Legislative Proposals and Explanatory Notes on Taxation of Foreign Bank Branches

Published by
The Honourable Paul Martin, P.C., M.P.
Minister of Finance

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Canada

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Legislative Proposals

FOREIGN BANK BRANCHES

PROPOSED AMENDMENTS TO THE *INCOME TAX ACT*

1. (1) Section 14 of the *Income Tax Act* is amended by adding the following after subsection (13):

Ceasing to use property in Canadian business

(14) If at a particular time a non-resident taxpayer ceases to use, in connection with a business or part of a business carried on by the taxpayer in Canada immediately before the particular time, a property that was immediately before the particular time eligible capital property of the taxpayer (other than a property that was disposed of by the taxpayer at the particular time), the taxpayer is deemed to have disposed of the property immediately before the particular time for proceeds of disposition equal to the amount determined by the formula

A - B

where

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

B is

(*a*) where at a previous time before the particular time the taxpayer ceased to use the property in connection with a business or part of a business carried on by the taxpayer outside Canada and began to use it in connection with a business or part of a business carried on by the taxpayer in Canada, the amount, if any, by which the fair market value of the property at the previous time exceeded its cost to the taxpayer at the previous time, and

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

Beginning to use property in Canadian business

(15) If at a particular time a non-resident taxpayer ceases to use, in connection with a business or part of a business carried on by the taxpayer outside Canada immediately before the particular time, and begins to use, in connection with a business or part of a business carried on by the taxpayer in Canada, a property that is an eligible capital property of the taxpayer, the taxpayer is deemed to have disposed of the property immediately before the particular time and to have reacquired the property at the particular time for consideration equal to the lesser of the cost to the taxpayer of the property immediately before the particular time and its fair market value immediately before the particular time.

(2) Subsection (1) applies after June 27, 1999 in respect of an authorized foreign bank, and after ANNOUNCEMENT DATE in any other case.

2. (1) Subsection 18(1) of the Act is amended by striking out the word "and" at the end of paragraph (*t*), by adding the word "and" at the end of paragraph (*u*) and by adding the following after paragraph (*u*):

Interest - authorized foreign bank

(*v*) where the taxpayer is an authorized foreign bank, an amount in respect of interest that would otherwise be deductible in computing the taxpayer's income from a business carried on in Canada, except as provided in section 20.2.

(2) Paragraph (*b*) of the definition "outstanding debts to specified non-residents" in subsection 18(5) of the Act is replaced by the following:

(*b*) an amount outstanding at the particular time as or on account of a debt or other obligation to pay an amount to

(i) a non-resident insurance corporation to the extent that the obligation was, for the non-resident insurance corporation's taxation year that included the particular time, designated insurance property in respect of an insurance business carried on in Canada through a permanent establishment as defined by regulation, or

(ii) an authorized foreign bank, if the bank uses or holds the obligation at the particular time in its Canadian banking business;

(3) Subsections (1) and (2) apply after June 27, 1999.

3. (1) The Act is amended by adding the following after section 20.1:

Interest - authorized foreign bank - interpretation

20.2 (1) The following definitions apply in this section.

"branch advance"
« *avance de succursale* »

"branch advance" of an authorized foreign bank at a particular time means an amount allocated or provided by, or on behalf of, the bank to, or for the benefit of, its Canadian banking business under terms that were documented, before the amount was so allocated or provided, to the same extent as, and in a form similar to the form in which, the bank would ordinarily document a loan by it to a person with whom it deals at arm's length.

"branch financial statements"
« *états financiers de succursale* »

"branch financial statements" of an authorized foreign bank for a taxation year means the unconsolidated statements of assets and liabilities and of income and expenses for the year, in respect of its Canadian banking business,

(*a*) that form part of the bank's annual report for the year filed with the Superintendent of Financial Institutions as required under section 601 of the *Bank Act*, and accepted by the Superintendent; and

(*b*) if no filing is so required for the taxation year, that are prepared in a manner consistent with the statements in the annual report or reports so filed and accepted for the period or periods in which the taxation year falls.

"calculation period"
« *période de calcul* »

"calculation period" of an authorized foreign bank for a taxation year means any one of a series of regular periods into which the year is divided in a designation by the bank in its return of income for the year or, in the absence of such a designation, by the Minister,

(*a*) none of which is longer than 31 days;

(*b*) the first of which commences at the beginning of the year and the last of which ends at the end of the year; and

(*c*) that are, unless the Minister otherwise agrees in writing, consistent with the calculation periods designated for the bank's preceding taxation year.

Formula elements

(2) The following descriptions apply for the purposes of the formulae in subsection (3), for any calculation period in a taxation year of an authorized foreign bank.

A is the amount of the bank's assets at the end of the period.

BA is the amount of the bank's branch advances at the end of the period.

IBA is the total of all amounts each of which is a reasonable amount on account of notional interest for the period, in respect of a branch advance, that would be deductible in computing the bank's income for the year if it were interest payable by, and the advance were indebtedness of, the bank to another person and if this Act were read without reference to paragraph 18(1)(*v*) and this section.

IL is the total of all amounts each of which is an amount on account of interest for the period in respect of a liability of the bank to another person or partnership, that would be deductible in computing the bank's income for the year if this Act were read without reference to paragraph 18(1)(*v*) and this section.

L is the amount of the bank's liabilities to other persons and partnerships at the end of the period.

Interest deduction

(3) In computing the income of an authorized foreign bank from its Canadian banking business for a taxation year, there may be deducted on account of interest for each calculation period of the bank for the year,

(*a*) where the total amount at the end of the period of its liabilities to other persons and partnerships and branch advances is 95% or more of the amount of its assets at that time, an amount not exceeding

(i) if the amount of liabilities to other persons and partnerships at that time does not exceed 95% of the amount of its assets at that time, the amount determined by the formula

$$IL + IBA \times (0.95 \times A - L) / BA$$

and

(ii) if the amount of those liabilities at that time exceeds 95% of the amount of its assets at that time, the amount determined by the formula

$$IL \times (0.95 \times A) / L$$

and

(*b*) in any other case, the total of

(i) the amount determined by the formula

$$IL + IBA$$

and

(ii) the product of

(A) the amount claimed by the bank, in its return of income for the year, not exceeding the amount determined by the formula

$$(0.95 \times A) - (L + BA)$$

and

(B) the average, based on daily observations, of the Bank of Canada bank rate for the period.

Branch amounts

(4) Only amounts that are in respect of an authorized foreign bank's Canadian banking business, and that are recorded in the books of account of the business in a manner consistent with the manner in which they are required to be treated for the purposes of the branch financial statements, shall be used to determine

(*a*) the amounts in subsection (2); and

(*b*) the amounts in subsection (3) of an authorized foreign bank's assets, liabilities to other persons and partnerships, and branch advances.

Notional interest

(5) For the purposes of the description of IBA in subsection (2), a reasonable amount on account of notional interest for a calculation period in respect of a branch advance is the amount that would be payable on account of interest for the period by a notional borrower, having regard to the time to repayment, the currency in which repayment is required and all other terms, as adjusted by paragraph (*c*), of the advance, if

(*a*) the borrower were a person that dealt at arm's length with the bank, that carried on the bank's Canadian banking business and that had the same credit-worthiness and borrowing capacity as the bank;

(*b*) the advance were a loan by the bank to the borrower; and

(*c*) any of the terms of the advance (excluding the rate of interest, but including the structure of the interest calculation, such as whether the rate is fixed or floating and the choice of any reference rate referred to) that are not terms that would be made between the bank as lender and the borrower, having regard to all the circumstances, including the nature of the Canadian banking business, the use of the advanced funds in the business and normal risk management practices for banks, were instead terms that would be agreed to by the bank and the borrower.

(2) Subsection (1) applies after June 27, 1999 except that in its application to amounts allocated or provided before the day that is 14 days after ANNOUNCEMENT DATE, the definition "branch advance" in subsection 20.2(1), as enacted by subsection (1), shall be read as follows:

"branch advance" of an authorized foreign bank at a particular time means an amount allocated or provided by, or on behalf of, the bank to, or for the benefit of, its Canadian banking business under terms that were documented, on or before December 31, 2000, to the same extent as, and in a form similar to the form in which, the bank would ordinarily document a loan by it to a person with whom it deals at arm's length.

4. (1) The definition "foreign bank" in subsection 33.1(1) of the Act is replaced by the following:

"foreign bank"
« banque étrangère »

"foreign bank" has the meaning assigned by the definition "foreign bank" in section 2 of the *Bank Act* (read without reference to paragraph (*g*)), except that an authorized foreign bank is not considered to be a foreign bank in respect of its Canadian banking business;

(2) Subsection (1) applies after June 27, 1999.

5. (1) The Act is amended by adding the following after section 76:

Non-resident moving debt from Canadian business

76.1 (1) If at any time a debt obligation of a non-resident taxpayer that is denominated in a foreign currency ceases to be an obligation of the taxpayer in respect of a business or part of a business carried on by the taxpayer in Canada immediately before that time (other than an obligation in respect of which the taxpayer ceased to be indebted at that time), for the purpose of determining the amount of any income, loss, capital gain or capital loss due to the fluctuation in the value of the foreign currency relative to Canadian currency, the taxpayer is deemed to have settled the debt obligation immediately before that time at the amount outstanding on account of its principal amount.

Non-resident assuming debt

(2) If at any time a debt obligation of a non-resident taxpayer that is denominated in a foreign currency becomes an obligation of the taxpayer in respect of a business or part of a business that the taxpayer carries on in Canada after that time (other than an obligation in respect of which the taxpayer became indebted at that time), the amount of any income, loss, capital gain or capital loss in respect of the obligation due to the fluctuation in the value of the foreign currency relative to Canadian currency shall be determined based on the amount of the obligation in Canadian currency at that time.

(2) Subsection (1) applies after June 27, 1999 in respect of an authorized foreign bank, and after ANNOUNCEMENT DATE in any other case.

6. (1) The portion of paragraph 95(2)(*a*.3) of the Act before subparagraph (iii) is replaced by the following:

(*a*.3) in computing the income from a business other than an active business for a taxation year of a foreign affiliate of a taxpayer there shall be included the income of the affiliate for the year derived directly or indirectly from indebtedness and lease obligations (which, for the purposes of this paragraph, includes the income of the affiliate for the year from the purchase and sale of indebtedness and lease obligations on its own account, but does not include income that is derived directly or indirectly from a specified deposit with a prescribed financial institution or that is included in computing the affiliate's income for the year from carrying on a business through a permanent establishment in Canada)

(i) of persons resident in Canada, or

(ii) in respect of businesses carried on in Canada

unless more than 90% of the gross revenue of the affiliate derived directly or indirectly from indebtedness and lease obligations (other than revenue that is derived from a specified deposit with a prescribed financial institution or that is included in computing the affiliate's income for the year from carrying on a business through a permanent establishment in Canada) was derived directly or indirectly from indebtedness and lease obligations of non-resident persons with whom the affiliate deals at arm's length and, where this paragraph applies to include income of the affiliate for the year in the income of the affiliate from a business other than an active business,

(2) Subsection (1) applies to taxation years that begin after 1999.

7. (1) The description of B in the definition "non-capital loss" in subsection 111(8) of the Act is replaced by the following:

B is the amount, if any, determined in respect of the taxpayer for the year under section 110.5 or subparagraph 115(1)(*a*)(vii),

(2) Subsection (1) applies after June 27, 1999.

8. (1) Paragraph 115(1)(*a*) of the Act is amended by striking out the word "and" at the end of subparagraph (v), by adding the word "and" at the end of subparagraph (vi) and by adding the following after subparagraph (vi):

(vii) in the case of an authorized foreign bank, the amount claimed by the bank to the extent that the inclusion of the amount in income

(A) increases any amount deductible by the bank under subsection 126(1) for the year, and

(B) does not increase an amount deductible by the bank under section 127 for the year,

(2) Subsection (1) applies after June 27, 1999.

9. (1) Section 126 of the Act is amended by adding the following after subsection (1):

Authorized foreign bank

(1.1) In applying subsections 20(12) and (12.1) and this subsection in respect of an authorized foreign bank,

(*a*) the bank is deemed, for the purposes of subsections (1), (4) to (5), (6) and (7), to be resident in Canada in respect of its Canadian banking business;

(*b*) the references in subsection 20(12) and paragraph (1)(*a*) to "country other than Canada" shall be read as a reference to "country that is neither Canada nor a country in which the taxpayer is resident at any time in the taxation year";

(*c*) the reference in subparagraph (1)(*b*)(i) to "from sources in that country" shall be read as a reference to "in respect of its Canadian banking business from sources in that country";

(*d*) subparagraph (1)(*b*)(ii) shall be read as follows:

"(ii) the lesser of

(A) the taxpayer's taxable income earned in Canada for the year, and

(B) the total of the taxpayer's income for the year from its Canadian banking business and the amount determined in respect of the taxpayer under subparagraph 115(1)(*a*)(vii) for the year;"

(*e*) in computing the non-business income tax paid by the bank for a taxation year to the government of a country other than Canada, there shall be included only taxes that relate to amounts that are included in computing the bank's taxable income earned in Canada from its Canadian banking business; and

(*f*) the definition "tax-exempt income" in subsection (7) shall be read as follows:

""tax-exempt income" means income of a taxpayer from a source in a particular country in respect of which

(*a*) the taxpayer is, because of a comprehensive agreement or convention for the elimination of double taxation on income, which has the force of law in the particular country and to which a country in which the taxpayer is resident is a party, entitled to an exemption from all income or profits taxes, imposed in the particular country, to which the agreement or convention applies, and

(*b*) no income or profits tax to which the agreement or convention does not apply is imposed in the particular country;"

(2) Subsections 126(4) and (4.1) of the Act are replaced by the following:

Portion of foreign tax not included

(4) For the purposes of this Act, an income or profits tax paid by a person resident in Canada to the government of a country other than Canada does not include a tax, or that portion of a tax, imposed by that government that would not be imposed if the person were not entitled under section 113 or this section to a deduction in respect of the tax or that portion of the tax.

No economic profit

(4.1) If a taxpayer acquires a property, other than a capital property, at any time after February 23, 1998 and it is reasonable to expect at that time that the taxpayer will not realize an economic profit in respect of the property for the period that begins at that time and ends when the taxpayer next disposes of the property, the total amount of all income or profits taxes (referred to as the "foreign tax" for the purpose of subsection 20(12.1)) in respect of the property for the period, and in respect of related

transactions, paid by the taxpayer for any year to the government of any country other than Canada, is not included in computing the taxpayer's business-income tax or non-business-income tax for any taxation year.

(3) Paragraph 126(4.4)(*a*) of the Act is replaced by the following:

(*a*) a disposition or acquisition of property deemed to be made by subsection 10(12) or (13), 14(14) or (15) or 45(1), section 70 or 128.1, paragraph 132.2(1)(*f*), subsection 138(11.3), 142.5(2) or 142.6(1.1) or (1.2), paragraph 142.6(1)(*b*) or subsection 149(10) is not a disposition or acquisition, as the case may be; and

(4) Subsection 126(5) of the Act is repealed.

(5) Subsection 126(6) of the Act is replaced by the following:

Rules of construction

(6) For the purposes of this section,

(*a*) the government of a country other than Canada includes the government of a state, province or other political subdivision of that country;

(*b*) where a taxpayer's income for a taxation year is in whole or in part from sources in more than one country other than Canada, subsections (1) and (2) shall be read as providing for separate deductions in respect of each of the countries other than Canada; and

(*c*) if any income from a source in a particular country would be tax-exempt income but for the fact that a portion of the income is subject to an income or profits tax imposed by the government of a country other than Canada, the portion is deemed to be income from a separate source in the particular country.

(6) The portion of the definition "business-income tax" in subsection 126(7) of the Act before paragraph (*a*) is replaced by the following:

"business-income tax"
« *impôt sur le revenu tiré d'une entreprise* »

"business-income tax" paid by a taxpayer for a taxation year in respect of businesses carried on by the taxpayer in a country other than Canada (in this definition referred to as the "business country") means, subject to subsections (4.1) and (4.2), the portion of any income or profits tax paid by the taxpayer for the year to the government of a country other than Canada that can reasonably be regarded as tax in respect of the income of the taxpayer from a business carried on by the taxpayer in the business country, but does not include a tax, or the portion of a tax, that can reasonably be regarded as relating to an amount that

(7) Paragraph (*b*) of the definition "economic profit" in subsection 126(7) of the Act is replaced by the following:

(*b*) income or profits taxes payable by the taxpayer for any year to the government of a country other than Canada, in respect of the property for the period or in respect of a related transaction, or

(8) The portion of the definition "non-business-income tax" in subsection 126(7) of the Act before paragraph (*a*) is replaced by the following:

"non-business-income tax"
« *impôt sur le revenu ne provenant pas d'une entreprise* »

"non-business-income tax" paid by a taxpayer for a taxation year to the government of a country other than Canada means, subject to subsections (4.1) and (4.2), the portion of any income or profits tax paid by the taxpayer for the year to the government of that country that

(9) Subsection 126(8) of the Act is repealed.

(10) Subsections (1) to (9) apply after June 27, 1999.

10. (1) The portion of subsection 142.2(1) of the Act before the definition "financial institution" is replaced by the following:

Definitions

142.2 (1) In this section and sections 142.3 to 142.7,

(2) Subsection (1) applies after June 27, 1999.

11. (1) Subsection 142.6(2) of the Act is replaced by the following:

Ceasing to use property in Canadian business

(1.1) If at a particular time in a taxation year a taxpayer that is a non-resident financial institution (other than a life insurance corporation) ceases to use, in connection with a business or part of a business carried on by the taxpayer in Canada immediately before the particular time, a property that is a mark-to-market property of the taxpayer for the year or a specified debt obligation, but that is not a property that was disposed of by the taxpayer at the particular time,

(*a*) the taxpayer is deemed

(i) to have disposed of the property immediately before the time that was immediately before the particular time for proceeds equal to its fair market value at the time of disposition and to have received those proceeds at the time of disposition in the course of carrying on the business or the part of the business, as the case may be, and

(ii) to have reacquired the property at the particular time at a cost equal to those proceeds; and

(*b*) in determining the consequences of the disposition in subparagraph (*a*)(i), subsection 142.4(11) does not apply to any payment received by the taxpayer after the particular time.

Beginning to use property in a Canadian business

(1.2) If at a particular time a taxpayer that is a non-resident financial institution (other than a life insurance corporation) begins to use, in connection with a business or part of a business carried on by the taxpayer in Canada, a property that is a mark-to-market property of the taxpayer for the year that includes the particular time or a specified debt obligation, but that is not a property that was acquired by the taxpayer at the particular time, the taxpayer is deemed

(*a*) to have disposed of the property immediately before the time that was immediately before the particular time for proceeds equal to its fair market value at the time of disposition; and

(*b*) to have reacquired the property at the particular time at a cost equal to those proceeds.

Specified debt obligation marked to market

(1.3) In applying subsection (1.1) to a taxpayer in respect of a property in a taxation year,

(*a*) the definition "mark-to-market property" in subsection 142.2(1) shall be applied as if the year ended immediately before the particular time referred to in subsection (1.1); and

(*b*) if the taxpayer does not have financial statements for the period ending immediately before the particular time referred to in subsection (1.1), references in the definition to financial statements for the year shall be read as references to the financial statements that it is reasonable to expect would have been prepared if the year had ended immediately before the particular time.

Deemed disposition not applicable

(2) For the purposes of this Act, the determination of when a taxpayer acquired a share shall be made without regard to a disposition or acquisition that occurred because of subsection 142.5(2) or subsection (1), (1.1) or (1.2).

(2) Subsection (1) applies after June 27, 1999 in respect of an authorized foreign bank, and after ANNOUNCEMENT DATE in any other case.

12. (1) The Act is amended by adding the following after section 142.6:

Conversion of Foreign Bank Affiliate to Branch

Definitions

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

"Canadian affiliate"
« *filiale canadienne* »

"Canadian affiliate" of an entrant bank at any time means a Canadian corporation that was, throughout the period that began on February 11, 1999 and ends at that time,

(*a*) affiliated with the entrant bank; and

(*b*) either

(i) a bank,

(ii) a corporation authorized under the *Trust and Loan Companies Act* to carry on the business of offering to the public its services as trustee, or

(iii) a corporation of which the principal activity in Canada consists of any of the activities referred to in subparagraphs 518(3)(*a*)(i) to (v) of the *Bank Act* and in which the entrant bank or a non-resident person affiliated with the entrant bank holds shares under the authority, directly or indirectly, of an order issued by the Minister of Finance or the Governor in Council under subsection 521(1) of that Act.

"eligible property"
« *bien admissible* »

"eligible property" of a Canadian affiliate at any time means a property described in any of paragraphs 85(1.1)(*a*) to (*g*.1) that is, immediately before that time, used or held by it in carrying on its business in Canada.

"entrant bank"
« *banque entrante* »

"entrant bank" means a non-resident corporation that is, or has applied to the Superintendent of Financial Institutions to become, an authorized foreign bank.

Amalgamation and merger

(2) For the purpose of the definition "Canadian affiliate" in subsection (1), if an entrant bank was formed as the result of an amalgamation or merger, after February 11, 1999, of two or more non-resident corporations (referred to in this subsection as "predecessors"), and at the time immediately before the amalgamation or merger, there were one or more Canadian corporations (referred to in this subsection as "predecessor affiliates"), each of which at that time would have been a Canadian affiliate of a predecessor if the predecessor were an entrant bank at that time,

(*a*) each predecessor affiliate is deemed to have been affiliated with the entrant bank throughout the period that began on February 11, 1999 and ended at the time of the amalgamation or merger;

(*b*) the expression "entrant bank" in subparagraph (*b*)(iii) of the definition is deemed to include a predecessor; and

(*c*) if two or more of the predecessor affiliates are amalgamated or merged at any time after February 11, 1999 to form a new corporation, the new corporation is deemed to have been affiliated with the entrant bank throughout the period that began on February 11, 1999 and ended at the time of the amalgamation or merger of the predecessor affiliates.

Branch-establishment rollover

(3) If a Canadian affiliate of an entrant bank transfers an eligible property to the entrant bank, the entrant bank begins immediately after the transfer to use or hold the transferred property in its Canadian banking business and the Canadian affiliate and the entrant bank jointly elect, in accordance with subsection (11), to have this subsection apply in respect of the transfer, subsections 85(1) (other than

paragraph (*e*.2)), (1.1), (1.4) and (5) apply, with any modifications that the circumstances require, in respect of the transfer, except that the portion of subsection 85(1) before paragraph (*a*) shall be read as follows:

"**85.** (1) Where a taxpayer that is a Canadian affiliate of an entrant bank (within the meanings assigned by subsection 142.7(1)) has, in a taxation year, disposed of any of the taxpayer's property to the entrant bank (referred to in this subsection as the "corporation"), if the taxpayer and the corporation have jointly elected under subsection 142.7(3), the following rules apply:"

No shareholder benefit or adjustment of terms

(4) If a Canadian affiliate of an entrant bank and the entrant bank make an election under subsection (3) in respect of a transfer of property by the Canadian affiliate to the entrant bank, receipt by the Canadian affiliate of consideration having a value which is less than the fair market value of the property but not less than the amount agreed to by the Canadian affiliate and the entrant bank in their election shall not in itself be a basis for the application of subsection 15(1), 69(1), (4) or (5) or 247(2) in respect of the transfer.

Specified debt obligations

(5) If a Canadian affiliate of an entrant bank transfers a specified debt obligation to the entrant bank in a transaction in respect of which an election is made under subsection (3), the Canadian affiliate is a financial institution in its taxation year in which the transfer is made, and the amount that the Canadian affiliate and the entrant bank agree on in their election in respect of the obligation is equal to the tax basis of the obligation within the meaning assigned by subsection 142.4(1), the entrant bank is deemed, in respect of the obligation, for the purposes of sections 142.2 to 142.4 and 142.6, to be the same corporation as, and a continuation of, the Canadian affiliate.

Mark-to-market property

(6) If a Canadian affiliate of an entrant bank described in paragraph (11)(*a*) transfers at any time within the period described in paragraph (11)(*c*) to the entrant bank a property that is, for the Canadian affiliate's taxation year in which the property is transferred, a mark-to-market property of the Canadian affiliate,

(*a*) for the purposes of subsections 112(5) to (5.21) and (5.4), the definition "mark-to-market property" in subsection 142.2(1) and subsection 142.5(9), the entrant bank is deemed, in respect of the property, to be the same corporation as and a continuation of, the Canadian affiliate; and

(*b*) for the purpose of applying subsection 142.5(2) in respect of the property, the Canadian affiliate's taxation year in which the property is transferred is deemed to have ended immediately before the time the property was transferred.

Reserves

(7) If, at a particular time, a Canadian affiliate of an entrant bank is a financial institution and transfers to the entrant bank an obligation or property that is an instrument or commitment described in paragraph 20(1)(*l*.1), or a loan or lending asset, for an amount equal to its fair market value, the entrant bank begins immediately after the transfer to owe, use or hold the obligation or property in its Canadian banking business and the Canadian affiliate and the entrant bank jointly elect, in accordance with subsection (11), to have this subsection apply in respect of the transfer,

(*a*) for the purposes of the application of paragraphs 20(1)(*l*), (*l*.1) and (*p*), the taxation year of the affiliate that includes the particular time is deemed to have ended immediately before the particular time; and

(*b*) any amount deducted by the Canadian affiliate in respect of the obligation or property under paragraph 20(1)(*l*) or (*l*.1) in the year that includes the particular time, or under paragraph 20(1)(*p*) in that year or a preceding year (to the extent that the amount has not been included in the affiliate's income under paragraph 12(1)(*i*)), is deemed to have been so deducted by the entrant bank in the last taxation year of the entrant bank that ended before the particular time.

Assumption of debt obligation

(8) If a Canadian affiliate of an entrant bank described in paragraph (11)(*a*) transfers at any time within the period described in paragraph (11)(*c*) property to the entrant bank, and any part of the consideration for the transfer is the assumption by the entrant bank in respect of its Canadian banking business of a debt obligation of the Canadian affiliate,

(*a*) where the Canadian affiliate and the entrant bank jointly elect in accordance with subsection (11) to have this paragraph apply,

(i) both

(A) the value of that part of the consideration for the transfer of the property, and

(B) for the purpose of determining the consequences of the assumption of the obligation and any subsequent settlement or extinguishment of it, the value of the consideration given to the entrant bank for the assumption of the obligation,

are deemed to be an amount (in this paragraph referred to as the "assumption amount") equal to the amount outstanding on account of the principal amount of the obligation at that time, and

(ii) the assumption amount shall not be considered a term of the transaction that differs from that which would have been made between persons dealing at arm's length solely because it is not equal to the fair market value of the obligation at that time; and

(*b*) where the obligation is denominated in a foreign currency, and the Canadian affiliate and the entrant bank jointly elect in accordance with subsection (11) to have this paragraph apply,

(i) the amount of any income, loss, capital gain or capital loss in respect of the obligation due to the fluctuation in the value of the foreign currency relative to Canadian currency realized by

(A) the Canadian affiliate on the assumption of the obligation is deemed to be nil, and

(B) the entrant bank on the settlement or extinguishment of the obligation shall be determined based on the amount of the obligation in Canadian currency at the time it became an obligation of the Canadian affiliate, and

(ii) for the purpose of an election made in respect of the obligation under paragraph (*a*), the amount outstanding on account of the principal amount of the obligation at that time is the total of all amounts each of which is an amount that was advanced to the Canadian affiliate on account of principal, that remains outstanding at that time, and that is determined using the exchange rate that applied between the foreign currency and Canadian currency at the time of the advance.

Branch-establishment dividend

(9) Despite any other provision of this Act, the rules in subsection (10) apply if

(*a*) a dividend is paid by a Canadian affiliate of an entrant bank to the entrant bank or to a person that is affiliated with the Canadian affiliate and that is resident in the country in which the entrant bank is resident, or

(*b*) a dividend is deemed to be paid for the purposes of this Part or Part XIII as a result of a transfer of property from the Canadian affiliate to such a person,

and the Canadian affiliate and the entrant bank jointly elect in accordance with subsection (11) to have subsection (10) apply in respect of the dividend.

Treatment of dividend

(10) If the conditions in subsection (9) are met,

(*a*) the dividend is deemed (except for the purposes of subsections 112(3) to (7)) not to be a taxable dividend; and

(*b*) there is added to the amount otherwise determined under paragraph 219(1)(*g*) in respect of the entrant bank for its first taxation year that ends after the time at which the dividend is paid, the amount of the dividend less, where the dividend is paid by means of, or arises as a result of, a transfer of eligible property in respect of which the Canadian affiliate and the entrant bank have jointly elected under subsection (3), the amount by which the fair market value of the property transferred exceeds the amount the Canadian affiliate and the entrant bank have agreed on in their election.

Elections

(11) An election under subsection (3) or (7), paragraph (8)(*a*) or (*b*) or subsection (10) is valid only if

(*a*) the entrant bank by which the election is made has, on or before March 31, 2001, complied with paragraphs 1.0(1.1)(b) and (c) of the "Guide to Foreign Bank Branching" in respect of the establishment and commencement of business of a foreign bank branch in Canada issued by the Office of the Superintendent of Financial Institutions, as it read on December 31, 1999;

(*b*) the election is made in prescribed form on or before the earlier of the filing-due date of the Canadian affiliate and the filing-due date of the entrant bank, for the taxation year that includes the time at which the dividend or the transfer to which the election relates is paid or made, as the case may be; and

(*c*) the dividend or the transfer to which the election relates is paid or made, as the case may be,

(i) after the day on which the Superintendent makes an order in respect of the entrant bank under subsection 534(1) of the *Bank Act*, and

(ii) on or before the earlier of

(A) the day that is 6 months after that day, and

(B) December 31, 2002.

Winding-up of Canadian affiliate: losses

(12) If

(*a*) a Canadian affiliate of an entrant bank has been dissolved pursuant to section 342 or 346 of the *Bank Act* or section 347 or 351 of the *Trust and Loan Companies Act*, or otherwise wound up under the terms of the corporate law that governs the affiliate,

(*b*) before the earlier of the dates described in subparagraph (11)(*c*)(ii) in respect of the entrant bank,

(i) the Minister of Finance has issued letters patent under section 342 of the *Bank Act* or section 347 of the *Trust and Loan Companies Act* dissolving the Canadian affiliate or an order under section 345 of the *Bank Act* or section 350 of the *Trust and Loan Companies Act* approving the Canadian affiliate's application for dissolution (such letters patent or order being referred to in this subsection as the "dissolution order"), or

(ii) the affiliate has been wound up under the terms of the corporate law that governs it, and

(*c*) the entrant bank carries on all or part of the business in Canada that was formerly carried on by the Canadian affiliate,

in applying section 111 for the purpose of computing the taxable income earned in Canada of the entrant bank for any taxation year that begins after the date of the dissolution order or the commencement of the winding up, as the case may be,

(*d*) subject to paragraphs (*e*) and (*h*), the portion of a non-capital loss of the Canadian affiliate for a taxation year (in this paragraph referred to as the "Canadian affiliate's loss year") that can reasonably be regarded as being its loss from carrying on a business in Canada (in this paragraph referred to as the "loss business") or being in respect of a claim made under section 110.5, to the extent that it

(i) was not deducted in computing the taxable income of the Canadian affiliate for any taxation year, and

(ii) would have been deductible in computing the taxable income of the Canadian affiliate for any taxation year that begins after the date of the dissolution order or the commencement of the winding up, as the case may be, on the assumption that it had such a taxation year and that it had sufficient income for that year,

is deemed, for the taxation year of the entrant bank in which the Canadian affiliate's loss year ended, to be a non-capital loss of the entrant bank from carrying on the loss business (or, in respect of a claim made under section 110.5, to be a non-capital loss of the entrant bank in respect of a claim under subparagraph 115(1)(*a*)(vii)) that was not deductible by the entrant bank in computing its taxable income earned in Canada for any taxation year that began before the date of the dissolution order or the commencement of the winding up, as the case may be,

(*e*) if at any time control of the Canadian affiliate or entrant bank has been acquired by a person or group of persons, no amount in respect of the Canadian affiliate's non-capital loss for a taxation year that ends before that time is deductible in computing the taxable income earned in Canada of the entrant bank for a particular taxation year that ends after that time, except that the portion of the loss that can reasonably be regarded as the Canadian affiliate's loss from carrying on a business in Canada and, where a business was carried on by the Canadian affiliate in Canada in the earlier year, the portion

of the loss that can reasonably be regarded as being in respect of an amount deductible under paragraph 110(1)(*k*) in computing its taxable income for the year are deductible only

(i) if that business is carried on by the Canadian affiliate or the entrant bank for profit or with a reasonable expectation of profit throughout the particular year, and

(ii) to the extent of the total of the entrant bank's income for the particular year from that business, and where properties were sold, leased, rented or developed or services rendered in the course of carrying on that business before that time, from any other business substantially all of the income of which was derived from the sale, leasing, rental or development, as the case may be, of similar properties or the rendering of similar services,

and, for the purpose of this paragraph, where subsection 88(1.1) applied to the dissolution of another corporation in respect of which the Canadian affiliate was the parent and paragraph 88(1.1)(*e*) applied in respect of losses of that other corporation, the Canadian affiliate is deemed to be the same corporation as, and a continuation of, that other corporation with respect to those losses,

(*f*) subject to paragraphs (*g*) and (*h*), a net capital loss of the Canadian affiliate for a taxation year (in this paragraph referred to as the "Canadian affiliate's loss year") is deemed to be a net capital loss of the entrant bank for its taxation year in which the Canadian affiliate's loss year ended to the extent that the loss

(i) was not deducted in computing the taxable income of the Canadian affiliate for any taxation year, and

(ii) would have been deductible in computing the taxable income of the Canadian affiliate for any taxation year beginning after the date of the dissolution order or the commencement of the winding-up, as the case may be, on the assumption that the Canadian affiliate had such a taxation year and that it had sufficient income and taxable capital gains for that year,

(*g*) if at any time control of the Canadian affiliate or the entrant bank has been acquired by a person or group of persons, no amount in respect of the Canadian affiliate's net capital loss for a taxation year that ends before that time is deductible in computing the entrant bank's taxable income earned in Canada for a taxation year that ends after that time, and

(*h*) any loss of the Canadian affiliate that would otherwise be deemed by paragraph (*d*) or (*f*) to be a loss of the entrant bank for a particular taxation year that begins after the date of the dissolution order or the commencement of the winding-up, as the case may be, is deemed, for the purpose of computing the entrant bank's taxable income earned in Canada for taxation years that begin after that date, to be such a loss of the entrant bank for its immediately preceding taxation year and not for the particular year, if the entrant bank so elects in its return of income for the particular year.

Winding-up of Canadian affiliate: SDOs

(13) If a Canadian affiliate of an entrant bank and the entrant bank meet the conditions set out in paragraphs (12)(*a*) to (*c*), the entrant bank is deemed to be the same corporation as, and a continuation of, the Canadian affiliate for the purposes of paragraphs 142.4(4)(*c*) and (*d*) in respect of any specified debt obligation disposed of by the Canadian affiliate.

(2) Subsection (1) applies after June 27, 1999.

13. (1) Paragraph 152(4)(*b*) of the Act is amended by adding the following after subparagraph (iii):

(iii.1) is made, if the taxpayer is non-resident and carries on a business in Canada, as a consequence of

(A) an allocation by the taxpayer of revenues or expenses as amounts in respect of the Canadian business (other than revenues and expenses that relate solely to the Canadian business, that are recorded in the books of account of the Canadian business, and the documentation in support of which is kept in Canada), or

(B) a notional transaction between the taxpayer and its Canadian business, where the transaction is recognized for the purposes of the computation of an amount under this Act or an applicable tax treaty.

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

14. (1) The portion of subsection 153(1) of the Act after paragraph (*t*) is replaced by the following:

shall deduct or withhold from the payment the amount determined in accordance with prescribed rules and shall, at the prescribed time, remit that amount to the Receiver General on account of the payee's tax for the year under this Part or Part XI.3, as the case may be, and, where at that prescribed time the person is a prescribed person, the remittance shall be made to the account of the Receiver General at a designated financial institution.

(2) Section 153 of the Act is amended by adding the following after subsection (5):

Meaning of "designated financial institution"

(6) In this section, "designated financial institution" means a corporation that

(*a*) is a bank, other than an authorized foreign bank that is subject to the restrictions and requirements referred to in subsection 524(2) of the *Bank Act*;

(*b*) is authorized under the laws of Canada or a province to carry on the business of offering its services as a trustee to the public; or

(*c*) is authorized under the laws of Canada or a province to accept deposits from the public and carries on the business of lending money on the security of real estate or investing in mortgages on real estate.

(3) Subsections (1) and (2) apply after June 27, 1999.

15. (1) Subparagraph 157(1)(*a*)(i) of the Act is replaced by the following:

(i) on or before the last day of each month in the year, an amount equal to 1/12 of the total of the amounts estimated by it to be the taxes payable by it under this Part and Parts I.3, VI, VI.1 and XIII.1 for the year,

(2) The portion of paragraph 157(1)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) the remainder of the taxes payable by it under this Part and Parts I.3, VI, VI.1 and XIII.1 for the year

(3) Subsection 157(2.1) of the Act is replaced by the following:

$1,000 threshold

(2.1) Where

(*a*) the total of the taxes payable under this Part and Parts I.3, VI, VI.1 and XIII.1 by a corporation for a taxation year (determined before taking into consideration the specified future tax consequences for the year), or

(*b*) the corporation's first instalment base for the year,

is not more than $1,000, the corporation may, instead of paying the instalments required for the year by paragraph (1)(*a*), pay to the Receiver General, under paragraph (1)(*b*), the total of the taxes payable by it under this Part and Parts I.3, VI, VI.1 and XIII.1 for the year.

(4) Subsections (1) to (3) apply to the 2001 and subsequent taxation years.

16. (1) Subparagraph 181.3(1)(*c*)(i) of the Act is replaced by the following:

(i) in the case of a financial institution, other than an authorized foreign bank or an insurance corporation, that proportion of its taxable capital for the year that its Canadian assets at the end of the year is of its total assets at the end of the year,

(2) Subparagraph 181.3(1)(*c*)(iv) of the Act is replaced by the following:

(iv) in the case of an insurance corporation that was throughout the year not resident in Canada and carried on an insurance business at any time in the year, or in the case of an authorized foreign bank, its taxable capital for the year.

(3) The portion of paragraph 181.3(3)(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) in the case of a financial institution, other than an authorized foreign bank or an insurance corporation, the amount, if any, by which the total at the end of the year of

(4) Subsection 181.3(3) of the Act is amended by striking out the word "and" at the end of paragraph (*c*), by adding the word "and" at the end of paragraph (*d*) and by adding the following after paragraph (*d*):

(*e*) in the case of an authorized foreign bank, the total of

(i) 10% of the total of all amounts, each of which is the risk-weighted amount at the end of the year of an on-balance sheet asset or an off-balance sheet exposure of the bank in respect of its Canadian banking business that the bank would be required to report under the OSFI risk-weighting guidelines if those guidelines applied and required a report at that time, and

(ii) the total of all amounts, each of which is an amount at the end of the year in respect of the bank's Canadian banking business that

(A) if the bank were a bank listed in Schedule II to the *Bank Act*, would be required under the risk-based capital adequacy guidelines issued by the Superintendent of Financial Institutions and applicable at that time to be deducted from the bank's capital in determining the amount of capital available to satisfy the Superintendent's requirement that capital equal a particular proportion of risk-weighted assets and exposures, and

(B) is not an amount in respect of a loss protection facility required to be deducted from capital under the Superintendent's guidelines respecting asset securitization applicable at that time.

(5) Subsection 181.3(4) of the Act is replaced by the following:

Investment allowance of financial institution

(4) The investment allowance for a taxation year of a corporation that is a financial institution is

(*a*) in the case of a corporation that was resident in Canada at any time in the year, the total of all amounts each of which is the carrying value at the end of the year of an eligible investment of the corporation;

(*b*) in the case of an insurance corporation that was throughout the year not resident in Canada, the total of all amounts each of which is the carrying value at the end of the year of an eligible investment of the corporation that was used or held by it in the year in the course of carrying on an insurance business in Canada;

(*c*) in the case of an authorized foreign bank, the total of all amounts each of which is the amount at the end of the year, before the application of risk weights, that the bank would be required to report under the OSFI risk-weighting guidelines if those guidelines applied and required a report at that time, of an eligible investment used or held by the bank in the year in the course of carrying on its Canadian banking business; and

(*d*) in any other case, nil.

Interpretation

(5) For the purpose of subsection (4),

(*a*) an eligible investment of a corporation is a share of the capital stock or long-term debt (and, where the corporation is an insurance corporation, is non-segregated property within the meaning assigned by subsection 138(12)) of a financial institution that at the end of the year

(i) is related to the corporation,

(ii) is not exempt from tax under this Part, and

(iii) is resident in Canada or can reasonably be regarded as using the proceeds of the share or debt in a business carried on by the institution through a permanent establishment (as defined by regulation) in Canada; and

(*b*) a credit union and another credit union of which the credit union is a shareholder or member are deemed to be related to each other.

(6) Subsections (1) to (5) apply after June 27, 1999, except that in its application to taxpayers other than authorized foreign banks for taxation years that end before 2002, paragraph 181.3(6)(*a*), as enacted by subsection (5), shall be read without reference to subparagraph (iii) thereof.

17. (1) Paragraph 190.11(*a*) of the Act is replaced by the following:

(*a*) in the case of a financial institution, other than an authorized foreign bank or a life insurance corporation, that proportion of its taxable capital for the year that its Canadian assets at the end of the year is of its total assets at the end of the year;

(2) Paragraph 190.11(*c*) of the Act is replaced by the following:

(*c*) in the case of a life insurance corporation that was non-resident throughout the year, or in the case of an authorized foreign bank, its taxable capital for the year.

(3) Subsections (1) and (2) apply after June 27, 1999.

18. (1) The portion of paragraph 190.13(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) in the case of a financial institution, other than an authorized foreign bank or a life insurance corporation, the amount, if any, by which the total at the end of the year of

(2) Section 190.13 of the Act is amended by striking out the word "and" at the end of paragraph (*b*), by adding the word "and" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) in the case of an authorized foreign bank, the total of

(i) 10% of the total of all amounts, each of which is the risk-weighted amount at the end of the year of an on-balance sheet asset or an off-balance sheet exposure of the bank in respect of its Canadian banking business that the bank would be required to report under the OSFI risk-weighting guidelines if those guidelines applied and required a report at that time, and

(ii) the total of all amounts, each of which is an amount at the end of the year in respect of the bank's Canadian banking business that

(A) if the bank were a bank listed in Schedule II to the *Bank Act*, would be required under the risk-based capital adequacy guidelines issued by the Superintendent of Financial Institutions to be deducted from the bank's capital in determining the amount of capital available to satisfy the Superintendent's requirement that capital equal a particular proportion of risk-weighted assets and exposures, and

(B) is not an amount in respect of a loss protection facility required to be deducted from capital under the Superintendent's guidelines respecting asset securitization applicable at that time.

(3) Subsections (1) and (2) apply after June 27, 1999.

19. (1) Subsection 190.14 of the Act is replaced by the following:

Investment in related institutions

190.14 (1) A corporation's investment for a taxation year in a financial institution related to it is

(*a*) in the case of a corporation that was resident in Canada at any time in the year, the total of all amounts each of which is the carrying value (or in the case of contributed surplus, the amount) at the end of the year of an eligible investment of the corporation in the financial institution;

(*b*) in the case of a life insurance corporation that was non-resident throughout the year, the total of all amounts each of which is the carrying value (or is, in the case of contributed surplus, the amount) at the end of the year of an eligible investment of the corporation in the financial institution that was used or held by the corporation in the year in the course of carrying on an insurance business in Canada (or that, in the case of contributed surplus, was contributed by the corporation in the course of carrying on that business); and

(*c*) in the case of a corporation that is an authorized foreign bank, the total of all amounts each of which is the amount at the end of the year, before the application of risk weights, that would be required to be reported under the OSFI risk-weighting guidelines if those guidelines applied and required a report at that time, of an eligible investment of the corporation in the financial institution that was used or held by the corporation in the year in the course of carrying on its Canadian banking business or, in the case of an eligible investment that is contributed surplus of the financial institution at the end of the year, the amount of the surplus contributed by the corporation in the course of carrying on that business.

Interpretation

(2) For the purpose of subsection (1), an eligible investment of a corporation in a financial institution is a share of the capital stock or long-term debt (and, where the corporation is an insurance corporation, is non-segregated property within the meaning assigned by subsection 138(12)) of the financial institution or any surplus of the financial institution contributed by the corporation (other than an amount otherwise included as a share or debt) if the financial institution at the end of the year is

(*a*) related to the corporation; and

(*b*) resident in Canada or can reasonably be regarded as using the surplus or the proceeds of the share or debt in a business carried on by the financial institution through a permanent establishment (as defined by regulation) in Canada.

(2) Subsection (1) applies after June 27, 1999 except that, in its application to taxpayers other than authorized foreign banks for taxation years that end before 2002, subsection 190.14(2) of the Act, as enacted by subsection (1), shall be read without reference to paragraph (*b*) thereof.

20. (1) Paragraph (*a*) of the definition "qualified investment" in section 204 of the Act is replaced by the following:

(*a*) money (other than money the fair market value of which exceeds its stated value as legal tender in the country of issuance or money that is held for its numismatic value) and deposits (within the meaning assigned by the *Canada Deposit Insurance Corporation Act* or with a branch in Canada of a bank) of such money standing to the credit of the trust,

(2) Subsection (1) applies after June 27, 1999 except that, before 2003, paragraph (*a*) of the definition "qualified investment" in section 204 of the Act, as enacted by that subsection, shall be read as follows:

(*a*) money (other than money the fair market value of which exceeds its stated value as legal tender in the country of issuance or money that is held for its numismatic value) and deposits (within the meaning assigned by the *Canada Deposit Insurance Corporation Act* or with a bank listed in Schedule

I or II to the *Bank Act* or with a branch in Canada of an authorized foreign bank) of such money standing to the credit of the trust,

21. (1) Paragraph (*g*) of the definition "foreign property" in subsection 206(1) of the Act is replaced by the following:

(*g*) indebtedness of a non-resident person, other than

(i) a deposit with a branch in Canada of an authorized foreign bank, or

(ii) indebtedness issued or guaranteed by

(A) the International Bank for Reconstruction and Development,

(B) the International Finance Corporation,

(C) the Inter-American Development Bank,

(D) the Asian Development Bank,

(E) the Caribbean Development Bank,

(F) the European Bank for Reconstruction and Development,

(G) the African Development Bank, or

(H) a prescribed person,

(2) Subsection (1) applies after June 27, 1999.

22. (1) Section 212 of the Act is amended by adding the following after subsection (13.2):

Application of Part XIII to authorized foreign bank

(13.3) An authorized foreign bank is deemed to be resident in Canada for the purposes of

(*a*) this Part, in respect of any amount paid or credited to or by the bank in respect of its Canadian banking business; and

(*b*) the application in paragraph (13.1)(*b*) of the definition "Canadian partnership" in respect of a partnership interest held by the bank in the course of its Canadian banking business.

(2) Subsection (1) applies after June 27, 1999.

23. (1) The Act is amended by adding the following after section 218.1:

PART XIII.1

ADDITIONAL TAX ON AUTHORIZED FOREIGN BANKS

Branch interest tax

218.2 (1) Every authorized foreign bank shall pay a tax under this Part for each taxation year equal to 25% of its taxable interest expense for the year.

Taxable interest expense

(2) The taxable interest expense of an authorized foreign bank for a taxation year is 15% of the amount, if any, by which

(*a*) the total of all amounts on account of interest that are deducted under section 20.2 in computing the bank's income for the year from its Canadian banking business

exceeds

(*b*) the total of all amounts that are included in paragraph (*a*) and that are in respect of a liability of the bank to another person or partnership.

Where tax not payable

(3) No tax is payable under this Part for a taxation year by an authorized foreign bank if

(*a*) the bank is resident in a country with which Canada has a tax treaty at the end of the year; and

(*b*) no tax similar to the tax under this Part would be payable in that country for the year by a bank resident in Canada carrying on business in that country during the year.

Rate limitation

(4) Despite any other provision of this Act, the reference in subsection (1) to 25% shall, in respect of a taxation year of an authorized foreign bank that is resident in a country with which Canada has a tax treaty on the last day of the year, be read as a reference to,

(*a*) if the treaty specifies the maximum rate of tax that Canada may impose under this Part for the year on residents of that country, that rate;

(*b*) if the treaty does not specify a maximum rate as described in paragraph (*a*) but does specify the maximum rate of tax that Canada may impose on a payment of interest in the year by a person resident in Canada to a related person resident in that country, that rate; and

(*c*) in any other case, 25%.

Provisions applicable to Part

(5) Sections 150 to 152, 158, 159, 160.1 and 161 to 167 and Division J of Part I apply to this Part with any modifications that the circumstances require.

(2) Subsection (1) applies to taxation years that end after June 27, 1999.

24. (1) Paragraph 219(2)(*a*) of the Act is repealed.

(2) Subsection (1) applies to taxation years that end after June 27, 1999.

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

"authorized foreign bank"
« *banque étrangère autorisée* »

"authorized foreign bank" has the meaning assigned by section 2 of the *Bank Act*;

"bank"
« *banque* »

"bank" means a bank within the meaning assigned by section 2 of the *Bank Act* or an authorized foreign bank;

"Canadian banking business"
« *entreprise bancaire canadienne* »

"Canadian banking business" means the business carried on by an authorized foreign bank through a permanent establishment (as defined by regulation) in Canada;

"foreign currency"
« *monnaie étrangère* »

"foreign currency" means currency of a country other than Canada;

"OSFI risk-weighting guidelines"
« *lignes directrices du BSIF sur la pondération des risques* »

"OSFI risk-weighting guidelines" means the guidelines, issued by the Superintendent of Financial Institutions under the authority of section 600 of the *Bank Act*, requiring an authorized foreign bank to provide to the Superintendent on a periodic basis a return of the bank's risk-weighted on-balance sheet assets and off-balance sheet exposures, that apply as of **ANNOUNCEMENT DATE**;

(2) Subsection (1) applies after June 27, 1999.

26. (1) Subsection 250(5) of the Act is replaced by the following:

Deemed non-resident

(5) Despite any other provision of this Act (other than paragraph 126(1.1)(*a*)), a person is deemed not to be resident in Canada at a time if, at that time, the person would, but for this subsection and any tax treaty, be resident in Canada for the purposes of this Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada.

(2) Subsection (1) applies after June 27, 1999.

FOREIGN BANK BRANCHES

PROPOSED AMENDMENTS TO THE *INCOME TAX REGULATIONS*

AMENDMENTS

1. The heading that precedes section 404 of the *Income Tax Regulations* and the portion of subsection 404(1) of the Regulations before paragraph (*a*) are replaced by the following:

Banks

404. (1) Despite subsections 402(3) and (4), the amount of taxable income that is deemed to have been earned by a bank in a taxation year in a province in which it had a permanent establishment is 1/3 of the total of

2. Section 413 of the Regulations is amended by adding the following after subsection (2):

(3) For the purpose of paragraph 404(1)(*b*), in the case of an authorized foreign bank, "all loans and deposits of the bank for the year" shall be read as a reference to "all loans and deposits of the bank for the year in respect of its Canadian banking business".

3. (1) The portion of subsection 808(1) of the Regulations before paragraph (*a*) is replaced by the following:

808. (1) For the purposes of paragraph 219(1)(*j*) of the Act, the allowance of a corporation (other than an authorized foreign bank) for a taxation year in respect of its investment in property in Canada is prescribed to be the amount, if any, by which

(2) Paragraphs 808(2)(*d*) to (*d*.2) of the Regulations are replaced by the following:

(*d*) where the corporation is not a principal-business corporation, within the meaning assigned by subsection 66(15) of the Act, an amount equal to the total of the corporation's

(i) Canadian exploration and development expenses, within the meaning assigned by subsection 66(15) of the Act, incurred by the corporation before the end of the year, except to the extent that such expenses were deducted in computing the corporation's income for the year or for a previous taxation year, and

(ii) cumulative Canadian exploration expense, within the meaning assigned by subsection 66.1(6) of the Act, at the end of the year minus any deduction under subsection 66.1(3) of the Act in computing the corporation's income for the year,

(*d*.1) an amount equal to the corporation's cumulative Canadian development expense, within the meaning assigned by subsection 66.2(5) of the Act, at the end of the year minus any deduction under subsection 66.2(2) of the Act in computing the corporation's income for the year,

(*d*.2) an amount equal to the corporation's cumulative Canadian oil and gas property expense, within the meaning assigned by subsection 66.4(5) of the Act, at the end of the year minus any deduction under subsection 66.4(2) of the Act in computing the corporation's income for the year,

(3) Subsection 808(2) of the Regulations is amended by adding the word "and" at the end of paragraph (*g*) and by repealing paragraph (*h*).

(4) Subparagraph 808(2)(*l*)(i) of the Regulations is replaced by the following:

(i) the purchase price of property that is referred to in paragraph (*a*), (*b*) or (*f*) or that would be so referred to but for the fact that it has been disposed of before the end of the year,

(5) Subparagraph 808(2)(*l*)(ii) of the Regulations is replaced by the following:

(ii) Canadian exploration and development expenses, Canadian exploration expense, Canadian development expense or Canadian oil and gas property expense, within the meanings assigned by subsections 66(15), 66.1(6), 66.2(5) and 66.4(5) of the Act, respectively,

(6) Subparagraphs 808(2)(*n*)(ii) and (iii) of the Regulations are replaced by the following:

(ii) that proportion of the Part I liability that the amount, if any, in respect of the corporation for the year that is the lesser of

(A) the amount, if any, by which the total of all amounts each of which is a taxable capital gain of the corporation for the year from a disposition of a taxable Canadian property that was not used or held by it in the year in the course of carrying on business in Canada exceeds the total of all amounts each of which is an allowable capital loss of the corporation for the year from a disposition of such a property, and

(B) the amount that would be determined under clause (A) for the year if it were read without reference to the expression "that was not used or held by it in the year in the course of carrying on business in Canada",

is of the corporation’s taxable income earned in Canada for the year; and

(7) Subparagraphs 808(2)(*o*)(ii) and (iii) of the Regulations are replaced by the following:

(ii) that proportion of the provincial tax liability that the amount, if any, in respect of the corporation for the year that is the lesser of

(A) the amount, if any, by which the total of all amounts each of which is a taxable capital gain of the corporation for the year from a disposition of a taxable Canadian property that was not used or held by it in the year in the course of carrying on business in Canada exceeds the total of all amounts each of which is an allowable capital loss of the corporation for the year from a disposition of such a property, and

(B) the amount that would be determined under clause (A) for the year if it were read without reference to the expression "that was not used or held by it in the year in the course of carrying on business in Canada"

is of the corporation’s taxable income earned in Canada for the year.

(8) Paragraph 808(2)(*p*) of the Regulations is repealed.

(9) Subparagraph 808(5)(*j*)(ii) of the Regulations is replaced by the following:

(ii) Canadian exploration and development expenses, Canadian exploration expense, Canadian development expense or Canadian oil and gas property expense, within the meanings assigned by subsections 66(15), 66.1(6), 66.2(5) and 66.4(5) of the Act, respectively,

(10) Paragraph 808(6)(*a*) of the Regulations is amended by deleting the word "and" at the end of subparagraph (iii) and by adding the following after that subparagraph:

to the extent that such amounts are attributable to the profits of the partnership from carrying on a business in Canada, or are used or held by the partnership in the year in the course of carrying on a business in Canada; and

(11) Section 808 of the Regulations is amended by adding the following after subsection (7):

(8) For the purpose of paragraph 219(1)(*j*) of the Act, the allowance of an authorized foreign bank for a taxation year in respect of its investment in property in Canada is prescribed to be the amount, if any, by which

(*a*) the average of all amounts, each of which is the amount for a calculation period (within the meaning assigned by subsection 20.2(1) of the Act) of the bank for the year that is the greater of

(i) the amount determined by the formula

$$0.05 \times A$$

where

A is the amount of the element A in the formulae in subsection 20.2(3) of the Act for the period, and

(ii) the amount by which

(A) the total of the cost amount to the bank, at the end of the period (or, in the case of depreciable property or eligible capital property, immediately after the end of the year), of each asset in respect of the bank's Canadian banking business that is an asset recorded in the books of account of the business in a manner consistent with the manner in which it is required to be treated for the purpose of the branch financial statements (within the meaning assigned by subsection 20.2(1) of the Act) for the year

exceeds

(B) the amount equal to the total of

(I) the amount determined by the formula

$$L + BA$$

where

L is the amount of the element L in the formulae in subsection 20.2(3) of the Act for the period, and

BA is the amount of the element BA in the formulae in subsection 20.2(3) of the Act for the period, and

(II) the amount claimed by the bank under clause 20.2(3)(*b*)(ii)(A) of the Act

exceeds

(*b*) the total of all amounts each of which is an amount that would be determined under paragraph (2)(*j*), (*k*), (*n*) or (*o*) if that provision applied to the bank for the year, except to the extent that the amount reflects a liability of the bank that has been included in the element L in the formulae in subsection 20.2(3) of the Act for the bank's last calculation period for the year.

4. (1) Paragraph 5301(1)(*b*) of the Regulations is replaced by the following:

(*b*) the total of the taxes payable by the corporation under Parts I.3, VI, VI.1 and XIII.1 of the Act for its taxation year preceding the particular year

(2) Clause 5301(4)(*a*)(i)(B) of the Regulations is replaced by the following:

(B) the total of the taxes payable under Parts I.3, VI, VI.1 and XIII.1 of the Act

(3) The portion of subsection 5301(8) of the Regulations before paragraph (*a*) is replaced by the following:

(8) Subject to subsection (9), if at a particular time a corporation (in this subsection referred as the "transferor") has disposed of all or substantially all of its property to another corporation with which it was not dealing at arm's length (in this subsection and subsection (9) referred to as the "transferee") and subsection 85(1), (2) or 142.7(3) of the Act applied in respect of the disposition of any of the property, the following rules apply:

(4) Subsection 5301(10) of the Regulations is replaced by the following:

(10) For the purpose of this section, tax payable under Part I, I.3, VI or XIII.1 of the Act by a corporation for a taxation year means the corporation's tax payable for the year under the relevant Part, determined before taking into consideration the specified future tax consequences for the year.

5. Section 7900 of the Regulations is replaced by the following:

7900. (1) For the purposes of section 33.1, paragraph 95(2)(*a*.3), the definition "specified deposit" in subsection 95(2.5), clause 212(1)(*b*)(iii)(D) and subparagraph 212(1)(*b*)(xi) of the Act, each of the following is a prescribed financial institution:

(*a*) a corporation that is a member of the Canadian Payments Association, other than an authorized foreign bank; and

(*b*) a credit union that is a shareholder or member of a body corporate or organization that is a central for the purposes of the *Canadian Payments Association Act*.

(2) For the purposes of paragraph 95(2)(*a*.3), the definition "specified deposit" in subsection 95(2.5) and clause 212(1)(*b*)(iii)(D) of the Act, an authorized foreign bank is a prescribed financial institution.

6. The portion of section 8201 of the Regulations before paragraph (*a*) is replaced by the following:

8201. For the purposes of subsection 16.1(1), the definition “outstanding debts to specified non residents” in subsection 18(5), subsection 34.2(6), paragraph 95(2)(*a*.3), subsections 112(2), 125.4(1) and 125.5(1), the definition “taxable supplier” in subsection 127(9), subparagraph 128.1(4)(*b*)(ii), paragraphs 181.3(5)(*a*) and 190.14(2)(*b*), subsection 206(1.3), the definition "Canadian banking business" in subsection 248(1) and paragraph 260(5)(*a*) of the Act, a “permanent establishment” of a person or partnership (referred to in this section as the “person”) means a fixed place of business of the person, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse and, where the person does not have any fixed place of business, the principal place at which the person’s business is conducted, and

7. (1) Section 9204 (proposed) of the Regulations is amended by adding the following after subsection (2):

Winding-up into Authorized Foreign Bank

(2.1) If subsection 142.7(13) of the Act applies in respect of the winding-up of a Canadian affiliate of an entrant bank, subsection (2) applies with respect to the winding-up and, for this purpose, the references in subsection (2) to "subsection 88(1)", "taxpayer" and "parent" shall be read as references to "subsection 142.7(13)", "Canadian affiliate" and "entrant bank", respectively.

(2) Subparagraph 9204(5)(*a*) (proposed) of the Regulations is replaced by the following:

(*a*) any time a taxpayer ceases to carry on all or substantially all of a business, otherwise than as a result of a merger to which subsection 87(2) of the Act applies, a winding-up to which subsection 88(1) or 142.7(13) of the Act applies or a transfer of the business to which subsection 98(6), 138(11.5) or (11.94) of the Act applies,

(3) Section 9204 (proposed) of the Regulations is amended by adding the following after subsection (5):

Non-Resident Taxpayer

(5.1) For the purpose of subsection (5), a non-resident taxpayer is considered to cease to carry on all or substantially all of a business if the taxpayer ceases to carry on, or ceases to carry on in Canada, all or substantially all of the part of the business that was carried on in Canada.

APPLICATION

8. (1) Sections 1 and 2, subsection 4(3) and sections 5 and 6 apply after June 27, 1999.

(2) Subsections 3(1), (3), (4), (6), (7) and (9) apply to taxation years that begin after 1995.

(3) Subsections 3(2), (5) and (8) apply to taxation years that end after November 1991.

(4) Subsection 3(10) applies to taxation years that end after August 11, 1993.

(5) Subsection 3(11) applies to taxation years that end after June 27, 1999.

(6) Subsections 4(1), (2) and (4) apply to the 2001 and subsequent taxation years.

(7) Section 7 applies after June 27, 1999 in respect of an authorized foreign bank, and after ANNOUNCEMENT DATE in any other case.

Explanatory Notes

PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act*. These explanatory notes describe theses amendments, clause by clause for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act*. These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

FOREIGN BANK BRANCHES

EXPLANATORY NOTES

Clause 1

Eligible Capital Property

ITA
14

Section 14 of the *Income Tax Act* provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties. The rules operate on a pooling basis, and annual deductions, calculated as a percentage of this pool, may be claimed under paragraph 20(1)(*b*). This section is amended by adding new subsections 14 (14) and (15) of the Act. These rules complement existing or proposed provisions in subsections 10(12) and (13) and 13(9), paragraph 45(1)(*d*) and new section 76.1 of the Act.

Ceasing to Use Property in Canadian Business

ITA
14(14)

Under new subsection 14(14) of the Act, a non-resident taxpayer that at any particular time ceases to use eligible capital property in a business in Canada – otherwise than by actually disposing of the property – will be treated as having disposed of the property immediately before the particular time. The provision applies, for example, if a taxpayer removes eligible capital property from a business carried on in Canada and begins to use it in a business carried on outside Canada. The taxpayer is deemed to receive proceeds of disposition equal to the property's fair market value immediately before the particular time. If the property was previously used in a business outside Canada, the deemed proceeds are reduced by any excess of the property's fair market value when it began to be used in Canada over its cost at that time. New subsection (15) will have set the cost of the property at the lesser of its cost and fair market value at that time. Therefore, the adjustment to the deemed proceeds on removal of the property from Canada ensures that only the change in value of the property during the time it was used in the Canadian business is taken into account at the time of removal.

New subsection 14(14) applies after June 27, 1999 in respect of an authorized foreign bank, and after Announcement Date in any other case.

Beginning to Use Property in Canadian Business

ITA
14(15)

New subsection 14 (15) of the Act treats a non-resident taxpayer that ceases to use eligible capital property in a business outside Canada, and begins using that property in a business in Canada as having disposed of the property and reacquired it for an amount equal to the lesser of the cost of the property and its fair market value at the time immediately before it begins to be used in the Canadian business.

New subsection 14(15) applies after June 27, 1999 in respect of an authorized foreign bank, and after Announcement Date in any other case.

Clause 2

Deductions – General Limitations - Interest

ITA
18(1)(*v*)

Subsection 18(1) of the Act contains a list of general deductions that are prohibited when determining a taxpayer's income. This list is expanded by adding new paragraph 18(1)(*v*) of the Act, which denies a deduction to an authorized foreign bank (newly defined in subsection 248(1) of the Act) for any amount in respect of interest that would otherwise be deductible in computing the bank's income from a business carried on in Canada, except as provided in new section 20.2 of the Act. New paragraph 18(1)(*v*) applies after June 27, 1999.

Thin Capitalization - Definitions

ITA
18(5)

Subsection 18(5) of the Act defines certain expressions for the purpose of the "thin capitalization" rules in subsections 18(4) to (8). In certain circumstances, the thin capitalization rules limit a corporation's deduction of interest expense. The rules' application depends on the amount of the corporation's "outstanding debts to specified non-residents" – a term defined in subsection 18(5).

Paragraph (*b*) of this definition currently provides an exclusion for certain obligations owing to non-resident insurers. The paragraph is amended to provide as well an exclusion for an obligation owing to an authorized foreign bank, if the bank uses or holds the obligation in its Canadian banking business (defined in a new definition in subsection 248(1) of the Act).

This amendment applies after June 27, 1999.

Clause 3

Interest – Authorized Foreign Bank

ITA
20.2

New section 20.2 of the Act contains rules that allow an authorized foreign bank operating in Canada to deduct, in computing its income from its Canadian banking business for a taxation year, amounts on account of interest expense. Given new paragraph 18(1)(*v*) of the Act (see separate note), this new section is comprehensive and exclusive: in computing its Canadian business income, an authorized foreign bank may only deduct amounts on account of interest that are authorized under section 20.2.

Under new section 20.2, each taxation year of an authorized foreign bank is divided into "calculation periods," which may be designated by the bank in its tax return for the year, subject to certain conditions described below, or, in the absence of such a designation, by the Minister of National Revenue. The amount that the bank may deduct on account of interest for a given year is the total of the deductible amounts determined for all the calculation periods in the year. Those deductible amounts may include one or more of the following:

- Interest expense actually incurred by the bank in the period, in relation to actual liabilities of the Canadian banking business to other persons or partnerships;
- Interest expense notionally incurred by the Canadian banking business in the period, in relation to documented "branch advances" from the bank itself to the business; and
- A residual amount, representing interest for the period calculated at the Bank of Canada bank rate on an amount not exceeding the amount by which 95% of the value of the Canadian banking business's assets exceeds the total of its actual liabilities and its branch advances.

These three categories of branch interest expense reflect the fact that an authorized foreign bank's Canadian operations may be funded through some combination of three sources of funds. First, the bank may, in the course of its Canadian operations, borrow directly from other persons or partnerships, recording the resulting obligation as a liability of the Canadian business itself. Second, the bank – typically, the bank's head office or other central source of internal financing – may advance funds to the Canadian business, with the lending unit recording the advance in more or less the same way it would an arm's length loan (and applying comparable terms – see below) and the branch recording it as a notional liability. Third, the bank may use its own, undifferentiated funds to operate the branch, without formally recording an advance to the branch.

Regardless what combination of these three sources is used for a given calculation period, section 20.2 limits the amount that the authorized foreign bank may deduct on account of its Canadian business's interest expense. On the principle that an authorized foreign bank's capital structure will include at least 5% of equity, interest is not deductible to the extent it reflects debt in excess of 95% of the value of the assets of the Canadian banking business at the end of the period.

Reference should also be had to the relationship between interest expense deductions under new section 20.2 and the "branch tax" under Part XIV of the Act, described in connection with the amendments to that Part.

New subsection 20.2 applies after June 27, 1999, except that a special transitional rule (described in the detailed notes to subsection 20.2(1), below) applies to branch advances made before the day that is 14 days after Announcement Date.

Definitions

ITA
20.2(1)

New subsection 20.2 (1) of the Act sets out definitions for the purposes of new section 20.2.

"branch advance"

A branch advance of an authorized foreign bank at a particular time means an amount allocated or provided by or on behalf of the bank to or for the benefit of the bank's Canadian banking business under terms that are documented, before the amount is allocated or provided, in a manner similar to the bank's documentation of loans to arms-length parties. It is contemplated that the documentation would relate to terms of the advance itself such as currency, amounts, further advances, time when repayment is required, computation of interest, payment of interest, prepayment rights, extensions and other amendments to terms, use of the funds, and whether or not the loan is considered to be secured. However, separate documentation setting out the terms of such security would not be required.

To accommodate authorized foreign banks that may already have begun to finance their Canadian operations, the requirement for prior documentation is modified in the case of branch advances made before the day that is 14 days after Announcement Date: such advances need only be documented on or before December 31, 2000.

"branch financial statements"

The branch financial statements of an authorized foreign bank for a taxation year are the unconsolidated statements of assets and liabilities, and income and expenses, for that year in respect of its Canadian banking business that are required, under the *Bank Act*, to be prepared and filed with the bank's annual

report to the Superintendent of Financial Institutions. If no such statements are required to be prepared for the taxation year, the term refers to statements that are prepared in a manner consistent with those that are required to be prepared for the annual report so filed.

"calculation period"

A calculation period of an authorized foreign bank for a taxation year means any of a series of regular periods into which the year is divided in a designation by the bank or in a designation by the Minister, such that:

- the periods in the year are regular (as, for example, monthly, weekly or daily);
- no period is longer than 31 days;
- the year's first period starts at the beginning of the year, and its last one ends at the end of the year; and
- except as authorized in writing by the Minister, the year's periods are consistent with the periods designated for the preceding taxation year.

Formula Elements

ITA
20.2(2)

New subsection 20.2(2) of the Act sets out five elements that are used in the formulas contained in new subsection (3) (described below). These elements, which are set out in terms of a given calculation period during the taxation year of an authorized foreign bank, are importantly qualified by new subsection (4) (described below).

The elements are identified with letters that reflect their meaning.

A is the amount of the bank's assets used in the Canadian banking business at the end of the relevant calculation period.

BA is the amount of the bank's branch advances at the end of the period.

IBA is that total of all reasonable amounts on account of notional interest for the period, with respect to branch advances, that would (but for new paragraph 18(1)(*v*) and section 20.2 itself) be deductible if the branch advances were actual indebtedness of the bank to another person and if paragraph 18(1)(*v*) were ignored. New subsection 20.2(5) of the Act (described below) provides additional guidance as to what is a reasonable amount on account of notional interest.

IL is the total of all amounts on account of interest for the period in respect of a liability of the bank in respect of the Canadian business to another

person or partnership that would, but for new paragraph 18(1)(*v*) and section 20.2 itself, be deductible.

L is the amount of the bank's liabilities in respect of the Canadian business to other persons and partnerships at the end of the period.

Interest Deduction

ITA
20.2(3)

The core of new section 20.2 of the Act is new subsection 20.2(3). This subsection contains formulas that are used to calculate the amount deductible, in computing the Canadian business income of an authorized foreign bank, on account of interest expense for each calculation period of the bank in a taxation year. The bank's maximum deduction on account of interest for the year will be the total of the amounts determined under these formulas for each of the calculation periods in the year.

An ordering principle underlies subsection 20.2(3). Interest expense is deductible first in respect of actual liabilities of the Canadian banking business to other persons or partnerships, to the extent those liabilities do not exceed 95% of the business's assets. Next, to the extent those liabilities are equal to less than 95% of the business's assets, interest may be deducted in respect of branch advances. Finally, if liabilities and branch advances together are less than 95% of assets, the bank may choose to deduct interest, computed by reference to the Bank of Canada bank rate, in respect of a residual "top-up" amount not exceeding the amount by which the 95% figure exceeds the total of liabilities and branch advances.

More specifically, subsection 20.2(3) applies one of three different formulas to the interest-deductibility calculation for a given calculation period. First, if the bank's liabilities to others (element L) at the end of the calculation period by themselves exceed 95% of its assets (A), the formula set out in new subparagraph 20.2(3)(*a*)(ii) applies for the period. That formula generally allows the bank to deduct that proportion of its actual interest expense in respect of liabilities to others (IL) that 95% of its assets (A) is of its liabilities (L).

Second, if the bank's liabilities to others (L) and its branch advances (BA) at the end of the calculation period total 95% or more of the amount of its assets (A) at that time, but its liabilities alone (i.e. without its branch advances) do not exceed that 95% figure, the formula set out in new subparagraph 20.2(3)(*a*)(i) applies for the period. In broad terms, that formula allows the bank to deduct its actual interest expense in respect of liabilities to others (IL), together with that proportion of its notional interest expense in respect of branch advances (IBA), that the excess of 95% of its assets is of its liabilities.

Third, if liabilities to others (L) and branch advances (BA) at the end of the calculation period total less than 95% of assets (A), the bank may deduct the total

of its actual interest expense in respect of liabilities (IL), its notional interest in respect of its branch advances (IBA), and interest at a specified rate on a residual top-up amount described in new subparagraph 20.2(3)(*b*)(ii) of the Act. That top-up amount is any amount the bank chooses to claim, not exceeding the amount by which 95% of assets (A) exceeds the total of liabilities (L) and branch advances (BA). The interest rate applicable to this elective top-up is the average, based on daily observations, of the Bank of Canada bank rate for the calculation period.

Branch Amounts

ITA
20.2(4)

New subsection 20.2(4) applies in determining the amounts in the descriptions of the formula elements in subsection (2) – which are used in the formulas in subsection (3) – and the amounts of an authorized foreign bank's assets, liabilities and branch advances for the purpose of subsection (3). Subsection (4) provides that these amounts must be in respect of the bank's Canadian banking business only, and must be recorded in the business's books of account in a manner consistent with the manner in which they are required to be treated for the purposes of the branch financial statements. Effectively, no deduction is permitted in respect of interest or liability amounts that are not recorded in the bank's books of account.

Notional Interest

ITA
20.2(5)

New subsection 20.2(5) of the Act provides clarification as to what constitutes, in applying the formula element "IBA" set out in subsection 20.2(2), a reasonable amount on account of notional interest in respect of a branch advance. A reasonable amount is described in subsection (5) as the amount that would be payable by a notional borrower, having regard to the time to repayment, the currency and all other terms, if:

- the notional borrower were a person dealing at arm's length with the bank, and carried on the bank's Canadian banking business and had the same credit-worthiness and borrowing capacity as the bank;
- the branch advance were a loan by the bank to the notional borrower; and
- the terms of the advance – excluding the interest rate itself, but including such terms as the method of calculating the interest rate where it is a structured rate that relies on external references, the currency of the loan, the time to repayment, provisions for early repayment and amendment – were terms that would be agreed to by the bank and the notional borrower, having regard to all the circumstances (including but not limited to the nature of the Canadian

banking business, the use of the advanced funds, the presence or absence of a hedge and normal banking practice).

In essence, a reasonable amount of interest is the amount that would be payable in the circumstances in a transaction between arm's length parties if the other terms of the advance themselves were those that would be agreed to in the circumstances by such parties.

Clause 4

International Banking Centres - Definitions

ITA
33.1(1)

Section 33.1 of the Act provides special rules for "international banking centres" (IBCs). Subsection 33.1(1) defines certain terms used in the section.

The definition "foreign bank" in subsection 33.1(1) is amended to provide that an authorized foreign bank is not considered to be a foreign bank with respect to its Canadian banking business.

This amendment applies after June 27, 1999.

Clause 5

Non-Resident Moving Debt from Canadian Business

ITA
76.1

New section 76.1 of the Act sets out rules that apply where a debt obligation denominated in a foreign currency, of a non-resident taxpayer that carries on business in Canada, either ceases to be or becomes an obligation in respect of the business. These rules ensure that income, gains and losses due to currency fluctuations are appropriately measured.

New subsection 76.1(1) applies any time a foreign-currency debt obligation ceases to be an obligation of a non-resident's Canadian business (otherwise than because the non-resident ceased to be indebted under the obligation). The subsection treats the non-resident, for the purposes of determining any income, loss, capital gain or capital loss due to foreign exchange fluctuation, as having settled the debt immediately before that time for its principal amount. This ensures that any foreign currency gain or loss that accrued during the time the debt was associated with the Canadian business is captured when the debt is transferred out of the Canadian business.

Similarly, new subsection 76.1(2) applies where a non-resident taxpayer's Canadian business acquires a foreign-currency debt obligation that the non-resident formerly held outside the business. This subsection provides that the amount to be used for the purposes of calculating any income, loss, capital gain or capital loss with respect to the debt because of foreign exchange fluctuations is the amount of the debt obligation in Canadian dollars at the time the debt became an obligation of the Canadian business. This ensures that only currency fluctuations from the time the debt was assumed by the Canadian business are subsequently taken into account.

New section 76.1 applies after June 27, 1999 in respect of an authorized foreign bank, and after Announcement Date in any other case.

Clause 6

Canadian-Source Income

ITA
95(2)(*a*.3)

Subsection 95(2) of the Act provides rules for determining the income of a foreign affiliate of a taxpayer resident in Canada from a particular source. Paragraph 95(2)(*a*.3) includes in the income from a business other than an active business – and thus the foreign accrual property income – of a foreign affiliate of a taxpayer resident in Canada, the income of the affiliate derived directly or indirectly from most forms of indebtedness or lease obligations of persons resident in Canada or in respect of businesses carried on in Canada. Currently excluded from the income treated in this way is income that derives from specified deposits with a prescribed financial institution. Paragraph 95(2)(*a*.3) is amended to exclude as well any income that is earned in a business carried on by the affiliate through a permanent establishment in Canada. Such business income is already subject to full Canadian taxation, and need not be added to the affiliate's income under this provision.

This amendment applies for taxation years that begin after 1999.

Clause 7

Losses Deductible - Definitions

ITA
111(8) "non-capital loss"

Section 111 of the Act establishes the extent to which a taxpayer is permitted to deduct amounts in computing the taxpayer's taxable income for the year in respect of losses of other taxation years.

Subsection 111(8) includes the definition “non-capital loss.” The definition, which takes the form of a formula, includes in a corporation's non-capital loss for a taxation year any amount the corporation has added to its taxable income under section 110.5 of the Act – a rule that in certain circumstances permits a corporation to increase its taxable income in order to increase the corporation’s foreign tax credit.

The definition “non-capital loss” is amended to add a reference to amounts determined under new subparagraph 115(1)(*a*)(vii) of the Act. That provision, which applies to authorized foreign banks, replicates the effect of section 110.5.

This amendment applies after June 27, 1999.

Clause 8

Foreign Tax Credit – Additional Amount

ITA
115(1)(*a*)

Section 115 of the Act provides rules for the calculation of the “taxable income earned in Canada” of a non-resident person, which is subject to tax under Part I. This amount includes Canadian-source employment and business income, taxable capital gains on taxable Canadian property, and certain other income amounts.

Paragraph 115(1)(*a*) is amended to add new subparagraph (vii), which includes in the taxable income earned in Canada of an authorized foreign bank the amount claimed by the bank to the extent that the inclusion increases the bank’s usable foreign tax credit under subsection 126(1) but does not increase any amount deductible by the bank under section 127 of the Act. This addition to taxable income earned in Canada parallels the addition to taxable income that is available to corporations resident in Canada under existing section 110.5 of the Act.

New subparagraph 115(1)(*a*)(vii) applies after June 27, 1999.

Clause 9

Foreign Tax Credit

ITA
126(1.1)

Section 126 of the Act provides rules under which taxpayers may deduct, from tax otherwise payable under Part I of the Act, amounts they have paid in respect of foreign taxes. These “foreign tax credits,” which are differently calculated and differently applied in respect of foreign business- and non-business-income taxes paid by the taxpayer, are generally available only to persons resident in Canada.

These amendments give an authorized foreign bank access to credits for foreign non-business-income tax paid in respect of its Canadian banking business.

The amendments consist principally of a series of directions to read the existing foreign tax credit rules (and certain related provisions) in special ways. These directions are set out in new subsection 126(1.1) of the Act as follows:

- An authorized foreign bank is deemed to be resident in Canada, in respect of its Canadian banking business, for the purposes of the foreign non-business-income tax credit in subsection 126(1) of the Act, the limitations on that credit in subsections 126(4) to (5), the interpretive and related rules in subsection 126(6), and the definitions in subsection 126(7).
- The references in subsection 20(12) of the Act (deduction for foreign tax) and paragraph 126(1)(*a*) to a country other than Canada are to be read as references to a country that is neither Canada nor a country in which the authorized foreign bank is resident at any time in the year. This ensures, in keeping with standard international practice, that Canada – and not the bank's home country – retains the first right to tax the bank's Canadian business income (subject to credit for third-country taxes).
- The limit on the foreign non-business-income tax credit, in paragraph 126(1)(*b*), is computed by reference to the lesser of the authorized foreign bank's taxable income earned in Canada and its income for the year from its Canadian banking business (together with any addition under new subparagraph 115(1)(*a*)(vii)), rather than by reference to its income. Without this special reading, the bank's foreign tax credits would be inappropriately constrained if, for example, the bank had a large amount of income outside its Canadian business.
- The non-business-income tax paid by an authorized foreign bank to the government of another country is restricted to taxes that relate to amounts included in computing the bank's taxable income earned in Canada from its Canadian banking business.
- The definition "tax-exempt income" in subsection 126(7) is modified to describe tax agreements or conventions between an authorized foreign bank's home country and another country rather than using the defined term "tax treaty," which encompasses only a treaty between Canada and another country.

New subsection 126(1.1) applies after June 27, 1999.

Portion of Foreign Tax Not Included

ITA
126(4)

Subsection 126(4) of the Act excludes from a taxpayer's creditable foreign taxes amounts that would not be imposed if the taxpayer were not entitled to a deduction under section 113 or section 126 of the Act. The subsection is amended to use the new defined term "government of a country other than Canada." (See the notes to amended subsection 126(6).)

This amendment, which makes no substantive change, applies after June 27, 1999.

No Economic Profit

ITA
126(4.1)

Subsection 126(4.1), which limits a taxpayer's foreign tax credits in certain cases where there is no reasonable expectation of profit, is amended to use the newly defined term "government of a country other than Canada", and to correct a minor drafting error in the English version.

This amendment, which makes no substantive change, applies after June 27, 1999.

Dispositions Ignored

ITA
126(4.4)

Subsection 126(4.4) of the Act directs that certain dispositions and acquisitions of property be ignored for the purposes of the foreign tax credit limitations in subsections 126(4.1) and (4.2) of the Act. Paragraph 126(4.4)(*a*) is amended to add to this list dispositions and acquisitions under new subsections 14(14) and (15) and 142.6(1.1) and (1.2) of the Act, as well as proposed subsections 10(12) and (13) of the Act, which are set out in the Notice of Ways and Means Motion tabled in the House of Commons on June 5, 2000.

These amendments apply after June 27, 1999.

Foreign Tax

ITA
126(5)

Ordinarily, the only foreign taxes that may be credited against tax under Part I of the Act are income or profits taxes. Subsection 126(5) of the Act provides that a foreign tax may, subject to prescribed conditions, be deemed to be an income or profits tax. No such conditions are in place, and the subsection has no practical

effect other than as a source of potential confusion. It is therefore repealed, with effect after June 27, 1999.

Rules of Construction

ITA
126(6)

Subsection 126(6) of the Act confirms that foreign tax credits are computed on a country-by-country basis. This confirmation is preserved in new paragraph 126(6)(*b*), and the provision is expanded to include two other rules that apply for the purposes of section 126. First, new paragraph 126(6)(*a*) provides that the government of a country other than Canada includes the government of a state, province or other political subdivision of such a country. This new meaning allows several of the foreign tax credit rules to be simplified. Second, new paragraph 126(6)(*c*) provides that if income from a source in a country would be "tax-exempt income," but is not so only because part of the income is subject to tax, that part is deemed to be income from a separate source in the country. This rule, already found in subsection 126(8) of the Act, is simplified by the use of the new term set out in paragraph (*a*), and subsection 126(8) is consequently repealed.

These amendments apply after June 27, 1999.

Definitions

ITA
126(7) "business-income tax"
"economic profit"
"non-business-income tax"

The definitions "business-income tax," "economic profit," and "non-business-income tax" in subsection 126(7) of the Act are simplified through the use of the new term "government of a country other than Canada." In addition, the language of the definition "business-income tax" is improved by replacing the term "any business" with the term "a business."

These amendments, which make no substantive change, apply after June 27, 1999.

Clause 10

Securities Held by Financial Institutions - Definitions

ITA
142.2(1)

Subsection 142.2(1) of the Act defines several terms for the purposes of the rules in sections 142.2 to 142.6 relating to securities held by financial institutions. These terms include "financial institution", "mark-to-market property" and

"specified debt obligation". The subsection is amended to specify that the definitions also apply for the purposes of the new rules in section 142.7 of the Act relating to the conversion of foreign bank affiliates to branch operations.

This amendment applies after June 27, 1999.

Clause 11

Additional Rules

ITA
142.6

Section 142.6 of the Act contains rules dealing with special situations involving securities held by financial institutions. This section is amended by adding new subsections 142.6(1.1) and (1.2), which deal with securities that a non-resident financial institution (other than a life insurer – dealt with in subsection 138(11.3) of the Act) begins or ceases to use in a Canadian business. These rules complement existing or proposed provisions in subsections 10(12) and (13), 13(9), new 14(14) and (15), paragraph 45(1)(*d*) and new section 76.1 of the Act. An application rule is set out in new subsection 142.6(1.3) and subsection 142.6(2) is modified to take into account the deemed dispositions and acquisitions in new subsections (1.1) and (1.2).

Ceasing to Use Property in Canadian Business

ITA
142.6(1.1)

New subsection 142.6(1.1) of the Act provides that a non-resident financial institution (other than a life insurer) that at a particular time ceases to use a mark-to-market property or a specified debt obligation in a business in Canada – otherwise than by actually disposing of the property – will be treated as having disposed of the property two moments before the particular time. The provision applies, for example, if a taxpayer removes such property from a business carried on in Canada and begins to use it in a business carried on outside Canada. The taxpayer is deemed to receive, in the course of carrying on the business, proceeds of disposition equal to the property's fair market value and to re-acquire the property at the particular time at a cost equal to those proceeds. Paragraph 142.6(1.1)(*b*) indicates that the rule in subsection 142.4(11) relating to payments received after a disposition is not applicable with respect to this deemed disposition.

Beginning to Use Property in Canadian Business

ITA
142.6(1.2)

New subsection 142.6(1.2) of the Act provides that a non-resident financial institution (other than a life insurer) that begins to use a mark-to-market property or a specified debt obligation in a business in Canada – other than a property that the taxpayer acquired at that time – is deemed to dispose of the property two moments before the particular time, and to reacquire it at the particular time, for an amount equal to its fair market value.

Specified Debt Obligation Marked to Market

ITA
142.6(1.3)

New subsection 142.6(1.3) of the Act is an interpretive rule regarding the application of paragraph (*b*) of the definition "mark-to-market property" in subsection 142.2(1) – dealing with specified debt obligations that are marked to market - in the context of new subsection 142.6(1.1). The rule indicates that in determining whether a specified debt obligation is a mark-to-market property, the taxation year in which the property ceases to be used in the Canadian business is deemed to have ended immediately before the time of that cessation. (If financial statements are not prepared for the period thus ending, the reference in the definition to financial statements is to be read as a reference to the statements that it is reasonable to expect would have been prepared if the year ended at that time.) This ensures that a specified debt obligation that is marked to market in the Canadian business will be considered for the purposes of subsection 142.5(1) to have been disposed of when it ceases to be used in the Canadian business, even if it does not continue to be marked to market for financial statement purposes after it is transferred out of the Canadian business.

Deemed Disposition Not Applicable

ITA
142.6(2)

Subsection 142.6(2) provides that for the purposes of the Act a deemed disposition and reacquisition of a share under certain rules relating to securities held by financial institutions does not affect the time at which a taxpayer is considered to have acquired the share. This provision is amended to add a reference to new subsections 142.6(1.1) and (1.2).

These amendments to section 142.6 apply after June 27, 1999 in respect of an authorized bank and after Announcement Date in any other case.

Clause 12

Conversion of Foreign Bank Affiliate to Branch

ITA
142.7

New section 142.7 of the Act, which applies after June 27, 1999, provides special, time-limited rules to facilitate foreign banks' transformation of certain Canadian operations, currently carried out through subsidiaries, into Canadian branches of the foreign banks themselves. The section includes three main forms of relief:

- The "branch-establishment rollover" rules allow a tax-deferred transfer of certain eligible property from an eligible subsidiary – a "Canadian affiliate" – to a foreign bank that is starting branch operations in Canada – an "entrant bank." Specific rules deal with particular kinds of property such as specified debt obligations, mark-to-market properties, and properties in respect of which certain reserves would be taken, as well as the consequences of assuming debt obligations.
- The "branch-establishment dividend" rules allow property to flow from a Canadian affiliate to an entrant bank (or to an affiliate resident in the same country as the bank) as a tax-free dividend, provided the entrant bank redeploys the dividend proceeds in its Canadian banking business.
- Where the Canadian affiliate is wound up as part of the entrant bank's move into Canada, special loss rules allow the entrant bank to inherit the affiliate's non-capital and net capital losses, on much the same terms as a Canadian corporation inherits the losses of its wound-up Canadian subsidiary. A special rule ensures continuity of amortization schedules in respect of specified debt obligations in these circumstances.

All of these provisions are subject to timing constraints and other conditions described in detail in the following notes.

Definitions

ITA
142.7(1)

New subsection 142.7(1) of the Act sets out definitions that apply in the section.

"Canadian affiliate"

A Canadian corporation is a "Canadian affiliate" of an "entrant bank" (see below) at a particular time if the corporation is a bank, a trust company or a non-bank subsidiary in which the entrant bank is authorized to invest under certain provisions of the *Bank Act*, and it has been affiliated with the entrant bank continuously from February 11, 1999 to the particular time.

“eligible property”

The definition of a Canadian affiliate’s “eligible property” for purposes of new section 142.7 incorporates by reference paragraphs (*a*) to (*g*.1) of the definition, in subsection 85(1.1) of the Act, that applies for transfers under subsection 85(1) of the Act. Provided they are used or held by the Canadian affiliate immediately before the relevant time in carrying on its business in Canada, eligible properties thus generally include:

- capital property;
- Canadian and foreign resource property;
- eligible capital property;
- inventory (other than real property);
- securities and debt obligations that are neither capital, inventory nor mark-to-market properties and that are used or held by the affiliate in the course of an insurance or money-lending business; and
- specified debt obligations (other than mark-to-market properties).

“entrant bank”

An “entrant bank” is a non-resident corporation that is an “authorized foreign bank” (see the notes to subsection 248(1) of the Act, below), or that has applied to the Superintendent of Financial Institutions to become an authorized foreign bank.

Amalgamation and Merger

ITA
142.7(2)

In general, the rules in new section 142.7 of the Act apply only where a foreign bank has operated a Canadian subsidiary since at least February 11, 1999. In some cases, however, two or more foreign banks may have amalgamated or otherwise merged after that date to form a new entrant bank. New subsection 142.7(2) ensures that the merged bank and its Canadian subsidiary or subsidiaries are not disqualified from the benefits of the section.

Specifically, the subsection provides that a corporation that would, immediately before the merger, have been a Canadian affiliate of one of the merging banks if the bank were an entrant bank at that time, is deemed to have been affiliated with the merged entrant from February 11, 1999 to the time of the merger. As well, if two or more Canadian subsidiaries of merging entrant banks themselves amalgamate or merge after February 11, 1999, the new merged subsidiary is treated as having been affiliated with the merged entrant bank since that date.

Branch-Establishment Rollover

ITA
142.7(3)

New subsection 142.7(3) of the Act allows an entrant bank's Canadian affiliate to transfer eligible property to the entrant bank on a tax-deferred basis. The model for this "branch-establishment rollover" is the tax-deferred transfer of property by a shareholder to a corporation under existing subsection 85(1) of the Act, and subsection 142.7(3) is structured in large part as a modification of subsection 85(1). The most notable difference between the two types of transaction is that the branch-establishment rollover, unlike the subsection 85(1) transfer, does not require that the transferor (the Canadian affiliate) take back a share of the transferee corporation (the entrant bank) as consideration.

In order to carry out a branch-establishment rollover, the entrant bank and its Canadian affiliate must meet two special conditions. First, immediately after the transfer the entrant bank must use or hold the eligible property in question in its "Canadian banking business" (see the notes to subsection 248(1) of the Act, below). Second, the entrant bank and the Canadian affiliate must jointly elect in accordance with subsection 142.7(11), described below.

Where these conditions are met, subsections 85(1) (except for paragraph (*e*.2)), (1.1), (1.4) and (5) of the Act apply to the transfer, except that the opening words of subsection 85(1) are modified to refer to the Canadian affiliate and the entrant bank, to remove the requirement that the consideration for the transfer include a share, and to refer to subsection 142.7(11).

It is proposed that a reference to new subsection 142.7(3) be added to subsection 5301(7) of the *Income Tax Regulations*, to ensure carry-over a Canadian affiliate's instalment base to the entrant bank if all or substantially all of the affiliate's property is transferred to the bank.

Shareholder Benefit

ITA
142.7(4)

A number of provisions of the Act, including subsections 15(1), 69(1), (4) and (5) and 247(2), may apply where a transaction between a corporation and its non-resident shareholder takes place on terms that do not reflect arm's length or fair market value standards. New subsection 142.7(4) of the Act limits the application of these rules where an entrant bank and its Canadian affiliate elect to have new subsection 142.7(3) of the Act apply to the affiliate's transfer of a property to the bank.

Provided the affiliate has at least received consideration that is equal to the elected amount in respect of the property, new subsection 142.7(4) provides that the rules listed above will not apply to the transfer just because the affiliate has

received less than fair market value proceeds in consideration for the property. (This does not exclude the possibility that those rules might apply for other reasons.)

Specified Debt Obligations

ITA
142.7(5)

New subsection 142.7(5) of the Act applies where a Canadian affiliate that is a financial institution (as defined in subsection 142.2(1)) transfers a specified debt obligation (that is not a mark-to-market property) to the affiliate's entrant bank, and the affiliate and the bank elect to transfer the obligation at its tax cost under the new branch-establishment rollover provisions. New subsection 142.7(5) is a continuity rule that deems the entrant bank to be the same corporation as, and a continuation of, the Canadian affiliate in respect of the obligation. This ensures that the tax treatment of the obligation is the same to the entrant bank as it would have been to the Canadian affiliate. Existing subsection 142.6(5) of the Act contains a similar continuity rule for other "rollover" transactions listed in subsection 142.6(6) of the Act.

Mark-to-Market Property

ITA
142.7(6)

New subsection 142.7(6) of the Act applies where a Canadian affiliate of the entrant bank transfers a mark-to-market property to the entrant bank within the period during which branch-establishment rollovers may be made. Paragraph 142.7(6)(*a*) provides that for the purpose of applying certain of the dividend stop-loss rules in section 112 relating to mark-to-market properties and determining whether certain specified debt obligations constitute "mark-to-market property" within the meaning of the definition in subsection 142.2(1), the entrant bank is deemed to be the same corporation as, and a continuation of , the Canadian affiliate. This provision may be compared to paragraph 87(2)(*e*.5) of the Act, which contains a similar rule.

Paragraph 142.7(6)(*b*) provides that for the purposes of the rule requiring marking-to-market at year-end, the Canadian affiliate's taxation year in which the property was transferred is deemed to have ended immediately before the time of transfer. This ensures that the property is marked-to-market for tax purposes at the time of transfer in spite of the continuity imposed by paragraph (*a*).

Reserves

ITA
142.7(7)

New subsection 142.7(7) of the Act provides an election that ensures continuity of reserve treatment upon transfer from a Canadian affiliate that is a financial institution to an entrant bank of certain assets and obligations in respect of which reserves have been claimed.

Subsection 142.7(7) applies to a transfer at fair market value of an instrument or commitment described in paragraph 20(1)(*l*.1), a loan or a lending asset that, immediately after the transfer, is owed, used or held by the entrant bank in its Canadian banking business. If the election is made, the taxation year of the Canadian affiliate in which the transfer is made is deemed to have ended immediately before the transfer for the purposes of the application of the deductions under paragraphs 20(1)(*l*) (reserve for doubtful or impaired debts), 20(1)(*l*.1) (reserve for credit risks under guarantees and other commitments) and 20(1)(*p*) (bad debts) of the Act. The deemed year-end allows the Canadian affiliate to claim a reserve for the year in which the obligation or property is transferred.

An amount deducted by the Canadian affiliate under any of those provisions in that year (and, with respect to subsection 20(1)(*p*), in previous years) is deemed to have been deducted by the entrant bank in its last taxation year that ended before the time of the transfer. This ensures that the reserve amounts will subsequently be included in the entrant bank's income and that the bank will be subject to an income inclusion if there is a subsequent recovery of a bad debt amount. Subsection 20(27) of the Act will typically ensure the entrant's bank's ability to claim a reserve in respect of the transferred obligations and properties.

Assumption of Debt Obligation

ITA
142.7(8)

In many cases, an entrant bank will assume some or all of its Canadian affiliate's debt obligations. Such an assumption may serve as consideration for the transfer of property by the affiliate to the entrant bank, either on a branch-establishment rollover or otherwise. Where this is the case, new subsection 142.7(8) of the Act applies to govern the tax consequences of the assumption.

New paragraph 142.7(8)(*a*) of the Act provides an election to assume a debt obligation at face value and so can ensure that changes in the value of the obligation that result from, for example, interest rate changes since the affiliate issued or acquired the obligation, do not produce an immediate tax consequence Under subparagraph (*a*)(i), where a joint election is made in accordance with subsection (11), for the purpose of determining the consequences of the

disposition of the property, the consideration for its transfer is deemed to be the outstanding principal amount of the obligation – referred to as the "settlement amount". The settlement amount is also considered to be the amount of consideration given to the bank for the assumption of the obligation. This is relevant to determining whether or not the assumption gives rise to debt forgiveness consequences or a loss to the affiliate, as well as the consequences to the entrant bank of eventual settlement of the obligation. Subparagraph (*a*)(ii) provides that assumption of the obligation at the settlement amount (even if that differs from the fair market value of the obligation) is not considered a non-arm's length term. This is relevant for such purposes as the transfer pricing rules in section 247 of the Act.

New paragraph 142.7(8)(*b*) of the Act provides an election to ensure that the assumption of a foreign currency debt obligation does not give rise to immediate tax consequences on account of foreign exchange fluctuations. Subsection (*b*)(i) provides for deferral of any foreign exchange gains or losses until the obligation is settled by the entrant bank. Subparagraph (*b*)(ii) ensures that the election in paragraph (*a*) operates net of foreign exchange effects.

Branch-Establishment Dividend

ITA
142.7(9), (10)

New subsections 142.7(9) and (10) of the Act allow an entrant bank to receive (directly or indirectly) a non-taxable dividend from its Canadian affiliate, provided certain conditions are met and provided the proceeds are immediately redeployed in the bank's Canadian branch operation.

New subsection 142.7(9) sets out the conditions for the payment of this "branch-establishment dividend." First, the Canadian affiliate must pay (or must be deemed to pay, as a result of transferring property) a dividend either to the entrant bank or to another person that is affiliated with the entrant bank and that is resident in the same country as the entrant bank. If, for example, an entrant bank does not hold the shares of its Canadian affiliate directly, but rather holds them through a holding company resident in its home country, the Canadian affiliate may pay a branch-establishment dividend to the holding company. Second, the Canadian affiliate and the entrant bank itself – whether or not the dividend is paid directly to the entrant bank – must jointly elect as set out in new subsection 142.7(11) of the Act to have these rules apply to the dividend.

Where these conditions are met, new paragraph 142.7(10)(*a*) of the Act provides that the dividend is deemed not to be a taxable dividend, except for the purposes of the dividend stop-loss rules in subsections 112(3) to (7) of the Act. The recipient of the dividend will thus not be subject to Canadian tax on the dividend, and a subsequent loss to the recipient on the shares of the Canadian affiliate may be adjusted to reflect that exemption.

The purpose of the tax exemption for branch-establishment dividends is to allow entrant banks to redeploy to their new Canadian branch operations the property (particularly retained earnings) that their Canadian affiliates hold in Canada. It is expected that normally the proceeds of any dividend to which these rules apply will immediately be used or held by the entrant bank in its Canadian banking business. Should this not be the case, it is appropriate that the dividend be subject to tax. New paragraph 142.7(10)(*b*) ensures this result by treating the dividend as having formed part of the entrant bank's prior-year "investment allowance" under paragraph 219(1)(*g*) of the Act, and thus including it in the bank's Part XIV branch tax base for the current year. To the extent the dividend proceeds have been redeployed to the entrant bank's Canadian banking business, they will figure in the bank's current-year investment allowance, and will be deducted from the branch tax base for the current year; to the extent they have not been so redeployed, they will be subject to the branch tax (which is comparable to withholding tax on a dividend).

In determining the addition to the paragraph 219(1)(*g*) amount, it should be noted that where a branch-establishment dividend is paid by, or arises from, a branch-establishment rollover of eligible property, the amount of the addition is reduced by any latent gain on the property. Since the amount of the dividend is the value of the property transferred, this rule ensures that the gain is deferred as long as long as the property remains deployed in the entrant bank's Canadian banking business.

Elections

ITA
142.7(11)

New subsection 142.7(11) of the Act sets out the procedural requirements for the various elections provided in the section. In general terms, an election is valid only if: (a) the entrant bank has, on or before March 31, 2001, formally applied for regulatory approval to operate in branch form in Canada; (b) the election is duly made on or before the earlier of the entrant bank's and the Canadian affiliate's filing-due date for the year in which the dividend or transfer was paid or made, as the case may be; and (c) the dividend or transfer is effected both (i) after a regulatory order has been made allowing the entrant bank to start operations in Canada in branch form, and (ii) before the earlier of December 31, 2002 and the day 6 months after the date of that order.

Winding-Up of Canadian Affiliate: Losses

ITA
142.7(12)

New subsection 142.7(12) of the Act sets out rules that give an entrant bank access to losses of its Canadian affiliate, where the affiliate is wound up as part of the entrant bank's commencement of Canadian operations.

Paragraphs 142.7(12)(*a*) through (*c*) set out the conditions that must be met for subsection (8) to apply. First, the Canadian affiliate must have been dissolved or wound up under the applicable corporate regulatory legislation: section 342 or 346 of the *Bank Act*, section 347 or 351 of the *Trust and Loan Companies Act*, or whatever other statutory provisions govern the winding-up of the affiliate. Second, the winding-up order or dissolution order must have been issued, or the wind-up accomplished, before the earlier of December 31, 2002 and the day six months after the Superintendent of Financial Institutions makes the order allowing the entrant bank to commence operations in Canada. Third, the entrant bank must carry on all or part of the Canadian business that the Canadian affiliate formerly carried on.

Where these conditions are met, new subsection 142.7(12) allows the entrant bank to treat the Canadian affiliate's unused non-capital losses and net capital losses as its own, in a similar manner as existing subsections 88(1.1) and (1.2) of the Act give a taxable Canadian corporation access to the losses of its wound-up Canadian subsidiary. The main features of these new rules are as follows:

- The Canadian affiliate's unused non-capital loss for a taxation year (the "loss year") from carrying on a business (the "loss business") in Canada is treated as a loss of the entrant bank from the loss business for its taxation year in which the Canadian affiliate's loss year ended. Losses in respect of a claim by the Canadian affiliate under section 110.5 (taxable income addition for foreign tax credit purposes) are also accommodated. (Paragraph (*d*))
- Similarly, the Canadian affiliate's unused net capital loss for a taxation year is treated as a net capital loss of the entrant bank for its taxation year in which the Canadian affiliate's loss year ended. (Paragraph (*f*))
- If control of the Canadian affiliate or of the entrant bank is acquired at any time, the affiliate's non-capital losses are streamed, and its net capital losses are blocked.
- Pre-acquisition non-capital losses of the affiliate are usable by the entrant bank in a given post-acquisition year only if it or the affiliate carries on the loss business throughout the year, and only to the extent of the income from that or a similar business (defined in a manner identical to that set out for Canadian corporations in existing paragraph 88(1.1)(*e*)). (Paragraph (*e*))

- The entrant bank may not use pre-acquisition net capital losses of the affiliate in any post-acquisition year. (Paragraph (*g*))
- Where a loss of the Canadian affiliate would be treated as a loss of the entrant bank for a year that begins after the date of the affiliate's dissolution order (or after its winding-up commences), the entrant bank can choose to treat the loss as having arisen in its immediately preceding year. This may enable the entrant bank to use the affiliate's final-year loss in its own first taxation year that begins after the dissolution of the affiliate. (Paragraph (*h*))

Winding-Up of Canadian Affiliate: SDOs

ITA
142.7(13)

New subsection 142.7(13) of the Act is a continuity rule that applies where a Canadian affiliate of an entrant bank is wound-up and all or part of its business is transferred to the entrant bank in accordance with the conditions in paragraphs 142.7(12)(*a*) to (*c*). In those circumstances, for the purpose of the amortization rules relating to specified debt obligations in paragraphs 142.4(*c*) and (*d*) of the Act, the entrant bank is deemed to be the same corporation as, and a continuation of, the Canadian affiliate. This ensures that, where a specified debt obligation was previously disposed of by the Canadian affiliate and the residual portion of the resulting gain or loss has been amortized over the remaining term to maturity of the obligation, the amortization schedule is not disrupted by the transfer of the affiliate's business to the entrant bank.

To implement this rule, it is proposed that section 9204 of the *Income Tax Regulations* be amended to extend the winding-up rule in subsection 9204(2) to the situation described in new subsection 142.7(13) of the Act and to exclude that situation from the rule in subsection 9204(5) of the Regulations dealing with cessation of business. On the other hand, it is proposed that this latter rule be extended to apply whenever a non-resident ceases to carry on all or substantially all of the part of its business that was carried on in Canada.

Clause 13

Assessment and Reassessment

ITA
152(4)(*b*)

Subsection 152(4) of the Act provides the time limits within which assessments, reassessments and additional assessments may be made. Paragraph (*b*) describes the circumstances in which the Minister of National Revenue may, after a taxpayer's normal reassessment period for a taxation year, assess or reassess tax payable under Part I of the Act for the year. The subsection is amended by adding

new subparagraph 152(4)(*b*)(iii.1), to allow the Minister under certain circumstances to assess or reassess, within three years after the end of the normal assessment period, the tax of a non-resident that carries on business in Canada. Such a (re)assessment may be made if it results from the taxpayer's allocation of revenue or expenses in respect of the Canadian business (unless the revenue or expenses relate solely to the Canadian business and are fully documented in Canada), or from a notional transaction between the taxpayer and its Canadian business, which transaction is recognized under the Act or a tax treaty. An example of such a notional transaction is a "branch advance" contemplated by new section 20.2 of the Act, which applies to a foreign bank that operates a branch in Canada. New subparagraph 152(4)(*b*)(iii.1) will treat such allocations and notional transactions in the same manner as transactions between a taxpayer and a non-resident person with whom the taxpayer does not deal at arm's length, which are covered by subparagraph (iii).

New subparagraph 152(4)(*b*)(iii.1) of the Act applies to the 2000 and subsequent taxation years.

Clause 14

Withholding

ITA
153

Section 153 of the Act authorizes the withholding of tax from certain payments, described in paragraphs 153(1)(*a*) to (*t*). The person making such a payment is required to remit the amount withheld to the Receiver General on behalf of the payee. Certain prescribed persons can make that remittance by depositing the withheld amount to the Receiver General's account at certain financial institutions, defined by reference to subsection 190(1).

Section 153 is amended to change the special purpose definition of financial institution with a reference to the new term "designated financial institution", which is defined in new subsection 153(6) of the Act. The language of the subsection is also updated, without changing its effect.

This amendment applies after June 27, 1999.

"Designated Financial Institution"

ITA
153(6)

New subsection 153(6) defines the term "designated financial institution", which is used in subsection 153(1), as a bank (other than an authorized foreign bank subject to the restrictions in subsection 524(2) of the *Bank Act – i.e.* one which operates as a so-called lending branch), a trust company and a deposit-taking

mortgage lender. The definition effectively includes only those authorized foreign banks that operate a so-called full-service branch in Canada.

New subsection 153(6) applies after June 27, 1999.

Clause 15

Payment by Corporations

ITA
157(1), (2.1)

Section 157 of the Act sets out the required payment dates for corporate income tax instalments and for any balance of corporate income tax payable. The list, in subparagraph 157(1)(*a*)(i), of Parts in respect of which monthly instalments are required is amended by adding a reference to new Part XIII.1 (the "additional tax on authorized foreign banks," or "branch interest tax"). The same reference is also added to the rules in paragraph 157(1)(*b*) that relate to the payment of the remainder of tax owing. As a result, a foreign bank's payments of Part XIII.1 tax will follow the same schedule as its payments of Part I tax.

Subsection 157(2.1) of the Act exempts a corporation from the requirement to pay its tax for a taxation year by instalments, where either the total of its taxes payable for the year or its "first instalment base" (defined by regulation) is $1,000 or less. The subsection is amended to include tax under new Part XIII.1 among the taxes covered by this rule.

These amendments apply to the 2001 and subsequent taxation years. More information on new Part XIII.1 itself is set out in the notes to new section 218.2 of the Act

Clause 16

Large Corporations Tax

ITA
Part I.3

Part I.3 of the Act imposes a tax (generally known as the "large corporations tax" or LCT) on the amount by which a large corporation's taxable capital employed in Canada exceeds a $10 million "capital deduction" (shared among related corporations).

Financial Institutions

ITA
181.3

Section 181.3 of the Act provides rules for determining the capital, taxable capital, taxable capital employed in Canada and investment allowance of a financial institution (as defined in subsection 181(1) of the Act) for the purposes of the LCT. The section is amended to include new rules, applicable after June 27, 1999, for determining these amounts in respect of an authorized foreign bank.

Taxable Capital Employed in Canada of Financial Institution

ITA
181.3(1)

Subsection 181.3(1) of the Act provides the rules for determining the amount of a financial institution's "taxable capital" - that is, its capital less its allowance for investments in related financial institutions – that is employed in Canada for purposes of Part I.3.

Subparagraph (*c*)(i) is amended to exclude authorized foreign banks, while subparagraph (*c*)(iv) is amended to specify that the relevant amount for an authorized foreign bank is its taxable capital for the year. It is not necessary to pro-rate this amount, since by definition all of the taxable capital of an authorized foreign bank is related to its Canadian banking business. By virtue of paragraphs 181.3(1)(*a*) and (*b*), the taxable capital employed in Canada of an authorized foreign bank also includes tangible property used in Canada.

These amendments apply after June 27, 1999.

Capital of Financial Institution

ITA
181.3(3)

Subsection 181.3(3) of the Act sets out the rules for calculating the capital of a financial institution for the purposes of Part I.3. This provision is amended to define a notional amount of capital for an authorized foreign bank.

Paragraph 181.3(3)(*a*) is amended to exclude authorized foreign banks from the general rule and new paragraph 181.3(3)(*e*) is added, to define the capital of an authorized foreign bank for a taxation year. This definition is based on the regulatory capital requirements that Canada's Office of the Superintendent of Financial Institutions (OSFI) applies to Canadian banks. Specifically, the capital of an authorized foreign bank for a year is the total of two amounts:

- Under new subparagraph 181.3(3)(*e*)(i), 10% of the bank's risk-weighted assets and exposures at the end of the year, in respect of its Canadian banking business, as those would be reported under OSFI's risk-weighting guidelines

if the guidelines applied and required reporting at that time. For this purpose, the relevant OSFI guidelines are newly defined in subsection 248(1) of the Act to mean the guidelines issued under authority of section 600 of the Bank Act, as those guidelines stood on Announcement Date.

- Under new subparagraph 181.3(3)(*e*)(ii), all amounts in respect of the business, at the end of the year, that would be deducted from the bank's capital, under OSFI's risk-based capital adequacy guidelines, in determining the adequacy of the bank's capital if the bank were a bank listed in Schedule II to the *Bank Act*. These amounts, which include goodwill that is recorded on the bank's balance sheet, unconsolidated investments in subsidiaries, and other substantial investments, generally carry a risk-weighting of zero, and so will not figure in the bank's capital for LCT purposes under subparagraph (*e*)(i). On the other hand, certain securitized assets, loss facilities in connection with which would be deducted from a Schedule II bank's capital, are nonetheless included in a foreign bank's risk-weighted assets pool at ratings greater that zero: to avoid counting these assets twice for LCT purposes, new clause (*e*)(ii)(B) excludes from the subparagraph (ii) amount any amount in respect of a loss protection facility that OSFI's asset securitization guidelines require to be deducted from capital.

These amendments apply after June 27, 1999.

Investment Allowance of Financial Institution

ITA
181.3(4)

Subsection 181.3(4) of the Act defines the investment allowance of a financial institution for a taxation year for the purposes of Part I.3. Paragraphs (4)(*a*) and (*b*) are amended to refer to an "eligible investment", a term defined in new subsection 181.3(5), which incorporates conditions previously contained in the text of these paragraphs, as well as a new residency condition.

New paragraph 181.3(4)(*c*) defines the investment allowance of an authorized foreign bank. Like other financial institutions, an authorized foreign bank's taxable capital for a taxation year is the amount, if any, by which its capital for the year exceeds its investment allowance for the year. Its investment allowance for a taxation year is essentially the full (i.e. not risk-weighted) year-end amount of its "eligible investments" used or held in its Canada banking business as those would be required to be reported under the OSFI risk-weighting guidelines (defined in subsection 248(1)) if the guidelines were applicable.

This amendment applies after June 27, 1999.

Interpretation

ITA
181.3(5)

Amended subsection 181.3(5) of the Act defines an “eligible investment” of a financial institution for the purpose of determining its investment allowance under subsection 181.3(4) of the Act. The main conditions, previously set out directly in subsection 181.3(4), are that the investment be a share or long-term debt of a related financial institution that is not exempt from tax. A new requirement is introduced that the investee corporation be either resident in Canada or use the proceeds of the share or debt in a business carried on through a permanent establishment in Canada. It is proposed that the definition of permanent establishment for this purpose be that set out in section 8201 of the *Income Tax Regulations*. New paragraph 181.3(5)(*b*) sets out an interpretive rule relating to credit unions that was previously contained in subsection 181.3(4) of the Act.

New subsection 181.3(5) generally applies after June 27, 1999 except that the coming-into-force of the requirement in subparagraph (5)(*a*)(iii) is deferred for taxpayers other than authorized foreign banks until the 2002 taxation year.

Clauses 17 to 19

Financial Institutions Capital Tax

ITA
Part VI

Part VI of the Act taxes the amount by which a financial institution’s taxable capital employed in Canada exceeds a capital deduction of up to $220 million (which is shared among related institutions). Part VI also applies additional taxes to life insurance corporations and deposit-taking institutions. Part VI is amended, with application after June 27, 1999, to include special rules for the taxation of authorized foreign banks.

Taxable Capital Employed in Canada

ITA
190.11

Section 190.11 of the Act provides rules for determining the amount of a financial institution's “taxable capital employed in Canada” for the purposes of Part VI. Section 190.11 is amended to exclude authorized foreign banks from the general rule in paragraph (*a*) and to provide, in amended paragraph (*c*), that an authorized foreign bank’s taxable capital employed in Canada for a taxation year is its taxable capital for the year.

These amendments apply after June 27, 1999.

Capital

ITA
190.13

Section 190.13 of the Act defines the capital of a financial institution for a taxation year for the purposes of Part VI. The section is amended to include, in new paragraph 190.13(*d*), a special rule for authorized foreign banks. This new rule defines such a bank's capital for purposes of Part VI in the same way as new paragraph 181.3(3)(*e*) of the Act does for the purposes of the large corporations tax in Part I.3 of the Act. Readers may refer to the notes to that provision for more information.

This amendment applies after June 27, 1999.

Investment in Related Institutions

ITA
190.14

Section 190.14 of the Act applies for the purpose of determining, under Part VI, the amount of a corporation's investment in related financial institutions. This amount is deductible from the corporation's capital, as determined under section 190.13 of the Act, in computing its taxable capital under section 190.12 of the Act.

Section 190.14 is amended by incorporating most of its content into a new subsection (1). Paragraphs (*a*) and (*b*) are amended to refer to an "eligible investment", a term defined in new subsection 190.14(2), which incorporates conditions previously contained in the text of these paragraphs, as well as a new residency condition.

New paragraph 190.14(1)(*c*) defines the investment allowance of an authorized foreign bank. The bank's investment in related institutions is essentially the full (i.e. not risk-weighted) year-end amount of its "eligible investments" used or held in its Canadian banking business as those would be reported under the OSFI risk-weighting guidelines (defined in subsection 248(1)) if the guidelines were applicable. The new provision clarifies that the relevant amount in respect of surplus contributed to an institution is the amount of such surplus contributed by the bank in the course of carrying on its Canadian banking business.

New subsection 190.14(2) of the Act defines an "eligible investment" of a corporation in a financial institution for the purpose of determining its investment allowance under subsection (1). The main conditions, previously set out directly in paragraphs 190.14(*a*) and (*b*) are that the investment be a share or long-term debt of, or surplus contributed to, a related financial institution. A new requirement is introduced in new paragraph 190.14(2)(*b*) that the investee financial institution be either resident in Canada or use the surplus or the proceeds of the share or debt in a business carried on through a permanent establishment in

Canada. It is proposed that the definition of permanent establishment for this purpose be that set out in section 8201 of the *Income Tax Regulations*.

These amendments generally applies after June 27, 1999 except that the coming-into-force of the requirement in subsection 190.14(2)(*b*) is deferred for taxpayers other than authorized foreign banks until the 2002 taxation year.

Clause 20

Definitions

ITA
204 "qualified investment"

The definition "qualified investment" in section 204 of the Act is relevant directly to deferred profit sharing plans (DPSPs), and indirectly to other tax-deferred registered plans such as registered retirement savings plans (RRSPs).

The definition of a qualified investment is amended in three respects. First, the definition is modified (with effect after June 27, 1999) to include money denominated in any currency, whether Canadian or foreign. An exception excludes currency held as a collectible or as a commodity: that is, money whose fair market value exceeds its stated value as legal tender in its country of issue or that is held for its numismatic value.

Second, deposits with a Canadian branch of an authorized foreign bank will, after June 27, 1999, be qualified investments.

Third, after 2002, the only deposits that will be qualified investments will be those that are either deposits within the meaning of the *Canada Deposit Insurance Act*, or deposits with bank branches in Canada. As a result, bank deposits that are excluded from the *Canada Deposit Insurance Act* definition because they are repayable outside Canada will not be qualified investments if they are made with a branch outside Canada.

Clause 21

Definitions

ITA
206(1) "foreign property"

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

Subsection 206(1) contains the definition of foreign property. Paragraph (*g*) of this definition treats as foreign property the indebtedness of a non-resident person

other than a prescribed person or any of various international organizations. The paragraph is amended so that a deposit with a Canadian branch of an authorized foreign bank is not foreign property. The amended definition applies after June 27, 1999.

Clause 22

Application of Part XIII to Authorized Foreign Bank

ITA
212(13.3)

Section 212 of the Act imposes a tax of 25% (reduced by many treaties) on certain amounts paid or credited to non-residents by residents of Canada. Pursuant to section 215 of the Act, this tax must be withheld by the resident payer.

New subsection 212(13.3) of the Act provides special rules regarding the application of withholding taxes under Part XIII of the Act to authorized foreign banks. This new subsection treats an authorized foreign bank as being resident in Canada for the purposes of any amount paid or credited to or by the bank with respect to its Canada banking business. An authorized foreign bank is also deemed to be resident in Canada with respect to the application of the definition of Canadian partnership to paragraph 212(13.1)(*b*) of the Act, with respect to a partnership interest held by the bank in the course of its Canadian banking business.

As a result of this amendment, an authorized foreign bank will not pay tax under section 212 on, for example, interest payments its Canadian banking business receives from residents of Canada. On the other hand, the bank will be responsible for withholding the tax payable by a non-resident to whom it makes a taxable payment.

This new subsection applies after June 27, 1999.

Clause 23

Additional Tax on Authorized Foreign Banks

ITA
Part XIII.2
218.2

New Part XIII.2 of the Act applies a special branch interest tax, in lieu of Part XIII withholding tax, to certain notional interest payments by an “authorized foreign bank.” The operation of this new tax is tied to the special interest-deductibility rules that apply to such banks.

In general terms, new section 20.2 of the Act allows an authorized foreign bank to deduct on account of the interest expense of its Canadian banking business for a year one or more of three amounts:

1. Interest expense actually incurred by the bank in the year, in relation to liabilities of the Canadian banking business to other persons or partnerships;
2. Interest expense notionally incurred by the Canadian banking business in the year, in relation to documented "branch advances" from the bank itself to the business; and
3. A residual amount, representing interest for the year on the amount by which 95% of the value of the Canadian banking business's assets exceeds the total of its actual liabilities and its branch advances.

Existing Part XIII of the Act applies withholding tax to certain payments of interest by persons resident in Canada to non-residents. An amendment to Part XIII (new subsection 212(13.3)) treats an authorized foreign bank, in respect of its Canadian banking business, as being resident in Canada for purposes of that Part. As a result, the bank's actual interest payments to non-residents (item 1 above) may attract tax under Part XIII.

New Part XIII.2 complements Part XIII by ensuring the appropriate tax results in respect of an authorized foreign bank's notional and residual interest expenses (items 2 and 3 above). Specifically, new subsection 218.2(1) of the Act imposes a tax equal to 25% (the statutory rate under Part XIII) of an authorized foreign bank's "taxable interest expense" for a year. "Taxable interest expense" for a year is defined in new subsection 218.2(2) of the Act as 15% of the amount by which the bank's interest expense deduction for the year exceeds that part of the deduction that relates to actual liabilities to other persons or partnerships.

Canada's tax treaties have important effects on the taxation of non-residents' Canadian-source income. New Part XIII.2 includes two rules that reflect the influence of tax treaties. First, new subsection 218.2(3) of the Act states that an authorized foreign bank that is resident in a country with which Canada has a tax treaty is exempt from this tax, provided that a Canadian-resident bank that carried on business in that country would not be required to pay a comparable tax. Thus an authorized foreign bank from a treaty country, which country either has no such tax or considers that its tax treaty with Canada precludes it from applying the tax to residents of Canada, is not liable to pay tax under new Part XIII.2.

Second, new subsection 218.2(4) of the Act limits the rate of tax under Part XIII.2 (otherwise 25%) where a tax treaty applies. If the relevant treaty includes a specific rate limit for the Part, that limit governs; if it does not, the applicable rate is the maximum rate that the treaty allows Canada to apply to interest payments between a resident of Canada and a related person in the treaty country.

New Part XIII.2 of the Act applies for taxation years that end after June 27, 1999.

Clause 24

Additional Tax on Non-Resident Corporations – Exempt Corporations

ITA
219(2)(*a*)

A non-resident corporation may carry on business in Canada either through a subsidiary corporation or by operating a branch here. Dividends paid by a subsidiary to its non-resident parent company are subject to non-resident withholding tax under Part XIII of the Act, as modified by any applicable tax treaty. In the case of a branch, Part XIV imposes what is intended to be a generally comparable tax: in broad terms, any after-tax Canadian earnings that are not reinvested in the corporation's Canadian business are subject to the so-called branch tax.

Paragraph 219(2)(*a*) of the Act currently exempts banks from the branch tax. In recent years, non-resident banks have not been permitted to operate branches in Canada in any event, so the exemption has had no practical effect. With changes to the regulatory rules, however, "authorized foreign banks" may now open Canadian branches. Since part of the appropriate tax treatment of these banks is the application to them of the branch tax, paragraph 219(2)(*a*) is repealed.

This amendment applies for taxation years that end on or after June 28, 1999 – the date on which the relevant *Bank Act* amendments were proclaimed.

Given the extension of the branch tax to authorized foreign banks, it is proposed that the *Income Tax Regulations* be amended to set out, in new subsection 808(8), how the investment allowance of an authorized foreign bank for the purpose of paragraph 219(1)(*j*) of the Act is calculated.

Clause 25

Definitions

ITA
248(1)

Section 248 defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Subsection 248(1) is amended to add several new definitions, all of which relate to Canadian branches of authorized foreign banks.

"authorized foreign bank"

An “authorized foreign bank” means the same thing as that term means under section 2 of the *Bank Act* – that is, a foreign bank in respect of which an order under subsection 524(1) of the *Bank Act* has been made.

“bank”

A “bank” means a bank within the meaning assigned by section 2 of the *Bank Act* (a “Schedule I” or “Schedule II” bank) or an authorized foreign bank.

“Canadian banking business”

A “Canadian banking business” is the business carried on by an authorized foreign bank through a permanent establishment in Canada.

“foreign currency”

“Foreign currency” means currency of a country other than Canada.

“OSFI risk-weighting guidelines”

The “OSFI risk-weighting guidelines” are those issued by the Superintendent of Financial Institutions under section 600 of the *Bank Act*. These guidelines require an authorized foreign bank periodically to provide to the Superintendent a return listing the bank’s risk-weighted on-balance sheet assets and off-balance sheet exposures. It is important to note that, as used here, the guidelines are static: they are the guidelines that apply as of Announcement Date, and not as they may be modified by the Superintendent from time to time.

These new definitions apply after June 27, 1999.

Clause 28

Deemed Non-Resident

ITA
250(5)

Subsection 250(5) of the Act deems a person not to be resident in Canada at a time if, at that time, the person, who would otherwise be resident in Canada under the Act, “tie-breaks” under a tax treaty as a resident of a treaty country.

Although non-resident, an authorized foreign bank may in certain cases claim foreign tax credits under section 126 of the Act. This is accomplished by an amendment to that section (new paragraph 126(1.1)(*a*)) that treats the bank as resident in Canada for foreign tax credit purposes.

This amendment to subsection 250(5) ensures that the residence deeming rule in new paragraph 126(1.1)(*a*) is not overridden by subsection 250(5). That is, an authorized foreign bank may still be deemed to be resident in Canada for foreign

tax credit purposes, even if subsection 250(5) confirms that it is resident in another country for other purposes.

This amendment applies after June 27, 1999.