

Notice of Ways and Means Motion to Amend the *Income Tax Act*

That it is expedient to amend the *Income Tax Act* in accordance with the following proposals:

1. (1) The *Income Tax Act* is amended by adding the following after section 143.2:

Expenditures

Definitions

143.3(1) The definitions in this subsection apply in this section.

“expenditure”

“expenditure” of a taxpayer means an expense, expenditure or outlay made or incurred by the taxpayer, or a cost or capital cost of property acquired by the taxpayer.

“option”

“option” means an option, warrant or similar right, issued or granted by a taxpayer, giving the holder the right to acquire an interest in the taxpayer or in another taxpayer with whom the taxpayer does not, at the time the option, warrant or similar right is issued or granted, deal at arm’s length.

“taxpayer”

“taxpayer” includes a partnership.

Options – limitation

(2) In computing a taxpayer's income, taxable income or tax payable or an amount considered to have been paid on account of the taxpayer's tax payable, an expenditure of the taxpayer is deemed not to include any portion of the expenditure that would – if this Act were read without reference to this subsection – be included in determining the expenditure because of the taxpayer having granted or issued an option on or after Announcement Day.

Shares - limitation

(3) In computing a corporation's income, taxable income or tax payable or an amount considered to have been paid on account of the corporation's tax payable, an expenditure of the corporation that would – if this Act were read without reference to this subsection – include an amount because of the corporation, or another corporation not dealing at arm's length with the corporation, having issued a share of its capital stock at any particular time on or after Announcement Day is reduced by

(a) if the issuance of the share is not a consequence of the exercise of an option, the amount, if any, by which

(i) the fair market value of the share at the particular time

exceeds

(ii) that portion of the amount of the consideration that the issuing corporation has received for issuing the share that is added to, and not deducted because of a provision of this Act from, the paid-up capital of the class of shares that includes the share; and

(b) if the issuance of the share is a consequence of the exercise of an option, the amount, if any, by which

(i) the fair market value of the share at the particular time

exceeds

(ii) that portion of the amount paid, pursuant to the terms of the option, by the holder to the issuing corporation for issuing the share, that is added to, and not deducted because of a provision of this Act from, the paid-up capital of the class of shares that includes the share.

Other interests - limitation

(4) In computing a taxpayer's (other than a corporation's) income, taxable income or tax payable or an amount considered to have been paid on account of the taxpayer's tax payable, an expenditure of the taxpayer that would – if this Act were read without reference to this subsection – include an amount because of the taxpayer, or another taxpayer not dealing at arm's length with the taxpayer, having issued an interest in itself at any particular time on or after Announcement Day is reduced by

(a) if the issuance of the interest is not a consequence of the exercise of an option, the amount, if any, by which

(i) the fair market value of the interest at the particular time

exceeds

(ii) the amount of the consideration that the issuing taxpayer has received for issuing the interest; and

(b) if the issuance of the interest is a consequence of the exercise of an option, the amount, if any, by which

(i) the fair market value of the interest at the particular time

exceeds

(ii) the amount paid, pursuant to the terms of the option, by the holder to the issuing taxpayer for issuing the interest.

Clarification

(5) For greater certainty, subsections (3) and (4) do not apply to reduce an expenditure if the expenditure does not include an amount determined to be an excess under subsection (3), or under subsection (4).

(2) Subsection (1) applies on and after Announcement Day.

2. (1) Section 220 of the *Income Tax Act* is amended by adding the following after subsection 220(2.1):

Exception

(2.2) Subsection (2.1) does not apply in respect of a prescribed form, receipt or document, or prescribed information, that is filed with the Minister on or after the day specified, in respect of the form, receipt, document or information, in subsection 37(11) or paragraph (m) of the definition “investment tax credit” in subsection 127(9).

(2) Subsection (1) applies in respect of a prescribed form, receipt and document, and prescribed information, filed with the Minister of National Revenue on or after Announcement Day other than a prescribed form, receipt or document, or prescribed information, in respect of which the Minister of National Revenue has received, before Announcement Day, a request made in writing with the Minister that the Minister waive the filing requirements in subsection 37(11) and paragraph (m) of the definition “investment tax credit” in subsection 127(9) that apply, but for any waiver, to the expenditures to which the prescribed form, receipt or document, or prescribed information, relates.

Explanatory Notes

Clause 1

Expenditure

ITA 143.3

New section 143.3 of the Act reduces, if applicable, the amount of a taxpayer's expenditure by certain amounts for the purposes of computing the taxpayer's income, taxable income and tax payable or an amount considered to have been paid on account of the taxpayer's tax payable.

Definitions

ITA 143.3(1)

New subsection 143.3(1) of the Act provides definitions that apply for the purposes of section 143.3. Those definitions are:

“expenditure” of a taxpayer, which means an expense, expenditure or outlay made or incurred by the taxpayer, or that is a cost or capital cost of property acquired by the taxpayer.

“option”, which means an option, warrant or similar right, issued or granted by the taxpayer, giving the holder the right to acquire an interest in the taxpayer or in another taxpayer with which the taxpayer does not, at the time the option, warrant or similar right is issued or granted, deal at arm's length.

“taxpayer”, which is defined to include a partnership.

Options – limitation

ITA

143.3(2)

New subsection 143.3(2) of the Act provides that, in computing a taxpayer's income, taxable income or tax payable or an amount considered to have been paid on account of the taxpayer's tax payable, an expenditure of the taxpayer is deemed not to include any portion of the expenditure that would – if the Act were read without reference to subsection 143.3(2) – be included in determining the expenditure because of the taxpayer having granted or issued an option on or after Announcement Day. In essence, the value of an option granted by a taxpayer is not considered to be an expenditure for income tax purposes.

Shares – limitation

ITA

143.3(3)

New subsection 143.3(3) of the Act provides for two reductions that apply to an expenditure that would – if the Act were read without reference to subsection 143.3(3) – include an amount because of a corporation (or another corporation not dealing at arm's length with the corporation) having issued a share of its capital stock at any particular time on or after Announcement Day. The reductions apply to the corporation in computing its income, taxable income or tax payable or an amount considered to have been paid on account of the corporation's tax payable.

New paragraph 143.3(3)(a) applies on the issuance of the share (other than on the exercise of an option). Generally, the corporation is to reduce the related expenditure by the amount, if any, by which

(i) the fair market value of the share

exceeds

(ii) that portion of the amount of the consideration that the issuing corporation has received for issuing the share that is added to, and not deducted because of a provision of the Act from, the paid-up capital of the class of shares that includes the share.

In addition, under new paragraph 143.3(3)(b), if the issuance of the share is a consequence of the exercise of an option, generally the corporation is to reduce the related expenditure by the amount, if any, by which

(i) the fair market value of the share

exceeds

(ii) that portion of the amount paid, pursuant to the terms of the option, by the holder to the issuing corporation for issuing the share, that is added to, and not deducted because of a provision of the Act from, the paid-up capital of the class of shares that includes the share.

EXAMPLE

Facts

In fiscal 2006, Corporation X grants an option to Y in return for \$1,000 worth of paintings by a little-known Canadian artist. Corporation X does not give cash or any other consideration for the paintings. The option gives Y the right to acquire one share of Corporation X for \$10,000 in 2007. (At the time the option is granted one share of Corporation X has a fair market value of \$10,000.)

In 2007, Y exercises the option and pays Corporation X \$10,000 cash for the share. The share has a fair market value of \$15,000 at the time of issue.

Corporation X files its 2007 income tax return on the basis that the cost of the paintings is \$5,000, representing the difference between the fair market value of the share when it was issued and the cash paid by Y for the share.

Application of section 143.3

1. On granting the option:

- New subsection 143.3(2) applies to clarify that there is no expenditure by Corporation X resulting from it issuing the option.

2. On the exercise of the option:

- When issuing the share on the exercise of the option, new paragraph 143.3(3)(b) ensures that an expenditure, if any, of Corporation X is reduced by \$5,000 – being the amount by which

- \$15,000 (the fair market value of the share – see subparagraph (b)(i))

exceeds

- \$10,000 (the amount paid for the share – see subparagraph (b)(ii)).

However, and as noted in the explanatory note accompanying new subsection 143.3(5), the reductions provided for under subsections 143.3(3) and (4) do not apply to reduce an expenditure if the expenditure itself does not include an amount determined to be excesses described in those subsections.

Other interests – limitation

ITA

143.3(4)

New subsection 143.3(4) of the Act provides for two reductions that apply to a non-corporate taxpayer's expenditure that would – if the Act were read without reference to subsection 143.3(4) – include an amount because the taxpayer (or another taxpayer not dealing at arm's length with the taxpayer) issues an interest in itself at any particular time on or after Announcement Day. The reductions apply to the taxpayer in computing its income, taxable

income or tax payable or an amount considered to have been paid on account of the taxpayer's tax payable.

In general terms, under new paragraph 143.3(4)(a), if the issuance of the interest in a taxpayer is a consequence of the exercise of an option, the taxpayer is to reduce the expenditure by the amount, if any, by which

(i) the fair market value of the interest

exceeds

(ii) the amount of the consideration that the issuing taxpayer has received for issuing the interest.

In addition, under new paragraph 143.3(4)(b), if the issuance of the interest is a consequence of the exercise of an option, the taxpayer is to reduce the expenditure by the amount, if any, by which

(i) the fair market value of the interest

exceeds

(ii) the amount paid, pursuant to the terms of the option, by the holder to the issuing taxpayer for issuing the interest.

However, and as noted in the explanatory note accompanying new subsection 143.3(5), the reductions provided for under subsections 143.3(3) and (4) do not apply to reduce an expenditure if the expenditure itself does not include an amount determined to be excesses described in those subsections.

Clarification

**ITA
143.3(5)**

New subsection 143.3(5) of the Act clarifies that the amounts of reductions provided for in subsections (3) and (4) do not apply to reduce an expenditure if the expenditure did not include such amount as are described in those subsections.

Subsection 143.3(5) recognizes that the jurisprudence that would recognize an expenditure of the type reduced by subsections (3) and (4) currently applies only to scientific research and experimental development (SR&ED) tax credits, and is limited to a single decision of the Tax Court of Canada. It may very well transpire that future jurisprudence may constrain or eliminate any such expenditure that may be considered to arise in these circumstances.

Clause 2

**ITA
220**

Section 220 of the Act sets out a number of rules relating to the administration and enforcement of the Act.

**ITA
220(2.1) and 220(2.2)**

Under subsection 220(2.1) of the Act, if a provision of the Act or the regulations requires a person to file a prescribed form, receipt or other document, or to provide prescribed information, the Minister may waive the requirement, but the document or information shall be provided at the Minister's request.

New subsection 220(2.2) provides that subsection 220(2.1) does not extend to a prescribed form, receipt, document or information,

or prescribed information, that is filed on or after the day specified – in respect of the form, receipt, document or information – in subsection 37(11) or paragraph (m) of the definition “investment tax credit” in subsection 127(9). Those provisions provide, in general, that a taxpayer’s claim and prescribed form must be received by the Minister no later than 12 months after the taxpayer’s filing-due date for the taxation year in which the expenditures were made.

The effect of new subsection 220(2.2) is that a person cannot deduct a scientific research and experimental development (SR&ED) expenditure under section 37, or claim an investment tax credit in respect of an expenditure, if the person takes more than the additional 12 months allowed to make a claim with the Minister.

In general, new subsection 220(2.2) applies on and after Announcement Day.