph 142.4(5)(*f*) of the Act contains a similar rule for the measurement and deduction of a loss. Currently, the corresponding provisions in paragraphs 142.4(5)(*d*) and (*e*) refer to the gain or loss determined under subsection 142.4(6) of the Act. This amendment to subsection 142.4(5) does not affect the amount of the gains and losses to be recognized, but is made so that subsection 142.4(6) can be simplified.

Subclauses 165(5) and (6)

Gain or Loss from Disposition of Obligation

ITA
142.4(6)

Subsection 142.4(6) of the Act provides for the determination of a taxpayer's gain or loss from the disposition of a specified debt obligation. The gain or loss is equal to

- the taxpayer's proceeds of disposition

minus

- the tax basis of the obligation to the taxpayer, and

- if subsection 142.4(4) of the Act applies to the disposition, the taxpayer's transition amount (as defined in subsection 142.4(1) of the Act) in respect of the obligation. (If the transition amount is negative, the absolute value of that amount is added.)

Two amendments are made to subsection 142.4(6).
Paragraph 142.4(6)(*b*) of the Act is amended so that a loss from a disposition is expressed as a positive amount rather than a negative amount. The second amendment, which is made to the description of C in the formula in the subsection, provides for the transition amount to always be taken into account in determining the gain or loss. A related amendment is made to subsection 142.4(5) of the Act so that subsection does not use the gain or loss as determined under subsection 142.4(6), but instead provides a separate determination of the gain or loss for the purpose of that subsection.

Subclause 165(7)

Current Amount

ITA
142.4(7)

Subsection 142.4(7) of the Act defines the current amount in respect of the disposition of a specified debt obligation by a taxpayer. It is the positive or negative amount equal to the sum of the transition amount in respect of the obligation and the credit-related portion of the gain or loss from the disposition (with the credit-related portion of a loss treated as a negative amount).

Subsection 142.4(7) is amended to define the current amount to be the credit-related portion of the gain or loss from the disposition of a specified debt obligation. The transition amount is not included as part of the current amount. Also, the current amount is a positive amount whether there was a gain or a loss. A related amendment to subsection 142.4(4) of the Act provides for the separate inclusion or deduction of the transition amount in computing income. These amendments do not make any substantive changes to the current rules.

Residual Portion of Gain or Loss

ITA
142.4(8)

Subsection 142.4(8) of the Act defines the residual portion of a taxpayer's gain or loss from the disposition of a specified debt obligation. The amendment to subsection 142.4(8) is consequential on the amendment to subsection 142.4(7) of the Act, and does not change the determination of the residual portion.

Disposition of Part of Obligation

ITA
142.4(9)

Subsection 142.4(9) of the Act provides that where a financial institution disposes of part of a specified debt obligation,

section 142.4 of the Act and the regulations made for the purpose of the section apply as if that part and the retained part were separate debt obligations. This subsection is amended so that it also applies for the purposes of section 142.3 of the Act. In addition, the reference to "regulations" is deleted, since subsection 142.4(9) applies to the *Income Tax Regulations* without explicitly referring to them.

Penalties and Bonuses

ITA
142.4(10)

New subsection 142.4(10) of the Act provides that a penalty or bonus received by a taxpayer in respect of the early repayment of a specified debt obligation is to be treated as part of the proceeds of disposition of the obligation. Subsection 142.4(10) applies instead of subsection 18(9.1) of the Act, where that latter subsection would otherwise apply to deem the amount to be received as interest.

Payments Received On or After Disposition

ITA
142.4(11)

New subsection 142.4(11) of the Act provides that a payment (other than proceeds of disposition) received by a taxpayer under a specified debt obligation on or after the disposition of the obligation shall be considered to have been received immediately before the disposition. Consequently, the payment will be taken into account in determining the tax basis of the obligation to the taxpayer immediately before the disposition, and hence in determining the taxpayer's gain or loss from the disposition.

Clause 166

Mark-to-Market Properties

Transition – Inclusion Re Non-Capital Amounts

ITA
142.5(5)

Subsection 142.5(5) of the Act applies to a financial institution that has claimed a transition deduction under subsection 142.5(4) of the Act in respect of the introduction of the mark-to-market requirement. It requires a prescribed portion of the deducted amount to be included in income in each taxation year starting with the year that includes October 31, 1994. Subsection 142.5(5) is amended to modify the way in which it confers regulation-making authority. This amendment applies to taxation years that end after October 30, 1994.

Transition – Deduction Re Net Capital Gains

ITA
142.5(6)

Subsection 142.5(6) of the Act is a transition rule that applies with respect to capital property that is deemed to be disposed of on the initial application of the mark-to-market requirement. It permits a financial institution to claim an allowable capital loss not exceeding a prescribed amount. The amendment to subsection 142.5(6) provides that, in the case of a taxpayer not resident in Canada, the allowable capital loss is considered to be from the disposition of taxable Canadian property. This amendment applies to taxation years that end after October 30, 1994.

Transition – Inclusion Re Net Capital Gains

ITA
142.5(7)

Subsection 142.5(7) of the Act applies to a financial institution that has elected to claim an allowable capital loss under subsection 142.5(6) of the Act for its taxation year that includes October 31, 1994. Subsection 142.5(7) deems the financial institution

to have a taxable capital gain for that year and for subsequent years equal to the portion of the elected amount prescribed for the year. Subsection 142.5(7) is amended to modify the way in which it confers regulation-making authority. It is also amended to provide that, in the case of a taxpayer not resident in Canada, the taxable capital gain is considered to be from the disposition of taxable Canadian property. These amendments apply to taxation years that end after October 30, 1994.

Clause 167

Accrued Capital Gains and Losses Election

ITA
142.6(8) to (10)

New subsection 142.6(8) of the Act is a transitional rule that applies to properties held by a financial institution in its last taxation year that ended before February 23, 1994. Where a financial institution holds a capital property (other than a depreciable property) in that year that will be a mark-to-market property or a specified debt obligation under the new mark-to-market property rules and on which there is an accrued capital gain, subsection 142.6(8) permits the financial institution to elect – subject to the limits imposed under new subsection 142.6(9) of the Act – to realize all or any part of that accrued capital gain. Similarly, where a financial institution holds a capital property (other than a depreciable property) in that year that will not be a mark-to-market property or a specified debt obligation under the new mark-to-market property rules and on which there is an accrued capital loss, the financial institution can elect – subject to the limits imposed under new subsection 142.6(10) of the Act – to realize all or any part of that accrued capital loss.

The effect of subsections 142.6(8) to (10) is to permit a financial institution to recognize any capital gains accrued on its assets that were capital properties, and that became mark-to-market properties or specified debt obligations in its first taxation year that ends after February 22, 1994, to offset its capital losses that have been realized or accrued on other properties before the beginning of that year.

New subsection 142.6(9) limits the amount of accrued capital gains a financial institution can elect to realize under subsection 142.6(8). Subsection 142.6(9) will deem an election to realize taxable capital gains under 142.6(8) not to have been made where the election would have the effect of increasing the financial institution's net taxable capital gains – that is, the amount by which the financial institution's taxable capital gains for the year exceed the total of its allowable capital losses for the year and the greatest amount it could claim in the year as a capital loss carryforward.

Subsection 142.6(9) prevents a financial institution from realizing accrued capital gains on mark-to-market properties or specified debt obligations under subsection 142.6(8) unless the financial institution has capital losses (from either actual or elected dispositions) or capital loss carryforwards to offset the elected gains.

Where a financial institution elects to realize an excessive amount of capital gains, the election is deemed not to have been made. However, the financial institution may, within certain time limits, file another election that satisfies the requirements of this subsection (and subsection 142.6(10)).

New subsection 142.6(10) places two limits on the amount of accrued capital losses a financial institution can elect to realize under subsection 142.6(8).

First, under paragraph 142.6(10)(*a*) of the Act, an election to realize allowable capital losses under subsection 142.6(8) will be valid only if the financial institution's allowable capital losses (including those sought to be realized under the election) and net capital loss carryforwards would not exceed its taxable capital gains (including those sought to be realized under the election) in the year. Paragraph 142.6(10)(*a*) restricts the election under subsection 142.6(8) to ensure that a financial institution does not use the election to realize accrued capital losses that it can not use to offset gains in the year in the expectation that it will be able to use those losses in a future year to offset taxable capital gains on other properties while still retaining the capital properties on which the losses accrued.

Second, under paragraph 142.6(10)(*b*) of the Act, a financial institution can elect to realize capital losses under

paragraph 142.6(8)(*b*) only to the extent that those losses do not exceed the capital gains it has elected to realize under paragraph 142.6(8)(*a*) of the Act. In other words, a financial institution may realize accrued losses to offset taxable capital gains only where it elected to realize the gains on properties that will be subject to the mark-to-market rules; an election to realize accrued capital losses will not be permitted simply to offset capital gains from actual dispositions made by the taxpayer in its last taxation year that ended before February 23, 1994.

Where a financial institution elects to realize an excessive amount of capital losses, the election is deemed not to have been made. However, the financial institution may, within certain time limits, file another election that satisfies the requirements of this subsection (and subsection 142.6(9)).

New subsections 142.6(8) to (10) apply to the 1993 and subsequent taxation years.

Clause 168

Cost of Tax Shelter Investments

ITA
143.2

New section 143.2 of the Act sets out the rules that apply for the purpose of computing the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment. New section 143.2 also applies to the amount of any expenditure of a taxpayer where an interest in the taxpayer is a tax shelter investment. New subsection 143.2(6) of the Act provides that a taxpayer is to reduce the amount of, or the cost or capital cost of, an affected expenditure by any limited-recourse amounts that can reasonably be considered to relate to the expenditure and by the taxpayer's at-risk adjustment in respect of the expenditure. The application of these rules is more fully described in the following commentary.

Definitions

ITA
143.2(1)

New subsection 143.2(1) of the Act provides definitions that apply for the purpose of new section 143.2 of the Act. The terms defined for this purpose are "expenditure", "limited partner", "limited-recourse amount", "taxpayer", and "tax shelter investment". "Limited-recourse amount" means the unpaid principal amount of any indebtedness for which recourse is limited, either immediately or in the future and either absolutely or contingently.

Generally, the definition "tax shelter investment" means a property that is defined to be a "tax shelter" under subsection 237.1(1) of the Act. In certain cases, a taxpayer's interest in a partnership is also considered to be a "tax shelter investment" notwithstanding that the taxpayer's partnership interest is not a "tax shelter" under subsection 237.1(1).

New subsection 143.2(1) generally applies to properties acquired and outlays and expenses made or incurred after November 1994.

At-risk Adjustment

ITA
143.2(2)

New subsection 143.2(2) of the Act provides that an "at-risk adjustment" in respect of an expenditure of a particular taxpayer means any amount or benefit that the particular taxpayer, or another taxpayer not dealing at arm's length with the particular taxpayer, is or may be entitled to receive or obtain. This subsection applies where the amount or benefit is intended to protect the particular taxpayer or the other taxpayer from loss in respect of the taxpayer's expenditure. Under new subparagraph 143.2(6)(*b*)(ii) of the Act, which generally applies after April 26, 1995, certain expenditures of a taxpayer are reduced by the amount of the taxpayer's at-risk adjustment in respect of the expenditure.

Amount or Benefit Not Included

ITA
143.2(3)

New subsection 143.2(3) of the Act provides circumstances where amounts or benefits are not considered to be amounts or benefits included in a taxpayer's "at-risk adjustment" in respect of an expenditure under new subsection 143.1(2) of the Act. New subsection 143.2(3) provides that new subsection 143.2(2) of the Act does not apply, for example, to the extent that a taxpayer's entitlement to an amount or benefit arises:

- under normal liability insurance protection;
- as a consequence of death of the taxpayer; or
- in respect of an amount not included in the expenditure.

This subsection generally applies after April 26, 1995.

Amount or Benefit

ITA
143.2(4)

New subsection 143.2(4) of the Act provides that, where an amount or benefit referred to in new subsection 143.2(2) of the Act is provided by way of an agreement under which a taxpayer has or may have a right to acquire property, the taxpayer is considered to be entitled at any time to an amount or benefit equal to the fair market value of the property at that time.

This subsection generally applies after April 26, 1995.

Amount or Benefit

ITA
143.2(5)

New subsection 143.2(5) of the Act provides that, for the purpose of the at-risk adjustment in new subsection 143.2(2) of the Act, where a

taxpayer, or a person not dealing at arm's length with the taxpayer, has a borrowing guaranteed or otherwise backed by a security or similar indemnity or covenant, the amount or benefit to which the taxpayer is entitled is considered to be equal to the outstanding balance of the borrowing.

This subsection generally applies after April 26, 1995.

Amount of Expenditure

ITA
143.2(6)

New subsection 143.2(6) of the Act applies to reduce the amount of any expenditure that is, or is the cost or capital cost of, a taxpayer's tax shelter investment by certain amounts. This reduction also applies to the amount of any expenditure of a taxpayer where an interest in the taxpayer is considered to be a tax shelter investment.

New subparagraph 143.2(6)(*b*)(i) of the Act provides a reduction of the total of all limited-recourse amounts in respect of an affected expenditure. For this purpose, an expenditure's limited-recourse amount refers to such amounts of the taxpayer and all other taxpayers not dealing at arm's length with the taxpayer, where the particular limited-recourse amount can reasonably be considered to relate to the expenditure. This reduction for limited-recourse amounts occurs at the time the expenditure was acquired, made or incurred including where the limited-recourse amount arises after the acquisition, making or incurring of the expenditure.

New subparagraph 143.2(6)(*b*)(ii) of the Act provides for a reduction of an amount, or cost or capital cost, of an affected expenditure of a taxpayer to the extent of the taxpayer's "at-risk adjustment" in respect of the expenditure.

New subparagraph 143.2(6)(*b*)(iii) of the Act provides for a reduction of an amount, or cost or capital cost, of an affected expenditure of a taxpayer to the extent of each limited-recourse amount and at-risk amount determined under section 143.2 of each other taxpayer who deals at arm's length with and holds, directly or indirectly, an interest in the taxpayer, that can reasonably be considered to relate to the expenditure.

New subparagraphs 143.2(6)(*b*)(i) and (iii) generally apply to property acquired and to outlays and expenses made or incurred after November 1994. New subparagraph 143.2(6)(*b*)(ii) generally applies after April 26, 1995.

Repayment of Indebtedness

ITA
143.2(7)

New subsection 143.2(7) of the Act describes circumstances in which the unpaid principal of indebtedness will be deemed to be a limited-recourse amount. This subsection generally applies after November 1994.

Limited-recourse Amount

ITA
143.2(8)

New subsection 143.2(8) of the Act treats the unpaid principal of an indebtedness relating to a taxpayer's expenditure as a limited-recourse amount where the taxpayer is a partnership and recourse against any member of the partnership in respect of the indebtedness is limited, either immediately or in the future and either absolutely or contingently. This subsection applies after November 1994.

Timing

ITA
143.2(9)

New subsection 143.2(9) of the Act sets out rules applicable upon payment of an amount on account of the principal amount of an indebtedness relating to an expenditure to which a subsection 143.2(2) "at-risk" adjustment previously applied. In such circumstances, the "at-risk" adjustment applies to the expenditure before the time of payment and, to the extent the amount of repayment is not subject to a reduction under new subsection 143.2(6) of the Act, the expenditure is considered to have been made or incurred at the time of, and by the amount of, the repaid amount. Generally, this subsection applies after April 26, 1995.

Timing

ITA
143.2(10)

New subsection 143.2(10) of the Act provides that the payment of a limited-recourse amount results in the repaid amount being an expenditure made or incurred at the time of the payment. The former limited-recourse indebtedness is also considered to be a limited-recourse amount at all times before its repayment. To the extent the amount of the repayment is not subject to a reduction under new subsection 143.2(6) of the Act, the expenditure is considered to have been made or incurred at the time of, and by the amount of, the repaid amount. This subsection applies after November 1994.

Short-Term Debt

ITA
143.2(11)

New subsection 143.2(11) provides an exception to the deemed "limited-recourse" rules in new subsections 143.2(7) and (8) of the Act where the otherwise affected indebtedness is fully repaid no later than 60 days after it arose, except where:

(a) any portion of the repayment is made with a "limited recourse amount", or

(b) the repayment is part of a series of loans or other indebtedness and repayments that ends more than 60 days after the indebtedness arose.

Generally, this subsection applies after November, 1994.

Series of Loans or Repayments

ITA
143.2(12)

New subsection 143.2(12) of the Act provides that, for the purpose of new paragraph 143.2(7)(*a*) of the Act, a debtor is considered not to

have made arrangements to repay an indebtedness within 10 years if the arrangement to repay is part of a series of loans or other indebtedness and repayments that ends more than 10 years after it begins. Generally, this subsection applies after April 26, 1995.

Information Located Outside Canada

ITA
143.2(13)

New subsection 143.2(13) of the Act applies where information relevant in respect of indebtedness is located outside Canada, and the Minister of National Revenue is not satisfied that the indebtedness is not a limited-recourse amount. In such cases, the unpaid principal of the indebtedness shall be considered to be a limited-recourse amount unless:

- the information is provided to the Minister; or

- the information is located in a country with which Canada has a tax treaty that includes a provision under which the Minister can obtain the information.

This subsection applies after November 1994.

Information Located Outside Canada

ITA
143.2(14)

New subsection 143.2(14) of the Act applies where information relevant for the purpose of determining whether a taxpayer is not dealing at arm's length with another taxpayer is located outside Canada, and the Minister of National Revenue is not satisfied that the taxpayers are dealing at arm's length. In such cases, the taxpayers will be deemed not to be dealing with each other at arm's length unless:

- the information is provided to the Minister; or

- the information is located in a country with which Canada has a tax treaty that includes a provision under which the Minister can obtain the information.

This subsection applies after November 1994.

Assessments

ITA
143.2(15)

New subsection 143.2(15) of the Act provides to the Minister of National Revenue the authority to make the assessments, determinations and redeterminations that are necessary to give effect to section 143.2 of the Act, notwithstanding that the taxation year in question is otherwise statute-barred from assessment. This subsection applies after November 1994.

Clause 169

Employee Profit Sharing Plans

ITA
144

Section 144 provides rules applicable to employees profit sharing plans.

Subclause 169(1)

Employee Profit Sharing Plan

ITA
144(1)

Subsection 144(1) of the Act provides a definition of the term "employees profit sharing plan" for the purposes of section 144. This amendment to subparagraph 144(1)(*a*)(iii) of the English version of the Act replaces the reference to paragraphs (*a*) and (*b*), which was inadvertently included when the subparagraph was amended by the Statutes of Canada 1994, chapter 21 (Bill C-27), with the correct

reference to subparagraphs (i) and (ii). This amendment applies to the 1992 and subsequent taxation years, the same period to which the amendment in Bill C-27 applied.

Subclause 169(2)

Unused Portion of a Beneficiary's Exempt Capital Gains Balance

ITA
144(1)

Subsection 144(1) of the Act is amended, applicable to the 1994 and subsequent taxation years, by adding the definition of "unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan. The addition of this definition is consequential on the elimination of the $100,000 lifetime capital gains exemption for gains arising on dispositions that occur after February 22, 1994 and the introduction of the mechanism in subsection 110.6(19) of the Act for recognizing gains accrued to the end of that day.

This definition is relevant where a beneficiary of a trust governed by an employees profit sharing plan has an exempt capital gains balance in respect of the trust and the beneficiary receives property, other than money, in satisfaction of all or a portion of the beneficiary's interests in the trust. Property, other than money, received from the trust is received on the rollover basis set out in paragraphs 144(7.1)(*a*) and (*b*) of the Act. Paragraph 144(7.1)(*c*) of the Act provides that an additional amount may be available to be included in the cost of property received from the trust in satisfaction of all or a portion of the beneficiary's interests in order that the beneficiary be able to make full use of an exempt capital gains balance in respect of the trust. This cost inclusion is also available in taxation years ending after 2004, even though exempt capital gains balances expire for such years, in order to be consistent with the adjusted cost base increase available under paragraph 53(1)(*p*) of the Act in respect of interests in flow-through entities. The total amount available to be included in the cost of properties received in satisfaction of all or a portion of the beneficiary's interests is the "unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan. This defined amount equals, where the property is received before the end

of the beneficiary's 2004 taxation year, the beneficiary's exempt capital gains balance in respect of the trust for the year minus the total of all reductions in capital gains in the year under section 39.1 of the Act due to the exempt capital gains balance. Where the property is received after the beneficiary's 2004 taxation year, this defined amount is the amount that would have been the exempt capital gains balance in respect of the trust for the beneficiary's taxation year minus any increase under paragraph 53(1)(*p*) in the adjusted cost base of an interest or a part of an interest of the beneficiary in the trust that was disposed of (other than in a disposition that is part of a transaction in which property was received from the trust in satisfaction of all or a portion of the beneficiary's interests in the trust). The unused portion of the beneficiary's exempt capital gains balance in respect of the trust governed by the employees profit sharing plan so determined is available to be allocated to the cost of each property received from the trust in the manner set out under paragraph 144(7.1)(*c*).

Subclause 169(3)

Where Property Other Than Money Received by Beneficiary

ITA
144(7.1)(*b*)

Paragraph 144(7.1)(*b*) of the Act is amended, applicable to the 1994 and subsequent taxation years, to permit an additional amount determined under new paragraph 144(7.1)(*c*) of the Act to be included in the cost of a property distributed to a beneficiary of an employees profit sharing plan by the trust in satisfaction of all or a portion of the beneficiary's interest in the trust.

Subclause 169(4)

Where Property Other Than Money Received By Beneficiary

ITA
144(7.1)(*c*)

New paragraph 144(7.1)(*c*) of the Act is added consequential on the elimination of the $100,000 lifetime capital gains exemption for gains arising on dispositions that occur after February 22, 1994 and the

introduction of the mechanism in subsection 110.6(19) of the Act for recognizing gains accrued to that date. Where an individual recognizes a capital gain accrued to the end of that date on an interest in, or a share of the capital stock of, a flow-through entity (within the meaning assigned by subsection 39.1(1) of the Act), the amount of the gain is credited to a special account referred to as the individual's exempt capital gains balance in respect of the entity. Claims may be made against this account to reduce gains that are flowed out to the individual by the entity for taxation years before 2005 and gains realized on dispositions of interests in or shares of the entity in those years.

An interest in a trust governed by an employees profit sharing plan is an interest in a flow-through entity on which a beneficiary of the trust may elect under subsection 110.6(19) and establish an exempt capital gains balance in respect of the trust. Distributions of property from the trust occur on the rollover basis set out in paragraphs 144(7.1)(*a*) and (*b*) of the Act. This rollover does not permit the beneficiary to increase the cost of the property received to the extent of any unused exempt capital gains balance in respect of the trust. If the beneficiary ceases to have an interest in the trust, the beneficiary's exempt capital gains balance in respect of the trust is deemed to be nil for taxation years beginning after that time pursuant to subsection 39.1(7) of the Act. In such circumstances, it is possible that the beneficiary may not have depleted the exempt capital gains balance in respect of the trust even though the property received from the trust had sufficient accrued gains to utilize all or a part of the undepleted exempt capital gains balance.

New paragraph 144(7.1)(*c*) is available to provide an addition to the cost to the beneficiary of each property determined under paragraph 144(7.1)(*b*). This cost inclusion is also available in taxation years ending after 2004, even though exempt capital gains balances expire for such years, in order to be consistent with the adjusted cost base increase available under paragraph 53(1)(*p*) of the Act in respect of interests in flow-through entities. The total amount available to be included under this new paragraph in the cost of properties received on a distribution in these circumstances is set out in the definition "the unused portion of a beneficiary's exempt capital gains balance" in respect of a trust governed by an employees profit sharing plan in subsection 144(1) of the Act. In general, this defined amount is the extent to which a beneficiary of a trust governed by an

employees profit sharing plan has not benefitted from his or her exempt capital gains balance in respect of the trust at a particular time. A beneficiary under an employees profit sharing plan who receives a distribution of property, other than money, in satisfaction of all or a portion of the beneficiary's interests in the trust may file an election with Revenue Canada in respect of a particular property received to include a designated amount in the cost to the beneficiary of the property determined under paragraph 144(7.1)(*b*). The designated amount must not exceed the lesser of two amounts. The first amount is the unused portion of the beneficiary's exempt capital gains balance in respect of the trust minus the total of all other cost inclusions under paragraph 144(7.1)(*c*) in respect of a property received from the trust in the year. The second amount is the fair market value of the particular property minus the amount deemed to be the cost of the particular property under subparagraph 144(7.1)(*b*)(iv) of the Act. Thus the cost of a property cannot be bumped to an amount higher than its fair market value. The election in respect of a property received by the beneficiary must be filed in prescribed form by the beneficiary's filing-due date for the taxation year in which the property was received.

New paragraph 144(7.1)(*c*) applies to the 1994 and subsequent taxation years. A prescribed form filed under paragraph 144(7.1)(*c*) before the end of the sixth month after the month that the bill that includes this amendment is assented to is deemed to be filed on time.

Clause 170

Registered Retirement Savings Plans

ITA
146

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

Subclause 170(1)

ITA
146(1)
"annuitant"

An amendment was made to the English version of the definition "annuitant" in the Fifth Supplement of the Revised Statutes of Canada, 1985 to make that definition gender-neutral. This amendment conforms the English version of the definition to the meaning of the expression before the Fifth Supplement changes became effective.

This amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment made to the definition "annuitant" in the Fifth Supplement applied.

Subclause 170(2)

ITA
146(1)
"benefit"

Under subsection 146(8) of the Act, amounts received by taxpayers as benefits from RRSPs are included in computing income. Under the definition of "benefit" in subsection 146(1) of the Act, certain amounts already included in computing income are not considered to be a "benefit".

The definition "benefit" is amended so that amounts received from a depositary RRSP that relate to interest or another amount that was credited or accrued after the end of the first calendar year commencing after the death of the annuitant are likewise excluded from the definition of "benefit", if such interest or other amount has been included in computing income otherwise that because of section 146 of the Act.

This amendment applies to deaths occurring after 1992.

Subclause 170(3)

ITA
146(1)
"earned income"

The expression "earned income" is relevant for the purposes of determining the maximum deduction in respect of premiums under an RRSP. New paragraph (*h*) is added to the expression as a consequence of the amendments to subparagraph 14(1)(*a*)(v) of the Act. Paragraph (*h*), which applies to the 1995 and subsequent taxation years, ensures that an amount determined under subparagraph 14(1)(*a*)(v) is not included in the determination of "earned income".

Subclause 170(4)

ITA
146(1)
"qualified investment"

The definition "qualified investment" in subsection 146(1) of the Act sets out the types of property that a trust governed by a registered retirement savings plan (RRSP) is permitted to hold. If a trust governed by an RRSP acquires or holds a property that is not a qualified investment, there are generally unfavourable tax consequences for the RRSP annuitant under subsection 146(10) of the Act or the trust under Part XI.1 of the Act.

Paragraph (*c*) of the definition provides that an annuity contract that could have been purchased directly as an RRSP by an RRSP annuitant is a qualified investment for a trust governed by an RRSP. For this paragraph to apply, it is expected that an annuity contract would specify that payments must ultimately be made directly to the RRSP annuitant and not to the trust.

Paragraph (*c*) of the definition is amended by replacing some of the existing words in the paragraph with the expression "licensed annuities provider". The latter expression is now defined in amended subsection 248(1) of the Act, as described in the commentary below. This amendment does not represent a change in policy.

New paragraph (*c*.1) permits another type of annuity contract to be a "qualified investment" for a trusteed RRSP, provided that the annuity contract satisfies two conditions:

- the RRSP trust must be the only person that has the right to receive any annuity payments under the contract (unless the trust disposes of the annuity); and

- the annuity contract must give the holder of the contract an ongoing right to surrender the contract for an amount that, ignoring reasonable sales and administrative charges, approximates the amount that could be required to fund the future periodic payments under the contract.

Paragraph (*c*.1) is intended to allow an RRSP trust to hold various types of accumulation annuities and segregated fund policies. In addition, a deferred annuity under which periodic payments have begun can continue to be a "qualified investment" under paragraph (*c*.1), if the holder has a right to surrender the contract after the payments begin.

New paragraph (*c*.2) of the definition allows a third type of annuity contract to qualify as an investment for an RRSP trust, provided that the annuity meets the following six conditions:

- (1) periodic payments under the annuity contract are required to be made on an annual or more frequent basis;

- (2) the RRSP trust must be the only person that has the right to receive any annuity payments under the contract (unless the trust disposes of the annuity);

- (3) neither the time nor the amount of any payment under the contract can vary because of the length of any life, other than the life of the RRSP annuitant;

- (4) the date on which the periodic payments began or are to begin must be no later than the end of the year in which the RRSP annuitant attains 70 years of age;

- (5) the annuity contract must be either

(a) a life annuity for the life of the RRSP annuitant that does not have a guaranteed period that runs past the end of the year in which the RRSP annuitant attains 90 years of age, except that where the RRSP annuitant had a spouse at the time that the contract was acquired, the guaranteed period, if any, can run up to the end of the year in which the spouse attains 90 years of age (if that is a later year), or

(b) a term annuity with a term equal to either 90 years minus the age of the RRSP annuitant at the date on which the periodic payments start or 90 years minus the age of the RRSP annuitant's spouse as of that date; and

- (6) the periodic payments must be equal unless

(a) they have been adjusted for reasons that would, if the contract were an annuity under a retirement savings plan, be in accordance with the indexing or other options provided under subparagraphs 146(3)(*b*)(iii) to (v) of the Act, or

(b) they have been uniformly reduced as a consequence of a partial surrender of the right to receive periodic payments under the contract.

Paragraph (*c*.2) is intended to permit an RRSP trust to hold an annuity that is similar to an annuity described in paragraph (*c*), except that the annuity can be in pay before the RRSP's maturity date and be paid to the RRSP trust. Paragraph (*c*.2) does not permit an RRSP trust to hold a life annuity for the joint lives of the RRSP annuitant and the RRSP annuitant's spouse, in order to avoid possible valuation problems on the death of the RRSP annuitant.

These amendments apply after 1996. Similar amendments have also been made to the definition "qualified investment" in subsection 146.3(1) of the Act which applies with respect to registered retirement income funds.

Subclause 170(5)

ITA
146(1)
"refund of premiums"

The definition "refund of premiums" is relevant for the purposes of determining the income inclusion for a deceased RRSP annuitant on death, the amount that is included in computing an RRSP beneficiary's income and the amount than can be transferred by a beneficiary on a tax-deferred basis under paragraph 60(l) of the Act.

This definition is amended to provide that a "refund of premiums" in respect of an RRSP does not include a "tax-paid amount" in respect of the plan. As described in the commentary to that definition, a "tax-paid amount" in respect of an RRSP is an amount received in respect of RRSP income for a taxation year for which that income is not exempt from tax under Part I. Because of the existing wording in the definition "designated benefit" in subsection 146.3(1) of the Act, the amendment also applies for the purposes of the rules for RRIFs.

This amendment applies to deaths occurring after 1992.

Subclause 170(6)

ITA
146(1)
"tax-paid amount"

The definition "tax-paid amount" is added to subsection 146(1) of the Act. A "tax-paid amount" paid to a person in respect of an RRSP is, in the case of a trusteed RRSP, an amount paid to the person in respect of the trust's income that is not exempt from tax under Part I because of paragraph 146(4)(*c*) of the Act. For this purpose RRSP income is computed without regard to subsection 104(6) of the Act. In the case of an RRSP that is a deposit, a "tax-paid amount" paid to the person in respect of the RRSP is an amount paid in respect of RRSP income that accrued or was credited after the end of the first calendar year beginning after the death of the RRSP annuitant. (Under paragraph 146(4)(*c*), RRSP trust income ceases to be exempt after the first calendar year that begins after the death of the RRSP

annuitant. A similar rule for depositary RRSPs is provided under subsection 146(20) of the Act.)

Under the definition "refund of premiums", a "tax-paid amount" does not qualify as a "refund of premiums". The definition is also relevant for the purposes of amended subsections 146(8.9) and 146.3(6.2) of the Act, under which the income inclusion on death for RRSP and RRIF annuitants is determined.

This amendment applies to deaths occurring after 1992. The first "tax-paid amounts" can be received beginning in 1995 in respect of post-1994 income.

Subclause 170(7)

ITA
146(8.9)

Subsection 146(8.8) of the Act generally requires an amount to be included in computing the income of an RRSP annuitant on death. The amount is equal to the fair market value of the RRSP assets at the time of death. However, subsection 146(8.9) of the Act allows a deduction in computing such income. The maximum deduction is equal to a specified fraction of total refunds of premiums in respect of the plan. To the extent that less than the maximum deduction is claimed on behalf of the deceased annuitant, RRSP amounts can be distributed on a tax-free basis to RRSP beneficiaries.

Before the existing version of subsection 146(8.9) was introduced, an offset equal to the full amount of a "refund of premiums" was available under former paragraph 146(8.8)(*b*) of the Act or former subsection 146(8.9) and was applied to reduce the income inclusion of the deceased annuitant. In cases where there were different classes of beneficiaries involved (e.g., a spouse and child sharing equally), this resulted in RRSP income that accrued after death and that was part of a "refund of premiums" being used inappropriately to reduce the income inclusion for the deceased annuitant.

Existing subsection 146(8.9) was designed to restrict the deduction available for the deceased in the above circumstances. The effect of subsection 146(8.9) is that the part of an RRSP "refund of premiums" that consists of post-death growth is ignored in calculating the offset

available to the deceased RRSP annuitant. The restriction is designed to have an effect only where there are two different classes of RRSP beneficiaries, referred to below as "qualifying" and "non-qualifying" beneficiaries. A qualifying beneficiary includes a spouse of the deceased RRSP annuitant who receives a "refund of premiums" (including a spouse deemed by subsection 146(8.1) of the Act to receive a "refund of premiums" through the deceased's estate). A qualifying beneficiary also includes a dependent child or grandchild of the deceased annuitant who receives a "refund of premiums" or is deemed by subsection 146(8.1) to receive a "refund of premiums". A non-qualifying beneficiary is any other RRSP beneficiary, including the estate of the deceased annuitant to the extent that amounts received by the estate are not deemed by subsection 146(8.1) to be refunds of premiums.

The description of A in subsection 146(8.9) is amended so that the deduction under subsection 146(8.9) is based not only on refunds of premiums (including deemed refunds of premiums under subsection 146(8.1)), but also amounts that would have been refund of premiums (or could have been deemed refunds of premiums under subsection 146(8.1)) if it were not for the exclusion of "tax-paid amounts" from the determination of refunds of premiums. As described in the commentary on "refund of premiums" and "tax-paid amount", a tax-paid amount in respect of an RRSP is an amount received in respect of RRSP income for a taxation year for which that income is not exempt from tax under Part I.

This amendment applies to deaths occurring after 1992.
The following examples illustrate the application of subsection 146(8.9).

EXAMPLE 1

Mary died in 1993. Her unmatured trusteed RRSP at the time of her death was $100,000. It was worth $120,000 on January 1, 1995 and $125,000 at the time of its distribution in July 1996. Mary's widower John received the entire distribution.

Results:

1. Mary's legal representatives are entitled to an offset of $100,000 against the income inclusion otherwise arising for Mary

under subsection 146(8.8). Assuming the full offset is claimed, the income inclusion for John is equal to $125,000, of which $120,000 counts as a "refund of premiums" because the $5,000 paid out in respect of growth after 1995 is a "tax-paid amount". John is entitled to claim a deduction of $120,000 if it is transferred on a tax-deferred basis under paragraph 60(l).

2. More specifically, Mary's $100,000 offset under subsection 146(8.9) is determined as follows. First, add the amount of the "refund of premiums" ($120,000) paid to John and the "tax-paid amounts" (($5,000) paid to John. This total is multiplied by a fraction (4/5), which is derived from the formula (1 – (B + C – D)/(B + C) contained in subsection 146(8.9). In this example, the values of the variables in this formula are:

- *B is nil, as it will be in every case where nothing remains in an RRSP after the distribution of a "refund of premiums";*
- *C is equal to $125,000, representing the total RRSP distributions; and*
- *D is $100,000, representing the RRSP value at the time of death.*

EXAMPLE 2

Same as example 1, except that $70,000 was distributed to John and $55,000 was distributed to Mary's daughter, Karen.

Results:

1. John is a 56-per-cent beneficiary and Karen is a 44-per-cent beneficiary of Mary's RRSP. Consequently, the "tax-paid amount" for John is equal to $2,800 (56 per cent of $5,000) and the remaining $67,200 received by John counts as a "refund of premiums" that can be transferred by John under paragraph 60(l) of the Act.

2. Mary's legal representatives are entitled to offset $56,000 against the $100,000 income inclusion otherwise arising for Mary under subsection 146(8.8). This offset is determined by multiplying

the distributions made to John ($70,000) by the specified fraction (4/5), which is calculated in the same way as in Example 1.

3. Assuming the entire $56,000 offset is claimed by Mary's legal representatives, the income inclusion for Mary is equal to $44,000 ($100,000 – $56,000). As a consequence, Karen receives $44,000 of her $55,000 RRSP distribution on a tax-free basis, because the $44,000 received by Karen is not an RRSP "benefit" as defined in subsection 146(1) of the Act.

4. In summary, $44,000 of the total $125,000 RRSP value at the time of distribution is included in computing Mary's income, $11,000 is included in computing Karen's income and the remaining $70,000 in included in computing John's income ($67,200 of which he can transfer on a tax-deferred basis under paragraph 60(l)).

Subclause 170(8)

Life Insurance Policies – Annuity Contracts

ITA
146(11.1)

Provisions incorporated by reference in subsection 146(11) of the Act deem the acquisition of a life insurance policy by an RRSP trust not to be the acquisition of a "non-qualified investment" in certain cases. When subsection 146(11) was enacted, the Act did not define the term "life insurance policy" and the term took its ordinary meaning, which did not include an annuity contract. However, the term "life insurance policy" was subsequently defined in subsections 138(12) and 248(1) of the Act to include an annuity contract and no consequential amendment was made to subsection 146(11). Accordingly, subsection 146(11) may permit an RRSP trust to acquire and hold an annuity contract in some cases.

Subsection 146(11.1) of the Act is introduced to provide that subsection 146(11) does not apply to annuity contracts issued after 1997. Instead, paragraph (*c*) and new paragraphs (*c*.1) and (*c*.2) of the definition "qualified investment" in subsection 146(1) expressly set out the types of annuity contracts which are qualified investments for trusteed RRSPs.

Clause 171

Registered Retirement Income Funds

ITA
146.3

Section 146.3 of the Act contains the rules governing registered retirement income funds (RRIFs).

Subclause 171(2)

ITA
146.3(1)

Subsection 146.3(1) of the Act defines a number of terms for the purposes of the rules governing registered retirement income funds (RRIFs) in section 146.3.

"minimum amount"

Each year, the carrier of a retirement income fund must generally pay to the annuitant not less than a prescribed fraction of the fair market value of the property held in connection with the fund at the beginning of the year. The required payment is determined under the definition "minimum amount". The fraction is prescribed in section 7308 of the *Income Tax Regulations*.

The amendments to the definition "minimum amount" are largely consequential on new paragraphs (*b*.1) and (*b*.2) of the definition "qualified investment". As described below, these paragraphs permit a trusteed RRIF to hold certain types of annuity contracts. For convenience, an annuity described in new paragraph (*b*.2) (other than a commutable annuity described in new paragraph (*b*.1)) is referred to below as a "locked-in annuity".

As a consequence of these amendments, the "minimum amount" for the year under an RRIF is now the total of:

- the prescribed fraction for the year multiplied by the total fair market value of properties (other than locked-in annuities) held in connection with the fund at the beginning of the year, and

- the total of all amounts each of which is either a periodic payment received by the trust in the year under a locked-in annuity or an estimate of a periodic payment the trust would have received under a locked-in annuity held at the start of the year if it had not disposed of the right to the payment during the year.

These amendments avoid the difficulty of determining the fair market value of a locked-in annuity each year and make it practical for a minimum amount to be calculated and distributed where a locked-in annuity is held by an RRIF trust. If an RRIF trust holds only locked-in annuities at the beginning of a year, the minimum amount for the year under the RRIF will never exceed the annuity payments received by the trust in that year.

These amendments also ensure that the carrier of an RRIF will not have to pay out any more in a given year with respect to a locked-in annuity than would be paid under an RRSP annuity acquired to provide a retirement income on the maturity of an RRSP. This is appropriate, given that locked-in annuities are very similar to the types of annuities that can be acquired to provide a retirement income on the maturity of an RRSP.

The definition of "minimum amount" is also amended so that the prescribed fraction, referred to above, is referred to in the definition as a prescribed factor, rather than a prescribed amount. This change has been made for technical clarity, as the expression "amount" in the Act is generally reserved for amounts of a monetary nature. Corresponding changes to section 7308 of the Regulations will be made to reflect this amendment.

As a consequence of these amendments, it is also proposed to amend paragraph (*j*.1) of the definition of "remuneration" in subsection 100(1) of the *Income Tax Regulations* to ensure that an exemption from withholding on account of Part I tax applies in connection with distributions in a year from an RRIF that would be in respect of the minimum amount under the fund for the year if an assumption were made. The assumption is that each payment, scheduled at the beginning of the year to be paid after the time of the

RRIF distribution and in the year into the fund under an annuity contract held in connection with the fund at the beginning of the year, is paid into the fund in the year.

These amendments generally apply to the 1998 and subsequent taxation years. However, the application of the amendment is subject to grandfathering that preserves some existing grandfathering that applies to certain pre-March 1986 plans.

Subclause 171(2)

"qualified investment"

The definition of "qualified investment" in subsection 146.3(1) of the Act sets out the types of property that a trust governed by an RRIF is permitted to hold. If a trust governed by an RRIF acquires or holds a property that is not a "qualified investment", there are generally unfavourable tax consequences for the RRIF annuitant under subsection 146.3(7) of the Act or the trust under Part XI.1 of the Act. Under the existing rules, an annuity contract is not a qualified investment for a trust governed by an RRIF.

Paragraphs (*b*.1) and (*b*.2) of the definition are added, effective after 1996, so that an RRIF trust can hold certain types of annuity contracts as qualified investments.

New paragraph (*b*.1) permits a trust governed by an RRIF to hold one type of annuity. The conditions that an annuity must satisfy to qualify under paragraph (*b*.1) are identical to the conditions that an annuity must satisfy under the new RRSP rules for qualified investments, described in the commentary on those provisions. Accordingly, where on maturity a trusteed RRSP holds such an annuity, it will be possible to transfer the annuity to an RRIF trust instead of disposing of it. An RRIF trust could also acquire such an annuity directly from an insurer.

New paragraph (*b*.2) permits an RRIF trust to hold a second type of annuity without penalty where the annuity satisfies six conditions:

- (1) periodic payments under the annuity contract are required to be made on an annual or more frequent basis;

- (2) the RRIF trust must be the only person that has the right to receive any annuity payments under the contract (unless the trust disposes of the annuity);

- (3) neither the time nor the amount of any payment under the contract can vary because of the length of any life, other than the life of the RRIF annuitant, except that where the annuitant under the fund has elected to have the carrier pay the minimum amount each year to the annuitant's spouse after the annuitant's death, the payments under the contract can be based on the joint lives of the annuitant and the annuitant's spouse;

- (4) the date on which the periodic payments began or are to begin must be no later than the end of the year following the year in which the contract was acquired by the trust;

- (5) the annuity contract must be either

  (a) a life annuity for the life of the RRIF annuitant or, where the RRIF annuitant had a spouse when the contract was acquired, for the joint lives of the RRIF annuitant and the RRIF annuitant's spouse, that does not have a guaranteed period that runs past the end of the year in which the RRIF annuitant attains 90 years of age, except that where the RRIF annuitant had a spouse at the time that the contract was acquired, the guaranteed period, if any, can run up to the end of the year in which the spouse attains 90 years of age (if it is a later year), or

  (b) a term annuity with a term equal to either 90 years minus the age of the RRIF annuitant at the date on which the periodic payments start or 90 years minus the age of the RRIF annuitant's spouse as of that date; and

- (6) the periodic payments must be equal unless

  (a) they have been adjusted for reasons that would, if the contract were an annuity under a retirement savings plan, be in accordance with the indexing or other options provided under subparagraphs 146(3)(*b*)(iii) to (v) of the Act, or

> (b) they have been uniformly reduced as a consequence of a partial surrender of the right to receive periodic payments under the contract.

New paragraph (*c*.2) of the definition "qualified investment" in subsection 146(1) is very similar to new paragraph (*b*.2) of the definition "qualified investment" in subsection 146.3(1). An annuity that qualifies under paragraph (*c*.2) will generally qualify under the RRIF rules, thus making it possible to transfer such an annuity to an RRIF on the maturity of the RRSP that holds it.

Subclause 171(3)

ITA
146.3(2)(*a*)

Subsection 146.3(2) of the Act sets out the conditions that must be satisfied in order to register a retirement income fund.
Paragraph 146.3(2)(*a*) of the Act describes the payments that may be made out of a RRIF.

When the Statute Revision Commission revised the Act in the Fifth Supplement of the Revised Statues of Canada, 1985, the reference in paragraph 146.3(2)(*a*) to paragraph (1)(*f*), which defined the term "retirement income fund", was erroneously replaced with the term "retirement income" in the English version of the Act. This amendment corrects that error by adding the word "fund" to the term "retirement income". The amendment applies to taxation years that end after November 1991, as these are the taxation years to which the amendment which gave rise to the error applied.

Subclauses 171(4) to (6)

Registration

ITA
146.3(2)(*e*) to (*e*.2)

Subsection 146.3(2) of the Act sets out the conditions that a retirement income fund must meet before Revenue Canada will register the fund.

Paragraph 146.3(2)(*e*) of the Act sets out one condition for registration — that the arrangement between the carrier and the RRIF annuitant give the RRIF annuitant the right to direct the carrier to transfer the property held in connection with the fund to another carrier. However, this condition is subject to paragraph 146.3(2)(*e*.1) of the Act under which the carrier must retain sufficient property to enable it to pay the "minimum amount" for the year to the annuitant. If this requirement were not imposed, the minimum amount might not be paid in the year of transfer as the original carrier would have no property with which to pay it and the minimum amount for that year in respect of the transferee fund could be nil because the minimum amount is based on the fair market value of the property held by a carrier at the beginning of a year.

Paragraph 146.3(2)(*e*) is amended to make the RRIF annuitant's right to demand a transfer of the property held in connection with the fund subject to either paragraph 146.3(2)(*e*.1) or new paragraph 146.3(2)(*e*.2) of the Act, depending on the circumstances.

Paragraph 146.3(2)(*e*) is also amended to remove the requirement that the transfer be made in prescribed form and manner. This amendment, which applies to all retirement income funds, is consistent with other types of transfers between registered plans.

Paragraph 146.3(2)(*e*.1) is amended so that it applies to an RRIF that governs a trust only if the trust was created before 1998 and the trust does not hold an annuity contract as a qualified investment. In any other case where an RRIF governs a trust, new paragraph 146.3(2)(*e*.2) applies.

Like paragraph 146.3(2)(*e*.1), new paragraph 146.3(2)(*e*.2) essentially requires the carrier to retain sufficient property to enable it to pay the "minimum amount" for the year to the annuitant after the transfer. However, paragraph 146.3(2)(*e*.2) provides special rules dealing with the holding of annuity contracts as qualified investments. While annuities that can be surrendered for cash are treated in the same manner as other RRIF property, in the case of other annuities, the "fair market value" of the retained annuity is ignored. Instead, only the annuity payments estimated to be made after the transfer and in the year of the transfer will effectively be considered to have been retained by the RRIF trust for the purposes of new paragraph 146.3(2)(*e*.2).

These amendments apply to retirement income funds entered into after July 13, 1990, which is the date on which the withholding requirement under paragraph 146.3(2)(*e*) first applied. However, the amendment to paragraph 146.3(2)(*e*) removing the requirement that transfers be made in prescribed form and manner applies to all retirement income funds.

Subclause 171(7)

ITA
146.3(5)

Under subsection 146.3(5) of the Act, amounts received by taxpayers from RRIFs are included in computing income, other than certain amounts already included in computing income.

Subsection 146.3(5) is amended so that amounts received from a depositary RRIF that relate to interest or another amount that accrued after the end of the first calendar year commencing after the death of the annuitant are likewise not included in computing income under subsection 146.3(5), if such interest or other amount has been included in computing income otherwise than because of section 146.3 of the Act.

This amendment applies to deaths occurring after 1992.

Subclause 171(8)

ITA
146.3(6.2)

Subsection 146.3(6) of the Act generally requires an amount to be included in computing the income of the last annuitant under a RRIF on death. The amount is equal to the fair market value of the RRIF assets at the time of death. However, subsection 146.3(6.2) of the Act allows a deduction in computing such income. The maximum deduction is equal to a specified percentage of total "designated benefits" in respect of the fund. To the extent that less than the maximum deduction is claimed on behalf of the deceased annuitant, RRIF amounts can be distributed on a tax-free basis to RRIF beneficiaries. As defined in subsection 146.3(1) of the Act, "designated benefits" in respect of a RRIF are essentially amounts

that would be "refunds of premiums" (or could be deemed to be "refunds of premiums" under subsection 146(8.1) of the Act) if the RRIF were an RRSP.

The description of A in subsection 146.3(6.2) is amended so that the deduction under subsection 146.3(6.2) in respect of a RRIF's assets is based not only on designated benefits, but also on amounts that would be excluded from the definition of "designated benefits" because they would be "tax-paid amounts" if the RRIF were an RRSP. As described in the commentary on "refund of premiums" and "tax-paid amount", a "tax-paid amount" in respect of an RRSP is an amount included in income in respect of RRSP income for a taxation year for which the RRSP income is not exempt from tax under Part I. For further discussion, see the commentary on the amendment to subsection 146(8.9) of the Act.

This amendment applies to deaths occurring after 1992.

Clause 172

Deferred Profit Sharing Plans

ITA
147(19)

Section 147 of the Act contains the rules governing deferred profit sharing plans (DPSPs). Subsection 147(19) of the Act provides for direct transfers of lump sum amounts between DPSPs and to DPSPs from other deferred income plans.

Subparagraph 147(19)(*b*)(ii) of the Act refers to "a spouse (within the meaning assigned by subsection 146(1.1))" of the Act. That subsection, which described spouses so as to include common-law spouses, was repealed with the enactment of subsection 252(4) of the Act, which also describes spouses so as to include common law spouses for the purposes of the Act. This amendment to subparagraph 147(19)(*b*)(ii), which applies after 1992, therefore deletes the reference to subsection 146(1.1) of the Act.

Clause 173

Registered Pension Plans – Deemed RPP Registration

ITA
147.1(3)(*a*)

Paragraph 147.1(3)(*a*) of the Act deems a pension plan that has been submitted to Revenue Canada for registration to be a registered pension plan until a final determination is made as to the plan's registration. However, it specifically provides that the deemed registered status of a pension plan does not apply for the purposes of certain provisions of the Act that would otherwise allow the tax-free transfer of funds to be made from the plan.

Paragraph 147.1(3)(*a*) of the Act is amended to provide that it also does not apply for the purposes of new section 147.4 of the Act. In general terms, that section allows an individual to acquire ownership of an annuity contract, in satisfaction of the individual's entitlement to benefits under a registered pension plan, without adverse tax consequences provided certain conditions are satisfied. Thus, an individual cannot acquire ownership of an annuity contract under a pension plan on a tax-neutral basis until the plan is actually registered.

This amendment applies after 1996.

Clause 174

Registered Pension Plans – Deductibility of Contributions

ITA
147.2

Section 147.2 of the Act provides rules that govern the deductibility of employer and employee contributions to registered pension plans (RPPs).

Subclause 174(1)

ITA
147.2(2)(*b*)

Subsection 147.2(2) of the Act defines "eligible contributions" for the purpose of subsection 147.2(1) of the Act, which provides for the deduction of employer contributions to RPPs. Under subsection 147.2(2), an employer contribution to a defined benefit provision of an RPP is an eligible contribution where the contribution is made pursuant to the recommendation of an actuary, in whose opinion the contribution is required to fund the benefits provided under the provision, and the recommendation is approved by the Minister of National Revenue on the advice of the Superintendent of Financial Institutions.

Paragraph 147.2(2)(*b*) of the Act is amended to delete the requirement that the Minister obtain the advice of the Superintendent in order to approve an actuarial recommendation. This amendment, which applies after March 1996, is consequential on the transfer of the Pension Advice Section of the Office of the Superintendent of Financial Institutions to the Department of National Revenue.

Subclause 174(2)

ITA
147.2(4)(*b*)(iii)

Paragraph 147.2(4)(*b*) of the Act allows an individual to deduct past service contributions made to an RPP in respect of pre-1990 service when the individual was not an RPP contributor. The amount that may be deducted is subject to a cumulative limit imposed by subparagraph 147.2(4)(*b*)(iii) of the Act. For the purpose of calculating the limit, past service additional voluntary contributions (AVCs) deducted under subparagraph 8(1)(*m*)(ii) of the Act are included in the amount Z in the formula in subparagraph 147.2(4)(*b*)(iii).

The description of Z is amended to refer to past service AVCs that were deducted in computing income for taxation years before 1987, and to refer to subparagraph 8(1)(*m*)(ii) as it read in the year in which the deductions were claimed. This amendment is made because

subparagraph 8(1)(*m*)(ii) did not permit the deduction of past service AVCs after the 1986 taxation year.

This amendment applies to the 1991 and subsequent taxation years.

Subclause 174(3)

Deductible Contributions

ITA
147.2(6)

Paragraphs 147.2(4)(*b*) and (*c*) of the Act allow a taxpayer to deduct, within limits, contributions made to an RPP in respect of service before 1990.

Paragraph 147.2(4)(*b*) allows a taxpayer to deduct contributions in respect of pre-1990 service during which the taxpayer was not a contributor to an RPP. It limits the deduction in any given year to $3,500, and limits the cumulative amount that can be deducted to $3,500 times the number of years of such service.

Paragraph 147.2(4)(*c*) allows a taxpayer to deduct contributions in respect of pre-1990 service during which the taxpayer was an RPP contributor. It limits the deduction in any given year to $3,500 minus other RPP contributions deducted in the year, but imposes no cumulative limit on the amount that can be deducted.

Both paragraphs allow contributions that are not deducted in one year to be carried forward and deducted in a subsequent year, subject to the relevant limits.

New subsection 147.2(6) of the Act modifies paragraphs 147.2(4)(*b*) and (*c*) for the year in which a taxpayer dies and for the preceding year. It provides that, in determining the amounts that can be deducted under those paragraphs for those years, the $3,500 annual limits are disregarded. Subsection 147.2(6) does not change the cumulative limit on deductions under paragraph 147.2(4)(*b*).

This amendment, which applies to taxpayers who die after 1992, ensures that RPP contributions which a taxpayer was unable to deduct

prior to death – because of the $3,500 annual limits – can generally be deducted on death.

Clause 175

Registered Pension Plans – Transfers

ITA
147.3

Section 147.3 of the Act provides rules governing the transfer of funds from registered pension plans (RPPs) to registered retirement savings plans (RRSPs), registered retirement income funds (RRIFs) and other RPPs.

Subclause 175(1)

Taxation of Amount Transferred

ITA
147.3(10)(*a*)

Subsection 147.3(10) of the Act provides rules that apply where an amount is transferred on behalf of an individual from an RPP to an RRSP, a RRIF or another RPP otherwise than in accordance with subsections 147.3(1) to (7) of the Act. In these circumstances, paragraph 147.3(10)(*a*) of the Act deems the amount to have been paid from the RPP directly to the individual, as a result of which it is included in the individual's income under paragraph 56(1)(*a*) of the Act. Paragraph 147.3(10)(*a*) specifically provides that it applies notwithstanding section 254 of the Act which, under certain circumstances, may have applied to exempt the amount from immediate taxation.

Paragraph 147.3(10)(*a*) is amended to delete the reference to section 254. This amendment is consequential on the introduction of new section 147.4 of the Act and the amendments to section 254. For further details, see the commentary on those provisions.

This amendment applies to transfers occurring on or after July 31, 1997.

Subclause 175(2)

Annuity Contract Commencing After Age 69

ITA
147.3(15)

Subsection 147.3(15) of the Act contains rules relating to annuities acquired by individuals before 1997 to provide benefits in lieu of their entitlement to benefits under an RPP. The rules apply in the event that payment of the annuity does not begin by the end of the year in which the individual turns 69 years of age. As a consequence of the introduction of section 147.4 of the Act, which contains other provisions dealing with individually-owned annuity contracts, subsection 147.3(15) is renumbered as subsection 147.4(4) of the Act.

This amendment applies from the time of the introduction of subsection 147.3(15) (after 1996).

Clause 176

RPP Annuity Contracts

ITA
147.4

Section 147.4 of the Act provides a new set of rules that deal primarily with individuals acquiring ownership of annuity contracts in satisfaction of their entitlement to benefits under an RPP.

Subsection 147.4(1) of the act replaces, in modified form, the mechanism provided under paragraph 254(*a*) of the Act for individuals to acquire annuities under superannuation or pension funds or plans without adverse consequences. It restricts the application of the relief previously afforded by paragraph 254(*a*) to annuities acquired under RPPs.

Subsections 147.4(2) and (3) of the Act provide rules that apply where an annuity contract to which subsection 147.4(1) or paragraph 254(*a*) applies is amended or replaced.

Subsection 147.4(4) of the Act is simply a renumbering of existing subsection 147.3(15).

Subclause 176(1)

RPP Annuity Contract

ITA
147.4(1)

Subsection 147.4(1) of the Act applies where an individual acquires ownership of an annuity contract in satisfaction of the individual's entitlement to benefits under an RPP. This might occur, for example, where a plan discharges its benefit obligations with respect to an individual either by transferring ownership of an existing annuity contract held in connection with the plan to the individual or by purchasing an annuity contract under which the individual is both the annuitant and the owner. Under these circumstances, the individual is deemed not to have received an amount from the RPP as a result of acquiring the annuity and any amounts received under the contract are deemed to be amounts received under the RPP. As a consequence, there is no immediate taxation on acquisition of the annuity and any payments under the contract are included in the recipient's income in the year in which they are received.

Subsection 147.4(1) provides that these deeming rules apply with respect to the acquisition of an RPP annuity contract only if the following conditions are met:

- the rights provided for under the contract are not materially different from those provided for under the RPP;

- the contract does not provide for any further premiums to be paid after it is acquired by the individual; and

- at the time of acquisition, the registration of the plan is not revocable. However, under subsection 147.4(1), the Minister of National Revenue has the authority to ignore the fact that the registration of the plan is revocable. It is generally expected that the Minister would do so where there is no connection between the cause of the plan being revocable and the benefits being provided by way of the annuity.

Also, subsection 147.4(1) provides that the deeming rules do not apply where an individual acquires an interest in an annuity contract by way of a transfer to an RRSP or RRIF. In such cases, the rules governing inter-plan transfers in section 147.3 of the Act apply.

Subsection 147.4(1) is intended to protect annuity acquisitions only where the rights provided for under the annuity contract are the same as the rights provided for under the RPP (ignoring any immaterial differences). It is not intended to allow a plan member to reconfigure the amount or modify the form of the benefits provided for under the plan. Plan members who want such flexibility can achieve this by transferring the value of their pension entitlements to an RRSP or RRIF (within the constraints of section 147.3 of the Act).

Where an individual acquires ownership of an annuity contract under an RPP otherwise than in accordance with subsection 147.4(1), the individual is considered to have received a payment in kind from the RPP and is required to include the value of the contract in income under paragraph 56(1)(*a*) of the Act.

Subsection 147.4(1) applies to contract acquisitions occurring on or after July 31, 1997.

The following are examples of RPP annuity acquisitions that do not satisfy the conditions for the deeming rules in subsection 147.4(1) to apply.

EXAMPLE 1

On retirement, Catherine, a member of a defined benefit RPP is entitled to an indexed pension of $20,000 per year. Under the terms of the plan, Catherine is given the option of either transferring the value of her benefits to a locked-in RRSP (subject to the transfer limits) or acquiring from a life insurance company an indexed annuity of $20,000 per year. Catherine elects the annuity option, but foregoes the indexing in exchange for additional lifetime annuity payments of $5,000 per year (an option that was not provided for under the plan). Subsection 147.4(1) does not protect the acquisition of the annuity contract since it provides for rights that are materially different from those provided for under the RPP.

It should be noted that, had the plan allowed Catherine to give up indexing in exchange for higher lifetime retirement benefits, Catherine's pension adjustments under the plan would have been calculated based on those higher lifetime retirement benefits.

EXAMPLE 2

A money purchase RPP has not been amended to reduce the latest time for a member's pension to commence from the end of the year in which the member turns 71 years of age to the end of the year in which the member turns 69 years of age. At retirement, a 65 year old member, David, acquires ownership of an annuity contract that provides for commencement at age 71. Since the plan is revocable for failing to comply with the registration requirements for pension commencement, David's acquisition of the annuity is not protected by subsection 147.4(1). This is not a situation in which Revenue Canada would be expected to ignore the fact that the registration of the plan is revocable.

Amended Contract

ITA
147.4(2)

New subsection 147.4(2) of the Act contains rules relating to amendments to annuity contracts to which subsection 147.4(1) of the Act or paragraph 254(*a*) of the Act applies. The rules apply if the rights provided for under the contract are materially altered as a consequence of the amendment. In such a case, an individual with an interest in the contract immediately before the amendment is deemed to have received an amount from a pension plan equal to the fair market value of that interest. By virtue of paragraph 56(1)(*a*) of the Act, the individual is required to include this amount in income.

Subsection 147.4(2) also deems the amended contract to be a separate annuity contract. Consequently, paragraph 147.4(1)(*g*) or 254(*a*) cease to apply to payments made under the contract. The contract is also deemed not to have been issued pursuant to or under a superannuation or pension fund or plan. This ensures that the amended contract is not a prescribed annuity contract by virtue of paragraph 304(1)(*a*) of the *Income Tax Regulations* and may thus be subject to the accrual rules in section 12.2 of the Act. Finally, an

individual with an interest in the amended contract is deemed to have acquired the interest at the time of the amendment at a cost equal to the fair market value of that interest immediately after the amendment. This establishes the date of acquisition and the adjusted cost basis for purposes of the accrual rules.

Subsection 147.4(2) does not apply where an annuity contract is amended to provide for an earlier annuity commencement date in order to avoid the application of subsection 147.4(4) of the Act.

Subsection 147.4(2) applies to contract amendments occurring on or after July 31, 1997.

New Contract

ITA
147.4(3)

New subsection 147.4(3) of the Act contains rules relating to annuity contracts that replace contracts to which subsection 147.4(1) or paragraph 254(*a*) of the Act applies. As long as the rights provided for under the new contract are not materially different from those provided for under the original contract, the new contract is considered to be the same contract as the original contract. As a result, any annuity payments received under the new contract will be treated as superannuation or pension benefits by virtue of paragraph 147.4(1)(*g*) or 254(*a*) of the Act.

However, where the rights are materially different, an individual with an interest in the original contract is deemed to have received an amount from a pension plan equal to the fair market value of that interest. By virtue of paragraph 56(1)(*a*) of the Act, the individual is required to include this amount in income. Since the replacement contract is a new contract, neither subsection 147.4(1) nor paragraph 254(*a*) applies with respect to annuity payments received under the contract. As a result, the new contract is subject to the tax treatment that would normally apply to an annuity contract that is not issued pursuant to a pension plan.

New subsection 147.4(3) applies to contract replacements occurring on or after July 31, 1997.

Annuity Contract Commencing After Age 69

ITA
147.4(4)

Subsection 147.3(15) of the Act is renumbered as subsection 147.4(4) of the Act. Subsection 147.3(15) deals with individually-owned RPP annuity contracts that were acquired before 1997 and under which payments do not begin by the end of the year in which the individual turns 69 years of age. This renumbering is consequential on the introduction of section 147.4 of the Act.

Clause 177

Eligible Funeral Arrangements

ITA
148.1

Section 148.1 of the Act, in conjunction with paragraph 149(1)(*s*.1) of the Act provides for the tax-free build-up of income earned on contributions made under an "eligible funeral arrangement". The contribution limit under the existing law is $15,000 per arrangement.

Subclauses 177(1) to (5)

ITA
148.1(1) and (2)

The expression "cemetery care trust" is introduced in subsection 148.1(1) of the Act. It is defined as a trust established pursuant to an Act of a province for the care and maintenance of a cemetery. (Such trusts are sometimes known as perpetual care funds.) New paragraph 149(1)(*s*.2) of the Act ensures that income earned in a cemetery care trust is expressly exempt from taxation. However, under the definition "eligible funeral arrangement", contributions to such trusts are relevant for the purposes of determining whether an arrangement with a cemetery operator is considered to be an "eligible funeral arrangement". If an arrangement with a cemetery operator is not an "eligible funeral arrangement", any

income earned under a pre-needs cemetery contract that is part of such an arrangement would be subject to taxation.

The definition "eligible funeral arrangement" is amended so that the contribution limit for an arrangement that only covers "cemetery services" is $20,000, rather than $15,000. "Cemetery services" is defined as property and services that relate directly to cemetery arrangements in Canada, including property and services to be funded out of a cemetery care trust. (However, the postamble to the definition "eligible funeral arrangement" ensures that payments made for the immediate acquisition of burial rights or of any interest in a building or structure for the placement of human remains is ignored for the purposes of the contribution limit, to the extent that such payments are not applied as a contribution to a cemetery care trust.)

The definition "eligible funeral arrangement" is also amended so that the contribution limit for an arrangement that combines funeral and cemetery arrangements is $35,000. This amendment is necessary because, in some provinces, funeral and cemetery services can be provided by the same operator.

The definition "funeral services" is amended so that "cemetery services" are no longer included within the definition. The existing definition "funeral services" is effectively replaced within subsections 148.1(1) and (2) of the Act by the new definition "funeral or cemetery services", which is defined as "funeral services" or "cemetery services" with respect to an individual, or any combination of such services. The definitions "custodian", "qualifying person" and "relevant contribution" in subsection 148.1(1) are also amended, strictly as a consequence of the new definition "funeral or cemetery services".

These amendments apply to the 1993 and subsequent taxation years.

Subclause 177(6)

Income Inclusion on Return of Funds

ITA
148.1(3)

Subsection 148.1(3) of the Act provides for an income inclusion in the event that there is return of funds from an eligible funeral arrangement. It is amended so that, for this purpose, any transactions with, or balances under, a cemetery care trust are ignored. As cemetery care trusts are irrevocable under provincial law, it is not necessary that growth under such trusts be considered for the purposes of this subsection.

This amendment applies to the 1993 and subsequent taxation years.

Clause 178

Exemptions from Tax

ITA
149

Section 149 of the Act exempts certain taxpayers from tax under Part I of the Act and provides special rules for such taxpayers.

Subclause 178(1)

ITA
149(1)(*d*) to (*d*.5)

Paragraph 149(1)(*d*) of the existing Act exempts from tax the taxable income of any corporation, commission or association at least 90 per cent of the shares or capital of which is owned by the federal government, a provincial government or a Canadian municipality. This exemption also applies to a wholly-owned subsidiary of such a corporation, commission or association.

The amendment to paragraph 149(1)(*d*) and new paragraphs 149(1)(*d*.1) to (*d*.5) of the Act clarify the scope of the

exemption in various situations where an entity or a combination of entities owns either 100 per cent or at least 90 per cent of the shares or capital of a corporation, commission or association.

Revised paragraph 149(1)(*d*) exempts from tax under Part I a corporation, commission or association if 100 per cent of its shares or capital are owned by Her Majesty in right of Canada or a province.

New paragraph 149(1)(*d*.1) provides a similar exemption where at least 90 per cent of the shares or capital of the corporation, commission or association are owned by Her Majesty in right of Canada or of a province.

New paragraph 149(1)(*d*.2) exempts from tax under Part I a wholly-owned corporation subsidiary to a corporation, commission or association all of the shares or of the capital of which is owned by Her Majesty in right of Canada or a province, as well as any wholly-owned corporation that is subsidiary to such a wholly-owned subsidiary.

New paragraph 149(1)(*d*.3) exempts from tax under Part I a corporation, commission or association if not less than 90 per cent of its shares or capital are owned by Her Majesty in right of Canada or a province, a corporation, commission or association that is tax-exempt under paragraph 149(1)(*d*), a wholly-owned corporation subsidiary to such corporation, commission or association or by one or more municipalities in combination with any such entity.

New paragraph 149(1)(*d*.4) exempts from tax under Part I a corporation the shares or capital of which are owned by a corporation, commission or association that is, itself, exempt under any of paragraphs 149(1)(*d*) to (*d*.3) or a corporation to which new paragraph 149(1)(*d*.4) already applies.

New paragraph 149(1)(*d*.5) includes a geographical restriction to ensure that the tax exemption for a municipal subsidiary corporation applies only where no more than 10 per cent of its income is earned from activities carried on outside the geographical boundaries of the municipalities owning the shares or capital of the corporation. Finally, the requirement in paragraph 149(1)(*d*) that no person other than a government or municipality may have a right to acquire shares

or capital of an otherwise eligible corporation, commission or association is moved to new subsection 149(1.1).

Subclause 178(2)

Pension Corporations

ITA
149(1)(*o*.1)

Paragraph 149(1)(*o*.1) of the Act provides an exemption from tax under Part I of the Act for corporations incorporated and operated solely for the administration of a registered pension plan, where the corporation has been accepted by the Minister of National Revenue as a funding medium for the purposes of the registration of a pension plan.

Paragraph 149(1)(*o*.1) is amended, applicable to the 1994 and subsequent taxation years, to provide that such corporations may also act as trustees and administrators of trusts governed by retirement compensation arrangements, where those arrangements provide for benefits supplementary to those provided under the registered pension plan.

Subclause 178(3)

Cemetery Care Trust

ITA
149(1)(*s*.2)

New paragraph 149(1)(*s*.2) of the Act provides that a "cemetery care trust", as defined by subsection 148.1(1) of the Act, is exempt from tax under Part I of the Act on its taxable income. For further detail, see the commentary on subsection 148.1(1).

This amendment applies to the 1993 and subsequent taxation years.

Subclause 178(4)

ITA
149(1.1) to (1.3)

New subsection 149(1.1) of the Act is consequential on the amendments to paragraph 149(1)(*d*) of the Act and the introduction of paragraphs 149(1)(*d*.1) to (*d*.5) of the Act. It contains the requirement that, in order for a corporation, commission or association to benefit from the exemption provided under any of those provisions, only the federal government, a province or a municipality can have the right to acquire shares or capital of the corporation, commission or association.

New subsection 149(1.2) of the Act is consequential on the introduction of new paragraph 149(1)(*d*.5). It excludes certain income from the determination of whether more than 10 per cent of the income of a corporation, commission or association to which that paragraph applies is derived from activities carried on outside the geographical boundaries of the municipality or municipalities that own the corporation, commission or association. Specifically, income derived from activities carried on pursuant to an agreement in writing with Canada, a province, or a municipality, within its geographical boundaries, are not included in the determination.

New subsection 149(1.3) of the Act provides that, for the purposes of new paragraph 149(1)(*d*.5) and subsection (1.2), 90 per cent of the capital of a corporation is to be considered to be owned by a person only if that person is entitled to at least 90 per cent of the votes associated with the shares of the corporation.

All these amendments apply to taxation years and fiscal periods commencing after 1997.

Subclauses 178(5) and (6)

ITA
149(10)

Subsection 149(10) of the Act sets out the tax treatment of a corporation that either becomes or ceases to be exempt from tax under Part I of the Act (otherwise than because of paragraph 149(1)(*t*)

of the Act, which exempts certain farmers' and fishers' insurers). In broad terms, subsection 149(10) provides for:

- a taxation year-end;
- the mandatory deduction of available reserves;
- the fair market value disposition and reacquisition of the corporation's property;
- the preservation of latent recapture on depreciable property; and
- a limitation on loss carry-forwards.

The principle underlying subsection 149(10) is that where a corporation's tax status changes, it ought to be treated more or less as though it had begun a new existence. This amendment applies that "fresh start" principle more comprehensively, drawing a clearer line between a corporation's tax position before it becomes or ceases to be exempt, and its position once that has happened. This is accomplished chiefly by broadening the deemed disposition and reacquisition rule in paragraph 149(10)(*b*) of the Act and by substantially reworking the portion of the subsection that follows that paragraph.

Paragraph 149(10)(*a*) of the Act is amended to allow a corporation that becomes or ceases to be tax-exempt to establish a new fiscal period for taxation years that begin after that change in its status.

The deemed disposition and reacquisition rules in paragraph 149(10)(*b*) are made more complete by deleting the existing exception for the resource properties of a corporation that ceases to be tax-exempt. A corporation will be treated as having disposed of all of its property for proceeds equal to its fair market value, at the "disposition time" – that is, the time immediately before the time immediately before it becomes or ceases to be exempt.

Next, the amendment replaces existing paragraphs 149(10)(*c*) and (*d*) of the Act. Paragraph 149(10)(*c*) currently applies where the corporation's capital cost of a depreciable property exceeds the property's fair market value. To ensure that on a later disposition of the property the corporation is subject to the recapture of any

excess capital cost allowance it claimed before its status changed, the paragraph preserves the property's capital cost, and treats the excess as having been allowed as capital cost allowance. In keeping with the more complete separation between the tax history of a corporation before its status changes and its treatment afterwards, this rule is deleted.

New paragraph 149(10)(*c*), which is unrelated to the existing provision, provides that a corporation that becomes or ceases to be exempt from tax is to be treated for certain purposes of the Act as a new corporation the first taxation year of which began with its change in status. Those purposes include: the scientific research and experimental development deduction and credit under sections 37 and 127.3, the resource property rules in sections 65 to 66.4 and 66.7, loss carryovers under section 111, foreign tax credits under section 126, and investment tax credits under subsections 127(5) to (26) of the Act. New paragraph 149(10)(*c*) thus precludes a corporation whose tax status changes from subsequently using any of the listed deductions and credits it may have accumulated before the change, and vice versa.

Existing paragraph 149(10(*d*) limits a corporation's use of losses incurred before its tax status changed. Since new paragraph 149(10)(*c*) denies any carryover of losses across a change in status, existing paragraph (*d*) is superfluous. It is replaced with a rule requiring the corporation to realize any latent loss in respect of its cumulative eligible capital (CEC). Where, immediately before the disposition time, the corporation's CEC in respect of a business exceeds the total of 3/4 of the fair market value of the business's eligible capital property and the CEC amount otherwise deducted under paragraph 20(1)(*b*) of the Act for the corporation's last taxation year before its tax status changes, the excess is to be deducted in computing the corporation's income for that year.

These changes to subsection 149(10) apply where a corporation becomes or ceases to be exempt from tax under Part I of the Act after April 26, 1995.

Subclause 178(7)

ITA
149(11)

Subsection 149(11) of the Act provides that subsection 149(10) of the Act does not apply to a corporation that becomes or ceases to be exempt from tax because its control is acquired, if the acquisition of control takes place pursuant to an agreement in writing entered into on or before November 12, 1981. With the passage of time, this transitional rule has become redundant. The subsection is repealed on Royal Assent to this legislation.

Clause 179

Charities – Disbursement Quota

ITA
149.1(1)

Section 149.1 of the Act contains rules relating to registered charities. Definitions for purposes of these rules are found in subsection 149.1(1) of the Act.

The definition "disbursement quota" in subsection 149.1(1) means an amount determined by a formula which requires that a charity spend a specified proportion of donations for which tax receipts are issued, and in the case of charitable foundations a specified percentage of the value of investment assets, on charitable activities or gifts to other charities.

This formula was introduced by the Statute Revision Commission in the Fifth Supplement of the Revised Statutes of Canada, 1985, to replace the then-existing narrative description of the disbursement quota. The formula erroneously departed from the underlying structure of the disbursement quota, by failing to properly account for the mathematical relationship between gifts received by a charitable foundation and the amount that such a foundation is required to disburse. This amendment to the definition, which generally applies to taxation years that end after November 1991, restores the correct relationship between these two factors.

Clause 180

Returns

ITA
150

Section 150 of the Act sets out the requirements relating to the filing of tax returns.

Subclause 180(1)

ITA
150(1)(*d*)(ii)(A)

Subsection 150(1) of the Act requires taxpayers to file their income tax returns by certain dates. Clause 150(1)(*d*)(ii)(A) of the Act is amended to replace the reference to "tax shelter" with "tax shelter investment" consequential on the enactment of the definition "tax shelter investment" in new subsection 143.2(1) of the Act. Generally, this amendment applies to the 1995 and subsequent taxation years.

Subclause 180(2)

Death of Partner or Proprietor

ITA
150(4)

Subsection 150(4) of the Act allows an individual's legal representative to file a separate return in the event that an individual dies after the end of a fiscal period of a business, in circumstances where a second fiscal period ends in the year because of the individual's death. (In contrast, where a second fiscal period does not end, subsection 70(2) of the Act may apply to the value of any "rights or things" receivable at the time of death in respect of the business.) Concurrent to the addition of new subsections 34.1(9) and 34.2(8) of the Act, subsection 150(4) is expanded in scope,

- to allow the representative to report the balance of the individual's reserve in respect of December 31, 1995 income in a separate return; and

- where the individual reports business income according to the "alternative fiscal period method" (i.e. with an off-calendar year-end), to permit a deduction in that separate return for any amount that is required to be included in income in the year of death on the subsection 150(1) return pursuant to new subsection 34.1(9).

New subsection 150(4) is applicable to 1996 and subsequent taxation years.

Clause 181

Assessments

ITA
152

Section 152 of the Act contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer and to determinations and redeterminations of amounts of tax deemed to have been paid by a taxpayer.

Subclause 181(1)

Provisions Applicable

ITA
152(1.2)

Subsection 152(1.2) of the Act provides for the application of paragraphs 56(1)(*l*) and 60(*o*) and Divisions I and J as they relate to assessments and to various determinations and redeterminations made under Part I of the Act. An exception is made, however, to ensure that subsections 152(1) and (2) of the Act do not apply to determinations made under subsections 152(1.1) and (1.11) of the Act.

This amendment to subsection 152(1.2) provides for a new exception: subsection 164(4.1) of the Act will not apply in respect of determinations and redeterminations made under new subsection 152(1.4) of the Act, which deals with partnerships. (For further information, reference may be made to the commentary on that provision.) Therefore, where a Court, on the disposition of an appeal of a determination or redetermination in respect of a partnership, orders the Minister of National Revenue to make a redetermination, the Minister will have discretion not to make the redetermination or to refund any resulting overpayment immediately, but to wait until all rights of appeal have expired.

The amendment applies to determinations made after Royal Assent.

Subclause 181(2)

ITA
152(1.4) to (1.8)

New subsections 152(1.4) to (1.8) of the Act provide rules to deal with partnerships. These new subsections apply to determinations made after Royal Assent.

Determination in Respect of a Partnership

ITA
152(1.4)

New subsection 152(1.4) of the Act provides the Minister of National Revenue with the authority to determine any income or loss of a partnership for a fiscal period within three years after the later of the day on which an information return in respect of the partnership for the fiscal period is required to be filed under section 229 of the *Income Tax Regulations* and the day on which the return is actually filed. This determination is made at the partnership level. The Minister will also have the authority to determine any deduction, amount or matter at the partnership level or relating to the partnership and that is considered relevant in determining the tax liability of, and various amounts payable by, or refundable to, the members of the partnership under the Act for any taxation year. This amendment applies on Royal Assent.

Notice of Determination

ITA
152(1.5)

Under new subsection 152(1.5) of the Act, the Minister of National Revenue must send a notice of the determination made under subsection 152(1.4) of the Act in respect of the fiscal period of a partnership to the partnership as well as to each person who was, during that fiscal period, a member of the partnership.

Absence of Notification

ITA
152(1.6)

New subsection 152(1.6) of the Act clarifies that a determination made under subsection 152(1.4) of the Act in respect of a partnership will still be valid even though one or more members of the partnership do not receive a notice of the determination. This could happen, for example, where the address of a member changed since the last filing of the partnership return under section 229 of the *Income Tax Regulations*.

Binding Effect of Determination

ITA
152(1.7)

New subsection 152(1.7) of the Act provides that a determination or redetermination made by the Minister of National Revenue in respect of a partnership under subsection 152(1.4) of the Act is binding on the Minister and all the members of the partnership in spite of the fact that the determination or redetermination was made at the partnership level. The Minister will then have one year after the expiration of the right to object or to appeal of a designated member of the partnership, as provided under new subsection 165(1.15), to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, any member of the partnership and any other affected taxpayer (such as a member's spouse). Such assessment or determination can only be made to the extent that it is necessary to give effect to the determination or

redetermination that was previously made at the partnership level or to a decision of a court in respect of that determination or redetermination.

Time to Assess

ITA
152(1.8)

New subsection 152(1.8) of the Act will come into play where the Minister of National Revenue makes a determination at the partnership level but it is subsequently demonstrated that there is no partnership or that a taxpayer in respect of which an assessment or determination was made on the basis that the taxpayer was a member of the partnership is not, in fact, a member of the partnership. In such cases, the one year time limit for the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, any taxpayer will start not after the day on which all rights of objection and appeal in respect of the determination made at the partnership level expired or are determined (as it would otherwise be under new paragraph 152(1.7)(*b*) of the Act), but after the day where it is demonstrated that there is no partnership or that the taxpayer is not a member of the partnership.

The authority for the Minister to make an assessment or determination under subsection 152(1.8) is restricted to the extent that the assessment or determination must be related to the same issues that triggered the making of a determination at the partnership level under subsection 152(1.4) of the Act and to the finding that no partnership existed or that the taxpayer is not a member of the partnership.

Subclause 181(3)

Definition of "normal reassessment period"

ITA
152(3.1)

The time within which the Minister of National Revenue may generally reassess is known as the "normal reassessment period", as defined by subsection 152(3.1) of the Act. More specifically, the

normal reassessment period is the 3 or 4-year period beginning after the day of mailing of a notice of an original assessment for a taxation year or the day of mailing of a notification that no tax is payable for the year. Subsection 152(3.1) is amended so that the definition of normal reassessment period applies for the purpose of new subsection 152(4.01). That provision limits the matters in respect of which the Minister can reassess, where a reassessment to which paragraph 152(4)(*a*) or (*b*) of the Act applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. A similar limitation was previously found in subsections 152(4) and (5) of the Act. Subsection 152(3.1) is also amended to clarify that the normal reassessment period begins to run from the time that is the earlier of the day of mailing of an original assessment and the day of mailing of a notification that no tax is payable.
Subsection 152(3.1) applies after April 27, 1989.

Subclause 181(4)

Assessment and Reassessment

ITA
152(4)

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*) of the Act have been met. More specifically, paragraph 152(4)(*a*) provides that the Minister may reassess at any time in cases of misrepresentation or fraud or where a waiver has been filed within the normal reassessment period for the taxpayer in respect of the year. Paragraph 152(4)(*b*) 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 required because of an adjustment described in subsection 152(6) of the Act, such as the carryback of a loss, or is made as a consequence of certain other matters described in that paragraph.

Subsection 152(4) is amended as a consequence of the addition of new subsection 152(4.01) of the Act. That provision limits the matters in respect of which the Minister may reassess, where a

reassessment to which paragraph 152(4)(*a*) or (*b*) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. A similar limitation was previously found in subsections 152(4) and (5). This amendment applies after April 27, 1989.

Subparagraph 152(4)(*b*)(v) of the Act is introduced to allow the Minister to reassess a taxpayer within 3 years after the end of the normal reassessment period where the reassessment is made as a consequence of a reduction under subsection 66(12.73) of the Act of an amount purported to be renounced under section 66 in respect of a flow-through share. This amendment applies to the 1996 and subsequent taxation years.

Assessment to which par. 152(4)(*a*) or (*b*) applies

ITA
152(4.01)

New subsection 152(4.01) of the Act limits the matters in respect of which the Minister of National Revenue can reassess, where a reassessment to which paragraph 152(4)(*a*) or (*b*) of the Act applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. In general terms, such a reassessment can be made only to the extent that it can reasonably be regarded as relating to a misrepresentation, fraud or waiver, or a matter specified in any of subparagraphs 152(4)(*b*)(i) to (v) of the Act, because of which the Minister is able to reassess beyond the normal reassessment period. This limitation replaces similar ones in subsections 152(4) and (5) of the existing Act. New subsection 152(4.01) applies after April 27, 1989, except that the reference to subparagraph 152(4)(*b*)(v) dealing with adjustments to flow-through share renunciations applies only to the 1996 and subsequent taxation years.

Subclause 181(5)

Limitation on Assessments

ITA
152(5)

Subsection 152(5) of the Act provides that where the Minister of National Revenue reassesses a taxpayer's tax for a taxation year beyond the normal reassessment period for the taxpayer in respect of the year in a case of fraud or misrepresentation or on the authority of a waiver filed by the taxpayer, the reassessment shall not include in income any amount not previously included in respect of which the taxpayer did not commit a fraud or misrepresentation or that does not relate to a matter specified in the waiver. Subsection 152(5) is amended as a consequence of the addition of new subsection 152(4.01) of the Act. New subsection 152(4.01) will henceforth limit the matters in respect of which the Minister may reassess, where a reassessment to which paragraph 152(4)(*a*) or (*b*) of the Act applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year. Subsection 152(5) will, however, continue to circumscribe the Minister's power to reassess beyond the normal reassessment period where, for example, a reassessment is made pursuant to subsection 165(3) of the Act as a consequence of an objection filed by a taxpayer to a notice of assessment. This amendment applies after April 27, 1989.

Subclause 181(6)

ITA
152(6)

Subsection 152(6) of the Act provides for the reassessment of tax payable for a taxation year where a deduction or credit is being claimed as the result of a carryback from a subsequent taxation year.

The subsection is amended to require the Minister of National Revenue to reassess a deceased taxpayer's return for the year prior to the year of death where a deduction is claimed for that prior year under subsection 147.2(4) of the Act as modified by new subsection 147.2(6) of the Act.

Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

This amendment to subsection 152(6) applies to taxpayers who die after 1992.

Clause 182

Withholding

ITA
153

Section 153 authorizes the withholding of tax from any of the payments described in subsection (1). Paragraph 153(1)(*d*.1) of the Act is amended to add a reference to the *Unemployment Insurance Act*, which was repealed by Bill C-12. This amendment is deemed to have come into force on June 30, 1996.

Clause 183

Tax Transfer Payments

ITA
154(2)

Subsection 154(2) of the Act permits the Minister of National Revenue to make a tax transfer payment in respect of an individual to the government of a province in certain cases where the individual has filed a return under the Act.

Paragraph 154(2)(*a*) of the Act is amended to clarify that the return filed with the Minister must be a return of income under Part I of the Act.

This amendment applies to the 1996 and subsequent taxation years.

Clause 184

Instalment Payments – Corporations

ITA
157

Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable.

Subclause 184(1)

Special Case

ITA
157(2)(*c*)

Subsection 157(2) of the Act sets out conditions under which a co-operative corporation or a credit union is permitted to make only one payment of the whole of its tax payable for a taxation year, rather than having to make instalments.

Subsection 157(2) is amended to ensure that these conditions apply to credit unions on a year-by-year basis. It is also amended to eliminate unnecessary words in existing paragraph 157(2)(*a*) of the Act.

These amendments apply to taxation years that end after February 22, 1994.

Subclause 184(2)

ITA
157(3)

Subsection 157(3) of the Act provides a reduction of the amount to be paid by instalments of tax for a year by certain corporations entitled to claim amounts deemed by the Act to have been paid on account of their taxes for the year.

This subsection is amended to add new paragraph 157(3)(*e*) which will allow the reduction of instalments to take into consideration the

deemed payment under subsection 127.1(1) of the Act in respect of the taxpayer's refundable investment tax credit for the year and under subsection 125.5(3) in respect of the taxpayer's film and video production services tax credit for the year.

This amendment generally applies to taxation years that end after February 22, 1994.

Clause 185

Acting For Another

ITA
159(1),(2) and (3)

Subsections 159(1), (2) and (3) of the Act provide that:

- a person required to file a tax return for another (in this note referred to as a "taxpayer") must make payments on behalf of the taxpayer,
- a responsible representative who acts in a fiduciary or representative capacity for a taxpayer must obtain a certificate before distributing the property of the taxpayer, certifying that liability under the Act has been satisfied, and
- such a person may be held personally liable to pay the taxpayer's liability, to the extent of the value of property under the person's control that is distributed without obtaining a certificate.

The amendments to subsections 159(1), (2) and (3) first change references to "persons required to file a return" and to "responsible representatives" to a uniform reference to legal representative. A new definition of "legal representative" is concurrently added to subsection 248(1) of the Act.

Amended subsection 159(1) provides that the legal representative of a taxpayer is jointly liable with the taxpayer to pay any amount payable by the taxpayer and to perform any duty or obligation imposed under the Act. This clarifies that, for all purposes of the Act (including assessments, objections and appeals as well as collection,

administration and enforcement), the legal representative is considered to be the taxpayer's agent; for example, where the legal representative carries on the business of the taxpayer, the representative will be required to deduct, withhold and remit amounts that the taxpayer would have been required to deduct, withhold and remit. Further, actions and proceedings under this Act taken by the representative (in that capacity) or taken by the Minister against the representative, will be binding on the taxpayer. For example, the issuance of a notice of assessment against a legal representative of the taxpayer (say a parent corporation that wound up its subsidiary and acquired its assets) will have the same effect as if it had been issued against the dissolved taxpayer at that time, assuming it had been in existence at the time. Conversely, the Minister will be bound by and the legal representative will benefit from, the same time limitations and safeguards as would have applied to an assessment made against the taxpayer.

Under new subparagraph 159(1)(*a*)(i) of the Act, the liability of the legal representative to pay an amount extends to any amount payable by the taxpayer under the Act at or before the time legal representative is called upon for a payment. Important safeguards exist in subparagraphs 159(1)(*a*)(i) and (ii) of the Act against too broad an application of the joint and several liability rules. The liability of the legal representative acting in good faith is limited to the property in the possession or control of the legal representative when that person is called upon to make a payment on behalf of the taxpayer, or to any proceeds of disposition and replacement property obtained by the legal representative from that property. Moreover, the legal representative is only liable to perform those obligations and duties under the Act that can reasonably be considered to relate to his responsibilities as representative. For example, a representative who has a general power of attorney will have broader responsibilities than one whose authority is limited to certain assets of the taxpayer.

These amendments clarify that the Minister of Revenue may reassess the legal representative of a taxpayer during the normal reassessment period notwithstanding that the taxpayer may have been dissolved and liquidated. Thus, where the Minister issues a reassessment in the name of a dissolved taxpayer against a legal representative of the taxpayer in the normal reassessment period, the reassessment would be valid as against the taxpayer and the liability to pay would accrue to the legal representative.

A special deeming rule is provided in new subsection 159(3.1) of the Act to deal with the situation where the legal representative acquires or otherwise appropriates property instead of distributing it. In such a case, a distribution is deemed to have occurred for purposes of the rules in subsections 159(2) and (3), and a certificate must be obtained by the legal representative if personal liability is to be avoided. This ensures that the rules in 159(2) and (3) are not defeated where assets are allocated to a related person in the course of a voluntary winding-up, for example.

These amendments apply on Royal Assent.

Clause 186

Tax Liability – Non-arm's Length Transfers of Property

ITA
160

Section 160 of the Act imposes joint and several liability for tax on certain transfers of property between persons who do not deal at arm's length with each other.

Subclause 186(1)

Joint Liability Where s. 69(11) Applies

ITA
160(1.1)

New subsection 160(1.1) of the Act provides that where subsection 69(11) of the Act applies to deem a disposition of property to have occurred at fair market value, both the person disposing of the property and the person acquiring the property are jointly and severally liable for the payment of each other's liabilities arising under the Act as a result of that disposition. Essentially, each person's liability for any taxation year affected by the disposition is the excess of the amount payable under the Act by that person for that year over the amount that would have been payable by that person for that year had subsection 69(11) not applied to the disposition. New subsection 160(1.1) of the Act applies to

dispositions deemed by subsection 69(11) to have occurred after April 26, 1995.

Subclause 186(2)

ITA
160(2) and (3)

Subsections 160(2) and (3) of the Act set out rules for the assessment, payment and extinguishment of the joint and several liabilities arising under subsection 160(1) of the Act. These subsections are replaced with new subsections 160(2) and (3), which apply both to subsection 160(1) and new subsection 160(1.1) of the Act and continue to apply to the assessment, payment and extinguishment of the liabilities arising under these subsections. New subsection 160(2) allows the Minister to assess a taxpayer at any time in respect of liabilities arising under section 160 and such an assessment will have the same effect as if it had been made under section 152 of the Act. New subsection 160(3) provides that where a particular 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. However, a payment by the other taxpayer on account of the other taxpayer's tax liability, will reduce the particular taxpayer's liability only to the extent that the total tax liability of the other taxpayer is reduced below the amount of the joint and several liability. New subsections 160(2) and (3) of the Act apply on Royal Assent.

Clause 187

Interest

ITA
161

Section 161 of the Act provides for the payment of interest on outstanding amounts of tax payable under Part I, as well as on late or deficient instalments in respect of such tax.

Subclauses 187(1) to (4)

ITA
161(7)

Subsection 161(7) of the Act provides that, where the amount of tax payable for a taxation year is reduced because of certain deductions or exclusions arising from the carryback of losses or tax credits or from events in subsequent years, interest on any unpaid tax for the taxation year is calculated without regard to the reduction until the latest of several dates.

Paragraph 161(7)(*a*) is amended to include in the list of deductions and exclusions a deduction claimed under subsection 147.2(4), as modified by new subsection 147.2(6), because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year. This amendment to paragraph 161(7)(*a*) applies to taxpayers who die after 1992.

Paragraph 161(7)(*a*) is further amended to clarify that the consequences of the deduction or exclusion of an amount referred to in the subparagraphs that follow must not be taken into consideration in the determination of taxes payable by a taxpayer for the taxation year. Paragraph 161(7)(*b*) is also amended as a result of the wording change in paragraph (*a*). These amendments apply to amounts that become payable after December 1995.

Subclause 187(5)

ITA
161(11)

Subsection 161(11) of the Act requires the payment of interest on penalties imposed under the Act. Subsection 161(11) is amended to add new paragraph (b.1) which applies in the case of a penalty payable under new subsection 237.1(7.4) of the Act. New subsection 237.1(7.4) is analogous to repealed subsection 162(9), which provides a penalty where a person fails to comply with the reporting requirements in respect of tax shelters under section 237.1.

This amendment applies after December 1, 1994.

Subclause 187(6)

ITA
161(12)

New subsection 161(12) of the Act allows the interest on a penalty under new subsection 237.1(7.4) of the Act to be assessed against a partnership and applies the provisions of the Act relating to assessments, payments and appeals with respect to interest on those penalties as if the partnership were a corporation. This subsection applies after December 1, 1994.

Clause 188

Penalties – Tax Shelter

ITA
162

Section 162 of the Act imposes penalties for failing to comply with various information and filing requirements.

Subclause 188(1)

Failure to Provide Information on Form

ITA
162(5)

Subsection 162(5) of the Act provides a penalty for the failure of any person to provide any information required on a prescribed form made pursuant to the Act or a regulation. Paragraph 162(5)(*a*) of the Act is amended to add a reference to a partnership and is consequential on the amendments made to section 237 of the Act.

This amendment applies on Royal Assent.

Subclause 188(2)

Failure to Provide Identification Number

ITA
162(6)

Subsection 162(6) of the Act provides a penalty for failure by an individual to provide on request their Social Insurance Number to any person who is required to make an information return in respect of the individual. Subsection 162(6) is amended to extend the penalty for failure by any person or partnership to provide their business number when required.

This amendment applies on Royal Assent.

Subclause 188(3)

Rules Where Partnership Liable to a Penalty

ITA
162(8.1)

Subsection 162(8.1) of the Act allows various penalties imposed under section 162 of the Act to be assessed against a partnership and applies the provisions of the Act relating to assessments, objections and appeals with respect to those penalties as if the partnership were a corporation. Subsection 162(8.1) is amended to apply to penalties levied under subsections 162(5) and (6) of the Act.

This amendment applies on Royal Assent.

Subclause 188(4)

Penalties – Tax Shelters

ITA
162(9)

Subsection 162(9) of the Act imposes a penalty for failure to comply with the reporting requirements in respect of tax shelters in section 237.1 of the Act. The repeal of subsection 162(9), applicable

after December 1, 1994, is consequential on the introduction of new subsection 237.1(7.4) of the Act.

Clause 189

Penalties

ITA
163

Section 163 of the Act imposes penalities in respect of serious failures to comply with the Act, such as making false statements or omitting to report income.

Subclause 189(1)

False Statements or Omissions

ITA
163(2)

Subsection 163(2) of the Act imposes a penalty where a taxpayer knowingly, or in circumstances amounting to gross negligence, participates in or makes a false statement for the purposes of the Act.

Subsection 163(2) is amended to clarify that taxpayers who volunteer false information for the purposes of the Act are liable to a penalty.

This amendment applies after June 20, 1996.

Subclause 189(2)

ITA
163(2)(*g*)

Subsection 163(2) of the Act imposes a penalty where a taxpayer knowingly or in circumstances amounting to gross negligence, participates in or makes a false statement or omission, in a return, form, certificate, statement or answer. New paragraph 163(2)(*g*) of the Act is added to apply to amounts deemed to be paid pursuant to

new subsection 125.5(3) (the film or video production services tax credit).

This amendment applies after October 1997.

Subclause 189(3)

ITA
163(4)

Subsection 163(2) of the Act imposes a penalty where a taxpayer, knowingly or through gross negligence, understates income for a taxation year. Subsection 163(4) of the Act clarifies that, in determining the understatement of income, certain deductions and exclusions arising from events in subsequent years are disregarded.

Subsection 163(4) is amended to include in the list of deductions and exclusions to be disregarded a deduction claimed under subsection 147.2(4) of the Act, as modified by new subsection 147.2(6) of the Act, because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

This amendment to subsection 163(4) applies to taxpayers who die after 1992.

Clause 190

Refunds

ITA
164

Section 164 of the Act contains rules relating to refunds of taxes, including provisions dealing with repayments, application to other debts, and interest.

Subclause 190(1)

ITA
164(1)(*a*)(i)

Subsection 164(1) of the Act provides rules governing refunds of overpayments of tax.

Subparagraph 164(1)(*a*)(i) of the Act is amended to correct the references to elements of the definition "refundable investment tax credit" in subsection 127.1(2) of the Act consequential on the amendments to that definition which apply to taxation years that end after December 2, 1992.

This amendment applies to taxation years that end after December 2, 1992.

Subclause 190(2)

ITA
164(1)(*b*)

If a taxpayer has filed the tax return for a taxation year within 3 years from the end of the year, the Minister of National Revenue may refund any overpayment of tax for the year. Where no such refund is made, paragraph 164(1)(*b*) of the Act allows the taxpayer to make an application for the refund within the period determined under paragraph 152(4)(*b*) or (*c*) of the Act within which the Minister may reassess tax payable by the taxpayer for the year. The amendments to paragraph 164(1)(*b*) are strictly consequential on the amendments to subsection 152(4) and effect no substantive changes to this provision. Amended paragraph 164(1)(*b*) applies after April 27, 1989.

Subclause 190(3)

Request to Pay Refund to Province

ITA
164(1.8)

New subsection 164(1.8) of the Act authorizes Revenue Canada, at the request of an individual to pay all or part of the individual's tax

refund for a taxation year to the government of a prescribed province. The individual must make the request in the individual's tax return for the year. Any amount paid to the province in accordance with the request is considered to be paid to the individual when the original assessment notice (or a notice that no tax is payable) is sent to the individual. Initially, it is intended that Ontario will be prescribed under the *Income Tax Regulations* for the purposes of this provision. The provision applies to requests made by taxpayers after 1997 for the 1997 and subsequent taxation years.

Subclause 190(4)

Application to Other Debts

ITA
164(2)

Subsection 164(2) of the Act deals with cases in which a taxpayer who is entitled to a refund or a repayment under section 164 of the Act is, or is about to become, indebted to Her Majesty in Right of Canada. In such cases, subsection 164(2) allows Revenue Canada to apply the refund or repayment to the debt instead of making the refund or repayment to the taxpayer. Subsection 164(2) is amended to provide that it applies not only to amounts owed to Her Majesty in Right of Canada but also to those owed to Her Majesty in Right of a province.

This amendment applies on Royal Assent.

Subclause 190(5)

ITA
164(2.1)

Subsection 164(2) of the Act provides that, where a taxpayer is liable or about to become liable for other income tax payments, the Minister may apply the amount of an overpayment to the other tax liability rather than make a refund. Subsection 164(2.1) of the Act provides for such an offset in the case of Goods and Services Tax credit payments. Subsection 164(2.1) is amended so that, when the applicable return is filed on time, the offset occurs on the day the amount would have been paid to the individual if the offset had not

occurred. When the individual's return for the year is not filed on time, the offset occurs on the day the amount is actually applied. This amendment applies on Royal Assent.

Subclauses 190(6) and (7)

ITA
164(5) and (5.1)

Subsection 164(5) of the Act provides that, where the tax payable for a taxation year is reduced because of certain deductions or exclusions arising from the carryback of losses or tax credits or from events in subsequent years, interest payable to a taxpayer on any resulting overpayment of tax is to be calculated as if the overpayment had arisen on the latest of several dates.

Subsection 164(5) is amended to include in the list of deductions and exclusions a deduction claimed under subsection 147.2(4) of the Act, as modified by new subsection 147.2(6) of the Act, because of the death of the taxpayer in the subsequent year. Subsection 147.2(4) allows a deduction for contributions to a registered pension plan, subject to certain limits where the contributions are in respect of service before 1990. Subsection 147.2(6) relaxes these limits for the year in which the taxpayer dies and for the preceding year.

Subsection 164(5.1) of the Act, which deals with interest payable in the case of a repayment of an amount in dispute, contains a rule analogous to that in subsection 164(5). The amendment to subsection 164(5.1) is similar to the amendment to subsection 164(5).

The amendments to subsections 164(5) and (5.1) apply to taxpayers who die after 1992.

Subclause 190(8)

ITA
164(6)(*c*)

Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses or terminal losses of the taxpayer's estate for its first taxation year as capital losses or terminal losses of the taxpayer for the taxpayer's last taxation year.

Under paragraph 164(6)(*c*) of the Act the election is limited to the amount by which the estate's capital losses exceed its capital gains for that year.

Paragraph 164(6)(*c*) is amended to ensure that subsection 112(3) of the Act does not apply to reduce a deceased taxpayer's loss which was transferred under that paragraph.

This amendment applies to deaths that occur after 1993.

Clause 191

Transitional Provision

Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses of the taxpayer's estate for its first taxation year to be capital losses of the taxpayer's last taxation year. Under paragraph 164(6)(*c*) of the Act the election must be made within a prescribed time and under paragraph 164(6)(*e*) of the Act the legal representative must file an amended return of income for the deceased taxpayer's last taxation year within the time prescribed for the election.

This transitional rule will provide a limited opportunity for an estate to transfer a capital loss arising from the disposition of a share of the capital stock of a corporation to the taxpayer's last taxation year even though the election was not made within the prescribed time, or the disposition occurred after the end of the estate's first taxation year. For this rule to apply, the estate's first taxation year must have ended after April 26, 1995 and before 1997 and the loss in respect of the share must have arisen from a disposition occurring before 1997. In conjunction with the coming-into-force provisions for the amended stop-loss rules in subsections 112(3) to (3.32) of the Act, the capital loss that can be transferred under subsection 164(4) of the Act by an estate will not be reduced by the tax-free dividends received by the estate on the share.

The transitional rule is applicable where the legal representative files a written election with the Minister of National Revenue within six months after the month in which this Act receives Royal Assent. Where a valid election is filed, the timing requirements under

paragraphs 164(6)(*c*) and (*e*) will be considered fulfilled provided that the paragraph 164(6)(*c*) election and the amended return referred to in paragraph 164(6)(*e*) of the Act are filed within the time allowed for the election above.

Clause 192

Objections to Assessments

ITA
165

Section 165 of the Act provides rules governing a taxpayer's right to object to an assessment or determination by the Minister of National Revenue of tax, interest, penalties and certain other amounts.

Subclauses 192(1) and (2)

Limitation of Right to Object to Assessments or Determinations

ITA
165(1.1)

Where the Minister of National Revenue has issued a notice of assessment or determination, subsection 165(1.1) of the Act restricts, in certain cases, the matters to which a taxpayer may object to those matters which gave rise to the assessment or redetermination. The amendments to subsection 165(1.1) are consequential to the introduction of subsection 152(1.8) of the Act, which allows the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, a taxpayer who was believed to be a member of a partnership or any other affected persons. Such an assessment or determination may only be made to give effect to a determination made under subsection 152(1.4) of the Act in respect of the entity that was believed to be a partnership.

The right of a taxpayer who was believed to be a member of a partnership to object to an assessment or determination made in respect of that partnership under new subsection 152(1.8) will be restricted to the matters that were relevant in the making of a

determination at the partnership level or that result from the finding that the taxpayer is not a member of the partnership or that there is no such partnership.

These amendments apply to determinations made after Royal Assent.

Subclause 192(3)

Partnership

ITA
165(1.15)

New subsection 165(1.15) of the Act provides that only the member of a partnership designated by all the members of the partnership in the partnership return filed annually under section 229 of the *Income Tax Regulations* can exercise the right to object to a determination made by the Minister of National Revenue under new subsection 152(1.4) of the Act. For that purpose, the Minister will request the members of a partnership to indicate, in the partnership return, the name and address of the member that has been designated by the partnership and its members as representative of the partnership. Only one person may be so named. If no member has been so designated, the authority to initiate legal proceedings is vested in any member expressly authorized to act on behalf of the partnership in respect of the proceedings.

New subsection 165(1.15) applies to determinations made after Royal Assent.

Subclause 192(4)

ITA
165(3.1) and (3.2)

Subsections 165(3.1) and (3.2) of the Act deal with referrals to the Minister of National Health and Welfare of notices of objections to determinations relating to the eligibility criteria for the child tax benefit. These subsections are repealed, after August 27, 1995, as the Minister of National Revenue will be entirely responsible for the child tax benefit provisions.

Subclause 192(5)

Validity of Reassessment

ITA
165(5)

Subsection 165(5) of the Act provides that the Minister of National Revenue may reassess tax for a year after receiving a notice of objection from a taxpayer, even though the reassessment is made beyond the period provided for under paragraph 152(4)(*b*) or (*c*) of the Act for making a reassessment. This subsection is amended as a consequence of the amendments to subsection 152(4) and the addition of new subsection 152(4.01) of the Act. It effectively provides that the limitations imposed by these subsections as to, respectively, the time within which the Minister may reassess and the scope of such reassessments are not applicable to a reassessment made pursuant to a notice of objection filed by a taxpayer. Subsection 152(5) of the Act will, however, continue to circumscribe the Minister's power to reassess beyond the normal reassessment period in such cases. Subsection 165(5) applies after April 27, 1989.

Clause 193

Appeals

ITA
169(2)

Subsection 169(2) of the Act restricts, in certain cases, the matters with respect to which a taxpayer may appeal to those matters which gave rise to the assessment or determination that is under appeal. The amendments to subsection 169(2) are consequential to the introduction of subsection 152(1.8) of the Act, which allows the Minister to assess the tax liability of, or to determine any amount deemed to have been paid or to have been an overpayment by, a taxpayer who was believed to be a member of a partnership or any other affected persons. Such an assessment or determination may be made only to give effect to a determination made under subsection 152(1.4) of the Act in respect of the entity that was believed to be a partnership.

The right of a taxpayer who was believed to be a member of a partnership to appeal an assessment or determination made in respect of that partnership under new subsection 152(1.8) will be restricted to the matters that were relevant in the making of a determination at the partnership level or that result from the finding that the taxpayer is not a member of the partnership or that there is no such partnership.

These amendments apply to determinations made after Royal Assent.

Clause 194

Large Corporations Tax

ITA
181.1(7)

A corporation may deduct, in computing its Part I.3 tax liability for a taxation year, an amount equal to the total of its Canadian surtax payable for the year and such amount as it chooses of its unused surtax credits for the seven preceding and three following taxation years that end after 1991. In general terms, a corporation's Canadian surtax payable is that portion of its corporate surtax that is attributable to its Canadian activities, and an unused surtax credit is the amount by which a corporation's Canadian surtax payable exceeds its tax payable under Part I.3.

Subsection 181.1(7) of the Act restricts the amount deductible in respect of a corporation's unused surtax credits where control of the corporation has been acquired between the year in which the credits arose and the year in which they are sought to be claimed. Currently, subsection 181.1(7) provides that a corporation's unused surtax credits for a taxation year ending before control is acquired are deductible (pursuant to the carry-over provisions of Part I.3) in a taxation year ending after control is acquired only if the business to which the credits relate is carried on throughout the later year, and only against that proportion of the corporation's Part I.3 tax payable for the later year that its income from the continued business or similar businesses in the later year is of the corporation's total taxable income in such later year. Similar restrictions apply in deducting an unused surtax credit for a taxation year ending after the time at which control of a corporation has been acquired in computing a

corporation's tax payable under Part I.3 for a taxation year ending before that time.

This amendment to subsection 181.7 changes the carry-over rules so that the portion of unused surtax credits that can be carried through a change of control will be based on the income from the continued business in the taxation year in which the surtax credits arise, and not the year against which the credits are sought to be applied. Specifically, paragraph 181.1(7)(*a*) of the Act is amended to provide that unused surtax credits for a particular taxation year ending before an acquisition of control may be deducted in a taxation year that ends after that time only to the extent of that proportion of its Canadian surtax payable for the earlier year that its income from the business or a similar business for the earlier year is of its total taxable income for that year. As before, the carryover of unused surtax credits is limited to the situation where the pre-change-of-control business is carried on throughout the subsequent year to which the unused surtax credits are being applied. Similar restrictions will apply where unused surtax credits are being carried back to pre-change-of-control years (see new paragraph 181.1(7)(*b*) of the Act).

These amendments apply to acquisitions of control that occur after April 26, 1995.

Clause 195

Large Corporations Tax – Calculation of Capital

ITA
181.2(3)

In general terms, a corporation is required to compute amounts relevant in determining its tax payable under Part I.3 of the Act using generally accepted accounting principles (GAAP).

The Canadian Institute of Chartered Accountants' Handbook (the "Handbook"), which is the principal source of GAAP in Canada, requires that the carrying values of foreign-denominated monetary assets and liabilities reflect unrealized foreign exchange gains and losses on such items. The Handbook also requires that certain of

these unrealized foreign exchange gains and losses be deferred and amortized into income over the life of the monetary item.

New paragraph 181.2(3)(*b*.1) of the Act applies to specifically include in capital unrealized foreign exchange gains that have been deferred in accordance with GAAP. Conversely, new paragraph 181.2(3)(*k*) of the Act permits deferred unrealized foreign exchange losses to be deducted from a corporation's capital. An amendment to paragraph 181.2(3)(*g*) of the Act provides similar treatment of a corporation's share of any deferred unrealized foreign exchange gains and losses of a partnership of which it is a member.

These amendments apply to the 1995 and subsequent taxation years.

Clause 196

Large Corporations Tax – Taxable Capital of Financial Institutions

ITA
181.3(3)(*d*)(i)

Subsection 181.3(3) of the Act contains the rules for determining the capital of a financial institution for the purpose of Part I.3. Paragraph 181.3(3)(*d*) of the Act applies to a non-resident insurer. Subparagraph 181.3(3)(*d*)(i) of the Act provides that the capital of a non-resident insurer includes the greater of its surplus funds derived from operations and its attributed surplus.

Subparagraph 181.3(3)(*d*)(i) is amended to take into account amounts on which the insurer has paid branch tax under Part XIV of the Act, and amounts on which it was not required to pay that tax because of an election under subsection 219(5.2) of the Act. These amounts for preceding taxation years are subtracted from surplus funds derived from operations. A current year amount is also subtracted if it arises because of the transfer of an insurance business where subsection 138(11.5) or (11.92) of the Act has applied to the transfer.

This amendment applies to the 1994 and subsequent taxation years.

Clause 197

Large Corporations Tax – Taxable Capital of Non-Residents

ITA
181.4(*d*)(i)

Section 181.4 of the Act provides rules for determining the taxable capital employed in Canada of a non-resident corporation (other than a financial institution) for the purposes of Part I.3 of the Act. Paragraph 181.4(*d*) of the Act excludes from this amount the carrying value of an asset that is a ship or an aircraft operated by a non-resident corporation in international traffic, or that is personal property used in its business of transporting passengers or goods in international traffic, where the country in which the corporation is resident does not impose a capital tax on similar assets, or a tax on the income therefrom, of any corporation resident in Canada. Subparagraph 181.4(*d*)(i) of the Act is amended to clarify that personal property, other than ships and aircraft, is excluded only where that property is used in the business of transporting passengers or goods by ship or aircraft in international traffic.

This amendment applies to the 1995 and subsequent taxation years.

Clause 198

Large Corporations Tax – Related Corporations

ITA
181.5(6)

Section 181.5 of the Act sets out rules for determining a corporation's capital deduction for a taxation year, for the purposes of Part I.3 of the Act. Generally, under section 181.5 the members of a group of related corporations that are associated with one another share a single $10,000,000 deduction. For the most part, the Act's ordinary tests will apply in determining whether corporations are related for this purpose. Subsection 181.5(6) of the Act provides an exception: two corporations that would be related only because of the control of a corporation by Her Majesty or a right referred to in paragraph 251(5)(*b*) of the Act will not be treated as being related.

This exception in turn contains an exception: if a taxpayer has a right referred to in paragraph 251(5)(*b*) with respect to shares, and it can reasonably be considered that the taxpayer acquired the right to avoid a limitation on a corporation's capital deduction, the corporations will be treated as being in the same relationship to each other as if the taxpayer owned the shares.

As a consequence of the amendment of paragraph 251(5)(*b*), the exception to the subsection 181.5(6) rule is amended. Rather than being treated as though the taxpayer in question owned the shares, the corporations will be treated as if the right the taxpayer acquired to avoid the limitation were an immediate and absolute right, and as if the taxpayer had exercised it. This ensures that the provision deals not only with rights to acquire shares, but also with rights to affect shares' voting rights.

This amendment applies after April 26, 1995.

Clause 199

Large Corporations Tax – Application to Crown Corporations

ITA
181.71

New section 181.71 of the Act, which applies to taxation years that end after June 1989, confirms that a prescribed federal Crown corporation is liable to tax under Part I.3 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part I.3 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(*d*) of the Act does not apply.

Clause 200

Part IV Tax – Exempt Corporations

ITA
186.1(*b*)

Section 186.1 of the Act exempts certain corporations from the requirement to pay the special refundable Part IV tax on dividend income. Paragraph 186.1(*b*) of the Act lists a number of types of corporations to which the exemption applies, including corporations described in paragraphs 39(5)(*b*) and (*c*) of the Act (banks and trust companies). Section 186.1 is amended, as a consequence of amendments to subsection 39(5), to replace the reference to paragraphs 39(5)(*b*) and (*c*) by the descriptions that were contained in those paragraphs. This amendment applies after February 22, 1994.

Clause 201

Part IV.1 Tax – Crown Corporations

ITA
187.61

New section 187.61 of the Act, which applies after 1987, confirms that a prescribed federal Crown corporation is liable to tax under Part IV.1 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part IV.1 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(*d*) does not apply.

Clause 202

Tax on Capital of Financial Institutions – Calculation

ITA
190.1(6)

Part VI of the Act levies a tax on the taxable capital employed in Canada of large financial institutions. Section 190.1 of the Act establishes the rate of that tax.

A financial institution is permitted to reduce its Part VI tax payable by an amount equal to the total of its Part I tax liability for the year and such amount as it chooses of its unused Part I tax credits and unused surtax credits for the seven preceding and three following taxation years that end after 1991 (or after 1990, where a special election is made). In general terms, a corporation's unused Part I tax credit is the amount by which its Part I tax payable for a year exceeds the sum of its Part VI tax payable and Canadian surtax payable for the year, and its unused surtax credit is the amount by which its Canadian surtax payable exceeds its tax payable under Part I.3 of the Act for the year.

Subsection 190.1(6) of the Act restricts the amount deductible under Part VI in respect of a corporation's unused surtax and Part I tax credits where control of the corporation has been acquired between the year in which the credits arose and the year in which they are sought to be claimed. Currently, subsection 190.1(6) provides that a corporation's unused surtax and Part I tax credits for a taxation year ending before control is acquired are deductible (pursuant to the carryover provisions of Part VI) in a taxation year ending after control is acquired only if the business to which the tax relates is carried on throughout the later year and only against that proportion of the corporation's Part VI tax payable for the later year that its income from the continued business or similar businesses in the later year is of the corporation's total taxable income in such later year. Similar restrictions apply in deducting a credit in respect of Part I tax for a taxation year ending after the time at which control of a corporation has been acquired in computing a corporation's tax payable under Part VI for a taxation year ending before that time.

This amendment to subsection 190.1(6) changes the carry-over rules so that the portion of unused surtax and Part I tax credits that can be carried through a change of control will be based on the income from the continued business in the taxation year in which the Part I tax credits arise, and not the year against which the credits are sought to be applied. Specifically, paragraph 190.1(6)(*a*) of the Act is amended to provide that unused surtax and Part I tax credits for a particular taxation year that ends before an acquisition of control may be deducted in a taxation year that ends after that time only to the extent of that proportion of its Part I tax payable for the earlier year that its income from the business or a similar business for the earlier year is of its total taxable income for that year. As before, the carryover of unused surtax and Part I tax credits is restricted to the situation where the pre-change-of-control business is carried on throughout the subsequent year to which the unused surtax and Part I tax credits are being applied. Similar restrictions will apply where unused surtax and Part I tax credits are being carried back to pre-change-of-control years (see new paragraph 190.1(6)(*b*) of the Act).

These amendments apply to acquisitions of control that occur after April 26, 1996.

Clause 203

Determination of Capital of Financial Institutions

ITA
190.13(*c*)(i)

Section 190.13 of the Act contains the rules for determining the capital of a financial institution for the purpose of Part VI of the Act. Paragraph 190.13(*c*) of the Act applies to a non-resident insurer. Subparagraph 190.13(*c*)(i) of the Act provides that the capital of a non-resident insurer includes the greater of its surplus funds derived from operations and its attributed surplus.

Subparagraph 190.13(*c*)(i) is amended to take into account amounts on which the insurer has paid branch tax under Part XIV of the Act, and amounts on which it was not required to pay that tax because of an election under subsection 219(5.2) of the Act. These amounts for preceding taxation years are subtracted from surplus funds derived

from operations. A current year amount is also subtracted if it arises because of the transfer of an insurance business where subsection 138(11.5) or (11.92) of the Act has applied to the transfer.

This amendment applies to the 1994 and subsequent taxation years.

Clause 204

Tax on Capital of Financial Institutions – Related Corporations

ITA
190.15(6)

Section 190.15 of the Act sets out rules for determining the capital deduction, for the purposes of Part VI of the Act, of a corporation that is a financial institution. Generally, under section 190.15 the members of a group of related financial institutions share a single $10,000,000 deduction. For the most part, the Act's ordinary tests will apply in determining whether corporations are related for this purpose. Subsection 190.15(6) of the Act provides an exception: two corporations that would be related only because of the control of a corporation by Her Majesty or a right referred to in paragraph 251(5)(*b*) of the Act will not be treated as being related. This exception in turn contains an exception: if a taxpayer has a right referred to in paragraph 251(5)(*b*) with respect to shares, and it can reasonably be considered that the taxpayer acquired the right to avoid a limitation on a corporation's capital deduction, the corporations will be treated as being in the same relationship to each other as if the taxpayer owned the shares.

As a consequence of the amendment of paragraph 251(5)(*b*), the exception to the subsection 190.15(6) rule is amended. Rather than being treated as though the taxpayer in question owned the shares, the corporations will be treated as if the right the taxpayer acquired to avoid the limitation were an immediate and absolute right, and as if the taxpayer had exercised it. This ensures that the provision deals not only with rights to acquire shares, but also with rights to affect shares' voting rights.

This amendment applies after April 26, 1995.

Clause 205

Tax on Capital of Financial Institutions – Application to Crown Corporations

ITA
190.211

New section 190.211 of the Act, which applies after May 23, 1985, confirms that a prescribed federal Crown corporation is liable to tax under Part VI of the Act. Specifically, the new section provides that section 27 of the Act applies to Part VI with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(*d*) of the Act does not apply.

Clause 206

Computation of Taxable Capital Employed in Canada

ITA
Part VI

Subsection 190.1(1.1) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of life insurance corporations. This tax was set at a rate which, when combined with basic Part VI tax, would generate an appropriate amount of tax from the industry. Whether deferred realized gains and losses on investment properties are required to be included in or excluded from the Part VI tax base is determined in accordance with the provisions of Part VI. Deferred realized gains on investment properties would, if included in the base for the period during which the additional tax is in effect, impose a level of tax on the life insurance industry that was higher than intended. Thus, this amendment excludes such gains and losses from taxable capital employed in Canada for the period between February 25, 1992 and 1999 – that is, while the additional Part VI tax on life insurance corporations applies.

Clause 207

Agreement Respecting Liability for Tax

ITA
191.3

Section 191.3 of the Act allows a corporation to transfer its Part VI.I tax liability to a related corporation provided a joint agreement for the transfer is filed with the Minister of National Revenue. Such transfers are beneficial where the transferor corporation does not have sufficient Part I tax to utilize the deduction for Part VI.I tax that is provided under paragraph 110(1)(*k*) of the Act.

Among other conditions in subsection 191.3(1) of the Act, the transferor corporation must be related to the transferee corporation throughout both the transferor's taxation year for which the tax sought to be transferred would be payable, and the last taxation year of the transferee corporation ending at or before the end of that taxation year of the transferor. Where the transferee was incorporated in that taxation year of the transferor, the transferee will be unable to satisfy the requirement that it be related to the transferor throughout that year. A similar problem arises where the transferor is incorporated during the last taxation year of the transferee corporation. Paragraphs 191.3(1)(*a*) and (*b*) of the Act are amended to allow tax transfers in such circumstances provided that the transferor and transferee are related throughout the balance of each company's taxation year in which the transferor or transferee, as the case may be, were incorporated. This amendment applies to taxation years of the transferor corporation that begin after 1994. A special transitional rule extends the time limit for corporations to file an agreement to transfer a Part VI.I tax liability under subsection 191.3(2) of the Act where that agreement arises because of the amendment to paragraph 191.3(1)(*a*) or (*b*).

Section 191.3 is also amended so that corporations related only by reason of being controlled by Her Majesty will not be permitted to transfer their Part VI.I tax liability to one another. This amendment applies only to taxation years of the transferor corporation that end after April 26, 1995.

Clause 208

Part VI.1 – Application to Crown Corporations

ITA
191.4(3)

New subsection 191.4(3) of the Act, which applies after 1987, confirms that a prescribed federal Crown corporation is liable to tax under Part VI.1 of the Act. Specifically, the new section provides that section 27 of the Act applies to Part VI.1 with whatever modifications may be necessary. The main effects of section 27 are to treat income and property of Her Majesty that is administered by a Crown corporation that is an agent of Her Majesty as though they were the corporation's own, and to provide that the exemption in paragraph 149(1)(*d*) of the Act does not apply.

Clause 209

Labour-Sponsored Venture Capital Corporations

ITA
204.8
"specified active business"

Section 204.81 of the Act sets out the conditions for the registration of labour-sponsored venture capital corporations (LSVCCs). Under section 127.4 of the Act, individuals acquiring Class A shares issued by LSVCCs are entitled to a tax credit. Registered LSVCCs must ultimately invest sufficient amounts in qualifying securities issued by eligible business entities (as defined by section 204.8 of the Act), in order to avoid penalty taxes levied under section 204.82 of the Act. One of the requirements for a corporation or partnership to qualify as an "eligible business entity" is that it, or a related entity, carries on a "specified active business".

"Specified active business" is defined in section 204.8 as an active business (as defined by subsection 248(1) of the Act) carried on in Canada, where at least 50 per cent of the full-time employees of the business are employed in Canada and at least 50 per cent of the

wages and salaries paid to employees of the business are attributable to services rendered in Canada by employees.

The definition of "specified active business" in section 204.8 is amended to clarify that qualification at any time as a "specified active business" is determined with reference to those individuals employed at that time in respect of the business. This amendment is made only to be consistent with the wording of the proposed definition of "specified active business" in subsection 206(1) of the Act.

This amendment applies after 1988.

Clause 210

Foreign Property Tax

ITA
206

Section 206 of the Act imposes a tax on the amount of "foreign property" (as defined in subsection 206(1) of the Act) held by pension funds and others in excess of defined limits.

Subclauses 210(1) to (4)

ITA
206(1)

"foreign property"

"Foreign property" is defined in subsection 206(1) of the Act. Under paragraph (*d*.1) of the definition, foreign property includes certain shares and debts issued by Canadian corporations, if shares of the corporation may reasonably be considered to derive their value primarily from "portfolio investments" in foreign property. Under paragraph (*e*) of the definition, foreign property includes, except as prescribed by regulation, shares of the capital stock of mutual fund corporations (other than investment corporations or registered investments).

Paragraph (*d*.1) of the definition is amended to provide that any share or debt issued by a corporation that is a Canadian corporation is, subject to the exceptions described below, considered to be foreign property where shares of the corporation can reasonably be considered to derive their value primarily from foreign property (whether or not the foreign property is a "portfolio investment"). The purpose of this amendment and the exceptions described below are to remove the uncertainty regarding the application of the foreign property rules in cases where a Canadian corporation acquires minority or controlling interests in corporations deriving their value from foreign property. This amendment applies to property acquired after 1995.

Paragraph (*d*.1) of the definition is also amended so that shares and debts issued by a corporation that is a Canadian corporation are not considered as foreign property under that paragraph where the Canadian corporation has a substantial presence in Canada. The determination of substantial Canadian presence is set out in new subsection 206(1.1) of the Act.

Paragraph (*d*.1) of the definition is also amended so that it does not apply to shares or debts issued by mutual fund corporations, investment corporations or registered investments. Mutual fund corporations and investment corporations that are not registered investments are subject to a stricter foreign property regime as a consequence of amended paragraph (*e*) of the definition and Part L of the *Income Tax Regulations*. A "registered investment" is a trust or a corporation that is subject to tax under Part XI of the Act with respect to its own investments, so it is not appropriate for shares or debts issued by registered investments to be considered as foreign property.

Paragraph (*d*.1) of the definition is also amended so that certain shares, described in the new definition of "excluded share" in subsection 206(1), are not considered to be foreign property under paragraph (*d*.1). An "excluded share" is defined as:

- a share that is of a class of shares listed on a prescribed stock exchange in Canada, where no share of that class has been issued after December 4, 1985 (otherwise than pursuant to an agreement in writing entered into before 5:00 p.m. Eastern Standard Time on December 4, 1985),

- a share last acquired after 1995 that is of a class of shares listed on a prescribed stock exchange in Canada, where
  - the share would, if paragraph (*d*.1) of the definition of "foreign property" applied only in respect of portfolio investments, not be foreign property, and
  - no share of that class has been issued after July 20, 1995 (otherwise than pursuant to an agreement in writing made before July 21, 1995), and
- a share last acquired after 1995 as a consequence of the exercise of a right acquired before 1996 where the share would, if paragraph (*d*.1) of the definition of "foreign property" applied only in respect of portfolio investments, not be foreign property.

The first part of the "excluded share" definition corresponds to grandfathering formerly provided in paragraph (*d*.1) of the definition. The second part extends similar grandfathering for shares acquired after 1995 that are affected by the expansion of "foreign property" under amended paragraph (*d*.1) of the definition. The third part extends grandfathering with respect to shares acquired after 1995 pursuant to the exercise of a right acquired before 1996.

Except as noted above, the amendments to paragraph (*d*.1) of the definition apply to shares and debts that were acquired after December 4, 1985 (otherwise than pursuant to an agreement in writing made before 5:00 p.m. Eastern Standard Time on December 4, 1985). This coming-into-force provision corresponds to the coming-into-force with respect to the introduction of paragraph (*d*.1) of the definition.

Paragraph (*e*) of the definition is amended to provide that, except as prescribed by regulation, a share issued by an investment corporation (as defined by subsection 130(3)) is considered to be "foreign property", unless it was acquired before October 14, 1971. For this purpose, existing subsections 5000(3) and (4) of the Regulations set out the circumstances where such a share is not considered to be foreign property. This amendment, which is consequential to the repeal of subsection 206(3) of the Act, applies to months that end after June 1995.

Paragraph (*g*) of the definition "foreign property" is amended by adding the European Bank for Reconstruction and Development and the African Development Bank to the list of non-resident organizations the indebtedness of which is exempt from the definition of "foreign property". This amendment applies to months after March 1991, except that the exemption for the African Development Bank does not apply to months before 1997.

ITA
206(1)
"affiliate"
"carrying value"
"designated value"
"excluded share"
"investment activity"
"qualified property"
"significant interest"
"specified active business"
"specified proportion"

Subsection 206(1) of the Act is amended to introduce definitions of "affiliate", "carrying value", "designated value", "investment activity", "qualified property", "specified active business" and "specified proportion". These definitions are used in new subsections 206(1.1) and (1.2) of the Act, which are discussed in the commentary below.

Subsection 206(1) is also amended to introduce the definition of "excluded share", which is used only in amended paragraph (d.1) of the definition "foreign property" in subsection 206(1). It is discussed in the commentary above.

Subsection 206(1) is also amended to introduce the definition of "significant interest", which is used only in the new definition "investment activity". It is discussed in the commentary below on paragraph 206(1.1)(*d*) of the Act.

ITA
206(1.1)(*a*) to (*c*) and (1.2)

Paragraphs 206(1.1)(*a*) to (*c*) of the Act provide relief from the application of paragraph (*d*.1) of the definition "foreign property" with respect to shares and debts issued by corporations that are

Canadian corporations and have a substantial Canadian presence, in accordance with the tests below. Each of the paragraphs provides a test for substantial Canadian presence. Paragraphs 206(1.1)(*d*) and (*e*) of the Act, discussed in the commentaries below, provide additional tests for substantial Canadian presence.

In this context, a share or debt obligation issued by a corporation will not be considered to be foreign property of a taxpayer under paragraph 206(1.1)(*a*) where, at any time in any of the last 15 months beginning before the acquisition of the share or debt or at any time in the calendar year that includes the acquisition time, the "designated value" of "qualified property" of the corporation and "affiliates" of the corporation exceeded $50 million. Definitions of these expressions are provided in amended subsection 206(1).

The $50 million test is designed to be a one time test. If a share or debt satisfies the $50 million test, a change in the circumstances of the issuing corporation will not result in the share or debt being reclassified as foreign property of the purchaser while continuously held by the purchaser.

Even if the $50 million test is not met, paragraph 206(1.1)(*b*) allows a share or debt issued by a corporation to be temporarily considered as not being foreign property for up to 15 months after the acquisition. This relief applies in respect of shares or debts issued by a corporation, where the total "designated value" of "qualified property" of the corporation (and other corporations controlled by the corporation) exceeds 50 per cent of the lesser of the fair market value of all the corporation's property and its "carrying value" (as defined in subsection 206(1)). This test must be satisfied at any time in any of the last 15 months beginning before the time of the acquisition. As described below, a share or debt that is excluded from foreign property classification under paragraph 206(1.1)(*b*) can continue to be so excluded under paragraph 206(1.1)(*c*).

Paragraph 206(1.1)(*c*) also allows for a share or debt issued by a corporation to be excluded from foreign property classification for a taxpayer. In order for a share or debt to be so excluded at a particular time, it must satisfy the 50-per-cent test described above at any time in any of the first 15 months beginning after the time of acquisition. (In the event that a share or debt initially excluded from foreign property because of paragraph 206(1.1)(*b*) becomes foreign

property because it fails to satisfy paragraph 206(1.1)(*c*), relief is provided under existing subparagraph 206(2)(*a*)(iii) of the Act. This relief has the effect of ignoring such foreign property for 24 months for the purposes of computing the Part XI tax.)

Subsection 206(1.2) of the Act provides a specific rule, relevant for the purposes of applying the tests in paragraphs 206(1.1)(*a*) to (*c*) above, to take into account partnerships. For the purposes of these paragraphs, a member of a partnership is deemed not to own any interest in the partnership at any time. Instead, the member is deemed to own the member's "specified proportion" (for the first fiscal period ending at or after that time) of each partnership property owned at that time. The "specified proportion" of a member of a partnership for a fiscal period of the partnership, as defined in subsection 206(1), is the proportion that the member's share of the total income or loss of the partnership for the partnership's fiscal period is of the partnership's total income or loss for that period. However, where such income or loss for a period is nil, the "specified proportion" is computed as if the partnership had income for that period in the amount of $1 million. The "carrying value" of the member's specified proportion of partnership property is likewise deemed to be the member's specified proportion of the carrying value of the partnership's property.

These amendments apply after December 4, 1985.

ITA
206(1.1)(*d*) and (1.3)

New paragraph 206(1.1)(*d*) of the Act provides the fourth of the five tests for substantial Canadian presence for a Canadian corporation. Unlike the other tests under paragraphs 206(1.1)(*a*) to (*c*) of the Act, this test is designed to apply on an ongoing basis. However, should a corporation cease to qualify under the criteria established in this paragraph, relief is provided under existing subparagraph 206(2)(*a*)(iii) for up to 24 months. Under paragraph 206(1.1)(*d*), a share or a debt obligation issued by a corporation will not be considered to be a foreign property of a taxpayer at a particular time where the particular time is after 1995 and three further conditions are met.

The first condition is satisfied where the issuing corporation was incorporated or otherwise formed under the laws of Canada or a province. Alternatively, where the corporation was not required to maintain an office under the laws under which it was incorporated, this condition is satisfied where the maintenance of an office in Canada is required under the constitutional documents of the corporation. (A corporation continued under the laws of Canada or a province is deemed to have been incorporated under the laws of Canada or the province pursuant to paragraph 250(5.1)(*a*) of the Act.)

The second condition is satisfied if the corporation actually does maintain an office in Canada.

The third condition is satisfied where any of the following criteria is met:

- the corporation employs more than 5 individuals in Canada full time otherwise than in connection with certain specified activities,

- another corporation that is controlled by the corporation employs more than 5 individuals in Canada full time otherwise than in connection with certain specified activities,

- the total amount incurred by the corporation for the services (other than services relating to an "investment activity" of the corporation or another corporation with which the corporation does not deal at arm's length) of employees and other individuals rendered in Canada in any calendar year that ends in the any of the last 15 months that end before the particular time exceeds $250,000,

- the total amount incurred by another corporation that is controlled by the corporation for the services (other than services relating to an "investment activity" of the other corporation or another corporation with which the other corporation does not deal at arm's length) of employees and other individuals rendered in Canada in any calendar year that ends in the any of the last 15 months that end before the particular time exceeds $250,000, or

- the corporation was incorporated or otherwise formed or continued from a jurisdiction outside Canada in the calendar year that includes the particular time and the total amount incurred by the corporation for the services (other than services relating to an

investment activity of the corporation or another corporation with which the corporation does not deal at arm's length) of employees and other individuals rendered in Canada in that calendar year exceeds $250,000.

For the purposes of the third condition, it is relevant whether or not the issuing corporation or a corporation controlled by it (referred to below as the "relevant corporation") is considered to carry on an "investment activity". As defined in subsection 206(1), an investment activity generally includes any business the principal purpose of which is to derive income from, or to derive profits from the disposition of, a number of listed properties (shares, trust interests, indebtedness, etc.) set out in the definition. If the corporation is not considered to carry on a business for tax purposes, the holding of such properties for such purposes likewise would generally be considered to be an "investment activity".

However, there is an important exception from this definition where the properties so held are shares and debts issued by other corporations in which the relevant corporation has a "significant interest". Where this is the case, such shares and debts are ignored, provided that the primary activity of the other corporation is not an "investment activity". Under the definition "investment activity", a relevant corporation has a significant interest in another corporation where

- the relevant corporation is related (otherwise than because of a right referred to in paragraph 251(5)(*b*) of the Act) to the other corporation, or

- the relevant corporation holds shares of the capital stock of the other corporation and those shares represent at least 10 per cent of the fair market value of, and the votes at an annual general meeting associated with, all issued shares of the other corporation.

Subsection 206(1.3) of the Act also provides a relieving rule relevant in applying the third condition, above. For this purpose, an employee of a corporation is deemed to be employed in Canada if the corporation's permanent establishment (as defined by regulation) to which the employee principally reports is situated in Canada. In addition, services are deemed to be rendered in Canada to a corporation where the permanent establishment for which the services

are rendered is situated in Canada. Note, in this regard, that it is contemplated that services could be rendered to a corporation directly (i.e., where the relevant corporation employs the individual or contracts directly with the individual) or indirectly (e.g., where the relevant corporation engages another corporation the employees of which render services to the relevant corporation). For this purpose, it is proposed to define "permanent establishment" in the manner set out in draft section 8201 of the Regulations.

These amendments apply after 1995.

ITA
206(1.1)(*e*)

New paragraph 206(1.1)(*e*) of the Act provides the last of the five tests for substantial Canadian presence for a Canadian corporation. As under paragraph 206(1.1)(*d*) of the Act, this test is designed to apply on an ongoing basis. Should a corporation cease to qualify for relief under this paragraph, relief is provided under existing subparagraph 206(2)(*a*)(iii) of the Act for up to 24 months. Under paragraph 206(1.1)(*e*), a share or a debt obligation issued by a corporation will not be considered to be a foreign property of a taxpayer at a particular time where the particular time is after 1995 and all or substantially all of the property of the corporation is not foreign property.

This amendment applies after 1995.

ITA
206(1.4)

Paragraphs (*f*) and (*h*) of the definition "foreign property" in subsection 206(1) of the Act apply in the event that a taxpayer has a right to, or a non-ownership interest in, another property. Paragraph (*f*) also generally applies where a taxpayer has property that is convertible into, or exchangeable for, another property. In these circumstances, the property owned by a taxpayer is generally treated as foreign property if the other property is foreign property.

New subsection 206(1.4) of the Act provides that, in these circumstances, the determination of whether property owned by a taxpayer is foreign property at any time is based on whether the other

property would be foreign property if it had been acquired immediately before that time. This provision is necessary because the tests in new paragraphs 206(1.1)(*a*) to (*c*) of the Act are predicated on there being an acquisition of a share or debt obligation.

This amendment applies after December 4, 1985.

ITA
206(1.5)

Subsection 206(1.5) of the Act is a rule which is provided for administrative convenience and ensures that properties owned by a single taxpayer are treated consistently for the purposes of the foreign property rules.

Subsection 206(1.5) provides that, where a share or debt obligation issued by a Canadian corporation (or an interest in or right to a share issued by a Canadian corporation) is excluded from classification as a foreign property of a taxpayer, any identical property held by the taxpayer is likewise excluded. This provision would be relevant, for example, if a taxpayer acquired shares of a corporation at the time the $50 million test was satisfied and subsequently the same taxpayer acquired shares when the $50 million test was not satisfied. In addition, this provision may also be relevant in the event that identical properties are acquired before 1996 and after 1995 and the property acquired before 1996 is not foreign property because of the timing of its acquisition.

Subsection 206(1.5) also provides that, where a taxpayer has an interest in or right to a share or debt issued by a Canadian corporation (or property that is exchangeable for or convertible into a share or debt issued by a Canadian corporation), the interest, right or property is not considered to be foreign property because of paragraph (*f*) or (*h*) of the definition "foreign property" in subsection 206(1) of the Act if the taxpayer actually owns another property identical to the share or debt that is not considered to be foreign property. This would be relevant, for example, where a taxpayer has an option to acquire a share issued by a Canadian corporation and also has an identical share that is not classified as foreign property because of subsection 206(1.1) of the Act. Where this is the case, there would be no need to test the classification of

the option as a foreign property on an on-going basis under new subsection 206(1.4) of the Act.

These amendments apply after December 4, 1985.

Subclause 210(4)

Registered Investments

ITA
206(2.01)

Subsection 206(2) of the Act imposes a 1 per cent per month tax on deferred income plans and certain other taxpayers, including "registered investments" (corporations and trusts registered under Part X.2 of the Act). The 1 per cent per month is generally applied to the cost of such a taxpayer's foreign property holdings that is in excess of 20 per cent of the cost of their total property. A registered investment is subject to Part XI tax because shares and interests issued by a registered investment are expressly excluded from other taxpayers' foreign property for the purposes of Part XI, no matter what the level of the registered investment's foreign content.

New subsection 206(2.01) provides limited relief for registered investments from the Part XI tax otherwise determined under subsection 206(2) of the Act. It is expected that registered investments will make use of the new rule only where they have significantly over-invested in foreign property, without regard to their status as registered investments. The rule is not designed to encourage registered investments to invest more in foreign property.

Relief for a registered investment from Part XI tax is provided only where there are interests in the registered investment (or shares of the capital stock of the registered investment where the registered investment is a corporation) that are held by taxpayers other than:

- deferred income plans, registered investments and other taxpayers described in paragraphs 205(*a*) to (*f*) of the Act,

- mutual fund corporations, investment corporations and mutual fund trusts, and

- trusts and partnerships to be prescribed, as set out below.

As a consequence of subsection 206(2.01), the maximum tax payable under Part XI by a registered investment in respect of a month is limited to the greater of:

- $5,000 plus a specified percentage of the tax otherwise determined in subsection 206(2) of the Act in respect of the month. (The specified percentage is the percentage that the total fair market value of all interests/shares in the registered investment that are held by the taxpayers listed above is of the total fair market value of all the interests/shares in the registered investment.); and

- 20 per cent of the tax otherwise determined under subsection 206(2) in respect of the month.

It is intended to amend Part L of the *Income Tax Regulations* to prescribe certain trusts and partnerships so that they are included in the list of taxpayers above. A trust will be prescribed for this purpose where it is a pooled fund trust (as defined by subsection 5000(7) of the Regulations), it would be a mutual fund trust if the 150 beneficiary requirement set out in paragraph 4801(*b*) of the Regulations were ignored or it is a resource property trust (as defined by subsection 5000(7) of the Regulations) or a master trust described in paragraph 149(1)(*o*.4) of the Act. A partnership will be prescribed where it is a qualified limited partnership (as defined by subsection 5000(7) of the Regulations).

These amendments apply to months that end after 1992.

Subclause 210(6)

ITA
206(3)

Subsection 206(3) of the Act provides that, except as prescribed, a share of the capital stock of an investment corporation (other than a registered investment) acquired after October 13, 1971 by a taxpayer is deemed to be a foreign property of the taxpayer.

Subsection 206(3) is being repealed, strictly as a consequence of amended paragraph (*e*) in the definition "foreign property".

This amendment applies to months that end after June 1995.

Clause 211

Tax in Respect of Acquisition of Shares

ITA
206.1

Section 206.1 of the Act imposes a penalty tax on a pension fund or other deferred income plan that enters into an agreement to purchase shares at a price that may differ from their fair market value at the time that the purchase is to take place. The penalty is equal to 1 per cent of the fair market value of the shares for each month that the agreement is outstanding. The provision is intended to discourage tax-exempt entities from temporarily transferring shares to persons who may be able to receive dividends on those shares on a tax-favoured basis. The provision is also intended to apply where the same result could be achieved by a delay in the acquisition of a share by the tax-exempt entity. However, the policy underlying this provision is respected when no dividends are paid while the agreement to purchase is outstanding or when the dividends paid are actually received by the tax-exempt entity.

Section 206.1 is amended to replace the 1-per-cent penalty tax with a tax equal to the amount of dividends paid during each month that the tax-exempt entity is a party to the agreement minus the amount of the dividends that are received by the tax-exempt entity.

Amended section 206.1 applies to agreements entered into after 1992. A transitional rule for agreements entered into after 1992 and before April 26, 1995 limits the tax to the lesser of 1 per cent of the fair market value of the shares for each month that the agreement is outstanding and the amount of dividends paid on the shares during that time.

Clause 212

Retirement Compensation Arrangements – Transfers

ITA
207.6(7)

New subsection 207.6(7) of the Act provides for the transfer of amounts between retirement compensation arrangements (RCAs) on a tax-neutral basis. It achieves this by providing that there is no inclusion required, or deduction permitted, in computing the income of any taxpayer under Part I of the Act where a lump sum amount is transferred directly from one RCA (the "transferor plan") to another RCA (the "transferee plan").

This means that, where such a transfer constitutes a payment out of the transferor plan to an employer or an individual, there is no requirement for the employer or the individual to include the payment in income under paragraph 12(1)(*n*.3) of the Act or under paragraph 56(1)(*x*) or (*z*) of the Act. Also, the individual is denied a deduction under paragraph 60(*t*), although consequential amendments to paragraphs 60(*t*) and (*u*) of the Act allow for the deduction when payments are ultimately received out of the transferee plan. (See the commentary on paragraphs 60(*t*) and (*u*) for further details.)

Similarly, where such a transfer constitutes a contribution to the transferee plan by an individual or an employee, subsection 207.6(7) denies any deduction that might otherwise be available under paragraph 8(1)(*m*.2) or 20(1)(*r*) of the Act.

Subsection 207.6(7) also clarifies that, for purposes of the 50-per-cent refundable RCA tax imposed under Part XI.3, an amount transferred under that subsection is considered to be a distribution from the transferor plan and a contribution to the transferee plan. This ensures that the obligation for the tax is transferred from the transferor plan to the transferee plan.

Amendments to the *Income Tax Regulations* will be proposed to provide that, where an amount is transferred under subsection 207.6(7), there is no withholding on the amount when it is paid out of the transferor plan or when it is paid into the transferee plan.

Subsection 207.6(7) applies to amounts that are transferred after 1995. However, it does not apply where the transferee plan has a non-resident custodian or is a foreign plan deemed by subsection 207.6(5) of the Act to be an RCA in respect of Canadian residents participating in the plan.

Clause 213

Tax on Investment Income of Life Insurers

ITA
211.1(3) and (4)

Part XII.3 of the Act levies a tax on the estimated investment income of life insurance companies. Subsection 211.1(3) of the Act provides a formula to determine an insurer's Canadian life investment income or loss for this purpose. Amounts A and D in this formula are determined by multiplying an annual interest rate by the maximum reserves that may be claimed by the insurer in respect of certain policies. Thus, these amounts include a full 12 months of imputed interest, regardless of the length of the insurer's taxation year.

The amendments provide for the proration of the imputed interest amounts where an insurer has a short taxation year. Specifically, amounts A and D in subsection 211.1(3) are amended to make them subject to new subsection 211.1(4) of the Act. Subsection 211.1(4) provides that where an insurer's taxation year is less than 51 weeks in length, the amounts otherwise determined for A and D are multiplied by the ratio of the number of days in the year (not including February 29th) to 365.

These amendments apply to the 1992 and subsequent taxation years.

Clause 214

Tax on Investment Income of Life Insurers – Instalments

ITA
211.3

Section 211.3 of the Act requires a life insurer to pay quarterly instalments of Part XII.3 tax. These instalments are based on the lesser of the insurer's Part XII.3 tax for the current taxation year and its Part XII.3 tax for the preceding year. The instalment rules are being amended to take into account the length of the insurer's taxation years, and to require monthly instalments. These amendments, which apply to taxation years that begin after 1995, will bring the instalment rules into closer conformity with the instalment rules for taxes payable under other Parts of the Act.

Existing section 211.3 is replaced by new subsections 211.3(1) and (2) of the Act. Subsection 211.3(1) requires a life insurer to pay monthly instalments of Part XII.3 tax equal to 1/12 of the lesser of (i) the estimated amount of annualized Part XII.3 tax payable by the insurer for the year, and (ii) the annualized tax payable by the insurer for the preceding year.

It should be noted that, in determining the instalments for the first taxation year of a life insurer formed by the amalgamation of two or more corporations, the Part XII.3 tax payable by those predecessor corporations for their last taxation years will be used in paragraph 211.3(1)(*b*) of the Act. This follows from the continuity rule in subsection 87(2.2) of the Act. Similarly, the continuity rule in paragraph 88(1)(*g*) of the Act will apply where a subsidiary that is an insurer is wound-up into its parent, and the continuity rule in paragraph 138(11.5)(*k*) of the Act will apply where an insurer transfers its business on a rollover basis to a Canadian corporation.

New subsections 211.3(1) and 211.5(2) of the Act refer to the annualized Part XII.3 tax payable by an insurer for a taxation year. New subsection 211.3(2) of the Act specifies how the annualized tax is to be calculated. If the insurer's taxation year is at least 51 weeks in length, its annualized tax is equal to its Part XII.3 tax for the year. Otherwise, the insurer's annualized tax is computed by multiplying its

Part XII.3 tax for the year by the ratio of 365 to the number of days in the year (other than February 29th).

Clause 215

Tax on Investment Income of Life Insurers – Interest on Instalments

ITA
211.5

Section 211.5 of the Act provides that certain provisions of Part I of the Act relating to assessments, interest, penalties, objections and appeals are also applicable to Part XII.3 of the Act. This section is renumbered as subsection 211.5(1).

New subsection 211.5(2) of the Act contains a rule relating to the application of subsection 161(2) and section 163.1 of the Act to instalments payable under Part XII.3. Subsection 161(2) provides for interest in respect of the late or deficient payment of instalments, while subsection 163.1 imposes a penalty in respect of late or deficient payments in some circumstances. New subsection 211.5(2) provides that, for the purpose of determining any interest or penalty, a life insurer is deemed to have been liable to pay monthly instalments based on the lesser of its annualized tax for the year and its annualized tax for the previous year. This differs from the instalment requirement in subsection 211.3(1) of the Act, in that the actual tax for the current year is used in place of the taxpayer's estimate of the tax.

The amendments to section 211.5 apply to taxation years that begin after 1995.

Clause 216

Tax on Income of Non-Residents

ITA
212

Section 212 of the Act is the principal provision of the Act dealing with the 25-per-cent non-resident withholding tax. It enumerates the various payments to non-residents that are subject to this tax.

Subclause 216(1)

RCA Benefits to Non-Residents

ITA
212(1)(*j*)

Paragraph 212(1)(*j*) of the Act imposes a 25-per-cent withholding tax on certain amounts including an amount paid or credited to a non-resident person on account of, or in satisfaction of, an amount described in paragraph 56(1)(*x*) of the Act. Paragraph 56(1)(*x*) refers to amounts received from a retirement compensation arrangement by a person (other than an employer) that can reasonably be considered to be in respect of a person's office or employment.

Paragraph 212(1)(*j*) is amended so that there is no requirement to withhold on amounts transferred after 1995 from one retirement compensation arrangement to another in accordance with subsection 207.6(7) of the Act.

Subclause 216(2)

Exemptions

ITA
212(9)

Subsection 212(9) of the Act provides an exemption from withholding tax under Part XIII of the Act with respect to certain amounts of a trust's income that are paid or credited to a non-resident beneficiary under the trust and that would otherwise be

subject to withholding tax under paragraph 212(1)(*c*) of the Act. The exemption applies only to the extent that the trust's income derives from dividends or interest received by the trust from a non-resident-owned investment corporation or from certain artistic royalties. If no Part XIII tax would have been payable with respect to the dividends, interest or royalties if they had been paid directly to the beneficiary, no Part XIII tax is payable with respect to distributions from trust income to non-resident beneficiaries deriving from such dividends, interest or royalties.

Subsection 212(9) is amended so that the exemption also applies with respect to all interest allocated to a non-resident beneficiary that is received by a mutual fund trust maintained primarily for the benefit of non-resident beneficiaries, provided no Part XIII tax would have been payable with respect to the interest if it had been paid directly to the non-resident beneficiary.

This amendment applies to amounts paid or credited after April 1995 to non-resident persons.

Clause 217

Optional Method of Payment

ITA
216(4)

Section 216 of the Act allows a non-resident person to elect to be taxed under Part I of the Act on that person's net income from Canadian real property and timber royalties in lieu of paying Part XIII tax on the gross amount of such payments.
Subsection 216(4) of the Act permits an agent of a non-resident person to withhold on the basis of the net amount of such rents or royalties where the non-resident person has filed an undertaking with the Minister of National Revenue to file a return of income for the year under Part I. Where the non-resident person fails to fulfil the undertaking or pay the proper amount of tax within the time provided for payment, the non-resident's agent becomes liable for the Part XIII tax which should have been withheld.

The amendment to this subsection corrects an error made in the Fifth Supplement of the Revised Statutes of Canada, 1985 which referred to the non-resident recipient of the payments, rather than the person receiving such payments on the non-resident's behalf, as the one having the obligations described in paragraphs 216(4)(*a*) and (*b*) of the Act. This amendment also clarifies that an agent's liability will arise where a non-resident member of a partnership fails to fulfil the member's obligations under subparagraph 216(4)(*b*)(i) or (ii) of the Act.

Amended subsection 216(4) applies to amounts paid or credited after November 1991.

Clauses 218 and 219

Branch Tax

ITA
219

Part XIV of the Act imposes what is commonly known as the "branch tax" on corporations, other than Canadian corporations, carrying on business in Canada. Together with the amendment of section 219.1 of the Act(see the following commentary on section 219.1), this amendment to section 219 of the Act simplifies Part XIV and better conforms it to the general scheme of the Act. This amendment applies to taxation years that begin after 1995.

A non-resident corporation may carry on business in Canada either through a subsidiary corporation or by operating a branch here. Dividends paid by a subsidiary to its non-resident parent company are subject to non-resident withholding tax under Part XIII of the Act, as modified by any applicable tax treaty. In the case of a branch, Part XIV imposes what is intended to be a generally comparable tax: in broad terms, any after-tax Canadian earnings that are not reinvested in the corporation's Canadian business are subject to the branch tax.

The branch tax currently applies to every corporation carrying on business in Canada that is not a Canadian corporation. Under subsections 89(1) and 250(5.1) of the Act, a corporation is a

Canadian corporation only if it both: (1) is resident in Canada; and (2) was incorporated in (or continued into) Canada or has been resident here since June 18, 1971. As a result, a corporation may be resident in Canada without being a Canadian corporation, and thus be subject to the branch tax.

Subclause 219(1)

ITA
219(1)

Subsection 219(1) of the Act imposes liability to branch tax and describes the tax base. This amendment modifies subsection 219(1) so that the branch tax applies only to non-residents. The amendment also makes certain changes to the branch tax base.

The opening words of subsection 219(1) are amended to apply the tax only to corporations that are non-resident in a taxation year. It should be noted that the tax may apply to a non-resident corporation whether or not the corporation is carrying on business in Canada, although in most cases only Canadian-source business income and related taxable capital gains will be subject to tax.

The general structure of the branch tax base remains the same: the base is the amount, if any, by which the total of certain amounts, now listed in paragraphs 219(1)(*a*) through (*g*) of the Act, exceeds the total of other amounts, now listed in paragraphs 219(1)(*h*) through (*l*) of the Act. The following notes describe each of these provisions in turn, while the accompanying table shows the relationship between the current and the new rules.

Unless otherwise noted, all paragraphs referred to form part of subsection 219(1).

Part XIV base computation under existing and new 219(1)

Existing	Effect	New	Notes
219(1)(a)	Inclusion: amount taxable ("base amount")	219(1)(a)	
(a.1)	Inclusion: dividends deducted under 112	–	Unnecessary – 219(1) applies to non-residents only
(a.2)	Inclusion: dividends deducted under 115	(b)	
(a.3)	Inclusion: amounts deducted under 20(1)(v.1)	(c)	
–	Inclusion: non-taxable portion of gains on TCP used in Canadian business	(d)	New
–	Inclusion: grants, credits, etc. re. amount deducted under (k) (existing (j))	(e)	New
(a.4)	Inclusion: deferred gain on transfer of branch property	(f)	Can now transfer to any "qualified related corporation" – see 219(8)
(b)	Inclusion: previous year's investment allowance	(g)	

(c)	Inclusion: previous year's claim for dividends paid while resident	–	Unnecessary – 219(1) applies to non-residents only
(d)	Deduction: (where non-resident throughout year) net TCG from non-business TCP	–	Unnecessary – new 219(1.1) includes in Part XIV base only gains relating to Canadian business property
(e)	Deduction: federal taxes	(h)	Combines existing (e) and (f)
(f)	Deduction: provincial taxes	(h)	
(f.1)	Deduction: non-deductible tax interest and penalties	(i)	
(g)	Deduction: foreign tax credits	–	Unnecessary – 219(1) applies to non-residents only
(h)	Deduction: investment allowance	(j)	
(i)	Deduction: dividends paid while resident	–	Unnecessary – 219(1) applies to non-residents only
(j)	Deduction: non-deductible Crown royalties, etc.	(k)	
(k)	Deduction: excess of FMV of property transferred over PUC increase + "boot"	(l)	Can now transfer to any "qualified related corporation" – see 219(8)

Inclusions

Paragraph (*a*), which is substantively unchanged, includes in a non-resident corporation's branch tax base the corporation's taxable income earned in Canada for the year. This amount is cited in several other paragraphs, and is described for the purposes of subsection 219(1) as the corporation's "base amount". Paragraph (*b*) includes the amount of any dividends deducted because of section 112 and paragraph 115(1)(*d*.1) of the Act in computing the corporation's base amount. Paragraph (*c*) includes any amount deducted under paragraph 20(1)(*v*.1) of the Act, other than a portion of such an amount deductible because of the corporation's membership in a partnership.

New paragraph (*d*) adds a new inclusion to the branch tax base. In general, the taxable portion of any net gain realized by a non-resident corporation on the disposition of a taxable Canadian property used in a Canadian business will be included in the corporation's base amount. This provision adds to the base the non-taxable portion of any such gain. This further conforms the branch tax to Part XIII of the Act: when a Canadian subsidiary dividends the exempt portion of its capital gains to its non-resident parent, non-resident withholding tax will normally be imposed.

The other new inclusion in the branch tax base is new paragraph (*e*). Under the Act, certain royalties, tax payments and deemed proceeds of disposition in respect of natural resources are either included in a taxpayer's income or not permitted to be deducted. Where such an amount has increased the taxable income earned in Canada of a corporation subject to the branch tax, and is not otherwise deductible in computing the corporation's branch tax base, paragraph (*k*) allows the corporation to deduct the amount. In some cases, however, a corporation may receive a grant or credit in respect of such an amount. New paragraph (*e*) adds these grants and credits to the corporation's base amount for the year they are received, unless they have already been included in the base amount for that or another year.

Paragraph (*f*) is triggered by a non-resident corporation's disposition under paragraph (*l*) of its Canadian business property to a Canadian corporation. Any excess of the fair market value of the property over the corporation's proceeds of disposition is included in the

corporation's branch tax base. It should be noted that while the present paragraph (*k*) requires that the transferee be a subsidiary wholly-owned corporation of the non-resident transferor, paragraph (*l*) will allow the transferee to be any other "qualified related corporation" as defined in amended subsection 219(8) of the Act.

Paragraph (*g*) brings into the branch tax base any "investment allowance" claimed by the corporation under paragraph (*j*) for the previous taxation year.

Deductions

Paragraphs 219(1)(*h*) through (*l*) of the Act, which describe the deductions available in computing the amount subject to branch tax, are substantively the same as the corresponding provisions in the current subsection 219(1). Paragraph (*h*) allows a deduction for federal and provincial income taxes payable for the year (as well as for taxes under Parts I.3 and VI of the Act). Since new subsection 219(1.1) of the Act excludes from the branch tax base taxable capital gains on non-business property, the deduction in paragraph (*h*) is reduced by the portion of a corporation's taxes that may be considered to relate to such gains. Expressed as a ratio, the deductible portion of the taxes in question is to their total as the corporation's base amount is to the amount that would be its base amount if subsection 219(1.1) did not apply.

Non-deductible interest and penalties paid in the year under the Act or under a provincial income tax law are also deducted from the branch tax base, under paragraph (*i*). For simplicity these amounts are, unlike taxes, not prorated for the excluded portion of taxable capital gains.

Paragraph (*j*) provides a deduction for a corporation's "investment allowance". Section 808 of the *Income Tax Regulations* prescribes the amount of a corporation's allowance for a taxation year in respect of its investment in property in Canada: in very broad terms, the allowance is the total of the cost amount of the corporation's Canadian business property and its liquid business assets, less related debts and unpaid tax liabilities. Although its general form will remain unchanged, this Regulation will be revised to reflect the amendment of subsection 219(1) of the Act.

Paragraph (*k*) allows a corporation to deduct in computing the branch tax base certain royalties, tax payments and deemed proceeds of disposition in respect of natural resources that are non-deductible or are included in income under Part I of the Act. Such an amount may be deducted to the extent it is not already deductible from the base either as a tax or as part of the investment allowance.

If a corporation that is subject to the branch tax transfers property used in its Canadian business to another corporation, that property will cease to figure in the transferor corporation's investment allowance, and the transferor's branch tax liability will increase. To allow a non-resident corporation to switch from carrying on business through a branch to carrying on business through a subsidiary, without facing this increase in its branch tax, paragraph (*l*) provides a special deduction from the branch tax base.

Three conditions must be met in order to use the paragraph (*l*) deduction. First, the property disposed of must have been used by the transferor corporation immediately before the disposition for the purpose of gaining or producing income from a business it carried on in Canada. Second, the purchaser of the property must be a Canadian corporation that was, immediately after the disposition, a qualified related corporation of the transferor. This represents a modification of the current rule, which requires that the purchaser be a subsidiary wholly-owned corporation of the non-resident. Finally, the consideration taken back by the transferor on the disposition must include a share (currently shares) of the purchaser corporation.

Where these conditions are met, the transferor corporation can deduct under paragraph (*l*) an amount equal to any excess of (i) the fair market value of the transferred property over the total of (ii) any increase in the purchaser's paid-up capital as a result of the disposition, and (iii) the fair market value of any non-share consideration taken back by the transferor. As noted above, at the same time, paragraph (*f*) includes in the branch tax base any excess of the transferred property's fair market value over the transferor corporation's proceeds of disposition.

The amendments to subsection 219(1) apply to taxation years that begin after 1995. A transitional rule ensures that the provision operates appropriately despite the renaming of its paragraphs. In computing the tax base for a year beginning in 1996, the previous

year's investment allowance will normally have been deducted under current paragraph (*h*), rather than under new paragraph (*j*). The transitional rule, which applies to taxation years that begin in 1996, therefore adds a reference to paragraph (*h*) as it read in its application to the 1995 taxation year.

ITA
219(1.1)

Under subsection 219(1) of the Act, a non-resident corporation's taxable income earned in Canada for a taxation year (which the subsection terms the corporation's "base amount") is one of the elements of the corporation's branch tax base. In determining a non-resident's taxable income earned in Canada, paragraph 115(1)(*b*) of the Act provides that the only taxable capital gains and allowable capital losses to be taken into account are those arising from dispositions of what is defined as "taxable Canadian property" (TCP).

New subsection 219(1.1) of the Act restricts the definition of TCP for purposes of computing a non-resident corporation's branch tax base under subsection 219(1). For those purposes, paragraph 115(1)(*b*) is to be read without reference to subparagraphs (i) and (iii) to (xii). This includes in the subsection 219(1) base amount only those gains and losses that arose on capital property used in carrying on the non-resident corporation's business in Canada.

This new provision applies to taxation years beginning after 1995.

Subclause 219(2)

ITA
219(8)
"qualified related corporation"

Subsection 219(8) of the Act defines the term "qualified related corporation" for purposes of the special treatment of non-resident insurers under Part XIV of the Act. The amendment to this definition extends its application beyond corporations related to insurers, to apply for other purposes of Part XIV as well. This is particularly relevant to the transfer of Canadian business property by a non-resident under amended paragraphs 219(1)(*f*) and (*l*) of the Act, which require that the transfer be to a qualified related corporation.

With this amendment to subsection 219(8), a corporation resident in Canada is a qualified related corporation of a particular corporation if all of its shares (other than directors' qualifying shares) are owned by any one or more of:

- the particular corporation;
- a subsidiary wholly-owned corporation of the particular corporation;
- a corporation of which the particular corporation is itself a subsidiary wholly-owned corporation; or
- a subsidiary wholly-owned corporation of a corporation of which the particular corporation is itself a subsidiary wholly-owned corporation.

The term "subsidiary wholly-owned corporation" of a given corporation, as defined in subsection 248(1) of the Act, includes only a subsidiary all of the shares of which (other than directors' qualifying shares) are held directly by that corporation. In this context, however, the term has a broader meaning. If C Ltd. is a subsidiary wholly-owned corporation of B Ltd., and B Ltd is itself a subsidiary wholly-owned corporation of A Ltd., then C Ltd. will also be a subsidiary wholly-owned corporation of A Ltd., for the purposes of subsection 219(8).

This amendment applies to taxation years that begin after 1995.

Clause 220

Corporate Emigration

ITA
219.1

Section 219.1 of the Act currently imposes a tax under Part XIV of the Act (commonly known as the "departure tax") where a corporation ceases to be a Canadian corporation. For the 1996 and subsequent taxation years, this amendment to section 219.1 applies the tax not to corporations that cease to be Canadian corporations,

but rather to corporations that cease to be resident in Canada. This ensures a better matching of the departure tax and the "branch tax" imposed under subsection 219(1) of the Act and, together with the amendments to that provision (see the commentary on subsection 219(1)), simplifies Part XIV and better conforms it to the general scheme of the Act.

Paragraph 128.1(4)(*a*) of the Act treats an emigrating corporation's taxation year as having ended immediately before the corporation ceased to be resident in Canada. Under amended section 219.1, such a corporation will be required to pay the 25-per-cent departure tax by the day it is required to file its return of income under Part I of the Act for that taxation year. The tax is payable on the fair market value of the corporation's property minus the total of the paid-up capital in respect of all of the corporation's shares immediately before year-end (paragraph 219.1(*b*) of the Act) and the corporation's debts and obligations, other than amounts payable in respect of dividends and amounts payable under section 219.1 itself (paragraph 219.1(*c*) of the Act). New paragraph 219.1(*d*) of the Act deducts a further amount in calculating the departure tax base where a corporation has paid tax under subsection 219(1) or section 219.1 for a taxation year that began before 1996. The need for paragraph 219.1(*d*) and its operation are explained below.

Pre-1996 Part XIV Tax – Paragraph 219.1(*d*)

The amendments to sections 219 and 219.1 of the Act shift the focus of both the subsection 219(1) branch tax and the section 219.1 departure tax in Part XIV of the Act from a corporation's status as a Canadian or other corporation to its residence. In most cases, this change will operate appropriately. In a few special circumstances, however, special relief is necessary to ensure that a corporation is not in effect taxed twice on the same amount.

For example, a corporation that is resident in Canada but not a Canadian corporation may have paid branch tax on any Canadian-source taxable income that was not reinvested in its Canadian business. If the corporation ceases to be resident in Canada after 1995, it will be subject to departure tax on the difference between the fair market value of its property and the total of its paid-up capital and its debts. To avoid taxing surplus on which the

corporation has already been taxed under Part XIV, the corporation's departure tax base should be reduced.

Similarly, a corporation that before 1996 ceases to be a Canadian corporation – perhaps by continuing abroad – and then ceases to be resident after 1995 will be subject to departure tax twice (and may be subject to branch tax in the interim as well). Again, the corporation's departure tax base on ceasing to be resident in Canada should be reduced to reflect the amounts on which it has already been taxed.

Paragraph 219.1(*d*) of the Act is intended to accommodate such cases, by applying to any corporation resident in Canada that has paid either the subsection 219(1) branch tax or the section 219.1 departure tax for a taxation year beginning before 1996 and after the corporation last became resident in Canada. In effect, paragraph 219.1(*d*) reduces the emigrant corporation's departure tax base by the total of the amounts on which the corporation has paid branch tax or departure tax.

More specifically, paragraph 219.1(*d*) reduces a corporation's departure tax base by 4 times the total of the amounts that the corporation would have paid under subsection 219(1) or section 219.1 for the years in question if sections 219.2 and 219.3 of the Act and any applicable international agreement or convention did not apply. By multiplying by 4 the (25 per cent) tax that would have been payable but for tax treaties and sections 219.2 and 219.3 (which reduce the rate of Part XIV tax to the relevant treaty rate), the provision establishes the base on which the tax was paid.

Clause 220.1

Effect of Tax Treaty

ITA
219.3

Section 219.3 of the Act reduces the rate of the departure tax imposed under section 219.1 of the Act. Section 219.3 applies where a corporation that is subject to the tax has become resident in a country whose tax treaty with Canada limits the rate of tax Canada may impose on dividends paid by a wholly-owned subsidiary in

Canada to its parent in that country. The provision limits the departure tax to that rate for dividends, unless it can reasonably be concluded that one of the main reasons the corporation became resident in that country was to reduce the tax payable under Parts XIII or XIV.

Section 219.3 is amended to reflect the amendment of section 219.1, under which that provision applies when a corporation ceases to be resident in Canada, rather than when it ceases to be a Canadian corporation. Section 219.3 is also simplified and updated.

This amendment applies to the 1996 and subsequent taxation years.

Clauses 221

Administration and Enforcement

ITA
220

Section 220 of the Act sets out a number of rules relating to the administration and enforcement of the Act.

Subclause 221(1)

Administration – Delegation

ITA
220(2.01) and 221(1)

New subsection 220(2.01) is added to the Act to provide that the Minister of National Revenue may administratively delegate the Minister's powers and duties under the *Income Tax Act* or *Income Tax Regulations* to an officer or class of officers in the Department. This new subsection replaces the requirement that such delegation be done by a regulation (Part IX of the *Income Tax Regulations*). This amendment will allow a more timely revision of the delegation of the Minister's powers and duties required by an amendment to the Act or a reorganization within the Department.

As a consequence of the addition of new subsection 220(2.01) to the Act, paragraph 221(1)(*f*) of the Act, which authorizes the making of regulations to delegate the Minister's powers and duties under the Act or Regulations, is repealed.

These amendments apply on Royal Assent.

Subclause 221(2)

Assessments

ITA
220(3.4)

Subsection 220(3.4) of the Act requires the Minister of National Revenue to reassess each taxation year of any taxpayer to take into consideration a late, amended or revoked election permitted by subsection 220(3.2) of the Act, even if the normal reassessment period for that year has expired. Subsection 220(3.4) is amended strictly as a consequence of the addition of new subsection 152(4.01) of the Act, and ensures that subsection 220(3.4) operates despite the limitations imposed by new subsection 152(4.01) on the Minister's power to reassess under subsection 152(4) of the Act beyond the normal reassessment period. Subsection 220(3.4) applies to elections in respect of the 1985 and subsequent years.

Clause 222

Regulations

ITA
221

Section 221 of the Act provides for the making and publication of regulations under the Act.

Subclause 222(1)

ITA
221(1)(*d*.1)

Paragraph 221(1)(*d*.1) of the Act enables the Governor in Council to make regulations requiring any person to provide their Social Insurance Number and other relevant information to any class of persons who are required to make an information return. Paragraph 221(1)(*d*.1) is amended to extend this regulatory power to require any person or partnership to provide certain information, including their business number.

This amendment applies on Royal Assent.

Subclause 222(2)

ITA
221(1)(*f*)

New subsection 220(2.01) of the Act authorizes the making of regulations to delegate the powers and duties of the Minister of National Revenue under the Act or the *Income Tax Regulations*. As a consequence of the addition of new subsection 220(2.01), paragraph 221(1)(*f*) of the Act, which provides the same authority, is repealed.

This amendment applies on Royal Assent.

Subclause 222(3)

Regulations – Incorporation by Reference

ITA
221(4)

Subsection 221(1) of the Act provides the Governor in Council with regulatory-making powers to carry out the purposes of the Act. For greater certainty, new subsection 221(4) of the Act will expressly provide that regulations may give legal effect to documents (either legislative or non-legislative instruments) and other laws not included

directly in the *Income Tax Regulations* but that are incorporated as amended from time to time.

This amendment will come into force on Royal Assent and applies to all regulations made under the Act, whether made before, on or after that date.

Clause 223

Court Costs

ITA
222.1

New section 222.1 is added to the Act to ensure that where an amount is payable to Her Majesty because of an order, judgment or award of a court in respect of the cost of litigation relating to a matter to which the Act applies, various relevant provisions of the Act apply to that amount as if it were a debt owing by the person on account of tax payable under the Act. New section 221.1 applies to amounts that are payable after Royal Assent, including where those amounts became payable before Royal Assent.

Clause 224

Amounts Payable

ITA
223

Section 223 allows Revenue Canada to register with the Federal Court a certificate specifying an amount payable by a taxpayer under the Act. Paragraph 223(1)(*b*) of the Act is amended to add a reference to the *Unemployment Insurance Act*, which was repealed by Bill C-12.

This amendment is deemed to have come into force on June 30, 1996.

Clause 225

Collection Restrictions

ITA
225.1(1)

Section 225.1 of the Act imposes certain limits on Revenue Canada's collection of unpaid amounts for which a taxpayer has been assessed under the Act. In general, collection actions are limited for 90 days after the date of assessment, or until any objection or appeal by the taxpayer has been disposed of. Some special assessments, however, cannot be objected to by the taxpayer. These include reassessments under subsections 152(4.2) (to determine a refund or reduction of an amount payable), 169(3) (to dispose of an appeal with the taxpayer's consent), and 220(3.1) (to account for the cancellation of interest or penalties) of the Act. This amendment to subsection 225.1(1) excludes amounts owing under these special provisions from the collection limitations in section 225.1. This amendment applies on Royal Assent.

Clause 226

Withholding Taxes

ITA
227

Section 227 of the Act provides special rules relating to source deductions and non-resident withholding tax under sections 153 and 215 of the Act respectively, and also deals with the application of certain Parts of the Act to particular persons and entities.

Subclause 226(1)

ITA
227(4) and (4.1)

Subsection 227(4) of the Act provides that amounts withheld from payments made by a payer in respect of taxes payable by the recipient are deemed to be held in trust for Her Majesty separate and

apart from the payer's own moneys and give rise to a lien and charge on property of the payer, from the time these amounts are withheld, whether or not they are kept separate and apart and whether or not the payer is in receivership, bankruptcy or liquidation.

Subsection 227(4) is amended effective June 15, 1994 to clarify that the Crown's deemed trust claim is a priority claim. The reference to the lien and charge on the property and assets of the payer is removed to ensure that the tracing requirements in relation to the property of the trust continue to be met in keeping with the jurisprudence on the priority status of the deemed trust, as it did before the enactment of the June 15, 1994 income tax technical amendments. New subsection 227(4.1) of the Act will provide that the deemed trust for the amounts withheld from payments, applies only to property of the payer equal in value to any such amount deemed to be held in trust and that was not paid to Her Majesty as and when required.

In addition, this change also clarifies that the deemed trust takes priority over a security interest of any secured creditor as defined in subsection 224(1.3) of the Act unless the security interest is a prescribed security interest. A prescribed security interest will include a mortgage interest in real estate. The proposed amendments respond to the recent decision of the Supreme Court of Canada in Her Majesty the Queen v. Royal Bank of Canada, which held that the current rules in the Act creating a deemed trust do not give priority to the Crown over certain assignments of inventory and that clearer language is required to assign absolute priority to the Crown. These amendments apply from June 15, 1994.

Similar amendments are made to the *Canada Pension Plan* and the *Unemployment Insurance Act* and a reference to new subsection 227(4.1) of the Act is added to the deemed trust exception in the *Bankruptcy and Insolvency Act* and the *Comapnies' Creditors Arrangement Act* at the same time as similar clarifications are made to the priority status of equivalent provincial deemed trusts.

Subclause 226(2)

Penalty

ITA
227(9.1)

Subsection 227(9.1) of the Act restricts the application of the penalty contained in subsection 227(9) of the Act for late or deficient remittances. Subsection 227(9.1) is amended to add a reference to the *Unemployment Insurance Act*, which was repealed by Bill C-12. This amendment is deemed to have come into force on June 30, 1996.

Subclause 226(3)

Assessment

ITA
227(10)

Subsection 227(10) of the Act empowers the Minister of National Revenue to assess a person for various amounts, including penalties and other amounts payable by the person in respect of the failure to comply with the various provisions of the Act. Subsection 227(10) is amended to apply to a person or partnership that is required to pay a penalty for failure to comply with the reporting requirements in respect of tax shelters under new subsection 237.1(7.4) of the Act.

This subsection applies after December 1, 1994.

Clause 227

Electronic Records

ITA
230(4.1) and (4.2)

Subsection 230(1) of the Act compels every person who carries on a business and every person who is required to pay or collect taxes to keep records and books of account. New subsection (4.1) requires a

person who keeps records in an electronic format to retain them in that format for the retention period referred to in subsection 230(4). New subsection (4.2) enables the Minister to exempt a person or a class of persons from the requirement to keep their records in an electronic format under such terms and conditions as are acceptable to the Minister.

This amendment applies on Royal Assent.

Clause 228

Definitions

ITA
231
"document"

The definition of "document" in section 231 of the Act is amended to remove certain items, which are now found in the definition of "record" in subsection 248(1) of the Act. This amendment applies on Royal Assent.

Clause 229

Copies as Evidence

ITA
231.5(1)

Subsection 231.5(1) of the Act permits the making of copies of documents obtained in certain circumstances, and states that the copy made has the same probative force as the original document. This subsection is amended to enable the making of a print-out of an electronic document and sets out that this print-out has the same probative force as the original document.

This amendment applies to copies and print-outs made after Royal Assent.

Clause 230

Solicitor-Client Privilege – Examination of Documents

ITA
232(3.1)

Subsection 232(3.1) of the Act provides a requirement to set aside and conserve a document in respect of which a lawyer has claimed solicitor-client privilege. This amendment clarifies that this requirement applies both to a claim made in the course of an on-site inspection under section 231.1 of the Act and to a claim made following a requirement in writing under section 231.2 of the Act. This amendment applies on Royal Assent.

Clause 231

Information Return

ITA
233.1

Section 233.1 of the Act requires every corporation resident in Canada or carrying on business in Canada in a taxation year to file an information return within six months from the end of the year. The return contains prescribed information regarding transactions with non-resident non-arm's length persons. A separate information return is required to be filed in respect of each such non-resident person.

Section 233.1 is amended in order to extend these filing requirements to partnerships and individuals (including trusts).

Subclause 231(1)

ITA
233.1(1)

New subsection 233.1(1) of the Act sets out a number of definitions for the purposes of the filing requirements in proposed new subsections 233.1(2) to (4) of the Act.