

DRAFT LEGISLATION ON THE TAX CONSEQUENCES OF DEMUTUALIZATION

1.(1) The *Income Tax Act* is amended by adding the following after section 49:

No disposition where obligation satisfied

49.1 For greater certainty, where a taxpayer acquires a particular property in satisfaction of an absolute or contingent obligation of a person or partnership to provide the particular property, the satisfaction of the obligation is not a disposition of property by the taxpayer.

(2) Subsection (1) applies to obligations satisfied after ANNOUNCEMENT DATE.

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

(k) any amount that would otherwise be proceeds of disposition of property of a taxpayer to the extent that the amount is deemed by subsection 84.1(1), 212.1(1) or 212.2(2) to be a dividend paid to the taxpayer;

(2) Subsection (1) applies to taxation years that end after ANNOUNCEMENT DATE.

3.(1) Subparagraph (b)(iii) of the definition "paid-up capital" in subsection 89(1) of the Act is replaced by the following:

(iii) where the particular time is after March 31, 1977, an amount equal to the paid-up capital in respect of that class of shares at the particular time, computed without reference to the provisions of this Act except subsections 51(3) and 66.3(2) and (4), sections 84.1 and 84.2, subsections 85(2.1), 85.1(2.1), 86(2.1), 87(3) and (9), 128.1(2) and (3), 138(11.7), 139.1(5) and (6), 192(4.1) and 194(4.1) and section 212.1,

(2) Subsection (1) applies after ANNOUNCEMENT DATE.

4.(1) The Act is amended by adding the following after section 139:

Demutualization of Insurance Corporations

Definitions

139.1(1) The definitions in this subsection apply in this section and section 139.2.

"cash"

«caisse»

"cash" of a corporation means the total of

(a) the total amount of the corporation's money (other than money the fair market value of which exceeds its stated value as legal tender);

(b) deposits (within the meaning assigned by the *Canada Deposit Insurance Corporation Act* or with a bank) of such money standing to the credit of the corporation; and

(c) the fair market value of bonds, debentures, notes or similar obligations described in clause 212(1)(b)(ii)(C) that are owned by the corporation.

"conversion benefit"

«*avantage de transformation*»

"conversion benefit" means a benefit received in connection with the demutualization of an insurance corporation because of an interest, before the demutualization, of any person in an insurance policy to which the insurance corporation has been a party.

"demutualization"

«*démutualisation*»

"demutualization" means the conversion of an insurance corporation from a mutual corporation into a corporation that is not a mutual corporation.

"holding corporation"

«*société de portefeuille*»

"holding corporation" means a corporation that

(a) in connection with the demutualization of an insurance corporation, has issued shares of its capital stock to stakeholders; and

(b) owns shares of the capital stock of the insurance corporation acquired in connection with the demutualization that entitle it to 90% or more of the votes that could be cast in respect of shares under all circumstances at an annual meeting of

(i) shareholders of the insurance corporation, or

(ii) shareholders of the insurance corporation and holders of insurance policies to which the insurance corporation is a party.

"mutual holding corporation"
«*société mutuelle de portefeuille*»

"mutual holding corporation" in respect of an insurance corporation means a mutual corporation established to hold shares of the capital stock of the insurance corporation, where the only persons entitled to vote at an annual meeting of the mutual corporation are policyholders of the insurance corporation.

"ownership rights"
«*droits de propriété*»

"ownership rights" means rights that are

(a) similar to rights attached to shares of the capital stock of a corporation; and

(b) held by a person in respect of a mutual insurance corporation or mutual holding corporation because of an interest of any person in an insurance policy to which that corporation (or, if that corporation is a mutual holding corporation, an insurance corporation in respect of which that corporation is the mutual holding corporation) is a party.

"person"
«*personne*»

"person" includes a partnership.

"share"
«*action*»

"share" of the capital stock of a corporation includes a right granted by the corporation to acquire a share of its capital stock.

"specified insurance benefit"
«*avantage déterminé*»

"specified insurance benefit" means a taxable conversion benefit that is

(a) an enhancement of benefits under an insurance policy;

(b) an issuance of an insurance policy;

(c) an undertaking by an insurance corporation of an obligation to pay a policy dividend; or

(d) a reduction in the amount of premiums that would otherwise be payable under an insurance policy.

"stakeholder"
«*intéressé*»

"stakeholder" means a person who is entitled to receive or who has received a conversion benefit but, in respect of the demutualization of an insurance corporation, does not include a holding corporation in connection with the demutualization or a mutual holding corporation in respect of the insurance corporation.

"taxable conversion benefit"
«*avantage de transformation imposable*»

"taxable conversion benefit" means a conversion benefit received by a stakeholder in connection with the demutualization of an insurance corporation, other than a conversion benefit that is

- (a) a share of a class of the capital stock of the corporation;
- (b) a share of a class of the capital stock of a corporation that is or becomes a holding corporation in connection with the demutualization; or
- (c) an ownership right in a mutual holding corporation in respect of the insurance corporation.

Rules of general application

(2) For the purposes of this section,

(a) subject to paragraphs (b) and (c), if in providing a benefit in respect of a demutualization, a corporation becomes obligated, either absolutely or contingently, to make or arrange a payment, the person to whom the undertaking to make or arrange the payment was given is considered to have received a benefit

(i) as a consequence of the undertaking of the obligation, and

(ii) not as a consequence of the making of the payment;

(b) where, in providing a benefit in respect of a demutualization, a corporation makes a payment (other than a payment, made pursuant to the terms of an insurance policy, that is not a policy dividend) at any time on or before the day that is 13 months after the demutualization (or such later day as is acceptable to the Minister),

(i) the recipient of the payment is considered to have received a benefit as a consequence of the making of the payment, and

(ii) no benefit is considered to have been received as a consequence of the undertaking of an obligation, that is either contingent or absolute, to make or arrange the payment;

(c) where a corporation's obligation to make or arrange a payment in connection with a demutualization ceases on or before the day that is 13 months after the demutualization (or a later day that is acceptable to the Minister) and without the payment being made in whole or in part, no benefit is considered to have been received as a consequence of the undertaking of the obligation unless the payment was to be a payment (other than a policy dividend) pursuant to the terms of an insurance policy;

(d) the time at which a stakeholder is considered to receive a benefit in connection with the demutualization of an insurance corporation is,

(i) where the benefit is a payment made at or before the time of demutualization or is a payment described in paragraph (b), the time at which the payment is made, and

(ii) in any other case, the time of demutualization of the corporation;

(e) the time at which an insurance corporation is considered to demutualize is the time at which it first issues a share of its capital stock (other than shares of its capital stock issued by it when it was a mutual corporation if the corporation did not cease to be a mutual corporation because of the issue of those shares); and

(f) the value of a benefit received by a stakeholder is the fair market value of the benefit at the time the stakeholder receives the benefit.

Special cases

(3) For the purposes of this section,

(a) where benefits under an insurance policy are enhanced in connection with a demutualization, the value of the enhancement is deemed to be a benefit received by the policyholder and not by any other person;

(b) where premiums payable under an insurance policy to an insurance corporation are reduced in connection with a demutualization, the policyholder is deemed, as a consequence of the undertaking to reduce the premiums, to have received a benefit equal to the present value at the time of demutualization of the additional premiums that would have been payable if the premiums had not been reduced in connection with the demutualization;

(c) the payment of a policy dividend by an insurance corporation or an undertaking of an obligation by the corporation to pay a policy dividend is considered to be in connection with the demutualization of the corporation only to the extent that

(i) the policy dividend is referred to in the demutualization proposal sent by the corporation to stakeholders,

(ii) the obligation to make the payment is contingent on stakeholder approval for the demutualization, and

(iii) the payment or undertaking cannot reasonably be considered to have been made or given, as the case may be, to ensure that policy dividends are not adversely affected by the demutualization;

(d) except for the purposes of paragraphs (c), (e) and (f), where part of a policy dividend is a conversion benefit in respect of the demutualization of an insurance corporation and part of it is not, each part of the dividend is deemed to be a policy dividend that is separate from the other part;

(e) a policy dividend includes an amount that is in lieu of payment of, or in satisfaction of, a policy dividend;

(f) the payment of a policy dividend includes the application of the policy dividend to pay a premium under an insurance policy or to repay a policy loan; and

(g) where the demutualization of an insurance corporation is effected by the merger of the corporation with one or more other corporations to form one corporate entity, that entity is deemed to be the same corporation as, and a continuation of, the insurance corporation.

Consequences of demutualization

(4) Where a particular insurance corporation has undertaken to demutualize,

(a) each of the income, loss, capital gain and capital loss of a taxpayer, from the disposition, alteration or dilution of the taxpayer's ownership rights in the particular corporation as a result of the demutualization, is deemed to be nil;

(b) no amount paid or payable to a stakeholder in connection with the disposition, alteration or dilution of the stakeholder's ownership rights in the particular corporation is an eligible capital expenditure;

(c) no election may be made under subsection 85(1) or (2) in respect of ownership rights in the particular corporation;

(d) where the consideration given by a person for a share of the capital stock of the particular corporation or a holding corporation in connection with the demutualization (or for particular ownership rights in a mutual holding corporation in respect of the particular corporation) includes the transfer, surrender, alteration or dilution of ownership rights in the particular corporation, the cost of the share (or the particular ownership rights) to the person is deemed to be nil;

(e) where a holding corporation in connection with the demutualization acquires, in connection with the demutualization, a share of the capital stock of the particular corporation from the particular corporation and issues a share of its own capital stock to a stakeholder as consideration for the share of the capital stock of the particular corporation, the cost to the holding corporation of the share of the capital stock of the particular corporation is deemed to be nil;

(f) where at any time a stakeholder receives a taxable conversion benefit and subsection (12) does not apply,

(i) the corporation that conferred the benefit is deemed to have paid a dividend at that time on shares of its capital stock equal to the value of the benefit, and

(ii) the benefit received by the stakeholder is deemed to be a dividend received by the stakeholder at that time; and

(g) for the purposes of Part I, where a dividend is deemed by paragraph (f) to have been paid by a non-resident corporation, that corporation is deemed in respect of the payment of the dividend to be a corporation resident in Canada that is a taxable Canadian corporation unless any amount is claimed under section 126 in respect of tax on the dividend.

Paid-up capital -- insurance corporation

(5) Where an insurance corporation resident in Canada has demutualized, in computing the paid-up capital at any particular time in respect of a class of shares of the capital stock of the corporation,

(a) there shall be deducted the total of all amounts each of which would, but for this subsection, have been deemed by subsection 84(1) to have been paid at or before the particular time by the corporation as a dividend on a share of that class because of an increase in paid-up capital (determined without reference to this subsection) in connection with the demutualization; and

(b) there shall be added the amount, if any, by which

(i) the total of all amounts each of which is deemed by subsection 84(3), (4) or (4.1) to be a dividend on shares of that class paid by the corporation before the particular time

exceeds

(ii) the total of all amounts each of which would be deemed by subsection 84(3), (4) or (4.1) to be a dividend on shares of that class paid by the corporation before the particular time, if this Act were read without reference to this subsection.

Paid-up capital -- holding corporation

(6) Where a particular corporation resident in Canada was at any time a holding corporation in connection with the demutualization of an insurance corporation, in computing the paid-up capital at any particular time in respect of a class of shares of the capital stock of the particular corporation,

(a) there shall be deducted the total of all amounts each of which is an amount by which the paid-up capital would, but for this subsection, have increased at or before the particular time as a result of the acquisition of shares of a class of the capital stock of the insurance corporation from the corporation on its demutualization; and

(b) there shall be added the amount, if any, by which

(i) the total of all amounts each of which is deemed by subsection 84(3), (4) or (4.1) to be a dividend on shares of that class paid by the particular corporation before the particular time

exceeds

(ii) the total of all amounts each of which would be deemed by subsection 84(3), (4) or (4.1) to be a dividend on shares of that class paid by the particular corporation before the particular time, if this Act were read without reference to this subsection.

Policy dividends

(7) Where the payment of a policy dividend by an insurance corporation is a taxable conversion benefit,

(a) for the purposes of this Act other than this section, the policy dividend is deemed not to be a policy dividend; and

(b) no amount in respect of the policy dividend may be included, either explicitly or implicitly, in the calculation of an amount deductible by the insurer for any taxation year under paragraph 20(7)(c) or subsection 138(3).

Payment and receipt of premium

(8) Where, in connection with the demutualization of an insurance corporation, a stakeholder receives a specified insurance benefit, the stakeholder is deemed to have paid and the corporation is deemed to have received, at the time of demutualization, a premium in respect of the policy to which the benefit relates equal to the value of the benefit.

Cost of taxable conversion benefit

(9) Where, in connection with the demutualization of an insurance corporation, a stakeholder receives a taxable conversion benefit (other than a specified insurance benefit), the stakeholder is deemed to have acquired the benefit at a cost equal to the value of the benefit.

No shareholder benefit

(10) Subsection 15(1) does not apply to a conversion benefit.

Exclusion of benefit from RRSP and other rules

(11) Subject to subsection (12), for the purposes of the provisions of this Act that relate to registered retirement savings plans, registered retirement income funds, deferred profit sharing plans and superannuation or pension funds or plans, a conversion benefit is deemed not to have been received out of, under or because of, any insurance policy.

Retirement benefit

(12) A conversion benefit received because of an interest in a life insurance policy held by a trust governed by a registered retirement savings plan, registered retirement income fund, deferred profit sharing plan or superannuation or pension fund or plan is deemed to be received under the plan or fund, as the case may be, if it is received by any person (other than the trust).

Employee-paid insurance

(13) Where

(a) a stakeholder receives a conversion benefit because of the stakeholder's interest in a group insurance policy under which individuals have been insured in the course of or because of their employment,

(b) at all times before the payment of a premium described in paragraph (c), the full cost of a particular insurance coverage under the policy has been borne by the individuals who have been insured under the particular coverage,

(c) the stakeholder pays a premium under the policy in respect of the particular coverage or under another group insurance policy in respect of coverage that has replaced the particular coverage, and

(d) it is reasonable to conclude that the purpose of the premium is to apply, for the benefit of the individuals who are insured under the particular coverage or the replacement coverage, all or part of the value of the portion of the conversion benefit that can reasonably be considered to be in respect of the particular coverage,

the following rules apply:

(e) for the purposes of paragraph 6(1)(f) and regulations made under subsection 6(4), the premium is deemed to be an amount paid by the individuals who are insured under the particular coverage or the replacement coverage, as the case may be, and not to be an amount paid by the stakeholder, and

(f) no amount may be deducted in respect of the premium in computing the stakeholder's income.

Acquisition of control

(14) For the purposes of subsections 10(10), 13(21.2) and (24), 14(12) and 18(15), sections 18.1 and 37, subsection 40(3.4), the definition "superficial loss" in section 54, section 55, subsections 66(11), (11.4) and (11.5), 66.5(3) and 66.7(10) and (11), section 80, paragraph 80.04(4)(h), subsections 85(1.2) and 88(1.1) and (1.2), sections 111 and 127, subsection 249(4) and subsection 256(7), control of an insurance corporation (and each corporation controlled by it) is deemed not to be acquired solely because of the acquisition of shares of the capital stock of the insurance corporation, in connection with the demutualization of the insurance corporation, by a particular corporation that at a particular time becomes a holding corporation in connection with the demutualization where, immediately after the particular time

(a) the particular corporation is not controlled by any person or group of persons, and

(b) the total of the cash of the particular corporation and the fair market value of shares of the capital stock of the insurance corporation held by the particular corporation is not less than 95% of the fair market value of all the assets of the particular corporation.

Mutual Holding Corporations

139.2 Where at any time a mutual holding corporation (as defined by subsection 139.1(1)) in respect of an insurance corporation distributes property to a policyholder of the insurance corporation, the mutual holding corporation is deemed to have paid, and the policyholder is deemed to have received from the mutual holding corporation, at that time a dividend on shares of the capital stock of the mutual holding corporation, equal to the fair market value of the property.

(2) Subsection (1) applies to transactions that occur after ANNOUNCEMENT DATE.

5.(1) Subsection 140(1) of the Act is amended by substituting the words "policy dividend" for the word "dividend".

(2) Subsection (1) applies after ANNOUNCEMENT DATE.

6.(1) Section 141 of the Act is replaced by the following:

Definitions

141.(1) In this section, "demutualization" and "holding corporation" have the meanings assigned by subsection 139.1(1).

Life insurance corporation deemed to be public corporation

(2) Notwithstanding any other provision of this Act, a life insurance corporation that is resident in Canada is deemed to be a public corporation.

Holding corporation deemed to be public corporation

(3) A corporation resident in Canada that is a holding corporation because of its acquisition of shares in connection with the demutualization of a life insurance corporation resident in Canada is deemed to be a public corporation at each time in the specified period of the holding corporation at which the holding corporation would have satisfied conditions prescribed under subparagraph (b)(i) of the definition "public corporation" in subsection 89(1) if the words "shareholders, the dispersal of ownership of its shares and the public trading of its shares" in that subparagraph were read as "shareholders and the dispersal of ownership of its shares".

Specified period

(4) For the purpose of subsection (3), the specified period of a corporation

(a) begins at the time the corporation becomes a holding corporation; and

(b) ends at the first time the corporation is a public corporation because of any provision of this Act other than subsection (3).

Exclusion from taxable Canadian property

(5) For the purpose of subparagraph 115(1)(b)(iv), a share of the capital stock of a corporation is deemed to be listed at any time on a stock exchange prescribed for the purpose of that subparagraph where

(a) the corporation is

(i) a life insurance corporation resident in Canada that has demutualized and that, at that time, would have satisfied conditions prescribed under subparagraph (b)(i) of the definition "public corporation" in subsection 89(1) if the words "shareholders, the dispersal of ownership of its shares and the public trading of its shares" in that subparagraph were read as "shareholders and the dispersal of ownership of its shares", or

(ii) a holding corporation that is deemed by subsection (3) to be a public corporation at that time;

(b) no share of the capital stock of the corporation is listed on any stock exchange at that time; and

(c) that time is no later than six months after the time of demutualization of

(i) the corporation, where the corporation is a life insurance corporation, and

(ii) in any other case, the life insurance corporation in respect of which the corporation is a holding corporation.

(2) Subsection (1) applies after ANNOUNCEMENT DATE.

7.(1) The Act is amended by adding the following after section 212.1:

Deemed dividend

212.2(1) This section applies where

(a) a taxpayer at a particular time disposes of a share of the capital stock of a corporation resident in Canada (or any property more than 10% of the fair market value of which can be attributed to shares of the capital stock of corporations resident in Canada) to

(i) a person resident in Canada,

(ii) a partnership in which any person resident in Canada has, directly or indirectly, an interest, or

(iii) a person or partnership that acquires the share or the property in the course of carrying on a business through a permanent establishment in Canada, as defined by regulation;

(b) subsection 212.1(1) does not apply to the disposition;

(c) the taxpayer is non-resident at the particular time;

(d) it is reasonable to conclude that the disposition is part of an expected series of transactions or events that includes the issue after ANNOUNCEMENT DATE of a particular share of the capital stock of a particular corporation resident in Canada and

(i) the redemption, acquisition or cancellation of the particular share, or a share substituted for the particular share, by the particular corporation or the issuer of the substituted share, as the case may be,

(ii) an increase in the level of dividends declared or paid on the particular share or a share substituted for the particular share, or

(iii) the acquisition of the particular share or a share substituted for the particular share by

(A) a person not dealing at arm's length with the particular corporation or with the issuer of the substituted share, as the case may be, or

(B) a partnership any direct or indirect interest in which is held by a person not dealing at arm's length with the particular corporation or with the issuer of the substituted share, as the case may be; and

(e) at the particular time, the person described in subparagraph (a)(i) or (iii) or any person who has, directly or indirectly, an interest in the partnership described in subparagraph (a)(ii) or (iii) knew, or ought reasonably to have known, of the expected series of transactions or events described in paragraph (d).

Deemed dividend

(2) For the purposes of this Part, where property is disposed of at any time by a taxpayer to a person or partnership in circumstances in which this section applies,

(a) a taxable dividend is deemed to be paid at that time by the person or partnership to the taxpayer and received at the time by the taxpayer;

(b) the amount of the dividend is deemed to be equal to the amount determined by the formula

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

where

A is the portion of the proceeds of disposition of the property that can reasonably be attributed to the fair market value of shares of a class of the capital stock of a corporation resident in Canada,

B is the fair market value immediately before that time of shares of that class, and

C is the paid-up capital immediately before that time of that class of shares; and

(c) in respect of the dividend, the person or partnership is deemed to be a corporation resident in Canada.

(2) Subsection (1) applies after ANNOUNCEMENT DATE.

8.(1) Paragraph 237(2)(b) of the English version of the Act is replaced by the following:

(b) shall not knowingly use, communicate or allow to be communicated, otherwise than as required or authorized under this Act or a regulation, the number without the written consent of the person or partnership.

(2) Section 237 of the Act is amended by adding the following after subsection (2):

Authority to communicate number

(3) A particular person may communicate, or allow to be communicated, a Social Insurance Number or business number to another person related to the particular person where the other person is required, pursuant to this Act or the regulations, to make an information return that requires the Social Insurance Number or business number.