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# **Legislative Proposals and Explanatory Notes on Trusts**

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## **Legislative Proposals**

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## INCOME TAX ACT

**1. (1) The definition "disposition of property" in subsection 13(21) of the *Income Tax Act* is repealed.**

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

**2. (1) Clause 40(2)(g)(iv)(A) of the Act is replaced by the following:**

(A) a trust governed by a deferred profit sharing plan, an employees profit sharing plan or a registered retirement income fund under which the taxpayer is a beneficiary or immediately after the disposition becomes a beneficiary, or 10

**(2) Subsection (1) applies to the 1998 and subsequent taxation years.**

**3. (1) Section 43 of the Act is replaced by the following:**

General rule for part dispositions

43. (1) For the purpose of computing a taxpayer's gain or loss for a 15 taxation year from the disposition of part of a property, the adjusted cost base to the taxpayer, immediately before the disposition, of that part is the portion of the adjusted cost base to the taxpayer at that time of the whole property that can reasonably be regarded as attributable to that part. 20

**Payments out of trust income, etc.**

(2) Where

(a) a trust makes a particular payment to a taxpayer out of the trust's 25 unrecognized gains balance or income (determined before the application of subsection 104(6)) for a taxation year or the trust satisfies the taxpayer's right to such a payment,

(b) the particular payment was made or the right was acquired in the 30 year, and

(c) a disposition of part of a capital interest of the taxpayer in the trust resulted from the making of the particular payment or the satisfaction of the right 35

notwithstanding subsection (1), no part of the adjusted cost base to the taxpayer of the capital interest in the trust shall be considered to relate to that part of the capital interest.

**(2) Subsection (1) applies to dispositions that occur after 1999.**

**4. (1) Subsections 52(1) and (1.1) of the Act are replaced by the following:**

**Cost of certain property the value of which included in income**

**52. (1) Where**

(a) a taxpayer acquired property after 1971 (other than an annuity contract, a right as a beneficiary under a trust to enforce payment to the taxpayer by the trust, property acquired as described in subsection (2) or (3) or property acquired from a trust in satisfaction of all or part of the taxpayer's capital interest in the trust), and

(b) an amount in respect of its value was

(i) included, otherwise than under section 7, in computing

(A) the taxpayer's taxable income or taxable income earned in Canada, as the case may be, for a taxation year during which the taxpayer was non-resident, or

(B) the taxpayer's income for a taxation year throughout which the taxpayer was resident in Canada, or

(ii) for the purpose of computing the tax payable under Part XIII by the taxpayer, included in an amount that was paid or credited to the taxpayer,

for the purposes of this subdivision, the amount so included shall be added in computing the cost to the taxpayer of the property, except to the extent that such amount was otherwise added to the cost or included in computing the adjusted cost base to the taxpayer of the property.

**(2) Subsection 52(6) of the Act is repealed.**

**(3) Subsection (1) applies after 1999 except that, with respect to property that has been acquired before 2000 and disposed of before March 2000, paragraph 52(1)(a) of the Act, as enacted by that subsection, shall be read as follows:**

(a) a taxpayer acquired property after 1971 (other than an annuity contract or property acquired as described in subsection (2), (3) or (6)), and

**(4) Subsection (2) applies after 1999, but not to rights that were acquired before 2000 and that are disposed of before March 2000.** 5

**5. (1) The portion of subparagraph 53(2)(h)(i.1) of the Act before clause (A) is replaced by the following:**

(i.1) any amount that has become payable to the taxpayer by the trust after 1987, before 2000 and before that time in respect of the interest (otherwise than as proceeds of disposition of the interest 10 or part thereof), except to the extent of the portion of the payment

**(2) Paragraph 53(2)(h) of the Act is amended by adding the following after subparagraph (i.1):**

(i.2) any amount paid to the taxpayer by the trust after 1999 and before that time in respect of the interest (otherwise than in 15 respect of a disposition of the interest or part thereof), except to the extent that the payment

(A) is in satisfaction of an amount that became payable by the trust after 1987 and before 2000, or 20

(B) is in satisfaction of an amount payable that was designated by the trust under subsection 104(20) in respect of the taxpayer,

**(3) The portion of paragraph 53(2)(i) of the Act before 25 subparagraph (i) is replaced by the following:**

(i) where the property is a capital interest in a trust (other than a unit trust) not resident in Canada that was purchased after 1971 and before that time by the taxpayer from a non-resident person at a time (in this paragraph referred to as the "purchase time") 30 when the property was not taxable Canadian property and the fair market value of such of the trust property as was

**(4) The portion of paragraph 53(2)(i) of the Act after subparagraph (v) is replaced by the following:**

was not less than 50 per cent of the fair market value of all the trust 35 property, that proportion of the amount, if any, by which

(vi) the fair market value at the purchase time of such of the trust properties as were properties described in any of subparagraphs (i) to (v)

exceeds

(vii) the total of the cost amounts to the trust at the purchase time of such of the trust properties as were properties described in any of subparagraphs (i) to (v), 5

that the fair market value at the purchase time of the interest is of the fair market value at the purchase time of all capital interests in the trust; 10

**(5) The portion of paragraph 53(2)(j) of the Act before subparagraph (i) is replaced by the following:**

(j) where the property is a unit of a unit trust not resident in Canada that was purchased after 1971 and before that time by the taxpayer from a non-resident person at a time (in this paragraph referred to as the "purchase time") when the property was not taxable Canadian property and the fair market value of such of the trust property as was 15

**(6) The portion of paragraph 53(2)(j) of the Act after subparagraph (v) is replaced by the following:** 20

was not less than 50 per cent of the fair market value of all the trust property, that proportion of the amount, if any, by which

(vi) the fair market value at the purchase time of such of the trust properties as were property described in any of subparagraphs (i) to (v) 25

exceeds

(vii) the total of the cost amounts to the trust at the purchase time of such of the trust properties as were properties described in any of subparagraphs (i) to (v),

that the fair market value at the purchase time of the unit is of the fair market value at the purchase time of all the issued units of the trust; 30

**(7) The portion of subsection 53(4) of the Act before paragraph (a) is replaced by the following:**



**Recomputation of adjusted cost base on transfers and deemed dispositions**

(4) Where at any time in a taxation year a person or partnership (in this subsection referred to as the "vendor") disposes of a specified property and the proceeds of disposition of the property are determined under paragraph 48.1(1)(c), section 70 or 73, subsection 85(1), paragraph 87(4)(a) or (c) or 88(1)(a), subsection 97(2) or 98(2), paragraph 98(3)(f) or (5)(f), subsection 104(4), paragraph 107(2)(a), (2.1)(a), (4)(d) or (5)(a), 107.4(3)(a) or 111(4)(e) or section 128.1, 5

**(8) Subsection (1) applies to amounts that become payable after 1999.** 10

**(9) Subsection (2) applies to amounts paid after 1999.**

**(10) Subsections (3) to (6) apply for the purpose of computing the adjusted cost base of property after April 26, 1995.**

**(11) Subsection (7) applies to the 1998 and subsequent taxation years.** 15

**6. (1) The definition "disposition" in section 54 of the Act is repealed.**

**(2) Subsection (1) applies to transactions and events that occur after ANNOUNCEMENT DATE.** 20

**7. (1) Subsection 59(5) of the Act is replaced by the following:**

Definition of "proceeds of disposition"

(5) In this section, "proceeds of disposition" has the meaning assigned by section 54.

**(2) Subsection (1) applies to transactions and events that occur after ANNOUNCEMENT DATE.** 25

**8. (1) The definitions "disposition" and "proceeds of disposition" in subsection 66.4(5) of the Act are replaced by the following:**

**"proceeds of disposition"  
« produit de disposition »**

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"proceeds of disposition" has the meaning assigned by section 54.

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

**9. (1) Paragraph 69(1)(c) of the Act is replaced by the following:**

(c) where a taxpayer acquires a property by way of gift, bequest or inheritance or because of a disposition that does not result in a change in the beneficial ownership of the property, the taxpayer is deemed to acquire the property at its fair market value. 5

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

**10. (1) Clause 94(1)(c)(i)(B) of the Act is replaced by the following:** 10

(B) the amount that would be the foreign accrual property income for the year of the trust if

(I) except for the purpose of applying subsections 104(4) to (5.2) to days after 1998 that are determined under subsection 104(4), the trust were a non-resident corporation all the shares of which were owned by a person who was resident in Canada, 15

(II) the description of A in the definition "foreign accrual property income" in subsection 95(1) were, in respect of dividends received after 1998, read without reference to paragraph (b) thereof, 20

(III) the descriptions of B and E in that definition were, in respect of dispositions that occur after 1998, read without reference to "other than dispositions of excluded property to which none of paragraphs (2)(c), (d) and (e) apply", 25

(IV) the value of C in that definition were nil, and 30

(V) for the purpose of computing the trust's foreign accrual property income, the consequences of the application of subsections 104(4) to (5.2) applied in respect of days after 1998 that are determined under subsection 104(4), 35

**(2) Subparagraph 94(1)(c)(i) of the Act is amended by adding the following after clause (C):**

(D) the amount, if any, required by section 94.1 to be included in computing its income for the year, and

(3) Subsections (1) and (2) apply to the 1999 and subsequent taxation years.

**11. (1) Subsection 104(1) of the Act is replaced by the following:**

**Reference to trust or estate**

**104.** (1) In this Act, a reference to a trust or estate (in this subdivision referred to as a "trust") shall, unless the context otherwise requires, be read to include a reference to the trustee or the executor, administrator, heir or other legal representative having ownership or control of the trust property. 5

(2) The portion of subsection 104(4) of the Act before paragraph (a) is replaced by the following: 10

**Deemed disposition by trust**

(4) Every trust is, at the end of each of the following days, deemed to have disposed of each property of the trust (other than exempt property) that was capital property (other than excluded property or depreciable property) or land included in the inventory of a business of the trust for proceeds equal to its fair market value at the end of that day and to have reacquired the property immediately thereafter for an amount equal to that fair market value, and for the purposes of this Act those days are 20

(3) The portion of subsection 104(5) of the Act before paragraph (a) is replaced by the following:

**Depreciable property**

(5) Every trust is, at the end of each day determined under subsection (4) in respect of the trust, deemed to have disposed of each property of the trust (other than exempt property) that was a depreciable property of a prescribed class of the trust for proceeds equal to its fair market value at the end of that day and to have reacquired the property immediately thereafter at a capital cost (in this subsection referred to as the "deemed capital cost") equal to that fair market value, except that 30

(4) The portion of subsection 104(5.2) of the Act before paragraph (b) is replaced by the following:

**Resource property**

(5.2) Where at the end of a day determined under subsection (4) in respect of a trust the trust owns a Canadian resource property (other 35

than an exempt property) or a foreign resource property (other than an exempt property),

(a) for the purpose of determining the amounts under subsection 59(1), paragraph 59(3.2)(c), subsections 66(4) and 66.2(1), the definition "cumulative Canadian development expense" in subsection 66.2(5), subsection 66.4(1) and the definition "cumulative Canadian oil and gas property expense" in subsection 66.4(5), the trust is deemed

(i) to have a taxation year (in this subsection referred to as the "old taxation year") that ended at the end of that day and a new taxation year (in this subsection referred to as the "new taxation year") that begins immediately after that day, and

(ii) to have disposed, immediately before the end of the old taxation year, of each of those properties for proceeds that became receivable at that time equal to its fair market value at that time and to have reacquired, at the beginning of the new taxation year, each such property for an amount equal to that fair market value; and

**(5) Subsection 104(5.3) of the Act is amended by adding the word "and" at the end of paragraph (b.1) and by replacing the portion of paragraph (c) before subparagraph (i) with the following:**

(c) subsection 107.4(3) does not apply to a disposition by the trust during the period

**(6) Subsection 104(5.3) of the Act is amended by striking out the word "and" at the end of paragraph (c) and by repealing paragraph (d).**

**(7) The portion of subsection 104(5.8) of the Act before paragraph (a) is replaced by the following:**

#### **Trust transfers**

(5.8) Where capital property (other than excluded property), land included in inventory, Canadian resource property or foreign resource property is transferred at a particular time by a trust (in this subsection referred to as the "transferor trust") to another trust (in this subsection referred to as the "transferee trust") in circumstances in which subsection 107(2) or 107.4(3) applies,

**(8) Subsection 104(13) of the Act is replaced by the following:**

## Income of beneficiary

(13) There shall be included in computing the income for a particular taxation year of a beneficiary under a trust such of the following amounts as are applicable:

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(a) in the case of a trust (other than a trust referred to in paragraph (a) of the definition "trust" in subsection 108(1)), such part of the amount that, but for subsections (6) and (12), would be the trust's income for the trust's taxation year that ended in the particular year as became payable in the trust's year to the beneficiary; and

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(b) in the case of a trust governed by an employee benefit plan to which the beneficiary has contributed as an employer, such part of the amount that, but for subsections (6) and (12), would be the trust's income for the trust's taxation year that ended in the particular year as was paid in the trust's year to the beneficiary.

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**(9) Subsection 104(20) of Act is replaced by the following:****Designation in respect of non-taxable dividends**

(20) The portion of the total of all amounts, each of which is the amount of a dividend (other than a taxable dividend) paid on a share of the capital stock of a corporation resident in Canada to a trust during a taxation year of the trust throughout which the trust was resident in Canada, that can reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to be part of an amount that became payable in the year to a particular beneficiary under the trust shall be designated by the trust in respect of the particular beneficiary in the return of the trust's income for the year and is deemed to have been so designated for the purposes of subclause 53(2)(h)(i.1)(B)(II), clause 53(2)(h)(i.2)(B), paragraphs 107(1)(c) and (d) and subsections 112(3.1), (3.2), (3.31), and (4.2).

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**(10) Subsection (1) applies to the 1998 and subsequent taxation years.**

**(11) Subsection (2) applies to days after ANNOUNCEMENT DATE that are determined in respect of a trust under subsection 104(4) of the Act and, for the purpose of determining the cost amount to a trust after ANNOUNCEMENT DATE of property, to days after 1992 that are determined in respect of the trust under subsection 104(4) of the Act.**

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**(12) Subsections (3) and (4) apply to days after ANNOUNCEMENT DATE that are determined under subsection 104(4) of the Act.**

**(13) Subsections (5) and (6) apply to transfers made after ANNOUNCEMENT DATE.**

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**(14) Subsection (7) applies to transfers after February 11, 1991 except that for transfers on or before ANNOUNCEMENT DATE, the portion of subsection 104(5.8) of the Act before paragraph (a), as enacted by subsection (7), shall be read as follows:**

(5.8) Where capital property (other than excluded property), land included in inventory, Canadian resource property or foreign resource property is transferred at a particular time by a trust (in this subsection referred to as the "transferor trust") to another trust (in this subsection referred to as the "transferee trust") in circumstances in which paragraph (e) of the definition "disposition" in section 54 or subsection 107(2) applies and the transferee trust is not described in paragraph (g) of the definition "trust" in subsection 108(1),

**(15) Subsection (8) applies to the 2000 and subsequent taxation years.**

**(16) Subsection (9) applies after 1999.**

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**12. (1) Subsection 106(1.1) of the Act is replaced by the following:**

**Cost of income interest in a trust**

(1.1) Notwithstanding subsection 107(2.11), the cost to a taxpayer of an income interest in a trust is deemed to be nil unless

(a) any part of the interest was acquired by the taxpayer from a person who was the beneficiary in respect of the interest immediately before that acquisition;

(b) the cost of any part of the interest would otherwise be determined not to be nil under paragraph 128.1(1)(c) or (4)(c); or

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(c) any part of the interest has ever been acquired for consideration.

**(2) Subsection (1) applies to the 2000 and subsequent taxation years.**

**13. (1) The portion of paragraph 107(1)(a) of the Act before subparagraph (i) is replaced by the following:**

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(a) where the trust is a personal trust (other than a unit trust) or a prescribed trust, for the purpose of computing the taxpayer's capital gain, if any, from the disposition, the adjusted cost base to the taxpayer of the interest or the part of the interest, as the case may be, immediately before the disposition is, unless any part of the interest has ever been acquired for consideration and, at the time of the disposition, the trust would be non-resident if this Act were read without reference to subparagraph 94(1)(c)(i), deemed to be the greater of 5

**(2) Paragraph 107(1)(b) of the Act is repealed.** 10

**(3) The portion of subsection 107(1) of the Act after paragraph (d) is repealed.**

**(4) Subsection 107(1.1) of the Act is replaced by the following:**

#### **Cost of capital interest in a trust**

(1.1) Notwithstanding subsection (2.11), the cost to a taxpayer of a capital interest in a personal trust or a prescribed trust is deemed to be, 15

(a) where the taxpayer elected under subsection 110.6(19) in respect of the interest and the trust does not elect under that subsection in respect of any property of the trust, the taxpayer's cost of the interest determined under paragraph 110.6(19)(a); and 20

(b) in any other case, nil, unless

(i) any part of the interest was acquired by the taxpayer from a person who was the beneficiary in respect of the interest immediately before that acquisition,

(ii) the cost of any part of the interest would otherwise be determined not to nil under section 48 as it read in its application before 1993, section 107.4 or paragraph 111(4)(e) or 128.1(1)(c) or (4)(c), or 25

(iii) any part of the interest has ever been acquired for consideration. 30

**(5) The portion of subsection 107(2) of the Act before paragraph (a) is replaced by the following:**

#### **Distribution by personal trust**

(2) Where at any time a property of a personal trust or a prescribed trust is distributed by the trust to a taxpayer who was a beneficiary 35

under the trust in satisfaction of all or any part of the taxpayer's capital interest in the trust, unless the trust elects, in prescribed form filed with the Minister before April 2001, that the rules in this subsection not apply in respect of the distribution,

**(6) The portion of subsection 107(2) of the Act before paragraph (a), as enacted by subsection (5), is replaced by the following:** 5

**Distribution by personal trust**

(2) Subject to subsections (4) to (5), where at any time a property of a personal trust or a prescribed trust is distributed by the trust to a taxpayer who was a beneficiary under the trust in satisfaction of all or any part of the taxpayer's capital interest in the trust, unless paragraph (g) of the definition "disposition" in subsection 248(1) applies in respect of the distribution or the trusts elects, in prescribed form filed with the Minister with the trust's return of income for its taxation year that includes that time, that the rules in this subsection not apply in respect of the distribution, 10 15

**(7) Paragraphs 107(2)(b) and (c) of the Act are replaced by the following:**

(b) subject to subsection (2.2), the taxpayer is deemed to have 20 acquired the property at a cost equal to the total of its cost amount to the trust immediately before that time and the specified percentage of the amount, if any, by which

(i) the adjusted cost base to the taxpayer of the capital interest or part thereof, as the case may be, immediately before that time 25 (determined without reference to paragraph (1)(a))

exceeds

(ii) the cost amount to the taxpayer of the capital interest or part thereof, as the case may be, immediately before that time;

(b.1) for the purpose of paragraph (b), the specified percentage is, 30

(i) where the property is capital property (other than depreciable property), 100 per cent,

(ii) where the property is eligible capital property in respect of a 35 business of the trust, 100 per cent, and

(iii) in any other case, 75 per cent;



(c) the taxpayer is deemed to have disposed of all or part, as the case may be, of the capital interest for proceeds equal to the amount, if any, by which

(i) the cost at which the taxpayer would be deemed by paragraph (b) to have acquired the property if the specified percentage referred to in that paragraph were 100 per cent 5

exceeds

(ii) the total of all amounts each of which is an eligible offset at that time of the taxpayer in respect of the capital interest or the part thereof; 10

**(8) Subsection 107(2) of the Act is amended by adding the following after paragraph (d):**

(d.1) where

(i) the taxpayer is non-resident at that time, 15

(ii) that time is before October 2, 1996, and

(iii) the property was deemed by paragraph 51(1)(f), 85(1)(i) or 85.1(1)(a), subsection 87(4) or (5) or paragraph 97(2)(c) to be taxable Canadian property of the trust, 20

the property is deemed to be taxable Canadian property of the taxpayer; 25

**(9) The portion of subsection 107(2.01) of the Act before paragraph (a) is replaced by the following:**

**Distribution of principal residence**

(2.01) Where property that would, if a personal trust had designated the property under paragraph (c.1) of the definition "principal residence" in section 54, be a principal residence (within the meaning of that definition) of the trust for a taxation year, is at any time (in this subsection referred to as "that time") distributed by the trust to a taxpayer in circumstances to which subsection (2) applies and the trust so elects in its return of income for the taxation year that includes that time, 30 35

**(10) Subsection 107(2.1) of the Act is replaced by the following:**

**Other distributions**

(2.1) Where at any time a property of a trust is distributed by the trust to a beneficiary under the trust in satisfaction of all or any part of the beneficiary's capital interest in the trust (which interest or part, as the case may be, is in this subsection referred to as the "former interest") and the rules in subsection (2), section 132.2 and paragraph (g) of the definition "disposition" in subsection 248(1) do not apply in respect of the distribution, 5

(a) the trust is deemed to have disposed of the property for proceeds equal to 10

(i) where the property is a Canadian resource property or foreign resource property, its fair market value at that time, and

(ii) in any other case, the greater of its fair market value at that time and its cost amount to the trust immediately before that time; 15

(b) the beneficiary is deemed to have acquired the property at a cost equal to the proceeds determined under paragraph (a); and

(c) the beneficiary is deemed to have disposed of the former interest for proceeds of disposition equal to the amount, if any, by which

(i) the proceeds determined under paragraph (a) 20

exceeds the total of

(ii) where the property is not a Canadian resource property or foreign resource property, the amount, if any, by which the fair market value of the property at that time exceeds the cost amount to the trust of the property immediately before that time, and 25

(iii) the total of all amounts each of which is an eligible offset at that time of the taxpayer in respect of the former interest. 30

**Issue of additional trust interests**

(2.11) Where at any time a trust makes a payment, or satisfies a right to enforce a payment by the trust, to a beneficiary solely by issuing additional units of the trust or by increasing the beneficiary's capital interest in the trust (determined without reference to the right), the payment is or would otherwise be out of the trust's unrecognized gains balance or income (determined before the application 35

of subsection 104(6)) for a taxation year and either that time is in the year or the right was acquired in the year,

(a) the beneficiary is deemed to have disposed of the portion of the beneficiary's capital interest in the trust to which the payment or right relates for nil proceeds; and 5

(b) where the interests of all beneficiaries under the trust are described with reference to units of the trust and the increased interest does not consist of new units of the trust, there shall be added immediately after that time in computing the cost to the beneficiary of each of the beneficiary's units of the trust the portion of the amount of the payment made or otherwise made that can reasonably be considered to relate to the value of that unit at that time. 10

**(11) Subsection 107(3) of the Act is repealed.** 15

**(12) The portion of subsection 107(4) of the Act after paragraph (c) is replaced by the following:**

subsection (2.1) applies in respect of the distribution.

**(13) The portion of subsection 107(4.1) of the Act after paragraph (c) is replaced by the following:** 20

subsection (2.1) applies in respect of the distribution.

**(14) Subsection 107(5) of the Act is replaced by the following:**

#### **Distribution to non-resident**

(5) Subsection (2.1) applies in respect of a distribution of property by a trust resident in Canada to a non-resident taxpayer (including a partnership other than a Canadian partnership) in satisfaction of all or part of the taxpayer's capital interest in the trust, except where the property is a share of the capital stock of a non-resident-owned investment corporation or property described in any of subparagraphs 128.1(4)(b)(i) to (xi). 25 30

#### **Gain not flowed-out to non-resident**

(5.1) Where there are one or more distributions of property in a taxation year by a trust in circumstances to which subsection (5) applies and the trust so elects in prescribed form filed with the trust's return of income under this Part for the year or the trust has made an election under this subsection for the preceding year, subsections 104(6) and (13) shall apply as if those properties had not been distributed. 35 40

Instalment interest

(5.2) Where, only because of the application of subsection (5), paragraphs (2)(a) to (c) do not apply to a distribution in a taxation year of taxable Canadian property by a trust, in applying sections 155, 156 and 156.1 and subsections 161(2), (4) and (4.01) and any regulations made for the purpose of those provisions, the trust's total taxes payable under this Part and Part I.1 for the year are deemed to be the lesser of

(a) the trust's total taxes payable under this Part and Part I.1 for the year, determined before taking into consideration the specified future tax consequences for the year, and

(b) the amount that would be determined under paragraph (a) if subsection (5) did not apply to each distribution in the year of taxable Canadian property to which the rules in subsection (2) do not apply only because of the application of subsection (5).

**(15) Subsections (1) to (4) apply to the 2000 and subsequent taxation years.**

**(16) Subsection (5) applies to distributions made after October 1, 1996.**

**(17) Subsections (6), (7), (9), (11), (12) and (13) apply to distributions made after 1999 but, for distributions made before the day on which this Act is assented to, an election under subsection 107(2) of the Act, as amended by subsection (6), is deemed to have been made on a timely basis if it is filed with the Minister of National Revenue before April 2001.**

**(18) Subsection (8) applies in determining after October 1, 1996 whether property is taxable Canadian property.**

**(19) Subsection 107(2.1) of the Act, as enacted by subsection (10), applies to distributions made after 1999, other than distributions before March 2000 in satisfaction of rights described in subsection 52(6) of the Act that were acquired before 2000.**

**(20) Subsection 107(2.11) of the Act, as enacted by subsection (10), applies to issues and to increases in interests that occur after 1999, other than issues and increases that occur before March 2000 in satisfaction of rights described in subsection 52(6) of the Act that were acquired before 2000.**

**(21) Subsection (14) applies to distributions made after October 1, 1996 except that,**

**(a) for distributions made after October 1, 1996 and before 2000, subsection 107(5) of the Act, as enacted by subsection (14), shall be read as follows:**

(5) Where subsection (2) applies to a distribution at any time by a trust resident in Canada of any property (other than a share of the capital stock of a non-resident-owned investment corporation or property described in any of subparagraphs 128.1(4)(b)(i) to (xi)) to a non-resident taxpayer (including a partnership other than a Canadian partnership) who is a beneficiary under the trust in satisfaction of the taxpayer's capital interest in the trust, notwithstanding paragraphs (2)(a) to (c),

(a) the trust is deemed to have disposed of the property for proceeds equal to its fair market value at that time;

(b) the taxpayer is deemed to have acquired the property at a cost equal to that fair market value; and

(c) the taxpayer is deemed to have disposed of all or part, as the case may be, of the taxpayer's capital interest in the trust, for proceeds of disposition equal to the adjusted cost base to the taxpayer of that interest or part thereof, as the case may be, immediately before that time.

**and**

**(b) for distributions made before the day on which this Act is assented to, an election under subsection 107(5.1) of the Act, as enacted by subsection (14), is deemed to have been made on a timely basis if it is filed with the Minister of National Revenue before April 2001.**

**14. (1) The Act is amended by adding the following after section 107.3:**

**Qualifying disposition**

**107.4** (1) For the purpose of this section, a "qualifying disposition" of a property means a disposition of the property where

(a) because of the disposition, there is a change in the legal ownership of the property that does not result in a change in the beneficial ownership of the property;

(b) the disposition is not made by a trust to a beneficiary under the trust;

(c) the disposition is neither

(i) by a person resident in Canada to a non-resident trust, nor

(ii) a transfer of taxable Canadian property from a non-resident person who was resident in Canada in any of ten calendar years preceding the transfer to a non-resident trust; 5

(d) the disposition is not by a partnership (other than a partnership each member of which is non-resident) to a non-resident trust; 10

(e) the disposition is not by a person or partnership to a trust where the person or partnership has the power to appoint beneficiaries under the trust (other than a power exercisable only by a will or other testamentary instrument); and 15

(f) the disposition is not by an individual to a trust described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1). 20

### **Division of trust property among other trusts**

(2) Where a particular trust disposes of one or more properties on a day to one or more other trusts, the particular trust receives no consideration for the disposition and, as a consequence of the disposition, the beneficial ownership at the beginning of the day of each beneficiary under the particular trust in each particular property of the particular trust is the same as the beneficiary's beneficial ownership at the end of the day in the particular property that relates to the beneficiary's combined interest in the particular trust and in the other trust or trusts, for the purpose of paragraph (1)(a), any change in the legal ownership of those properties on the disposition is deemed not to result in a change in the beneficial ownership of those properties. 25 30

### **Tax consequences of qualifying dispositions** 35

(3) Where at a particular time there is a qualifying disposition of a property to a particular trust,

(a) the transferor's proceeds of disposition of the property are deemed to be the cost amount to the transferor of the property immediately before the particular time; 40

(b) the particular trust's cost of the property is deemed to be the amount, if any, by which 45

(i) the cost amount to the transferor of the property immediately before the particular time,

exceeds

(ii) the amount by which the particular trust's loss otherwise determined from the qualifying disposition would be reduced because of subsection 100(4), paragraph 107(1)(c) or (d) or any of subsections 112(3) to (4.2) if the proceeds determined under paragraph (a) were equal to the fair market value of the property at the particular time; 5

(c) if the property was depreciable property of a prescribed class and its capital cost to the transferor exceeds the amount determined under paragraph (a) in respect of the qualifying disposition, for the purposes of sections 13 and 20 and any regulations made for the purpose of paragraph 20(1)(a), 10

(i) the capital cost of the property to the particular trust is deemed to be the amount that was capital cost of the property to the transferor, and 15

(ii) the excess is deemed to have been allowed to the particular trust in respect of the property under regulations made for the purpose of paragraph 20(1)(a) in computing income for taxation years that ended before the particular time; 20

(d) if the property was eligible capital property of the transferor in respect of a business of the transferor, 25

(i) where the eligible capital expenditure of the transferor in respect of the property exceeds the cost at which the particular trust is deemed by this subsection to have acquired the property, for the purposes of sections 14, 20 and 24, 30

(A) the eligible capital expenditure of the particular trust in respect of the property is deemed to be the amount that was the eligible capital expenditure of the transferor in respect of the property, and 35

(B) 3/4 of the excess is deemed to have been allowed under paragraph 20(1)(b) to the particular trust in respect of the property in computing income for taxation years that ended 40

(I) before the particular time, and

(II) after the adjustment time of the particular trust in respect of the business, and 45

(ii) for the purpose of determining after the particular time the amount to be included under subparagraph 14(1)(a)(v) or

paragraph 14(1)(b) in computing the particular trust's income in respect of any subsequent disposition of the property of the business, there shall be added to the value otherwise determined for Q in the definition "cumulative eligible capital" in subsection 14(5) the amount determined by the formula 5

$$A \times B/C$$

where

A is the amount, if any, determined for Q in that definition in respect of the business of the transferor immediately before the particular time, 10

B is the fair market value of the property immediately before the particular time, and 15

C is the fair market value immediately before the particular time of all eligible capital property of the transferor in respect of the business; 20

(e) if the property was deemed to be taxable Canadian property of the transferor by this paragraph or paragraph 51(1)(f), 85(1)(i) or 85.1(1)(a), subsection 87(4) or (5) or paragraph 97(2)(c) or 107(2)(d.1), the property is deemed to be taxable Canadian property 25 of the particular trust;

(f) if the transferor is a trust and a taxpayer disposes of all or part of a capital interest in the transferor because of the qualifying disposition and, as a consequence, acquires a capital interest or part 30 thereof in the particular trust,

(i) the taxpayer is deemed to dispose of the capital interest or part thereof in the transferor for proceeds equal to the cost amount to the taxpayer of that interest or part immediately before the 35 particular time, and

(ii) the taxpayer is deemed to acquire the capital interest or part thereof in the particular trust at a cost equal to the amount, if any, by which 40

(A) that cost amount

exceeds

(B) the amount by which the taxpayer's loss otherwise 45 determined from the disposition referred to in subparagraph (i) would be reduced because of paragraph 107(1)(c) or (d) if the



proceeds determined under that subparagraph were equal to the fair market value of the capital interest or part thereof in the transferor immediately before the particular time; and

(g) the transferor is deemed to acquire the capital interest or part thereof in the particular trust that is acquired as a consequence of the qualifying disposition 5

(i) where the particular trust is a personal trust, at a cost equal to nil, and 10

(ii) in any other case, at a cost equal to the excess determined under paragraph (b) in respect of the qualifying disposition.

**Subsequent dispositions of trust interests** 15

(4) Where

(a) at a particular time a taxpayer acquired a capital interest in a trust as a consequence of a qualifying disposition, 20

(b) the trust is not described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1),

(c) capital interests in the trust are not ordinarily disposed of for consideration that reflects the fair market value of the net assets of the trust, and 25

(d) all or part of the capital interest is disposed of at a time (in this subsection referred to as the "current time") after the particular time otherwise than by way of a qualifying disposition or a transaction to which subsection 107(2) or (2.1) applies, 30

the following rules apply:

(e) the disposition of the part of the capital interest that is disposed of at the current time is deemed to be to a person with whom the taxpayer does not deal at arm's length, and 35

(f) the fair market value of the taxpayer's capital interest in the trust at the current time is deemed to be not less than the amount determined by the formula 40

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

where 45

- A is the fair market value at the current time of the property of the trust that can reasonably be considered to be attributable to the interest,
- B is the total of all amounts each of which is the amount of a debt owing by the trust at the current time or the amount of any other obligation of the trust to pay any amount that is outstanding at the current time, and
- C is the fair market value at the current time of the property of the trust.

**(2) Subsections 107.4(1) and (3) of the Act, as enacted by subsection (1), apply**

**(a) to dispositions that occur after ANNOUNCEMENT DATE, and**

**(b) to transfers of capital property that occur on or before ANNOUNCEMENT DATE for the purpose of applying those subsections to the 1993 and subsequent taxation years,**

**except that, in its application to transfers on or before ANNOUNCEMENT DATE,**

**(c) subsection 107.4(1) of the Act, as enacted by subsection (1), shall be read as follows:**

**107.4** (1) For the purpose of this section, a "qualifying disposition" of a property means a transfer of the property to a particular trust that was not a disposition of the property for the purpose of subdivision c because of paragraph (e) of the definition "disposition" in section 54, except where

(a) if the transfer is from another trust to the particular trust, each trust can reasonably be considered to act as agent for the same beneficiary or beneficiaries with respect to the property transferred; and

(b) in any other case, it is reasonable to consider that the particular trust acts as agent in respect of the property.

**and**

**(d) subsection 107.4(3) of the Act, as enacted by subsection (1), shall be read without reference to paragraph 107.4(3)(a) of the Act, as enacted by subsection (1) and as if the amounts determined under subparagraph 107.4(3)(b)(ii) and**

clause 107.4(3)(f)(ii)(B) of the Act, as enacted by subsection (1), were nil.

(3) Subsections 107.4(2) and (4) of the Act, as enacted by subsection (1), apply to dispositions that occur after ANNOUNCEMENT DATE.

5

**15. (1) The definition "capital interest" in subsection 108(1) of the Act is replaced by the following:**

**"capital interest"**

**« participation**

**au capital »**

10

"capital interest" of a taxpayer in a trust means all rights of the taxpayer as a beneficiary under the trust and, after 1999, includes a right acquired after 1999 (or not disposed of before March 2000) to enforce payment by the trust that arises as a consequence of any such right but, notwithstanding the foregoing, does not include

15

(a) an income interest in the trust, or

(b) a right of the taxpayer acquired because of a transfer of property as a consequence of which there is a change in the legal ownership of the property that does not result in a change in the beneficial ownership of the property, where the trust acts as agent for its beneficiaries but the right is not acquired as a consequence of a disposition to which subsection 248(25.1) applies;

25

**(2) The definition "income interest" in subsection 108(1) of the Act is replaced by the following:**

**"income interest"**

**« participation**

**au revenu »**

30

"income interest" of a taxpayer in a trust means a right (whether immediate or future and whether absolute or contingent) of the taxpayer as a beneficiary under a personal trust to, or to receive, all or any part of the income of the trust and, after 1999, includes a right acquired after 1999 (or not disposed of before March 2000) to enforce payment by the trust that arises as a consequence of any such right, but does not include a right of the taxpayer acquired at any time after 1999 where the taxpayer had a capital interest in the trust at that time;

35

**(3) The portion of the definition "trust" in subsection 108(1) after paragraph (e.1) is replaced by the following:**

and, in applying subsections 104(4), (5), (5.2), (12) and (15) and section 106 at any time, does not include

(f) a trust that, at that time, is a unit trust, or 5

(g) a trust (other than a trust described in paragraph 104(4)(a), a trust that has elected under subsection 104(5.3), a trust that, in its return of income under this Part for its first taxation year ending after 1992, has elected that this paragraph not apply or a trust that is at that time resident in Canada where a beneficiary under the trust at that time is not resident in Canada) all interests in which have vested indefeasibly and no interest in which may become effective in the future. 10

**(4) Subsection 108(1) of the Act is amended by adding the following definitions in alphabetical order:**

"eligible offset" 15  
 «montant de  
 réduction  
 admissible»

"eligible offset" at any time of a taxpayer in respect of the taxpayer's 20  
 capital interest or part of the interest in a trust (referred to in this  
 definition as the "taxpayer's interest") is

(a) an amount paid at that time by the trust to the taxpayer in  
 satisfaction of the taxpayer's interest, where 25

(i) the payment by the trust was out of the trust's unrecognized  
 gains balance or income (determined before the application of  
 subsection 104(6) and before taking into account the distribution  
 in satisfaction of the taxpayer's interest at that time) for a taxation 30  
 year of the trust, and

(ii) the payment was made, or the right to enforce payment of the  
 amount was acquired, in the year, and 35

(b) the portion of the amount of any debt or obligation that is  
 assumed by the taxpayer and can reasonably be considered to be  
 applicable to property distributed at that time in satisfaction of the  
 taxpayer's interest, if the distribution is conditional upon the  
 assumption by the taxpayer of the debt or obligation; 40

**"exempt property"**

« bien exonéré »

"exempt property" of a taxpayer at any time means property any income or gain from the disposition of which by the taxpayer at that time would, because the taxpayer is non-resident or because of a provision contained in a tax treaty, not cause an increase in the taxpayer's tax payable under this Part; 5

**(5) Section 108 of the Act is amended by adding the following after subsection (6):** 10

**Interests acquired for consideration**

(7) For the purposes of paragraph 53(2)(h), subsections 106(1.1) and 107(1) and (1.1), subparagraph 128.1(4)(b)(viii) and the definition "personal trust" in subsection 248(1), where all the beneficial interests in a particular *inter vivos* trust acquired by way of the transfer, assignment or other disposition of property to the particular trust were acquired by 15

(a) one person, or 20

(b) two or more persons who would be related to each other if

(i) a trust and another person were related to each other, where the other person is a beneficiary under the trust or is related to a beneficiary under the trust, and 25

(ii) a trust and another trust were related to each other, where a beneficiary under the trust is a beneficiary under the other trust or is related to a beneficiary under the other trust, 30

any beneficial interest in the particular trust acquired by such a person is deemed to have been acquired for no consideration.

**(6) Subsections (1) and (5) apply after ANNOUNCEMENT DATE.**

**(7) Subsection (2) applies in respect of interests created or materially altered after January 31, 1987 that were acquired after 10 p.m. EST, February 6, 1987.** 35

**(8) Subsection (3) applies to the 1998 and subsequent taxation years except for the purpose of applying paragraph (g) of the definition "trust" in subsection 108(1) of the Act, as enacted by subsection (3), on or before ANNOUNCEMENT DATE.** 40

**(9) The definition "eligible offset" in subsection 108(1) of the Act, as enacted by subsection (4), applies after 1999.**

**(10) The definition "exempt property" in subsection 108(1) of the Act, as enacted by subsection (4), applies after 1992 except that, before 1999, the words "tax treaty" in that definition shall be read as "convention or agreement with another country that has the force of law in Canada".** 5

**16. (1) Paragraphs 132(7)(a) and (b) of the Act are replaced by the following:**

(a) throughout the period beginning on the later of February 21, 1990 and the day of its creation and ending at that time, all or substantially all of its property consisted of property other than property that would be taxable Canadian property if the definition "taxable Canadian property" in subsection 248(1) were read without reference to paragraph (b) of that definition; or 10 15

(b) it has not issued any unit (other than a unit issued to a person as a payment, or in satisfaction of the person's right to enforce payment, out of the trust's unrecognized gains balance or income, determined before the application of subsection 104(6)) of the trust after February 20, 1990 and before that time to a person who, after reasonable inquiry, it had reason to believe was non-resident, except where the unit was issued to that person under an agreement in writing entered into before February 21, 1990. 20

**(2) Paragraph 132(7)(a) of the Act, as enacted by subsection (1), applies after October 1, 1996.** 25

**(3) Paragraph 132(7)(b) of the Act, as enacted by subsection (1), applies after February 20, 1990.**

**17. (1) Paragraph 210.2(2)(b) of the Act is replaced by the following:**

(b) the only taxable capital gains and allowable capital losses referred to in paragraph 3(b) were from dispositions of taxable Canadian property; and 30

**(2) Subsection (1) applies after October 1, 1996.**

**18. (1) The portion of the definition "personal trust" in subsection 248(1) of the Act after subparagraph (b)(ii) is repealed.** 35

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

"disposition"	
« disposition »	
"disposition" of any property, except as expressly otherwise provided, includes	5
(a) any transaction or event entitling a taxpayer to proceeds of disposition of the property,	10
(b) any transaction or event by which,	
(i) where the property is a share, bond, debenture, note, certificate, mortgage, agreement of sale or similar property, or an interest therein, the property is redeemed in whole or in part or is cancelled,	15
(ii) where the property is a debt or any other right to receive an amount, the debt or other right is settled or cancelled,	20
(iii) where the property is a share, the share is converted because of an amalgamation or merger, and	
(iv) where the property is an option to acquire or dispose of property, the option expires,	25
(c) any transfer of the property to a trust or, where the property is property of a trust, any transfer of the property to any beneficiary under the trust, except as provided by paragraphs (e) and (f), and	30
(d) where the property is a beneficiary's capital interest or a part thereof in a trust, except as provided by paragraph (g), a payment after 1999 to the beneficiary of the trust's capital that can reasonably be considered to be	35
(i) in respect of that property, and	
(ii) to have been made because of the beneficiary's capital interest in the trust,	40
but does not include	
(e) any transfer of the property as a consequence of which there is a change in the legal ownership of the property that does not result in any change in the beneficial ownership of the property, where	45

(i) unless the transfer is from one trust to another, it is reasonable to consider that a trust acts as agent in respect of the property it receives or transfers, as the case may be,

(ii) if the transfer is from one trust to another, each trust can reasonably be considered to act as agent for the same beneficiary or beneficiaries with respect to the property transferred, and 5

(iii) except where the Minister is satisfied that the transfer will not jeopardize the collection of taxes payable under this Act and so advises the transferor in writing, the transfer is not from either a person resident in Canada or a partnership (other than a partnership each member of which is non-resident) to a non-resident trust, 10

(f) any transfer of the property as a consequence of which there is a change in the legal ownership of the property that does not result in any change in the beneficial ownership of the property, where 15

(i) the transferor and the transferee are trusts, 20

(ii) the transfer is not by a trust resident in Canada to a non-resident trust,

(iii) the transferor cannot reasonably be considered to act as agent for its beneficiaries with respect to the property transferred, 25

(iv) the transferee held no property immediately before the transfer,

(v) the transferor held no property immediately after the transfer, and 30

(vi) neither the transferor nor transferee is described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1), 35

(g) where the property is part of a capital interest of a taxpayer in a trust (other than a trust that would be non-resident if this Act were read without reference to subparagraph 94(1)(c)(i)) that is described by reference to units issued by the trust, a distribution after 1999 of money that is legal tender in Canada from the trust's capital (other than any portion in respect of which paragraph (a) of the definition "eligible offset" in subsection 108(1) applies) where the number of units in the trust that are owned by the taxpayer is not reduced because of the distribution, 40 45



(h) any transfer of the property for the purpose only of securing a debt or a loan, or any transfer by a creditor for the purpose only of returning property that had been used as security for a debt or a loan,

(i) any issue of a bond, debenture, note, certificate or mortgage, and 5

(j) any issue by a corporation of a share of its capital stock, or any other transaction that, but for this paragraph, would be a disposition by a corporation of a share of its capital stock;

10

**"unrecognized  
gains balance"**  
« solde des gains  
non constatés »

15

"unrecognized gains balance" of a trust for a taxation year means 1/4 of the amount, if any, by which

(a) the total of all amounts each of which is a capital gain of the trust for the year from a disposition of property 20

exceeds

(b) the total of all amounts each of which is a capital loss of the trust for the year from a disposition of property; 25

**(3) Section 248 of the Act is amended by adding the following after subsection (25):**

**Where transfer to bare trust is disposition**

(25.1) Where there is a disposition of property to a trust that would, 30 if the definition "disposition" in subsection (1) were read without reference to subparagraph (e)(iii), not be a disposition of the property, the transferee is deemed

(a) to have received the property solely in its capacity as a trust; and 35

(b) not to hold the property as an agent for the transferor nor, where the transferor is a trust, as an agent for beneficiaries under the transferee.

40

**Trust-to-trust transfers**

(25.2) Where there is a transfer of property from a particular trust to another trust, the transfer is not a disposition and the transfer would be a disposition if the definition "disposition" in subsection (1) were read 45 without reference to paragraph (f), without affecting the personal

liabilities of the trustees of either trust under this Act the other trust is after the transfer deemed to be the same trust as, and a continuation of, the particular trust.

**(4) Subsection (1) applies after ANNOUNCEMENT DATE.**

**(5) The definition "disposition" in subsection 248(1) of the Act, as enacted by subsection (2), applies to transactions and events that occur after ANNOUNCEMENT DATE.** 5

**(6) The definition "unrecognized gains balance" in subsection 248(1) of the Act, as enacted by subsection (2), applies after February 20, 1990.** 10

**(7) Subsections (3) applies to dispositions and transfers that occur after ANNOUNCEMENT DATE.**

**19. (1) Subsection 251(1) is amended by striking out the word "and" at the end of paragraph (a) and by replacing paragraph (b) with the following:** 15

*(b)* a taxpayer and a trust are deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, is beneficially interested in the trust; and

*(c)* where paragraph (b) does not apply, it is a question of fact whether persons not related to each other are at a particular time 20 dealing with each other at arm's length.

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

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## **Explanatory Notes**

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## PREFACE

These explanatory notes describe, for discussion purposes, proposed amendments to the Income Tax Act. The proposed amendments are described, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin  
Minister of Finance



EXPLANATORY NOTES ON  
INCOME TAX PROPOSALS ON TRUSTS

**Clause 1**

**Recaptured Depreciation**

ITA  
13(21)  
"disposition of property"

Subsection 13(21) of the *Income Tax Act* defines the expression "disposition of property" for the purposes of the depreciation recapture rules in section 13.

The definition is being repealed, strictly as a consequence of the new definition "disposition" in subsection 248(1).

The amendment applies to transactions and events that occur after ANNOUNCEMENT DATE.

**Clause 2**

**Capital Losses**

ITA  
40(2)(g)(iv)(A)

Paragraph 40(2)(g) of the Act denies the recognition of losses arising from certain dispositions, including dispositions by a taxpayer to a trust under which the taxpayer is a beneficiary and which is governed by a deferred profit sharing plan, employees profit sharing plan or registered retirement income fund.

Clause 40(2)(g)(iv)(A) is amended to replace a cross reference to such vehicles with a description of them. This amendment is strictly consequential on the replacement of the definition "disposition" in section 54 with a new definition of the same expression in subsection 248(1).

This amendment applies to the 1998 and subsequent taxation years.

**Clause 3****Part Dispositions**

ITA

43

Section 43 of the Act is a rule governing the disposition of a part of a property. For the purpose of computing a taxpayer's gain or loss from the disposition of a part of a property, the adjusted cost base (ACB) of the whole property must be allocated to the part on a reasonable basis.

Existing section 43 is being renumbered as subsection 43(1), strictly as a consequence of the introduction of new subsection 43(2).

New subsection 43(2) applies where a trust makes a particular payment to a taxpayer out of the trust's income for the particular year or out of the tax-exempt portion of its net capital gains for the particular year. (The latter amount is referred to as the trust's "unrecognized gains balance", which is now defined in subsection 248(1).) It also applies where the trust satisfies a beneficiary's right to such a payment, whether or not the manner of satisfying the right is construed as itself being a "payment". In either of these two cases, subsection 43(2) applies where

- the particular payment is made in the particular year or the right to such a payment was acquired in the particular year, and
- part of the beneficiary's "capital interest" in subsection in the trust (as that expression has been amended in subsection 108(1)) is disposed of as a consequence of the making of the particular payment or the satisfaction of the right.

In these circumstances, subsection 43(2) ensures that the ACB allocated to the part of the capital interest in the trust disposed of is nil. Consequently, no capital loss can result from a timely distribution from a trust of its income or the tax-exempt portion of its net capital gains. In addition, no capital gain can arise from the disposition, because the proceeds of disposition in these circumstances are reduced under amended subsection 107(2) or (2.1) or new subsection 107(2.11).



**EXAMPLE**

*Joseph buys 1,000 units of XYZ Mutual Fund on December 23, 2000 for \$10,000. XYZ has not made an election under proposed subsection 132.11(1) to have a December 15 year end. XYZ makes \$400 of its income for its 2000 taxation year payable to Joseph on December 31, 2000. However, without making any cash distribution of the income, XYZ issues 42 additional units on that date in satisfaction of the \$400 of income payable. In November 2001, Joseph disposes of his 1,042 units for \$10,700.*

*Results:*

- 1. Joseph is required to include \$400 in computing his income for the 2000 taxation year.*
- 2. Under subsection 43(2), the ACB allocated to the right to the income payable is nil. This ensures that there is no capital loss when the right is satisfied by the issue of the additional 42 units. The proceeds of disposition are nil, in this case because of the operation of paragraph 107(2.11)(a).*
- 3. The 42 additional units are acquired for \$400. Consequently, the total ACB of the 1,042 units at the time of the disposition is \$10,400.*
- 4. Consequently, the capital gain realized on the subsequent disposition of all of the units is \$300.*

The introduction of subsection 43(2) is part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. Other related amendments include the repeal of subsection 52(6), amended paragraph 53(2)(h), amended subsections 107(2) and (2.1), new subsection 107(2.11), the amended definition of "capital interest" in subsection 108(1), paragraphs (d) and (g) of the definition "disposition" in subsection 248(1) and the definition "eligible offset" in subsection 108(1). For further detail, see the notes on those provisions.

These amendments apply to dispositions that occur after 1999.

**Clause 4****Determination of Cost**

ITA

52(1) and (1.1)

Subject to a number of exceptions, subsection 52(1) of the Act provides that, where an amount in respect of the value of a property has been included in computing a taxpayer's income, that amount is added in determining the cost to the taxpayer of the property for the purposes of the rules for capital gains and losses. A similar rule for non-residents is provided in subsection 52(1.1), except that a taxpayer's taxable income earned in Canada (as well as any amount subject to Part XIII withholding tax) are referred to instead of a taxpayer's income. In addition, subsection 52(1.1) only applies in respect of taxable Canadian property. One of the exceptions to which subsections 52(1) and (1.1) are currently subject is that those subsections do not apply to rights to enforce payments from a trust that are described in subsection 52(6).

Subsection 52(1) is amended and subsection 52(1.1) is repealed so that subsection 52(1) applies to all taxpayers, whether or not resident in Canada. Amended subsection 52(1) generally applies where a taxpayer acquired property and an amount in respect of its value is included in computing the taxpayer's income for a taxation year throughout which the taxpayer was resident in Canada (or in computing a non-resident taxpayer's taxable income earned in Canada under section 115, taxable income under section 114 or an amount from which tax is withheld under Part XIII).

The exceptions in existing subsection 52(1) also generally apply for the purposes of amended subsection 52(1). However, the exception relating to rights to enforce payments from a trust is eliminated as a consequence of the repeal of subsection 52(6) described in the notes below. Instead, amended subsection 52(1) does not apply to any property that is a beneficiary's right to enforce payments by a trust or that is acquired in satisfaction of a beneficiary's "capital interest" in the trust (as defined in amended subsection 108(1)).

These amendments apply after 1999, except with respect to property that is acquired before 2000 and is disposed of before March 2000.

ITA  
52(6)

Subsection 52(6) of the Act provides that the cost to a trust beneficiary of a right acquired in a trust's taxation year to enforce payment by the trust of an amount out of the trust's capital gain or income (determined without reference to the provisions of the Act) for the year is the amount that became so payable. This ensures that there is generally no capital gain realized where a payment is made in satisfaction of such a right.

Subsection 52(6) is being repealed. Instead, amended subsections 107(2) and (2.1), new subsection 107(2.11) and the new definition "eligible offset" in subsection 108(1) provide a different mechanism to achieve a similar result that avoids double taxation on distributions to beneficiaries under subsection 107(2.1).

The repeal of subsection 52(6) is part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. See the notes on new subsection 43(2) for references to further related amendments.

The repeal of subsection 52(6) also means that technical amendments will be needed in the amendments that will implement the election to allow mutual fund trusts a year end of December 15. The required technical amendments are not included in the draft legislation released today.

The repeal of subsection 52(6) applies after 1999, except with respect to property that is acquired before 2000 and disposed of before March 2000.

**Clause 5****Adjustments to Adjusted Cost Base**

ITA

53(2)(h)(i.1) and (i.2)

Under paragraph 53(2)(h) of the Act, certain amounts are deducted in computing the adjusted cost base (ACB) to a beneficiary of the beneficiary's capital interest in a trust (other than certain excluded interests in trusts described in the paragraph). Among the deducted amounts (as described in subparagraph 53(2)(h)(i.1)) are certain amounts payable to a trust beneficiary in respect of the beneficiary's capital interest in a trust, otherwise than as proceeds of disposition.

Subparagraph 53(2)(h)(i.1) is amended so that it does not cause an ACB reduction in connection with amounts that become payable after 1999. After 1999, most trust distributions to beneficiaries will be treated as partial dispositions of capital interests in trusts because of the definition "capital interest" in subsection 108(1) and the new definition "disposition" in subsection 248(1). ACB reductions for capital interests in trusts are now provided for in new subparagraph 53(2)(h)(i.2). Note, in addition, that subsection 43(2) ensures that the adjusted cost base of a capital interest in a trust is not reduced because of ordinary distributions of income and capital gains.

Subparagraph 53(2)(h)(i.2) is introduced so that an ACB reduction will generally only arise for a capital interest in a trust (other than one of the excluded interests), where the trust makes a distribution after 1999 to a beneficiary and, as a consequence of paragraph (g) of the definition "disposition" in subsection 248(1), the distribution does not constitute a partial disposition of the beneficiary's capital interest in the trust. As a consequence, the ACB reduction under this subparagraph will generally arise only in connection with a capital distribution of money by a commercial trust resident in Canada. However, clause 53(2)(h)(i.2)(B) still allows a distribution, without any reduction in the ACB of a beneficiary's capital interest in a trust, of non-taxable dividends designated in favour of the beneficiary under subsection 104(20). In addition, there is a transitional rule in clause 53(2)(h)(i.2)(A) which ensures that any ACB reduction in respect of amounts that became payable before 2000 occurs under subparagraph 53(2)(h)(i.1) rather than subparagraph 53(2)(h)(i.2).

The amendments to paragraph 53(2)(h) are part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. See the notes on new subsection 43(2) for references to further related amendments.

ITA  
53(2)(i) and (j)

Paragraphs 53(2)(i) and (j) of the Act set out certain reductions required to be made in determining the ACB of a capital interest in a non-resident trust (including a unit of a non-resident unit trust) acquired by a purchaser. The ACB reduction for a trust capital interest occurs, in general terms, where the purchaser acquired the interest from a non-resident person and assets of the trust consist primarily of any combination of taxable Canadian properties, Canadian resource properties, timber resource properties and income interests in trusts resident in Canada. The ACB reduction reduces the overall tax advantages associated with the sale of such capital interests by reducing the ACB to the purchaser of the capital interest. The ACB reduction takes into account the deferral of the recognition of gains on such properties that always used to result when a capital interest in a trust holding such properties (rather than the underlying property) was sold by a non-resident person.

Paragraphs 53(2)(i) and (j) are amended so that such ACB reductions are no longer required in connection with purchases of trust capital interests, where those interests constitute taxable Canadian property to the non-resident vendor. This amendment, which is relevant to purchases after April 26, 1995, is consequential to the extension of taxable Canadian property (under former subsection 115(1) and the new definition "taxable Canadian property" in subsection 248(1)) to include capital interests in non-resident trusts, in cases where trust assets consist primarily of taxable Canadian properties and other assets described above.

ITA  
53(4)

Subsection 53(4) of the Act provides rules that affect the computation of the adjusted cost base to a taxpayer of any "specified property"

(as defined in section 54). The rules in subsection 53(4) apply where the proceeds of disposition of a specified property are determined under any one of a number of provisions in the Act set out in the subsection. Where this is the case and the adjusted cost base of the specified property was reduced under paragraph 53(2)(g.1) as a consequence of a forgiveness of debt, subsection 53(4) generally provides for the adjusted cost base to continue to be reduced under that paragraph. The only significance of this subsection is with respect to the potential future application of section 80.03 which, in certain cases, recaptures reductions previously made under paragraph 53(2)(g.1) in computing the adjusted cost base of specified property on a future disposition of such property.

Subsection 53(4) is amended to add a reference in the subsection to paragraph 107.4(3)(a), which provides for a rollover on certain transfers to trusts that do not involve any change in beneficial ownership.

This amendment applies to the 1998 and subsequent taxation years.

## **Clause 6**

### **Definitions**

ITA

54

"disposition"

The expression "disposition" is defined, for the purposes of the capital gains rules, in section 54 of the Act.

The definition is being repealed strictly as a consequence of the introduction of the new definition "disposition" in subsection 248(1).

The repeal of this definition applies to transactions and events that occur after ANNOUNCEMENT DATE.

## **Clauses 7 and 8**

### **Resource Property**

ITA

59(5) and 66.4(5)

"disposition"

Subsections 59(5) and 66.4(5) of the Act define the expressions "disposition" and "proceeds of disposition" for the purposes of sections 59 and 66.4. These expressions are defined in the same way as they are defined under section 54.

Subsections 59(5) and 66.4(5) are amended to eliminate the references to the expression "disposition", as this expression is now defined under subsection 248(1).

These amendments apply to transactions and events that occur after ANNOUNCEMENT DATE.

## **Clause 9**

### **Non-arm's Length Transfers**

ITA

69(1)(c)

Subsection 69(1) of the Act provides rules that deal with gifts and non-arm's length dispositions of property, except where such transactions are covered by other express provisions in the Act (e.g., section 85, subsections 107(2) and (2.1) and new subsection 107.4(3)). Where subsection 69(1) applies, a taxpayer who has acquired property by way of gift, bequest or inheritance is deemed by paragraph 69(1)(c) to have acquired the property at its fair market value.

Paragraph 69(1)(c) is amended so that a taxpayer, where subsection 69(1) applies, is also considered to acquire property at its fair market value where the acquisition is because of a disposition that does not result in any change in the beneficial ownership of the property. For a description of circumstances where a transfer without any change in beneficial ownership is not a "disposition", reference

should be made to the notes on the new definition "disposition" in subsection 248(1).

This amendment applies to acquisitions that occur after ANNOUNCEMENT DATE.

## **Clause 10**

### **Foreign Trusts**

ITA

94(1)(c)(i)(B) and (D)

Where certain conditions are met, a non-resident discretionary trust to which section 94 of the Act applies is generally treated as a trust resident in Canada the taxable income of which is the total of its taxable income earned in Canada (computed on the assumption that the trust was non-resident) and two other amounts. One of these other amounts for a taxation year is described in clause 94(1)(c)(i)(B) as the amount that would be the trust's foreign accrual property income for the year if paragraph 94(1)(d) applied. Under paragraph 94(1)(d), a trust is treated as a corporation for the purpose of computing foreign accrual property income.

Clause 94(1)(c)(i)(B) is amended so that the amount determined under that clause in respect of a trust for a taxation year is generally the trust's foreign accrual property income for the year, determined on the assumptions that the trust is a non-resident corporation and that all of the shares of the capital stock of that corporation are owned by a person resident in Canada. Exceptions to this general rule are described below.

Clause 94(1)(c)(i)(B) is also amended to clarify that the consequences of the 21-year deemed disposition rule for trusts apply for the purpose of computing the amount determined under clause 94(1)(c)(i)(B), despite the fact that the 21-year deemed disposition rule applies to trusts and not to corporations. This clarification applies to disposition dates determined after 1998.

Subclause 94(1)(c)(i)(B)(II) is introduced so the exclusion in the definition "foreign accrual property income" for dividends from other foreign affiliates does not apply for the purpose of computing the



amount determined under clause 94(1)(c)(i)(B). This is appropriate because a trust which receives such dividends would be expected to ultimately distribute such dividends as trust capital. This measure applies to dividends received after 1998.

Under the definition "foreign accrual property income", taxable capital gains and allowable capital losses that have accrued after the 1975 taxation year and relate to "excluded property" are generally disregarded. Subclause 94(1)(c)(i)(B)(III) is introduced so that the disregarding of "excluded property" does not apply for the purpose of determining the amount determined under clause 94(1)(c)(i)(B). This is appropriate because the distribution of gains of this nature would also be expected to be distributed as trust capital. This measure applies to dispositions that occur after 1998.

Subclause 94(1)(c)(i)(B)(IV) is introduced so that section 94.1 is no longer relevant for the purposes of determining the amount under clause 94(1)(c)(i)(B). Instead, new clause 94(1)(c)(i)(D) adds the amount determined under that section in respect of a trust in computing the trust's taxable income under subparagraph 94(1)(c)(i). These measures apply to the 1999 and subsequent taxation years.

## **Clause 11**

### **Trust Taxation**

ITA  
104(1)

Subsection 104(1) of the Act provides that a reference to a trust or estate is read in the Act as a reference to the trustee or the executor, administrator, heir or other legal representative having ownership or control over trust property.

Subsection 104(1) is amended so that this rule does not apply where the context otherwise requires and to clarify that the reference is merely meant to be a convenient way of linking the trustees and others described in the subsection with a trust for the purposes of the Act. This amendment recognizes that there are references to "trust" in the Act which are meant to indicate a trust arrangement, rather than the persons who are responsible for the operation of the arrangement.

This amendment applies to the 1998 and subsequent taxation years.

ITA

104(4) to (5.2)

Subsections 104(4) to (5.2) of the Act set out what is generally referred to as the "21-year deemed realization" rule for trusts. The purpose of the rule is to prevent the use of trusts to defer indefinitely the recognition for tax purposes of gains accruing on capital properties, resource properties and land inventories. These subsections generally treat such properties as having been disposed of and reacquired by trusts every 21 years at the properties' fair market value.

Subsections 104(4) to (5.2) are amended so that the deemed realization rules do not apply to "exempt property" of a non-resident trust, as the expression is now defined in subsection 108(1). "Exempt property" is defined as property the income or gain from the disposition of which by a taxpayer is exempt from Canadian taxation for the taxpayer either because the taxpayer is not resident in Canada or because of a tax treaty. The purpose of this amendment is to prevent the deemed realization rules from being used to increase the cost of such property. The increased cost might be relevant in the event that a non-resident trust distributes such property to Canadian beneficiaries.

These amendments apply to deemed disposition days that are after ANNOUNCEMENT DATE. In the case of capital property (other than depreciable property), the amendments also apply to deemed disposition days that are after 1992, but only for the purpose of determining after ANNOUNCEMENT DATE the cost amount to a trust of property.

ITA

104(5.3)(c) and (d)

Subsection 104(5.3) of the Act allowed the 21-year deemed disposition date for certain family trusts to be deferred. The measure has already been terminated under the existing rules, so that the deferred disposition date is no later than January 1, 1999.

Paragraph 104(5.3)(c) ensures that the deemed disposition date cannot be deferred beyond January 1, 1999 (or an earlier date, where applicable) through a transfer of property from one trust to another that does not constitute a "disposition" because of existing paragraph (e) of the definition "disposition" in section 54. Subject to paragraph 104(5.3)(d), any trust-to-trust transfer in the period (referred to below as the "relevant period") that is after the original date of the deemed disposition and before the date of the deferred deemed disposition is considered to be a "disposition" (i.e., a taxable event) for a trust that has made an election under subsection 104(5.3). Paragraph 104(5.3)(d) provides for relief from paragraph 104(5.3)(c), essentially where one trust is replaced by another trust with the same terms and beneficiaries. In this case, the new trust is deemed to be the same trust as, and a continuation of, the original trust.

Paragraph 104(5.3)(c) is amended to eliminate the reference to the existing definition of "disposition" in section 54, as a consequence of the repeal of that definition and its replacement by a new definition of "disposition" in subsection 248(1).

Paragraph 104(5.3)(c) is also amended so that it only applies where there is a "disposition" of property (as now defined by subsection 248(1)). The only relevant "trust-to-trust" transfer where there is no "disposition" is one to which paragraph (f) of the new definition "disposition" and new subsection 248(25.2) apply. Where paragraph (f) of the new definition applies, the transferee trust is considered under subsection 248(25.2) to be the same as the transferor trust.

Paragraph 104(5.3)(d) is being repealed. The relief provided by that paragraph is largely provided through paragraph (f) of the new definition "disposition" and new subsection 248(25.2), as explained above.

These amendments apply to transfers made after  
ANNOUNCEMENT DATE.

ITA  
104(5.8)

Subsection 104(5.8) of the Act is a special rule designed to prevent the avoidance of the 21-year rule through the use of trust-to-trust

transfers that do not involve dispositions of property at fair market value.

Subsection 104(5.8) is amended to eliminate a reference to trust transfers under paragraph (e) of the definition "disposition" in section 54, as a consequence of the repeal of that definition. It is not necessary to refer to the new definition of "disposition" in subsection 248(1) in this context because relevant trust-to-trust transfers would be expected to occur at fair market value under section 69. This amendment applies to transfers made after ANNOUNCEMENT DATE.

Subsection 104(5.8) is also amended so that it now covers rollovers under new subsection 107.4(3). This amendment applies to transfers made after ANNOUNCEMENT DATE.

Subsection 104(5.8) is also amended so that it does not apply to transfers between trusts, if the transferee trust is described in paragraph (g) of the definition "trust" in subsection 108(1). This amendment, which is made as a consequence of proposed amendments to that paragraph, applies to transfers made after February 11, 1991 and on or before ANNOUNCEMENT DATE.

#### ITA 104(13)

Subsection 104(13) of the Act sets out amounts included in computing the income of a beneficiary under a trust. Where a trust is not resident in Canada, paragraph 104(13)(c) provides that the beneficiary must include in computing income all amounts payable in respect of the beneficiary's interest in the trust, otherwise than as proceeds of disposition or amounts paid in satisfaction of the distribution of capital by a personal trust. There is uncertainty in this regard under the existing law, given that different types of distributions from a trust to a beneficiary might arguably be viewed as resulting in proceeds of disposition with respect to all or part of a beneficiary's interest in the trust.

Subsection 104(13) is amended so that it requires a beneficiary to include in income under that subsection only current income payable from a non-resident trust. Distributions by a non-resident trust to beneficiaries after 1999 generally constitute dispositions – see in this

regard the new definition of "capital interest" in subsection 108(1) and paragraphs (d) and (g) of the definition "disposition" in subsection 248(1). The adjusted cost base of a capital interest in a non-resident personal trust is, for capital gains purposes, determined under paragraph 107(1)(a), unless the interest has been acquired for consideration (whether by the current holder of the interest or any previous holder).

This amendment applies to the 2000 and subsequent taxation years.

ITA  
104(20)

For the purposes of certain loss limitation and other rules in the Act, subsection 104(20) requires a trust resident in Canada to designate the non-taxable dividends that are received by the trust and subsequently distributed to the trust's beneficiaries.

Subsection 104(20) is amended so that it also applies for the purpose of the amended loss limitation rules in sections 107 and 112 and for the purpose of new clause 53(2)(h)(i.2)(B).

This amendment applies after 1999.

## **Clause 12**

### **Income Interests in Trusts**

ITA  
106(1.1)

Subsection 106(1.1) of the Act provides that, for the purposes of determining the deduction available under subsection 106(1) in respect of a beneficiary's income interest in a trust, the cost to the beneficiary of the interest is nil except where the interest was acquired from a beneficiary under the trust.

Subsection 106(1.1) is amended so that the deemed nil cost also does not apply to an income interest in a trust where:

- the cost of any part of the interest was ever determined not to be nil under the taxpayer migration rules in section 128.1, or

- any part of the interest, with reference to new subsection 108(7), has been acquired by the beneficiary or a previous beneficiary for consideration.

Subsection 106(1.1) is also amended so that it overrides new subsection 107(2.11).

Subsection 106(1.1) is also amended to ensure that it applies for the purposes of the Act, and not simply subsection 106(1).

These amendments apply to the 2000 and subsequent taxation years.

### **Clause 13**

#### **Dispositions of Capital Interests in Trusts**

ITA  
107(1)

Subsection 107(1) of the Act contains special rules that apply to the disposition of a capital interest in a trust.

Paragraph 107(1)(a) applies for the purpose of computing a taxpayer's taxable capital gain from the disposition of a capital interest in a personal trust (or a prescribed trust described in section 4800.1 of the Regulations), except where the interest was an interest in a non-resident *inter vivos* trust purchased by the taxpayer and the disposition was not by way of a distribution to which subsection 107(2) applies.

Where paragraph 107(1)(a) applies, the adjusted cost base (ACB) to the taxpayer of a trust capital interest for capital gains purposes is generally equal to the greater of the ACB otherwise determined and the cost amount of the interest. Subsection 108(1) provides that, for this purpose, the cost amount of a capital interest at any time is based on the amount of the trust's money and the cost amount of the trust's other property. The "cost amount" mechanism in paragraph 107(1)(a) generally allows the flow-out from a personal or prescribed trust to a beneficiary of trust capital without adverse tax consequences. However, the concluding words in subsection 107(1) provide that paragraph 107(1)(a) generally does not apply with regard to certain purchased interests in non-resident trusts.

Paragraph 107(1)(a) is amended, in conjunction with the repeal of the concluding wording in subsection 107(1), to ensure that paragraph 107(1)(a) never applies to dispositions of capital interests in unit trusts nor to dispositions of any interests in non-resident trusts (and in trusts that are deemed to be resident in Canada because of subparagraph 94(1)(c)(i)) acquired for consideration. New subsection 108(7) is relevant in determining where an interest in a trust has been acquired for consideration.

Paragraph 107(1)(b) has been eliminated because it is unnecessary.

These amendments apply to the 2000 and subsequent taxation years.

#### ITA

##### 107(1.1)

Subsection 107(1.1) of the Act provides, for the purposes of subsection 107(1), that the cost of a capital interest in a trust is nil except where the interest is acquired from a previous capital beneficiary in the trust or where the interest is issued to the beneficiary for consideration equal to the fair market value of the interest at the time of issuance.

Subsection 107(1.1) is amended so that it applies only to personal trusts and prescribed trusts. It is intended that trusts described in section 4800.1 of the Regulations be prescribed for this purpose.

Subsection 107(1.1) is also amended to eliminate the existing exceptions to the nil cost rule and to provide that the deemed nil cost also does not apply to a beneficiary's capital interest in a trust where:

- the cost of any part of the interest was ever determined not to be nil under the taxpayer migration rules in former section 48 or section 128.1, under new section 107.4 (as described below) or under paragraph 111(4)(e) (acquisition of control), or
- any part of the interest was purchased by the beneficiary from another beneficiary or acquired, by the beneficiary or a previous beneficiary, for consideration. (See in this regard, new subsection 108(7).)

Subsection 107(1.1) is also amended so that it overrides new subsection 107(2.11).

Subsection 107(1.1) is also amended to ensure that it applies for the purposes of the Act, and not simply subsection 107(1).

These amendments apply to the 2000 and subsequent taxation years.

#### ITA

#### 107(2) and (3)

Subsection 107(2) of the Act applies where a personal trust (or a trust described in section 4800.1 of the Regulations) distributes property to a beneficiary in satisfaction of all or part of the beneficiary's capital interest in the trust. Under paragraphs 107(2)(a) and (b), the trust is deemed to have disposed of the property for proceeds of disposition equal to the property's cost amount and the property is deemed to have been acquired by the beneficiary for the same amount plus a "bump" equal to the specified percentage of any excess of the adjusted cost base to the beneficiary of the capital interest over its "cost amount" to the beneficiary (as defined by subsection 108(1)). Under paragraph 107(2)(c), the beneficiary is deemed to have disposed of the capital interest for proceeds equal to the deemed acquisition cost (determined as if the specified percentage referred to above were 100 per cent) less a reduction equal to the amount of debt assumed by the beneficiary that is conditional upon the distribution of the property. Under subsection 107(3), the specified percentage is 100 per cent in the case of non-depreciable capital property (e.g., land and shares) and 50 per cent in any other case.

Subsection 107(2) is amended so that it is subject to amended subsections 107(4) to (5). This amendment is made for technical clarity and does not represent any change in policy. Amended subsections 107(4) to (5) describe trust distributions to which subsection 107(2.1) is to apply.

Subsection 107(2) is amended to allow a trust to elect out of the rules in the subsection in respect of a distribution and, as a consequence, be subject to the rules in amended subsection 107(2.1). An electing trust is generally required to file a prescribed form with the Minister with its tax return for the taxation year that includes the time of the distribution. This amendment applies to distributions made after



October 1, 1996. However, for distributions before Royal Assent, the prescribed form is permitted to be filed before April 2001. This election may assist trusts in treating beneficiaries equitably where there is a mixture of resident and non-resident beneficiaries.

Paragraph 107(2)(b.1) is introduced (in conjunction with consequential amendments to paragraphs 107(2)(b) and (c) and the repeal of subsection 107(3)) so that the specified percentages referred to above are explicitly provided under subsection 107(2). This amendment is intended to clarify the operation of subsection 107(2). In addition, the specified percentage for property (other than non-depreciable capital property and eligible capital property) is being increased from 50 per cent to 75 per cent in recognition of the 75 per cent inclusion rate for capital gains. The specified percentage for eligible capital property is increased from 50 per cent to 100 per cent in recognition that only a maximum of 75 per cent of the cost of eligible capital property can ultimately be deducted for income tax purposes.

Paragraph 107(2)(c) is amended so that the reduction, because of debt assumed by the beneficiary, to a beneficiary's proceeds of disposition of the beneficiary's capital interest that is now provided because of the application of paragraph (b) of the new definition "eligible offset" in subsection 108(1).

Paragraph 107(2)(d.1) is amended to clarify the tax consequences of the disposition of taxable Canadian property by a trust to non-resident beneficiaries before October 2, 1996. In the event that the property was explicitly deemed to have been taxable Canadian property under a number of specified provisions of the Act, paragraph 107(2)(d.1) ensures that it continues to be taxable Canadian property of the beneficiary. This amendment applies in determining after October 1, 1996 whether property is taxable Canadian property.

Except as indicated above, these amendments apply to distributions made after 1999.

ITA  
107(2.01)

Subsection 107(2.01) of the Act allows a personal trust to elect to be treated as if it had disposed of, and reacquired, a principal residence

at its fair market value immediately before distributing the property to one of its beneficiaries under subsection 107(2). The rule does not apply to distributions of property by a post-1971 spousal trust in circumstances to which subsection 107(4) applies. (Subsection 107(4) generally applies to distributions made by such a spousal trust to a beneficiary, other than the beneficiary spouse, before the death of the beneficiary spouse.) Subsection 107(2.01) is designed to allow a personal trust to take advantage of the principal residence exemption. In this regard, reference can be made to the definition of "principal residence" in section 54.

Subsection 107(2.01) is amended to eliminate the reference to subsection 107(4). As a consequence of amendments to subsection 107(4), the reference to subsection 107(4) is now redundant as subsection 107(2.1) now applies to distributions in the event that subsection 107(4) applies.

This amendment applies to distributions made after 1999.

#### ITA 107(2.1)

Where trust property is distributed by a trust to a beneficiary in satisfaction of the beneficiary's capital interest in the trust and subsection 107(2) of Act does not apply, the rules in subsection 107(2.1) apply. Subsection 107(2.1) also applies to a distribution by a trust in satisfaction of a right described in subsection 52(6). Under paragraphs 107(2.1)(a) to (c), the trust is deemed to have disposed of the distributed property for the property's fair market value and the beneficiary is deemed to have acquired the property, and disposed of the capital interest or right described in subsection 52(6), for the same amount. Despite the reference to subsection 52(6) (under which a cost is ascribed to the right to enforce payment out of a trust's capital gains and income), it is unclear that there is relief from double taxation on gains associated with the dispositions of the distributed property and the relinquished capital interest.

Subsection 107(2.1) is amended so that it does not override every other provision of the Act. For example, subsection 107(2.1) no longer deems there to be a "disposition" of property where the existing law provides that there was no "disposition" because of

paragraph (e) of the definition "disposition" in section 54. This amendment is consequential on the replacement of the existing definition "disposition" in section 54 with the new definition of the same expression in subsection 248(1) and new rules in section 107.4 to deal with acquisitions by trusts that do not involve any change in beneficial ownership.

Subsection 107(2.1) is also amended to eliminate the reference to the right described in subsection 52(6). This is consequential on the repeal of subsection 52(6) and allows, in combination with the amendment to the definition "capital interest" in subsection 108(1), a right of a beneficiary under a trust to payment in respect of the capital interest in the trust to be treated as part of the capital interest in a trust.

Subsection 107(2.1) is also amended to provide that it has no application to a distribution of capital described in paragraph (g) of the new definition "disposition" in subsection 248(1). Where there is such a distribution, amounts paid will generally reduce the adjusted cost base of a taxpayer's capital interest in a trust pursuant to new subparagraph 53(2)(h)(i.2).

The elimination of the reference to subsection 52(6) in subsection 107(2.1) and the addition of the reference to paragraph (g) of the new definition "disposition" is part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. See the notes on new subsection 43(2) for references to further related amendments.

Subsection 107(2.1) is amended so that the deemed proceeds of disposition for property distributed under the subsection are, except in the case of Canadian resource property or foreign resource property, the greater of the fair market value of the property and its cost amount to the trust. This amendment is intended to prevent the creation of losses, often unusable, at the trust level as a consequence of the transfer of property in circumstances to which subsection 107(2.1) applies. The exception with regard to Canadian resource and foreign resource property recognizes that there is no explicit rule to determine the cost amount of such property provided under the Act. The deemed proceeds of disposition, determined as

indicated above, are deemed to be the cost to the beneficiary of the distributed property.

Subsection 107(2.1) is also amended so that, where property (other than a Canadian resource property or foreign resource property) is distributed by a trust in satisfaction of a capital interest in the trust, the deemed proceeds from the disposition of the interest are reduced to take into account gains arising at the trust level because of the disposition and any "eligible offset" described in subsection 108(1).

These amendments apply to distributions made after 1999 (other than distributions before March 2000 in connection with rights described in subsection 52(6) of the Act that were acquired before 1999).

The examples below illustrate the operation of amended subsection 107(2.1). It is assumed that the trusts referred to below are all resident in Canada.

#### **EXAMPLE 1**

*In 2000, a commercial trust distributes non-depreciable capital property (shares) to its beneficiary resident in Canada in satisfaction of the beneficiary's capital interest in the trust. The adjusted cost base of the shares is \$40. The adjusted cost base of the beneficiary's capital interest is \$20. The fair market value of the property is \$100.*

*Results:*

- 1. Subsection 107(2.1) applies to the distribution.*
- 2. The trust is deemed by paragraph 107(2.1)(a) to have disposed of the property for \$100 proceeds, so there is a capital gain of \$60 on the resulting disposition and a taxable capital gain of \$45.*
- 3. The beneficiary is deemed by paragraph 107(2)(b) to have acquired the property at a \$100 cost.*
- 4. Because the distribution gives rise to a capital gain, the amount of the capital gain (\$60) reduces the proceeds of the beneficiary's capital interest under subparagraph 107(2.1)(c)(ii). The*

*beneficiary is deemed to have disposed of the capital interest for \$40 proceeds (\$100 - \$60). The "eligible offset" mechanism does not apply in this particular case because any relevant income or tax-exempt capital gains in respect of the distribution was created because of the distribution itself.*

*5. Consequently, the capital gain from the disposition of the capital interest is \$20 (\$40 - \$20).*

## **EXAMPLE 2**

*A personal trust distributes non-depreciable capital property (shares that are not taxable Canadian property) to its non-resident beneficiary in satisfaction of the beneficiary's capital interest in the trust. The adjusted cost base of the shares is \$40. The adjusted cost base of the beneficiary's capital interest, determined before the application of paragraph 107(1)(a), is \$0. The fair market value of the property is \$100.*

*Results:*

- 1. Subsection 107(2.1) applies to the distribution because of the application of subsection 107(5).*
- 2. The trust is deemed by paragraph 107(2.1)(a) to have disposed of the property for \$100 proceeds, so there is a capital gain of \$60 from the resulting disposition and a taxable capital gain of \$45.*
- 3. The beneficiary is deemed by paragraph 107(2.1)(b) to have acquired the property at a \$100 cost.*
- 4. Because the distribution gives rise to a capital gain, the amount of the capital gain (\$60) reduces the proceeds of the beneficiary's capital interest under subparagraph 107(2.1)(c)(ii). The beneficiary is deemed to have disposed of the capital interest for \$40 proceeds (\$100 - \$60).*
- 5. The capital interest in the trust constitutes taxable Canadian property for the non-resident beneficiary. For the purposes of computing capital gains, the adjusted cost base of the capital interest under subsection 107(1) is \$40, being the greater of its adjusted cost base (\$0) determined before the application of that*

*subsection and the cost amount (\$40) of the distributed property to the trust. Consequently, the taxable capital gain from the disposition of the capital interest is nil.*

*6. The allowable capital loss from the disposition of the capital interest is also nil.*

## ITA

### 107(2.11)

New subsection 107(2.11) of the Act provides an explicit mechanism for "capitalizing" current year entitlements of beneficiaries to income and the tax-exempt portion of net capital gains, without any actual distribution being involved. Where this occurs, proceeds of disposition of rights to such income and capital gains are deemed to be nil and the amount capitalized is recognized in computing the adjusted cost base to a beneficiary of the beneficiary's capital interest in the trust.

More specifically, subsection 107(2.11) applies where

- a trust at any time makes a payment, or satisfies a right to a payment by the trust to a beneficiary, solely by issuing additional units of the trust or by increasing the beneficiary's capital interest in the trust (determined without reference to the right),
- the payment is or would otherwise be out of the trust's "unrecognized gains balance" or income (determined before the application of subsection 104(6)) for a taxation year,
- either that time is in the year or the right was acquired in the year.

In these circumstances, the proceeds of disposition of the right are deemed to be nil. (Note: the adjusted cost base allocated to the right is also nil in these circumstances under new subsection 43(2).) For detail on a trust's "unrecognized gains balance" see the notes below on the new definition of that expression in subsection 248(1).)

An increase in a beneficiary's capital interest in a unit trust is almost always achieved through the issuing of further units of the trust. Where this is the case, no special rule is required to provide that the cost to the beneficiary is the fair market value of the cash

payment forgone to acquire the units. However, if no additional units are issued and the amount made payable to unitholders is simply capitalized, the tax results are less clear. Consequently, in the latter case new paragraph 107(2.11)(b) provides for an addition to the cost of each of a beneficiary's existing units in the trust to reflect the appropriate portion of the payment foregone.

New subsection 107(2.11) is part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. See the notes on new subsection 43(2) for references to further related amendments.

These amendments apply to issues of units and increases in interests that occur after 1999, other than issues and increases that occur before March 2000 in satisfaction of rights described in subsection 52(6) that were acquired before 2000.

ITA  
107(3)

Subsection 107(3) of the Act is being repealed. See the notes above on amendments to subsection 107(2).

ITA  
107(4)

Subsection 107(4) of the Act applies where a post-1971 spousal trust distributes capital property, resource property or land to a beneficiary other than the beneficiary spouse. When this occurs while the beneficiary spouse is alive, there is generally a deemed disposition of the property at its fair market value.

Subsection 107(4) is amended so that, for distributions after 1999, the rules set out in amended subsection 107(2.1) apply.

ITA  
107(4.1)

Subsection 107(4.1) of the Act applies in certain cases where a reversionary trust distributes property to a specified beneficiary under the trust. When this occurs, there is a deemed disposition of the property at its fair market value.

Subsection 107(4.1) is amended so that, for distributions after 1999, the rules set out in amended subsection 107(2.1) apply.

ITA  
107(5)

Subsection 107(5) of the Act applies to the distribution of property (other than taxable Canadian property, Canadian resource property and shares in non-resident-owned investment corporations), where the distribution would otherwise be made to a non-resident beneficiary on a rollover basis under subsection 107(2). With regard to such distributions, subsection 107(5) provides for a deemed disposition of the distributed property at its fair market value and an acquisition by the beneficiary for the same amount. In addition, paragraph 107(5)(c) provides for proceeds of disposition of the relinquished capital interest equal to the adjusted cost base of that interest.

Subsection 107(5) is also amended to replace existing exemptions with regard to taxable Canadian property and Canadian resource property with narrower exemptions for property described in any of new subparagraphs 128.1(4)(b)(i) to (xi). This amendment applies to distributions made after October 1, 1996. For further detail on the enumerated subparagraphs, see the notes on amended subsection 128.1(4).

Subsection 107(5) is also amended so that it only applies with regard to distributions by trusts resident in Canada. This amendment applies to distributions made after October 1, 1996 and recognizes that, if a distribution of the property is made from a non-resident trust to a non-resident beneficiary, Canada's authority to ultimately collect tax on a future disposition of the property has not been compromised because of the distribution. This amendment is consistent with the policy with regard to distributions before October 2, 1996, as the type of property deemed to be disposed of before that date under subsection 107(5) would not have resulted in a non-resident trust being subject to Canadian tax.



Subsection 107(5) is amended so that, where it applies, the amended rules in subsection 107(2.1) provide for the corresponding tax consequences. This amendment applies with regard to distributions made after 1999.

ITA  
107(5.1)

Subsection 107(5.1) of the Act allows a trust to elect that the flow-through of income to beneficiaries be calculated without reference to the tax consequences of distributions to which subsection 107(5) applies. This ensures that the gains, if any, that would otherwise flow-out to beneficiaries as a consequence of such a distribution will instead be taxed at the trust level. Any election in this regard must be filed with the trust's tax return for the taxation year in which the distribution occurs.

This amendment applies to distributions made after October 1, 1996. However, an election in connection with a distribution made before Royal Assent is deemed to have been made on a timely basis if it is filed with the Minister before April 2001.

ITA  
107(5.2)

Subsection 107(5.2) of the Act is a special rule which applies for the purposes of computing instalment interest. The rule applies where

- there has been one or more distributions after October 1, 1996 of taxable Canadian property by a trust resident in Canada in a taxation year to non-resident beneficiaries, and
- paragraphs 107(2)(a) to (c) do not apply to such distributions only because of subsection 107(5).

For the purposes of the measures pertaining to instalment interest in sections 155, 156 and 156.1, the trust's total taxes under Part I and Part I.1 are deemed in these circumstances to be the lesser of two amounts. The first amount is the trust's total taxes payable under those Parts for the distribution year, determined without taking into consideration the carryback of losses and other consequences described in the definition "specified future tax consequences" in

subsection 248(1). The second amount is computed in the same manner, except that it is assumed that subsection 107(5) does not apply to each distribution of trust property in the distribution year that is described above. The general effect of subsection 107(5.2) is to ignore a trust's income tax liabilities arising from the distribution of taxable Canadian property to a non-resident beneficiary for the purpose of computing the trust's instalment interest obligations.

Subsection 107(5.2) is similar to new subsection 128.1(5). Both of these subsections should be read in conjunction with new sections 220.1 and 220.2, under which the posting of security can result in a deferral of the accrual of arrears interest on unpaid taxes.

## **Clause 14**

### **Qualifying Dispositions**

ITA

107.4(1) to (3)

Subsection 107.4(3) of the Act applies where there has been a "qualifying disposition" of property. As set out in subsection 107.4(1), a "qualifying disposition" of property is a disposition that does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions set out in that subsection. Subsection 107.4(3) generally provides for the rollover of property on the disposition.

To put new section 107.4 in context, the notes below summarize the tax consequences of transfers to bare trusts, protective trusts and revocable living trusts under the existing law before describing new section 107.4.

#### *Bare Trusts*

Revenue Canada's stated interpretation of the existing law is that, where property is held by a bare trust, the trust is ignored for income tax purposes and the transferor/settlor is considered to be the owner of property held by the trustee in the trustee's capacity as an agent. Paragraph (e) of the definition "disposition" in section 54 is the current authority for the position that there is no "disposition" of property on its transfer to a "bare trust".

Revenue Canada has stated that it generally views a trust to be a bare trust when:

- the trustee has no significant powers or responsibilities, and can take no action without instructions from the settlor;
- the trustee's only function is to hold legal title to the property; and
- the settlor is the sole beneficiary and can cause the property to revert to him or her at any time.

Revenue Canada's position that transfers to bare trusts do not constitute "dispositions" has generally been reinforced under proposed paragraph (e) of the new definition "disposition" in subsection 248(1). The new definition replaces the definition of the same expression in section 54.

#### *Revocable living trusts*

Revenue Canada has expressed the view that a "revocable living trust" should be fully recognized as a trust for income tax purposes. It is of the view that the transfer of property to such a trust involves a change in beneficial ownership of the property and is at the full fair market value of the property. A "revocable living trust" is an estate planning tool used, instead of a will, by individuals. The settlor of the trust is the trustee and, during his or her lifetime, is the sole income and capital beneficiary and retains the right to revoke, alter or amend the trust at any time. However, there is a change of beneficial ownership involved in a transfer to a "revocable living trust" because other beneficiaries under the trust have rights under the trust in the event that the settlor does not revoke the trust before his or her death.

The draft amendments are consistent with Revenue Canada's present views in this regard. New subsection 107.4(3) is not intended to apply to transfers to revocable living trusts, on the basis that there is no "qualifying disposition" of property involved.

#### *Protective trusts*

Revenue Canada has also expressed its view with respect to "protective trusts". The attributes of a "protective trust" are as follows:

- The settlor is the sole beneficiary under the trust.
- The settlor is entitled to as much of the annual income and realized capital gains of the trust as he or she requests.
- The property of the trust will revert to the settlor if the trust is terminated prior to the settlor's death.
- The trust will terminate upon the death of the settlor unless it is terminated at an earlier date. (When the settlor dies, any property held by the trust will devolve in accordance with the terms of the settlor's will or, if the settlor dies intestate, the property of the trust will devolve in accordance with the laws of intestacy that are relevant to the estate.)

Revenue Canada considers that a protective trust is fully recognized as a trust for income tax purposes and that there is no "disposition" of property where a settlor transfers it to a protective trust. Trust income and gains are attributed to the settlor in accordance with subsection 75(2).

New subsection 107.4(3) will apply to transfers to protective trusts, assuming that the requirements for a "qualifying disposition" are met. The rules in subsection 107.4(3) also bridge a gap in the existing law by making it clear at what cost a transferee is considered to acquire property, where there has been a transfer of property without any change in its beneficial ownership and the bare trust regime does not apply.

*New subsections 107.4(1) to (3)*

As discussed above, subsection 107.4(3) applies whenever there is a "qualifying disposition" of property to a trust. Where there is a "qualifying disposition", a rollover is generally provided. Under new subsection 107.4(1), a "qualifying disposition" of property is a "disposition" (as defined in subsection 248(1)) of the property where

- because of the disposition, there is a change in the legal ownership of the property that does not result in a change in the beneficial ownership of the property,
- the disposition is not from a trust to a beneficiary under the trust,

- the disposition is neither by a person resident in Canada to a non-resident trust nor a transfer of taxable Canadian property from a non-resident person who was resident in Canada in any of the ten calendar years preceding the transfer to a non-resident trust,
- the disposition is not by a partnership (other than a partnership each member of which is non-resident) to a non-resident trust,
- the transferor does not have the power to appoint beneficiaries under the transferee trust (other than a power exercisable only by a will or other testamentary instrument), and
- the disposition is not to a trust described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1).

Subsection 107.4(2) provides a supplementary rule designed to allow for the division of trust assets in certain cases. Consider, for example, the situation where 1000 shares of ABC Corp. are held in trust A for X and Y. Assume that X has a 30 per cent interest in the trust and Y has the remaining 70 per cent interest. If 300 shares are transferred on the same day to trust B for X and the remaining 700 shares are transferred to trust C for Y, there has been no change in the economic interests of X and Y. Subsection 107.4(2) provides that, in these circumstances, the first condition described above (requiring no change in beneficial ownership) is satisfied. Consequently, assuming the other conditions described above are satisfied, there would be a "qualifying disposition" of the 300 shares to trust B and another "qualifying disposition" of the 700 shares to trust C.

Under paragraph 107.4(3)(a), the transferor's proceeds from the qualifying disposition are deemed to be the cost amount of the property. Under paragraph 107.4(3)(b), the same amount is generally the cost to the transferee of the property. However, this amount is reduced in some cases where the fair market value of the property is less than the cost amount. The reduction in these cases is equal to a hypothetical reduction under specified stop loss rules in the transferor's loss on the disposition of the property. This hypothetical reduction is computed on the assumption that the proceeds of disposition were the fair market value of the property rather than its cost amount. The rules specified are the stop-loss rules with regard to partnership interests (subsection 100(4)),

trust interests (paragraphs 107(1)(c) and (d)) and shares (subsections 112(3) to (4.2)).

In addition, where the property is depreciable property or eligible capital property, there are rules in paragraphs 107.4(3)(c) and (d) designed to put the transferee in the same position as the transferor in the event that the transferee subsequently disposes of the property. These rules are parallel to existing rules for trust distributions to beneficiaries in subsection 107(2).

Paragraph 107.4(3)(e) provides that, if the property was deemed to be taxable Canadian property of the transferor because of a number of specified provisions in the Act, the property retains that character in the hands of the transferee.

Paragraph 107.4(3)(f) applies where the transferor (as well the transferee) is a trust. Where, because of a qualifying disposition, a taxpayer disposes of all or part of a capital interest in the transferor and acquires a corresponding interest in the transferee, the proceeds are deemed to equal the cost amount of the former interest (or part thereof) to the taxpayer. The cost of the corresponding interest in the transferee is generally deemed to be the same amount. However, the cost of that corresponding interest is reduced to reflect any reduction under paragraph 107(1)(c) or (d) in the loss on the disposition of the interest in the transferor trust that would have occurred had that interest been disposed of at its fair market value.

Paragraph 107.4(3)(g) applies to a transferor who acquires a capital interest in the transferee trust because of the qualifying disposition. If the transferee trust is a personal trust, the cost of the transferor's interest in the trust is deemed to be nil. In any other case, the cost of the transferor's interest is deemed to be equal to the deemed cost of the transferred property under paragraph 107.4(3)(b).

These amendments apply to dispositions that occur after ANNOUNCEMENT DATE. However, in order to ensure that there will be a cost assigned in certain cases to property previously transferred, these amendments also apply in simplified form to the

1993 and subsequent taxation years. The previous transfers to which the simplified rules apply are transfers (other than transfers to bare trusts) that were not dispositions of property because of paragraph (e) of the definition "disposition" in section 54. No proceeds of dispositions are ascribed to these previous transfers and the stop-loss rules in subsection 107.4(3) do not apply.

ITA  
107.4(4)

New subsection 107.4(4) of the Act provides special rules dealing with the disposition of capital interests in a trust that have been acquired by a taxpayer as a consequence of a "qualifying disposition", as described above. For subsection 107.4(4) to apply to a taxpayer's capital interest in a trust, the following additional conditions must be satisfied:

- the trust is not described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1),
- capital interests in the trust are not ordinarily disposed of for consideration that reflects the fair market value of the net assets of the trust, and
- the subsequent disposition is of all or part of that interest and is not by way of a qualifying disposition under subsection 107.4(3) or a transaction to which subsection 107(2) or (2.1) applies.

Where there is a disposition of any part of such capital interest, it is deemed to have been made to a non-arm's length party. If section 69 applies as a consequence, the proceeds of disposition are deemed to be not less than the fair market value of the capital interest. The fair market value of the capital interest is deemed to be not less than the value of the net assets of the trust attributable to the capital interest.

These amendments apply to dispositions of capital interests that occur after ANNOUNCEMENT DATE.

**Clause 15****Definitions**

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. Amendments to section 108 are described below.

ITA  
108(1)  
"capital interest"

Subsection 108(1) of the Act contains the definition "capital interest". Except in the case of a personal trust or a prescribed trust and certain "grandfathered" trusts, a taxpayer's capital interest generally encompasses all rights of the taxpayer as a beneficiary under the trust. In the case of a personal trust or a prescribed trust, a taxpayer's capital interest encompasses all rights of the taxpayer to receive all or any part of the trust's capital.

The definition "capital interest" is amended so that, subject to the exclusions described below, a taxpayer's capital interest in a trust encompasses all rights of the taxpayer as a beneficiary under any type of trust and, after 1999, includes rights acquired after 1999 (or not disposed of before March 2000) to enforce payment by the trust that arises as a consequence of such rights. However, an exclusion is still provided with regard to any "income interest" of a taxpayer in a trust.

The definition is also amended to provide an explicit exclusion from the definition of "capital interest" with regard to a taxpayer's right as principal/beneficiary under a bare trust. The only exception to this exclusion is where a non-resident bare trust is treated as an ordinary trust under new subsection 248(25.1) for the purposes of the Act. For further discussion of bare trusts, see the notes on new section 107.4.

Except as noted above, the amendment applies after  
ANNOUNCEMENT DATE.



ITA  
108(1)  
"income interest"

Subsection 108(1) of the Act contains the definition "income interest". It is defined as a right as a beneficiary under a personal trust to income of the trust. Under subsection 108(3), "income" for this purpose is determined without reference to the provisions of the Act.

The definition is amended to provide that, after 1999, an income interest also includes a right acquired after 1999 (or not disposed of before March 2000) to enforce payment by the trust that arises as a consequence of a right that is an income interest. The definition is also amended to provide that a taxpayer's income interest does not include a right of the taxpayer in respect of a trust created after 1999 where the taxpayer has a capital interest in the trust at the time the trust was created.

Except as noted above, these amendments apply in respect of interests created or materially altered after January 31, 1987 that were acquired after 10 p.m. EST, February 6, 1987.

ITA  
108(1)  
"trust"

Subsection 108(1) of the Act defines "trust". For the purposes of the 21-year deemed disposition rule and the preferred beneficiary election, the definition excludes unit trusts (as defined in subsection 108(2)) and, except as specified, trusts all interests in which have vested indefeasibly and no interest in which may become effective in the future.

The definition is amended so that the above exclusion also applies for the purpose of the rules in section 106 governing the taxation of income interests.

The definition is also amended so that the exclusion for trusts in which all interests are vested is narrowed so that, in applying the 21-deemed disposition rule and the other specified provisions, it does not apply to a trust resident in Canada that has a non-resident

beneficiary. This amendment applies after ANNOUNCEMENT DATE.

ITA  
108(1)  
"eligible offset"

Subsection 108(1) of the Act is amended to introduce the expression "eligible offset".

A taxpayer's "eligible offset" in respect of all or part of a taxpayer's capital interest in a trust reduces the taxpayer's proceeds of disposition arising from the satisfaction of all or part of that total interest, in the event there is a distribution to which amended subsection 107(2) or (2.1) applies.

The eligible offset mechanism is largely meant to ensure that there is no double taxation of a taxpayer where the taxpayer disposes of rights which have already been recognized in computing the taxpayer's income.

An eligible offset at any time of a taxpayer in respect of the taxpayer's capital interest or part thereof in a trust is:

- an amount paid at that time by the trust to the taxpayer in satisfaction of the taxpayer's interest, where
  - the payment by the trust was out of the trust's unrecognized gains balance or income (determined before the application of subsection 104(6) and before taking into account the distribution in satisfaction of the taxpayer's interest at that time) for a taxation year of the trust, and
  - the payment was made, or the right to the payment was acquired, in the year, and
- such portion of any debt, or other legal obligation to pay an amount, as is assumed by the taxpayer and can reasonably be considered to be applicable to property distributed at that time in satisfaction of the taxpayer's interest, if the distribution was conditional upon the assumption by the taxpayer of the debt or obligation.

For notes on a trust's "unrecognized gains balance", see the definition of that expression in subsection 248(1). Note, in addition, a further reference to "eligible offset" in paragraph (g) of the new definition "disposition" in subsection 248(1).

This amendment applies after ANNOUNCEMENT DATE. For further detail of the effect of this amendment, see the notes on amendments to subsections 107(2) and (2.1).

ITA  
108(1)  
"exempt property"

Subsection 108(1) of the Act introduces the definition "exempt property". The expression is used in amended subsections 104(4) to (5.2), which is described in the notes above. For further detail, see the notes above on those subsections.

This amendment applies after 1992.

ITA  
108(7)

New subsection 108(7) of the Act replaces a rule formerly provided within the definition "personal trust" in subsection 248(1). For further information, reference may be made to the notes below on the amendment to that definition.

New subsection 108(7) applies after ANNOUNCEMENT DATE.

## **Clause 16**

### **Mutual Fund Trusts**

ITA  
132(7)

Under subsection 132(7) of the Act, a trust does not qualify as a mutual fund trust in certain cases where it is reasonable to conclude that the trust was established primarily for the benefit of non-resident persons. The purpose of this amendment was to discourage the use of mutual fund trusts as an intermediary through which non-residents

could invest in Canadian real estate and other taxable Canadian property without recognizing any gains on the disposition of units in trust. However, grandfathering was intended to be provided in the case of a trust which did not issue units after February 20, 1990 otherwise than as a capitalization of an income distribution.

Subsection 132(7) is amended to change references to "taxable Canadian property" in section 115 to parallel references to the new definition in subsection 248(1). This amendment applies after October 1, 1996.

Subsection 132(7) is also amended to ensure that the grandfathering rules operate as described above. Amended subsection 132(7) also contemplates units issued through a crystallization of a payment that is made out of the exempt portion of a trust's net capital gains (which is referred to as the trust's "unrecognized gains balance", as newly defined in subsection 248(1)). This amendment applies after February 20, 1990.

#### **Clause 17**

#### **Part XII.2 Tax**

ITA  
210.2(2)(b)

Part XII.2 of the Act imposes a special tax on certain trusts resident in Canada with respect to distributions to non-resident beneficiaries. The tax is calculated with reference to the trust's "designated income", as determined under subsection 210.2(2). "Designated income" is calculated with reference to taxable capital gains and allowable capital losses from the trust's taxable Canada property (determined on the assumption that the trust is non-resident).

Paragraph 210.2(2)(b) is amended to remove the assumption described above. The amendment merely simplifies paragraph 210.2(2)(b) and does not represent any policy change.

This amendment applies after October 1, 1996.

## Clause 18

### Definitions

ITA  
248(1)  
"personal trust"

A "personal trust" is essentially defined in subsection 248(1) of the Act as a testamentary trust or an inter vivos trust in which no beneficial interest was acquired for consideration payable to the trust or to a contributor to the trust. A special rule within the definition generally ensures that one person (or two or more related persons) can make contributions to a trust and retain an interest under the trust without the prohibition on consideration being considered to apply. This special rule also applies for the purposes of paragraph 53(2)(h), which deals with the calculation of the adjusted cost bases of certain trust interests.

The definition is amended so that this special rule is removed from the definition. Instead, the special rule is now provided in new subsection 108(7). The special rule also is to apply, under subsection 108(7), for the purposes of amended subsections 106(1.1) and 107(1) and (1.1), strictly as a consequence of the amendments to those provisions.

The amendment to the definition "personal trust", and new subsection 108(7), apply after ANNOUNCEMENT DATE.

ITA  
248(1)  
"disposition"

The proposed new definition of "disposition" in subsection 248(1) of the Act replaces a definition of the same expression in section 54. The proposed new definition applies for the purposes of the entire Act.

The table below briefly compares the new definition with the former definition, with further detail provided below with regard to the policy changes introduced by the new definition. The first column

and second column indicate paragraph references in the new definition and the former definition, respectively.

<b>New</b>	<b>Old</b>	<b>Description</b>
(a)	(a)	Disposition of property by a taxpayer includes transaction or event entitling taxpayer to proceeds. No policy change.
(b)	(b)	Specified redemptions, cancellations, conversions and expirations of debt, equity and options treated as dispositions. No policy change.
(c)	(c)	Except as otherwise specified, dispositions include transfers to and from trusts. No policy change.
(d) and (g)	N/A	Circumstances in which distribution by a trust constitutes disposition of a capital interest in a trust. See description of new definition below.
(e) and (f)	(e)	Circumstances in which a transfer not a "disposition" because no change in beneficial ownership. Under new rules, these circumstances are narrower. See description of new definition below.
(h)	(d)	Transfer to secure debt not disposition. No change in policy.
(i)	(f)	Issue of debt not disposition. No change in policy.
(j)	(g)	Issue of share not disposition. No change in policy.

Paragraph (d) of the new definition applies with respect to capital interests in trust. Paragraph (d) makes it clear that, except as specifically provided in paragraph (g), every payment (in kind or otherwise) by a trust to a taxpayer in respect of the taxpayer's capital interest (as defined in subsection 108(1)) in the trust will result in a disposition of all or part of the taxpayer's capital interest in the trust. The exception under paragraph (g) applies after 1999 with respect to a payment where the following conditions are satisfied:

1. the trust is resident in Canada (and is not a trust that is deemed by section 94 to be resident in Canada),

2. the payment is made by way of money that is legal tender in Canada,
3. the capital interest in the trust is described by reference to units issued by the trust,
4. the payment is a distribution from trust capital (other than a distribution which gives rise to an "eligible offset" under paragraph (a) of the new definition "eligible offset" in subsection 108(1)), and
5. the payment does not result in a reduction of the number of units in the trust owned by the taxpayer.

The exclusion under the fourth condition, for distributions in respect of "eligible offsets", results in any payment in satisfaction of a right to enforce payments out of the income or unrecognized gains balance of a trust being treated as disposition of an interest in the trust.

Paragraphs (d) and (g) are part of a set of amendments designed to clarify the tax consequences of distributions from trusts to their beneficiaries after 1999. For the large part, the end results achieved under these rules are intended to accord with existing income tax practice. See the notes on new subsection 43(2) for references to further related amendments.

Paragraph (e) of the new definition provides that a transfer of property is not a disposition where it does not involve a change in the beneficial ownership of the property, if three conditions are satisfied. In the event that these conditions are not satisfied, the transfer will generally be a "qualifying disposition" under new subsection 107.4(1), unless paragraph (f) applies. Where the transfer is a disposition and no other provision in the Act applies, amended subsections 69(1) and 251(1) generally ensure that the transfer occurs at fair market value.

The first of these conditions (subparagraph (e)(i)) applies only where the transferor or the transferee is a trust, but not where both are trusts. In these circumstances, in order to avoid characterization as a "disposition", it must be reasonable to consider that the trust receives or transfers the property in its capacity as agent.

The second condition (subparagraph (e)(ii)) applies only where both the transferor and transferee are trusts. To avoid characterization as a "disposition", the transferor and transferee must each act as agents for the same beneficiary or beneficiaries with respect to the property transferred.

The third condition (subparagraph (e)(iii)) is that, to avoid characterization as a disposition, the transferee generally cannot be a non-resident trust if the transfer is from a person resident in Canada or a partnership (other than a partnership each member of which is non-resident). An exception in this regard is made where the Minister is satisfied that the transfer will not jeopardize the collection of taxes payable and so advises the transferor in writing. Where a transfer is a disposition as a consequence of this condition, new subsection 248(25.1) provides that the transferee trust is deemed to be a person separate from the transferor.

Paragraph (f) of the new definition avoids a disposition in the case of certain very simple trust-to-trust transfers. Where this paragraph applies, new subsection 248(25.2) provides that the transferee trust is deemed to be the same trust as, and a continuation of, the transferor trust. One of the results of subsection 248(25.2) is that the transferee trust will have access to deductions from certain tax pools (e.g., undepreciated capital cost, resource expense pools) generated by the transferor trust. Where the paragraph does not apply, the transfer will generally be a "qualifying disposition" under new subsection 107.4(1). For this paragraph to apply, the following additional conditions must be satisfied:

- there cannot be any change in the beneficial ownership of the property because of the transfer,
- the transfer cannot be from a trust resident in Canada to a non-resident trust,
- the transferor cannot reasonably be considered to act as agent for its beneficiaries with respect to the property transferred,
- the transferee can hold no property immediately before the transfer,
- the transferor can hold no property immediately after the transfer, and



- neither the transferor nor the transferee is described in any of paragraphs (a) to (e.1) of the definition "trust" in subsection 108(1).

Except as indicated otherwise above, these amendments apply to transactions and events that occur after ANNOUNCEMENT DATE.

ITA  
248(1)  
"unrecognized gains balance"

The new definition "unrecognized gains balance" in subsection 248(1) of the Act is introduced as a consequence of new subsection 43(2), the new definition "eligible offset" in subsection 108(1) and amended subsection 132(7).

A trust's "unrecognized gains balance" for a taxation year is 1/4 of the amount, if any, by which the trust's capital gains for the year from the disposition of property exceed the trust's capital losses for the year from the disposition of property. This balance represents the portion of a trust's net capital gains for a taxation year that is not included in computing the income of the trust for the year.

This amendment applies after February 20, 1990, in order that it can be used conveniently in the relieving amendment to subsection 132(7).

ITA  
248(25.1)

New subsection 248(25.1) of the Act applies where there is a transfer after ANNOUNCEMENT DATE of a property to a bare trust that, because subparagraph (e)(iii) of the definition "disposition" in subsection 248(1) does not apply, constitutes a disposition of the property. Subsection 248(25.1) ensures that, in these circumstances, the transferor and transferee will be treated as separate taxpayers.

For more detail, see the notes above on the definition "disposition".

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ITA  
248(25.2)

This amendment, which applies to trust-to-trust transfers after ANNOUNCEMENT DATE, is explained in the notes above on paragraph (f) of the new definition "disposition" in subsection 248(1) of the Act.

### **Clause 19**

#### **Arm's Length**

ITA  
251(1)

Section 251 of the Act defines the circumstances in which persons are considered not to deal with each other at arm's length for the purposes of the Act.

Subsection 251(1) is amended to ensure that a taxpayer and a trust are deemed not to deal with each other at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, is beneficially interested in the trust. The non-arm's length relationship is relevant, for example, in applying amended subsection 69(1).

This amendment applies after ANNOUNCEMENT DATE.