1996 Supplement to the 1995 T2 Corporation Income Tax Guide

You may need a copy of the **1995 *T2 Corporation Income Tax Guide*** along with this Supplement to complete your 1996 *T2 Corporation Income Tax Return*.

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La version française de cette publication est intitulée *Supplément 1996 au Guide T2 – Déclaration de revenus des sociétés de 1995*.

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Printed in Canada

Introduction

The purpose of this publication is to advise corporations of the changes that may affect them for the 1996 taxation year. Since there are not many changes affecting the 1996 *T2 Corporation Income Tax Return*, we decided to publish this supplement rather than a full guide, as in previous years.

The 1995 *T2 Corporation Income Tax Guide* and this 1996 supplement contain the information needed to complete the 1996 return. If you did not keep your 1995 guide, you can get a copy from your tax services office or tax centre.

The 1996 T2 return now contains only seven pages instead of eight. Pages 1, 2, 3, 4, 5, 6, and 7 of the 1996 T2 return refer respectively to chapters 1, 2, 3, 4, 5, 6, and 7 of the 1995 T2 guide.

Please note that when using the 1995 T2 guide, the following item numbers reflect proposed legislation that has now become law:

- Items 18, 19, 31, and 44 – Fiscal period of a professional corporation that is a member of a partnership
- Items 47 and 77 – SR&ED
- Item 56 – Ecological gifts
- Items 68 and 70 – Income from an active business
- Item 68 – Reduction to business limit
- Items 70 and 71 – Additional refundable tax on investment income
- Item 71 – Corporate surtax
- Items 81 and 83 – Part IV tax
- Item 85 – Part I.3 tax
- Item 88 – Temporary surtax on financial institutions
- Item 112 – Canadian film or video production tax credit refund

Also, item numbers 19 and 68 reflect draft legislation released in April 1995 which is currently contained in a Notice of Ways and Means Motion tabled on June 20, 1996.

Item 38 in the 1995 guide contains a February 1995 proposal concerning foreign reporting requirements. Draft legislation has been released in a joint news release on March 5, 1996. See “Foreign property” in this 1996 supplement for further details.

If you have access to the Internet, many of our publications are available on line. Our Internet address is: http://www.rc.gc.ca

What’s Coming

Processing redesign

At Revenue Canada, we are currently redesigning our processing system for corporation income tax returns to improve efficiency and client service. We are replacing manual verification with electronic validation, so we can process your return faster and more accurately. The new system will also enable us to respond more quickly to your enquiries.

This redesign effort will result in changes to the corporation return and related schedules. We will be reprinting forms to clearly specify the information we need, and are consulting with commercial software developers to ensure that their packages reflect the changes to the forms. We will provide details well before the changes become effective.

Filing Electronic Corporation Income Tax Returns

Revenue Canada wants to expand its electronic services for businesses and to support the Government's strategy of promoting the use of electronic commerce. The Department is now developing an electronic filing system for corporation income tax returns using Electronic Data Interchange (EDI), and is working with Alberta, Ontario, and Quebec to develop a compatible electronic filing process.

Financial statement information

To support the above initiatives, we are developing a new method of collecting financial statement information that will meet the needs of the federal government and be acceptable to corporations and their accountants. Consultations with clients and stakeholders are underway, and further information will be provided as it becomes available.

Changes for 1996

Changing fiscal period

Effective September 30, 1996, a corporation that becomes a bankrupt must obtain approval from the department to change its fiscal period. For more information, please refer to item 18 in the 1995 *T2 Corporation Income Tax Guide.*

Penalties

A non-profit corporation for scientific research and experimental development who does not file Form T661, *Claim for Scientific Research and Experimental Development (SR&ED) Expenditures Carried on in Canada*, by its income tax return filing date for the year will be subject to a penalty.

The penalty is equal to the amount determined by the formula

A × B, where:

A is the greater of
i) $500, and
ii) 2% of its taxable income for the year; and

B is the lesser of
i) 12, and

ii) the number of months in whole or part that are in the period that begins on the day on or before which Form T661 is required to be filed and ends on the day it is filed.

Electronic records

Draft legislation released in June 1996 proposes that an electronic version of the books and records will be required to be kept where electronic record-keeping systems are used.

Foreign property

In a joint press release dated March 5, 1996, the Ministers of Finance and Revenue released draft legislation to implement the new foreign reporting requirements announced in the February 27, 1995 budget. Also released were drafts of four new information returns that will have to be filed under the new rules.

Note that these proposals were not law at the time of printing and are subject to future changes.

Foreign affiliate

For taxation years and fiscal periods that begin after 1995, a corporation resident in Canada, of which a non-resident corporation or trust is a foreign affiliate at any time in the year, must file in respect of the affiliate, Form T1134, *Information Return Relating to Foreign Affiliates*, on or before the filing date of the T2 return. However, for a taxation year or fiscal period that ends in 1996 or 1997, the form is required to be filed on or before the later of:

- December 31, 1997; and
- the day on or before which the return is otherwise required to be filed.

Form T1134 contains more information about filing.

Specified foreign property

A corporation that is a specified Canadian entity which owns specified foreign property, the total cost amount of which exceeds CAN$100,000, must file Form T1135, *Information Return Relating to Foreign Property*.

A "specified Canadian entity" for a taxation year or fiscal period means:

- a taxpayer resident in Canada in the year other than
  - a mutual fund corporation,
  - a non-resident-owned investment corporation,
  - a corporation or trust exempt from tax under Part I,
  - a mutual fund trust, or
  - a trust described in paragraph (*a*) to (*e*.1) of the definition of "trust" in subsection 108(1) or
- a partnership where the share of the income or loss of the partnership for the fiscal period accruing to or for the benefit of taxpayers not resident in Canada is less than 90% of the total income or loss of the partnership for the period.

Specified foreign property includes:

- funds or intangible property held outside Canada, including foreign bank accounts, securities held outside Canada, and shares of Canadian companies deposited with a foreign broker;
- tangible property situated outside Canada;
- a share of the capital stock of a non-resident corporation;
- an interest in a non-resident trust or a trust that, but for section 94 would be a non-resident trust;
- an interest in, or a right with respect to, an entity that is non-resident;
- any interest in a partnership (other than a partnership that is a "specified Canadian entity");
- a debt (such as a note, bond, or debenture) owed by a non-resident; and
- a property that is convertible into, exchangeable for or confers a right to acquire specified foreign property.

However, specified foreign property does not include:

- property used or held exclusively in the course of carrying on an active business of the specified Canadian entity;
- personal use property of the entity;
- a share of the capital stock of a foreign affiliate of the entity;
- an interest in a non-resident trust that is either a foreign affiliate of the entity or that was not acquired for consideration by the entity or a person related to the entity; and
- an interest in or right to acquire any such property.

Beneficiaries of non-resident trusts

A corporation which is a specified Canadian entity which received a distribution of property from, or which is indebted to, a non resident trust must file Form T1142, *Information Return in Respect of Distributions From and Indebtedness Owed to a Non-Resident Trust*.

For taxation years and fiscal periods that begin after 1995, a specified Canadian entity that is a corporation must file Forms T1135 and T1142 on the filing date of the T2 return. However, for a taxation year or fiscal period that ends in 1996 or 1997, the forms are required to be filed on or before the later of:

- April 30, 1997; and
- the day on or before which the return is otherwise required to be filed.

Forms T1135 and T1142 contain more information about filing.

Transfers or loans to a specified foreign trust or a non-resident corporation

In respect of trusts' taxation years that begin after 1995, a corporation, which has made transfers or loans, either directly or indirectly, to a specified foreign trust, or to a non-resident corporation that is a controlled foreign affiliate of a specified foreign trust, is required to file Form T1141 *Information Return in Respect of Transfers to Non-Resident Trust*, on or before the filing date of the T2 return. However, for a taxation year that ends in 1996 or 1997, the form is required to be filed on or before the later of:

- April 30, 1997; and
- the day on or before which the return is otherwise required to be filed.

Form T1141 contains more information about filing.

Penalties

There are substantial penalties for not completing and filing Forms T1134, T1135, T1141, and T1142 by the due date. For more information on penalties refer to these forms.

Debt forgiveness

There are four new forms available in respect of debt forgiveness.

- Use Form T2153, *Designations Under Paragraph 80(2)(*i*) for Forgiven Debts*, to designate the order of forgiven debts. If only one debt was forgiven, ignore this form.
- Use Form T2154, *Application of Designated Forgiven Debt Under Section 80*, if an amount of forgiven debt remains after applying any amount to utilize all losses from previous years.
- Use Form T2155, *Alternative Treatment of Capital Gains Under Section 80.03 That Arise From a Forgiven Debt*, to treat a capital gain that would otherwise arise under subsection 80.03(2) or (4) as a forgiven amount.
- Use Form T2156, *Agreement to Transfer Forgiven Debt Under Section 80.04*, to transfer a forgiven amount to a consenting eligible transferee under section 80.04.

You can get these forms from your tax services offices or tax centre.

Form T106, *Corporate Information Return of Non-Arm's Length Transactions with Non-Resident Persons*

When you complete this form, please send it to the following address:

Other Programs Unit
Employer Services Division
Ottawa Tax Centre
875 Heron Road
Ottawa ON K1A 1A2

For more information, please refer to item 38 in the 1995 *T2 Corporation Income Tax Guide*.

Lines 113 and 115 – Charitable donations

The March 1996 federal budget proposes to raise the limit on charitable donations for the 1996 and subsequent taxation years. Therefore when calculating the amount to enter on line 115, you can claim up to the total of:

- 50% of the amount of line 111; and
- 50% of the amount of taxable capital gains arising in respect of gifts of capital property included in the donor's taxable income for the year.

For more information, please refer to item 55 in the 1995 *T2 Corporation Income Tax Guide*.

Line 225 – Taxable income

An amendment has been made to the calculation of taxable income for the purposes of calculating the small business deduction (SBD) if the corporation has claimed a foreign non-business income tax credit.

If this is the case, subtract from the corporation's taxable income 10/3 of the amount that would be deductible as a foreign non-business income tax credit (line 211) calculated as if such credit was determined without reference to the refundable tax on Canadian-controlled private corporation's (CCPC) investment income under section 123.3 (line 212).

Also subtract 10/4 of the amount you are deducting as a foreign business income tax credit. In addition, reduce taxable income by any amount that, because of federal law is exempt from Part I tax.

On line 225, page 3 of the T2 Return, enter the corporation's taxable income for the purposes of calculating the SBD.

Line 221 – Investment tax credit

The definition of investment tax credit is amended for taxation years that begin after 1995.

A corporation can now earn an investment tax credit of 20% of its scientific research and experimental development (SR&ED) qualified expenditure pool at the end of the year.

In general, this pool will consist of all the qualified expenditures the corporation incurred in the year and any qualified expenditures transferred to the corporation under the agreement in paragraph 127(13)(*e*). However, amounts the corporation transferred for the year under subsection 127(13)(*d*), will reduce the pool.

Some CCPCs can claim an additional investment tax credit of 15% on qualified expenditures up to their expenditure limit.

For taxation years that begin after 1995, a CCPC's expenditure limit for a taxation year will be reduced in accordance with the reduction to the CCPC's business limit under section 125 of the *Income Tax Act*. Consequently, if the CCPC's business limit is zero, its expenditure limit will also be zero.

For more information on investment tax credits, refer to item 77 of the 1995 *T2 Corporation Income Tax Guide*. You can also get a copy of Form T2038(CORP), *Investment Tax Credit – Corporations*, and the guide called *Claiming Scientific Research and Experimental Development Expenditures* from your tax services office or tax centre.

Line 134 – Part VI tax payable

The March 1996 budget proposed that the Part VI surtax on financial institutions (other than life insurers) will be extended to include taxation years that begin before November 1, 1997. Also, it was announced that the additional temporary tax on life insurance corporations under Part VI will continue to apply until the end of 1998.

For more information refer to item 88 of the 1995 *T2 Corporation Income Tax Guide.*

Provincial changes

Newfoundland

Form T1129, *Newfoundland Scientific Research and Experimental Development Tax Credit*

You can get this form from your tax services office or tax centre.

To calculate the Newfoundland scientific research and experimental development (SR&ED) tax credit, use Form T1129.

A corporation can claim this credit if it has a permanent establishment in Newfoundland and if it made eligible expenditures, after December 31, 1995, for SR&ED carried out in Newfoundland. The amount of the credit is equal to 15% of eligible expenditures.

The credit is fully refundable. When the current-year credit exceeds tax otherwise payable for the year, we will apply the balance first to any amounts owing under federal and provincial Income Tax Acts, the Canada Pension Plan, and the *Unemployment Insurance Act*. We will refund any remaining balance. There are no carry forward or carry back provisions.

This credit cannot be renounced.

To claim the credit, file Form T1129 with the T2 return. Include the amount of your credit from line F on Form T1129 at line 150, page 7 of your T2 return.

Nova Scotia

Prospectus tax credit

A seven-year carry forward has been added to the prospectus tax credit.

On line 779 of schedule T2S-TC, enter the entire amount of credit the corporation is claiming (including the credit carried forward from preceding years). The credit may be deducted from provincial tax otherwise payable.

ISO 14000 Certification tax credit

This credit is based on an eligible expenditure made after 1995 by a corporation with a permanent establishment in Nova Scotia in respect of certain expenses necessary to become ISO 14000 certified.

Such a corporation may apply for a tax credit equal to 25% of the lesser of:

- the amount of current year eligible expenditures and
- $150,000.

The Minister of Finance for Nova Scotia will issue a certificate for the amount of the tax credit. This certificate is to be filed with the T2 return.

The ISO 14000 tax credit cannot exceed $37,500 and may be deducted from the Nova Scotia provincial tax otherwise payable. The credit cannot be transferred, carried back or carried forward, or refunded.

In Part II of Schedule T2S-TC, enter on line 653 the amount of the credit the corporation is claiming.

New Brunswick

Labour incentive film tax credit

The Minister of Finance for the Province of New Brunswick will issue a tax credit certificate to a corporation producing an eligible film in the province.

The amount of the credit is equal to:

- 40% of New Brunswick eligible labour costs for first time productions,
- 30% for subsequent productions, and
- 35% of incremental eligible labour costs over a previous year's labour costs.

The credit is fully refundable but must be applied first against total tax payable. There is no carry back or carry forward provisions.

To claim the credit, file the certificate with the T2 return and enter the amount of the credit earned in the current year on line 170, page 7 of your T2 return.

Manitoba

The manufacturing and processing tax credit has been extended for one year to June 30, 1997.

British Columbia

Effective July 1, 1996, the small business income tax rate will be reduced from 10% to 9%.

New Small Business Tax Reduction

The province of British Columbia will issue a certificate of eligibility, FIN 562, to new corporations incorporated after April 30, 1996 and before April 1, 2001 and carrying on business in British Columbia for some period of time between those dates. The taxation year for which the deduction is claimed must be the first or second taxation year of the corporation. The corporation must apply for the certificate within three years after the end of the applicable taxation year end. A separate certificate must be obtained for each taxation year. The province may rescind or refuse to issue the certificate of eligibility.

The corporation must be carrying on an active business and be allowed a small business deduction under the federal Act. Credit Unions which are allowed the small business deduction or its equivalent will also be eligible for this reduction.

At least 25% of wages / salaries paid by the corporation must be to employees resident in British Columbia. The tax reduction will be equal to the provincial tax payable at the low rate.

A corporation is not eligible for this reduction if:

- it is the result of an amalgamation;
- the corporation is associated with another corporation;
- the corporation was the beneficiary of a trust;
- the business activity after incorporation is mainly the same as that carried on before incorporation as all or part of the activity of a proprietorship, partnership or joint venture unless the activity was carried on as all or part of the business activity of a proprietorship or partnership for a period of 90 days or less before the date of incorporation and that period did not begin after April 30, 1996.

To claim the credit, complete the calculation on the certificate FIN 562 and file it with the T2 return. Enter the amount of the credit on line 654 of Schedule T2S-TC.