Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*, *Income Tax Regulations* and related legislation. These explanatory notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisers.

The Honourable William Francis Morneau, P.C., M.P.
Minister of Finance

These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

Table of Contents

Clause 1

Bond Premiums

ITA
12(1)(*d.2*)

New paragraph 12(1)(*d.2*) is added to the *Income Tax Act* to include in income in a taxation year the amount of unamortized bond premium reserve that has been deducted under new paragraph 20(1)(*m.3*) in a preceding year.

For more information, see the comments under paragraph 20(1)(*m.3*).

This amendment applies to bonds issued after 2000.

Character Conversion

ITA
12(1)(*z.7*)(i) and (ii)

Paragraph 12(1)(*z.7*) of the Act requires the inclusion in computing a taxpayer's income of any profit from a derivative forward agreement, which is defined in subsection 248(1).

Subparagraph 12(1)(*z.7*)(i) applies to purchases of capital property under a derivative forward agreement. It provides that, if a taxpayer acquires a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the fair market value of the property at the time it is acquired by the taxpayer exceeds the cost to the taxpayer of the property.

Subparagraph 12(1)(*z.7*)(i) is amended to provide that the amount required to be included in computing the taxpayer’s income in the taxation year is equal to the portion of the amount by which the fair market value of the property at the time it is acquired by the taxpayer exceeds the cost to the taxpayer of the property that is attributable to an underlying interest other than an underlying interest referred to in subparagraphs (*b*)(i) to (iii) of the definition of “derivative forward agreement” in subsection 248(1).

Subparagraph 12(1)(*z.7*)(ii) applies to sales of capital property under a derivative forward agreement. It provides that, if a taxpayer disposes of a property under a derivative forward agreement in a taxation year, an amount is required to be included in computing the taxpayer's income for the year equal to the amount by which the proceeds of disposition (within the meaning assigned by subdivision c) of the property exceeds the fair market value of the property at the time the agreement is entered into.

Subparagraph 12(1)(*z.7*)(ii) is amended to provide that the amount required to be included in computing the taxpayer’s income in the taxation year is equal to the portion of the amount by which the proceeds of disposition (within the meaning assigned by subdivision c) of the property exceeds the fair market value of the property at the time the agreement is entered into by the taxpayer that is attributable to an underlying interest other than an underlying interest referred to in clauses (*c*)(i)(A) to (C) of the definition of “derivative forward agreement” in subsection 248(1).

These amendments apply to acquisitions and dispositions of property that occur on or after Announcement Date.

Clause 2

Foreign spin-offs & shareholder benefits

ITA
15(1.4)(*e*)

Subsection 15(1.4) of the Act provides rules of interpretation that apply for the purposes of applying the shareholder benefit income inclusion in subsection 15(1). For these purposes, paragraph 15(1.4)(*e*) deems a non-resident corporation (the original corporation) to have conferred a benefit on its shareholder if the original corporation is divided under the laws of the foreign jurisdiction that govern the original corporation and the shareholder acquires a share of another corporation as a consequence of the division of the original corporation. An example of a foreign law that allows for the division of a corporation is Mexican law that results in an "escision" of the corporation. However, no benefit is deemed to be conferred to the extent that any of subparagraphs 15(1)(*a.1*)(i) to (iii) and paragraph 15(1)(b) apply to the acquisition of the share.

Paragraph 15(1.4)(*e*) is amended to ensure that a division is, in effect, treated as giving rise to a dividend described in subparagraph 15(1)(*b*) (or, in certain circumstances described below, a reduction of paid-up capital described in subparagraph 15(1)(*a.1*)(ii)), if all the shares of the new corporation are received by the shareholders of one or more classes of shares of the original corporation on a *pro rata* basis. The shares of the new corporation will be considered to be received on a *pro rata* basis if each shareholder's proportionate interest in shares of the new corporation received in the division (determined by reference to the fair market value of the shares) is the same as its proportionate interest in classes of shares of the original corporation.

More specifically, where this condition is met, subparagraph 15(1.4)(*e*)(i) provides that:

- The original corporation is deemed to have distributed the shares of the new corporation to its shareholders. Thus, the division results in a *pro rata* distribution, which, by virtue of subsection 90(2), is deemed to be a dividend in the hands of a shareholders of which the original corporation is a foreign affiliate, unless the conditions in subsection 90(3) are met for a qualifying return of capital. It is intended that such a division qualify as a dividend for purposes of paragraph 15(1)(*b*), or, where the relevant conditions are met, a reduction of paid-up capital described in subparagraph 15(1)(*a.1*)(ii), and thus not give rise to a shareholder benefit.
- The total amount of the distribution in respect of a class of shares of the original corporation is deemed to be the total fair market value of the shares of the new corporation distributed in respect of that class.
- Any gain or loss of the original corporation from the deemed distribution of the shares of the new corporation, which gain or loss could otherwise arise from the application of subsection 52(2) to the deemed distribution, is deemed to be nil.
- Each share of the new corporation acquired by a shareholder on the distribution is deemed to be received by the shareholder as a dividend in kind in respect of the class of shares of the original corporation to which the distribution of that share relates. This ensures that the cost of the shares of the new corporation to the shareholder is established under subsection 52(2). It is also intended to ensure that the shares of the new corporation are received as a taxable dividend (the amount of

which is equal to the fair market value of the shares received) by any shareholder of which the original corporation is not a foreign affiliate.

- Each property that was, immediately before the time of the acquisition of the shares of the new corporation by the shareholders, owned by the original corporation and that becomes property of the new corporation as a consequence of the division is deemed to be (i) disposed of by the original corporation immediately before that time for proceeds of disposition equal to its fair market value, and (ii) acquired by the new corporation at a cost equal to the amount of those proceeds of disposition.

Subparagraph 15(1.4)(*e*)(ii) applies in any case where the condition in subparagraph 15(1.4)(*e*)(i) is not met (i.e., where all the shares of the new corporation are not received by the shareholders of the original corporation on a *pro rata* basis). In that case, the original corporation is deemed to have conferred a benefit on the shareholder equal to the value, at the time of acquisition, of the shares of the new corporation acquired by the shareholder.

This amendment applies to divisions of non-resident corporations that occur after October 23, 2012.

Clause 3

Work space in home

ITA
18(12)(*b*)

Subsection 18(12) of the Act restricts the deduction of expenses incurred by an individual in respect of a home office. No amount may be deducted in respect of a “work space” in a self-contained domestic establishment in which the individual resides unless certain conditions are met. The work space must be either the principal place of business of the individual or be used by the individual exclusively for the purpose of earning income from the business and for meeting clients, customers, or patients on a regular and continuous basis.

Where these conditions are met, a deduction in respect of a home office may be claimed; however, paragraph 18(12)(*b*) limits such a deduction to the individual’s income from the business for the year. Paragraph 18(12)(*b*) is amended to delete a cross reference to repealed section 34.2, which concerned the now-expired grandfathering for the 1995 fiscal period rules that apply to individuals who carry on a business.

This amendment applies to the 2011 and subsequent taxation years.

Clause 4

Bond Premiums

ITA
20(1)(*m.3*)

New paragraph 20(1)(*m.3*) is introduced to provide relief in situations where a premium is received by a taxpayer upon the re-opening of a bond issue where the bond's interest rate is higher than the market rate of interest for similar debt instruments at the time of such re-opening.

This new provision allows a taxpayer to claim a reserve in a taxation year for the unamortized amount at the end of the year of any premium received on the issuance of a bond (referred to in new paragraph 20(1)(*m.3*) as the "new bond") that arose on the re-opening of a prior issuance of bonds (referred to in new paragraph 20(1)(*m.3*) as the "original issuance") by the taxpayer.

More specifically, a taxpayer may claim a reserve for the amount that may reasonably be considered to be in respect of the unamortized amount at the end of the year of a premium received by the taxpayer in the year, or a previous year, for the issuance of a new bond where

- the terms of the new bond are identical to the terms of bonds previously issued (referred to in new paragraph 20(1)(*m.3*) as the "old bonds") , except for the date of issuance and total amount of the bonds,
- the old bonds were issued by the taxpayer as part of the original issuance,
- the interest rate on the old bonds was reasonable at the time of the original issuance,
- the new bond is issued on the re-opening of the original issuance,
- the premium received by the taxpayer on issuance of the new bond is reasonable in consideration of prevailing interest rates for similar debt instruments of the time of the new bond's issuance, and
- the amount of the premium has been included in computing the taxpayer's income for the year or a previous taxation year.

New subparagraph 12(1)(*d.2*) includes the amount of the reserve in computing a taxpayer's income for the following taxation year.

This amendment applies to bonds issued after 2000.

Character Conversion

ITA
20(1)(*xx*)

Paragraph 20(1)(*xx*) of the Act provides a deduction in computing a taxpayer's income of a loss from a derivative forward agreement, which is defined in subsection 248(1). The amount of the deduction that is available in a particular year is determined by the formula A – B.

Variable A is the lesser of subparagraphs (i) and (ii). Subparagraph (i) represents the accumulated losses under the derivative forward agreement. Subparagraph (ii) limits deductions in respect of partial (i.e., not final) settlements of a derivative forward agreement to the amount of income that has been included in respect of the agreement.

Subparagraph (i) of variable A provides the cumulative total of losses under the agreement. Clause (i)(A) applies to purchases and clause (i)(B) applies to sales.

The amount determined for clause (i)(A), is the amount by which the cost to the taxpayer of the property exceeds the fair market value of the property at the time it is acquired by the taxpayer. Clause (i)(A) is amended to provide that the amount determined by that clause is equal to the portion of the amount by which the cost to the taxpayer of the property exceeds the fair market value of the property at the time it is acquired by the taxpayer that is attributable to an underlying interest other than an underlying interest referred to in subparagraphs (*b*)(i) to (iii) of the definition of “derivative forward agreement” in subsection 248(1).

The amount determined for clause (i)(B), is the amount by which the fair market value of the property at the time the agreement is entered into exceeds the proceeds of disposition (within the meaning assigned by subdivision c) of the property. Clause (i)(B) is amended to provide that the amount determined by that clause is equal to the portion of the amount by which the fair market value of the property at the time the agreement is entered into by the taxpayer exceeds the proceeds of disposition (within the meaning assigned by subdivision c) of the property that is attributable to an underlying interest other than an underlying interest referred to in clauses (*c*)(i)(A) to (C) of the definition of “derivative forward agreement” in subsection 248(1).

These amendments apply to acquisitions and dispositions of property that occur on or after Announcement Date.

Clause 5

Scientific Research and Experimental Development

ITA
37

Section 37 of the Act sets out the rules governing the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR&ED).

ITA
37(8)(*a*)(ii)(B)(II)

Paragraph 37(8)(*a*) of the Act provides rules for interpreting the expression "expenditures on or in respect of scientific research and experimental development" which is used in subsections 37(1), (2) and (5).

Clause 37(8)(*a*)(ii)(B) provides for the alternative "proxy" method for determining SR&ED expenditures and lists the expenditures that a taxpayer can deduct, if the taxpayers makes an election to use the proxy method for determining SR&ED expenditures.

Subclause 37(8)(*a*)(ii)(B)(II) is amended by replacing the phrase “in respect of” in the subclause with “for” in the English version of the Act. This change ensures that wording in the English and French versions of the Act is consistent and ensures that the English version reflects properly the underlying tax policy. The case law has established that the phrase “in respect of” has the broadest meaning possible. However, this is not the tax policy intent in respect of expenditures described in subclause 37(8)(*a*)(ii)(B)(II).

This amendment applies to expenditures incurred after Announcement Date.

Filing requirement

ITA
37(11)

Section 37 provides, among other things, that a taxpayer carrying on business in Canada may deduct certain expenditures of a current nature incurred in respect of scientific research and experimental development (SR&ED) carried on in Canada.

Subsection 37(11) is amended (and new subsection (11.1) is introduced) to clarify the filing requirements (and the consequences for failing to provide required information) in respect of SR&ED claims. Under subsection 37(11), a taxpayer must file a prescribed form with the Minister in respect of any expenditure that is claimed by the taxpayer for the year as a deduction under subsection 37(1), identifying the expenditure and supporting its characterization as SR&ED as well as any claim preparer information (as defined in subsection 162(5.3)). The form must be filed with the Minister within one year of the taxpayer's filing-due date for the year in which the expenditure was incurred.

This amendment applies on Royal Assent.

Failure to file

ITA
37(11.1)

New subsection 37(11.1) generally provides that a taxpayer who fails to file a prescribed form, containing information identifying an expenditure and supporting its characterization as SR&ED (as referred to in paragraph 37(11)(*a*)), with the Minister may not deduct that amount as a SR&ED expenditure under subsection 37(1).

Subsection 162(5.1) contains a penalty for failing to provide information relating to the claim preparer. This amendment clarifies that failure to provide the required claim preparer information will not prevent a taxpayer from deducting an amount in respect of the expenditure under subsection 37(1).

This amendment applies on Royal Assent.

Clause 6

Business investment loss

ITA
39(1)(*c*)(iv)(B)

A taxpayer's business investment loss for a taxation year is determined under paragraph 39(1)(*c*). Clause 39(1)(*c*)(iv)(B) refers to debts owing by a Canadian-controlled private corporation that is a bankrupt.

Clause 39(1)(*c*)(iv)(B) is amended to remove an expired reference to the definition "bankrupt" in subsection 128(3), which was repealed by 1998, c. 19. "Bankrupt" is now defined in subsection 248(1).

Upstream loans – transitional set-off

ITA
39(2.1) and (2.2)

Subsection 39(2.1) is a temporary measure that sets off, in certain circumstances, foreign exchange gains or losses of a taxpayer on the repayment of a debt obligation owing to a foreign affiliate of the taxpayer against the related losses or gains of the foreign affiliate from the repayment. This provision is intended to provide relief to taxpayers that repay "upstream loans" in order to avoid the application of new subsection 90(6).

Subsection 39(2.1) is amended in three ways, each of which expands the scope of its application. First references are added to subparagraph 40(2)(*g*)(ii), to make relief under subsection 39(2.1) available where a repayment of a non-interest bearing upstream loan results in a foreign exchange loss to the creditor foreign affiliate. In the absence of such references, relief would not be available in that situation because the loss is otherwise denied under subparagraph 40(2)(*g*)(ii), on the basis that a non-interest bearing debt is not acquired by the creditor foreign affiliate for the purpose of earning income.

Second, subsection 39(2.1) is modified to apply in cases where the foreign exchange capital gains or losses of the creditor foreign affiliate resulting from the repayment of an upstream loan are not equal to the debtor's foreign exchange capital losses or gains from the repayment. Prior to this amendment, a set-off was available under subsection 39(2.1) only where these amounts were equal.

Third, subsection 39(2.1) is modified to introduce the concept of a "qualifying entity" (defined in new subsection 39(2.2)), effectively extending relief under subsection 39(2.1) to situations where the specified debtor under the upstream loan is not the taxpayer of which the creditor foreign affiliate is a foreign affiliate, but rather another member of the taxpayer's corporate group (e.g., a wholly-owned subsidiary of the Canadian taxpayer) of which the creditor foreign affiliate is not a foreign affiliate (or of which the creditor foreign affiliate is a foreign affiliate, but the member has only an indirect equity interest in the creditor foreign affiliate). These changes also allow relief in limited circumstances where the specified debtor under an upstream loan from a particular creditor foreign affiliate is not a member of the Canadian taxpayer's group, provided that all or substantially all of the shares of the Canadian taxpayer are owned by corporations resident in Canada that are specified debtors in respect of upstream loans from the particular creditor foreign affiliate because of the application of the back-to-back upstream loan rule in subsection 90(7). Prior to these amendments, the set-off under subsection 39(2.1) was available only where the debtor was the taxpayer itself.

Given their connection to the upstream loan rules in subsections 90(6) to (15), the application dates for these amendments correspond with the transitional rule for the upstream loan rules and are the same as the dates for the set-off provision in subsection 39(2.1) in general. Thus, these amendments apply only to a foreign exchange gain or loss of a taxpayer on the repayment of the portion of a debt obligation outstanding on August 19, 2011 where that repayment occurs on or before August 19, 2016.

For more information, see the comments under paragraph 95(2)(*g.04*).

Clause 7

Deemed gain – negative adjusted cost base

ITA
40(3)(*d*) and (*e*)

Subsection 40(3) of the Act applies where, at a particular time in a particular taxation year, the adjusted cost base ("ACB") of a capital property (other than an interest in a partnership) of a taxpayer has been reduced below nil as a result of certain adjustments to ACB required under subsection 53(2). This ensures that the "negative" ACB is generally treated as a capital gain of the taxpayer from a disposition of a property.

Paragraph 40(3)(*c*) deems there to be a gain from a disposition of the property. Paragraphs 40(3)(*d*) and (*e*) deem there to be a disposition of the property for the purposes of sections 93 and 110.6, respectively.

Paragraph 40(3)(*d*) is amended to deem there to be a disposition by the taxpayer for the purposes of subsections 116(6) and (6.1) at the time the ACB has been reduced below nil. Paragraph 40(3)(*e*) is amended to deem there to be a disposition by the taxpayer in the taxation year for the purposes of subsection 2(3) and section 150.

These amendments are strictly technical. The addition of a reference to subsection 2(3) clarifies that, consistent with the clear policy intent, a non-resident is subject to tax in Canada in respect of a deemed gain under paragraph 40(3)(*c*) from a disposition of a property that is taxable Canadian property (other than treaty-protected property) of the taxpayer, as defined in subsection 248(1) of the Act. The taxable portion of the deemed gain, which is described in paragraph 115(1)(*b*), is included in computing the non-resident's taxable income earned in Canada for the taxation year, by virtue of subparagraph 115(1)(*a*)(iii).

The addition of the references to section 150 and subsections 116(6) and (6.1) clarifies that a non-resident is required to file an income tax return for each taxation year for which it is deemed under paragraph 40(3)(*c*) to have a gain from a disposition of a taxable Canadian property – unless the property is a treaty-protected property (as defined in subsection 248(1)), in which case it is intended that the deemed disposition qualify as an excluded disposition (within the meaning of subsection 150(5)) for the purposes of section 150.

The amendments to subsection 40(3) apply in respect of gains from dispositions that occur on or after Announcement Date.

Deemed gain for certain partners

ITA
40(3.1)(b)

Subsection 40(3.1) of the Act deems a member of a partnership to realize a gain from a disposition of the member's interest in the partnership equal to the "negative adjusted cost base" of the member's interest at the end of the fiscal period of the partnership, provided that the member is a limited partner or was, since becoming a partner, a "specified member of the partnership".

Paragraph 40(3.1)(*a*) deems there to be a gain from a disposition of the member's partnership interest. Paragraph 40(3.1)(*b*) deems the member to have disposed of the partnership interest for the purposes of section 110.6.

Paragraph 40(3.1)(*b*) is amended to deem the member to have disposed of the partnership interest at the end of the fiscal period of the partnership, for the purposes of subsection 2(3), subsections 116 (6) and (6.1) and section 150.

These amendments are strictly technical and clarifying. They clarify that, consistent with the clear policy intent, a non-resident is subject to tax in Canada in respect of a deemed gain under paragraph 40(3.1)(*a*) from a disposition of a property that is taxable Canadian property (other than treaty-protected property) of the taxpayer. They also clarify that a non-resident is required to file an income tax return for each taxation year for which it is deemed under paragraph 40(3.1)(*a*) to have a gain from a disposition of a taxable Canadian property – unless the property is a treaty-protected property.

These amendments are analogous to the amendments being made to subsection 40(3). For more information, see the commentary on that subsection.

The amendments to subsection 40(3.1) apply in respect of gains from dispositions that occur on or after Announcement Date.

Clause 8

Partnership stop-loss rules

ITA
53(2)(*c*)(i)(C)

Paragraph 53(2)(*c*) of the Act provides that certain amounts must be deducted in computing the adjusted cost base (ACB) of a taxpayer's partnership interest. In general terms, subparagraph 53(2)(*c*)(i) reduces the ACB of a partnership interest by the taxpayer's share of losses of the partnership that are not included in the taxpayer's limited partnership losses.

Clause 53(2)(*c*)(i)(C) provides that any loss of a partnership is to be determined without reference to subsections 100(4), 112(3.1) and (4.2) (as subsection 112(4.2) read in its application to dispositions of property that occurred before April 27, 1995) of the Act. Under those subsections, a taxpayer's share of a partnership loss from the disposition of shares can be reduced by certain dividends received by the taxpayer on the shares.

Clause 53(2)(*c*)(i)(C) is amended to include references to subsections 112(4) and (5.2).

This amendment is deemed to have come into force on Announcement Date.

Clause 9

Pooled registered pension plans

ITA
56(1)(*z.3*)

Subsection 56(1) of the Act describes certain amounts that are required to be included in computing the income of a taxpayer for a taxation year.

Paragraph 56(1)(*z.3*) creates a reference to amounts required to be included in income because of section 147.5. Section 147.5 provides rules relating to pooled registered pension plans (PRPPs) and, in general terms, amounts distributed from a taxpayer's account under a PRPP are required to be included in computing the taxpayer's income.

Paragraph 56(1)(*z.3*) is amended to exempt from inclusion in the income of the taxpayer an amount paid out of a PRPP as a refund of contributions made to the PRPP where: 1) the refund is described under clause 147.5(3)(*d*)(ii)(A) or (B) (i.e., a refund of contributions made to the PRPP as a result of a reasonable error or a refund to avoid the revocation of the PRPP) and 2) the amount is not deducted as a PRPP contribution for the taxation year in which the refund is made or for any preceding taxation year.

This amendment is deemed to have come into force on December 14, 2012.

Clause 10

Restrictive Covenants

ITA
56.4

Section 56.4 of the Act provides for amounts that are received or receivable with respect to restrictive covenants.

Realization of goodwill

ITA
56.4(7)(*b*), (*c*) and (*g*)

Subsection 56.4(7) provides a set of conditions that, if met, result in subsection 56.4(5) applying with respect to a restrictive covenant granted by a taxpayer with the result that section 68 does not apply to deem consideration to be received or receivable by a taxpayer for granting the restrictive covenant. In general, for subsection 56.4(7) to apply, a non-compete covenant is required to be granted in conjunction with a realization of a “goodwill amount” or the disposition of property. The conditions that must be satisfied differ depending on whether the restrictive covenant is granted to a person who deals with the vendor on an arm’s length basis or is made to an eligible individual (i.e., a related individual who has attained the age of 18 years).

Subsection 56.4(7) is amended in three respects.

(1) Clause 56.4(7)(b)(ii)(A)

Paragraph 56.4(7)(*b*) provides conditions that must be met in the case of a grant of a non-compete restrictive covenant by a taxpayer (the vendor) to another taxpayer (the purchaser) who deals at arm’s length with the vendor. Subparagraph (7)(*b*)(i) requires that the amount of consideration that can reasonably be regarded as being for a non-compete covenant be included in computing the income of the vendor as a goodwill amount (clause (A)) or be included in computing the income of the vendor’s eligible corporation as a goodwill amount (clause (B)). In general, “goodwill amount” is defined in subsection

56.4(1) to be an amount that is an eligible capital amount to which the description of E in the definition "cumulative eligible capital" in subsection 14(5) applies.

Although subparagraph (7)(*b*)(i) applies to goodwill amounts, concern has been expressed that subparagraph (7)(*b*)(ii) could also apply to property that is in respect of a goodwill amount, and that this can cause difficulty in applying paragraph (*b*). In general, clause (7)(*b*)(ii)(A) requires that it be reasonable to conclude that the restrictive covenant is integral to an agreement in writing under which the vendor or the vendor's eligible corporation disposes of property (other than property described in clause (B)) to the purchaser, or the purchaser's eligible corporation. Property described in clause (B) is excluded from the application of clause (A) (i.e. shares of a target corporation). Clause (A) does not exclude from its application an agreement that concerns property that is in respect of a goodwill amount to which subparagraph (7)(*b*)(i) could apply.

Clause (7)(*b*)(ii)(A) is amended to also exclude from its application property described in subparagraph (b)(i).

(2) Subclause 56.4(7)(c)(i)(B)(I)

An analogous issue to the one described above in respect of paragraph 56.4(7)(*b*) exists under paragraph 56.4(7)(*c*), which concerns a vendor's grant, on a non-arm's length basis, of a non-compete covenant to an eligible individual or an eligible corporation of the eligible individual. To address the concern, subclause 56.4(7)(*c*)(i)(B)(I) is amended to exclude from its application property described in clause (7)(*c*)(i)(A).

(3) Subparagraphs 56.4(7)(g)(i) and (ii)

Paragraph 56.4(7)(*g*) requires the filing of a joint election in prescribed form where the consideration in respect of a non-compete covenant is a goodwill amount to which subparagraph 56.4(7)(*b*)(i) or clause (*c*)(i)(A) applies.

Subparagraphs (*g*)(i) and (ii) are amended to clarify that the persons required to file the joint election are

- the person that includes the goodwill amount in computing its income (that is, the vendor or the vendor's eligible corporation), and
- the person that incurs the expenditure that is a goodwill amount (that is, the purchaser or the purchaser's eligible corporation). Concern has been expressed that the purchaser might also have to file the joint election in such a case. Under the change (which adds a parenthetical comma to subparagraphs (i) and (ii)), if for example, the vendor includes in its income the goodwill amount resulting from granting a non-compete covenant to the purchaser's eligible corporation which incurs the expenditure, the joint election is to be filed by the vendor and the purchaser's eligible corporation.

These amendments apply to restrictive covenants granted on or after Announcement Date.

Clause 11

Eligible Pension Income

ITA
60.03(1)

Subsection 60.03(1) provides definitions that apply for the purposes of the pension income splitting rules, which allow a taxpayer to allocate up to 50% of the taxpayer's "eligible pension income" to the taxpayer's spouse or common-law partner in certain circumstances.

The existing definition "eligible pension income" in subsection 60.03(1) includes a) eligible pension income as defined in subsection 118(7) and which applies in relation to the pension income credit, and b) income received from a retirement compensation arrangement (RCA) in certain circumstances.

The definition "eligible pension income" in subsection 60.03(1) is amended by adding paragraph (*c*) to also include amounts received by the taxpayer on account of a retirement income security benefit (RISB amount) under Part 2 of the Canadian Forces Members and Veterans Re-establishment and Compensation Act. The RISB amount to be split is capped at the amount described in subparagraph (*c*)(ii) of the definition. This amount is the defined benefit limit (as defined in subsection 8500(1) of the *Income Tax Regulations*) multiplied by 35 minus the total of the taxpayer's other eligible pension income and income received under an RCA.

The effect of new paragraph (*c*) will be to enable couples to split RISB amounts, but only to the extent that the total amount of eligible pension income they elect to split does not exceed the defined benefit limit multiplied by 35 ($101,150 for 2016). The defined benefit limit, multiplied by 35, is equal to the maximum defined benefit pension available under the existing registered pension plan limits for a 35-year career.

This amendment applies to the 2015 and subsequent taxation years.

Clause 12

Eligible moving expenses (students)

ITA
62(2)

Subsection 62(2) provides a deduction for the qualifying moving expenses of an individual who moves to or from Canada to pursue higher education. The provision contains a "read as" rule which provides that "both" in paragraph (*b*) of the definition "eligible relocation" in subsection 248(1) is to be read as "either or both".

Subsection 62(2) is amended to correct the reference to "both" in the definition "eligible location", which is found in paragraph (*c*) of the definition.

Clause 13

Trust attribution

ITA
75(3)(*d*)

Subsection 75(2) of the Act generally provides for the attribution to a person resident in Canada of income and losses derived from certain trust property where the property was received by the trust from the person and can revert to the person (or pass to other persons determined by that person). Subsection 75(3) exempts certain property from this attribution rule.

Paragraph 75(3)(*d*) provides for the exemption of a prescribed trust. No regulations are enacted under this prescribing power. The prescribing power in that paragraph is repealed and the paragraph replaced by new paragraph 75(3)(*d*).

New paragraph 75(3)(*d*) provides that, if certain conditions are met, subsection 75(2) does not apply to property received by a trust from an individual who in turn received the property in respect of a child under section 4 of the *Universal Child Care Benefit Act* or as consequence of the operation of subsection 122.61(1) of the Act. To qualify, the trust's only beneficiaries must be children in respect of whom those benefits are received by an individual (e.g., the child's parent) from whom the trust acquired the property. Where these conditions are met in respect of a property received by the trust, paragraph 75(3)(d) also applies to the trust's property that is substituted for that property.

This amendment ensures that this attribution rule operates – with respect to Canada Child Tax Benefit, the Universal Child Care Benefit and the Canada Child Benefit amounts held in trust for a child – similarly to the attribution rule in subsection 74.1(2). This amendment does not affect the application of subsection 75(2) to a trust with respect to property of the trust not described by paragraph 75(3)(*d*).

This amendment applies to taxation years that end after on or after Announcement Date.

Clause 14

Definitions – Deferred Recognition of Debtor's Gain on Settlement of Debt

ITA
80.03(1)

Section 80.03 of the Act contains rules relating to the debt forgiveness rules in section 80. Subsection 80.03(1) provides that a number of expressions used in the section have the meanings assigned by subsection 80(1).

Subsection 80.03(1) of the English version of the Act is amended to reinstate the definitions "commercial debt obligation", "commercial obligation", "distress preferred share", "forgiven amount" and "person" which had been inadvertently deleted in the English version of the Act when the definition "taxable dividend" was repealed.

This amendment applies to taxation years that end after February 21, 1994.

Clause 15

Foreign mergers - rollover

ITA
87(8.4) and (8.5)

New subsections 87(8.4) and (8.5) allow taxpayers to elect for dispositions of taxable Canadian property ("TCP") that is shares of a Canadian-resident corporation to occur on a tax-deferred ("rollover") basis, where the disposition results from a foreign merger that meets certain conditions. A disposition of property by a merging foreign corporation on a foreign merger otherwise occurs on a taxable basis; the combined effect of subsections 87(4) and (8) is to provide tax-deferred rollover treatment in respect of a disposition of shares of a merging foreign corporation on a foreign merger, but not in respect of a disposition of property owned by the merging foreign corporations.

Subsection 87(8.4) contains the conditions of application for the operative rule in subsection 87(8.5). Subsection 87(8.4) provides that subsection 87(8.5) applies at any time if the following conditions are satisfied:

- There is, at that time, a foreign merger of two or more predecessor foreign corporations that were, immediately before that time, resident in the same country and related to each other (determined without reference to paragraph 251(5)(*b*)). The terms "foreign merger" and "predecessor foreign corporation" are defined in subsection 87(8.1), but for purposes of determining whether these conditions are satisfied, subsection 87(8.1) and (8.2) are to be read without reference to their exclusions for windings-up.
- Because of the foreign merger,
    - a predecessor foreign corporation (the "disposing predecessor foreign corporation") disposes of taxable Canadian property (other than treaty-protected property) that is a share (the "subject share") of a corporation resident in Canada, and
    - the subject share becomes property of a corporation that is a new foreign corporation for the purposes of subsection 87(8.1).
- No shareholder (other than a predecessor corporation) that owned shares of a predecessor foreign corporation immediately before the foreign merger received consideration for the disposition of the shares on the merger, other than shares of the new corporation.
- The corporation resident in Canada is not – at any time in the 24–month period ending after that time, as part of a transaction or event, or series of transactions or events including the foreign merger – subject to a loss restriction event (as defined in subsection 251.2(2)).
- The new foreign corporation and the disposing predecessor foreign corporation jointly elect tax-deferred treatment under subsection 87(8.4) and (8.5), in accordance with prescribed rules.

Whether a foreign merger results in a disposition of property (including TCP) owned by a predecessor foreign corporation generally depends on the applicable foreign law. For example, in the case of a foreign "absorptive merger" (in which one corporation ceases to exist upon merging with and into a "surviving" corporation), the non-surviving predecessor foreign corporation could be considered to dispose of its property to the surviving foreign corporation. Since the deeming rules in subsection 87(8.2) allow an absorptive foreign merger to constitute a foreign merger within the meaning of subsection 87(8.1), and the surviving corporation on such a merger to be considered a "new foreign corporation" in respect of the foreign merger (even though such a merger does not legally result in a "new" foreign corporation being created), absorptive foreign mergers may, depending on the circumstances, satisfy the conditions in subsection 87(8.4).

Where the conditions in subsection 87(8.4) are satisfied, subsection 87(8.5) applies to provide a tax-deferred rollover in respect of the disposition of the subject share (i.e., the TCP), by deeming:

- the subject share to have been disposed of, at the time of the foreign merger, by the disposing predecessor foreign corporation to the new foreign corporation for proceeds of disposition equal to the adjusted cost base of the subject share to the disposing predecessor foreign corporation immediately before that time; and
- the cost of the subject share to the new foreign corporation to be the amount of the deemed proceeds of disposition of the subject share.

These amendments apply to foreign mergers that occur on or after Announcement Date.

Clause 16

Parked Debt

ITA
88(1) (re application of ss. 80.01(10))

Subsection 88(1) of the Act provides rules that apply where a subsidiary has been wound up into its parent corporation, if both corporations are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the subsidiary's capital stock.

Paragraph 88(1)(*e.2*) provides that a number of the rules that apply to amalgamations under section 87 of the Act also apply, with certain modifications, to windings-up under subsection 88(1). Paragraph 87(2)(*l.21*) specifically allows for a deduction under subsection 80.01(10) to a successor corporation when a subsequent payment is made against a parked debt of one of the pre-amalgamation corporations.

Paragraph 88(1)(*e.2*) is amended to include a reference to paragraph 87(2)(*l.21*) in order to provide for the parent on a winding up to be deemed to be a continuation of its subsidiary for the purposes of subsection 80.01(10).

This amendment applies to taxation years ending after 2001.

Clause 17

Capital Dividend Account

ITA
89(1) "capital dividend account"

The definition "capital dividend account" is part of a mechanism for allowing capital gains to flow through a private corporation without attracting an extra level of tax. To the extent that a private corporation has a capital dividend account, it may generally elect to treat dividends that it pays as capital dividends. Capital dividends may be received tax-free by the corporation's shareholders.

Under paragraph (*a*) of the definition, the non-taxable portions of capital gains realized by a private corporation are added to its capital dividend account and these capital gains amounts are reduced by the non-allowable portions of the corporation's realized capital losses.

Under paragraph (*f*) of the definition, the non-taxable portions of capital gains distributed to a private corporation from a trust may be added to the corporation's capital dividend account. However, these amounts are not reduced by the non-allowable portion of the corporation's realized capital losses.

Paragraph (*a*) of the definition capital dividend account is amended so that in computing a private corporation's capital dividend account at any time it is the total of the non-taxable portions of capital gains distributed from a trust to the corporation and the non-taxable capital gains realized by the corporation that is reduced by the non-allowable portion of the corporation's realized capital losses.

Paragraph (*f*) of the definition is repealed consequential on the amendment to paragraph (a).

These amendments apply in respect of trust distributions made on or after Announcement Date.

Clause 18

Upstream loan continuity – reorganizations

ITA
90(6.1) and (6.11)

New subsections 90(6.1) and (6.11) provide "continuity" rules for purposes of the upstream loan rules in subsections 90(6) and 90(7) to (15) (and certain related temporary relieving rules) where there has been a reorganization of a corporation or partnership. These new subsections are intended to ensure that the upstream loan rules continue to apply, and cannot be avoided, where a reorganization occurs following the making of an upstream loan. They are also intended to ensure that a reorganization does not result in double taxation, either by causing the upstream loan rules to apply multiple times in respect of what is in substance the same debt, or by preventing a repayment of a debt from being effective for purposes of the rules.

New subsection 90(6.1) provides the conditions for the application of the continuity rules contained in new subsection 90(6.11). New subsection 90(6.1) provides that new subsection 90(6.11) applies where the following conditions are met:

- Immediately before the reorganization, a person or partnership (the "original debtor") owes an amount in respect of a loan or indebtedness (the "pre-transaction loan") to another person or partnership (the "original creditor");
- The pre-transaction loan was, at the time it was made or entered into, a loan or indebtedness that is described in subsection 90(6). It is intended that, where a pre-transaction loan arose prior to the introduction of the upstream loan rules, this condition is satisfied if the pre-transaction loan would have been described in subsection 90(6) had that subsection come into force prior to the time when the pre-transaction loan arose.
- In the course of an amalgamation, merger, foreign merger, winding-up or liquidation and dissolution,
    - the amount owing in respect of the pre-transaction loan becomes owing by another person or partnership (the "new debtor");

- the amount owing in respect of the pre-transaction loan becomes owing to another person or partnership (the "new creditor"); or
- the taxpayer, in respect of which the original debtor was a specified debtor at the time the pre-transaction loan was entered into, ceases to exist or merges with one or more corporations to form one corporate entity (the "new corporation").

Where the conditions in new subsection 90(6.1) are satisfied in respect of a reorganization, new subsection 90(6.11) provides deeming rules for the purposes of subsections 90(6), 90(7) to (15), 39(2.1) and (2.2) and paragraph 95(2)(*g.04*). Where, in the course of the reorganization, the amount owing in respect of the pre-transaction loan becomes owing by a new debtor, or to a new creditor, subsection 90(6.11) deems the loan or indebtedness that becomes owing by the new debtor, or to the new creditor, to be the same as that owing by the original debtor, or to the original creditor. Subsection 90(6.11) also deems the new debtor or new creditor to be the same as the original debtor or original creditor, respectively. Similarly, where the taxpayer is involved in a reorganization, the new corporation (in the case of an amalgamation), or any entity that held a partnership interest in or owned shares of the taxpayer immediately prior (in the case of a wind-up), is deemed to be the same as, and a continuation of, the taxpayer.

These rules are designed to ensure, among other things, that, consistent with the policy intent, the annual inclusions and deductions under subsections 90(12) and (9), respectively, continue to occur following a reorganization, notwithstanding that a taxpayer may have ceased to exist in the course of the reorganization. The rules are also intended to ensure that a reorganization does not cause a new income inclusion under subsection 90(6) in respect of an upstream loan for which there has already been a subsection 90(6) inclusion, or inappropriately interfere with the ability to qualify for relief under subsection 90(8) or (14) on a subsequent repayment of an upstream loan.

New subsections 90(6.1) and (6.11) apply in respect of transactions and events that occur on or after Announcement Date. However, if a taxpayer files an election with the Minister before 2017, new subsection 90(6.1) and (6.11) apply in respect of the taxpayer as of August 20, 2011.

Back-to-back loans

ITA
90(7)

Subsection 90(7) of the Act collapses certain back-to-back loans into one, to the extent of the lesser loan amount. This rule operates iteratively so that multiple loans may, in appropriate circumstances, all be collapsed into one.

Subsection 90(7) is amended to add references to subsections 39(2.1) and (2.2) and paragraph 95(2)(*g.04*), so that the back-to-back loan rules will apply for the purposes of those provisions. Subsections 39(2.1) and (2.2), together with their companion rule in paragraph 95(2)(*g.04*), provide a temporary measure that sets off, in certain circumstances, foreign exchange gains or losses of a taxpayer on the repayment of a debt obligation owing to a foreign affiliate of the taxpayer against the related foreign exchange losses or gains of the foreign affiliate from the repayment. These set-off rules apply only in respect of the repayment on or before August 19, 2016 of the portion of a debt obligation outstanding on August 19, 2011.

This amendment applies in respect of loans received and indebtedness incurred after August 19, 2011. However, the amendment also applies in respect of any portion of a particular loan received or a particular indebtedness incurred on or before August 19, 2011 that remains outstanding on August 19, 2014 as if that portion were a separate loan or indebtedness that was received or incurred, as the case may be, on August 20, 2014 in the same manner and on the same terms as the particular loan or indebtedness.

Corporations – deduction for amounts included under subsection 90(6) or (12)

ITA
90(9)(*a*)(ii)

Subsection 90(9) provides relief from the upstream loan rules. This rule, together with subsection 90(12), provides for a deduction and inclusion on an annual basis for the period during which the loan or indebtedness is outstanding. Essentially, this deduction is intended to allow taxpayers to make loans instead of paying dividends where there is no intention to achieve a Canadian tax benefit. The deduction under subsection 90(9) is for a particular amount in respect of the specified amount included in income under subsection 90(6) (or in respect of an amount included under subsection 90(12)) where the particular amount is the total of certain deductions that could have been claimed had the specified amount in respect of the upstream loan been instead distributed as dividends (as set out in paragraph 90(9)(a)), and where these same deductions have not been claimed in respect of other loans or distributions (as set out in paragraphs 90(9)(*b*) and (*c*)).

Under subparagraph 90(9)(*a*)(ii) of the existing rules, previously-taxed foreign accrual property income ("FAPI") is an element of the subsection 90(9) deduction, but only where the specified debtor is a non-resident person that does not deal at arm's length with the taxpayer or a partnership of which such a person is a member. Subparagraph 90(9)(*a*)(ii) is amended to instead include previously-taxed FAPI in the subsection 90(9) deduction only in the converse case: namely, only where the specified debtor is a person or partnership other than a non-resident person that does not deal at arm's length with the taxpayer or a partnership of which such a non-resident person is a member. On the one hand, this ensures that the rules apply as intended, to include previously-taxed FAPI in the subsection 90(9) deduction where the specified debtor is either the Canadian-resident taxpayer, a person resident in Canada that does not deal at arm's length with the taxpayer or a partnership no member of which is a non-resident person that does not deal at arm's length with the taxpayer. On the other hand, this amendment ensures that the subsection 90(9) deduction does not include previously-taxed FAPI in circumstances where a foreign multinational corporate group may otherwise synthetically repatriate the FAPI free of withholding tax.

The amendment to subparagraph 90(9)(*a*)(ii) applies in respect of loans received and indebtedness incurred after August 19, 2011, and any portion of a particular loan received or a particular indebtedness incurred on or before August 19, 2011 that remains outstanding on August 19, 2014. In respect of loans received and indebtedness incurred prior to Announcement Date, subparagraph 90(9)(*a*)(ii) is to be read without reference to "unless the specified debtor is a person or partnership described in subclause (i)(D)(I) or (II)".

Definition "specified debtor"

ITA
90(15)

Subsection 90(15) defines certain terms that are relevant for purposes of the upstream loan rules in subsections 90(6) to (15). The definition “specified debtor”, which is used in subsections 90(6) and (9), defines the recipients of credit in respect of which the upstream loan rules apply. Specified debtors include the taxpayer, certain non-arm’s length persons (other than controlled foreign affiliates (“CFA”) of the taxpayer, as defined in subsection 17(15)) and certain partnerships of which the taxpayer or non-arm’s length persons are members.

Paragraph (*b*) of the definition “specified debtor” is amended by adding a new exception, in new subparagraph (*b*)(ii), for certain non-arm’s length persons, in addition to the existing exception for CFAs. The new exception is for a non-resident corporation (other than a CFA, as defined in subsection 17(15)) that meets the following conditions:

- it is a foreign affiliate of the taxpayer; and
- each share of the corporation is owned by any of
  - the taxpayer,
  - persons resident in Canada,
  - non-resident persons that deal at arm’s length with the taxpayer,
  - CFAs of the taxpayer, as defined in subsection 17(15),
  - partnerships, each member of which is a person or partnership described in this list, and
  - corporations, each shareholder of which is a person or partnership described in this list.

This amendment applies in respect of loans received and indebtedness incurred after August 19, 2011 and in respect of any portion of a particular loan received or indebtedness incurred on or before August 19, 2011 that remained outstanding on August 19, 2014.

Example

Assumptions

- A corporation resident in Canada (Canco) owns 100% of the shares of two non-resident corporations (FA1 and FA2).
- FA1 owns a 99% interest in a partnership, with the other 1% partnership interest held by FA2.
- The partnership holds a 40% equity interest in another non-resident, joint venture corporation (FA3). The other 60% equity interest in FA3 is held by two non-resident corporations (40% and 20% respectively) that deal at arm’s length with Canco and are not controlled foreign affiliates of a taxpayer resident in Canada.
- The shareholders of FA3 have entered into a unanimous shareholders’ agreement (“USA”) with FA3 that establishes certain rights and obligations in respect of the shares of FA3, the management and control of FA3, as well as other matters. In addition, there are a number of agreements between the parties with respect to resource projects of FA3 (the “project agreements”). The project agreements provide for funding of FA3’s projects by its shareholders.

- The partnership makes loans to FA3 pursuant to the project agreements, to satisfy cash calls made for projects and operations. The other shareholders of FA3 similarly make loans to FA3 to satisfy cash calls.

Analysis

Each of FA1 and FA2 are foreign affiliates of Canco (as defined in subsection 95(1) of the Act) and controlled foreign affiliates of Canco (within the meaning assigned by section 17 of the Act). FA3 is a foreign affiliate, but not a controlled foreign affiliate, of Canco.

If it is determined, based on the above assumptions – in particular, the rights and obligations under the USA and the project agreements – that Canco, through its indirect interest in the partnership, does not deal at arm's length with FA3, then FA3 is a specified debtor in respect of Canco, unless each of the shares of FA3 is owned by one of the persons or partnerships enumerated in clauses (A) to (F) of subparagraph (*b*)(ii) of the definition "specified debtor". Each share of FA3 is owned either by non-resident persons that deal at arm's length with Canco (i.e., persons described in clause (C) of subparagraph (*b*)(ii)) or by the partnership. Since both members of the partnership (FA1 and FA2) are CFA's (as defined in subsection 17(15)) of Canco (i.e., persons described in clause (D) of subparagraph (*b*)(ii)), the partnership is described in clause (E) of subparagraph (*b*)(ii). Accordingly, FA3 is not a specified debtor, with the result that the upstream loan rule in subsection 90(6) does not apply to loans from the partnership to FA3.

Clause 19

Stub Period FAPI

ITA
91

New subsections 91(1.1) to (1.5) of the Act are introduced to ensure that "stub period" foreign accrual property income (FAPI) is included in the income of a taxpayer for the taxation year in which the taxpayer disposes of, or reduces in certain circumstances, its interest in a foreign affiliate. Related amendments are also made in subsections 5907(8) and (8.1) of the Regulations.

Subsection 91(1.1) provides that the operative rule in subsection 91(1.2) applies at a particular time in respect of a particular foreign affiliate of a Canadian-resident taxpayer if the following conditions are satisfied:

- An amount would be included in the taxpayer's income under subsection 91(1) – in respect of a share of the particular affiliate or another foreign affiliate of the taxpayer that has an equity percentage in the particular affiliate – for the taxation year of the particular affiliate that includes the particular time, if that taxation year ended at the particular time (paragraph 91(1.1)(*a*)).
    - For this purpose, the particular affiliate's taxation year (in particular, its taxation year-end) is to be determined without reference to the deeming rule in subsection 91(1.2).
- Immediately after the particular time, there is an acquisition or disposition of shares of a foreign affiliate of the taxpayer that results in a change to the surplus entitlement percentage of the taxpayer in respect of the particular affiliate (paragraph 91(1.1)(*b*)).

  - For these purposes, if the taxpayer is not a Canadian-resident corporation (e.g., if the taxpayer is a partnership), its surplus entitlement percentage is nevertheless to be determined as if it were a Canadian-resident corporation.
  - A relevant disposition or acquisition could be by the taxpayer, or by another person or partnership. It could also be as a result of an issuance of shares.

The condition in paragraph 91(1.1)(*b*) is not satisfied, however, if any of the following exceptions applies:

- The change that results from the acquisition or disposition that occurs immediately after the particular time is a decrease in the surplus entitlement percentage of the taxpayer (determined as if the taxpayer were a Canadian-resident corporation) in respect of the particular affiliate – and, as a result of the acquisition or disposition, one or more taxpayers, each of which is a taxable Canadian corporation that does not deal at arm's length with the taxpayer immediately after the particular time, have increases to their surplus entitlement percentages in respect of the particular affiliate that are, in total, equal to the reduction in the taxpayer's surplus entitlement percentage in respect of the particular affiliate immediately after the particular time. In general terms, this exception ensures that subsection 91(1.2) does not apply to certain transactions within a corporate group, where a disposition or acquisition of shares by one group member does not result in a decrease in the overall surplus entitlement percentage of the group in a foreign affiliate.
- The acquisition or disposition is on an amalgamation described in subsection 87(1). The reason for this exception is that such an amalgamation does not result in a decrease in the overall surplus entitlement percentage of the group.
- The acquisition or disposition is one of multiple in the year, and the net decrease in the taxpayer's surplus entitlement percentage in respect of the particular affiliate resulting from such acquisitions or dispositions is less than a *de minimis* amount. Specifically, this exception applies where one or more acquisitions or dispositions of shares of a foreign affiliate of the taxpayer that results in a change to the surplus entitlement percentage of the taxpayer in respect of the particular affiliate, but in respect of which neither of the exceptions in subparagraphs 91(1.1)(*b*)(i) or (ii) applies, occurs in a particular taxation year of the particular affiliate (determined without reference to subsections 91(1.1) and (1.2)), and the percentage determined by the formula A – B is not greater than 5%. For these purposes:
  - A is the total decrease in the taxpayer's surplus entitlement percentage in respect of the particular affiliate resulting from such acquisitions or dispositions in the particular year, and
  - B is the total increase in the taxpayer's surplus entitlement percentage in respect of the particular affiliate resulting from such acquisitions or dispositions in the particular year (other than an acquisition from a person that does not deal at arm's length with the taxpayer).

Where the conditions in subsection 91(1.1) are satisfied, subsection 91(1.2) applies at the particular time, and provides the following deeming rules for the purposes of sections 91 and 92:

- The affiliate's taxation year that would otherwise have included the particular time is deemed to have ended at the time (referred to in section 91 as the "stub-period end time") that is immediately before the particular time. This deemed taxation year-end applies in respect of only the particular taxpayer and each corporation or partnership that is connected (within the meaning assigned by new subsection 91(1.3)) to the particular taxpayer.

- If the affiliate is, immediately after the particular time, a foreign affiliate of the particular taxpayer or a corporation or partnership that is connected to the particular taxpayer, the affiliate's next taxation year after the stub-period end time is deemed, in respect of the taxpayer or the connected corporation or partnership, to begin immediately after the particular time.
- For purposes of determining the affiliate's FAPI for its taxation year that is deemed to end at the stub-period end time, in respect of the particular taxpayer or a corporation or partnership that is connected to the particular taxpayer, all transactions or events that occur at the particular time are deemed to occur at the stub-period end time. This is to ensure that FAPI resulting from such transactions or events is attributed to the particular taxpayer, and relevant connected corporations, for their taxation years that include the stub-period end time.

New subsection 91(1.3) contains the rules for determining the corporations and partnerships that are connected to the particular taxpayer for purposes of subsection 91(1.2).

New subsections 91(1.4) and (1.5) provide elections that taxpayers can make to have subsection 91(1.2) apply in circumstances where it would otherwise not apply because the conditions in subsection 91(1.1) are not satisfied.

New subsection 91(1.4) provides that subsection 91(1.2) applies in respect of a particular affiliate at a particular time if the following conditions are met:

- The conditions in paragraph 91(1.1)(*a*) are met in respect of the particular affiliate at the particular time.
- Immediately after the particular time there is a disposition of shares of the particular affiliate or another foreign affiliate of the taxpayer that had an equity percentage (as defined in subsection 95(4)) in the particular affiliate by
  - the taxpayer, or
  - a controlled foreign affiliate of the taxpayer, if the shares are not excluded property of the controlled foreign affiliate immediately after the particular time.
- The taxpayer and all specified corporations jointly elect, by filing with the Minister in prescribed manner a form containing prescribed information, by the relevant time. "Specified corporation" is defined for these purposes in subparagraphs 91(1.4)(*c*)(i) to (iii).

New subsection 91(1.5) provides that a particular taxpayer resident in Canada may elect to have subsection 91(1.2) apply at a particular time in respect of a particular foreign affiliate of the particular taxpayer if the following conditions are satisfied:

- Immediately after the particular time, there is an acquisition or disposition of shares of a foreign affiliate of another taxpayer (this could be either the particular affiliate or another affiliate) that results in a decrease to the surplus entitlement percentage of the other taxpayer in respect of the particular affiliate.
- As a result of this acquisition or disposition, subsection 91(1.2) applies to the other taxpayer resident in Canada in respect of the particular affiliate.
- The surplus entitlement percentage of the particular taxpayer in respect of the particular affiliate increases as a result of the acquisition or disposition.

- Subsection 91(1.2) does not apply, in the absence of subsection 91(1.5), to the particular taxpayer in respect of the acquisition or disposition.
- The particular affiliate is a foreign affiliate of the particular taxpayer at the particular time.

These amendments are deemed to have come into force on July 12, 2013.

Example 1

Assumptions

- Canco, a corporation resident in Canada, owns all of the shares of FA1 and FA3, each of which are non-resident corporations. FA1 owns all of the shares of FA2.
- The adjusted cost base of Canco in the shares of FA1, and of FA1 in the shares of FA2, is nominal.
- FA1, FA2 and FA3 all have calendar taxation years.
- The shares of FA2 are not excluded property of FA1.
- FA2's only income for a particular taxation year is $100 of FAPI, earned in the first half of the year.
- Halfway through the particular taxation year, FA1 sells the shares of FA2 to FA3 for $100. Canco subsequently sells the shares of FA1 to an arm's length party prior to the end of the particular taxation year.

Analysis

FA1 earns $50 of FAPI from its sale of the shares of FA2 to FA3 (½ taxable portion of the $100 capital gain). Unless an election is filed under subsection 91(1.4), subsection 91(1.2) does not apply to deem FA1 to have a taxation year-end as a result of the sale because Canco's surplus entitlement percentage in FA2 did not decrease as a result of the sale. In that case, when Canco subsequently sells the shares of FA1 to an arm's length party, subsection 91(1.2) then applies to deem FA1's taxation year to end at the "stub-period end time", which is the time immediately before the "particular time" referred to in subsections 91(1.1) and (1.2) (the "particular time" is immediately before the disposition by Canco of the shares of FA1). As a result, under subsection 91(1), FA1's $50 of FAPI is included in computing Canco's income for its taxation year that includes the stub-period end time. In addition, all of FA2's $100 of FAPI is included in computing Canco's income for its taxation year that includes FA2's taxation year end. Thus, a total of $150, in respect of FA2's FAPI, is included in computing Canco's income, even though FA2's underlying income is only $100.

If Canco instead elects (jointly with all "specified corporations", as defined in subparagraphs 91(1.4)(*c*)(i) to (iii)) under subsection 91(1.4) to have subsection 91(1.2) apply in respect of FA1's sale of the shares of FA2 to FA3, then paragraph 91(1.2)(a) deems FA2's taxation year to end at the stub-period end time in respect of that sale (i.e., the time immediately before the time immediately before the sale). This election gives appropriate tax results. In particular, all $100 of FA2's FAPI is included in computing Canco's income for its taxation year that includes FA2's stub-period end time. For the purposes of computing FA2's taxable surplus, subsections 5907(8) and (8.1) of the Regulations deem FA2's taxation year to end, and the sale of FA2 shares by FA1 to occur, at the stub-period end time. Therefore, $100 is also included in FA2's taxable surplus, which, by virtue of the application of subsections 93(1.1) and 93(1.11), eliminates the gain that FA1 would otherwise realize on the disposition of the shares of FA2. In addition, paragraph 92(1)(a) applies to add $100 to Canco's adjusted cost base of the shares of FA1, with the result that Canco does not realize a gain on its subsequent sale of the shares of FA1.

Example 2

Assumptions

- Canco 1 and Canco2, two corporations resident in Canada that deal at arm's length with each other, each own 50% of the shares of a non-resident corporation that is a controlled foreign affiliate (CFA) of both Canco1 and Canco2.
- Halfway through a taxation year, Canco1 sells all of the shares of CFA owned by Canco1 to Canco2.
- CFA earns $100 of FAPI, which accrues evenly over the taxation year.

Analysis

The sale by Canco1 of shares of CFA to Canco2 causes subsection 91(1.2) to apply in respect of CFA at the "particular time" referred to in subsections 91(1.1) and (1.2), which is the time immediately before the disposition by Canco1 of the shares of CFA. As a result, paragraph 91(1.2)(a) deems CFA's taxation year that includes the particular time to have ended at the time immediately before the particular time (the "stub-period end time"), in respect of Canco1 and each corporation or partnership that is connected to Canco1. Since Canco2 deals at arm's length with Canco1, Canco2 is not connected to Canco1, and thus the deemed year-end does not apply in respect of Canco2, subject to the filing of an election under subsection 91(1.5).

The result of this deemed year-end is that, under subsection 91(1), $25 of CFA's FAPI is included in computing Canco1's income for its taxation year that includes the stub-period end time ($100 x ½ year x 50% participating percentage). However, because there is no deemed year-end under subsection 91(1.2) in respect of Canco2 – and paragraph 95(2)(*f.1*) does not apply to limit the amount of CFA's FAPI in respect of Canco2 because CFA was already a foreign affiliate of Canco2 prior to its acquisition of the remaining CFA shares from Canco1 – the CFA's full $100 of FAPI is included under subsection 91(1) in computing Canco2's income for its taxation year that includes CFA's regular taxation year-end (based on Canco2's 100% participating percentage in respect of CFA at that time). Thus, a total of $125 is included, in respect of CFA's FAPI, in computing the income of Canco1 and Canco2, even though CFA only earned $100 of FAPI.

In order to ensure that, in computing the income of Canco1 and Canco2, the appropriate amount is included in respect of CFA's FAPI, Canco2 can file an election under subsection 91(1.5), to have subsection 91(1.2) apply to deem CFA's tax year to end, in respect of Canco2, at the stub-period end time, as it does in respect of Canco1. As a result, $25 of CFA's FAPI is included in computing Canco2's income for its taxation year that includes the stub-period end time ($100 x ½ year x 50% participating percentage), and $50 of CFA's FAPI is included in computing Canco2's income for its taxation year that includes CFA's regular taxation year-end ($50 x 100% participating percentage in respect of CFA at that time). Thus, a total of $100 is included, in respect of CFA's FAPI, in computing the income of Canco1 and Canco2, which matches the amount of CFA's FAPI.

Exception – hybrid entities

ITA
91(4.5)

Subsections 91(4.1) to (4.7), together with related rules in section 5907 of the Regulations, are intended to address tax schemes established by taxpayers with the intent of creating deductions for foreign accrual tax ("FAT") in respect of foreign tax the burden of which is not, in fact, borne by the taxpayer. These schemes generally seek to exploit asymmetries between the tax laws of Canada and those of a relevant foreign jurisdiction in the characterization of equity and debt instruments.

Subsection 91(4.1) denies FAT in respect of the foreign accrual property income ("FAPI") of a foreign affiliate of a taxpayer in certain circumstances that include an investment in either a partnership or a corporation that is characterized as an equity investment for the purposes of the Act but that is characterized as a debt instrument issued by that entity, or another entity, under the relevant foreign tax law. More specifically, subparagraph 91(4.1)(*a*)(i) provides that this FAT denial rule will apply where the taxpayer (or certain persons connected to the taxpayer, as set-out in the definition of "specified owner" in subsection 91(4.2)), is considered to own less than all of the shares of the foreign affiliate, or certain other connected corporations (as set-out in the definition of "pertinent person or partnership" in subsection 91(4.3)), under the relevant foreign tax law that are considered to be owned by the taxpayer (or other specified owner) under the Act.

Subsection 91(4.5) provides an exception for the purposes of subparagraph 91(4.1)(*a*)(i). It ensures that subsection 91(4.1) will not apply solely because an entity that is treated as a corporation under the Act, but that is treated as a fiscally transparent entity under the relevant foreign tax law (a "hybrid entity"), owns shares of a foreign corporation.

Subsection 91(4.5) is amended to provide, in effect, that the condition in subparagraph 91(4.1)(*a*)(i) is not considered to be met (and thus the FAT denial rule in subsection 91(4.1) does not apply) solely because either a specified owner in respect of a taxpayer, or a corporation that is a pertinent person or partnership in respect of a particular foreign affiliate, is a hybrid entity. Prior to this amendment, the exception from subparagraph 91(4.1)(*a*)(i) applied only where a specified owner in respect of the taxpayer was a hybrid entity. This amendment better aligns subsection 91(4.5) with its underlying policy intent.

Similar changes are made to subsection 5907(1.07) of the Regulations, which is a rule analogous to subsection 91(4.5).

This amendment applies in respect of the computation of foreign accrual tax applicable to an amount included in computing a taxpayer's income under subsection 91(1), for a taxation year of the taxpayer that ends after October 24, 2012, in respect of a foreign affiliate of the taxpayer.

Clause 20

Non-Resident Trusts

ITA
94(3)(*b*)

Paragraph 94(3)(*b*) provides a number of rules for determining the recognition by Canada of foreign taxes paid by a trust that is deemed by paragraph 94(3)(*a*) to be resident in Canada for a particular taxation year. These rules also apply in determining the amount of foreign source income and foreign taxes that may be allocated to a beneficiary under subsections 104(22) to (22.3), and to an electing contributor under subsection 94(16).

Subparagraph 94(3)(*b*)(ii) sets out one of those rules. It provides that for the purposes of subsection 20(12) and section 126, the trust's income, and foreign taxes paid by it, for the particular taxation year are "pooled" to the country, if any, other than Canada in which the trust is resident for the particular taxation year.

Clause 94(3)(*b*)(ii)(A) is amended to clarify that the pooling of the trust's income to the other country for foreign tax computation purposes does not apply to the trust's income from sources in Canada. This is intended to ensure that the trust excludes from its foreign taxes pooled under the rule any foreign taxes paid on Canadian-source income.

This amendment applies to taxation years that end on or after Announcement Date.

Clause 21

Foreign Affiliate Definitions

ITA
95(1) – definition of "trust company"

The definition "trust company" in subsection 95(1) of the Act is relevant for the purposes of subparagraph 95(2)(*l*)(iv), paragraphs 95(2.1)(*a*) and (2.3)(*a*) and paragraph (*b*) of the definition "indebtedness" in subsection 95(2.5) of the Act. This definition provides that a trust company includes a corporation that is resident in Canada that is a "loan company" as defined in subsection 2(1) of the *Canadian Payments Association Act*.

The definition "trust company" is amended to change the reference "*Canadian Payments Association Act*" to "*Canadian Payments Act*" to reflect the new title of that statute.

This amendment is deemed to have come into force on October 24, 2001.

Income from sale of property

ITA
95(2)(a.1)

Paragraph 95(2)(*a.1*) includes in the income from a business other than an active business (and thus the foreign accrual property income (FAPI)) of a foreign affiliate of a taxpayer resident in Canada, the affiliate's income from the sale of property (including income derived from services as agent provided in relation to a purchase or sale of property) if certain conditions are met.

The portion of paragraph 95(2)(*a.1*) after subparagraph (ii) and before subparagraph (iii) includes a "safe harbour", which provides that paragraph 95(2)(*a.1*) does not apply where more than 90% of the affiliate's gross revenue from the sale of property is derived from sales to arm's length persons, other than certain sales that are specifically excluded. The specific exclusions are, first, for sales of property that is described in subparagraph 95(2)(*a.1*)(ii) and the cost of which to any person is a cost referred to in subparagraph 95(2)(*a.1*)(i), and, second, for sales of property to which paragraph 95(2)(a.1) does not apply because of subsection 95(2.31). This second exclusion was added in connection with the recent introduction of the exception in subsection 95(2.31), which provides that paragraph 95(2)(*a.1*) (and paragraph 95(2)(*a.3*)) does not apply to certain securities transactions between a Canadian-based bank and certain of its foreign affiliates that are carried out in the course of the bank's business of facilitating trades for arm's length customers.

The second exclusion is inconsistent with the original policy intent. Accordingly, the portion of subparagraph 95(2)(*a.1*) after subparagraph (ii) and before subparagraph (iii) is amended to better align with the policy intent. As a result of the amendment, for the purpose of determining whether an affiliate meets the 90% safe harbour in paragraph 95(2)(*a.1*), any of the affiliate's revenues from securities transactions that qualify for the exception in subsection 95(2.31) are to be excluded in determining the affiliate's gross revenue from the sale of property (i.e., the denominator), in addition to being excluded in determining the affiliate's revenues derived from sales to arm's length persons (i.e., the numerator).

The amendment to paragraph 95(2)(*a.1*) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after October 2012.

Currency to be used for foreign affiliate

ITA
95(2)(*f.13*)

Paragraph 95(2)(*f.13*) applies where the calculating currency of a foreign affiliate of a taxpayer is a currency other than Canadian currency. The paragraph currently provides that the foreign affiliate shall determine the amount included in computing its foreign accrual property income that is attributable to its capital gain or taxable capital gain, from the disposition of an excluded property, in Canadian currency by converting the amount of the capital gain, or taxable capital gain, otherwise determined under subparagraph 95(2)(*f.12*)(i) using its calculating currency for the taxation year into Canadian currency using the rate of exchange quoted by the Bank of Canada at noon on the day on which the disposition was made.

Beginning on March 1, 2017, the Bank of Canada will no longer publish two exchange rates daily (noon and closing), but will instead publish a single rate per currency pair each day at 16:30 eastern time. It will also reduce the number of currencies for which it provides rates of exchange. Consequential to these changes, two amendments are made to paragraph 95(2)(*f.13*).

First, paragraph 95(2)(*f.13*) is amended to remove the reference to the rate of exchange quoted by the Bank of Canada at noon on the day on which the disposition was made. As a result, a foreign affiliate's capital gain or taxable capital gain determined in its calculating currency is to be converted to Canadian currency using the single exchange rate for those currencies quoted by the Bank of Canada on the day on which the disposition was made.

Second, the paragraph is amended to allow the use of another rate of exchange that is acceptable to the Minister. It is intended that a rate other than that published by the Bank of Canada may be used only where the Bank of Canada does not publish a rate of exchange for the relevant currency.

These amendments apply as of March 1, 2017.

Currency to be used by foreign affiliate

ITA
95(2)(*f.15*)

Paragraph 95(2)(*f.15*) provides a “reading rule” for the application of subsection 39(2). This reading rule requires that, in respect of a debt obligation that is owing by a foreign affiliate (or a partnership of which it is a member) and is referred to in paragraph 95(2)(*i*)(i) or (ii), the foreign affiliate (or partnership) must determine the foreign exchange gains and losses contemplated by subsection 39(2) in its calculating currency.

Paragraph 95(2)(*f.15*) is amended to extend its application to the determination, in applying subsection 39(2), of foreign exchanges gains and losses in respect of an agreement described in subparagraph 95(2)(*i*)(iii) (i.e., an agreement entered into to reduce currency risk with respect to a debt referred to in subparagraph 95(2)(*i*)(i) or (ii)) entered into by a foreign affiliate of a taxpayer, or a partnership of which the foreign affiliate is a member.

This amendment applies to taxation years of a foreign affiliate that begin after October 2, 2007.

Upstream loans – Transitional set-off of foreign exchange capital gains and capital losses

ITA
95(2)(*g.04*)

Paragraph 95(2)(*g.04*) is directly related to subsection 39(2.1), which is a temporary measure that sets off, in certain circumstances, foreign exchange gains or losses of a taxpayer on the repayment of a debt obligation owing to a foreign affiliate of the taxpayer against the related losses or gains of the foreign affiliate from the repayment. These provisions are intended to provide relief to taxpayers that repay “upstream loans” in order to avoid the application of new subsection 90(6).

The result of the application of paragraph 95(2)(*g.04*) is that the subject gains and losses are reduced. Paragraph 95(2)(*g.04*) is amended in two ways, each of which expands the scope of its application and parallels the amendments to subsection 39(2.1).

First, paragraph 95(2)(*g.04*) is modified to apply in cases where the foreign exchange capital gains or capital losses of the creditor foreign affiliate resulting from the repayment of an upstream loan are not equal to the borrowing party’s foreign exchange capital losses or capital gains from the repayment. Prior to this amendment, a set-off was available only where these amounts were equal, and the effect of the rule was to deem the creditor foreign affiliate’s foreign exchange loss to be nil. Because the rule can now apply where the amount of the creditor’s foreign exchange gain or loss exceeds that of the borrowing party’s loss or gain, a formula is added to paragraph 95(2)(*g.04*) for determining the amount by which the creditor’s gain or loss is reduced.

Second, paragraph 95(2)(*g.04*) is modified to apply in situations where the debtor under an upstream loan is not the taxpayer of which the creditor foreign affiliate is a foreign affiliate, but rather another member of the taxpayer’s corporate group (e.g., a wholly-owned subsidiary of the Canadian taxpayer) of which the creditor foreign affiliate is not a foreign affiliate. Prior to this amendment, the set-off was available only where the debtor was the taxpayer itself. Specifically, the rule is amended to require that the creditor under the upstream loan be a foreign affiliate of a qualifying entity (within the meaning assigned by subsection 39(2.2)).

For more information, see the comments under subsection 39(2.1).

The amendments to paragraph 95(2)(*g.04*) apply to a foreign exchange gain or loss of a foreign affiliate on the repayment of the portion of a debt obligation outstanding on August 19, 2011 where that repayment occurs on or before August 19, 2016. This is consistent with the amendments to subsection 39(2.1).

Clause 22

Depreciable property — leasehold interests and options

ITA
98(7)

New subsection 98(7) provides that, for the purposes of paragraphs (3)(*c*) and (5)(*c*), a leasehold interest in a depreciable property and an option to acquire a depreciable property are depreciable properties. This amendment ensures that the cost base of such properties cannot be “bumped” under the related rules that apply when a partnership ceases to exist.

This amendment applies in respect of partnerships that cease to exist on or after Announcement Date.

Clause 23

Transfer of an interest in partnership to tax exempt

ITA
100(1)

Subsection 100(1) of the Act provides that a taxpayer’s taxable capital gain for a taxation year from the disposition of an interest in a partnership to a person or partnership described in paragraphs 100(1.1)(*a*) to (*d*) – in general, tax-exempt entities and non-resident persons, along with partnerships and trust that have such members or beneficiaries – is one-half of the portion of the capital gain from the disposition that can reasonably be attributed to increases in value of capital property other than depreciable property plus the whole of the remaining portion of the gain.

Paragraph 100(1)(*a*) is amended to clarify the wording of the provision by placing the phrase “other than depreciable property” within brackets.

This amendment applies in respect of dispositions made after August 13, 2012.

Clause 24

Trust CGE flow through

ITA
108(1)

"eligible taxable capital gains"

Subsection 104(21.2) of the Act sets out the rules for establishing those net taxable capital gains of a personal trust or a trust referred to in subsection 7(2) that, for the purposes of section 110.6, can be attributed to the beneficiaries of the trust and to specific types of properties disposed of by the trust. This attribution permits the beneficiary to claim the lifetime capital gains exemption under section 110.6 for dispositions by the trust of qualified farm property, qualified fishing property or a share of a qualified small business corporation. The attributable amount is determined by reference to the eligible taxable capital gains of the trust.

The definition "eligible taxable capital gains" is amended to clarify its application to a trust referred to in subsection 7(2).

This amendment comes into force on Royal Assent.

Clause 25

Stock option deduction in situations of death

ITA
110(1)(*d*)

Paragraph 110(1)(*d*) of the Act provides for a deduction in computing taxable income if certain conditions are met. The deduction is equal to 50% of the benefit deemed by subsection 7(1) to have been received by a taxpayer in respect of a security under an employee stock option agreement.

Pursuant to subparagraph 110(1)(*d*)(i), the first condition for entitlement to the deduction is that the security must be acquired under the agreement by the taxpayer or a person not dealing at arm's length with the taxpayer in circumstances described in paragraph 7(1)(*c*). Paragraph 110(1)(*d*) is amended to permit a deduction in computing taxable income of a deceased taxpayer who is deemed by subsection 7(1)(*e*) to have received a benefit in respect of a security because, immediately before death, the taxpayer owned a right to acquire the security under an employee stock option agreement. Under new clause 110(1)(*d*)(i)(B), the deduction is available in these circumstances if (among other conditions) the security is acquired under the agreement within the first taxation year of the graduated rate estate of the taxpayer by:

- the graduated rate estate of the taxpayer,
- a person who is a beneficiary (as defined in subsection 108(1)) under the graduated rate estate of the taxpayer, or
- a person in whom the rights of the taxpayer under the agreement have vested as a result of the taxpayer's death.

Pursuant to subparagraph 110(1)(*d*)(i.1), the second condition is that the security underlying the option must be either a prescribed share (as defined in section 6204 of the *Income Tax Regulations*) or a unit of a mutual fund trust at the time of its sale or issue, or would have been a prescribed share or unit of a mutual fund trust if it were issued or sold to the taxpayer at the time the taxpayer disposed of rights under the agreement. New clauses 110(1)(*d*)(i.1)(B.1) and (E) ensure that, in the case of a benefit deemed by paragraph 7(1)(*e*) to have been received by a deceased taxpayer, this condition is met in order for the deduction to be available.

This amendment applies in respect of acquisitions of securities and transfers or dispositions of rights occurring after 4:00 p.m. Eastern Standard Time on March 4, 2010. For taxation years ending before 2016, the reference to graduated rate estate in clause 110(1)(*d*)(i)(B) is to be read as a reference to "estate".

ITA
110(1.1)

Subsection 110(1.1) of the Act allows a taxpayer who did not acquire a security under an employee stock option agreement (as required under subparagraph 110(1)(*d*)(i)) to claim the 50% deduction under paragraph 110(1)(*d*) if the taxpayer's employer makes an election that neither the employer, nor a person with whom the employer does not deal at arm's length, will deduct any amount in respect of a payment to or for the benefit of the taxpayer in respect of the disposition (a "cash out") of the taxpayer's rights under the agreement.

Subsection 110(1.1) is amended to take into account situations where a taxpayer is deceased and the taxpayer's terminal return is handled by the taxpayer's graduated rate estate (or, for taxation years before 2016, the taxpayer's estate). More specifically:

- paragraph 110(1.1)(*c*) is amended to require the employer to provide evidence in writing of the election to the graduated rate estate (or, for taxation years ending before 2016, the estate) of the deceased taxpayer; and
- paragraph 110(1.1)(*d*) is amended to permit the graduated rate estate (or, for taxation years ending before 2016, the estate) of the deceased taxpayer to file evidence of the election with the Minister of National Revenue with the deceased taxpayer's return of income.

This amendment applies in respect of acquisitions of securities and transfers or dispositions of rights occurring after 4:00 p.m. Eastern Standard Time on March 4, 2010.

Clause 26

Definitions

ITA
111(8)

"exchange rate"

The definition "exchange rate" is relevant for the purposes of subsections 40(10) and (11) and subsection 111(12), regarding capital gains and losses resulting from foreign currency fluctuations on debt liabilities denominated in a foreign currency. The "exchange rate", at any time in respect of a foreign currency, is currently defined as the rate of exchange between that currency and Canadian currency quoted by the

Bank of Canada at noon on the day that includes that time (or, if that day is not a business day, on the day before) or a rate of exchange acceptable to the Minister.

Beginning on March 1, 2017, the Bank of Canada will no longer publish two exchange rates daily (noon and closing), but will instead publish a single rate per currency pair each day at 16:30 eastern time. Consequential to this change, the definition "exchange rate" is amended to remove the reference to the rate of exchange quoted by the Bank of Canada at noon on the relevant day, and to instead refer to the single exchange rate for the currency quoted by the Bank of Canada on the relevant day.

This amendment applies as of March 1, 2017.

Clause 27

Interest in a partnership – cost reduction

ITA
112(11) to (13)

New subsections 112(11) to (13) together with the amendment to clause 53(2)(c)(i)(C) are intended to ensure that taxpayers do not circumvent the dividend stop-loss rules in subsections 112(3) to (7) by holding shares through a partnership, instead of holding the shares directly. These rules are intended to deny the inappropriate loss created in certain circumstances through the fluctuation of the cost to the taxpayer of an interest in a partnership arising from the shares held or disposed of by the partnership.

New subsections 112(11) to (13) apply for the purposes of computing the cost to a taxpayer of an interest in a partnership that is property other than capital property of the taxpayer.

Under new subsection 112(11), the cost to a taxpayer of an interest in a partnership that is property other than capital property of the taxpayer is reduced by an amount equal to the share of the taxpayer's loss (referred to as the "partnership loss" in subsections (11) and (12)) from the disposition of a share of a corporation by the partnership (or another partnership of which the partnership is a direct or indirect member), if the share is disposed of during a fiscal period of the partnership or a prior fiscal period. The partnership loss is to be determined without reference to subsections 112(3.1), (4) and (5.2).

New subsections 112(12) and (13) provide application rules for the purposes of new subsection 112(11).

Under new subsection 112(12), if the taxpayer disposes of an interest in a partnership, the taxpayer's share of a partnership loss for the purpose of subsection 112(11) is to be computed as if:

- the fiscal period of any partnership of which the taxpayer is a direct or indirect member ended immediately before the time that is immediately before the taxpayer disposed of the partnership interest,
- any partnership of which the taxpayer is a direct or indirect member disposed of any share of a corporation that was property of the partnership at the time the taxpayer disposed of a partnership interest,
- the relevant partnership(s) disposed of those shares immediately before the end of their fiscal periods for proceeds equal to the fair market value of the shares when the taxpayer disposed of the partnership interest, and

- each member of any partnership of which the taxpayer is a direct or indirect member were allocated their specified proportion of any loss realized by the partnerships, which loss is to be computed without reference to subsections 112(3.1), (4) and (5.2).

New subsection 112(13) applies to determine the cost of partnership interest that a taxpayer acquires from another taxpayer if new subsection (11) applied to reduce the cost of the partnership interest to the other taxpayer. In such a case, the total of all amounts each of which is an amount deducted from the cost of the partnership interest to the other taxpayer is added to the cost of the partnership interest to the taxpayer (other than an amount to which subsection 112(3.1) would apply).

New subsections 112(11) to (13) are deemed to have come into force on Announcement Date.

Clause 28

Pension Credit

ITA
118(3)

Subsection 118(3) provides for a non-refundable credit for individuals who are in receipt of eligible pension income (as defined in subsection 118(7)). The credit is determined by the formula A x B:

- Variable A is the appropriate percentage for the year (15% for 2016).
- Variable B is the lesser of $2,000 and the eligible pension income of the individual for the year.

Variable B is amended such that amounts received by the individual on account of a retirement income security benefit (RISB amount) payable to the individual under Part 2 of the *Canadian Forces Members and Veterans Re-establishment and Compensation Act* will be eligible for the non-refundable credit. Specifically, the credit will be calculated by reference to up to $2,000 of the individual's combined eligible pension income and RISB amounts for the year, multiplied by the appropriate percentage for the year.

This amendment applies to the 2015 and subsequent taxation years.

Clause 29

Financial Institution Definition

ITA
118.1(20)

Subsection 118.1(20) of the Act defines a "financial institution" for the purpose of the "non-qualifying security" definition in subsection 118.1(18). For this purpose, "financial institution" is defined as being a member of the Canadian Payments Association or a credit union that is a shareholder or member of a central for the purposes of the *Canadian Payments Association Act*.

Subsection 118.1 is amended to change the reference "*Canadian Payments Association Act*" to "*Canadian Payments Act*" to reflect the new title of that statute.

This amendment is deemed to have come into force on October 24, 2001.

Clause 30

Medical Expense Credit -- Marihuana

ITA
118.2(2)(*u*)

Existing paragraph 118.2(2)(*u*), which provides the medical expense tax credit for medical marihuana under the *Medical Marihuana Access Regulations*, is repealed consequential to the repeal of those regulations. References to the new *Marihuana for Medical Purposes Regulations* are contained in new paragraph 118.2(2)(*v*).

For more information, see the comments under new paragraph 118.2(2)(*v*).

This amendment applies on Royal Assent.

ITA
118.2(2)(*v*)

New paragraph 118.2(2)(*v*) of the Act effectively replaces existing paragraph 118.2(2)(*u*) in allowing amounts paid for medical marihuana as an eligible expense under the medical expense tax credit. To be eligible under the medical expense tax credit, medical marihuana must be purchased on behalf of a patient who is authorized to possess marihuana for medical purposes under the *Marihuana for Medical Purposes Regulations* or section 56 of the *Controlled Drugs and Substances Act*. The medical marihuana must be purchased from

- a licensed producer (as defined in subsection 1(1) of the *Marihuana for Medical Purposes Regulations*), in accordance with a medical document (as defined in subsection 1(1) of the *Marihuana for Medical Purposes Regulations*),
- a health care practitioner (as defined in subsection 1(1) of the *Marihuana for Medical Purposes Regulations*) in the course of treatment for a medical condition,
- a hospital, under subsection 65(2.1) of the *Narcotics Control Regulations*, or
- an individual who possesses an exemption for cultivation or production under section 56 of the *Controlled Drugs and Substances Act*.

New paragraph 118.2(2)(*v*) is deemed to have come into force on June 19, 2013.

Clause 31

Tax Payable by Trust

ITA
122(1)(*c*)

Section 122 sets out certain rules that apply in determining the tax payable by a trust under Part I of the Act. Paragraph 122(1)(*c*) provides for a “recovery” of tax in a taxation year of a trust that elected in an earlier taxation year to be a qualified disability trust. The recovery tax is in addition to the 33% tax under paragraph 122(1)(*a*) on the trust's taxable income for the year.

The recovery tax is the amount determined by the formula A – B. In general terms, variable A of the formula computes the total of all amounts each of which is the tax the trust would have paid under Part I for an earlier taxation year if the trust had not been a qualified disability trust for the earlier taxation year and it made payable (i.e., flowed out) in the earlier taxation year to an electing beneficiary under the trust for the earlier year the amount of its taxable income for the earlier year that was subsequently distributed to that beneficiary (i.e., as a capital distribution). Variable B of the formula computes the actual tax paid by the trust on its taxable income for each of those earlier taxation years. The difference between these two amounts is the amount of the tax recovered for the year in which paragraph 122(1)(*c*) applies. The amount recovered is, in effect, the income tax for the earlier year on the trust's taxable income for the earlier year that is not distributed to an individual who was an "electing beneficiary" of the trust for the earlier year.

The formula in paragraph 122(1)(*c*) for the recovery tax is amended to be A – (B – C). Elements A and B of the formula are not changed. New element C is the total of the amounts determined, in computing the amount for A for the year the recovery tax is payable, under clause (ii)(B) of A for an earlier year of the trust. That subclause describes (for purposes of determining the amount under A) the portion of the trust's federal income tax (on taxable income) for the earlier year that is reasonably attributable to the reduction under clause (ii)(A) of A in taxable income attributable to payments made to an electing beneficiary. The effect of C of the formula is to ensure that, to the extent that credit is given in computing element A of the formula for federal income taxes paid in respect of an electing beneficiary's share of the trust's taxable income for an earlier year, credit for that amount is not also provided for under element B of the formula.

This amendment applies to taxation years that end on or after Announcement Date.

Clause 32

Refundable medical expense supplement

ITA
122.51(2)(*b*)(i)

Section 122.51 provides a refundable medical expense supplement equal to the lesser of $1,000 (indexed after 2006) and 25% of the total of allowable expenses claimed under the disability supports deduction and the medical expense tax credit by an eligible individual for the year. The supplement is reduced by 5% of "adjusted income" in excess of an indexed threshold.

The 25% factor is set out in subparagraph (*b*)(i) of the description of A in subsection 122.51(2), as a function of certain amounts creditable at 15%, the "appropriate percentage" for the 2008 and subsequent taxation years.

The 25% factor is set out in the fraction "25/C" in the formula in the description of A. However, the reference to 25 should be read as a reference to 25%. The formula is adjusted to provide the correct mathematical result.

This amendment applies to the 2005 and subsequent taxation years.

Clause 33

Definitions

ITA
127(9)

Subsection 127(9) of the Act provides various definitions relevant for the purpose of calculating the investment tax credits (ITCs) of a taxpayer.

“pre-production mining expenditure”

The definition pre-production mining expenditure in subsection 127(9) describes the type of exploration expenses that are eligible for the 10% ITC (specified percentage) rate and are included in paragraph (a.3) of the definition “investment tax credit”.

The definition “pre-production mining expenditure” in subsection 127(9) of the English version of the Act is amended to correct a typographical error by adding “or” at the end of subparagraph (*a*)(i). This error occurred when the provision was amended effective on March 21, 2013.

This amendment is deemed to have come into force on March 21, 2013.

“specified percentage”

The definition “specified percentage” in subsection 127(9) sets out the relevant rates at which investment tax credits (ITCs) are earned in different circumstances.

Budget 2012 reduced the general ITC rate for qualified scientific research & experimental development (SR&ED) expenditures to 15% from 20%. The 15% rate is fully phased in for taxation years that begin after 2014.

Subparagraph (*f.1*)(i) of the definition is amended to reduce the ITC rate to 15% for any repayment of any government assistance, non-government assistance or contract payments (assistance) received by a taxpayer in a taxation year beginning after 2014.

This amendment applies to repayments of assistance made after Announcement Date.

Clause 34

Dividends paid to bankrupt controlling corporation

ITA
129(1.1)(*b*)

Subsection 129(1) entitles corporations to claim a partial refund for a taxation year on taxable dividends paid in the year. Paragraph 129(1.1)(b) provides that dividends paid to a shareholder that was a bankrupt at any time during the taxation year of the corporation do not qualify for the dividend refund.

Paragraph 129(1.1)(*b*) is amended to remove an expired reference to the definition “bankrupt” in subsection 128(3), which was repealed by 1998, c. 19. “Bankrupt” is now defined in subsection 248(1).

Clause 35

Definition of “retirement savings plan”

ITA
146(1)

The definition “retirement savings plan” is described for the purposes of section 146. Clause (*b*)(iii)(B) of the definition is amended to change the reference “*Canadian Payments Association Act*” to “*Canadian Payments Act*” to reflect the new title of that statute.

This amendment is deemed to have come into force on October 24, 2001.

Application of section 212 to payments made out of Saskatchewan Pension Plan

ITA
146(21.2)

Subsection 146(21.2) of the Act applies for various purposes of the Act and *Income Tax Regulations* to deem an individual's account under a specified pension plan (i.e., the Saskatchewan Pension Plan) to be a registered retirement savings plan under which the individual is the annuitant.

Subsection 146(21.2) is amended to add references to paragraphs 212(1)(*j.i*) and (*m*). As a result, the deeming rule will apply to exclude from non-resident withholding tax the portion of a retiring allowance or a payment out of a deferred profit sharing plan that is transferred to a specified pension plan.

This amendment is deemed to have come into force on January 1, 2010, except that in its application before December 14, 2012, it is to be read without reference to paragraph 147.5(21)(*c*).

Clause 36

RDSP Transfers

ITA
146.4

Subsection 146.4(4) of the Act sets out the conditions that a disability savings plan must meet in order to be registered.

In particular, paragraph 146.4(4)(*f*) requires that the plan prohibit contributions from being made in a year in respect of which its beneficiary is no longer a “DTC-eligible individual” (as defined in subsection 146.4(1)). It also requires that the plan prohibit contributions after the death of the beneficiary.

Generally, the plan must also be wound up by the end of the calendar year following the first calendar year throughout which the beneficiary has no severe and prolonged impairments with the effects described in paragraph 118.3(1)(*a.1*) (i.e., the beneficiary is no longer DTC-eligible). An election under subsection 146.4(4.1) may be made in certain circumstances to keep a registered disability savings plan (RDSP) in respect of a DTC-ineligible beneficiary open for up to five years.

Consistent with the elective rule in subsection 146.4(4.1) and the rules in section 60.02 providing for the tax-deferred transfer of amounts from a deceased individual's registered retirement savings plan, registered retirement income fund, registered pension plan, pooled registered pension plan or specified pension plan (i.e., the Saskatchewan Pension Plan) to the RDSP of a financially dependent infirm child or grandchild, paragraph 146.4(4)(*f*)(i) is amended to permit a transfer of similar amounts to the RDSP of a DTC-ineligible financially dependent infirm child or grandchild in respect of whom there is a valid election under subsection 146.4(4.1) at the time of the transfer.

This amendment applies to the 2014 and subsequent taxation years.

Clause 37

Excess Transfers to SPP and PRPP

ITA
147.3(13.1)(*a*)(i)

Subsection 147.3(13.1) of the Act provides relief from double taxation where amounts are transferred from a registered pension plan (RPP) to a registered retirement savings plan (RRSP) or registered retirement income fund (RRIF) in excess of the amounts permissible by subsections 147.3(1) and (4) to (7) by providing for a deduction.

Subparagraph 147(13.1)(*a*)(i) is amended to add a reference to clause 56(1)(*a*)(i)(C) and paragraph 56(1)(*z.3*) to clarify that the deduction is available where amounts are transferred from an RPP to a specified pension plan (SPP) or pooled registered pension plan (PRPP).

This amendment is deemed to have come into force on January 1, 2010 except that in its application before December 14, 2012, it is to be read without reference to paragraph 56(1)(*z.3*).

Clause 38

Joint and several liability in respect of amounts received from a PRPP

ITA
147.5(12)

Subsection 147.5(12) of the Act deems an individual's account under a pooled registered pension plan (PRPP) to be a registered retirement savings plan (RRSP) under which the individual is the annuitant for the purposes of a number of provisions of the Act and the *Income Tax Regulations*.

Subsection 147.5(12) of the English version of the Act is amended to appropriately refer to one of these provisions (i.e., subsection 147.1(18)).

This amendment is deemed to have come into force on December 14, 2012.

Contribution deemed not paid

ITA
147.5(32.1)

New subsection 147.5(32.1) of the Act provides that a refund of a contribution made to a PRPP by a taxpayer as a result of a reasonable error or a refund to avoid the revocation of the PRPP, which amount is not deducted as a PRPP contribution for the taxation year in which the refund is made or for any preceding taxation year, is deemed not to have been a contribution made by the taxpayer to the PRPP. As a result, such an amount will not be a contribution for the purposes of the deeming rule in subsection 147.5(11) and provisions listed therein. This is relevant in particular for the purposes of subsections 146(5) and (5.1) and Part X.I, as these provisions apply because of subsection (11) in respect of contributions made to the PRPP (i.e., generally deductible contributions and the tax on over-contributions).

This amendment is deemed to have come into force on December 14, 2012.

Clause 39

Life Insurance Policies

ITA
148

Section 148 of the Act sets out rules for determining the income tax consequences of the disposition of an interest in a life insurance policy. Subsection 148(1) generally requires that an amount be included in a policyholder’s income for a taxation year in respect of a disposition of an interest in a life insurance policy. The amount to be included is the amount by which the proceeds of the disposition of the interest that the policyholder (or a beneficiary or assignee) is entitled to receive in the year exceeds the adjusted cost basis to the policyholder of the interest immediately before the disposition.

Deemed Proceeds of Disposition

ITA
148(2)

Subsection 148(2) of the Act deems there to have been, in certain circumstances, a disposition of an interest in a life insurance policy for the purposes of subsections 148(1) and 20(20) and the definition “adjusted cost basis” in subsection 148(9).

Paragraph 148(2)(*e*) applies to a policy, issued after 2016 that is an exempt policy, to impose a deemed disposition of part of a policyholder’s interest under the policy for proceeds equal to an excess amount. The paragraph applies if a benefit on death (as defined in subsection 1401(3) of the *Income Tax Regulations*) under a coverage (as defined in subsection 1401(3) of the *Income Tax Regulations*) under the policy is paid at a particular time, the payment results in the termination of the coverage but not the policy, and the amount of the fund value benefit (as defined in subsection 1401(3) of the *Income Tax Regulations*) paid at that time in respect of the coverage exceeds the maximum fund value benefit – determined on the policy anniversary that is on or that first follows the date of death of an individual whose life is insured under the coverage – that would be payable under the policy if no other coverage were offered (as determined under subclause (A)(I) of variable B of the formula in subparagraph 306(4)(*a*)(iii) of the *Income Tax Regulations*).

Paragraph 148(2)(*e*) is amended so that the term coverage used in that paragraph carries the meaning assigned by paragraph (*a*) of the definition "coverage" in section 310 of the *Income Tax Regulations*. The paragraph is also amended to modify how the excess amount (i.e., the excess that is the deemed proceeds amount determined under the paragraph where it applies) is computed. The excess will continue to be computed by reference to the maximum fund value benefit that would be payable under the policy if no other coverage were offered (as determined under subclause (A)(I) of variable B of the formula in subparagraph 306(4)(a)(iii) of the *Income Tax Regulations*). However, the determination of that maximum will be on:

- in the case where there is no policy anniversary before the date of death of the individual whose life is insured under the coverage, on the policy anniversary that is on or that first follows that date; and
- in any other case, on the last policy anniversary before the date of death.

For information on related amendments, see the commentary on the description of variable O of the formula in the definition "adjusted cost basis" in subsection 148(9).

This amendment comes into force on Royal Assent.

Repayment of Policy Loan on Partial Surrender

ITA
148(4.01)

Subsection 148(4.01) of the Act applies for the purposes of paragraph 60(*s*) and the definition "adjusted cost basis" in subsection 148(9). Subsection 148(4.01) deems a particular amount that reduces – as a result of a partial surrender of a taxpayer's interest in a life insurance policy issued after 2016 – the amount payable by the taxpayer in respect of a policy loan in respect of the policy to be a repayment, made at a particular time that is immediately before the time of the partial surrender, in respect of the policy loan. The particular amount is deemed to be a repayment in respect of a policy loan only if it is not otherwise considered to be a repayment of the policy loan and does not reduce the proceeds of disposition of the partial surrender (i.e., it is not an amount payable in respect of a policy loan applied to pay a premium under the policy).

Subsection 148(4.01) is amended to correct a cross-reference by replacing the cross-reference to the definition "adjusted cost basis" with a reference to the definition "proceeds of the disposition". It is also amended to clarify that the cross-reference in the formula is to paragraph (*a*) of the definition "proceeds of the disposition".

Definitions

ITA
148(9)

Subsection 148(9) of the Act contains a number of definitions that apply for the purposes of sections 12.2 and 148.

"adjusted cost basis"

The adjusted cost basis (ACB) of a taxpayer's interest in a life insurance policy is relevant to determining the amount of any income inclusion in respect of the interest under the accrual taxation rules in section 12.2 of the Act and the amount of any income inclusion that may, under subsection 148(1) or (1.1), result from a disposition of the interest or a part of the interest. If the policyholder is a private corporation, the interest's ACB is also relevant to determining the proceeds of the life insurance policy received by the corporation in consequence of the death of an insured under the policy that may be added to the corporation's capital dividend account. In general terms, the ACB of a taxpayer's interest in a policy (other than an annuity contract) is the total of the premiums paid by the taxpayer under the policy less the net costs of pure insurance in respect of the interest (i.e., the costs of the protection element of the interest) and certain other adjustments to reflect previous dispositions of the interest. For further information on "net cost of pure insurance", see the commentary on section 308 of the *Income Tax Regulations*.

Variable E (which is expressed as the excess of E.1 over E.2) of the ACB formula provides for an ACB increase on the repayment of the portion of a policy loan used immediately after the loan to pay a premium under the policy to the extent that the portion has not reduced the proceeds of disposition of a partial surrender of the interest. Variable E.1 is amended to clarify that an existing cross reference in the formula is to paragraph (*a*) of the definition "proceeds of the disposition".

Variable O of the formula reduces the ACB of a taxpayer's interest in a policy under which more than one coverage is provided, if a benefit on death under a coverage under the policy is paid and the payment terminates the coverage (but not the policy). The reduction in the ACB is intended to represent the portion of the ACB of the interest that corresponds to the share of the savings in the policy associated with the payment and any fund value benefit paid on termination. Savings for this purpose is determined by reference to a number of amounts determined under subsection 1401(3) of the *Income Tax Regulations* and having regard to savings as measured for purposes of the exemption test. For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), the ACB reduction applies only to a benefit on death paid at or after the particular time.

Variable O of the ACB formula is amended in two respects. First, an amendment clarifies that the ACB reduction under O does not apply to the payment of an endowment benefit. This is because the payment of an endowment benefit is a disposition for tax purposes, it is intended that the ACB of the policy be reduced in this case under variable H of the ACB formula. The second amendment, which is made to O and a number of its constituent elements, being variables Q through U of the ACB formula, is consequential on the amendment to paragraph 148(2)(*e*). These amendments stipulate which concept of the term coverage is to be used in those elements of the formula, reflecting the amendment to paragraph 148(2)(e) to adopt the meaning of coverage assigned by paragraph (a) of the definition "coverage" in section 310 of the *Income Tax Regulations*.

These amendments come into force on Royal Assent.

Loss of Grandfathering

ITA
148(11)

Subsection 148(11) of the Act applies in determining whether certain life insurance policies issued before 2017, and not otherwise subject to the rules for policies issued after 2016, are to be treated as having been issued at a particular time after 2016 for certain purposes under the tax rules. Paragraph 1401(5)(*b*) of the *Income Tax Regulations* provides a similar rule for purposes of applying the new rules for purposes of Part XII.3 of the Act.

Subsection 148(11) is amended consequential to new subsection 306(10) of the *Income Tax Regulations* to provide that it does not apply for the purpose of that subsection.

Subsection 148(11) is also amended to clarify that paragraph 148(11)(*a*) applies only where term insurance in a policy is converted to a permanent policy within the policy.

This amendment comes into force on Royal Assent.

Clause 40

Where tax not payable

ITA
181.1(3)(*b*)

Paragraph 181.1(3)(*b*) provides that a corporation that was a bankrupt at the end of a taxation year is not subject to tax under Part I.3 for that year.

Paragraph 181.1(3)(*b*) is amended to remove an expired reference to the definition “bankrupt” in subsection 128(3), which was repealed by 1998, c. 19. “Bankrupt” is now defined in subsection 248(1).

Clause 41

Exempt corporations

ITA
186.1(a)

Paragraph 186.1(*a*) provides that a corporation that was a bankrupt at any time in a taxation year is exempt from tax under Part IV for that year.

Paragraph 186.1(*a*) is amended to remove an expired reference to the definition “bankrupt” in subsection 128(3), which was repealed by 1998, c. 19. “Bankrupt” is now defined in subsection 248(1).

Clause 42

Undeducted RRSP premiums

ITA
204.2(1.2)

Subsection 204.2(1.2) of the Act provides rules for determining the amount of an individual's undeducted RRSP premiums at any time. This amount is used in computing the individual's cumulative excess amount in respect of RRSPs under subsection 204.2(1.1).

Paragraph (*a*) of the description of J in subsection 204.2(1.2) is amended to subtract from an individual's undeducted RRSP premiums amounts that are withdrawn from the individual's specified pension plan in the year and before the time of the determination and that are included in computing the individual's income for the year.

This amendment is deemed to have come into force on January 1, 2010 except that in its application before December 14, 2012, it is to be read without reference to a pooled registered pension plan.

Clause 43

Non-resident withholding tax – Pension benefits

ITA
212(1)(*h*)(iii.1)

Section 212 of the Act imposes a tax, commonly referred to as a "non-resident withholding tax", on certain payments made by residents of Canada to non-residents. Paragraph 212(1)(*h*) includes superannuation or pension benefits paid to non-residents as payments subject to the withholding tax. Paragraph 212(1)(*h*) lists, in subparagraphs (iii) to (iv.1), a number of exclusions from the application of the withholding tax.

Existing subparagraph 212(1)(*h*)(iii.1) exempts from withholding tax a payment that is transferred directly to a registered pension plan, registered retirement savings plan or registered retirement income fund for the benefit of the non-resident person if the transfer is made pursuant to an authorization in prescribed form.

Subparagraph (iii.1) is amended to add a reference to a "specified pension plan" (i.e., the Saskatchewan Pension Plan), which will extend the exemption from the non-resident withholding tax to payments transferred to such plans pursuant to an authorization in prescribed form.

This amendment is deemed to have come into force on January 1, 2010 except that in its application before December 14, 2012, it is to be read without reference to a pooled registered pension plan.

Clause 44

Foreign affiliate dumping – conditions for application

ITA
212.3(1)

Subsection 212.3(1) of the Act provides the conditions for the application of subsection 212.3(2), the main operative rule for the foreign affiliate dumping rules.

Subsection 212.3(1) is amended in two ways. First, paragraph 212.3(1)(*a*) is amended to ensure that subsection 212.3(2) applies to an investment by a corporation resident in Canada (a "CRIC") in a non-resident corporation that is not a foreign affiliate of the CRIC but is a foreign affiliate of another corporation resident in Canada that does not deal at arm's length with the CRIC. This amendment is in line with the policy of the foreign affiliate dumping rules. Second, consequential on the first amendment, paragraph 212.3(1)(*b*) is amended so that the condition in that paragraph is satisfied where either the CRIC, or the non-arm's length corporation resident in Canada that has a foreign affiliate in which the CRIC makes an investment, is, or becomes as part of a transaction or event or a series that includes the making of the investment, controlled by a non-resident (and the other requirements of paragraph 212.3(1)(*b*) are also met).

These amendments apply in respect of transactions and events that occur on or after Announcement Date. They also apply, in certain circumstances, in respect of the portion of a particular amount owing to a CRIC by, or debt obligation of, a subject corporation that became owing prior to Announcement Date and remains outstanding on January 1, 2017.

Election to not reduce deemed dividend

ITA
212.3(7.1)

New subsection 212.3(7.1) allows taxpayers to elect out of the application of the paid-up capital (PUC) offset rules in subsection 212.3(7), in respect of certain transactions occurring between March 28, 2012 and August 16, 2013.

As a result of amendments to the PUC offset rules announced on August 16, 2013, where the conditions for the application of the rules are satisfied, they apply automatically (without the need for taxpayers to file an election) to offset the PUC in respect of relevant shares against the dividend deemed under paragraph 212.3(2)(*a*). These amendments were made to apply retroactively, in respect of transactions or events that occurred after March 28, 2012. Prior to these amendments, the PUC offset rules applied only on an elective basis.

New subsection 212.3(7.1) restores the option for taxpayers to decide not to have the PUC offset rules apply to reduce the amount of a deemed dividend under paragraph 212.3(2)(*a*) in respect of certain investments. More specifically, it allows a corporation resident in Canada (a "CRIC") to elect out of the PUC offset rules in subsection 212.3(7), provided the following conditions are met:

- the investment was made after March 28, 2012 and before August 16, 2013; and
- at the investment time, each share of the CRIC, and each qualifying substitute corporation in respect of the CRIC, that was not owned by the parent was owned by persons or partnerships with which the parent did not deal at arm's length.

The CRIC must file the election with the Minister before 2017.

New subsection 212.3(7.1) is deemed to have come into force on March 29, 2012.

Clause 45

Character Conversion

ITA
248(1) – “derivative forward agreement”

Paragraph (*b*) of the definition “derivative forward agreement” deals with agreements to purchase a capital property. Paragraph (*c*) of the definition deals with agreements to sell a capital property. In order for a purchase to be a derivative forward agreement, the economic return on the agreement must have a derivative component. If the agreement is a derivative forward agreement, this return will be included (or potentially deducted if there is a loss) in computing the taxpayer's income under paragraph 12(1)(*z.7*) (or paragraph 20(1)(*xx*)).

For the purpose of determining whether the economic return of an agreement has a derivative component, the return must be attributable, in whole or in part, to an underlying interest that is not described in subparagraph (*b*)(i) or (ii), in the case of a purchase agreement, or clause (*c*)(i)(A) or (B), in the case of a sale agreement.

New subparagraph (*b*)(iii) and clause (*c*)(i)(C) are added to provide additional underlying interests that will not be considered to be a derivative component for the purposes of the definition “derivative forward agreement”.

Subparagraph (*b*)(iii) provides that an underlying interest that relates to a purchase of currency will not be considered to be a derivative component, if it can reasonably be considered that the purchase is agreed to by the taxpayer in order to reduce its risk of fluctuations in the value of the currency in which a purchase or sale by the taxpayer of a capital property is denominated, in which an obligation that is a capital property of the taxpayer is denominated or from which a capital property of the taxpayer derives its value.

Clause (*c*)(i)(C) provides that an underlying interest that relates to a sale of currency will not be considered to be a derivative component, if it can reasonably be considered that the sale is agreed to by the taxpayer in order to reduce its risk of fluctuations in the value of the currency in which a purchase or sale by the taxpayer of a capital property is denominated, in which an obligation that is a capital property of the taxpayer is denominated or from which a capital property of the taxpayer derives its value.

Subparagraph (*b*)(iii) and clause (*c*)(i)(C) are deemed to have come into force on March 21, 2013.

Clause 46

Where ss. (9) ceases to apply

ITA
249.1(9.1)

Section 249.1 defines “fiscal period” for the purposes of the Act.

In general, paragraph (1)(*c*) provides that partnerships that are members of a tiered-partnership structure are required to have a common fiscal period ending on December 31. However, this treatment does not apply to a partnership for which a multi-tiered alignment election has been made pursuant to subsection (9), with the entitlement to make such an election having expired.

New subsection 249.1(9.1) allows partnerships in a tiered-partnership structure to which a multi-tiered alignment election applies to retain their common non-calendar fiscal period in certain cases not currently permitted if certain conditions are met. New paragraph (9)(*a*) provides that subsection (9) ceases to apply for the purpose of paragraph 249(1)(*c*) if another (the new) partnership becomes a member of the tiered-partnership structure, or any of the aligned multi-tier partnerships becomes a member of another (the new) partnership, except if certain conditions in paragraphs (i) and (ii) apply. In general terms, these conditions require that the fiscal period of a new partnership to the structure end on the same day as the aligned multi-tiered partnerships and each partner of the multi-tier partnership structure that is not a partnership be a member of the aligned structure at the end of the preceding calendar year and immediately before the new partnership becomes part of the multi-tiered structure.

New paragraph (9)(*b*) provides in general a continuity rule that ensures that the original multi-tier alignment election remains operative despite the multi-tier structure having a new partnership to which the exception in subparagraphs (*a*)(i) and (ii) applies.

This amendment applies to fiscal periods of partnerships ending after March 2014.

Clause 47

Reverse takeover of trust or partnership by a loss corporation

ITA
256(7)

Subsection 256(7) of the Act provides rules for determining whether control of a corporation is deemed to be (or not to be) acquired for the purposes of the Act.

Existing paragraphs 256(7)(*c*) and (*c.1*) of the Act deem an acquisition of control of an acquiring corporation, and corporations controlled by it, in the case of certain “reverse takeovers”. A reverse takeover typically involves the acquiring corporation having realized, but unused, losses (or other tax attributes) available for carryover. An acquiring corporation acquires ownership of an income-generating “target” entity (e.g., another corporation or a publicly-traded trust or partnership, such as a real estate investment trust (REIT) or specified investment flow-through entity (SIFT)). That income can be paid or allocated to the acquiring corporation and sheltered by the corporation’s unused losses or other tax attributes. Paragraphs 256(7)(*c*) and (*c.1*) seek to prevent this result in circumstances where the acquiring corporation and the target entity are, in general terms, not part of a related or affiliated group prior to the relevant transactions.

New paragraph 256(7)(*c.2*) extends the “reverse takeover” rules in paragraphs 256(7)(*c*) and (*c.1*) to apply to similar transactions, entered into on or after Announcement Date, between a corporation and an ordinary trust or partnership (i.e., without regard to whether the target entity is a REIT or a SIFT trust or SIFT partnership). Subject to the exceptions in subparagraphs 256(7)(*c.2*)(i), (ii) and (iii), new paragraph 256(7)(*c.2*) provides for control of a corporation (and of corporations controlled by it) to be deemed to have been acquired if, as part of a series of transactions or events, two or more persons acquire shares at a particular time (the acquisition time) in the corporation (the acquiring corporation) in exchange for interests in a trust or partnership (the target entity). For this purpose, an exchange includes a redemption, surrender or distribution of an interest.

Consistent with the general scheme of the acquisition of control regime in subsection 256(7) of the Act, a deemed acquisition of control of a corporation will not occur under paragraph 256(7)(*c.2*) if, in respect of the exchange, there is appropriate continuity of ownership of the corporation. Subparagraphs 256(7)(*c.2*)(i) and (ii) provide for this result.

Subparagraph 256(7)(*c.2*)(i) applies to a corporation (and to each corporation controlled by it immediately before the acquisition time) if more than 50% (measured by value) of the shares of the corporation were owned immediately before the particular time by a person (including a partnership) who was affiliated with the target entity immediately before the particular time. Subparagraph 256(7)(*c.2*)(ii) applies to a corporation (and to each corporation controlled by it immediately before the acquisition time) if, were a hypothetical person to have acquired all the securities (carrying the extended meaning provided by subsection 122.1(1)) of the acquiring corporation that were actually acquired at or before the acquisition time and as part of the series, that hypothetical person would not have more than 50% of the shares (measured by value), and would not have control, of the acquiring corporation.

Subparagraph 256(7)(*c.2*)(iii) provides a third exception under which a deemed acquisition of control of a corporation will not occur under paragraph 256(7)(*c.2*). That subparagraph applies to a corporation if, as part of the series, either paragraph 256(7)(*c.1*) or (*c.2*) has already applied to deem an acquisition of control of the acquiring corporation.

This amendment applies to transactions undertaken on or after Announcement Date. However, the amendment does not apply, subject to certain exceptions, to transactions undertaken on or after that date if the parties to the transactions were obligated, pursuant to an agreement in writing entered into before that date, to complete the transactions.

Clause 48

Functional currency tax reporting – Definitions

ITA
261(1)

"relevant spot rate"

The relevant spot rate for a particular day is to be used, in the manner described elsewhere in section 261, in converting amounts from a particular currency to another currency. The meaning of "relevant spot rate" depends on whether either of the currencies is the Canadian dollar.

Beginning on March 1, 2017, the Bank of Canada will no longer publish two exchange rates daily (noon and closing), but will instead publish a single rate per currency pair each day at 16:30 eastern time. Consequential to this change, the definition "relevant spot rate" is amended to remove the references to the rates of exchange quoted by the Bank of Canada at noon on the relevant day, and to instead refer to the single exchange rate for the currencies quoted by the Bank of Canada on the relevant day.

The definition is also amended to clarify that, if there is no such exchange rate quoted by the Bank of Canada for the particular day, the relevant spot rate is the exchange rate quoted on the closest preceding day for which such a rate is quoted, but only if the Bank of Canada ordinarily quotes such a rate.

This amendment applies as of March 1, 2017.

Functional currency tax reporting

ITA
261(5)(h)(ii)

Subsection 261(5) provides a number of rules for taxpayers that have elected under the functional currency tax reporting regime. Subparagraph 261(5)(*h*)(ii) provide a “reading rule” for paragraph 95(2)(*f.13*), in respect of foreign affiliates of a functional currency tax reporter.

Beginning on March 1, 2017, the Bank of Canada will no longer publish two exchange rates daily (noon and closing), but will instead publish a single rate per currency pair each day at 16:30 eastern time. Consequential to this change, and the related amendment to paragraph 95(2)(*f.13*), subparagraph 261(5)(*h*)(ii) is amended by deleting the reference to the exchange rate quoted by the Bank of Canada “at noon”. As a result, that subparagraph instead refers to “the rate of exchange quoted by the Bank of Canada on”.

This amendment applies as of March 1, 2017.

Clause 49

Exempt Policies

ITR
306

Under the income tax rules, income earned in an exempt policy is not taxed on an accrual basis at the policyholder level. Instead, it is subject to a 15% minimum tax (the Investment Income Tax) that is levied on the insurer. In contrast, income earned in a non-exempt policy is taxed as interest income and on an accrual basis at the policyholder level.

Section 306 of the *Income Tax Regulations* contains rules for determining whether a life insurance policy is an exempt policy or not. A test (the exemption test) is applied each year to determine whether a policy is an exempt policy. The exemption test measures the extent to which a life insurance policy is protection-oriented (i.e., an exempt policy) or savings-oriented (i.e., a non-exempt policy). A life insurance policy is an exempt policy if the savings accumulating in the policy do not exceed the savings in its associated benchmark policies (the exemption test policies or ETPs).

ITR
306(3) to (5)

Subsections 306(3) to (5) contain rules in respect of ETPs. The rules apply differently based on whether the life insurance policy, in respect of which the ETP is a benchmark policy, is issued before 2017 or after 2016.

Subsections 306(3) to (5) contain special rules where a life insurance policy’s issue date is before 2017, but it subsequently loses its grandfathering at a particular time after 2016, such that subsection 148(11) of the Act treats the life insurance policy as having been issued at the particular time. The special rules that apply in this case modify the application of subsections 306(3) to (5).

Subsections 306(3) to (5) are amended to remove the references to the special rules that apply where subsection 148(11) has applied to treat a life insurance policy as having been issued at a particular time. The special rules that apply in this case are now found in new subsection 306(10).

For more information, see the commentary on subsection 306(10).

These amendments apply on Royal Assent.

ITR
306(6) and (7)

Subsections 306(6) and (7) contain an anti-avoidance rule that limits the ability to increase the savings in a policy several years after its issuance in circumstances in which savings were not contributed in earlier years of the policy.

Subsection 306(6) sets out the conditions for the rule to apply. Paragraph 306(6)(*a*) and (*b*) provide that the rule applies if the accumulating fund of (*i.e.*, the savings in) a life insurance policy on its 10th or any subsequent policy anniversary exceed 250% of its savings on its third preceding policy anniversary. Where the rule applies, then under subsection 306(7) the policy is in effect treated as being re-issued, by having the issuance dates of each ETP associated with the policy re-dated to the later of that third preceding policy anniversary and the date on which the relevant ETPs were issued.

Paragraph 306(6)(*b*) is amended to address the special case where a life insurance policy's issue date is before 2017, but it subsequently loses its grandfathering at a particular time after 2016, such that subsection 148(11) of the Act treats the life insurance policy as having been issued at the particular time. In this case, in applying the anti-avoidance rule, where the policy's third preceding policy anniversary occurs at a time before the particular time determined under subsection 148(11), then the measurement of the policy's accumulating fund on that third preceding policy anniversary is to made on the assumption that the policy was issued after 2016, such that the rules for determining the accumulating fund of a policy issued after 2016 apply.

Subparagraph 306(7)(*a*)(i) is amended to add a cross-reference to new subsection 306(10) of the Regulations. This ensures that where the ETPs associated with a policy are re-dated under the rule, ETPs issued under either subsection 306(3) or (10) are subject to the rule. This amendment, which is consequential on the introduction of subsection 306(10), applies where subsection 148(11) has applied to treat a life insurance policy as having been issued at a particular time.

These amendments apply on Royal Assent.

ITR
306(10)

Subsection 148(11) of the Act applies in determining whether certain life insurance policies issued before 2017, and not otherwise subject to the rules for policies issued after 2016, are to be treated as having been issued at a particular time after 2016 for certain purposes under the tax rules. Where subsection 148(11) applies to treat a policy as having been issued at a particular time (i.e., the policy's grandfathered status is lost), in determining at and after the particular time whether the policy is an exempt policy, the tax rules that apply to policies issued after 2016 apply. In particular, in determining at and after the particular time the death benefit of ETPs associated with the policy, the rules that apply to policies issued after 2016 apply. However, certain historical attributes that the tax rules assign to the policy are intended to preserved in order for exempt policy status to be determined after the loss of grandfathering. These attributes include: the issue dates of the ETPs issued in respect of the policy, the issue dates of any coverage under the policy and the policy's anniversary date for exemption testing.

Subsection 306(10) of the Regulations is replaced. New subsection 306(10) provides the special rules that apply, in respect of ETPs issued before a particular time determined under subsection 148(11), at and after a particular time determined under subsection 148(11). Consequential on new subsection 306(10), subsections 306(3) to (5) are amended to remove references to these special rules. New subsection 306(10) also accounts for the possibility of a multiple life policy issued before 2017 losing its grandfathered status by ensuring that at and after the loss of grandfathering all of the previously issued ETPs are treated as being issued on a coverage basis while preserving the issue dates of ETPs issued before loss of grandfathering.

In general terms, subsection 306(10) provides the following rules that apply to a life insurance policy in respect of which a particular time is determined under subsection 148(11) of the Act. The rules apply in applying sections 306 (other than subsection 306(9) and (10)) and 307 at and after the particular time.

- Under subparagraph 306(10)(*a*)(i), a separate ETP is deemed to be issued – in respect of each coverage under the policy issued before the particular time – on the date of issue of the life insurance policy. This preserves the historical issue date of the policy's initial ETP and provides for an ETP to be issued on that date in respect of each policy coverage issued as of the date. In addition, under subparagraph 306(10)(*a*)(ii), in cases where the policy had one or more additional ETPs issued before the particular time (i.e., issued under subparagraph 306(3)(*a*)(ii)), a separate ETP would be deemed to have been issued in respect of each coverage issued before the particular time on each policy anniversary that ends before the particular time if the benefit on death under the policy increases by more than 8% from the time of the immediately preceding policy anniversary and the increase can be reasonably attributed to the coverage.
- Under paragraph 306(10)(*b*), subsection 306(3) is deemed not to apply to deem an ETP to be issued in respect of the policy, or in respect of a coverage under the policy, at any time before the particular time. This is because paragraph 306(10)(*a*) will have applied to determine the ETPs issued before the particular time for purposes of applying sections 306 and 307 at and after the particular time in respect of the policy.
- Under paragraph 306(10)(*c*), the rules in subsections 306(4) and (5) that apply to determine the death benefit of ETPs issued under 306(3)(*b*)(i) also apply, subject to paragraph 306(10)(*e*), to determine the death benefit of ETPs the date of issuance of which is determined under subparagraph 306(10)(*a*)(i).
- Under paragraph 306(10)(*d*), the death benefit of ETPs the date of issuance of which is determined under subparagraph 306(10)(*a*)(ii) is to be determined using a modified version of subparagraph 306(4)(*a*)(iv). Specifically, that modified 306(4)(*a*)(iv) would apply in respect of each such ETP issued in respect of the coverage to allocate to the coverage a reasonable portion of the amount that would be determined, at the time immediately before the particular time, under subparagraph 306(4)(*a*)(ii), if the exemption test policy were issued in respect of the policy on the same date as the date determined for it because of a failure of the policy level 8% test, that can be reasonably allocated to the coverage in the circumstances. An amount would not be considered

reasonable for this purpose if the total of the amounts determined for A and B in subparagraph 306(4)(*a*)(iii) is less than the amount determined for C in that subparagraph in respect of the ETP the date of issuance of which is determined under subparagraph 306(10)(*a*)(i) in respect of the coverage.

- Under paragraph 306(10)(*e*), paragraph 306(5)(*b*) will apply only where a reduction referred to in paragraph 306(5)(*b*) occurs at or after the particular time. This ensures that only for a reduction in a policy death benefit that occurs at or after a loss of grandfathering will there be a resulting reduction in the death benefit of an ETP the date of issuance of which is determined under subparagraph 306(10)(*a*)(ii).

This amendment applies on Royal Assent.

Clause 50

Banks Allocation

ITR
404

Section 404 of the Regulations prescribes rules for determining the amount of a bank's "taxable income earned in a province" for the purposes of the 10% federal tax abatement.

The provisions in regulation 404 are amended, along with the introduction of new section 404.1 of the Regulations, to conform certain wording in this regulation to current drafting conventions. These changes are not intended to have any substantive effect.

These amendments are deemed to have come into force on Announcement Date.

Clause 51

Federal Credit Union Allocation

ITR
404.1

New section 404.1 of the Regulations prescribes rules for determining the amount of a federal credit union's "taxable income earned in a province" for the purposes of the 10% federal tax abatement.

The rules for determining the taxable income earned by a federal credit union in a province mirror the special rules in section 404 for determining the taxable income earned by a bank in a province.

New subsection 404.1(1) provides that the portion of the taxable income earned by a federal credit union in a taxation year that is to be allocated to a province in which the credit union has a permanent establishment in the year is to be based on two factors: salaries and wages and the amount of loans and deposits. New paragraphs 404.1(1)(*a*) and (*b*) provide the specific proportions to be used in the calculation of the taxable income earned in a province by a federal credit union.

New subsection 404.1(2) provides that, for the purposes of subsection 404.1(1), the amount of loans for the year in respect of the federal credit union will be the total of 1/12 of the amount of loans outstanding at the close of business on the last day of each month in the year.

New subsection 404.1(3) provides that, for the purposes of subsection 404.1(1), the amount of deposits for a taxation year in respect of the federal credit union will be the total of 1/12 of the amount on deposit with the federal credit union at the close of business on the last day of each month in the year.

New subsection 404.1(4) provides that, for the purposes of subsections 404.1(2) and (3), loans and deposits do not include bonds, stocks, debentures, items in transit and deposits in favour of Her Majesty in right of Canada.

These amendments are deemed to have come into force on Announcement Date.

Clause 52

Federal Credit Union Allocation

ITR
412

Section 412 of the Regulations provides rules for calculating the "taxable income earned in a province by a corporation" other than a specialized corporation described in sections 403 to 411 of the Regulations, that has more than one type of business that could be described in any of sections 403 to 411 of the Regulations (the "divided businesses rule").

Section 412 of the Regulations is amended consequential on the introduction of new section 404.1. The preamble to section 412 adds a reference to section 404.1 (which provides rules for the determination of taxable income earned in a province by a federal credit union).

These amendments are deemed to have come into force on Announcement Date.

Clause 53

International organizations and agencies

ITR
806 and 806.1

Section 806 of the Regulations prescribes international organizations and agencies for the purposes of former clause 212(1)(*b*)(ii)(B) of the Act. Section 806 is repealed, consequential on the repeal of former clause 212(1)(*b*)(ii)(B) by S.C. 2007, c. 35, applicable after 2007.

Section 806.1 of the Regulations prescribes international agencies for the purposes of former subparagraph 212(1)(*b*)(x) of the Act, which exempted interest payments to prescribed agencies from withholding tax under Part XIII of the Act. Former subparagraph 212(1)(*b*)(x) was replaced by paragraph (*c*) of the definition "fully exempt interest" in subsection 212(3) of the Act by S.C. 2007, c. 35, applicable after 2007.

Section 806.1 is amended to replace the cross reference to subparagraph 212(1)(*b*)(x) with a cross reference to paragraph (*c*) of the definition "fully exempt interest" in subsection 212(3). Section 806.1 is also renumbered to be section 806.

These amendments apply on Royal Assent.

Clause 54

Policy reserves

ITR
1401

Section 1401 of the Regulations applies in determining certain amounts for the purpose of calculating a life insurer's Canadian life investment income for the purposes of Part XII.3 of the Act.

Paragraph 1401(5)(*b*) may apply in certain circumstances to a policy otherwise issued before 2017 to determine the time at which the policy is issued or whether life insurance issued under the policy is deemed to be separate policy for purposes of the applicable rules.

Paragraph 1401(5)(*b*) is amended to clarify that it applies, in cases where insurance is not added to a policy, only where term insurance in a policy is converted to a permanent policy within the policy.

This amendment comes into force on Royal Assent.

Clause 55

Donations

ITR
3500

The definitions "official receipt" and "other official receipt" are updated to reflect changes to the income tax provisions in respect of which those definitions apply.

The references to subsections 110.1(3) and 118.1(6) and (7) in the definition "official receipt" are repealed. The reference to subparagraph 110.1(3)(*a*)(ii) is changed to 110.1(2.1)(*a*)(ii) in the definition "other recipient of a gift".

These amendments come into force on Royal Assent.

Clause 56

Prescribed distributions

ITR
5600

Section 5600 prescribes foreign spin-off distributions for the purposes of the foreign spin-off tax-deferred distribution rules in section 86.1 of the Act. Section 86.1 requires that various conditions be met before a distribution is considered to be an "eligible distribution". The various conditions ensure, among other things, that Canadian shareholders of a foreign corporation are not treated more favourably with respect to a foreign distribution than Canadian shareholders receiving similar distributions from a Canadian corporation.

Certain distributions under the U.S. Internal Revenue Code are considered acceptable without the need for prescription, and this result is provided for in subsection 86.1(2) of the Act. Because there is not the same familiarity with the way in which other countries approach the taxation of spin-off transactions, there is the additional requirement that a non-U.S. foreign spin-off be prescribed.

Section 5600 is amended to prescribe the distribution by BHP Billiton Limited of Australia, to its common shareholders, of common shares of South32 Limited of Australia on May 24, 2015.

Clause 57

Foreign tax credit generators – hybrid entities exception

ITR
5907(1.07)

Subsections 5907(1.03) to (1.09) of the Regulations are analogous to the rules in subsections 91(4.1) to (4.7) of the Act. Subsection 5907(1.03), in particular, is a rule analogous to subsection 91(4.1) of the Act, and denies underlying foreign tax ("UFT") with respect to foreign income or profits tax if the burden of that tax is not, in fact, borne by the taxpayer.

Subsection 5907(1.07) provides an exception for the purposes of paragraph 5907(1.03)(*a*) that is analogous to the exception provided in subsection 91(4.5) for the purposes of subparagraph 91(4.1)(*a*)(i). It ensures that subsection 5907(1.03) will not apply solely because an entity that is treated as a corporation under the Act, but that is treated as fiscally transparent entity under the relevant foreign tax law (a "hybrid entity"), owns shares of a foreign corporation.

Subsection 5907(1.07) is amended in a manner analogous to the amendment to subsection 91(4.5), to better align subsection 5907(1.07) with the underlying policy intent. For further information, see the commentary on subsection 91(4.5).

This amendment applies in respect of income or profits tax paid, and amounts referred to in subsections 5907(1.092), (1.1) and (1.2) of the Regulations, in respect of the income of a foreign affiliate of a corporation for taxation years of the foreign affiliate that end in taxation years of the corporation that end after October 24, 2012.

Stub Period FAPI

ITR
5907(8)

New paragraph 5907(8)(b) and new subsection 5907(8.1) of the Regulations ensure appropriate surplus consequences in circumstances where new subsections 91(1.1) to (1.5) of the Act apply. The latter provisions are intended to ensure that "stub period" foreign accrual property income (FAPI) is included in the income of a taxpayer for the taxation year in which the taxpayer disposes of, or reduces in certain circumstances, its interest in a foreign affiliate. For more information, see the commentary under subsections 91(1.1) to (1.5).

Subsection 5907(8) provides rules for the purposes of computing the various amounts in section 5907 (generally, surplus balances of foreign affiliates and amounts relating to them). New paragraph 5907(8)(*b*) provides that, for these purposes, if subsection 91(1.2) of the Act applies at a particular time in respect of a foreign affiliate of a corporation, the various amounts are to be computed, in respect of "attributed amounts" for the stub period in respect of the particular time, as if

- the affiliate's taxation year that would have included the particular time ended at the stub-period end time in respect of the particular time, and
- all transactions or events, giving rise to attributed amounts, that occurred at the particular time, occurred at the stub-period end time in respect of the particular time.

These rules are intended to ensure that, where subsection 91(1.2) of the Act applies to cause FAPI of a particular foreign affiliate to be included in computing a taxpayer's income, the FAPI is also reflected in the affiliate's surplus balances at the appropriate time. In particular, this ensures that the resulting surplus is available for the purposes of an election under subsection 93(1), to reduce the gain that the taxpayer or another foreign affiliate of the taxpayer would otherwise realize on a disposition of the particular affiliate's shares prior to the particular affiliate's "normal" taxation year-end.

The deeming rules in paragraph 5907(8)(*b*) apply only for purposes of computing the various amounts in respect of attributed amounts for the stub period in respect of the particular time. Thus, in general terms, the deemed year-end is intended to allow only a foreign affiliate's "stub-period FAPI" to be reflected in its surplus balances. The rules do not deem a foreign affiliate's taxation year to end for all surplus computation purposes.

New subsection 5907(8.1) defines the terms "attributed amounts", "stub period" and "stub-period end time", for the purposes of new paragraph 5907(8)(*b*).

These amendments are deemed to have come into force on July 12, 2013, subject to an election that allows taxpayers to have the amendments apply prospectively.

Clause 58

Prescribed shares

ITR
6204(1)

Subsection 6204(1) of the Regulations sets out the requirements for a share to be a prescribed share for the purposes of the deduction under paragraph 110(1)(*d*) of the *Income Tax Act*.

Subsection 6204(1) is amended in two respects.

First, the preamble is amended to replace the reference to subparagraph 110(1)(*d*)(i) with a reference to subparagraph 110(1)(*d*)(i.1). This amendment is consequential on amendments made in 2010 that renumbered the former subparagraph 110(1)(*d*)(i) – which set out the requirement that a security underlying an employee option agreement be a prescribed share in order to qualify for the deduction under paragraph 110(1)(*d*).

Second, paragraph 6204(1)(*b*) is amended to expand the listed exceptions to the requirement that the corporation or a specified person (within the meaning assigned by subsection 6204(3)) in relation to the corporation cannot reasonably be expected to, within two years after the time the share is sold or issued, redeem, acquire or cancel the share in whole or in part, or reduce the paid-up capital of the corporation in respect of the share. Specifically, new subparagraph 6204(1)(*b*)(iv) provides that a share is not precluded from being a prescribed share where the redemption, acquisition or cancellation of the share of the corporation, or the reduction in the paid-up capital of the corporation in respect of the share, arises a consequence of an exchange to which subsection 51(1) of the Act applies or a disposition to which subsection 86(1) of the Act applies, if the corporation provides no consideration for the share other than shares of the capital stock of the corporation that are prescribed shares.

The amendment to the preamble applies in respect of acquisitions of securities and transfers or dispositions of rights occurring after 4:00 p.m. Eastern Standard Time on March 4, 2010.

New subparagraph 6204(1)(*b*)(iv) applies to the 2012 and subsequent taxation years.

Clause 59

Prescribed provisions - Pensions

ITR
6503

Paragraphs 60(*j.02*) to (*j.04*) of the *Income Tax Act* allow the deduction of certain repayments of pension benefits received by an individual. The deduction is available where the repayments are made pursuant to a prescribed statutory provision as a condition of acquiring other past-service pension benefits.

Regulation 6503 prescribes these statutory provisions for the purposes of paragraphs 60(*j.02*) to (*j.04*). These statutory provisions allow for the repayment of pension benefits that accrued in periods during which individuals were federal Members of Parliament, public servants or members of the Royal Canadian Mounted Police.

Regulation 6503 is amended to add a reference to subsection 41(5) of the *Canadian Forces Superannuation Act*. This amendment will allow former Canadian Forces pensioners who are re-enrolled in the reserve force to claim a deduction for repayments required to be made to the Canadian Forces pension fund, similar to the deductions permitted under paragraph 60(*j.04*) of the *Income Tax Act* for repayments made under certain statutory provisions of public sector pension plans.

This amendment applies to repayments made after March 31, 2007.

Clause 60

Saskatchewan Loan Forgiveness Program

ITR
7300

Paragraph 12(1)(*x*) of the Act provides that certain inducements, reimbursements, contributions, allowances and assistance received by a taxpayer in the course of earning income from a business or property must be included in the taxpayer's income to the extent that the amounts have not otherwise been included in income or reduced the cost of a property or the amount of an outlay or expense. Section 7300 of the *Income Tax Regulations* provides a list of prescribed amounts that are excluded from the application of paragraph 12(1)(*x*) of the Act.

Paragraph 7300(*c*) prescribed the forgiveness of loans under section 9.2 of the *Canada Student Financial Assistance Act* and 11.1 of the *Canada Student Loans Act* for doctors and nurses who locate their professional practices to certain remote regions.

Section 7300 of the Regulations is amended to include as a prescribed amount the portion of a student loan forgiven under a provincial program that would be a prescribed amount under paragraph 7300(*c*) if section 9.2 of the *Canada Student Financial Assistance Act* and 11.1 of the *Canada Student Loans Act* had applied to that portion of the loan.

This amendment applies after 2012.

Clause 61

Eligible Service

ITR
8503

Paragraph 8503(3)(*a*) of the Regulations restricts the lifetime retirement benefits that may be provided to a member (as defined in subsection 147.1(1) of the Act) under a defined benefit provision of a registered pension plan (RPP) to benefits that are provided in respect of certain periods of service (referred to as "eligible service").

Clause 8503(3)(*a*)(v)(A) permits a period in respect of which benefits attributable to employment of the member with a former employer accrued to the member under a defined benefit provision of another RPP to be recognized as eligible service if the individual has ceased to be a member of the other RPP. This means that an RPP administrator is prohibited from recognizing a member's past service under a former employer's RPP in circumstances where the employee has further benefit entitlements under that other RPP.

Paragraph 8503(3)(*a*) is amended by adding new subparagraph (v.1) to permit a member's past service under a former employer's RPP to be recognized as eligible service on a pro-rated basis in circumstances where the *Pension Benefits Standards Act, 1985* or a similar law of a province require partial transfers of benefit entitlements. The effect of subparagraph 8503(3)(*a*)(v.1) will be to permit an RPP administrator to recognize any portion of a member's past service determined by reference to the proportion of property that has been transferred from the former employer's RPP.

Clause 8503(3)(*a*)(v)(A) is amended, consequential on the introduction of new subparagraph (v.1), to exclude periods of eligible service recognized under subparagraph (v.1).

These amendments apply in respect of transfers of property that occur after 2012.

Clause 62

Capital Cost Allowance

ITR
Schedule II CCA Class 43.1

Class 43.1 in Schedule II to the Regulations provides an accelerated CCA rate of 30% per year (on a declining-balance basis) for clean energy generation and energy conservation equipment. Class 43.2 provides an accelerated CCA rate of 50% per year (on a declining-balance basis) for most property otherwise included in Class 43.1. In general, Class 43.2 applies to cogeneration equipment and waste-fueled electricity generation equipment described in paragraphs (*a*) to (*c*) of Class 43.1 only if the energy efficiency of the system does not exceed a 4,750 BTU per kilowatt-hour requirement (instead of 6,000 BTU per kilowatt-hour requirement for Class 43.1). It also applies to equipment otherwise included in Class 43.1 because of its paragraph (*d*).

Subparagraph (*d*)(iv) of Class 43.1 currently applies to certain heat recovery equipment used by a taxpayer, or by a lessee of the taxpayer, primarily for the purpose of conserving energy, or reducing the requirement to acquire energy, by extracting for reuse thermal waster that is generated directly in an industrial process (other than an industrial process that generates or processes electrical energy).

Subparagraph (*d*)(iv) is amended to apply where the primary purpose of the heat recovery equipment is “extracting heat for sale”. This type of heat recovery equipment may also be eligible for inclusion in Class 43.2 (50% CCA rate).

This amendment applies to heat recovery equipment acquired after March 3, 2010.

Clause 63

AMT & Limited Partnership Losses

Economic Action Plan 2013 Act, No. 2 (re ITA 127.52(1))

Subsection 127.52(1) of the Act defines the “adjusted taxable income” of an individual for the purpose of determining the individual’s minimum tax liability under Division E.1 of Part I of the Act. An individual’s “adjusted taxable income” for a taxation year is the amount that would be the individual’s taxable income for that year if the assumptions set out in paragraphs 127.52(1)(*b*) to (*j*) were made.

Prior to amendments implemented in *Economic Action Plan 2013 Act, No. 2*, the deduction of limited partnership losses was generally denied for alternative minimum tax purposes to the extent the taxpayer did not also realize taxable capital gains from the limited partnership in the same taxation year. Furthermore, the carryforward of those denied limited partnership losses to offset income for alternative minimum tax purposes in a future year was not permitted.

Amendments in Economic Action Plan 2013, No. 2 to paragraphs 127.52(1)(*c.1*) and (*i*) provided that an individual’s limited partnership loss for the purpose of calculating the alternative minimum tax was restricted only if the individual’s interest in the partnership is an interest for which an identification number is required to be, or has been, obtained under section 237.1. These amendments generally applied to the 2012 and subsequent taxation years, unless the taxpayer had filed an election, in which case they also applied to the 2006 to 2011 taxation years.

This amendment further extends the application of the amendments in *Economic Action Plan 2013, No. 2* to the taxpayer's 2003 to 2011 taxation years where the taxpayer has filed the election in writing with the Minister of National Revenue before March 12, 2014.

Clause 64

Repeal of Part LIV

Regulations Amending the Income Tax Regulations (Omnibus, No. 3)
29(14) re ITR 5400

Subsection 29(14) of the *Regulations Amending the Income Tax Regulations (Omnibus, No. 3)* is amended to correct a typographical error by deeming the reference to "1984" to always have been the reference to "1994".

This amendment applies on Royal Assent.