Revenue Canada Taxation
Revenu Canada Impôt

T2

CORPORATION

INCOME TAX GUIDE

1988

Cette publication est disponible en français

Canada

This Guide is based on the Income Tax Act as amended by Bill C-64 which received Royal Assent on December 8, 1987 and Tax Reform which received Royal Assent on September 13,1988.

Further consideration should be given to any changes which may have been enacted into law after September 13, 1988.

CONTENTS

Guide	Item	Page
INTRODUCTION		1
1	Filing	1
1A	Filing Date	2
1B	Facsimile T2 Returns and Schedules	2
1C	Computer-Generated T2 Returns	2
1D	Free-Format Schedules	3
1E	What Happens on Filing?	3
1F	Appeals Process	4
2	Payment of Income Tax	4
3	Penalties	5
4	Corporation Income Tax Return	5
COMPLETION OF IDENTIFICATION AREA		6
5	Identification Area	6
5A	Nature of Business Information	8
6	Type of Corporation	8
6A	Canadian-Controlled Private Corporation	8
6B	Other Private Corporation	8
6C	Public Corporation	9
6D	Other Corporations	9
6E	Changes in Corporation Type	9
COMPLETION OF SCHEDULES AND INFORMATION REQUIRED AREA		9
7	Attachments	9
8	T2S(1)* Reconciliation of Net Income	10
9	T2S(2)* Charitable Donations	11
10	T2S(3) Schedule of Dividends Received and Dividends Paid	11
11	T2S(4)* Schedule of Losses	13
11A	Non-Capital Losses	14
11B	Farm Losses	14
11C	Net Capital Losses	15
11D	Allowable Business Investment Losses	15
11E	Restricted Farm Losses	16
12	T2S(6) Summary of Dispositions of Capital Property	16
12A	Proceeds of Disposition	17
12B	Adjusted Cost Base	17
12C	Adjusted Cost Base of Depreciable Property	18
12D	Outlays and Expenses	18
12E	Personal-Use Property	18
12F	Listed Personal Property	19
12G	Shares	19
12H	Real Estate	19
13	T2S(7) Income Analysis	19
13A	Active Business Income	20
13B	Canadian and Foreign Investment Income	20
13C	Specified Investment Business Income	20
13D	Personal Services Business Income	21
14	T2S(7)(A) Corporate Partnerships	21
15	T2S(8)* Capital Cost Allowance	21
16	Corporate Relationships	24
16A	T2S(9)* Related Corporations	25
16B	T2013 Associated Corporations	25
16C	T2S(10)* Non-Resident Related/Associated Corporations	26
17	T2S(11)* Transactions with Shareholders, Officers and Employees	26
17A	T2S(11A)* Non-Arm's Length Transactions	26
18	T2S(12)* Natural Resource Earned Depletion	27
19	T2S(13)* Continuity of Reserves	27
20	T2S(14)* Miscellaneous Payments to Residents	27
21	T2S(15)* Deferred Income Plans	27
22	T2S(16) Patronage Dividend Deduction	28
23	T2S(17)* Allocation in Proportion to Borrowing	28
24	T2S(18)* Refundable Capital Gains Tax on Hand	28
25	T2S(19)* Non-Resident Ownership	29
26	T2S(20)* Additional Tax Under Part XIV	29
27	T2S(22)* Non-Resident Discretionary Trust	29
28	T2S(23)* Scientific Research and Experimental Development	29
29	T2S(24)* First-Time Filers	30

30 T2S(25)* Investment in Foreign Affiliates 30
31 T2S(26)* Allowable Refund 30
32 T2S(27) Computation of Canadian Manufacturing and Processing Profits 30
33 T2S(28)* Addition to Taxable Income under Section 110.5 31
34 T2S(29)* Payments to Non-Residents 31
35 T2S(30)* Non-Canadian Advertising Expense 31
36 Additional Information 31

COMPLETION OF COMPUTATION OF TAXABLE INCOME 31
37 Net Income 31
37A Deduction for Gifts 32
37B Taxable Dividends Received 33
37C Restricted Farm Losses 33
37D Non-Capital Losses 34
37E Net Capital Losses 34
37F Farm Losses 34

COMPLETION OF T2-FTC SCHEDULE 1 35
38 Part 1 Tax on Taxable Income 35
38A Small Business Deduction 35
38B Investment Corporation Deduction 36
38C Additional Deduction – Credit Unions 37
38D Federal Tax Abatement 38
38E Manufacturing and Processing Profits Deduction 38
38F Corporate Surtax 39
38G Foreign Tax Credits 39
38H Federal Logging Tax Credit 41
38I Federal Political Contribution Tax Credit 41
38J Share-Purchase Tax Credit 41
38K Scientific Research and Experimental Development Tax Credit 42
38L Investment Tax Credit 42
38M Employment Tax Credit 46
39 Refundable Portion of Part 1 Tax 46
40 Part IV Tax 46
41 Refundable Dividend Tax on Hand (RDTOH) 47
42 Dividend Refund 48

COMPLETION OF SUMMARY OF TAX AND CREDITS AREA 49
43 Federal Tax 49
43A Part II Tax Payable 49
43B Part XIV Tax Payable 50
44 Provincial and Territorial Tax 50
45 Provincial Tax Credits – Rebates 52
46 Provincial Foreign Tax Credits 52
47 Provincial Political Contribution Tax Credits 53
47A Prince Edward Island Political Contribution Tax Credit 53
47B Nova Scotia Political Contribution Tax Credit 53
47C New Brunswick Political Contribution Tax Credit 53
47D Manitoba Political Contribution Income Tax Credit 54
47E British Columbia Political Contribution Tax Credit 54
47F Yukon Political Contribution Tax Credit 54
47G Northwest Territories Political Tax Credit 54
48 Newfoundland New Small Business Deduction 54
49 Prince Edward Island Small Business Deduction 54
50 Nova Scotia Tax Reduction for New Small Business Corporations 55
51 Nova Scotia Research & Development Tax Credit 55
52 New Brunswick Small Business Corporate Tax Reduction 55
53 Manitoba Manufacturing Investment Tax Credit 55
54 Saskatchewan Royalty Tax Rebate 56
55 Saskatchewan Corporate Tax Reduction for New Small Businesses 56
56 Saskatchewan Manufacturing and Processing Tax Reduction 56
57 Saskatchewan Venture Capital Tax Credit 56
58 Saskatchewan Livestock Investment Tax Credit 57
59 Saskatchewan Livestock Facilities Tax Credit 57
60 British Columbia Royalty and Deemed Income Rebate 57
61 British Columbia Logging Tax Credit 57
62 British Columbia Venture Capital Tax Credit 58
63 British Columbia Refundable Tax Credit 58
63A British Columbia Housing and Employment Development Bond Tax Credit 58

63B	British Columbia Small Business Employment Tax Credit	58
64	Yukon Manufacturing and Processing Profits Tax Credit	59
65	Instalments and Other Credits	59
65A	Instalments of Income Tax	59
65B	Investment Tax Credit Refund	60
65C	Federal and Provincial Capital Gains Refund	60
66	Tax Withheld at Source	60
67	Payment on Filing	61
68	Refund Code	61
69	Books and Records	61
70	Reassessments	61
NEW LEGISLATION		62
71	Index of New Legislation Addressed in This Guide	62
71A	Corporate Tax Rates	63
71B	Eligible Capital Property	63
71C	Flow-Through Shares	63
71D	General Anti-Avoidance Rule	64
71E	Resource Limited Partnerships	64
71F	Tax on Dividends on Preferred Shares	65
71G	Part II.1 Tax – Tax on Corporate Distributions	66
71H	Part VI Tax – Capital Tax	66
72	Listing of Federal & Provincial Corporate Forms	67
73	Partial Listing of Interpretation Bulletins and Information Circulars	68
74	Alphabetical Index	69
	District Taxation Offices	73

* Revenue Canada does not produce a prescribed version of this form.

INTRODUCTION

This Guide contains general information for the completion of the Corporation Income Tax Return for 1988. It is not intended as a substitute for the Income Tax Act and Regulations.

Unless otherwise stated, parts, subdivisions, sections, subsections, paragraphs and subparagraphs referred to are those of the Income Tax Act.

Further reference is also made to various Information Circulars and Interpretation Bulletins which contain information on situations not covered in this Guide. A partial listing of these Information Circulars (IC) and Interpretation Bulletins (IT) is included in this Guide. These may be obtained from your District Taxation Office as listed at the end of this Guide.

1
Filing

A Corporation Income Tax Return (form T2) must be filed by all corporations except Registered Charitable Corporations. Non-profit organizations and tax exempt corporations are not excluded from this requirement. One completed T2 return, including the required financial statements and schedules as identified in this Guide and on the reverse of the T2 return, is to be filed within six months from the end of the taxation year.

If the corporation has total assets of $10,000,000 (ten million dollars) or more, a duplicate T2 return together with the required financial statements and schedules is to accompany the original return.

The T2 return and duplicate, if required, may be delivered to the District Taxation Office in your area or mailed to one of the following Taxation Centres:

Corporations served by District Taxation Offices located in –

British Columbia and the Yukon Territory	Taxation Centre Surrey British Columbia V3T 5E6
Alberta, Saskatchewan, Manitoba and the Northwest Territories	Taxation Centre Winnipeg Manitoba R3C 3M3
Ontario	Taxation Centre Ottawa Ontario K1A 1A3
Montréal, St. Hubert, Laval	Taxation Centre Shawinigan-Sud Québec G9N 7V9
Sherbrooke, Québec, Rouyn-Noranda, Chicoutimi, Rimouski, Trois-Rivières	Taxation Centre Jonquière Québec G7S 5J2
Nova Scotia, New Brunswick, Prince Edward Island, Newfoundland	Taxation Centre St. John's Newfoundland A1B 3Z2

A corporation that is required to file a Part VIII tax return (form T2115) should submit the Part VIII return together with its Corporation Income Tax Return for the year to:

Part VII /Part VIII Tax Group
Petroleum and Gas Revenue Tax Section
Taxation Centre
Ottawa
Ontario
K1A 1A2

1A
Filing Date

A T2 return will be accepted as filed on time if:

(i) When the fiscal year ends on the last day of the month, the return is delivered, or the postmark on the envelope is, on or before the last day of the sixth succeeding month, or

(ii) When the fiscal year ends on other than the last day of the month, the return is delivered, or the postmark on the envelope is, on or before the same day of the sixth succeeding month.

Example

Year End	Required Filing Date
February 28	August 31
March 31	September 30
June 30	December 31
August 31	February 28
September 23	March 23

Where the required filing date for a T2 return falls on a Saturday, Sunday or a statutory holiday, the return will be accepted as filed on time if it is delivered on, or the postmark on the envelope is for, the first working day following the required filing date.

Note: **Recent changes in legislation stipulate that** for purposes of determining whether a return is filed on time, a return sent by first class mail or its equivalent (e.g. a courier service) is considered to have been received on the day it was mailed. This is applicable to all items sent by mail with the exception of remittances of source deductions which must be **RECEIVED** by the Receiver General on or before their due date.

1B
Facsimile T2 Returns and Schedules

Facsimile returns and schedules are exact replicas of the Department's forms although they may be printed on separate pages. Facsimiles must meet Departmental requirements with respect to colour, legibility, paper quality and format as outlined in Information Circular IC 85-5R.

1C
Computer-Generated T2 Returns

The Department is currently accepting computer-generated T2 returns on a trial basis, after which the procedure will be evaluated to determine whether it should be continued.

A computer-generated T2 return is one which is printed by a computer on yellow coloured paper.

To be acceptable a computer-generated return must be in an approved format, it must be on yellow-coloured paper equal in quality to the departmental prescribed form, and a Keying Summary must be submitted which includes Keying Fields 111 to 680 from the return and pertinent schedules.

Computer-generated returns received which are not acceptable will be returned to the corporation with a request for a T2 in approved format or a Departmental prescribed form.

Suppliers of software programs and individuals or tax preparers who devise their own programs which are used to produce computer-generated returns must submit a sample of the proposed computer-generated return and keying summary for approval by the Department, on an annual basis.

A four-digit hyphenated certification code is then issued which remains valid only for the specific format and taxation year approved by Revenue Canada, Taxation and must be included on each return below the Certification Area on page 4.

Important information including guidelines on format and style of programs, for preparing and printing T2 Returns and Keying Summaries, is available in Information Circular IC 85-3R.

1D
Free-Format Schedules

Whether you file a facsimile, computer-generated or prescribed T2 return, free-format schedules may be filed in lieu of schedules printed by the Department.

Free-format schedules are computer-generated schedules which contain the same information as requested on the Department's form. They will be accepted provided the following specifications are met:

(a) the computer program for free-form schedules must have received prior approval by the Tax Forms Directorate (refer to Information Circular IC 85-5R or Information Circular IC 85-3R for details);

(b) a **Keying Summary** must accompany any of the following schedules, when they are submitted in free-format style, in order to constitute a complete return: T2-FTC, Schedule 1, T2S-TC and T2028;

(c) the schedule must have the corporation's name, account number and fiscal period end clearly identified;

(d) all field codes and numbers as well as any questions contained on the Department's pre-printed form must be included;

(e) abbreviations are acceptable provided that the required information is clear; and

(f) the guidelines outlined in Information Circular IC 85-3R concerning paper quality and printing are followed.

1E
What Happens on Filing?

Once a T2 return is filed, it is forwarded for processing in the Assessing Division of the Taxation Centre responsible for the jurisdiction in which the corporation resides.

After an assessing officer reviews and checks the information on the return, a Notice of Assessment is mailed to the corporation and, where required, an Explanation of Changes.

On receipt of its Notice of Assessment the corporation should compare it to its copy of the return. If further details or clarification is required relating to the assessment its District Taxation Office should be contacted.

Mailing addresses and telephone numbers are provided at the end of this Guide.

1F
Appeals Process

Where there are unresolved differences in interpretation of the law as it applies to a corporation's assessment, the corporation has 90 days from the date the assessment or reassessment was issued to file a notice of objection. It is filed with the Deputy Minister of National Revenue for Taxation.

Upon receipt of a Notice of Objection, the corporation's assessment or reassessment will be given an **impartial** review by an appeals officer in a District Office or Taxation Centre who will then contact the corporation or its representative to discuss the differences.

If the differences in interpretation of the law are not resolved, the corporation may further appeal the assessment or reassessment to the Tax Court of Canada and/or the Federal Court of Canada.

Information Circular IC 80-7 provides further guidance regarding this process.

2
Payment of Income Tax

The Income Tax Act provides for the payment of income tax by corporations in monthly instalments. One instalment is due on or before the last day of each month of the corporation's taxation year. For example:

(a) If the taxation year end falls on the last day of a month, each instalment payment would be due on the last day of each month.

(b) If the taxation year end falls on a day other than the last day of the month, each payment would be due on the day of the month identical to the taxation year end. Therefore, if the taxation year end falls on July 6, instalment due dates would fall on August 6, September 6, etc.

The balance of tax is payable three months after the taxation year end **if** the following criteria are met:

(a) a small business deduction was claimed in the taxation year or the immediately preceding taxation year, **AND**

(b) the corporation is throughout the year a Canadian-Controlled Private Corporation and the total of

  (i) the taxable income for the immediately preceding taxation year, and

  (ii) the taxable incomes of all corporations with which it was associated in the year, for their taxation years ending in the calendar year in which the immediately preceding taxation year of the corporation ended

  does not exceed the total amount determined to be their business limit as defined in the Income Tax Act.

For all other corporations, the balance due date is two months after the taxation year end.

Where the Part I and Part VI.1 tax payable by a corporation for a taxation year or its first instalment base for the year is not more than $1000 (this limit excludes any

Share Purchase Tax Credit and/or Scientific Research and Experimental Development Tax Credit but includes the Surtax), instalment payments are not required. Also, new corporations generally are not required to make instalment payments until after the completion of the first year of operations. In both of these situations, however, the balance of tax payable is due as outlined above.

Instalments of Income Tax are discussed under Guide Item 65A and additional information is available in Information Circular IC 81-11R2.

3
Penalties

Failure to File: **Recent changes in legislation** have amended the penalties for late filing. Under Tax Reform, corporations that fail to file their T2 returns as and when required are liable to a penalty of 5% of the unpaid tax for the year and 1% of the unpaid tax per complete month of default (not exceeding 12%) until the return is filed. Where a demand has been made by Revenue Canada under subsection 150(2) of the Income Tax Act, and the corporation has been previously assessed a penalty for failure to file a T2 return for any of the preceding 3 taxation years, the corporation is liable to a penalty of 10% of the unpaid tax for the year and 2% of the unpaid tax per complete month of default (not exceeding 40%) until the return is filed.

Failure to Report Income: **Tax Reform also included** a new penalty for corporations which fail to report an amount of income and have failed to report an amount of income in any of the 3 preceding taxation years. In such instances the corporation will be liable for 10% of the unreported income amount, unless the corporation is assessed a penalty under subsection 163(2) for knowingly or under circumstances amounting to gross negligence making a false statement or omission. This new 10% penalty would be applicable to circumstances not amounting to gross negligence.

Gross Negligence: **Under Tax Reform,** the penalty for making a false statement or omission knowingly or under circumstances amounting to gross negligence has increased to the greater of $100 and 50% of the tax attributable to the false statement or omission.

Dishonoured Cheques: **Under Tax Reform,** a penalty of $10 will be levied for any cheque given to Revenue Canada which is not honoured when presented for payment, applicable on a date to be fixed by proclamation.

Penalties are also assessed for failure to provide information required on a prescribed form made pursuant to the Income Tax Act or regulations, failure to furnish foreign based information and late or deficient instalment payments.

4
Corporation Income Tax Return (forms T2, T2-FTC Schedule 1 and T2-FTC Schedule 1 Supplementary)

The prescribed Corporation Income Tax Return (form T2) is a one sheet form in a three-part snap set on which:

(a) the corporation is identified, and

(b) taxable income, tax payable, and tax credits are reported based on the financial statements and various schedules as identified on the reverse of the return.

Together, the FTC Schedule 1 and the FTC Schedule 1 Supplementary provide for the calculation of Parts I and IV federal taxes, tax deductions and refundable taxes.

The T2-FTC Schedule 1 must be filed with the T2 return if any of the following conditions exist:

(a) The corporation has taxable income.

(b) Dividends were paid or received.

(c) Part IV tax is payable.

(d) There is a balance in the Refundable Dividend Tax on Hand Account.

(See Guide Items 38 to 42)

COMPLETION OF IDENTIFICATION AREA

5
Identification Area

The accurate completion of the Identification portion of the T2 Return allows Revenue Canada to accurately identify the corporation and facilitates the processing of T2 Returns.

The Department relies on the answers to the two questions asking if the address has changed and if the Department has been previously notified to determine whether or not the computer system address should be changed prior to the Notice of Assessment issue. In all cases Notices are mailed using the address on the Department's computer system. In order to avoid the misdirection of Notices or other documents to an old address, it is **essential** that the department be advised of any address changes.

Each corporation is identified by an eight digit Corporation Account Number which is notated on prior year assessment notices, instalment receipts or remittance forms, and should be entered in the top left hand corner of the Identification area.

New corporations will automatically be assigned an account number. Notice of this number will be mailed to the corporation's registered head office. Should no notice be received before submitting your T2 return please contact your local District Office for instruction. New corporations formed as a result of an amalgamation will be assigned an account number when notification of the amalgamation is received. The account number will be forwarded to the newly formed corporation. Any correspondence or instalment payments relating to a corporation should include its account number.

The name and address should be completed in detail including street, city, province and postal code. The mailing address should also be completed in detail if it differs from the Head Office address. If the mailing address shown on the last return filed is to be deleted and not replaced by a new one, leave the mailing address lines blank, indicate that there has been a change, and indicate also whether or not the Department has already been notified of the change. All correspondence will normally be directed to this mailing address. However, if a tick mark is entered in the box to the right of "Mailing Address", instalment receipts and remittance forms will be directed to the Head Office address.

In completing "Return for taxation year from...", the current taxation year must start on the day following the last year's taxation year end and cannot exceed 53 weeks.

For the first return of a new corporation, the taxation year should not exceed 53 weeks from the date of incorporation. Interpretation Bulletins IT-364 and IT-454 provide additional information relating to the commencement of business operations and transactions prior to the date of incorporation.

If the fiscal period changed from the last return filed, indicate by placing a tick mark in the applicable box. Changes to an established fiscal period, except when a change of control occurs or through the election noted below, can only be made with the concurrence of the Minister. The fiscal period entered on the return should not be changed unless this approval has been granted or the circumstances notated below exist.

Where a change of control occurs, subsection 249(4) deems the taxation year of the corporation to end immediately before that time. Deemed year ends pursuant to subsection 249(4) do not require prior approval from the Minister.

Under Tax Reform, an election is available to allow a Canadian-Controlled Private Corporation with a fiscal period that includes December 31,1987 and would otherwise end thereafter, to terminate its taxation year on December 31,1987. Any private corporations, other than Canadian-Controlled Private Corporations, with a fiscal period that includes June 30, 1988 and would otherwise end thereafter may elect to have their taxation year end on June 30, 1988. These changes do not require prior approval from Revenue Canada and where a corporation does elect to change its taxation year end as noted above, its next fiscal period is permitted to end any time in the subsequent 53 weeks. Corporations electing to change their taxation year end under this provision should do so by attaching a letter to the respective T2 return indicating that they are exercising this election.

If you require further information on change of fiscal period, obtain Interpretation Bulletin IT-179.

If the corporation has wound-up and is filing the final return, include this information with the financial statements.

If the corporation is not a resident of Canada, the country of residence line should be completed.

Enter either the date of incorporation **or** where it is the first return of an **amalgamated** corporation, the **effective** date of amalgamation. Where two or more corporations have amalgamated, EVERY corporation must file returns to the EFFECTIVE DATE of CERTIFICATION as indicated on their "Certificate of Amalgamation" and/or "Articles of Amalgamation".

Returns for the period up to the "adoptive" date of amalgamation or the date of the shareholder's resolution will be rejected and the corporation required to provide a return for the period up to the **effective** date of amalgamation.

The Employer Remittance Account number is the number used when remitting your employee's payroll deductions and should be inserted where applicable.

Discontinued T2 Identification Label

The "T2 Identification Label" (form T562) which previously was mailed to all corporations one month after their fiscal year end is being discontinued after the end of the 1989 taxation year.

The Label, which has been in use since 1983, was first intended to expedite the processing of corporate returns. Surveys, however, showed that this program met with limited acceptance from the corporate community. Consequently, the Label will be issued to all corporations with a taxation year end in 1989 with a notice explaining this decision and providing instructions explaining how to use their last T2 Identification Label.

It remains this department's mandate to provide quick and efficient service in the processing of returns. The discontinuation of the T2 Identification Label will not adversely affect the level of service currently provided in processing corporate returns.

5A
Nature of Business Information

The major business or professional activity should be completed with sufficient detail to both support deductions claimed, e.g. Manufacturing and Processing Profits Deduction, if applicable, and to provide an exact industrial classification. If the corporation has several major lines of business, please indicate.

Also specify the principal product(s), services or revenue sources generated from the business activity described above and indicate the approximate percentage of total revenue that each comprises. If the corporation's business involves the resale of goods, please specify whether wholesale or retail. Some examples of nature of business descriptions are men's retail clothing store, manufacturing of wooden office furniture, single residential building contractor, etc. If you are a trucking company such as truck transportation of bulk liquids, please specify. However, if the corporation is an owner-operator, leased-operator or broker-operator working for another trucking company please specify.

6
Type of Corporation

The type of corporation should be indicated on the return according to the definitions provided below.

6A
Canadian-Controlled Private Corporation

A Canadian-Controlled Private Corporation at any time is one which meets all of the following requirements:

(a) it is a private corporation,

(b) it is a corporation that was resident in Canada at that time and was
   (i) incorporated in Canada, or
   (ii) resident in Canada from June 18, 1971 to that time,

(c) it is not controlled directly or indirectly by one or more non-resident persons,

(d) it is not controlled directly or indirectly by one or more public corporations (other than a prescribed Venture Capital Corporation), and

(e) it is not controlled directly or indirectly by any combination of persons in (c) and (d) above.

(Paragraphs 89(1)(a), 89(1)(f) and 125(7)(b))

Interpretation Bulletin IT-458 provides further information concerning this type of corporation.

6B
Other Private Corporation

A Private Corporation at any time is one which meets at such time all of the following requirements:

(a) it is resident in Canada,

(b) it is not a public corporation, and

(c) it is not controlled directly or indirectly by one or more public corporations.

(Paragraphs 89(1)(f) and (g))

6C
Public Corporation

A Public Corporation is a resident corporation which has a class of shares listed on a prescribed Canadian Stock Exchange or which has elected or been designated by the Minister of National Revenue to be a Public Corporation, having complied with prescribed conditions regarding the number of its shareholders, dispersal of ownership of its shares, public trading of its shares, and size of corporation. A Public Corporation may elect, or be designated by the Minister of National Revenue, not to be a Public Corporation if certain prescribed conditions are met. The fact that company shares are traded "over the counter" does not by itself qualify the corporation to be classed as a Public Corporation.

(Paragraph 89(1)(g))

6D
Other Corporations

"Other" describes any corporation which does not fall within the definitions of a Canadian-Controlled Private, a Private, or a Public Corporation. An example is a subsidiary of a Public Corporation that would otherwise qualify as a Private Corporation were it not controlled by the Public Corporation.

6E
Changes in Corporation Type

If the type of corporation changed during the year, please indicate and specify the change. Such a change is significant since a number of calculations on the return are contingent upon the corporation being Private or Canadian-Controlled Private throughout the year, at any time in the year, or at the end of the year.

Note: The "type" of corporation changes when, for example, a Canadian-Controlled Private Corporation becomes a "Public Corporation". **Do not** include other types of changes such as the change from an "Active" to "Inactive" status, etc.

COMPLETION OF SCHEDULES AND INFORMATION REQUIRED AREA

7
Attachments

The return for each corporation must contain complete financial statements (including auditor's report, if any).

Where the corporation has been inactive or dormant (no financial transactions during a taxation year), the T2 return must contain at least a balance sheet showing the financial position of the company at the end of its taxation year.

The questions listed on the reverse of the return must be completed by all corporations. For those questions answered "yes", forms or schedules with the appropriate attachment number, as indicated, must be attached to the T2 return.

It should be noted that, where applicable, forms and schedules may be required in addition to those listed in the questionnaire, for example, T2S-TC and T2S(27).

Printed forms as listed in the back of this booklet are available at any District Taxation Office.

The order of attachments placed under the T2 Return and stapled securely in the top left hand corner is as follows:

Keying Summary (where a computer-generated return or schedule is used – see Guide Item 1C)
FTC Schedule 1
T2S-TC
T2028
FTC Schedule 1 Supplementary
Correspondence
Official Receipts
Financial Statements
Schedule Attachments

8
T2S(1) Reconciliation of Net Income

This schedule provides a reconciliation of net income per financial statements with net income for Income Tax purposes where the two amounts differ. Where expenses not allowable for Income Tax purposes have been deducted on the income statement, these expenses should be added back to income; where non-taxable amounts have been included on the income statement, these amounts should be deducted. When calculating the reconciliation of the two amounts, ensure the amount entered to reflect the net income (loss) per financial statements is identical to the amount found on the statements.

Examples of items to be added back to income on the T2S(1) are income tax provisions, depreciation (if different from capital cost allowance claimed for tax purposes), charitable donations, expenses attributable to exempt income, interest and penalties on income taxes, taxable capital gains, losses on disposal of fixed assets, the amount of Employment Tax Credit claimed in the year, grants received from the Gas and Electric Conversion Assistance Program, amounts paid under the Petroleum and Gas Revenue Tax Act, political donations, etc.

Examples of amounts to be deducted on Schedule T2S(1) are capital cost allowance, capital gains on disposal of depreciable and other property, non-taxable dividends, amortization of cumulative eligible capital, allowable business investment loss, foreign tax deduction under subsection 20(12), etc.

Where a credit union received taxable dividends and/or realized taxable capital gains and has elected under subsection 137(5.1) within 120 days of its taxation year end to allocate a portion of these dividends and/or gains to members who are credit unions, the member credit unions may, in computing their taxable income, deduct the portion allocated to them pursuant to paragraph 137(5.2)(c). The electing credit union will provide the members with a letter, indicating the amount deductible by them. A copy of this letter should be attached to the members' return. Although this is a deduction in computing taxable income, this amount should be deducted on the T2S(1) as a line is not provided on the return for this deduction.

A credit union making the election on form T2004 must increase its income by the amount equal to the taxable capital gains allocated and reduce its deduction under section 112 for taxable dividends allocated to member credit unions.

Interest on a life insurance policy loan used to earn income is deductible, providing the interest is actually paid and not added to the adjusted cost base of the policy. If interest paid on a policy loan has been deducted in determining the corporation's net income for Income Tax purposes, the insurer must complete form T2210 "Verification of Policy Loan Interest by the Insurer" no later than the required filing date

of the T2 return. The completed form T2210 should be filed with the T2 return. If you require further information, obtain Interpretation Bulletin IT-355R.

Charitable donations, taxable dividends and net capital, non-capital, farm and restricted farm losses of other years are not to be deducted on Schedule T2S(1) in arriving at net income for Income Tax purposes. These items are deductions to arrive at taxable income and are deducted on the front page of the T2 return.

Enter net income for Income Tax purposes on line 111 of the Income Tax Return (form T2).

9
T2S(2) Charitable Donations

This schedule is to be completed by all corporations that have made charitable donations during the year.

For donations of $100 or more, please provide the name of the organization and its registration number. Donations of less than $100 may be aggregated and the total entered as a single amount. Receipts are not required to be filed with the T2 return but should be retained for future examination. Incomplete or inaccurate organization names or registration numbers may result in a delay in processing and a disallowance of the claim.

Credit Unions which have reduced their income by making bonus interest payments, payments pursuant to allocations in proportion to borrowing, or which have a deduction under paragraph 137(5.2)(c) (see T2S(1)), may claim charitable donations to a maximum of 20% of income before deducting these amounts.

The total of donations, including any carry-over from the five immediately preceding taxation years, should be entered on line 113. See Guide Item 37A.

10
T2S(3) Schedule of Dividends Received and Dividends Paid

This Schedule should be used by Private Corporations or Subject Corporations to report dividends received during the year (Area "A") and taxable dividends paid during the year (Area "B") for purposes of a dividend refund.

The **1988 revision of Schedule T2S(3)** provides for the identification of dividends received/paid before 1988 separately from those received/paid after 1987. This is necessary since, **as a result of new legislation,** the Part IV tax on dividends received has been revised to ¼ from ⅓ on dividends received after 1987 and the Dividend Refund has been reduced to ¼ from ⅓ of taxable dividends paid after 1987.

Area "A"

In Area "A", the corporation should list all dividends received, the payer corporation and indicate if the corporations are connected. Where applicable, dividends received should be categorized in Area A. It should be noted that a dividend may be included in more than one of the categories shown below.

(1) Total dividends received,

(2) Dividends deductible in computing taxable income under section 112 or 113.

Under subsection 112(1), taxable dividends are deductible if received from a taxable Canadian corporation or from a corporation resident in Canada (other than a non-resident-owned investment corporation or a corporation exempt from tax under Part I) and controlled by the receiving corporation. Dividends

received from a non-resident corporation (other than from a foreign affiliate) are deductible as calculated under subsection 112(2).

New legislation denies a deduction for dividends on collateralized preferred shares. There is a related-person exception to this rule. A new anti-avoidance rule prevents corporations from becoming related in order to take advantage of this exception.

Section 113 provides for the deduction of dividends received from foreign affiliates.

The total of these dividends should be entered on line 119 on the front page of the T2 return.

(3) Dividends subject to Part IV tax

The following dividends received by a corporation that was a private Corporation or "a Subject" corporation at any time in the taxation year are subject to Part IV tax:

(a) taxable dividends received by the corporation in the year from corporations with which it is **not connected** to the extent that such dividends are deductible in computing taxable income under subsection 112(1),

(b) taxable dividends received from foreign affiliates not connected to the extent of the amounts deductible under paragraphs 113(1)(a), (b) or (d) or subsection 113(2) in computing the recipient's taxable income, and

(c) taxable dividends received by the corporation in the year from private corporations with which it is **connected** (to the extent that such dividends give rise to a "dividend refund" in the hands of the payer corporation). The amount subject to Part IV tax is calculated as follows:

Dividends Received Before 1988	**Dividends Received After 1987**
$3\left[(C) \times \frac{(A)}{(B)}\right]$	$4\left[(C) \times \frac{(A)}{(B)}\right]$

Where

(A) equals taxable dividends received from the "connected" corporation

(B) equals total taxable dividends paid by the "connected" corporation

(C) equals the dividend refund of the payer "connected" corporation

The total amount calculated above for dividends received before 1988 should be entered on line 404 of the T2-FTC Schedule 1 and on line 405 for those received after 1987.

Where the payer corporation has a year end more than three months after that of the recipient, the recipient should estimate the payer's dividend refund in calculating the tax payable under Part IV. For further information, see Interpretation Bulletin IT-269R2.

Dividends received in respect of a Small Business Development Bond are not subject to Part IV Tax.

Definitions of subject corporations and connected corporations, for purposes of Part IV tax, are described in Guide Item 40.

(4) Dividends not taxable (e.g. received under section 83).

Dividends received on which the payer corporation has made an election under

Section 83 to pay dividends out of its capital dividend account are not included in the income of the recipient.

Life insurance proceeds received by a corporation may be distributed tax-free to its shareholders to the extent the proceeds were included in the corporation's Capital Dividend Account.

Area B

In Area "B", the Corporation should determine the amount of taxable dividends paid for purposes of the Dividend Refund. The total dividends paid before 1988 and after 1987 are to be entered on lines 424 and 414 of the T2-FTC Schedule 1 respectively.

11
T2S(4) Schedule of Losses

This schedule should contain the following:

(a) the continuity of non-capital, net capital, farm, or restricted farm losses,

(b) the amount of each loss deducted in computing taxable income,

(c) the amount of any non-capital and farm losses claimed to reduce dividends subject to Part IV tax,

(d) the amount of any non-capital, net capital, farm and restricted farm losses of a new corporation on amalgamation as provided for in subsection 87(2.1), and

(e) the amount of any non-capital, net capital, farm and restricted farm losses of a parent corporation upon the winding-up of a wholly owned subsidiary corporation as provided for in subsections 88(1.1) and 88(1.2). These subsections apply where 90% or more of the issued shares of the subsidiary were owned by the parent corporation.

A corporation may choose whether or not to apply an available loss in a taxation year. Furthermore, there is no restriction on the order of application for the different types of losses whether they were incurred in the 1983 and subsequent taxation years or are unapplied losses being carried forward from taxation years prior to 1983. If the corporation chooses to apply a loss, the oldest available loss of each type (i.e. non-capital, farm, net capital, restricted) must be applied first.

Further information on the meaning of farm losses, restricted farm losses, non-capital losses and net capital losses is contained in the Guide Items following and in Interpretation Bulletin IT-232R2.

Subsection 96(2.1) restricts the deductibility of partnership losses by limited partners. A partner may only deduct losses to the extent of its "at-risk" amount as at the end of the fiscal period of the partnership ending in the year.

The excess of losses allocated to the partner over the amount deductible for the year is defined as the taxpayer's limited partnership loss in respect of the partnership for the year. It is available for carry forward indefinitely, under paragraph 111(1)(e), against any type of income in a taxation year, to the extent that, at the end of the last fiscal period of the partnership ending in that year, the taxpayer has an amount at-risk in respect of the partnership.

A limited partner's at-risk amount is calculated as follows:

i) the adjusted cost base of its partnership interest, **plus**

ii) its share of the current year's income from the partnership, **less**

iii) all amounts owing by the partner to the partnership and any amount or benefit to which the partner is entitled that is intended to protect it from the loss of its investment.

A grand-fathering provision is provided for interests in partnerships that were carrying on business on a regular and continuous basis on and after February 25, 1986. However, these "exempt" partnership interests may lose their "exempt" status where, after February 25, 1986, there has been a substantial contribution of capital to the partnership or substantial partnership borrowings.

11A
Non-Capital Losses

A non-capital loss of a corporation for a taxation year is the amount by which:

(a) the total of all amounts, each of which is a loss for the year from business or property, its allowable business investment loss for the year, plus all dividends received that were deductible under Section 112 or subsections 113(1) or 138(6) in computing taxable income for the year, plus any amount added to taxable income by virtue of Section 110.5,

exceeds

(b) the total of the incomes from business or property, plus the excess of taxable capital gains over allowable capital losses, less deductions allowed by Sections 60 to 66.4 inclusive which are not allocated to a source, and

(c) the farm loss, if any, for the year.

The inclusion of deductible dividends in (a) above means that if carrying charges in respect of taxable dividend income are in excess of other income in (b) and the farm loss in (c) above, the excess will become a non-capital loss and be eligible for application against income in the three prior years and the seven subsequent years.

New legislation provides that for 1988 and subsequent years; a non-capital loss of a corporation for a taxation year is revised to include any unused portion of a deduction available in computing taxable income which is equal to 5/2 of its Part VI.1 tax payable (4/2 for taxation years ending before July 1988) on dividends paid on its taxable preferred shares.

The application of a loss from another year does not create nor increase any non-capital loss for the taxation year.

A non-capital loss can be carried back to offset income of the three prior years (by filing prescribed form T2A) and carried forward for seven years from year of origin. Refer to Guide Item 37D.

Paragraph 111(8)(b)

11B
Farm Losses

A farm loss is the corporation's loss from a farming or fishing business carried on in the year. The farm loss may not exceed the amount that would be the non-capital loss for the taxation year if the loss from farming and fishing businesses was included in the calculation of the non-capital loss.

A corporation's non-capital and farm losses for the year are to be recorded separately on schedule T2S(4).

11C
Net Capital Losses

A net capital loss of a corporation for a taxation year is the excess of:

(a) its allowable capital losses for the year from dispositions of property (other than listed personal property), less its allowable business investment loss, over

(b) its taxable capital gains for the year from dispositions of property (other than listed personal property) and its taxable net gain from dispositions of listed personal property (described in Guide Item 12F). Refer to Guide Item 37E.

Net capital losses may be carried back and applied to taxable capital gains in the three immediately preceding taxation years. Unapplied net capital losses may be carried forward indefinitely and applied to taxable capital gains in subsequent taxation years.

The unused portion of the Share Purchase Tax Credit or Scientific Research and Experimental Development Tax Credit is deemed to be a capital loss from a disposition of property in the year following the year in which the credit was earned. Guide Items 38J and 38K.

11D
Allowable Business Investment Losses

An allowable business investment loss is one-half of any capital losses incurred on the disposition (or deemed disposition) of shares or certain debts of a Small Business Corporation to a person or corporation with whom the corporation was dealing at arm's length. Since this loss is included in the definition of non-capital loss, the allowable capital loss must be reduced by the amount of the allowable business investment loss. See Guide Item 12 for calculation of the loss.

The definition of a Small Business Corporation was amended to include cooperative corporations and credit unions for dispositions after 1985.

A corporation's allowable business investment loss incurred in a year should be deducted in computing net income for Income Tax purposes on schedule T2S(1). Any such losses which cannot be deducted in the year in which they arose are to be included with the corporation's non-capital loss (if any) for the year on schedule T2S(4).

For 1985 and subsequent taxation years, a corporation's allowable business investment losses which cannot be deducted within the carry forward period for non-capital losses can be carried forward indefinitely as net capital losses. This is achieved by including in the corporation's net capital loss for a year it's unused allowable business investment loss in respect of which the carry forward period expires in that year and reducing the balance of non-capital losses by the same amount.

Where a corporation undergoes a change of control during the seven year carry-forward period for an allowable business investment loss, the loss may not be included in the company's net capital loss. This new legislation is effective for the 1987 and subsequent taxation years. This change is consistent with the provisions that do not allow an allowable business investment loss to be carried forward for deduction after a change of control as a non-capital loss.

The business investment loss on the disposition of any share issued before 1972 or any share substituted thereof must be reduced by the amount of taxable dividends received on that share after 1971.

For further information, obtain Interpretation Bulletin IT-484.

11E
Restricted Farm Losses

Where a corporation's chief source of income is neither farming nor a combination of farming and some other source of income, a loss incurred in the business of farming is only allowed to reduce income of that year from other sources to the extent of the lesser of:

(a) the farming loss for the year, or

(b) $2,500 plus the lesser of:

  (i) one-half of the amount by which the farming loss for the year exceeds $2,500, and

  (ii) $2,500.

The balance of the farming loss in a taxation year is called a "restricted farm loss" (Section 31).

This loss can be carried back three years or forward ten years and applied against farming income in those years. Refer to Guide Item 37C.

12
T2S(6) Summary of Dispositions of Capital Property

This schedule must be completed and attached to the T2 return of a corporation that has realized any capital gains (including any capital gains dividends per paragraphs 131(1)(b), 133(7.1)(a) and 130.1(4)(b)) or incurred any capital losses.

Although allowable business investment losses are calculated in the same manner as capital losses, do not report this type of loss on the T2S(6). Attach a separate statement containing the following information:

- Name of corporation.
- Number and class of shares or the date of issue and type of debt disposed of.
- Date the debt or shares were acquired.
- Proceeds of disposition.
- Adjusted cost base.
- Outlays and expenses on the disposition.
- Amount of loss claimed.

A capital gain results whenever the proceeds of disposition of a capital property exceeds the adjusted cost base plus any outlays or expenses incurred in connection with the disposition. Where the adjusted cost base plus outlays and expenses exceed the proceeds, a capital loss results except in the case of depreciable property.

Where a depreciable property is disposed of, the proceeds of disposition are less than the undepreciated capital cost and the property is the last remaining property in the class, a terminal loss results. See Guide Item 15.

Where a building is disposed of and the proceeds of disposition are less than the undepreciated capital cost and, in the same year, the land on which the building was situated is disposed of, the loss on the sale of the building will be reduced to the extent of any gain on the sale of the land. For a more detailed explanation of this and other land/building transactions, refer to subsection 13(21.1).

The passage of Tax Reform has increased the inclusion rate from one-half to two-thirds for capital gains included in income for a taxation year. The new rate is applicable for Canadian-Controlled Private Corporations for that portion of a taxation year that is after December 31, 1987 and before 1990. For other corporations the rate is applicable for that portion of a taxation year that is after June 30, 1988 and before 1990.

Where a corporation's year straddles the relevant date the percentage of any capital gain to be included in income is determined by providing the rates based on the number of days in the taxation year on either side of the applicable date.

An adjustment is required to the amount of Net Capital Losses that are carried back or forward to a year with a different inclusion rate for capital gains. The net capital losses are adjusted to compensate for the difference between the inclusion rate for capital gains and losses for the loss year and the inclusion rate for the capital gains and losses for the particular year in which the loss is claimed. The net capital loss claimed in a particular year will be increased where the loss is carried forward from a loss year in which the inclusion rate is lower than the inclusion rate for the year in which the loss is claimed. The net capital loss claimed will be reduced where the loss is carried back from a loss year in which the inclusion rate is greater than the inclusion rate for the year in which the loss is to be claimed. These adjustments are achieved by multiplying the net capital loss claimed by the ratio of the inclusion rate for the year in which the loss is to be claimed divided by the inclusion rate for the loss year.

eg. $A \times B/C$
where

A is the net capital loss for the loss year claimed under paragraph 111(1)(b) for the particular year.

B is the inclusion rate for the particular year.

C is the inclusion rate for the loss year.

The T2S(6) has been revised to enable a corporation to include capital properties which have been designated by the corporation, pursuant to paragraph 111(4)(e) of the Act, to have been disposed of prior to the time when control of the corporation has changed hands.

12A
Proceeds of Disposition

Proceeds of disposition arise on the disposition of property, including a deemed disposition. Such proceeds are usually the sale price of property sold, however, also include compensation for property expropriated, destroyed, unlawfully taken or injuriously affected. Compensation, including an insurance recovery in respect of property damaged, is proceeds of disposition to the extent that the compensation or recovery has not been expended on repairing the damage within a reasonable time. The foreclosure of mortgaged property and the sale of property under a provision of a mortgage can also give rise to proceeds of disposition. If you require further information, obtain Interpretation Bulletins IT-259R2 and IT-271R.

12B
Adjusted Cost Base

The cost of property for the purpose of computing any capital gain or loss thereon is referred to as the "adjusted cost base". Although the original cost of acquisition of a property is usually a fixed amount, the "adjusted cost base" may vary considerably from that amount due to adjustments as a result of transactions and occurrences between the time of acquisition and the time of disposition. These adjustments will vary depending on the type of property.

For property held before January 1, 1972, a capital gain is measured from the **greater** of the cost or Valuation Day value of an asset and a capital loss is measured from the **lower** of the cost or Valuation Day value of an asset. Two valuation days were established:

December 22, 1971 for Canadian common and preferred shares listed on one or more Canadian stock exchanges, foreign stocks listed on Canadian stock exchanges, most publicly-traded unlisted Canadian stocks, rights and warrants (listed or unlisted).

December 31, 1971 for all other capital property.

Where deductions from the cost base of a property (other than a partnership interest) reduce the balance to a negative amount at any time in the year, the taxpayer will be deemed to have made a capital gain to the extent of the negative balance, and the cost base will be adjusted to nil. Subsequent additions to the "adjusted cost base" cannot be used to reduce previous gains on the property resulting from a negative balance; these additions can only be considered in the determination of future gains or losses.

The rules of determining the adjusted cost base of a partnership interest are outlined under paragraphs 53(1)(e) and 53(2)(c).

The cost of a share must be reduced by the amount of any share-purchase tax credit or scientific research tax credit computed in respect of that share.

12C
Adjusted Cost Base of Depreciable Property

When property is depreciable property such as a building or equipment acquired for the purpose of gaining or producing income (other than a capital gain), the "adjusted cost base" of that property is the capital cost of the property to the owner.

12D
Outlays and Expenses

Most outlays of funds for the purpose of putting property into saleable condition and expenses incurred in connection with the disposition itself are deductible in the computation of any gain or loss. They include certain "fixing-up" expenses, finder's fees, commissions, surveyor's fees, transfer taxes and other reasonable expenses directly attributable to facilitating the disposition.

12E
Personal-Use Property

Personal-use property of a corporation is property owned by a corporation primarily for the personal use or enjoyment of an individual related to the corporation.

In computing gains and losses on the disposition of personal-use property, a $1,000 rule (subsection 46(1)) provides that if the adjusted cost base is less than $1,000, it is deemed to be $1,000. Consequently, there is no need to keep cost records unless the cost of acquisition is in excess of $1,000. Furthermore, where the proceeds of disposition are less than $1,000, they are deemed to be $1,000 as well.

The general rule is that losses on dispositions of personal-use property, with the exception of listed personal property (Guide Item 12F), are not deductible in computing income.

Where the amount of a gain is decreased or a loss is increased on the disposition of the capital stock of a corporation, an interest in a partnership, or an interest in a trust, and the reduction in gain or increase in loss can be reasonably attributed to a decline in the fair market value of personal-use property owned by the corporation, the amount of the gain or loss will be computed without reference to this decrease in value.

12F
Listed Personal Property

Listed personal property is personal-use property that is all or any portion of, or any interest in, or right to, any:

(a) Print, etching, drawing, painting, sculpture, or other similar work of art,

(b) jewelry,

(c) rare folio, manuscript or book,

(d) stamp, or

(e) coin.

Losses on dispositions of such items may only be deducted from gains on the dispositions of listed personal property. However, the total of such deductible losses may not exceed the total of such gains for the year. Any unabsorbed losses in the year may be applied to reduce similar net gains in the three immediately preceding years and in the following seven years.

12G
Shares

The disposition of a share in the capital stock of a corporation will normally produce a taxable capital gain or an allowable capital loss, except where the taxpayer is in the business of trading shares, in which case any gain or loss thereon would be used in determining business income.

A share conversion effected by means of a merger or amalgamation is considered to be a disposition of the share under subparagraph 54(c)(ii).

12H
Real Estate

Dispositions of depreciable or non-depreciable real property, other than that which may be described as a taxpayer's inventory, may result in a capital gain or loss (a terminal loss in the case of depreciable property).

Where part of the proceeds of disposition of real property are not payable to the taxpayer until after the end of the year, a reasonable amount may be deducted as a reserve in calculating a gain on the disposition. A maximum of 5 years may be used for a reserve with a minimum of 1/5 of the gain recognized in the year of disposition and in each of the four subsequent years (paragraph 40(1)(a)).

Further information is found in Interpretation Bulletins IT-152R3 and IT-153R2.

13
T2S(7) Income Analysis

This schedule provides for an analysis of the corporation's net income for income tax purposes showing separately the income from an **active business** carried on in Canada and the amounts of Canadian and foreign **investment** income.

Income from an active business will qualify for a Small Business Deduction providing the corporation is a Canadian-Controlled Private Corporation throughout the taxation year (Guide Item 38A). Canadian and foreign investment income will qualify for inclusion in the calculation of the refundable portion of Part I tax where a corporation was a Canadian-Controlled Private Corporation throughout the taxation year.

13A
Active Business Income

Income from an active business can generally be described as income from manufacturing or processing property for sale or lease, mining, operating an oil or gas well, prospecting, exploring or drilling for natural resources, construction, logging, farming, fishing, selling property as a principal, transportation, or any other business carried on by the corporation including any income incidental to carrying on an active business. It does not include income from a specified investment business or from a personal services business, taxable capital gains or property income. Active business income is further explained in Interpretation Bulletin IT-73R3.

13B
Canadian and Foreign Investment Income

Canadian investment income and foreign investment income include the following amounts:

(a) the excess, if any, of taxable capital gains over allowable capital losses for the year but excluding those gains or losses that accrued while the property was held by a corporation other than a Canadian-Controlled Private Corporation, **and**

(b) income from property, which includes income from a specified investment business but does not include

- income from a property held principally for the purposes of producing income from an active business carried on by it,
- income from any property that is incidental to an active business carried on by it,
- income deemed to be income from property by virtue of paragraph 108(5)(a)
- exempt income,
- dividends deductible from income under sections 112 and 113,
- income from a business carried on outside Canada,

less

- losses from a property (including losses from a specified investment business).

13C
Specified Investment Business Income

A specified investment business carried on by a corporation means a business (except the business carried on by a credit union or a business of leasing property other than real property) the principal purpose of which is to derive income from property (including interest, dividends, rents or royalties). The income of a specified investment business will not qualify for a Small Business Deduction.

The income of a corporation that would otherwise qualify as income from a specified investment business will not be regarded as such where:

(a) the corporation employs in the business throughout the year more than 5 full-time employees, or

(b) in the course of carrying on an active business, any other corporation associated with it provides managerial, financial, administrative, maintenance or other

similar services to the corporation in the year and the corporation could reasonably be expected to require more than 5 full-time employees if those services had not been provided.

13D
Personal Services Business Income

A personal services business carried on by a corporation is a business where an incorporated employee or any person related to the incorporated employee is a specified shareholder of the corporation and the incorporated employee performs services for the entity in what would otherwise be considered an employee-employer relationship. Where such a corporation employs more than 5 full-time employees or where the services are provided to an associated corporation, its income will not be regarded as being derived from a personal services business.

A Specified Shareholder includes a taxpayer who owns, directly or indirectly at anytime in the year, at least 10% of the issued shares of any class of capital stock of the corporation or a related corporation.

14
T2S(7)(A) Corporate Partnerships

Where a Canadian-Controlled Private Corporation carries on an active business in Canada as a member of a partnership, that corporation will be eligible for a Small Business Deduction to the extent that:

(a) the total of its income for the year from active businesses carried on by it in Canada other than as a member of a partnership, and

(b) its specified partnership income for the year,

exceeds

(c) the total of its losses for the year from all active businesses carried on by it in Canada other than as a member of a partnership, and

(d) its specified partnership loss for the year.

Form T2S(7)(A) is available for the determination of active business income by a corporation that is carrying on business as a member of a partnership. It should be submitted by all such corporations that are claiming the Small Business Deduction.

For purposes of completing form T2S(7)(A), the following definition of "specified partnership loss" is provided.

The **specified partnership loss** of a corporation for a taxation year is the total of the corporation's share of losses from active businesses carried on in Canada by it as a member of a partnership for each fiscal period of the partnership ending in the taxation year *(paragraph 125(7)(g))*.

"Specified partnership income" is defined in paragraph 125(7)(f).

15
T2S(8) Capital Cost Allowance

Paragraph 20(1)(a) allows a corporation to charge a portion of the capital cost of certain (depreciable) property against income earned in the year from a business or property, to the extent permitted by regulation. Where a taxation year is less than *12 months a proration may be required.*

The Capital Cost Allowance System generally provides an accelerated tax write-off compared to the actual depreciation in the value of the asset. Recent changes in

legislation have reduced the number of classes subject to the fast write-offs for depreciable property through the C.C.A. system for assets acquired after 1987.

Under Part XI of the Income Tax Regulations, depreciable property is grouped into prescribed classes, most of which are set out in Schedule II.

An overall maximum rate is prescribed for each class, and is normally applied to the undepreciated capital cost of the class at year end to determine the maximum capital cost allowance available to the taxpayer. The corporation may deduct any amount up to the maximum available for the year.

Tax Reform introduced substantial changes to the C.C.A. rates for assets acquired after 1987 (subject to grandfathering and transitional rates), as indicated in the following table.

Previous Class	New Class		Previous Rate	Current Rate
2	1	Public Utility Property	6% D.B.*	4% D.B.
3	1	Buildings	5% D.B.	4% D.B.
10	41	Resource Extraction Assets	30% D.B.**	25% D.B.***
11	8	Outdoor Advertising Signs	35% D.B.	20% D.B.
22	38	Earth-Moving Equipment	50% D.B.	30% D.B.
28	41	Drillships and Offshore Platforms	30% D.B.	25% D.B.
29	39	Manufacturing Machinery and Equipment	50% S.L.****	25% D.B.
30	10	Satellites	40% D.B.	30% D.B.

* D.B. indicates the declining balance method.

** The old C.C.A. rate for Resource Extraction Assets was 30% using the declining balance method **plus** immediate write-off up to income from new mine.

*** The current C.C.A. rate for Resource Extraction Assets is 25% declining balance **plus** immediate write-off up to income from new mine.

**** S.L. indicates the straight line method.

Grandfathering provisions

These C.C.A. rate reductions do not affect property acquired by a taxpayer after December 31,1987 and before 1990;

- pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987,
- that is a building, structure, plant facility or other property where the property was under construction by or on behalf of the taxpayer on June 18, 1987 or
- that is machinery or equipment that was a fixed and integral part of property under construction by or on behalf of the taxpayer on June 18, 1987.

Transitional Rates

For class 39 property, the rate is
40% for 1988,
35% for 1989, and
30% for 1990.

For class 38 property, the rate is
40% for 1988 and
35% for 1989.

In both cases, proration rules apply for taxation years that straddle January 1.

Half Year Rule

The half year rule now applies to cutting and shaping parts of a machine, dies, jigs, etc. acquired after 1987 (subject to the grandfathering provisions).

Other Recent Changes

Mining costs such as mine shafts, main haulage ways etc. incurred after 1987 are treated as Canadian development expenses as opposed to the former treatment as Class 12 property; similarly, overburden removal costs incurred after 1987 are treated as operating costs instead of Class 12 property.

The circumstances in which the original prescribed class of a property may be preserved on a transfer of the property are restricted to non-arm's length acquisitions of property and to transfers occurring as part of a so-called "butterfly transaction" after June 17, 1987.

Property acquired on a rollover or from a non-arm's length person is exempt from the half year rule. For acquisitions after June 17, 1987, these rules only apply to non-arm's length transfers and so-called "butterfly transfers."

Both of these changes do not apply to property acquired before 1990 pursuant to an obligation in writing entered into by the taxpayer before June 18, 1987.

Capital Cost Allowance Schedule

A basic schedule of Capital Cost Allowance and how to complete it follows:

(1) Class No.	(2) Undepreciated Capital Cost at Beginning of Year	(3) Cost of Additions During Year	(4) Adjustments	(5) Proceeds from Disposals	(6) Undepreciated Capital Cost Col. (2) plus (3) less (4) and (5)
	$	$	$	$	$

(7) Deduct 1/2 of the Amount, If Any, by Which Col. (3) (Net of Any Related Investment Tax Credit) Exceeds Col. 5 (If negative Enter NIL)	(8) Amount on which Capital Cost Allowance may be claimed (6) – (7)	(9) Rate %	(10) Capital Cost Allowance	(11) Undepreciated Capital Cost at end of year (6) – 10)
$	$	$	$	

Use a separate line for each class of property.

Column (3)

Enter for each class the total cost of assets acquired in the taxation year. The "Capital Cost" generally means the full cost of acquiring the property including legal, accounting, engineering or other fees incurred, but excluding the cost of land.

Column (4)

Enter the amount of any government assistance received or entitled to receive in the year and/or investment tax credits claimed in the preceding year relating to the capital property acquired. By virtue of subsection 13(7.1), the capital cost of depreciable property is reduced by the amount of such assistance. These amounts are not to be included in income. Applicable to 1985 and subsequent taxation years subsection 13(7.4) permits a taxpayer to elect to reduce the capital cost of depreciable property by the amount of related assistance received that would otherwise be included in income by virtue of paragraph 12(1)(x). In addition, subsection 13(7.4) allows for an increase in capital cost where any payment that previously reduced capital cost under the subsection is subsequently repaid.

Column (5)

Enter for each class the total amount for which assets were disposed of during the year. Where an asset is disposed of for an amount greater than its capital cost, the amount to be entered is the capital cost, not the proceeds of disposal. When the amount in column (5) of a class exceeds the total of columns (2) plus (3) less (4) of that class, the excess which represents a "recapture" of capital cost allowance must be added to income.

Column (7)

In most cases, the maximum capital cost allowance that may be claimed by the corporation in the year an asset is acquired is limited to one-half of the net amount attributable to the specific asset acquired. In computing capital cost allowance for that year, the undepreciated capital cost of each class (column 6) must be reduced by one-half of the amount of the net additions (cost of additions less proceeds from disposals) to that class for the year.

For further information including exceptions (e.g. class 12) concerning this "half-year rule" refer to Regulation 1100(2) – "Property Acquired in the Year" and IT-285R.

Column (9)

Enter the rate prescribed under Part XI of the Regulations.

Column (10)

To claim the maximum capital cost allowance, multiply the amount in column (8) for each class by the rate in column (9) to obtain the amount for column (10). However, if the corporation does not wish to claim the maximum, any amount up to the maximum computed above may be claimed.

A terminal loss results where all of the assets of a particular class have been disposed of and there is a remaining undepreciated capital cost (column 6) for that class. The amount of the terminal loss may be claimed as a deduction from income on schedule T2S(1).

Several Information Circulars and Interpretation Bulletins have been published to provide guidance relating to Capital Cost Allowance. These are available from your local District Office.

16
Corporate Relationships

Effective January 15, 1987, the acquisition of control of a corporation is considered to occur at the commencement of the day on which the change takes place. The corporation may elect to not have this apply by noting this on its

return for its taxation year ending immediately before the acquisition of control (Subsection 256(9)).

The following information should be completed as it applies to related and associated corporations.

16A
T2S(9) Related Corporations

A list of related corporations showing their names and addresses, details of any inter-company shareholdings and the type of relationship (foreign parent, Canadian parent, foreign subsidiary, Canadian subsidiary, or associated). Related corporations are defined in Section 251.

An amalgamated corporation is treated as being related to a predecessor corporation where immediately before the amalgamation, they would have been related had the amalgamated corporation been in existence at that time with the same shareholders as after the amalgamation.

Further information is contained in Interpretation Bulletin IT-64R2.

16B
Form T2013 Associated Corporations

Form T2013, "Agreement Among Associated Corporations", must be filed in accordance with instructions contained thereon by associated Canadian-controlled private corporations to allocate the Business Limit for purposes of the Small Business Deduction, and to allocate the Expenditure Limit for purposes of calculating Investment Tax Credit at the 35% rate in respect of qualifying scientific research and experimental development expenditures. The prior year taxable income of each corporation should also be provided for the purposes of determining the corporation's eligibility for the 35% rate of Investment Tax Credit, the 40% rate of refund in respect of unused Investment Tax Credits and the one-month extension of the date on or before which the corporation's balance of tax payable for a taxation year becomes due (the "balance due" date).

The amount of the business limit to be allocated among corporations that are associated is $200,000, and the amount of the expenditure limit to be so allocated is $2,000,000. However, where the particular corporation has a taxation year that is less than 51 weeks or where the corporation has two or more taxation years ending in the same calendar year, the following rules are applicable:

(a) Where the corporation has a taxation year that is less than 51 weeks its business and/or expenditure limits otherwise determined for the year must be prorated by a factor equal to the number of days in the taxation year divided by 365.

(b) Where the corporation has two or more taxation years that end in the same calendar year, its business and/or expenditure limits for each such taxation year in which it is associated are, subject to prorating as mentioned in (a), equal to its business and/or expenditure limits otherwise determined for the first such taxation year.

A Canadian-controlled private corporation qualifies for the special 35% rate of Investment Tax Credit, the 40% rate of refund in respect of unused Investment Tax Credits and the three-month balance due date where the total of the corporation's prior year taxable income together with the prior year taxable incomes of all corporations with which it was associated in the year does not exceed the aggregate of the business limits of the corporation and the associated corporations for those preceding years. For purposes of the 3 month balance due date, the corporation must also have deducted the Small Business Deduction in the year or immediately preceding taxation year.

"Prior year taxable income" means:

(a) for the particular corporation, its taxable income for the immediately preceding taxation year, and

(b) for the associated corporations, the taxable incomes for their taxation years ending in the calendar year preceding the calendar year in which the particular corporation's current taxation year ended.

16C
T2S(10) Non-Resident Related/Associated Corporations

A list of non-resident related or associated corporations with which there were any sales, purchases of goods or transfers of assets. For each such corporation, indicate the approximate total of amounts

- paid or credited for inter-company purchases and for services provided,
- received or charged for inter-company sales and for services rendered, and
- assets transferred.

Do not include royalties, rents and other charges described in Guide Item 34.

New legislation authorizes Revenue Canada to require the production of foreign based information or document which is available or located outside Canada that is relevant to the Canadian tax treatment of a transaction. It also stipulates that a separate prescribed form is required to be filed by corporations either resident in or carrying on business in Canada that have engaged in transactions with foreign related corporations.

The statutory limit for the assessments relating to cross border transactions has been extended to 6 years.

17
T2S(11) Transactions with Shareholders, Officers and Employees

A list providing full details of transactions, **other than transactions in the ordinary course of business,** with shareholders, officers or employees in respect of:

(a) assets sold to or purchased from shareholders, officers or employees, including those on which an election was made under section 85,

(b) payments made to or for the account of shareholders, officers or employees which did not form part of their authorized remuneration or reimbursement of expenditures, and

(c) loans or indebtedness to shareholders, persons connected with a shareholder, officers or employees which were not repaid by the end of the taxation year.

Exclude any transactions listed in Schedule T2S(10).

If the corporation has been involved in the year in a transfer of property under section 85, ensure the applicable election form T2057 or T2058 has been filed. Form T2058 is to be used when property has been transferred from a partnership and form T2057 is to be used in all other cases. These election forms may be obtained from any District Taxation Office.

17A
T2S(11A) Non-Arm's Length Transactions

Where the transaction was between corporations not dealing at arm's length and in respect of which a section 85 election is made, and all or substantially all of the

transferor's assets are disposed of to the transferee, provide the name, address and account number of the transferor.

Regulation 5301(8) requires that in such circumstances the transferee's instalment requirements be calculated with reference to those of the transferor.

Generally, it is the Department's position that "all or substantially all" means 90% or more. However, this is intended as a guideline only and must also produce results that are relative. For the valuation of assets, either cost or fair market value may be used, whichever produces the more realistic results.

18
T2S(12) Natural Resource Earned Depletion

This is a schedule for corporations engaged in mining, petroleum exploration and similar types of undertakings showing the continuity of qualifying expenditures incurred since November 7, 1969 or May 8, 1972, where applicable, that qualify for inclusion in the computation of the "earned depletion base".

For certain exploration and development expenditures incurred in the mining and petroleum industries, taxpayers are now permitted an earned depletion allowance which, together with other existing write-offs, permits a total deduction in excess of amounts actually spent.

New legislation phases out the earned depletion allowance by reducing the rate at which it can be earned from 33⅓ per cent to 16⅔ per cent for eligible expenditures incurred after June 30,1988 and by eliminating the ability to earn depletion on expenditures made after June 30, 1989. Eligible expenditures incurred before July 1988 continue to earn depletion at 33⅓ per cent and the legislation will not affect the ability to claim unused amounts of depletion earned before July 1989.

The provisions that require the recapture of earned depletion by a taxpayer on a disposition of the related resource property is being phased out in a similar manner after June 30, 1988.

19
T2S(13) Continuity of Reserves

A schedule showing the continuity of all reserves claimed including provisions for doubtful debts, reserves in respect of certain goods and services and capital gains reserves (Guide Item 12H). If you require further information, obtain Interpretation Bulletin IT-215R.

20
T2S(14) Miscellaneous Payments to Residents

A list of royalties for which a T5 has not been filed, technical assistance fees, research and development fees, management fees, and similar payments paid to *residents of Canada. List only payments in excess of $100 showing the names and* addresses of the recipients.

Technical assistance fees/payments are payments for services of a technical or industrial character related to the production of goods or the application of processes, formulae, and "know how" in the production process.

21
T2S(15) Deferred Income Plans

A list of the amounts claimed as a deduction from income for payments made to a *registered pension plan, registered supplementary unemployment benefit plan*, deferred profit sharing plan or employees profit sharing plan. The list should show:

(a) the names of each plan and the amount claimed as a deduction in respect of each,

(b) the registration number assigned by Revenue Canada, Taxation to each of the first three above-mentioned plans, and

(c) the name and address of the trust governed by an employee's profit sharing plan. If the trust is not resident in Canada, state whether forms T4PS Supplementary were filed for the last calendar year and by whom (trustee or employer).

22
T2S(16) Patronage Dividend Deduction

Form T2S(16), "Patronage Dividend Deduction", must be completed and attached to the T2 return of a corporation claiming a deduction for payments made pursuant to allocations in proportion to patronage.

Previously, in a taxation year where a corporation had made payments pursuant to allocations in proportion to patronage to its member and non-member customers at different rates, the Income Tax Act restricted the deduction the taxpayer may claim in a taxation year in respect of such payments made to member customers. This deduction was limited in any year to the lesser of the payments made by the taxpayer to member customers during the taxation year and its income for the year attributable to business done with its member customers. Where the patronage payments made to member customers in a taxation year under those circumstances exceeded this limit, the excess payment could not be deducted in any other year.

New legislation introduced a special provision to allow the carry-over of excess dividend payments. This amendment provides that where, in a taxation year ending after 1985, a taxpayer made payments pursuant to allocations in proportion to patronage to member customers in excess of the limitation imposed as detailed above, the undeductible excess payment will be deductible (within specified limits) against the income of the taxpayer for a subsequent taxation year attributable to business done with member customers of that year.

23
T2S(17) Allocation in Proportion to Borrowing

Credit unions claiming a deduction in respect of an "allocation in proportion to borrowing" must submit this schedule showing the computation of the deduction.

24
T2S(18) Refundable Capital Gains Tax On Hand

This schedule is required to be filed by every corporation that is an investment corporation under paragraph 130(3)(a), or a mutual fund corporation under subsection 131(8). The schedule should also provide the federal and provincial computations of any "capital gains refund" requested by such corporations. Corporations may refer to the Provincial Income Tax Acts for the necessary details concerning the provincial capital gains refund calculations.

A "capital gains refund" (federal portion) is to be shown as a credit on line 149. The provincial and territorial capital gains refund is to be shown as a credit on line 151.

New legislation has revised the percentage used in determining the Refundable capital Gains Tax on Hand from 36% to 28% applicable to taxation years ending after June 1988. For a taxation year which straddles June 30, 1988, the 36% rate is still applicable for the period before July 1988.

25
T2S(19) Non-Resident Ownership

Where a share of any class of capital stock of the corporation is owned by a non-resident, provide a list of the number of shares issued and outstanding and the percentage thereof owned by non-resident shareholders at the end of the taxation year.

26
T2S(20) Additional Tax Under Part XIV

A calculation of the additional tax which is applicable to corporations (other than corporations that were, throughout the year, Canadian corporations) that have, at any time in the taxation year, carried on business in Canada. Details of the calculation are contained in Section 219 of the Income Tax Act. The amount should be entered on line 135. If you require further information, obtain Interpretation Bulletins IT-137R2 and IT-277R.

27
T2S(22) Non-Resident Discretionary Trust

If the corporation or any controlled foreign affiliate of the corporation, or any other corporation or trust with which the corporation did not deal at arm's length had, at any time during the taxation year, a beneficial interest in a non-resident discretionary trust to which subsection 94(1) applied, it is required to provide the names and mailing addresses of:

(a) each such non-resident discretionary trust, and

(b) the trustees thereof.

28
T2S(23) Scientific Research and Experimental Development

Expenditures incurred in the year in respect of scientific research and experimental development may be specified for the purposes of Part I (in the calculation of the Investment Tax Credit) or Part VIII, but not both. On this schedule provide the following information:

(a) Qualified Expenditures specified for the purposes of the Investment Tax Credit and the current year credit applicable to those expenditures as reported on form T2038 (Guide Item 38L), and

(b) Expenditures specified in the calculation of the Part VIII refund as reported on line 17 of the Corporation Part VIII Tax Return (form T2115).

Every corporation claiming scientific research and experimental development expenditures under subsection 37(1) must submit prescribed form T661 (Rev. 86), Claim for Scientific Research and Experimental Development Expenditures, with their return whether or not an investment tax credit is also claimed.

New legislation requires partnerships to deduct their R. & D. expenditures in the year those expenditures are made for the purpose of computing income at the partnership level. Also any loss for tax purposes that is allocated by a partnership to limited partners and other partners not actively engaged in the partnership business will be denied in the hands of the partner to the extent that the partner's share of the loss is attributable to R. & D. deductions taken by the partnership. This is applicable to fiscal periods ending after December 15, 1987 (subject to grandfathering).

29
T2S(24) First-Time Filers

(A) Every corporation that is filing a T2 return for the first time must submit:

   (i) the opening balance sheet and, where applicable,

   (ii) copies of all relevant agreements, or full particulars thereof, regarding the issuance of shares for other than cash consideration, and

   (iii) the closing balance sheet of any proprietorship, partnership or corporation that was acquired by the new corporation.

   On the front page of the return, provide the date of incorporation and tick "yes" to the question "Is this the first year of filing?".

(B) For the first return of a newly amalgamated corporation, in addition to the above, include:

   (i) the names of the predecessor corporations and the corporation account numbers.

   (ii) Taxation Office(s) where the last returns of the predecessor corporations were filed.

   Provide the date of amalgamation on the front page of the return in the Identification area.

(C) For the first return of a parent corporation after winding-up a subsidiary, provide:

   (i) the name(s) of the subsidiary corporation(s) and the corporation account number(s), and

   (ii) Taxation Office(s) where the last returns of the subsidiary corporation(s) were filed.

All such documents should be identified as "T2S(24)".

30
T2S(25) Investment in Foreign Affiliates

Every corporation resident in Canada that holds shares in one or more foreign affiliates, as defined in paragraph 95(1)(d), is required to provide:

(a) the names of all its foreign affiliates, distinguishing between "controlled" and "other" foreign affiliates, and

(b) the "equity percentage", as defined in paragraph 95(4)(b), in respect of each foreign affiliate.

31
T2S(26) Allowable Refund

This is a schedule showing the calculation of the "allowable refund" of a non-resident-owned investment corporation in accordance with paragraph 133(8)(a). A separate calculation should be prepared for each taxable dividend paid during the year. The total amount should be entered on line 153.

32
T2S(27) Computation of Canadian Manufacturing and Processing Profits

This schedule provides for the calculation of Canadian Manufacturing and Processing Profits. Companies deriving 10% or more of their gross revenue for the year

from all active businesses carried on in Canada from the sale or lease of goods manufactured or processed in Canada may claim a deduction from tax in respect of such profits. The amount determined on this schedule is entered on the T2-FTC Schedule 1.

33
T2S(28) Additions for Foreign Tax Deductions

Every corporation that is claiming an addition to taxable income under section 110.5, in order to avoid a wastage of the foreign tax credit, must provide a reconciliation between taxable income otherwise determined under the Income Tax Act, and taxable income including the section 110.5 addition.

The amount added to income under section 110.5 is to be included in line 127 on the front of the T2 return. Indicate to the immediate left of line 127 the amount of the section 110.5 addition with the following notation: "Section 110.5 – $________."

34
T2S(29) Payments to Non-Residents

Every corporation who has paid, credited or distributed amounts in lieu of or in satisfaction of any royalties, rents, dividends, management fees, technical assistance fees, research and development fees, interest or film payments and/or any payments for services either regular or continuous and/or other services to Non-residents of Canada is required to file the appropriate information return in accordance with the relevant provisions of the Income Tax Regulations.

Where an NR4-NR4A or T4-T4A return has not been filed in respect of any such payments, list the types of payments, dollar amounts, and the names and addresses of the payees.

35
T2S(30) Non-Canadian Advertising Expense

Where a corporation is claiming an expense for advertising space in an issue of a Non-Canadian newspaper or periodical or for an advertisement broadcast by a foreign broadcasting undertaking, list on this schedule the amount claimed for each such newspaper, periodical or broadcasting undertaking.

36
Additional Information

In addition to the above schedules, all corporations must complete the remaining areas identified as Additional Information, Location of Books and Records, and Certification.

COMPLETION OF COMPUTATION OF TAXABLE INCOME

The total of all the following deductions should be subtracted from net income to arrive at taxable income for the year to be entered on line 127. Where the corporation has taxable income, the amount from line 127 should be entered in the Part I tax calculation on the T2-FTC Schedule 1.

37
Net Income

Where a corporation has net income for the year, that amount should be entered on line 111 on the front page of the T2 return from the financial statements or T2S(1) (if adjustments were made to net income per financial statements). Where a corporation incurs a loss for the year, that amount should be entered on line 111 and

enclosed in brackets. This loss should be included with other losses on schedule T2S(4) (Guide Item 11).

37A
Deduction for Gifts

Charitable Gifts – A corporation, for the purpose of computing the taxable income for a taxation year, may deduct the total amount applicable as a gift made during the taxation year (and in the 5 immediately preceding years to the extent that such amounts were not previously deducted by the taxpayer) to

(a) registered charities,

(b) registered Canadian amateur athletic associations,

(c) housing corporations resident in Canada and exempt from Part I tax by paragraph 149(1)(i),

(d) Canadian municipalities,

(e) the United Nations or agencies thereof,

(f) prescribed universities outside Canada whose student body ordinarily includes students from Canada, and

(g) charitable organizations outside Canada to which Her Majesty in right of Canada has made a gift during the corporation's taxation year or the 12 months immediately preceding that taxation year.

This deduction can not exceed 20% of its income for the year (computed without reference to subsection 137(2)).

Charitable donations made, including amounts carried forward, should be entered on line 113 from schedule T2S(2). The maximum amount deductible on line 115 is limited to an amount not exceeding 20% of net income on line 111. If there are donations remaining in excess of this claim, this excess may be carried forward for up to 5 years and claimed, subject to the 20% of net income limitation, to the extent that they were not deducted in a previous year.

Where the corporation reports a loss on line 111, the donations will not increase that loss but can be carried forward to the subsequent year.

Donations carried forward from a previous year(s) are to be claimed before donations made in the current year.

Paragraph 110.1(1)(a)

Gifts to Her Majesty – A corporation, for the purpose of computing its taxable income for a taxation year, may deduct the total amount applicable as a gift made during the taxation year (and in the 5 immediately preceding years to the extent that such amounts were not previously deducted by the taxpayer) to Her Majesty in right of Canada and Her Majesty in right of the provinces.

After reducing net income by the allowable amount of charitable donations, any excess of these gifts not required to reduce taxable income to nil may be carried forward for up to 5 years to the extent that they were not deducted in a previous year.

Paragraph 110.1(1)(b)

Gifts to Institutions – A corporation, for the purpose of computing its taxable income for a taxation year, may deduct the total amount applicable as a gift of cultural significance made during the taxation year and in the 5 immediately

preceding years to the extent that such amounts were not previously deducted by it, to qualifying institutions.

Paragraph 110.1(1)(c)

After reducing net income by the allowable amount of charitable donations,any excess of these gifts required to reduce taxable income to nil may be carried forward for up to 5 years to the extent that they were not deducted in a previous year.

37B
Taxable Dividends Received

The total of taxable dividends received which are deductible from income under sections 112 and 113 should be entered on line 119 from schedule T2S(3). Where the corporation is a Private Corporation or a "Subject" corporation at any time in the taxation year, these dividends may be subject to Part IV tax. See Guide Items 10 and 40 for further clarification.

Reducing net income on line 111 by taxable dividends received may have the effect of creating a non-capital loss for the year or increasing that non-capital loss where no income is shown on line 111. These situations are illustrated in the following examples.

Example 1

Net Income (Loss)	$ (8,500)
Less: Taxable Dividends	3,000
Non-Capital Loss for the year	$(11,500)

Example 2

Net Income (Loss)	$ 3,500
Less: Taxable Dividends	6,800
Non-Capital Loss for the Year	$ (3,300)

Example 3

Net Income(Loss)		$ 10,000
Less: Charitable Donations ($2500)	Nil	
Gifts to Canada ($1200)	Nil	
Taxable Dividends	12,000	12,000
Taxable Income		Nil

The non-capital loss for the year is $2000 ($10,000 – $12,000). Donations available to be carried forward are $2500. Gifts available to be carried forward are $1200.

Charitable donations, gifts to Canada or a province and gifts of cultural property that are deducted in a year cannot create or increase a non-capital loss.

Non-capital losses and farm losses may be applied to reduce taxable dividends subject to Part IV tax. (Guide Items 37E, 37G and 40).

37C
Restricted Farm Losses

Enter the restricted farm loss on line 121 as determined on Schedule T2S(4), (see also Guide Items 11 and 11E). Ensure that the amount claimed does not exceed the amount of farming income included in net income on line 111.
Paragraph 111(1)(c)

37D
Non-Capital Losses

A Non-capital loss incurred in the current taxation year may be applied to reduce all types of income for the three immediately preceding and seven immediately following taxation years.

Non-capital losses of other years applied to reduce income subject to Part I tax should be included on line 123.

The corporation may choose to apply non-capital losses to reduce taxable dividends subject to Part IV tax. (See Guide Item 40.) When either a current year non-capital loss or non-capital losses of other years are applied to reduce taxable dividends subject to Part IV tax, the amount of the applied loss should be included on line 406 in the Part IV tax calculation area on the reverse of the T2-FTC Schedule 1.

If a non-capital loss is applied to Part IV tax it is no longer deductible in computing taxable income in other years.

Where the control of the corporation is changed, any non-capital loss of the corporation incurred in carrying on a particular business for a taxation year ending before the change is deductible in a taxation year ending after the change in control if certain conditions in subsection 111(5) are met.

For acquisitions of control occurring in the taxation year, the carry-back of non-capital losses for a taxation year commencing after the date of acquisition of control are allowable in a taxation year commencing before that date only if certain conditions in subsection 111(5) are met.

Guide Items 11 and 11A provide further information concerning non-capital losses.

Paragraph 111(1)(a)

37E
Net Capital Losses

In computing taxable income for the current taxation year, there may be deducted from the income for the year the net capital losses for preceding taxation years, and for the three immediately following taxation years, but only to the extent of the lesser of the following amounts:

(a) the balance of any unapplied portion of the net capital losses for preceding taxation years and the three immediately following taxation years, and

(b) the taxable capital gain for the year from disposition of property other than listed personal property, and its taxable net gains for the year from dispositions of listed personal property, minus the allowable capital losses for the year from dispositions of property other than listed personal property.

(See also Guide Items 11 and 11C). Enter Net Capital Losses of other years on Line 125.

Paragraph 111(1)(b)

37F
Farm Losses

A farm loss is the corporation's net loss from farming and fishing businesses, and may be applied to reduce all types of income in the three immediately preceding taxation years and the ten immediately following taxation years. Farm losses of other years applied to reduce income for the year should be entered on line 126.

Farm losses may also be applied to reduce dividends subject to Part IV tax (See

Guide Item 40). When either a current year farm loss or farm losses of other years are applied to reduce dividends subject to Part IV tax, the amount of the applied loss should be included on line 406 in the Part IV tax calculation area on the T2-FTC Schedule 1.

(See also Guide Items 11 and 11B).

Paragraph 111(1)(d)

COMPLETION OF T2-FTC SCHEDULE 1

The T2-FTC Schedule 1 incorporates the calculations for the Part I tax, Small Business Deduction, Manufacturing and Processing Profits Deduction, Refundable Taxes on Investment Income, and Part IV tax.

38
Part I Tax on Taxable Income

The rate of Part I tax was reduced from 46% to 43% after June 30, 1987. Transitional provisions in the Income Tax Act originally provided for the phasing in of this rate between July 1987 and June 1989.

Under Tax Reform, the basic rate of Part I Tax after June, 1988 is 38% on all income for all corporations. For Canadian-Controlled Private Corporations, the tax on their investment income becomes 38% effective January 1, 1988.

The revised rates are to be prorated for taxation years that straddle the effective dates of July 1, 1987, January 1, 1988 and July 1, 1988.

There is an additional Part I tax at 5% in respect of taxable income earned in the Nova Scotia Offshore area.

In addition to Part I tax, taxable income earned in the Newfoundland Offshore area is subject to a corporate tax equal to the prevailing Newfoundland corporate rate of tax, currently 16% reduced to 10% for income eligible for the small business deduction. A federal tax abatement of 10% is permitted in respect of taxable income allocated to the Newfoundland Offshore area. These provisions are applicable to taxation years commencing after April 4, 1987.

The tax computed at these rates can be reduced by various deductions and credits as outlined in this guide.

The T2-FTC Schedule 1 Supplementary is used in conjunction with the T2-FTC Schedule 1 to calculate adjustments to Part I Tax. These forms have been revised to accommodate all legislative changes and are available from any District Taxation Office. Enter the amount calculated on the T2-FTC Schedule 1 Supplementary in field 208 of the T2-FTC Schedule 1.

Section 123.

Proposed legislation: Taxable income allocated to the Nova Scotia Offshore area will be treated similar to taxable income allocated to the Newfoundland Offshore area in that it will be subject to a corporate tax equal to the prevailing Nova Scotia corporate rate of tax. This is currently 15% reduced to 10% for income eligible for the small business deduction.

38A
Small Business Deduction

Small Business Deduction is available to corporations that were Canadian-Controlled Private Corporations throughout the taxation year.

For corporations whose taxation year ends before July, 1988, this deduction reduces Part I tax by 21% on the portion of the corporation's income that is active business income. For corporations whose taxation year ends after June, 1988, **Tax Reform reduces this deduction rate** to 16%.

For taxation years that straddle June 30, 1988, the small business deduction computed with the 16% rate is increased to 21% of the least of amounts determined in "a" to "c" below prorated by the number of days in the taxation year before July, 1988 divided by the number of days in the taxation year.

Active business income is defined in Guide Item 13A. The amount of active business income should be entered on line 223.

The Small Business Deduction is calculated as the applicable percentage (21% or 16%) of the least of:

(a) (i) income from an active business carried on primarily in Canada where the corporation does not carry on business as a member of a partnership, or

(ii) where the corporation is a member of one or more partnerships, the active business income determined in accordance with form T2S(7)(A),

(b) its taxable income for the year, less the sum total of:

(i) 10/4 of the amount deductible from Part I tax in respect of foreign non-business income tax credit, if the tax for the year otherwise payable under Part I were determined without reference to the tax in respect of the investment income of Canadian-controlled private corporations per subparagraph 123(1)(a)(iv), and

(ii) two times the amount deducted from Part I tax in respect of foreign business income taxes, and

or

(c) its "business limit" for the year.

For taxation years commencing after June, 1988, in computing taxable income for the small business deduction calculation (relating to the limitation under paragraph 125(1)(b) of the Act) taxable income will be reduced by

(i) 10/3 of the amount deducted as Foreign Non-Business-Income Tax Credit, and

(ii) 10/4 of the amount deducted as a Foreign Business-Income Tax Credit.

A corporation's **business limit** for a taxation year generally is equal to $200,000. However, where the corporation is associated in the year with one or more other corporations, the $200,000 business limit must be allocated among the associated corporations. Form T2013 – "Agreement Among Associated Corporations" provides for the allocation of the business limit among the associated corporations. See Guide Item 16B for more information concerning form T2013.

Where a corporation has a taxation year that is less than 51 weeks, its business limit otherwise determined for the year must be prorated by a factor equal to the number of days in the taxation year divided by 365.

Section 125

38B
Investment Corporation Deduction

The Investment Corporation Deduction is allowed to a corporation that throughout the year met all of the following conditions:

(a) it was a Canadian corporation that was a public corporation.

(b) at least 80% of its property throughout the year consisted of shares, bonds, marketable securities or cash.

(c) not less than 95% of its income for the year was derived from investments,

(d) not less than 85% of its gross revenue for the year was from sources in Canada,

(e) not more than 25% of its gross revenue for the year was from interest,

(f) at no time in the year did more than 10% of its property consist of shares, bonds, or securities of any one corporation or debtor other than her Majesty in right of Canada or of a province or a Canadian municipality,

(g) none of its shareholders at any time in the year held more than 25% of the issued shares of the corporation, and

(h) not less than 85% of the amount determined under clauses 130(3)(viii)(A) and (B) (less any dividends or interest received by it in the form of shares, bonds, or other securities that had not been sold before the end of the year) was distributed, otherwise than by way of capital gains dividends, to its shareholders before the end of the year.

Tax Reform legislation has reduced this deduction (determined under subsection 130(1) of the Act) from 22% to 20%, of taxable income other than taxed capital gains, applicable to taxation years ending after 1987. For taxation years commencing before July 1988, the deduction is increased by the total of the following amounts:

(i) 5% of the excess* multiplied by the number of days in the taxation year before July, 1987 divided by the number of days in the taxation year,

(ii) 4% of the excess* multiplied by the number of days in the taxation year after June, 1987 and before 1988 divided by the number of days in the taxation year, and

(iii) 7% of the excess* multiplied by the number of days in the taxation year after 1987 and before July, 1988 divided by the number of days in the taxation year.

* excess refers to the excess of taxable income over taxed capital gains for the year.

38C
Additional Deduction – Credit Unions

In addition to the Small Business Deduction, a credit union is permitted to pay tax at a reduced rate on income which may be needed to build up a tax-paid reserve equal to 5% of deposits and capital. This additional deduction is in recognition of the statutory reserves required by provinces, and the fact that these reserves may not be available for distribution to members.

For taxation years ending before July, 1988, the additional deduction is equal to 21% of the lesser of:

(a) the corporation's taxable income for the year less the amount of income, if any, on which the Small Business Deduction has been claimed for the year, and

(b) ⅓ of the maximum cumulative reserve of the Credit Union at the end of the current year

minus

(c) the preferred rate amount of the Credit Union at the end of the previous year, plus the amount eligible for the Small Business Deduction for the current year.

Tax Reform reduced the rate used in computing this additional deduction for Credit Unions from 21% to 16% for taxation years ending after June 1988. For taxation years commencing before July 1988 and ending after June 1988, a transitional provision will maintain the deduction at 21% in respect of the portion of the year which falls before July, 1988.

Section 137.

38D
Federal Tax Abatement

The Federal Tax Abatement is calculated at 10% of the taxable income earned in a province including the Yukon, Northwest Territories and Newfoundland Offshore Area. This abatement is intended to offset all or part of the provincial or territorial Corporation Income Tax. No abatement is allowable in respect of taxable income earned outside Canada or taxable income earned in the Nova Scotia Offshore area.

Section 124.

Proposed legislation: The Nova Scotia Offshore area will be eligible for the federal tax abatement effective on a date to be set by proclamation.

38E
Manufacturing and Processing Profits Deduction

The Manufacturing and Processing Profits Deduction provides that a corporation engaged in manufacturing or processing, in Canada, of goods for sale or lease will pay a reduced Part I Tax. This deduction applies to taxable income to the extent it represents Canadian manufacturing and processing profits, and **under recent changes in legislation,** is computed at the following rates:

	June '87– June '88	July '88	July '89	July '90	July '91 & Sub.
Income eligible for the Small Business Deduction	6%	N/A*	N/A	N/A	N/A
Income Not Eligible for the Small Business Deduction	7%	2%**	3%	4%	5%

* The MPPD, in respect of income eligible for the small business deduction, has been eliminated for taxation years ending after June, 1988. However, a transitional rule provides that for taxation years commencing before July 1988 and ending after June, 1988, a proration is applicable.

** Prorations will be required for all straddle years based on the number of days on either side of the effective dates.

The terms "manufacture" and "process" are outlined in Interpretation Bulletin IT-145R.

The computation of "Canadian Manufacturing and Processing Profits" is provided for on form T2S(27), available from any District Taxation Office. The rules contained thereon should be followed to determine if a corporation, in determining these profits, should use the small manufacturer's method of calculation or the more detailed method for other corporations. Form T2S(27) should be filed with the T2 return.

In the Manufacturing and Processing Profits Deduction calculation, taxable income should, **as a result of recent changes in legislation,** now be reduced by any Foreign Business-Income Tax Credit grossed up by

(a) 10/4, if the taxation year commenced after June, 1988, and,

(b) 2, if the taxation year commenced before July, 1988.

The T2-FTC Schedule 1 has been revised to accommodate these changes for the 1988 and subsequent taxation years.

Enter the deduction on line 243.

Section 125.1

38F
Corporate Surtax

Effective January 1, 1987, a 3% corporate surtax is applicable on federal tax otherwise payable.

The 3% surtax is not applicable to non-resident-owned investment corporations.

Tax Reform provided a technical change in the calculation of the Corporate Surtax as it applies to corporations that were Canadian-Controlled Private Corporations throughout the taxation year.

The amount (in item "iv" of form T2215) which was previously deducted by CCPC's from the "Net Amount from the Part I Tax on Taxable Income calculation on the T2-FTC Schedule 1" will now be factored by 4/5.

This is applicable to the 1988 and subsequent taxation years. For taxation years commencing before 1988 and ending after 1987, an additional amount is deducted. This additional amount is equal to 1/5 of the factored amount above times the number of days before 1988 divided by the number of days in the taxation year.

In addition to the changes noted above, this legislation provided that effective for 1988 and subsequent years, the new Part VI tax credit is not to be deducted in determining the federal tax for purposes of the application of the corporate surtax.

Form T2215 Rev.88 is used to calculate the corporate surtax and is available from any District Taxation Office.

Sections 123.1 and 123.2.

38G
Foreign Tax Credits

The calculation of non-business and business foreign tax credits should be completed in Part II of form T2S-TC. This schedule provides for calculating a maximum of three non-business and three business foreign tax credits only. Corporations claiming more than three of either the non-business or business foreign tax credits should attach a separate schedule. The calculated credits should be entered on lines 211 and 213 of T2-FTC Schedule 1.

Subsection 20(12) permits a deduction from income in respect of all, or any portion, of non-business income tax paid in the year to the government of a foreign country. The portion of the non-business foreign tax so deducted may not be used in the calculation of the foreign tax credit.

An excess of non-business foreign tax paid over the federal non-business foreign tax credit allowed is eligible to be deducted as a provincial foreign tax credit. (Guide Item 46).

Any excess of business foreign tax paid over the business foreign tax credit deductible in the year becomes a corporation's unused foreign tax credit for the year. Unused foreign tax credits incurred in the taxation year are available for a three year carry-back and a seven year carry-forward, but no carry-back is allowable prior to 1984.

The unused foreign tax credit for a taxation year may be claimed in any other taxation year within the carryover period to the extent the corporation chooses. However, unused foreign tax credits must be utilized in the order in which they arose. Further, the amount of the business foreign tax credit claimed in a taxation year is considered first to be in respect of foreign business tax paid for that year and any remaining balance of business foreign tax credits claimed is considered to be a deduction in respect of unused foreign tax credits carried over from other years.

For 1985 and subsequent taxation years, a corporation is permitted under section 110.5 to increase its taxable income for purposes of utilizing an otherwise non-deductible foreign tax credit. However, the corporation may not add an amount under section 110.5 if that addition increases the deductible portion of any of the following amounts:

- Small Business Deduction
- Manufacturing and Processing Profits Deduction
- Federal Logging Tax Credit
- Federal Political Contribution Tax Credit
- Investment Tax Credit
- Employment Tax Credit
- Share-Purchase Tax Credit
- Scientific Research and Experimental Development Tax Credit

The amount added to a corporation's taxable income under section 110.5 is included in the corporation's non-capital loss otherwise determined for the year.

Schedule T2S(28) should be submitted where taxable income is increased under section 110.5. The amount added to income is to be included in the amount entered on line 127 on the front of the T2 return. Indicate to the immediate left of line 127 the amount of the section 110.5 addition with the following notation:

Section 110.5 – $__________."

Recent changes in legislation included a technical change relating to Part I Tax Otherwise Payable.

For purposes of calculating the Foreign Non-Business Income Tax Credit, the references to the base amounts for the supplementary tax on investment income of Canadian Controlled Private Corporations have been deleted for the computation of tax otherwise payable, and the 10% abatement will apply only to taxable income earned in a province, instead of **all** taxable income.

For purposes of calculating the Foreign Business-Income Tax Credit, the references to the supplementary tax on investment income of Canadian Controlled Private Corporations and the supplementary tax on Investment and Mutual Fund Corporations have been deleted for the computation of tax otherwise payable.

These technical adjustments are applicable to the 1987 and subsequent taxation years, except that in their application to taxation years ending after 1986 and commencing before July, 1988 there are transitional provisions.

Part II of form T2S-TC reflects these changes in legislation.

38H
Federal Logging Tax Credit

Corporations which have income from logging operations and which have paid logging tax to the provinces of Quebec or British Columbia are eligible for this credit. The calculation should be completed on form T2S-TC and submitted with the T2 return. The credit should be entered on line 215 of the T2-FTC Schedule 1.

38I
Federal Political Contribution Tax Credit

In accordance with subsection 127(3), a portion of contributions to registered federal political parties or officially nominated candidates at an election to the House of Commons is deductible in computing Part I tax. Political contributions that qualify for any grant, credit, subsidy or other form of assistance from other government bodies are not deductible.

The allowable credit is as follows:

75% of the first $100 contributed, plus
50% of the next $450 contributed, plus
33⅓% of the amount contributed exceeding $550
to a maximum credit of $500.

Enter the total amount of the contribution and the amount of the allowable credit on lines 219 and 217 respectively.

Proof of payment in the form of an official receipt signed by the registered agent to the registered party or the official agent of the candidate must be attached to the return. Photocopies of receipts are only acceptable for Income Tax purposes if they are certified as true copies by the issuer.

38J
Share-Purchase Tax Credit

Canadian Private or Public Corporations that issued shares after June 30, 1983 and before January, 1987 could offer the initial purchasers of these shares a Share-Purchase Tax Credit of up to 25 per cent of the amount of consideration for which the share was issued.

A corporation's Share-Purchase Tax Credit consists of the sum of the amounts designated as credits under subsection 192(4) by an issuing corporation in respect of each share acquired in the year by the corporation as the first registered holder.

The corporation's unused Share-Purchase Tax Credit arises when the Share-Purchase Tax Credit for the year could not be deducted by the corporation from Part I tax otherwise payable for the year or applied to obtain a Part VII tax refund.

Under subsection 127.2(1), a corporation may deduct from its Part I Tax otherwise payable both its Share-Purchase Tax Credit for the year and its unused Share-Purchase Tax Credit for the following year.

Where a corporation is tax-exempt under paragraphs 149(1)(e) to (y), a refund equal to its Share-Purchase Tax Credit is allowed (subsection 127.2(2)).

Information slip T2111 from the issuing corporation, identifying the amount of the credit, should be attached to the T2 return and the amount entered on line 220. Tax exempt corporations should enter the amount on line 157.

Where the corporation (other than an exempt corporation) does not have sufficient tax payable either in the year in which the tax credit is earned or in its immediately

preceding taxation year, any remaining unused portion of the credit will be treated as a capital loss for the year following the year in which the tax credit is earned.

A designation in respect of a share-purchase tax credit is only available in respect of qualifying shares issued after May 22, 1985 and before 1987. A "qualifying share" is defined as a prescribed share of the capital stock of a taxable Canadian corporation issued after May 22, 1985, other than a share issued after that date and before 1986 under the terms of an agreement in writing entered into before May 23, 1985.

38K
Scientific Research and Experimental Development Tax Credit

First time investors qualify for a Scientific Research and Experimental Development Tax Credit where the issuing corporation has renounced the tax benefit of deductions and related investment tax credits for scientific research and experimental development expenditures.

The amount of credit is 50% of the amount designated in respect of qualifying investments defined as shares or debt obligations issued, or rights granted under a scientific research and experimental development financing contract by a corporation after September, 1983 where the investor is the first person (other than a broker or dealer in securities) to have acquired the share, debt obligation or right.

The amount of credit is deductible either from the corporation's tax under Part I or against any liability that may arise under Part VIII of the Income Tax Act.

An unused Scientific Research and Experimental Development Tax Credit results when the Scientific Research and Experimental Development Tax Credit for the year cannot be deducted from Part I tax otherwise payable for the year or applied to obtain a Part VIII refund.

Under subsection 127.3(1), a corporation may deduct both the Scientific Research and Experimental Development Tax Credit for the year and its unused Scientific Research and Experimental Development Tax Credit of the following year. Information slip T2114 from the issuing corporation, identifying the amount of the credit should be attached to the T2 return for the year in which the credit was earned and the amount entered on line 216.

Where the corporation does not have sufficient tax payable either in the year in which the tax credit is earned or in its immediately preceding taxation year, any remaining unutilized portion of the credit will be treated as a capital loss for the year following the year in which the tax credit is earned.

As a result of the May 23, 1985 Budget, legislation was passed which eliminates the designating of scientific research tax credits on shares issued after May 22, 1985. Transitional rules permit the designation of SRTC on "qualifying shares" issued after May 22, 1985 and before January 1, 1986 under the terms of an agreement in writing entered into before May 23, 1985.

Section 127.3

38L
Investment Tax Credit

A corporation that acquires any of the following types of property or which incurs any of the following expenditures, as defined in subsection 127(9) and part XLVI of the Regulations, may qualify for an Investment Tax Credit:

- qualified property;
- approved project property;
- qualified transportation equipment;

- certified property;
- qualified construction equipment;
- expenditures in respect of scientific research and experimental development (R & D); or
- qualified Canadian exploration expenditure.

The specified percentages used to calculate these credits are listed in subsection 127(9) of the Income Tax Act.

Form T2038 (CORP) is available from your District Taxation Office and one completed copy of the form must be included with the T2 return where the corporation:

(1) has acquired any property or incurred any of the expenditures listed above which qualifies for the Investment Tax Credit;

(2) is carrying-over unused Investment Tax Credits from a previous year;

(3) has requested a carry-back of unused Investment Tax Credits to a prior taxation year; or

(4) has requested a refund in respect of the unused Investment Tax Credit. See Guide Item 65B.

Form T2038 (CORP) provides for two separate pools of Investment Tax Credit. For property acquired and expenditures incurred prior to April 20, 1983, previous legislative limitations remain in effect, i.e. any unused credits are not available for carry-back to prior years but may be carried forward five years.

Unclaimed Investment Tax Credits earned after April 19, 1983 may be carried forward ten years and carried back three years, but in no event to a taxation year prior to 1981. Investment Tax Credits may be carried back to a prior year only to the extent that the credits are not deductible in the year in which they are earned.

Qualified Property includes new prescribed buildings, machinery or equipment acquired during the year. The Investment Tax Credit earned on Qualified Property varies according to the date purchased.

A special 60% Investment Tax Credit is applicable for **approved project property** with a minimum capital cost of $25,000. Approved project property is defined as new prescribed buildings, machinery or equipment that has been certified by the Minister of Regional Industrial Expansion as having been acquired for use or lease by the corporation in respect of a project located in Cape Breton. This credit, commonly referred to as the Cape Breton Investment Tax Credit, may be carried back 3 years and forward 10 years. A claim for the Cape Breton Investment Tax Credit must be supported by a Certificate of Eligibility form issued by the Department of Regional Industrial Expansion (form DRIE 1231), or by the Atlantic Canada Opportunities Agency (form ACOA 59).

Tax Reform legislation reduces the specified percentages with respect to the Investment Tax Credit to

(a) 15% (from 20%) for qualified property acquired after 1988 for use in Newfoundland, Prince Edward Island, Nova Scotia, New Brunswick, the Gaspe' Peninsula or in a prescribed offshore region,

(b) 30% (from 40%) for certified property acquired after 1988,

and,

(c) 45% (from 60%) for approved project property acquired after 1988 for use in Cape Breton.

Property acquired which is **qualified construction equipment** or **qualified transportation equipment** is eligible for an Investment Tax Credit at varying rates de-

pending on the date purchased as specified in the Income Tax Act.

Expenditures in respect of **scientific research and experimental development** which are used to offset taxes payable under Part VIII must not be used in the calculation of the available Investment Tax Credit.

Prescribed form T661 (Rev 86) (Claim for Scientific Research and Experimental Development Expenditures) is required along with form T2038 where simultaneous claims are being made under subsection 37(1) and 127(5) in respect of a qualified expenditure in scientific research and experimental development.

The Investment Tax Credit in respect of **certified property** has been reduced from 50% to 40% for investments after 1986. However, the 50% rate will continue to apply to such property acquired before January 1, 1987 or where such property is a building under construction or machinery and equipment ordered in writing before January 1, 1987 which is acquired before 1988.

An Investment Tax Credit of 25% of **qualified Canadian exploration expenditures** is available in respect of such expenditures made after November 30, 1985.

The investment tax credit in respect of property acquired or an expenditure made is calculated by reference to the cost of the property or the amount of the expenditure less any assistance, contract payment, reimbursement or inducement received or receivable in respect of the property or expenditure.

Deduction limitation

Tax Reform legislation provides the following definition for "annual investment tax credit limit" of a corporation for a taxation year. It is

- (a) where the corporation is a Canadian-Controlled Private Corporation throughout the year, 3% of the amount determined as eligible for the small business deduction plus ¾ of the Part I federal tax for the year otherwise payable, and
- (b) in the case of any other corporation ¾ of it's Part I federal tax otherwise payable for the year.

This is applicable to taxation years ending after 1987. For a taxation year commencing before 1988, the "annual investment tax credit limit" shall be the total of:

- (a) tax otherwise payable multiplied by the number of days in the year before 1988 divided by the number of days in the taxation year and,
- (b) the amount that would be the "annual investment tax credit limit" (if that subsection were applicable for the year) multiplied by the number of days in the year that are after 1987 divided by the number of days in the taxation year.

For taxation years commencing before July, 1988, the "3% of the amount determined as eligible for the small business deduction" applicable to CCPC's throughout the year shall be read as 1/4 of the amount, if any, by which:

(A) the total of

- (i) 15% of the least of the amounts determined for the small business deduction multiplied by the number of days in the year before July, 1987 divided by the number of days in the year,
- (ii) 14% of the least of the amounts determined for the small business deduction multiplied by the number of days in the year that are after June, 1987 and before July, 1988 divided by the number of days in the year, and
- (iii) 12% of the least of the amounts determined for the small business deduction multiplied by the number of days in the year after June, 1988 divided by the number of days in the year,

exceeds

(B) amount "E" from the Manufacturing and Processing Profits deduction calculation area on the T2-FTC Schedule 1.

Refundability

Qualifying Corporations – The refundability provision has been extended indefinitely at the current rate of 40% of the investment tax credit earned in the year that is not deducted in that year or a previous year. There has been no change to the legislation which permits the full refundability of any unused portion of the 35% investment tax credit earned on up to two million of R. & D. expenditures of a current nature made by small R. & D. corporations.

Others – The 20% refundability provision of investment tax credits earned by corporations other than qualifying corporations has been repealed for property acquired or expenditures made after 1987, one year earlier than previously scheduled. Investment Tax Credits earned on Approved Project Property is eligible for the 40% refund only in respect of property acquired before 1988. Investment Tax Credits in respect of Qualifying Canadian Exploration Expenses is eligible for the 40% refund only with respect to taxation years commencing before 1988.

Capital Cost

Effective for taxation years ending after 1987, the rule that requires the capital cost of a depreciable property to be reduced in the year a related investment tax credit is claimed has been modified to limit the reduction to the related investment tax credit claimed in preceding taxation years, thereby eliminating the current circular calculation problem.

Research and Development Buildings

Tax Reform legislation also addressed the investment tax credit provisions in respect of expenditures for scientific research and experimental development. **New legislation** effectively excludes from the definition of "qualified expenditure":

(a) any capital expenditure made in respect of a building, including a leasehold interest therein, acquired by a taxpayer or a partnership ("purchaser") after 1987 (other than a prescribed special purpose building or a building or leasehold interest acquired before 1990 pursuant to an obligation in writing entered into by the purchaser before June 18, 1987 or a building acquired before 1990, the construction of which was commenced before June 18, 1987, by or on behalf of the purchaser) and,

(b) any rental expense incurred after 1987 pursuant to a lease renewed, extended or entered into after June 17, 1987 for a building other than a prescribed special purpose building.

Special rules restrict the carryover of Investment Tax Credits where control of a corporation is acquired.

Enter the amount of Investment Tax Credit claimed for the year on line 221 of the T2-FTC Schedule 1.

For further information on the Investment Tax Credit refer to Interpretation Bulletin IT-331R and Information Circular 78-4R3. Information pertaining to scientific research is contained in Interpretation Bulletin IT-151R2 and Information Circular 86-4R.

Form T2038 has been amended to address Tax Reform legislation.

Section 127

38M
Employment Tax Credit

The Employment Tax Credit was available to eligible employers who entered into an agreement with the Minister of Employment and Immigration before April 1, 1981 in respect of eligible workers in eligible employment.

Tax Reform repealed the legislation relating to the employment tax credit. This credit, and more specifically its carryover, is no longer available after 1987. This amendment is applicable to the 1988 and subsequent taxation years.

39
Refundable Portion of Part I Tax

A refundable tax system is in effect in respect of investment income of a corporation which was a Canadian-Controlled Private Corporation throughout the year.

The investment income on which a portion of the Part I Tax paid is refunded should be determined on Schedule T2S(7). The net Canadian investment income and net foreign investment income should be entered on the T2-FTC Schedule 1 on lines 247 and 249 respectively. These amounts should exclude any business income flowed through a trust that is deemed to be property income but not the investment income of a trust that is distributed to a corporation.

Taxable capital gains or allowable capital losses on dispositions of property (other than designated property as defined in subsection 129(4.3)) should include only those gains or losses that accrued while the corporation was a Canadian-Controlled Private Corporation, an Investment Corporation, a Mortgage Investment Corporation or a Mutual Fund Corporation.

Enter the amount of Refundable Portion of Part I Tax on line 261 and on the line provided in the Refundable Dividend Tax on Hand calculation.

Tax Reform legislation dictates that effective for taxation years commencing after 1987 the refundable portion of Part I tax is revised to 4/5 of the lesser of

(a) 5/4 of the Part I tax payable and,

(b) 25% of the investment income for the year.

The percentage of Foreign Investment Income entering into the computation was revised to "30%", applicable for taxation years ending after 1987. A proration is required for taxation years that straddle December 31, 1987.

Form T2-FTC Schedule 1 reflects these changes.

40
Part IV Tax

Part IV requires every corporation, that was at any time in the taxation year a Private Corporation or a Subject Corporation, to pay tax on the gross amount of certain dividends received which are deductible in computing taxable income. Part IV tax is completely refundable to the corporation if the dividends are passed on to the shareholders.

In the case of a corporation that was, throughout the year, a prescribed venture capital corporation, **new legislation provides that certain dividends received are not to be considered as taxable dividends** for purposes of the Part IV tax only. Therefore, such dividends do not give rise to Part IV tax. For dividends received after February 18, 1987, this provision is applicable only to dividends received from corporations that are prescribed qualifying corporations (as defined in the Income Tax Regulations) with respect to the dividends. If the shares qualify as eligible in-

vestments under the applicable provincial venture capital program at the time of issue, the issuer of the share will be recognized as a prescribed qualifying corporation. The amendment is applicable to dividends received in taxation years ending after February 18, 1987 and a special transitional rule ensures that all dividends received in that taxation year and before February 19, 1987 are exempt from Part IV tax for prescribed venture capital corporations.

Dividends received **in 1987** are subject to Part IV tax at the rate of 33 1/3%. Taxable dividends received **after 1987** are subject to Part IV Tax at the rate of 25%.

Schedule T2S(3) provides for the identification of dividends received, for purposes of Part IV tax, either before 1988 or after 1987.

It should be noted that no Part IV tax is payable by a corporation that was bankrupt at any time during the year, or a corporation that was, throughout the year, a prescribed labour-sponsored venture capital corporation, a prescribed investment contract corporation, an insurance corporation or a corporation licensed as a trustee, a bank or a non-resident-owned investment corporation.

Dividends received from a connected corporation are subject to Part IV tax only to the extent that their payment generates a refund of tax under section 129 to the corporation which paid the dividend.

Tax Reform legislation provides that Part IV tax otherwise payable on dividends received may be reduced by any Part IV.1 tax payable in respect of the same dividend (Part IV.1 tax is discussed in Guide Item 71F).

For purposes of the Part IV tax, the following definitions apply:

SUBJECT CORPORATION is a corporation resident in Canada, other than a private corporation, which is controlled directly or indirectly in any manner by or for the benefit of an individual or related group of individuals. (subsection 186(1)).

CONNECTED CORPORATIONS exist when the payer corporation is controlled by a particular corporation, or the particular corporation owns more than 10% of the issued share capital (full voting rights) of the payer corporation and the shares have a fair market value of more than 10% of the fair market value of all the issued share capital (subsection 186(4)). Control of the corporation is to be determined by reference to the actual ownership of shares and without regard to any right referred to in paragraph 251(5)(b).

Taxable dividends subject to Part IV tax are to be entered on line 404 or line 405 of the T2-FTC Schedule 1 depending on whether they were received before 1988 or after 1987 respectively.

Non-capital and farm losses used to reduce taxable dividends subject to Part IV tax should be entered on line 406 of the T2-FTC Schedule 1. In straddle 1987-88 taxation years, non-capital and farm losses applied for purposes of Part IV tax are required to be applied first to reduce taxable dividends received in the year and before 1988; and any excess is then applied to reduce taxable dividends received after 1987. Non-capital and farm losses from a taxation year in which the corporation was neither a Private Corporation nor a Subject Corporation may be carried over to be applied under Part IV.

The calculated amount of Part IV tax should be entered on line 131 on the front page of the T2 return.

41
Refundable Dividend Tax on Hand (RDTOH)

This account is only applicable to corporations which were Private Corporations or Subject Corporations at the end of the taxation year. The total RDTOH as calculated

below is available to be refunded to the corporation if taxable dividends are paid to shareholders during the taxation year.

For taxation years ending prior to 1988, a corporation's Refundable Dividend Tax on Hand account consisted of the following:

(a) Refundable Dividend Tax on Hand carried forward from the preceding year;

(b) Refundable portion of Part 1 tax for the year;

(c) Part IV tax payable for the year;

(d) Addition at December 31, 1986 of Refundable Dividend Tax On Hand, as calculated on form T713;

less

(e) Dividend refund for the preceding year.

The **Addition at December 31, 1986 of RDTOH** (subsection 129(3.3)) is applicable in computing a corporation's refundable dividend tax on hand in the first taxation year ending after 1986.

Form T713 is available from any District Taxation Office for the purpose of computing the Addition at December 31, 1986 of RDTOH. Enter the calculated Addition on line 408 of form T2-FTC Schedule 1 – 1987 and subsequent years.

Tax Reform legislation reduces a corporation's refundable dividend tax on hand by ¼ effective as at December 31, 1987. This reduction is applicable in computing a corporation's RDTOH in the first taxation year ending after 1987.

Generally, the "Reduction" is equal to 1/4 of the amount by which the corporation's RDTOH balance at the end of its last taxation year beginning before 1988 exceeds the aggregate of any Part IV tax payable on dividends received in that year and after 1987 and ⅓ of any taxable dividends paid in that year and before 1988.

Form T763 has been developed for the calculation of the RDTOH Reduction under Tax Reform. Enter the calculated deduction on line 412 of form T2-FTC Schedule 1 – 1988 and subsequent years.

Section 129(3).

42
Dividend Refund

A corporation that was a Private Corporation or a Subject Corporation at the end of a taxation year is eligible for a dividend refund for the year, if taxable dividends are paid to shareholders, of an amount equal to the lesser of:

(a) ⅓ of taxable dividends paid in 1987, plus ¼ of the taxable dividends paid in the year and after 1987, and

(b) the refundable dividend tax on hand at the end of the taxation year.

In determining the taxable dividends eligible for a dividend refund, do not include interest (deemed dividends) paid on a small business development bond, and dividends paid to a controlling corporation that was bankrupt at any time in the year. Corporations that were Mutual Fund Corporations throughout the taxation year should not include capital gains dividends paid. The calculation to determine eligible taxable dividends is found in Area "B" of Schedule T2S(3).

A taxable dividend paid by a Private Corporation or a Subject Corporation means a dividend paid out of the earnings of the corporation except dividends paid out of Tax-Paid Undistributed Surplus, 1971 Capital Surplus on Hand and the Capital Dividend Account. It will also include the following:

(a) a stock dividend, other than those which are excluded under the definition of dividends in subsection 248(1),

(b) a dividend deemed to have been paid pursuant to section 84, and

(c) an amount paid as interest or as a dividend on an income bond or debenture which is not deductible in computing the corporation's income.

To claim a dividend refund, a corporation must make an actual payment to shareholders except when a dividend is deemed to have been paid. This payment can be either in the form of cash or of other tangible assets at their fair market value.

To qualify for a refund, a corporation must have been a Private Corporation or a Subject Corporation at the end of the taxation year in which the taxable dividend was paid. No refund will be made in respect of dividends paid in the year that a Private Corporation or a Subject Corporation becomes a Public Corporation (or a subsidiary to a Public Corporation) notwithstanding that the dividend may have been paid before the corporation became public and notwithstanding that there still may be a balance in the refundable dividend tax account.

Where any amount of tax due for a taxation year is required to be paid by instalments, each instalment payment may be reduced by 1/12 of the dividend refund for that year. A Private Corporation or a Subject Corporation may therefore minimize its instalment payments by taking into account its anticipated dividend refund.

Where the dividend refund exceeds taxes owing under Part I, the excess will be applied first against any other taxes owing under the Income Tax Act, and any balance will be available for refund. For further information, obtain Interpretation Bulletin IT-243R3.

The amount calculated as a dividend refund should be entered on line 147 on the front page of the T2 return.

COMPLETION OF SUMMARY OF TAX AND CREDITS AREA

43
Federal Tax

Federal Tax is the total of Part I, Part II, Part IV, Part IV.1, Part VI.1, and Part XIV taxes.

Part I and Part IV taxes, as determined in the calculation areas on the T2-FTC Schedule 1, should be entered on lines 129 and 131 on the front page of the T2 return.

Part IV.1 and Part VI.1 taxes, as determined on form T761 should be entered on lines 132 and 133 respectively on the T2 return. Guide Item 71F provides further information on these taxes.

43A
Part II Tax Payable

Part II of the Income Tax Act provides for a tax designed to ensure that the refund of corporate tax to the shareholder in the form of the Dividend Tax Credit does not exceed the tax actually paid by the corporation.

Part II tax has been repealed for taxation years commencing after 1986. Transitional provisions provide for the application of Part II tax on dividends paid in a 1986-87 straddle year and before January 1, 1987.

The Part II tax payable by a corporation for a taxation year is 12½% of the amount of taxable dividends paid by the corporation in the year to a maximum of one-ninth of its Preferred-Earnings Amount at the end of the year (section 181).

The preferred earnings amount at the end of a particular taxation year is the preferred earnings at the end of the preceding year plus 3/4 of the income subject to the small business deduction under subsection 125(1) for the particular taxation year less:

(a) taxable dividends paid in the previous taxation year, and corporate distributions tax paid in respect of those dividends to the extent these do not exceed the preferred earnings amount at the end of that previous taxation year;

(b) 9 times the tax paid for the year pursuant to subsection 181(4); and

(c) where subsection 190(1) applied in regard to corporate taxation years ending before 1985: ¾ of the corporation's preferred rate amount where the corporation or a predecessor corporation was previously a Canadian-controlled private corporation and became during the year a private corporation controlled by one or more non-resident persons. See Note 3 on form T2028.

The preferred-earnings amount at the end of taxation years commencing before 1983 is deemed to be nil.

The "Calculation of Part II Tax" is provided on form T2028 Rev.86 available from any District Taxation Office. A completed copy of the form is to be submitted for every year in which a tax is payable under Part II or the Preferred-Earnings Amount changed. The amount of tax payable under Part II is due and payable on or before the last day of the third month after the end of the corporation's taxation year.

The amount of Part II tax calculated is to be entered on line 136 on the front of the T2 return.

Section 181

43B
Part XIV Tax Payable

Part XIV is an additional tax on corporations, other than Canadian corporations, carrying on business in Canada. The provisions of most Tax Conventions provide that the foreign corporation must have a permanent establishment in Canada before it can be subjected to Canadian Tax. The 25% Branch Tax may be moderated under the provisions of the applicable tax convention.

The calculation is provided in section 219 and the tax should be calculated on Schedule T2S(20) which must be attached to the T2 return. A Canadian corporation at any time means a corporation that was resident in Canada at that time and was incorporated in Canada or was resident in Canada throughout the period commencing June 18, 1971 and ending at that time. If you require further information, obtain Interpretation Bulletins IT-137R2 and IT-277R for the calculation of Part XIV tax.

44
Provincial and Territorial Tax

All corporations should indicate on line 137 the province or territory where income has been earned, including Ontario, Quebec or Alberta, if applicable. If income has been earned in more than one province, line 137 should indicate "multiple". In the latter situation, form T2S-TC Part I should be completed and attached to the return.

Income earned in the Nova Scotia and Newfoundland Offshore area is not subject to provincial tax. Refer to Guide Item 38 for further information on the taxation of income earned in these areas.

The following provinces and the Yukon and Northwest Territories, which levy Corporate Income Tax at the rates indicated, have entered into tax collection agreements with the federal government. The Corporation Income Taxes payable to those provinces and the territories are to be computed and paid in conjunction with the federal Corporation Income Tax.

Newfoundland	10%, 16%	Nova Scotia	10%, 15%
Prince Edward Island	15%	New Brunswick*	9%, 16%
Manitoba	10%, 17%	Yukon	5%, 10%
Saskatchewan	10%, 17%	Northwest Territories	10%
British Columbia**	9%, 14%		

* Effective January 1, 1988, the general corporate provincial rate for New Brunswick increased from 15% to 16%. For taxation years straddling this date a proration is required.

** Effective January 1, 1988 the general corporate rate for British Columbia decreased from 15% to 14%. Effective July 1, 1988 British Columbia's small business corporate rate decreased from 11% to 9%. For taxation years straddling these dates a proration is required.

Note: (1) The provinces of Quebec, Ontario and Alberta have not entered into tax collection agreements in respect of corporation taxes. Separate provincial returns must be filed for corporations with a permanent establishment in any of these provinces.

(2) Included in the Manitoba tax rate is 1% to be used for municipal purposes.

All provinces and territories except Prince Edward Island and the Northwest Territories have dual rates of tax as shown above. A Canadian-Controlled Private Corporation which has taxable income attributed to any jurisdiction other than the Northwest Territories and/or Prince Edward Island and which is eligible for and has deducted a Small Business Deduction in computing Part I tax payable will be subject to the lower rate of tax on the portion of its active business income that qualifies for the Small Business Deduction under subsection 125(1). A corporation which does not qualify for a Small Business Deduction will be subject to the higher rate of provincial Income Tax on all of its taxable income allocated to that province.

An example follows:

A corporation with a fiscal period ending December 31, 1988 located in Saskatchewan.

Taxable income allocated to Saskatchewan	$90,000
Subtract: Least of (A), (B), and (C) per calculation of Small Business Deduction per subsection 125(1)	78,000
	$12,000

Amount taxed at high rate	
12,000 × 17% =	$ 2,040.00
Amount taxed at low rate	
78,000 × 10% =	$7,800.00
Saskatchewan Tax Payable	$9,840.00

If in the above example the corporation did not qualify for a Federal Small Business Deduction, the provincial corporation tax payable would be calculated:

90,000 × 17% =	$15,300.00
Saskatchewan Tax Payable	$15,300.00

As stated in the first paragraph of this Guide Item, form T2S-TC must be completed and submitted with the T2 return where a corporation has a permanent establishment in more than one jurisdiction. It shows the basis of computing the 10% federal tax abatement (subsection 124(1)) and the amount of provincial income tax for provinces which have entered into tax collection agreements with the Federal government.

Corporations for which special rules appear in the Income Tax Regulations in respect of the allocation of taxable income, such as insurance companies and chartered banks, must attach to their return a schedule showing the basis of the allocation to each jurisdiction in accordance with the special rules applicable to them.

For 1987 and subsequent taxation years, where a corporation has income attributable to 2 or more provinces, income eligible for the small business deduction must be apportioned to the provinces in the same ratio as taxable income earned in the province bears to taxable income earned in all provinces.

For credit unions eligible for the Small Business Deduction, Saskatchewan, Manitoba, and British Columbia also extend the lower Provincial Corporate Income Tax rate to the amount qualifying for the Additional Deduction under subsection 137(3). Prince Edward Island also allows the 5% deduction to the amount qualifying for the Additional Deduction under subsection 137(3).

The provinces which have entered into tax collection agreements do not levy corporation income tax on the taxable income of non-resident-owned investment corporations or corporations which are exempt from tax on their taxable income in accordance with Section 149.

45 Provincial Tax Credits – Rebates

The Provincial and Territorial Tax Credits and Rebates area on form T2S-TC, Part IV must be completed by corporations claiming provincial tax credits or rebates. The sum total of the provincial tax credits from form T2S-TC should be entered on line 141 on the front page of the T2 return and form T2S-TC submitted with it on filing. The following are the provincial credits allowed to reduce taxes payable to certain provinces.

46 Provincial Foreign Tax Credits

Each of the provinces, the Yukon and the Northwest Territories provide for the allowance of a foreign tax credit in respect of foreign taxes paid on foreign non-business income. However, such a credit is not allowable on a federal return for the provinces of Quebec, Ontario and Alberta as these provinces levy their own taxes. A separate calculation is required for each province for which a credit is claimed. This credit is calculated as the lesser of:

(a) Provincial or Territorial Tax Rate (%)* x Foreign Non-Business Income x $\frac{\text{Taxable Income allocated to province or territory}}{\text{Total Taxable Income}}$

and

(b) (i) x (ii-iii)

where

(i) = *Taxable Income allocated to province or territory* / Taxable Income allocated to all provinces or territories

(ii) = Non-Business Foreign Tax paid (not including tax paid on income, such as dividends, from a share of a foreign affiliate) net of subsection 20(12) deduction,

(iii) = Federal Non-Business Foreign Tax Credit allowed.

* Corporations with a taxation year straddling two periods that have different provincial rates must complete a calculation shown in (a) for both portions of the taxation year. Prorate the result by the number of days of the taxation year that are in each period over the total number of days in the taxation year. Where a corporation has dual rates of corporate tax the higher rate should be used in the Foreign Tax Credit calculation.

The total of provincial foreign tax credits should be entered on line 601.

47
Provincial Political Contribution Tax Credits

Nova Scotia, New Brunswick, Prince Edward Island, Manitoba, British Columbia the Yukon and the Northwest Territories allow a Political Contribution Tax Credit as defined under their respective provincial legislation and outlined in the Guide Items following.

The calculation for the allowable credit for the above provinces is based on the total political contributions to that province. This calculation is, with the exception of the Northwest Territories (which is provided later), as follows:

75% of the first $100 contributed, plus
50% of the next $450 contributed, plus
33⅓% of the amount contributed exceeding $550 to a maximum credit of $500.

The amount of allowable credit and the amount of contributions should be entered in the Provincial and Territorial Tax Credits and Rebates Area in Part IV of form T2S-TC.

Official receipts must be attached to the return. Photocopies of receipts are only acceptable for Income Tax purposes if they are certified as true copies by the issuer.

47A
Prince Edward Island Political Contribution Tax Credit

The province of Prince Edward Island allows a Political Contribution Tax Credit for contributions to recognized Prince Edward Island political parties and to candidates who have been officially nominated pursuant to the Election Act of Prince Edward Island. Enter the amount of the contributions on line 630 and the allowable credit on line 632.

47B
Nova Scotia Political Contribution Tax Credit

The province of Nova Scotia allows a Political Contribution Tax Credit for contributions to candidates and recognized parties as defined under the Elections Act of Nova Scotia. Enter the amount of contributions on line 616 and the allowable credit on line 612.

47C
New Brunswick Political Contribution Tax Credit

The province of New Brunswick allows a Political Contribution Tax Credit for con-

tributions made to a registered political party, a registered district association, or a registered independent candidate as defined under the Elections Act of New Brunswick. Enter the amount of contributions on line 622 and the allowable credit on line 624.

47D
Manitoba Political Contribution Tax Credit

The province of Manitoba allows a Political Contribution Tax Credit for contributions to registered political parties and registered candidates as defined under The Election Finances Act of Manitoba. Enter the amount of contributions on line 620 and the allowable credit on line 619.

47E
British Columbia Political Contribution Tax Credit

The province of British Columbia allows a Political Contribution Tax Credit for contributions to recognized British Columbia political parties, recognized British Columbia constituency associations or to candidates at an election to the British Columbia Legislative Assembly. Enter the amount of contributions on line 606 and the allowable credit on line 604.

47F
Yukon Political Contribution Income Tax Credit

The Yukon allows a Political Contribution Income Tax Credit for contributions to a registered political party or to a candidate at an election to serve in the Legislative Assembly of the Yukon Territory. Enter the amount of contributions on line 626 and the allowable credit on line 628.

47G
Northwest Territories Political Contribution Tax Credit

The Northwest Territories have recently passed legislation which allows a Political Contribution Tax Credit for contributions to a candidate only (not to political parties) for election as a member of the Legislative Assembly. The calculation for the allowable credit is an amount equal to:

(a) 100% of the first $100 contributed, plus
(b) 50% of the next $800 contributed,

to a maximum credit of $500.

This credit is effective for 1987 and subsequent taxation years. Enter the amount of contributions on line 648 and the allowable credit on line 609.

48
Newfoundland New Small Business Deduction

The Newfoundland New Small Business Deduction applies to the first three taxation years of Canadian-controlled private corporations which incorporate after April 2, 1987, and before April 3, 1989. This deduction, available only to corporations eligible to claim a federal small business deduction for the year, may be deducted from a corporation's Newfoundland corporate tax otherwise payable for the year.

The deduction, calculated on form T745, is to be entered on line 669 in Part IV of form T2S-TC.

49
Prince Edward Island Small Business Deduction

The Prince Edward Island Small Business Deduction may be claimed on income

earned in Prince Edward Island in 1987 and subsequent years by corporations which were Canadian-controlled private corporations throughout the taxation year. The allowable deduction is calculated on active business income earned in Prince Edward Island on which a Small Business Deduction under section 125 of the Federal Income Tax Act was allowed.

The deduction is calculated on form T708. Enter the claim on line 680 in Part IV of form T2S-TC.

50
Nova Scotia Tax Reduction For New Small Business Corporations

The Nova Scotia Corporate Tax Reduction for new small businesses applies to the first two taxation years of Canadian-controlled private corporations incorporated in Nova Scotia after April 18, 1986. The reduction, available only to corporations eligible to claim a federal Small Business Deduction for the year, may be deducted from the corporation's Nova Scotia provincial corporate tax otherwise payable for the year.

The credit is calculated on form T701. Enter the credit claimed on line 668 in Part IV of form T2S-TC.

51
Nova Scotia Research and Development Tax Credit

A corporation with a permanent establishment in Nova Scotia which made eligible expenditures in respect of scientific research carried out in Nova Scotia is eligible for a Nova Scotia provincial tax reduction equal to 10 per cent of the qualified expenditures. Form T85, "Nova Scotia Research and Development Tax Credit", which provides details of the calculation and is to be completed by all corporations claiming the credit, is available at any District Taxation Office. Enter the total qualified expenditures made in the year on line 670 of form T2S-TC and the amount of credit claimed on line 671.

52
New Brunswick Small Business Corporate Tax Reduction

The New Brunswick Small Business Corporate Tax Reduction is applicable for the period after December 31, 1985 and until December 31, 1988. It is available to Canadian-controlled private corporations with active business income earned during the year in Canada of $110,000 or less.

A corporation which is associated during the year with one or more Canadian-controlled private corporations is eligible only if the total active business income earned in Canada by all of the associated corporations is $110,000 or less.

The reduction is calculated on form T549. Enter the amount of the reduction on line 640 of form T2S-TC.

53
Manitoba Manufacturing Investment Tax Credit

A corporation that purchased qualified property after April 24, 1984 and before 1987, to be used in Manitoba for the purpose of manufacturing and processing, is eligible for an Investment Tax Credit which may be deducted from the Manitoba provincial tax payable.

Any credit not claimed for a current year investment may be carried back and applied against Manitoba tax otherwise payable in the three immediately preceding taxation

years and any excess could be carried forward to the seven subsequent taxation years.

Form T86, "Manitoba Investment Tax Credit", which provides details of the calculation and is to be completed by all corporations claiming the credit, is available from any District Taxation Office. Enter the amount of credit claimed on line 673.

54 Saskatchewan Royalty Tax Rebate

The Saskatchewan Royalty Tax Rebate is available to corporations which, in the taxation year, had taxable income earned in Saskatchewan and "attributed Canadian royalties and taxes" per paragraph 2(1)(a) of the Saskatchewan Royalty Tax Rebate Regulations. Form T70, "Saskatchewan Royalty Tax Rebate Calculation (Corporations)", provides details of the calculation and is to be completed by all corporations claiming the rebate. This credit is then claimed on lines 605, 614, or 615 of form T2S-TC. Both forms are available at any District Taxation Office.

55 Saskatchewan Corporate Tax Reduction For New Small Businesses

The Saskatchewan Corporate Tax Reduction for new small businesses applies to the first two taxation years of Canadian-controlled private corporations incorporated in Saskatchewan after March 26, 1986 and before April 1990 (previously March 27, 1988). The reduction, available only to corporations eligible to claim a federal small business deduction for the year, may be deducted from the corporation's Saskatchewan provincial corporate tax otherwise payable for the year.

The credit is calculated on form T700. Enter the credit claimed on line 674 in Part IV of form T2S-TC.

56 Saskatchewan Manufacturing and Processing Tax Reduction

Corporations which are entitled to a small business deduction (under section 125) and to a manufacturing and processing profits deduction (under section 125.1) are eligible for a reduction of Saskatchewan provincial tax. Form T623, "Saskatchewan Manufacturing and Processing Profits Tax Reduction", which provides details of the calculation and is to be completed by all corporations claiming the tax reduction, is available from any District Taxation Office. Enter the calculated tax reduction on line 635 of form T2S-TC.

57 Saskatchewan Venture Capital Tax Credit

Corporations resident in Saskatchewan which invest in equity shares of a Venture Capital Corporation may be eligible to claim a Venture Capital Tax Credit. The province of Saskatchewan will issue an information slip, T2C (SASK), which must be filed with the T2 return in order to claim the credit. The available credit must be applied to reduce the Saskatchewan provincial tax to nil, and any remaining credit is available for carry forward to be applied to Saskatchewan provincial tax payable in the seven immediately following taxation years.

Enter the total credit earned in the year as reported on the information slip, T2C(SASK), plus the amount of credit available for carry forward from the previous taxation year, on line 636 of form T2S-TC. Enter the credit claimed on line 637.

58
Saskatchewan Livestock Investment Tax Credit

Corporations resident in Saskatchewan which own, feed and market eligible classes of livestock between March 22, 1984 and December 31, 1989 may be eligible for the Livestock Investment Tax Credit. The province of Saskatchewan will issue an information slip, T2C(SASK), which must be filed with the T2 Return in order to claim the credit.

The available credit must be applied to reduce the Saskatchewan provincial tax to nil, and any remaining credit is available for carry forward to be applied to Saskatchewan provincial tax payable in the seven immediately following taxation years.

Enter the total credit earned in the year, as reported on the information slip, T2C(SASK), plus the amount of credit available for carry forward from the previous taxation year, on line 638 of form T2S-TC. Enter the credit claimed on line 639.

The amount of credit claimed for a taxation year is to be included in computing the income of the corporation for the year unless the cash basis of accounting is being used in which case it may be included in income of the subsequent year.

59
Saskatchewan Livestock Facilities Tax Credit

Corporations resident in Saskatchewan that invest in eligible livestock facilities are eligible for a Saskatchewan Livestock Facilities Tax Credit computed as a percentage of the capital cost of eligible investments. The credit will be available to reduce Saskatchewan provincial tax otherwise payable for the taxation year and any excess may be carried forward to be applied to reduce the Saskatchewan provincial tax payable in the seven immediately following taxation years. The province of Saskatchewan will issue an information slip, T2C(SASK), which must be filed with the T2 Return in order to claim the credit.

Enter the total credit earned in the year as reported on the information slip, T2C(SASK), plus the amount of credit available for carry forward from the previous taxation year, on line 678 in Part IV of form T2S-TC. Enter the credit claimed on line 676.

60
British Columbia Royalty and Deemed Income Rebate

This rebate allows a deduction for Crown royalties and deemed income rather than the Federal Resource Allowance. The adjusted taxable income is then used to recalculate provincial taxes payable. Any difference between the British Columbia tax otherwise payable and the recalculated British Columbia tax payable will be shown as a rebate **receivable** or **payable** by the subject corporation.

Corporations who are subject to British Columbia income tax and whose income is affected by either of paragraphs 12(1)(o), 18(1)(m), 20(1)(v.1) or subsections 69(6) or 69(7) must complete form T81, "British Columbia Royalty and Deemed Income Rebate Calculation and Application". The calculated deemed rebate (amount D on form T81) is then carried forward onto line 607 on form T2S-TC.

These forms are available at any District Taxation Office.

61
British Columbia Logging Tax Credit

Corporations which have paid a "logging tax" to British Columbia imposed in respect of income derived from logging operations for the year in British Columbia are eligible

for a British Columbia Logging Tax Credit. The credit, which is equal to ⅓ of the logging tax paid, should be entered on line 608 of form T2S-TC.

62
British Columbia Venture Capital Tax Credit

Corporations investing in shares of a registered venture capital corporation are entitled to claim a B.C. Venture Capital Tax Credit. The province of British Columbia will issue an information slip (form FIN 565) which must be filed with the T2 return in order to claim the credit. The available credit must be applied to reduce the British Columbia provincial tax payable for the year to nil, and any remaining credit is available for carry forward to reduce B.C. tax payable in the four immediately following taxation years. Enter the total credit earned in the year as reported on the information slip (FIN 565), plus any credit available for carry forward from the previous taxation year, on line 642 of form T2S-TC. Enter the credit claimed on line 644.

63
British Columbia Refundable Tax Credits

The province of British Columbia allows certain tax credits which, to the extent that they exceed the B.C. provincial Income Tax payable by the corporation, are refundable to the corporation.

Form T87 is available at any District Taxation Office for purposes of calculating the B.C. Housing and Employment Development tax credit and the B.C. Small Business Employment tax credit. The total of these two credits claimed by a corporation should be entered on line 158 on the front of the T2 return.

For purposes of the Income Tax Act, the amount of B.C. Housing and Employment tax credit or B.C. Small Business Employment tax credit calculated for a taxation year is to be included in computing the income of the corporation for the year.

63A
British Columbia Housing and Employment Development Bond Tax Credit

The British Columbia Housing and Employment Development Bond Tax Credit may be claimed by all corporations which, during the taxation year, received interest from bonds issued by the B.C. Housing and Employment Development Financing Authority.

Enter the amount of eligible bond interest calculated on form T87 on line 633 of form T2S-TC.

63B
British Columbia Small Business Employment Tax Credit

The B.C. Small Business Employment Tax Credit may be claimed by a small business corporation with qualifying salaries and wages paid inside British Columbia. The credit is effective for a maximum of two taxation years, and those years must commence between April 1, 1985 and March 31, 1987.

A small business corporation is defined as a Canadian-controlled private corporation that is carrying on active business. See Guide Items 6A and 13A.

The B.C. Employment tax credit is equal to 1.5% of a small business corporation's salaries and wages (to a maximum of $750,000) paid inside B.C. The maximum credit available per year is $11,250. Where the corporation's total salaries and wages paid (inside and outside of Canada) exceed $750,000, the maximum credit is reduced by 10% for each full $10,000 of total salaries and wages in excess of $750,000.

Effectively, the credit is eliminated where the corporation's total salaries and wages exceed $850,000.

Where a small business corporation is associated in the taxation year with other corporations, the total salaries and wages paid in all jurisdictions by the associated corporations for their taxation years ending in the same calendar year must be used in determining the reduction to be applied to the maximum credit. Further, where the total salaries and wages paid by all of the associated corporations in all jurisdictions exceeds $750,000 but does not exceed $850,000, the corporations may elect to allocate the credit among themselves as they choose.

64
Yukon Manufacturing and Processing Profits Tax Credit

Corporations eligible for this tax credit are those which have taxable income earned in the Yukon Territory and Canadian manufacturing and processing profits. Form T572, "Yukon Manufacturing and Processing Profits Tax Credit" provides the calculation to be completed and should be submitted with the T2 return on filing. This form is available at any District Taxation Office. Enter the amount of the credit on line 634 of form T2S-TC.

65
Instalments and Other Credits

From the total of federal and provincial taxes entered on line 143 ("Total Tax Payable"), a corporation should deduct instalments and other credits as shown on lines 145 to 157. These credits should be totalled and the aggregate subtracted from total tax payable to determine whether a refund or an overpayment results.

Information relating to the Allowable Refund, the Dividend Refund and the British Columbia Tax Credit are provided in Guide Items 31, 42 and 63 respectively.

65A
Instalments of Income Tax

Instalments are payable by a corporation in accordance with the provisions of section 157. Payments, procedures and assistance in calculating instalments are detailed in form T7B, "Instalment Guide for Corporations", available at any District Taxation Office. All remittances should be made payable to the Receiver General and forwarded with form T9R "Income Tax Instalment Remittance Form". All payments should indicate the corporation account number and the fiscal period to which the payment is to be allocated.

Every statement of account received, form T9, should be reviewed to ensure that instalment payments have been allocated to the correct fiscal period. If any payment is not allocated correctly, corporations should contact their local Taxation Centre immediately and advise them of the error.

Instalments for the taxation year are to be reported on line 145 of the T2 return. Where a discrepancy arises between the amount reported on the return and the amount in the instalment account, the return will be processed using the instalment credits available in the account for the fiscal period being assessed.

Tax Reform legislation introduced a new penalty for late or deficient instalments in addition to the interest charged under the Act. Effective for instalments payable for taxation years commencing after a day to be fixed by order of the Governor in Council, the penalty will be 50% of the interest payable in respect of such instalments. This penalty does not apply in respect of the first $1000 of interest.

For further information relating to instalments, obtain Information Circular IC 81-11R2.

65B
Investment Tax Credit Refund

A corporation may claim a refund of its unused Investment Tax Credit (ITC) earned during the taxation year as outlined in either (A) or (B) below:

(A) Canadian-controlled private corporations:

(a) A **qualifying corporation** (as defined in subsection 127.1(2)), other than an excluded corporation (as defined in subsection 127.1(2)), is eligible for a full (100%) refund of ITC earned by it at the rate of 35% in respect of up to $2 million of scientific research expenditures (other than expenditures for the acquisition of depreciable property) made in the taxation year.

(b) To the extent that a **qualifying corporation** has remaining unused ITC (after the refund in (a) above), it may claim a refund at the rate of 40%.

(c) A Canadian-controlled private corporation, **other than a qualifying corporation,** is entitled to claim a 40% refund in respect of unused ITC earned on approved project property or qualified Canadian exploration expenditures and 20% in respect of any remaining unused ITC.

(B) Corporations other than Canadian-controlled private corporations (except exempt corporations):

(a) Corporations other than Canadian-controlled private corporations are entitled to claim an ITC Refund at the rate of 40% in respect of unused ITC earned in the year on approved project property or qualified Canadian exploration expenditures. Any other unused ITC earned in the year qualifies for a 20% refund.

Enter the amount of the ITC refund claimed, as calculated on form T2038 (CORP), on line 146 of the T2 return.

Further information relevant to Investment Tax Credits is included in Guide Item 38L.

Section 127.1.

65C
Federal and Provincial Capital Gains Refund

These refunds are available only to Investment Corporations. Where applicable, the calculations should be completed on schedule T2S(18) which is to be attached to the T2 return. The T2S(18) is addressed in Guide Item 24.

Tax Reform legislation revised the rate for the calculation of the Capital Gains refund for Mutual Fund corporations to 21% from 18%. This will be applicable to taxation years ending after June 1988 **except** for taxation years ending after June 1988 and before 1990 the reference to 21% is to be read as "18⅔%".

66
Tax Withheld at Source

This is the amount shown as Income Tax Deducted on T4A or T4A-NR information slips which show the corporation as payee. These information slips should be attached to the T2 return.

A refund of Non-Resident tax deducted may be claimed by submitting form T4A-NR, NR4, NR4-A or NR7-R, or by submitting a signed letter requesting the refund.

Additional information is available in Information Circular IC 77-16R2.

67
Payment on Filing

Payment on filing should be entered on line 159. This payment should not be included with instalments.

Attach a cheque or money order payable to the Receiver General to the T2 return.

68
Refund Code

Corporations entitled to a refund of current year tax may instruct the Department where the refund should be directed. One of the following codes may be entered in the "Refund Code" box on page 1 of the T2 return.

1. Refund overpayment.
2. Transfer overpayment to subsequent year instalment account.

Note: An overpayment of current year taxes will first be applied to any outstanding prior year's tax balance. Any excess will be directed according to the code entered. If a code is not entered, the overpayment will be refunded.

69
Books and Records

Books and records necessary to verify the income or loss from a business or property are required to be kept available for audit and may not be destroyed without permission from Revenue Canada – Taxation.

Under the Income Tax Act corporations are required to file certain receipts and documents with the T2 return. Other claims made may be verified after the T2 return has been assessed. To substantiate these claims, any receipts or documents that have not been filed with the T2 return must be kept available in an orderly manner.

Your return after initial processing and assessment may or may not be selected for further review or audit. If it is not so selected, you should not conclude that the Department has accepted the deductions from income claimed on your return.

In accordance with subsection 152(4), the Department may reassess a return of income or make additional assessments, or assess tax, interest or penalties within six years from the date of the original Notice of Assessment or notification that no tax is payable for the taxation year in order to give effect to the carry-back of a credit or loss, or where there has been a non-arms length transaction involving the taxpayer and a non-resident person, or where an additional income tax payment to, or reimbursement from, the government of a foreign country arises, and within three years from the date described above in any other case.

70
Reassessments

In order to request the application of a loss or credit to a prior year return, a prescribed form should be filed by the required filing date of the return for the year in which the loss was incurred or the credit earned.

The prescribed forms are:

T2A –	to request the carry-back of a loss
T2038 (CORP) –	to request the carry-back of the Investment Tax Credit
T2116 –	to request the carry-back of an unused Share Purchase Tax Credit
T2117 –	to request the carry-back of an unused Scientific Research and Experimental Development Tax Credit

These forms are available from your District Taxation Office.

NEW LEGISLATION

Details of new legislation not addressed elsewhere in this Guide are provided in this section. Please note, this Guide will only provide a general overview of amendments relevant to the general corporate population.

71
Index of New Legislation Addressed in This Guide

Subject	*Guide Item*
Access to Foreign Based Information	16C
Acquisition of Control	16
Additional Deduction – Credit Unions	38C
Allowable Business Loss – Carry Forward	11D
Capital Cost Allowance	15
Capital Dividends	12I
Capital Gains – Inclusion Rate	12
Capital Gains Refund – Federal and Provincial	65A
Corporate Surtax	38F
Corporate Tax Rates	72A
Credit Unions – Additional Deductions	38C
Dividends on Collateralized Preferred Shares	10
Dividends Received and Dividends Paid	10
Election to Change Fiscal Year End	5
Eligible Capital Property	71B
Employment Tax Credit	38M
Federal and Provincial Capital Gains Refund	65C
Filing Date – Determination	1A
Flow-Through Shares	71C
Foreign Tax Credits	38G
General Anti-Avoidance Rule	71D
Instalments of Income Tax	65A
Investment Corporation Deduction	38B
Investment Tax Credit	38L
Manufacturing and Processing Profits Deduction	38E
Natural Resource Earned Depletion	18
Non-Capital Losses	11A
Northwest Territories Political Contribution Tax Credit	47G
Part I Tax on Taxable Income	38
Part I Tax – Refundable Portion	39
Part II.1 Tax	71G
Part IV Tax	40
Part IV.1 Tax	71F
Part VI Tax – Capital Tax	71H
Part VI.1 Tax	71F
Patronage Dividend Deduction	22
Penalty – Dishonoured Cheques	3
– Failure to File	3
– Failure to Report Income	3
– Gross Negligence	3
– Incomplete returns	3
– Tax Instalments	65A
Provincial and Federal Capital Gains Refund	65C
Refundable Capital Gains on Hand	24
Refundable Dividend Tax on Hand (RDTOH)	41
Refundable Portion of Part I Tax (RPP2)	39

Resource Limited Partnerships....71E
Saskatchewan Manufacturing and Processing Tax Reduction....56
Scientific Research and Experimental Development....28
Small Business Deduction....38A
Tax on Dividends on Preferred Shares....71F

71A
Corporate Tax Rates

The following chart represents the Corporate Tax Rates under Tax Reform.

	Prior to July '88	1988	New Rates* 1989	1990	1991
General	35%	28%	28%	28%	28%
Manufacturing	28%	26%	25%	24%	23%
General (Small)	14%	12%	12%	12%	12%
Manufacturing (Small)	8%	12%	12%	12%	12%

* after 10% Federal Tax Abatement (Guide Item 38D)

New Corporate tax rates effective July 1st of each year.

Investment income of Canadian-Controlled Private Corporations taxed at 28% (after 10% Federal Tax Abatement) effective January 1, 1988.

3% surtax not eliminated until sales tax reform takes effect.

Corporate tax rates are detailed in Guide Items 38 through 38F.

71B
Eligible Capital Property

Previous legislation provided special rules for business related expenditures that are neither deductible in full, being of a capital nature, nor eligible for capital cost allowance. These expenditures on account of "eligible capital property" include goodwill, certain customer lists and trademarks and quota rights. One-half the cost of eligible capital property was added to a special pool and 10 per cent could be written off annually, on a declining balance basis.

Tax Reform legislation, for corporate fiscal periods commencing after June, 1988, increased the portion of an eligible capital expenditure that was added to the pool of cumulative eligible capital property from one-half to three-quarters. The portion of proceeds of disposition of an eligible capital property that is required to be deducted in calculating the pool was also increased to three-quarters. For existing pools, the amount of a corporation's opening cumulative eligible capital was increased by one-half for its first fiscal period commencing after June 30, 1988.

The rate at which eligible capital expenditures may be written off was reduced to 7 per cent, on a declining basis. This rate reduction generally maintains the amount of the annual deduction.

For dispositions after June 17, 1987, a corporation is required to deduct, in calculating the balance of the pool of cumulative eligible capital, the applicable percentage of the proceeds of disposition of eligible capital property at the time of the disposition, rather than at the time at which the purchase price is to be paid by the purchaser.

71C
Flow-Through Shares

Flow-through share arrangements permit shareholders of resource corporations to

deduct resource expenditures (such as Canadian exploration expense) that are incurred by the corporation and are then renounced to the shareholders.

New legislation retains this mechanism, however it limits the types of shares that qualify as flow-through shares by broadening the definition of "prescribed shares" that do not qualify for flow-through treatment. Under the new definition, flow-through share treatment will be denied for shares that carry any entitlement to a payment, repayment, loan or dividend or any retraction or conversion right.

This legislation also provides that gas and oil exploration expenses incurred within 60 days after the end of 1987 and subsequent calendar years under a flow-through share arrangement may be treated as if they had been incurred on the last day of the preceding calendar year.

71D
General Anti-Avoidance Rule

This legislation is intended to prevent artificial tax avoidance transactions or arrangements while not interfering with legitimate commercial and family transactions. Consequently, this rule seeks to distinguish between legitimate tax planning and artificial tax avoidance.

A transaction that results in a tax benefit will be considered to be an avoidance transaction unless the transaction may reasonably be considered to have been undertaken or arranged **primarily** for "bona fide purposes" other than to obtain a tax benefit.

Where a transaction is an avoidance transaction, the tax consequences will be determined by the department as is reasonable in order to deny tax benefit that would otherwise result. In determining the tax consequences of an avoidance transaction and thus denying the tax benefit, the department may;

(a) allow or disallow any deduction in whole or in part,

(b) allocate any such deduction, or income, loss or other amount to any person,

(c) recharacterize the nature of any payment, or,

(d) ignore the tax effects resulting from the application of other provisions of the Act.

The taxpayer may object to such actions in the usual manner. Also any other person may, within the 90 days after mailing the notice, request the Minister to make a reassessment or determination in respect of that person's side of the transaction.

This rule will take effect on Royal Assent.

71E
Resource Limited Partnerships

Previously, deductions for resource expenditures incurred by a partnership could be "flowed out" to its partners.

New legislation extends the existing "at risk" rules applicable to limited partnerships and other partnerships to apply to resource expenditures incurred by partnerships. This limits a partner's share of resource expenditures to the amount of investment the partner has "at risk".

The proposal to treat oil and gas expenditures incurred within 60 days after the end of a calendar year as if incurred on the last day of the preceding calendar year will apply to expenses incurred after December 31, 1987.

The extension of the "at risk" rules to resource expenditures will apply in respect of

such expenditures incurred by a partnership after June 17, 1987 except where the partnership was carrying on business on that date. This exception will lapse if there is a substantial contribution of capital to the partnership or substantial borrowings by the partnership after June 17, 1987.

71F
Tax on Dividends on Preferred Shares

This tax does not apply to dividends paid before 1988, with the exception of a tax on the recipient of a dividend paid after December 15, 1987 and before 1988, to avoid or limit the application of the new legislation.

Types of Shares

Short Term Preferred Share – generally includes a share (other than a grandfathered share) issued or deemed to be issued after December 15, 1987, that is retractable or required to be redeemed, acquired or cancelled within 5 years of its issue date.

Taxable Preferred Share – generally includes a share (other than a grandfathered share) issued or deemed to be issued after June 18, 1987 where either the dividend entitlement or liquidation entitlement of the share is fixed, limited, or established to be not less than a minimum. This may include "Short Term Preferred Shares.

Taxable RFI Share – most preferred shares issued before June 18, 1987 (except term preferred shares) and preferred shares issued after June 17, 1987 that are grandfathered shares.

(i) Issuer – Part VI.1 Tax

Tax Reform instituted a new tax of 66 2/3%, payable by the "Issuer" corporation on dividends paid on "Short Term Preferred Shares" in excess of $500,000 (Dividend Allowance) annually, and a 25% tax is payable on dividends paid on "Taxable Preferred Shares" (other than short term preferred shares) in excess of any remaining dividend allowance. Corporations (other than a financial intermediary corporation or a private holding corporation) can elect to pay a 40% tax, in lieu of the 25% tax, on dividends paid with respect to a class of its taxable preferred shares for the taxation year in which shares of that class are first issued or first become taxable preferred shares, in which case the Holder would be exempt from a 10% tax (see below). The corporation can not make this election unless the rights of the shares require the issuer to make this election.

A special rule reduces the $500,000 dividend allowance if $1,000,000 or more of dividends were paid on taxable preferred shares in the immediately preceding year. (Subsection 191.1(2)).

If there are corporations associated with the issuer, the $500,000 dividend allowance is available to the corporate group, and not to each individual corporation.

A corporation can deduct 5/2 of its Part VI.1 tax in computing taxable income (4/2 for taxation years ending before July, 1988). To the extent that the deduction exceeds the amount required to reduce taxable income to nil, the excess is included in the corporation's non-capital loss for the year.

(ii) Holder – Taxable Preferred Shares – Part IV.1 Tax

A new tax of 10% is payable by public corporations and certain other corporations on dividends received on taxable preferred shares. A special rule

permits the Issuer of the taxable preferred shares to elect to pay a 40% tax (in lieu of the 25% tax) in which case the Holder is exempt from this 10% tax. (Subsection 191.2(1)).

An exemption from tax is provided where the recipient corporation is related to, or has substantial interest in, the dividend-paying corporation.

(iii) Holder – Taxable RFI Shares – Part IV.1 Tax

A new tax of 10% is payable by a restricted financial institution (financial corporation or corporation it controls) on dividends received on taxable RFI shares.

An exemption from tax has been provided where the recipient corporation is related to, or has a substantial interest in the dividend-paying corporation.

New legislation allows a corporation that would otherwise be liable to pay tax under Part VI.1 in a taxation year (a transferor corporation) and a related corporation (a transferee corporation) to file an agreement whereby all or a portion of the Part VI.1 tax liability is transferred to the transferee corporation. This agreement is only valid if the transferee corporation was related to the transferor throughout the taxation year of the transferor corporation and also throughout the last taxation year of the transferee corporation ending at or before the end of that taxation year of the transferor corporation.

A new form (number T761) is available for the calculation of Parts IV.1 and VI.1 taxes as well as new forms for the **election** pursuant to subsection 191.2(2) (form T769) and the **agreement** pursuant to subsection 191.3(1) (form T770).

71G
Part II.1 Tax
Tax on Corporate Distributions

Part II.1 is intended to prevent tax avoidance on corporate distributions that might otherwise be achieved where a corporation arranges to convert an otherwise taxable distribution to individuals into a payment that will qualify for the capital gains exemption.

As a result of the introduction of the General Anti-Avoidance Rule, Part II.1 has been substantially revised so it applies only to a corporation (other than a mutual fund corporation) whose shares are publicly traded where the corporation has paid an amount to its shareholders as proceeds of disposition of capital property that can reasonably be regarded as a substitute for normal dividends.

An exception from the Part II.1 tax is provided where it can be established that none of the purposes of the transaction may reasonably be considered to have been to enable shareholders of the corporation who are individuals or non-resident persons to receive an amount as proceeds of disposition of property instead of as a dividend.

Form T2141 is used to calculate Part II.1 tax and is filed separately from the T2 return.

71H
Part VI Tax – Capital Tax

The capital tax on financial institutions provided under Part VI of the Income Tax Act (form T2044) currently due to expire at the end of 1987, will be extended to apply after 1987.

For 1988 and subsequent taxation years, Part VI tax will no longer be deductible in computing income but will be deductible in computing tax payable under Part I for the year. To the extent that it has not been so deducted in the current year, the excess is deductible from Part I tax payable for any of the three preceding taxation years that end after 1987 or any of the seven subsequent taxation years.

The annual rate of Part VI Tax on a financial institution has been increased from 1 per cent to 1¼ per cent for the 1988 and subsequent taxation years. For 1988 and subsequent years, financial institutions are entitled to claim a capital deduction in computing taxable capital equal to $200 million plus the lesser of $20 million and ⅕ of capital in excess of $200 million. Thus the tax will be levied at a rate of 1 per cent on capital between $200 million and $300 million and a rate of 1¼ per cent on capital in excess of $300 million. An adjustment is required for taxation years that straddle 1987.

This legislation is intended to levy a tax on only that portion of a financial institution's capital that is employed in Canada.

For 1989 and subsequent taxation years, the amount of quarterly instalment is to be reduced by any monthly tax instalments required under Part I of the Act during the quarter.

The Part VI tax deduction will be reported on the T2-FTC Schedule 1 (line 224) in the Part I tax calculation area and Form T2044 should now be filed with your annual T2 corporate tax return.

72
Listing of Federal & Provincial Corporate Forms

CORPORATE FORMS – The following forms printed by the Department are available from your District Taxation Office. When ordering, please use the telephone numbers and addresses listed in this guide.

Form Number	Title
T2	Corporation Income Tax Return
T2-A	Request for Corporation Loss Carry-Back
T2-FTC Schedule 1	(calculation of Part I, Part IV, and Refundable Taxes)
T2-FTC Schedule 1 Supplementary	Adjustments to Part I Tax
T2S-TC	Tax Calculation Supplementary
T2S(3)	Schedule of Dividends Received and Taxable Dividends Paid
T2S(6)	Summary of Disposition of Capital Property
T2S(7)	Income Analysis
T2S(7)(A)	Income from Corporate Partnerships
T2S(16)	Patronage Dividend Deduction
T2S(27)	Computation Of Canadian Manufacturing and Processing Profits
T7B-1	Schedule of Instalment Remittances
T70	Saskatchewan Royalty Tax Rebate
T81	British Columbia Royalty and Deemed Income Rebate
T85	Nova Scotia Research & Development Tax Credit
T86	Manitoba Manufacturing Investment Tax Credit
T87	British Columbia Refundable Tax Credits
T549	New Brunswick Corporate Tax Reduction
T572	Yukon Manufacturing & Processing Profits Tax Credit

T623	Saskatchewan Manufacturing & Processing Profits Tax Reduction
T661	Claim for Scientific Research and Experimental Development Expenditures
T700	Saskatchewan Corporate Tax Reduction for New Small Businesses
T701	Nova Scotia Tax Reduction for New Small Business Corporations
T708	Prince Edward Island Small Business Deduction
T713	Addition at December 31, 1986 of Refundable Dividend Tax on Hand
T761	Calculation of Parts IV.1 and VI.1 Taxes – Taxes on Dividends on Taxable Preferred Shares
T763	Reduction at December 31, 1987, of Refundable Dividend Tax on Hand
T769	Election under Section 191.2 by an Issuer of Taxable Preferred Shares to Pay Part VI.1 Tax at a Rate of 40%
T770	Agreement Respecting Liability for Part VI.1 Tax
T2013	Agreement Among Associated Corporations
T2028	Calculation of Part II Tax
T2038(CORP)	Investment Tax Credit(ITC)-Corporations
T2044	Part VI Tax Return – Tax on Capital of Financial Institutions
T2111	Claim for Share-Purchase Tax Credit
T2114	Claim for Scientific Research Tax Credit
T2116	Allocation of Unused Share-Purchase Tax Credit
T2117	Allocation of Unused Scientific Research Tax Credit
T2208	Employment Tax Credit
T2215	Corporate Surtax

73
Partial Listing of Interpretation Bulletins and Information Circulars

The following represents a partial list of Interpretation Bulletins (IT) and Information Circulars (IC) which provide information concerning legislation relevant to the completion of a Corporate Tax Return. These are provided free to the public as a service and are available at all District Offices.

Subject	*Bulletin or Circular No.*
Active Business, Income from	IT-73R3
Additional Tax (Part XIV – Branch Tax)	IT-137R2
Additional Tax – Effect of Agreements and Conventions	IT-277R
Appeal Procedures – Appeals and Objections	IC 80-7
Associations and Control	IT-64R2
Books and Records – Business Investment Tax Credit Rates	IC 78-4R3
Business Transactions Prior to Incorporation	IT-454
Canadian-Controlled Private Corporations	IT-458
Canadian Manufacturing and Processing Profits	IT-145R
Capital Cost Allowance – General Comments	IT-285R
Capital Losses – Net	IT-232R2
Carrying Charges on Land – Land Developers	IT-153R2
Commencement of Business Operations	IT-364
Corporate Instalments	IC 81-11R2
Custom and Facsimile Tax Forms	IC 85-5R

Dividends – (Part IV Tax) IT-269R2
– Refund to Private Corporation IT-243R3
Expenses – Scientific Research IT-151R3
Experimental Development and Scientific Research .... IC 86-4R
Expropriation of Property – Replacement Property IT-259R2
– Time and Proceeds of Disposition IT-271R
Fiscal Period, Change of IT-179
Gifts of Capital Properties to a Charity and Others IT-288R
Guidelines for Preparing Corporate Tax Returns .... IC 85-3R
Income – Active Business – Meaning of IT-73R3
Instalments, Corporate .... IC 81-11R2
Interest on Loans to Purchase Life Insurance Policies
and Annuity Contracts and Interest on Policy Loans IT-355R
Investment Tax Credit IT-331R
Land – Sale of – Special Reserves IT-152R3
Losses – Business Investment IT-484
Manufacturing and Processing Profits IT-145R
Non-Capital Losses IT-232R2
Profits – Canadian Manufacturing and Processing –
– Reduced Rate of Corporate Tax IT-145R
Research – Scientific Expenditures IT-151R3
Reserves, Contingent Accounts and Sinking Funds IT-215R
Scientific Research and Experimental Development .... IC 86-4R
Scientific Research Expenditures IT-151R3
Transactions Prior to Incorporation IT-454

ALPHABETICAL INDEX

Subject — Guide Item

Active Business Income 13A
Addition to Taxable Income Under Section 110.5 33
Additional Deduction – Credit Unions 38C
Additional Information 36
Additional Tax Under Part XIV 26
Adjusted Cost Base (Capital Property Disposition) 12B
Adjusted Cost Base of Depreciable Property 12C
Allocation in Proportion to Borrowing 23
Allowable Business Investment Losses 11D
Allowable Refund 31
Appeals Process 1F
Associated Corporations 16B
Attachments 7
Books and Records 69
British Columbia Housing and Employment Development Tax Credit 63A
British Columbia Logging Tax Credit 61
British Columbia Political Contribution Tax Credit 47E
British Columbia Refundable Tax Credits 63
British Colombia Royalty and Deemed Income Rebate 60
British Columbia Small Business Employment Tax Credit 63B
British Columbia Venture Capital Tax Credit 62
Canadian and Foreign Investment Income 13B
Canadian-Controlled Private Corporation 6A
Capital Cost Allowance 15

Changes in Corporation Type 6E
Charitable Donations 9
Computation of Canadian Manufacturing and Processing Profits 32
Computer-Generated T2 Returns 1C
Continuity of Reserves 19
Corporate Partnerships 14
Corporate Relationships 16
Corporate Surtax 38F
Corporate Tax Rates 71A
Corporation Income Tax Return 4
Deduction for Gifts 37A
Deferred Income Plans 21
Dividend Refund 42
Eligible Capital Property 71B
Employment Tax Credit 38M
Facsimile T2 Returns and Schedules 1B
Farm Losses .... 11B and 37F
Federal and Provincial Capital Gains Refund 65C
Federal Logging Tax Credit 38H
Federal Political Contribution Tax Credit 38I
Federal Tax 43
Federal Tax Abatement 38D
Filing 1
Filing Date 1A
First-Time Filers 29
Flow-Through Shares 71C
Foreign Tax Credits 38G
Free-Format Schedules 1D
General Anti-Avoidance Rules 71D
Identification Area 5
Income Analysis 13
Index of New Legislation Addressed in this Guide 71
Instalments and Other Credits 65
Instalments of Income Tax 65A
Investment Corporation Deduction 38B
Investment in Foreign Affiliates 30
Investment Tax Credit 38L
Investment Tax Credit Refund 65B
Listed Personal Property 12F
Listing of Federal & Provincial Corporate Forms 72
Manitoba Manufacturing Investment Tax Credit 53
Manitoba Political Contribution Income Tax Credit 47D
Manufacturing and Processing Profits Deduction 38E
Miscellaneous Payments to Residents 20
Natural Resource Earned Depletion 18
Nature of Business Information 5A
Net Capital Losses .... 11C and 37E
Net Income 37
New Brunswick Political Contribution Tax Credit 47C
New Brunswick Small Business Corporate Tax Reduction 52
Newfoundland New Small Business Deduction 48
Non-Arm's Length Transactions 17A
Non-Canadian Advertising Expense 35
Non-Capital Losses .... 11A and 37D
Non-Resident Discretionary Trust 27

Non-Resident Ownership . . . 25
Non-Resident Related/Associated Corporations . . . 16C
Northwest Territories Political Contribution Tax Credit . . . 47G
Nova Scotia Political Contribution Tax Credit . . . 47B
Nova Scotia Research and Development Tax Credit . . . 51
Nova Scotia Tax Reduction for New Small Business Corporations . . . 50
Other Corporations . . . 6D
Other Private Corporation . . . 6B
Outlays and Expenses (Capital Property Dispositions) . . . 12D
Part I Tax on Taxable Income . . . 38
Part II Tax Payable . . . 43A
Part II.1 Tax -Tax on Corporate Distributions . . . 71G
Part IV Tax . . . 40
Part IV.1 Tax . . . 71F
Part VI Tax – Capital Tax . . . 71H
Part VI.1 Tax . . . 71F
Part XIV Tax Payable . . . 43B
Partial Listing of Interpretation Bulletins and
Information Circulars . . . 73
Patronage Dividend Deduction . . . 22
Payment of Income Tax . . . 2
Payment on Filing . . . 67
Payments to Non-Residents . . . 34
Penalties . . . 3
Personal Service Business Income . . . 13D
Personal-Use Property . . . 12E
Prince Edward Island Political Contribution Tax Credit . . . 47A
Prince Edward Island Small Business Deduction . . . 49
Proceeds of Disposition (Capital Property) . . . 12A
Provincial and Territorial Tax . . . 44
Provincial Foreign Tax Credits . . . 46
Provincial Political Contribution Tax Credits . . . 47
Provincial Tax Credits – Rebates . . . 45
Public Corporation . . . 6C
Real Estate (Capital Property Dispositions) . . . 12H
Reassessments . . . 70
Reconciliation of Net Income . . . 8
Refund Code . . . 68
Refundable Capital Gains Tax on Hand . . . 24
Refundable Dividend Tax On Hand (RDTOH) . . . 41
Refundable Portion of Part I Tax . . . 39
Related Corporations . . . 16A
Resource Limited Partnerships . . . 71E
Restricted Farm Losses . . . 11E and 37C
Saskatchewan Corporate Tax Reduction for New Small Businesses . . . 55
Saskatchewan Livestock Facilities Tax Credit . . . 59
Saskatchewan Livestock Investment Tax Credit . . . 58
Saskatchewan Manufacturing and Processing Tax Reduction . . . 56
Saskatchewan Royalty Tax Rebate . . . 54
Saskatchewan Venture Capital Tax Credit . . . 57
Schedule of Dividends Received and Dividends Paid . . . 10
Schedule of Losses . . . 11
Scientific Research and Experimental Development . . . 28
Scientific Research and Experimental Development Tax Credit . . . 38K
Share-Purchase Tax Credit . . . 38J

Shares (Capital Property Disposition) 12G
Small Business Deduction 38A
Specified Investment Business Income 13C
Summary of Dispositions of Capital Property 12
Tax on Dividends on Preferred Shares 71F
Tax Withheld at Source 66
Taxable Dividends Received 37B
Transactions with Shareholders, Officers and Employees 17
Type of Corporation 6
Yukon Manufacturing and Processing Profits Tax Credit 64
Yukon Political Contribution Tax Credit 47F
What Happens on Filing 1E

DISTRICT TAXATION OFFICES	GENERAL ENQUIRIES — ENGLISH SERVICES		FORMS REQUEST LOCAL
	LOCAL	LONG DISTANCE	
NEWFOUNDLAND			
St. John's – 215 Water Street, A1C 6C9	772-2610	1-800-563-2600	772-5088
PRINCE EDWARD ISLAND			
Charlottetown – 90 Richmond Street, C1A 8L3	566-7200	1-566-7200	566-7250
NOVA SCOTIA			
Halifax – 1557 Hollis Street, B3J 2T5	426-2210	1-426-2210	426-2151
Sydney – 49 Dorchester Street, B1P 6K3	564-7080	1-564-7081	564-7120
NEW BRUNSWICK			
Bathurst – 786 King Avenue, E2A 1R5	548-7100	1-800-222-9622	548-7100
Saint John – 65 Canterbury Avenue, E2L 4H9	648-4600	1-800-222-9622	648-4618
QUÉBEC			
Chicoutimi – 100 Lafontaine Avenue, Office 211, G7H 6X2	545-8026	1-800-463-4421	545-8026
Laval – 3131 St-Martin Boulevard West, H7T 2A7	283-5300	1-800-361-2808	335-8658
Montréal – 305 Rene-Levesque Blvd. West, H2Z 1A6	283-5300	1-800-361-2808	283-5623
Québec – 165, Pointe-aux-Lièvres Street South, G1K 7L3	648-3180	1-800-463-4421	648-4083
Rimouski – 411 Sirois Street, G5L 8B2	722-3104	1-800-463-4421	722-3104
Rouyn-Noranda – 11 Terminus Street East, J9X 3B5	764-5171		764-5151
Calls from area code 418		1-800-567-6428	
Calls from area code 819		1-800-567-6403	
Sherbrooke – 50 Place de la Cite, J1H 5L8	565-5888	1-800-567-6184	821-8565
St. Hubert – 5245 Cousineau Boulevard, J3Y 7Z7	283-5300	1-800-361-2808	445-5264
Trois-Rivières – 55 des Forges Boulevard, G9A 2G4	373-2723	1-800-567-9325	373-2723
ONTARIO			
Belleville – 11 Station Street, K8N 2S3	962-8611	1-800-267-2130	962-4816
Hamilton – 150 Main Street West, L8N 3E1	522-8671		572-2609
Calls from area code 416		1-800-263-9200	
Calls from area code 519		1-800-263-9210	
Kingston – 385 Princess Street, K7L 1C1	545-8371	1-800-267-9447	1-800-267-2139
Kitchener – 166 Frederick Street, N2G 4N1	579-2230	1-800-265-2530	579-8951
London – 451 Talbot Street, N6A 5E5	645-4211	1-800-265-4900	679-4244
Mississauga – 36 Adelaide Street East, M5C 2T4	869-1500		865-9469
Calls from area code 416		1-800-387-1700	
Calls from area code 519, 705		1-800-387-1710	
Ottawa – 360 Lisgar Street, K1A 0L9	598-2275		598-2300
Calls from area code 613		1-800-267-8440	
Calls from area code 819		1-800-267-4735	
St-Catharines – 32 Church Street, L2R 6R4	688-4000	1-800-263-5672	688-4000
Scarborough – 200 Town Centre Court, M1P 4Y3	296-1950		296-0104
Calls from area code 416		1-800-387-5229	
Calls from area code 705		1-800-387-5183	
Sudbury – 19 Lisgar Street South, P3E 3L5	671-0581	1-800-461-4060	671-0596
Thunder Bay – 201 North May Street, P7C 3P5	623-3443	1-800-465-6981	623-2751
Toronto – 36 Adelaide Street East, M5C 1J7	869-1500		865-9469
Calls from area code 416		1-800-387-1700	
Calls from area code 519, 705		1-800-387-1710	
Windsor – 185 Ouellette Avenue, N9A 5S8	258-8302		252-3611
Calls from Essex County		1-800-265-4841	
MANITOBA			
Winnipeg – 391 York Avenue, R3C 0P5	983-6350	1-800-282-8079	983-3942
SASKATCHEWAN			
Regina – 1955 Smith Street, S4P 2N9	780-6015	1-800-667-7555	780-6079
Saskatoon – 201-21st Street East, S7K 0A8	975-4595	1-800-667-2083	975-4577
Calls from exchange numbers 825, 871, 875		Zenith 1-9400	
ALBERTA			
Calgary – 220-4th Avenue Street East, T2G 0L1	292-4101		292-4225
Calls from Southern Alberta		1-800-332-1410	
Edmonton – 9700 Jasper Avenue, T5J 4C8	420-3510		420-3544
Calls from Northern Alberta		1-800-232-1966	
Calls from North West Territories and North Eastern British Columbia		1-800-661-6451	
BRITISH COLUMBIA			
Penticton – 277 Winnipeg Street, V2A 1N6	492-9200	1-800-642-8259	492-9200
Vancouver – 1166 West Pender Street, V6E 3H8	689-5411	1-800-663-9033	666-0337
Calls from Yukon Territory and North Western British Columbia		1-800-663-0451	
Victoria – 1415 Vancouver Street, V8V 3W4	388-0121	1-800-742-6108	388-3291

HEARING DISABILITY
If you are deaf or have a hearing disability and have access to a telephone device for the Deaf, telephone 1-800-665-0354*.

REGULAR HOURS OF TELEPHONE AND COUNTER SERVICE
Monday to Friday - 8:15 a.m. to 5:00 p.m. (holidays excepted)

Long Distance Calls:
No charge to caller.
Dial direct, per instructions.