

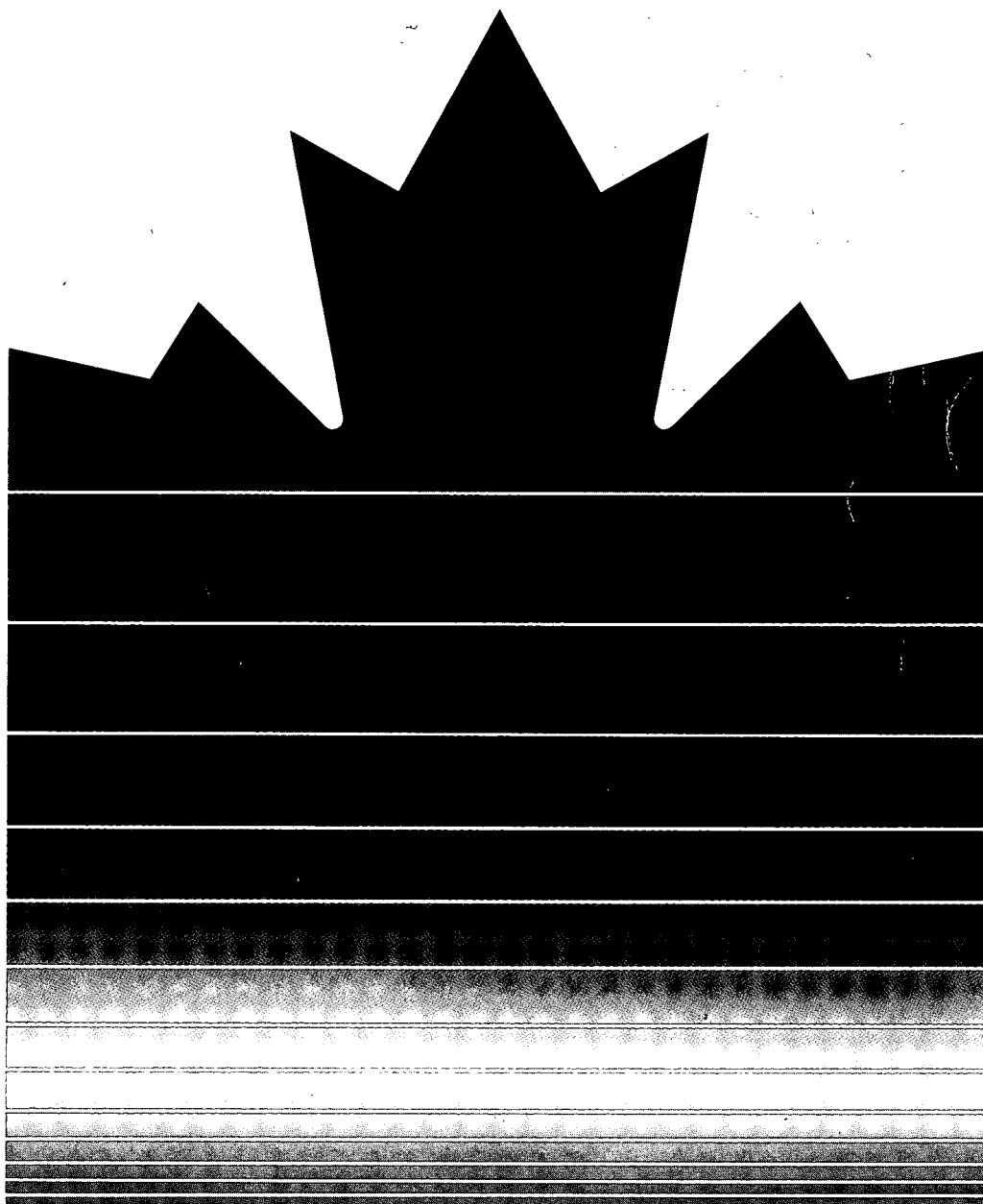
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Securing Economic Renewal

Budget Papers

Tabled in the House of Commons
by the Honourable Michael H. Wilson
Minister of Finance

February 10, 1988



Canada

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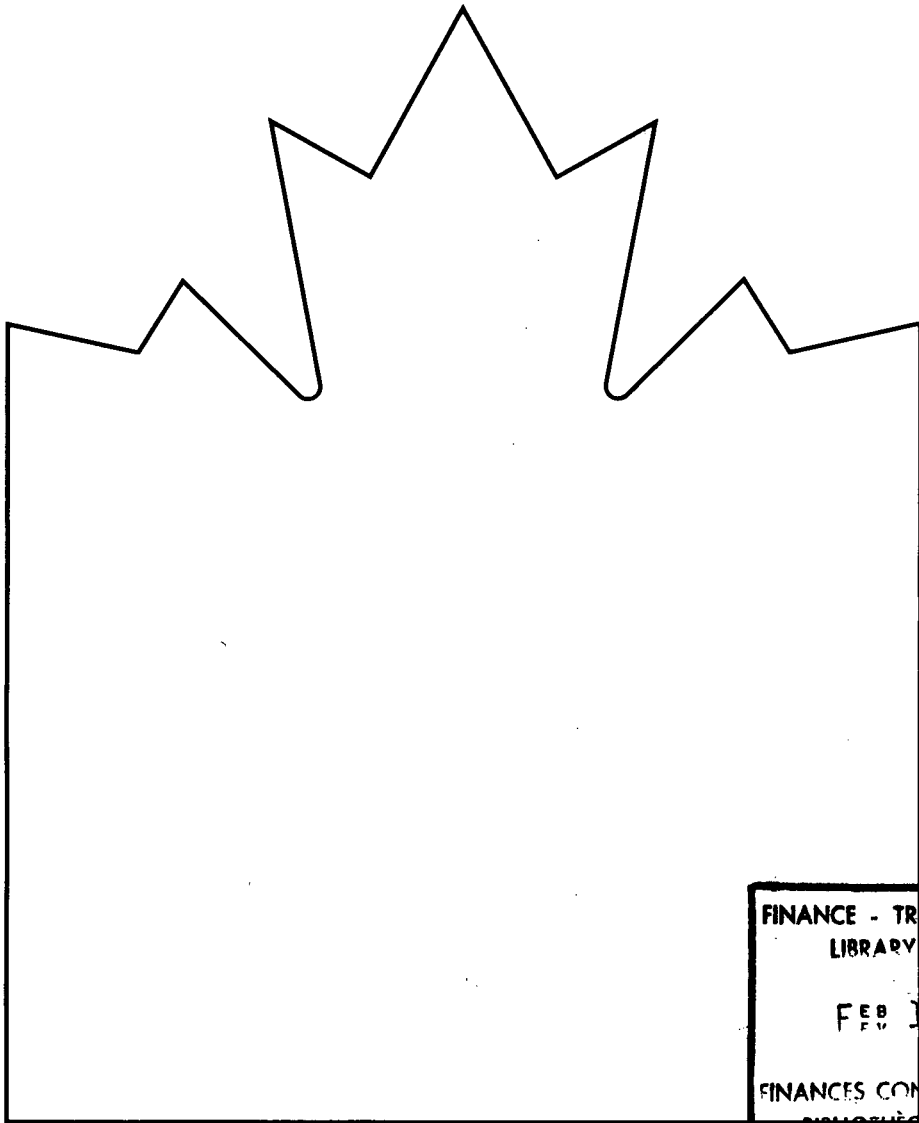
Securing Economic Renewal

Budget Papers

Supplementary Information and
Notices of Ways and Means Motions
on the Budget

Tabled in the House of Commons
by the Honourable Michael H. Wilson
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Table of Contents

I	The Government's Expenditure Plan	1
II	Income Tax Measures	5
	Associated Corporation Rules	5
	National Labour-Sponsored Venture Capital Corporations	8
	Child Benefits	9
	Alimony and Maintenance Payments	10
	Support Payments to a Common-Law Spouse	11
	Social Assistance Payments	11
	Social Insurance Numbers	12
	Minimum Tax: Block Averaging	12
	Minimum Tax: Northern Allowances	12
	Definition of Mineral Resource: Kaolin	13
	Resource Allowance Calculation	13
	Capital Cost Allowance: Energy Conservation Equipment	14
	Non-Resident Withholding Tax	15
	Non-Resident-Owned Investment Corporations	16
	Provincial Deductions at Source	16
	Jeopardy Collection	16
	Limitation Period on Prosecutions	17
	Certificates for Unpaid Amounts	17
III	Sales and Excise Tax Measures	19
	Treatment of Marketing and Distribution Costs	19
	Wholesaler Licence Provisions	20
	Fuel Tax Increase	22
	Exemption for Original Prints	22
	Certified Public Institutions	22
	Transportation Cost Deduction	23
	Increase in Tax Threshold for Periodic and Seasonal Filers	23
IV	Tariff Measures	25
V	Federal Revenue Impact of Budget Tax Measures	27

VI Notices of Ways and Means Motions

Notice of Ways and Means Motion to Amend the Income Tax Act	31
Notice of Ways and Means Motion to Amend the Canada Pension Plan.....	37
Notice of Ways and Means Motion to Amend the Unemployment Insurance Act, 1971	41
Draft Legislation Relating to Associated Corporations	45
Explanatory Notes: Associated Corporations	55
Notice of Ways and Means Motion to Amend the Excise Tax Act (1)	65
Notice of Ways and Means Motion to Amend the Excise Tax Act (2)	71
Notice of Ways and Means Motion to Amend the Customs Tariff.....	75

I The Government's Expenditure Plan

The Expenditure Record

In the late 1970s and early 1980s, rapid increases in federal government expenditures were the major factor contributing to the rise in the deficit. This growth reflected discretionary initiatives, such as the National Energy Program, and non-discretionary factors related to the impact of the 1981-1982 recession on cyclically-sensitive expenditures. The rising deficits over this period resulted in a build-up of public debt which produced substantial increases in interest costs. Budgetary expenditures as a percentage of gross domestic product (GDP) advanced from 21.0 per cent in 1981-82 to a postwar record of 24.5 per cent in 1984-85.

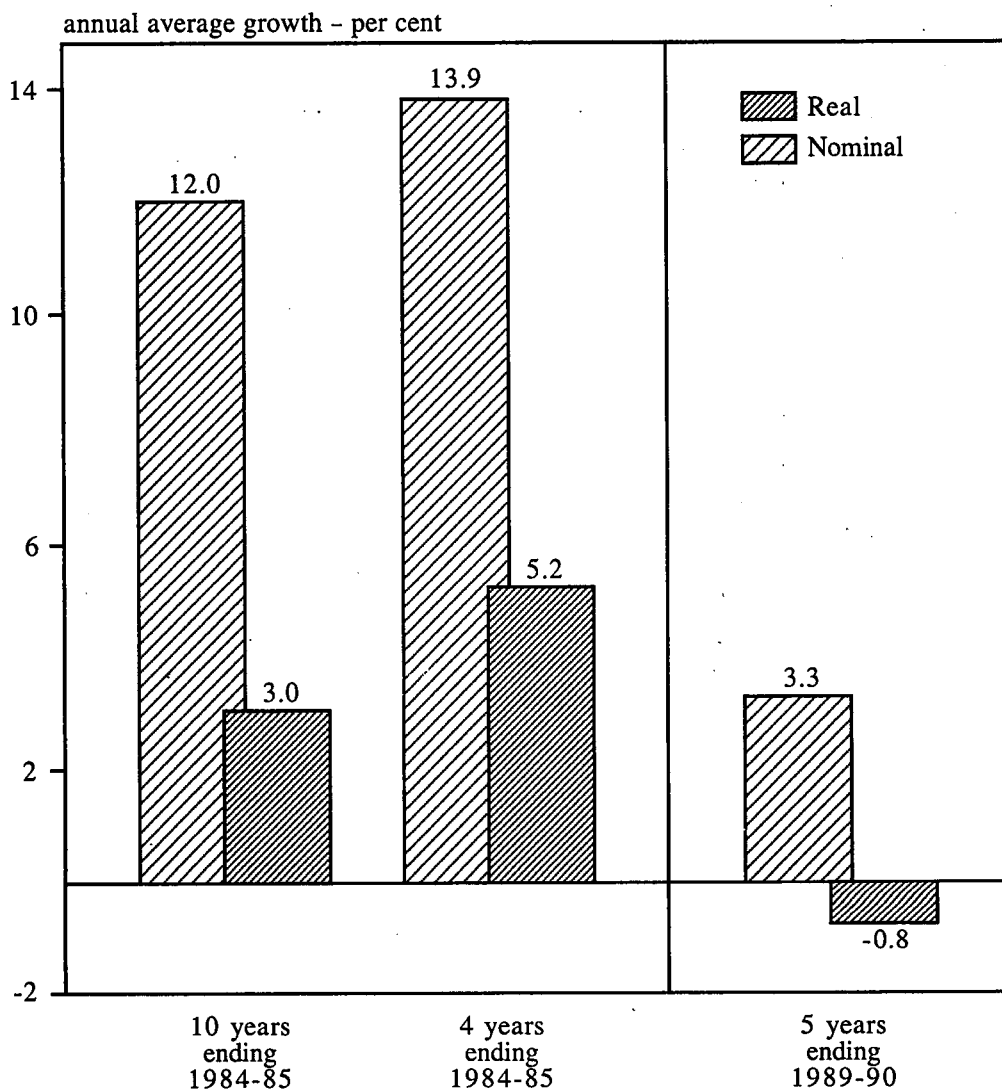
Regaining Control of Expenditures

Since September 1984, the government's expenditure management strategy has had two objectives: first, to regain control over spending in order to achieve sustained year-over-year reductions in the deficit, and second, to help create the flexibility that would allow the government to introduce new initiatives that are more supportive of economic growth and more responsive to the social needs of Canadians.

To gain control over spending, programs were scaled back or eliminated and government efficiency was increased. The actions taken to date have had a dramatic impact in restraining federal expenditures. After growing by almost 14 per cent per year during the four-year period ending 1984-85, program spending (total expenditures excluding the costs of public debt charges) will be reduced to a growth rate of 3.3 per cent per year, on average, during the five years ending in 1989-90 (Chart 1). As a percentage of GDP, program expenditures will fall to 16.3 per cent in 1989-90 from 19.5 per cent in 1984-85.

The expenditure management strategy, together with strong economic growth, has permitted the government to redirect resources toward high-priority areas. These include, for example, new regional development programs, increased funding for science and technology, additional funding to assist in the implementation of the White Paper on defence, and the introduction of a national child care program. As well, additional assistance has been provided to farmers in financial difficulty, and to the oil and gas sector.

Chart 1
**Nominal and Real Growth
 in Program Expenditures**

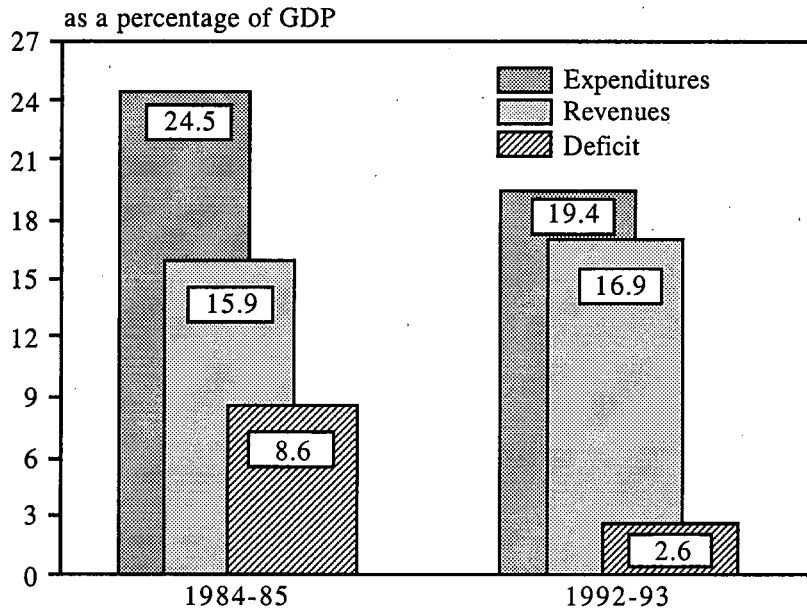


In keeping with the government's expenditure management strategy and to ensure that the deficit track presented with the June 1987 White Paper on tax reform is realized, additional expenditure restraint measures are being introduced in this budget.

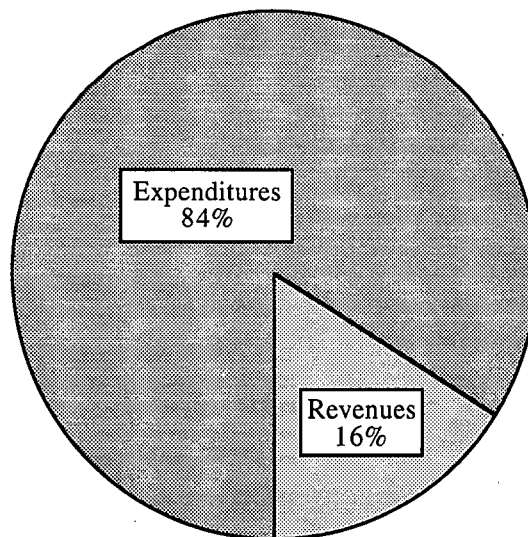
A reduction of \$300 million in annual expenditures will be applied beginning in 1989-90 to non-statutory spending, excluding defence and Official Development Assistance (ODA). Over the course of the year, the Treasury Board will be ensuring that this reduction is achieved. As well, given the strength in economic activity in 1987 and the resulting impact on the fiscal position, it has been possible to bring forward into 1987-88 more than \$250 million of expenditures originally targeted for 1988-89. This action will mainly involve defence expenditures.

Chart 2

**Expenditures, Revenues and Deficit
Relative to GDP
1984-85 and 1992-93**



**Contributions to Deficit Reduction Relative to GDP
From 1984-85 to 1992-93**



Looking Ahead

With ongoing restraint built into the expenditure framework, together with the actions announced in this budget, program spending is projected to grow by less than the rate of inflation over the medium term, thus declining in real terms by about 0.8 per cent per year. The absolute level of non-statutory program spending, excluding defence and ODA, is projected to be \$400 million lower in 1989-90 compared to actual expenditures in 1984-85. In real terms this represents a decline of approximately 20 per cent over a five-year period.

Public debt charges, reflecting reductions in the deficit and declines in interest rates, will drop from 5 per cent of GDP in 1984-85 to 4.7 per cent in 1992-93. All told, budgetary expenditures in terms of the size of the economy will decline five percentage points of GDP, from 24.5 per cent in 1984-85 to 19.4 per cent in 1992-93, accounting for over 80 per cent of the reduction in the deficit (Chart 2).

II Income Tax Measures

Associated Corporation Rules

The federal government delivers financial assistance through the tax system to Canadian-controlled private corporations that carry on an active business in Canada. One of the major incentives available is the small business deduction. This deduction provides a reduced rate of tax on the first \$200,000 of active business income earned annually by an eligible corporation. In order to target support to the intended beneficiaries, the concept of associated corporations has been used to prevent the multiplication of benefits to more than one corporation within a controlled group of corporations. The associated corporation rules require a group of “associated corporations” to share the annual \$200,000 business limit, since they can be considered to be a single economic entity. The associated corporation rules are also used for similar purposes in respect of other tax preferences. For example, an enriched investment tax credit is allowed in respect of certain scientific research and experimental development expenditures of a Canadian-controlled private corporation in circumstances where its taxable income, together with the taxable incomes of all corporations with which it was associated for the immediately preceding year, does not exceed \$200,000.

Except for minor technical and consequential amendments, the existing associated corporation rules have remained largely unchanged since 1949. A number of deficiencies in the rules exist and a number of taxpayers have become aggressive in implementing arrangements designed to avoid two or more corporations being associated, for the purpose of increasing the amount of income that qualifies for the small business deduction.

Accordingly, the associated corporation rules will be amended to ensure that a group of corporations will not gain multiple access to benefits through innovative corporate structures or other arrangements designed to frustrate the intended policy and to reduce taxes payable or increase taxes refundable.

The existing rules regarding investment by family members in corporations controlled by other members of the family are unduly restrictive and will be amended to better accommodate such investment. The new rules will facilitate investment by an individual in a corporation controlled by a related family member.

Control

Corporations that are controlled by the same person or group of persons are considered a single economic entity and therefore associated. For this purpose, “control” is not defined in the Income Tax Act but is determined on the basis of a large body of jurisprudence which has developed over time. The test of control which has emerged is a relatively narrow one, generally referred to as *de jure* control, under which the most important single factor considered is the voting rights attached to shares. The test of control has traditionally been the ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors. Under existing law, however, it has been possible to circumvent the associated corporation rules, through the use of special voting agreements, special classes of shares or by ownership of shares by intermediaries.

Changes to the associated corporation rules will be made to ensure that they operate in a more effective manner. First, the meaning of control will be extended to include circumstances of factual control. Second, a person or group of persons owning more than 50 per cent of the fair market value of all the issued shares of the capital stock of a corporation (other than certain preferred shares) or more than 50 per cent of the fair market value of all the issued common shares of the capital stock of a corporation will be treated as controlling the corporation, notwithstanding the fact that the person or group of persons does not own a majority of the voting shares of the corporation.

Groups of Persons

Under the existing law, two corporations are associated if they are controlled by the same person or group of persons. The courts have determined, however, that a group of persons cannot control a corporation where a member of the group has, by himself, a sufficient number of shares to control the corporation. This produces anomalous results. If, for example, two individuals each owned 50 per cent of the voting shares of corporation X and corporation Y, these corporations would be associated because they were controlled by the same group of persons. However, if one individual owned 51 per cent of the shares of corporation X and 49 per cent of the shares of corporation Y, and the other individual owned the remaining shares, the two corporations would not be associated under the current rules, since each of the corporations would be controlled, by reason of votes attached to shares, by different individuals. The associated corporation rules will be amended to provide that a group of persons may control a corporation notwithstanding the fact that the corporation is also controlled by another person or other group of persons. Thus, in both of the examples above, corporations X and Y would be considered to be associated under the new rules.

Indirect Ownership

The existing associated corporation rules may, under certain circumstances, be circumvented by holding shares of a corporation indirectly through a trust, partnership or a holding corporation. The rules will be amended to correct this deficiency. Shares of a corporation held by a holding corporation will, for the purposes of the associated corporation rules, be treated as being owned by the shareholders of the holding corporation in proportion to their fair market value shareholding in the equity shares of the holding corporation. Shares of a corporation held by a partnership will be treated as being owned by its partners in proportion to their shares of the income or loss of the partnership. In addition, shares of a corporation owned by a trust will, in general, be treated as owned by the beneficiaries of the trust, although in certain limited circumstances they will be treated as being owned by the person who contributed property to the trust.

Related Persons and Related Groups

Currently, related persons are treated differently from unrelated persons for the purposes of the associated corporation rules. For example, two corporations will be associated if the person who controls one of the corporations is related to the person who controls the other and also owns, in respect of each corporation, not less than 10 per cent of the issued shares of any class of its capital stock. Similar provisions exist for related groups. These restrictions are considered to be too stringent.

The special rules for related persons will remain but the percentage ownership test will increase from 10 per cent to 25 per cent. In addition, certain non-voting preferred shares with a fixed dividend entitlement will be excluded for the purpose of this test. Thus, for example, if a husband owns all the shares of one corporation, he can acquire all of the shares of a class of such preferred shares of a corporation controlled by his wife or by other persons and up to 25 per cent of the equity shares of such a corporation without causing the corporations to be associated.

To prevent the avoidance of the associated corporation rules through the ownership of shares for the benefit of minor children, a new rule will attribute the ownership of shares owned by, or held for the benefit of, a minor. Shares of a corporation owned by a child who is under the age of 18 years will be treated as owned by each parent for the purpose of determining whether that corporation is associated with any other corporation that is controlled by that parent or by a group of persons of which the parent is a member.

Other Amendments

Several other amendments will be made to existing provisions of the Act relating to the small business deduction. Provisions will be introduced to ensure that entitlement to the small business deduction is not increased by virtue of the fact

that a business is carried on by a partnership instead of a corporation. A new provision will be introduced to deny the small business deduction in respect of a business carried on by a partnership that is effectively controlled by non-residents or by public corporations. Technical or consequential amendments will also be made to the anti-avoidance provisions relating to associated corporations and to the rule which deems two corporations to be associated if each of them is associated with a third corporation at the same time.

Effective Date

In most cases, the new provisions will be effective for taxation years of corporations or fiscal periods of partnerships commencing after 1988. In some cases, however, most notably those provisions dealing with partnerships, the new rules will apply to taxation years or fiscal periods commencing after February 10, 1988.

More detail on the changes to the associated corporation rules can be obtained by referring to the accompanying draft legislation and explanatory notes.

National Labour-Sponsored Venture Capital Corporations

The federal budget of May 23, 1985 introduced the labour-sponsored funds tax credit, designed to encourage long-term investment by individuals in labour-sponsored venture capital corporations set up under provincial legislation.

This budget introduces a new measure which will make available to individuals a federal tax credit of 20 per cent of the cost of shares of a national labour-sponsored venture capital corporation, whether or not a province provides a matching tax credit, for shares acquired in the 1988 and subsequent taxation years. The federal tax credit will be available for investment in national labour-sponsored venture capital corporations that meet criteria similar to existing criteria applying to the fund set up by the Quebec Federation of Labour – le Fonds de solidarité des travailleurs du Québec. The maximum aggregate federal tax credit in respect of all labour-sponsored venture capital corporation shares will remain at \$700 per annum.

A qualifying national corporation will be required to be sponsored by a national labour association. Funds raised will have to be invested in active small and medium-sized businesses, with at least 60 per cent of the funds invested in equity investments. Regulations will be issued to govern the incorporation, management and share capital of the corporation and to define the criteria for eligible investments for the corporation. The credit provided in respect of a share of a qualifying corporation will not reduce its cost base for capital gains purposes.

The tax credit will provide an investment incentive to many Canadian workers who were not previously able to benefit from such opportunities. The targeting of the investment to small and developing businesses chosen by labour-sponsored venture capital corporations will promote job creation.

Child Benefits

The government's new policy on child care was recently announced by the Minister of National Health and Welfare. Amendments to the Income Tax Act are proposed to implement the taxation aspects of that policy.

Child Care Expenses

For the 1988 and subsequent taxation years, the maximum child care expense deduction will be increased from \$2,000 to \$4,000 for each eligible child who is under seven years of age at the end of the year or who has a severe and prolonged mental or physical impairment. In addition, the overall maximum limit of \$8,000 per taxpayer for child care expense deductions will be abolished.

Refundable Child Tax Credit

The Income Tax Act provides for payment of a refundable child tax credit. The maximum amount of this credit for 1988, as proposed in tax reform, is \$559 per child.

To assist families with low and middle incomes, and to recognize the contribution made by the parent who cares for the child at home, a new \$200 supplement in respect of children six years and under will be added to the refundable child tax credit. The increase will be \$100 for the 1988 tax year and will rise to \$200 in subsequent years. The supplement in respect of a child will be reduced by 25 per cent of the child care expense deduction claimed for the year in respect of the child. This supplement will be included in the calculation of the prepayment of the refundable child tax credit that is made in November of each year to those individuals who meet the criteria for the prepayment and who did not claim child care expenses in respect of that child for the preceding year.

Under the existing law, a portion of the refundable tax credit is prepaid in November of a year, for those recipients whose net family income for the preceding year did not exceed \$15,000. Amendments are proposed to increase this income level to an amount equal to two-thirds of the family income threshold for the basic refundable child tax credit. For 1988, the threshold for the basic credit is \$24,090; therefore, families with net income not in excess of two-thirds of that amount, or \$16,060, will receive the prepayment. The full \$100 supplement will be included in the November 1988 prepayment. For subsequent years, two-thirds of the \$200 supplement will qualify for the prepayment. For 1990 and subsequent years, the amount of the \$200 supplement will be adjusted to reflect any increase in the consumer price index in excess of 3 per cent.

Alimony and Maintenance Payments

The recent Supreme Court of Canada decision in *Gagnon v. the Minister of National Revenue* altered the generally understood tax treatment of alimony and maintenance payments.

Background

The Income Tax Act provides that alimony and maintenance payments are deductible by the person making the payment and included in the recipient's income if the payments conform to the interpretation of the term "allowance" as established by the courts. Before 1984, for an amount to be considered a deductible allowance, it must have been a fixed sum of money paid directly to the recipient for maintenance and support pursuant to a court order, decree or separation agreement. The amount must have been determined in advance and, once paid, the recipient must have had complete discretion as to its disposition. Where the court order or separation agreement provided that certain payments for the benefit of the spouse, former spouse or children of the marriage were to be made directly to a third party, the law permitted their deduction by the payor where the amount to be paid to the third party was deducted from the total amount required to be paid to the spouse or former spouse with the express or implied concurrence of the latter person. Amounts paid to third parties for actual expenses – for example, educational, medical or heating costs – did not qualify as an allowance.

In 1984, the law was changed to provide for the deduction of certain types of third party payments which would not otherwise qualify as an allowance – medical, educational, home maintenance expenses and certain mortgage payments – and their inclusion in the income of the beneficiary spouse or former spouse, but only where both parties expressly agreed to this treatment.

The Supreme Court of Canada, in *Gagnon v. MNR*, held, in relation to a pre-1984 agreement, that the term "allowance" includes amounts paid to third parties for the benefit of the spouse on whose behalf they were paid. This interpretation permits the payor a deduction for these amounts and requires their inclusion in the income of the beneficiary even in circumstances where the parties had not expressly agreed to this treatment. As a result, the beneficiary of a third party payment operating under an agreement not covered by the 1984 amendment will have an increased tax liability without having additional resources from which to meet this liability.

The proposed amendments will prevent the hardship which would otherwise arise for those recipients whose support arrangements were made on the assumption that such third party payments would not be included in their income.

Proposal

For the 1986 and 1987 taxation years, qualifying third party payments under support arrangements concluded on or before March 27, 1986 – the date on which the *Gagnon* decision was rendered – will be deductible by payors under the general alimony and maintenance provisions in section 60 of the Income Tax Act, but such payments will not have to be included in the beneficiary's income. For the 1988 and subsequent taxation years, the amendments will restore the status quo prior to the *Gagnon* decision. Thus, third party payments after 1987 will fall within the rules set out in sections 56.1 and 60.1 of the Act.

For separation agreements and court orders made after the date of the *Gagnon* decision and before January 1, 1988, the consequences as established in the *Gagnon* decision will apply, with the result that allowances paid to a third party will be deductible by the payor and included in the income of the beneficiary.

For separation agreements and court orders made after December 31, 1987, the provisions of sections 56.1 and 60.1 of the Act will apply to these types of payments. As a result, third party payments contemplated in those sections and made pursuant to such arrangements will be deductible by the payor and included in the income of the person on whose behalf the amount was paid only where both parties so agree.

Support Payments to a Common-Law Spouse

The term "spouse" under the Income Tax Act does not include a common-law spouse. However, the Act and Regulations contemplate a deduction of support payments made pursuant to a court order to those common-law spouses included within a prescribed class of persons described in provincial legislation. Given the differences in provincial legislation, this method of identifying qualifying payments is unsatisfactory and, in fact, only payments made under certain Ontario orders now qualify for this treatment.

The Act will be amended to provide that allowances paid for support of common-law spouses pursuant to provincial court orders made under the relevant provincial law relating to support may be deducted from the income of the payor and shall be included in the income of the payee. This measure will be effective for orders made after February 10, 1988. It will also apply for earlier orders, but only where the parties jointly elect that this measure shall apply to allowances paid in the year of the election and subsequent years. This change will not affect the existing treatment for allowances made where subclause 14(b)(i) of the Ontario Family Law Reform Act is relevant.

Social Assistance Payments

The Income Tax Act currently allows taxpayers an offsetting deduction in computing taxable income in respect of social assistance payments included in

income. Amendments to the legislation will clarify that the deduction will not be available to third parties who are recipients of such payments made directly to them by governments or charitable agencies for housing provided or services rendered on behalf of the beneficiaries of social assistance. As a further clarification, the legislation will be amended to provide that social assistance payments received by foster parents in respect of foster children in their care will not be required to be included in the income of the foster parent. The amendment will be effective in respect of social assistance payments received after 1981 – the date on which the existing provisions of the Act relating to the tax treatment of social assistance payments were first made effective.

Social Insurance Numbers

Under the present law, the social insurance number of an individual filing a return must be disclosed on that return where the individual is required to pay income tax, or has received a prepayment of the refundable child tax credit. The inclusion of the social insurance number of the individual filing the return is important for verification purposes. Accordingly, for the 1987 and subsequent taxation years, persons who file an income tax return and claim the refundable child tax credit and/or the federal sales tax credit will also be required to have a social insurance number and to provide it on the return.

Minimum Tax: Block Averaging

An individual who elects to use the block averaging provisions in calculating tax payable for a taxation year is required to recalculate tax payable for the four preceding years included in the averaging period. Where the individual was liable for minimum tax for any of those preceding years, the recalculation of the tax payable presents major computational difficulties and also leads to inappropriate results in cases where the minimum tax carry-forward mechanism applies. The existing legislation recognizes the difficulty arising from the interaction of the block averaging provision and the minimum tax calculations, by providing that a taxpayer will not be subject to minimum tax for the year that he or she elects to block average.

The Income Tax Act will be amended to provide that any minimum tax assessed will not be taken into account for block averaging purposes and any minimum tax carry-over claimed in a preceding year will be ignored for the purposes of the block averaging calculations. This will reduce the number of calculations required for taxpayers who have minimum tax payments or carry-overs in respect of the averaging period.

Minimum Tax: Northern Allowances

The northern allowance deduction provides a standard income tax deduction to residents of the north and certain isolated communities in recognition of the high

cost of living in those areas. For 1987 and subsequent taxation years, the Act will be amended to clarify that the northern allowance deduction will be excluded from the tax preferences that are subject to minimum tax. In addition, this deduction will be added to the list of deductions from taxable income provided in section 111.1 of the Income Tax Act for the purpose of establishing the order in which such deductions may be claimed. The deduction for northern allowances will be applied last for the purposes of this ordering rule.

Definition of Mineral Resource: Kaolin

The Income Tax Act defines certain types of deposits – such as base or precious metals, coal, oil sands, and oil shale – as “mineral resources”. Expenditures incurred in exploring or developing a mineral resource receive special tax treatment. For example, such expenditures may be eligible for flow-through share treatment, and the income will qualify for the resource allowance.

The budget proposes that, where the principal substance extracted from a deposit is kaolin, the deposit be treated as a “mineral resource”. This change will assist the financing of kaolin mining and processing in Canada and will be effective for the 1988 and subsequent taxation years.

Resource Allowance Calculation

The Income Tax Act and Regulations generally provide taxpayers with a special deduction in respect of certain types of income from resource activities (oil and gas and mining) in recognition of the non-deductibility of Crown royalties and provincial mining taxes. This deduction is called the resource allowance. In the case of production from oil or gas wells, the resource allowance is calculated before the payment of certain types of third party royalties, such as an overriding royalty that is calculated as a percentage of the gross wellhead revenue. In the case of production from mines, the resource allowance is calculated after the payment of such royalties.

The budget proposes that the Regulations be amended to provide that income attributable to production from tar sands generally be treated in the same manner as production from an oil well. This change will redirect the resource allowance to those taxpayers who are operators or hold working interests and incur non-deductible Crown royalties.

The amendment will be effective in respect of income from tar sands production after July 1, 1988. There will be no change made to the resource allowance for other types of mines such as base or precious metal mines.

Capital Cost Allowance: Energy Conservation Equipment

Accelerated rates of capital cost allowance (CCA) are permitted in respect of certain types of depreciable property as an incentive for investment. Although many of the accelerated CCA rates have been reduced or eliminated as a result of tax reform, the accelerated rate of CCA (50 per cent on a straight-line basis) has remained unchanged for energy conservation equipment included in Class 34. This class includes equipment used for the generation of electricity or the production or distribution of heat, active solar heating equipment, heat recovery equipment, small-scale hydroelectric projects and wind energy equipment.

The accelerated rate of CCA for Class 34 equipment was introduced to encourage taxpayers who are carrying on business or earning income from property to invest in such equipment as part of the effort to diversify Canada's energy sources and to conserve Canada's conventional, non-renewable energy supplies. However, the incentive in respect of Class 34 equipment was not intended to provide an after-tax financing mechanism for tax-exempt or non-taxable entities. Certain non-taxable and tax-exempt entities have entered into arrangements in which taxable investors provide financing in respect of the acquisition of such equipment and, in exchange, these investors gain access to the accelerated CCA deductions. In this way, the accelerated CCA deductions provide a tax shelter to passive investors in exchange for after-tax financing to the non-taxable or tax-exempt entities.

To prevent this unintended use, it is proposed that the accelerated CCA rate in respect of Class 34 equipment be restricted to taxpayers who use that equipment primarily in the course of earning income from their own business or property, other than earning income from selling the product derived from the equipment.

However, the accelerated rate of CCA for Class 34 equipment will continue to be available to corporations whose primary source of income is from selling the product derived from such equipment or from selling other similar products.

These changes will be applicable to property acquired after February 9, 1988 other than property acquired after that time pursuant to

- (a) an obligation in writing entered into before February 10, 1988,
- (b) the terms of a prospectus, preliminary prospectus, registration statement or offering memorandum filed before February 10, 1988 with a public authority in Canada pursuant to and in accordance with the securities legislation of any province, or
- (c) an offering memorandum distributed as part of an offering of securities where
 - (i) the offering memorandum contained a complete or substantially complete description of the securities contemplated in the offering as well as the terms and conditions of the offering of the securities,
 - (ii) the offering memorandum was distributed before February 10, 1988,

- (iii) solicitations in respect of the sale of the securities contemplated by the offering memorandum were made before February 10, 1988, and
- (iv) the sale of the securities was substantially in accordance with the offering memorandum.

Non-Resident Withholding Tax

Interest

The Income Tax Act currently provides an exemption from non-resident withholding tax for interest paid on certain government and long-term corporate debt obligations issued before 1989. The expiry date of this exemption has been extended several times in order to maintain the ability of Canadian borrowers to obtain long-term financing at competitive rates. Such financing will continue to be of importance. Accordingly, it is proposed that the expiry date for these withholding tax exemptions be removed to ensure that access to long-term foreign capital is maintained and that any uncertainty associated with a fixed termination date is eliminated.

Film and Video Tape

The Income Tax Act currently applies the withholding tax to payments for the use in Canada of motion picture films and for film and video tape used in connection with television.

Canadian television broadcasters often obtain news material gathered by foreign sources where financial resources or staff location would not permit first-hand coverage of a news event. Situations also arise in which a comprehensive film or video tape report concerning a particular news item is compiled by a Canadian news operation in conjunction with a foreign news service. The application of a withholding tax obligation in respect of payments made in these circumstances may be viewed as an impediment to access by Canadians to news from foreign sources, and it is proposed to exempt payments for film or video tape used in connection with television news programs produced in Canada. This change is effective for payments made after 1985.

A further change will extend the withholding tax on payments for all other film and video tape for use in connection with television to payments made with respect to other means of reproduction for such use. This change will bring the legislation into conformity with recent Canadian tax treaties, and will apply to payments made after 1988.

Non-Resident-Owned Investment Corporations

Section 212.1 of the Income Tax Act contains special provisions applying to a non-resident who disposes of shares of a Canadian corporation to another Canadian corporation with which the non-resident does not deal at arm's length. The purpose of these provisions is to prevent the conversion of a corporation's surplus – which would be subject to tax upon distribution to the non-resident shareholder – into proceeds from the disposition of the corporation's shares, thereby giving rise to a capital gain that may not be subject to tax in Canada.

In its present form, section 212.1 treats a dividend as having been paid to a non-resident shareholder to the extent that any non-share consideration, including debt, received on the sale of the shares exceeded their paid-up capital. This treatment does not apply where the shares are disposed of by a non-resident-owned investment corporation which is treated, for most other purposes of the Act, as a non-resident person.

To restrict the opportunity to convert a corporation's surplus into interest-bearing debt through the interposition of a non-resident-owned investment corporation, it is proposed to extend the rules in section 212.1 where, after February 9, 1988, a non-resident-owned investment corporation disposes of shares to a Canadian corporation with which it does not deal at arm's length.

Provincial Deductions at Source

Income tax deducted at source from wages and certain other payments is treated as an amount held in trust for the Crown. In the event of the liquidation, assignment, receivership or bankruptcy of or by a person, such amounts held in trust are deemed not to form part of the estate of that person notwithstanding the provisions of the Bankruptcy Act. This rule, however, applies only with respect to the portion of taxes withheld that represents federal tax.

Effective on Royal Assent to the amending legislation, this rule will be extended to provincial income tax that the federal government collects under a tax collection agreement.

Jeopardy Collection

Section 225.2 of the Income Tax Act provides for special powers of immediate collection of taxes payable where it is reasonable to consider that any delay in the collection of an amount would jeopardize its collection. This rule is an exception to the general rule that taxes payable may not be collected until the taxpayer is afforded sufficient time to object to or appeal the assessment or, alternatively, if the taxpayer disputes the assessment, until a judgment is rendered. As a result of recent court cases it has become apparent that the procedure provided in section 225.2 is deficient.

The Act will be amended to provide for prior judicial approval of directions for the immediate collection of taxes in jeopardy pursuant to that section. Such judicial approval will provide added safeguards in respect of the determination of whether collection is in jeopardy and also in respect of the appropriateness of the collection direction in the circumstances. The court would thus, in an *ex parte* application, be asked to approve the direction of the Minister of National Revenue and could approve or change the terms of the direction as to the need for notifying the taxpayer, for providing an opportunity for payment, or for proceeding with a particular means of collection. This proposal will take effect on Royal Assent to the amending legislation.

Limitation Period on Prosecutions

Subsection 244(4) of the Income Tax Act provides that criminal prosecution by summary conviction in respect of an offence under the Act must be initiated within five years from the time the matter giving rise to the offence occurs. This time limitation does not apply where the Minister of National Revenue has knowledge that there exists evidence, sufficient in his opinion to justify prosecution for the offence, and where prosecution is initiated within one year from the time such knowledge is acquired. The Minister's certificate as to the day on which such evidence came to his knowledge is conclusive evidence thereof. Recent court cases have indicated that the Minister must have personal knowledge of the evidence supporting the prosecution.

The subsection will be amended to clarify that, for purposes of the exception to the five-year limitation period, the Deputy Minister and certain other prescribed officials of Revenue Canada, Taxation may also formulate the opinion that evidence sufficient for prosecution exists and issue a certificate to that effect. This amendment will avoid the necessity for the Minister to review the supporting evidence for prosecution, while ensuring that any decision to prosecute after the five-year limit is taken promptly by senior officials who have personal knowledge of the evidence.

Certificates for Unpaid Amounts

Section 223 of the Income Tax Act allows Revenue Canada, Taxation to register with the Federal Court a certificate specifying an amount payable by a taxpayer under the Act. When registered, the certificate has the same effect as if it were a judgment of the Court for the amount specified plus interest.

After a certificate is registered in the Federal Court, Revenue Canada generally requires the certificate or a document evidencing the certificate to be filed or registered against any land the taxpayer may own. The procedure for doing this varies from one province to another. In some provinces, the procedure is to have a memorial of the certificate registered under the province's land registry system. A recent New Brunswick Court of Appeal decision has cast doubt on whether New Brunswick's enforcement of judgment legislation applies to such a certificate, with

the result that doubt is also cast on whether a memorial of the certificate is effective to bind the land in New Brunswick against which it is registered.

The Income Tax Act will be amended to provide that a certificate is to be treated under a province's enforcement of judgment and land registry legislation as if it were a judgment of the superior court of the province. Although this amendment is proposed to be retroactive in order to ensure the effectiveness of certificates issued after 1971 and documents evidencing certificates issued after 1977, the amendment will not apply with respect to certificates that have been the subject of court decisions given on or before February 10, 1988 or actions pending before a court on that date. Similar amendments are proposed respecting amounts payable under the Canada Pension Plan and Unemployment Insurance Act, 1971.

III Sales and Excise Tax Measures

Treatment of Marketing and Distribution Costs

As an integral part of comprehensive tax reform, the government is committed to replacing the current federal sales tax at the manufacturer's level with a broad-based, multi-stage sales tax. Discussions are continuing with the provinces and other interested parties to assess the feasibility of a new national sales tax system.

In the interim, changes are necessary to correct some of the most serious distortions in the current system and to stem the erosion of the tax base through tax avoidance mechanisms. Among other problems, the current system provides an unfair advantage to imported goods and to private brand products in comparison with Canadian-produced goods for which marketing and distribution costs are included in the manufacturer's selling price. The current tax base is also subject to erosion as the result of some taxpayers establishing related marketing companies in order to avoid tax. This latter problem has recently grown more serious.

In the June 1987 White Paper on tax reform, the government brought forward proposals to deal with some of these problems. Implementation of two of the proposals – the application of tax to sales by marketing companies related to a manufacturer, and the shifting of the tax to the wholesale level for a range of products – was delayed pending further consultation to ensure that they could achieve the intended purposes in an effective manner.

These consultations have resulted in a revised proposal. The government will proceed, effective November 1, 1988, with amendments to the Excise Tax Act to deal with the tax treatment of marketing and distribution expenses and related distortions. The effect of the new proposal will be to tax all those goods presently taxable at the basic 12-per-cent rate at the manufacturer's trade level on their manufacturing cost plus profit.

This will be accomplished by allowing the deduction from the manufacturer's selling price of either actual marketing and distribution costs or standard deductions. Since these deductions would otherwise substantially reduce the value subject to tax, the resulting value, net of deductions, will be adjusted upward by 25 per cent. This tax base, when subject to the 12-per-cent tax rate, will produce revenues to ensure that sales tax revenues are maintained at the level forecast last June when the initial proposals were announced. The system of standard deductions will afford significant relief for taxpayers with annual taxable sales of less than \$250,000 (representing about two-thirds of all federal sales tax payers).

Under the revised method of calculating the tax, domestic manufacturers currently paying tax on their selling price, including all marketing and distribution costs, will now pay tax at a level more in line with that for goods imported or channelled through marketing companies. This will significantly reduce many of the existing tax inequities between competing goods. As a result, it will be unnecessary to proceed with the June proposals to shift the sales tax to the wholesale level for household chemicals, games, toys, sporting goods and equipment, and records and tapes. In addition, the wholesale tax on pet foods, snack foods, candy and confectionery, microwave ovens, televisions and video recorders and players will be shifted back to the manufacturer's trade level, effective November 1, 1988.

Notwithstanding this new approach to the treatment of marketing and distribution costs, the fundamental problems of the current federal sales tax remain. The only adequate solution is to replace the tax. This will occur in the second stage of tax reform.

To assist taxpayers and their advisers and to receive input on the design of the measure, the government will be asking professional organizations to hold information seminars in a number of cities. Written submissions to the Department of Finance before March 15, 1988 will be taken into consideration in developing final legislation to implement the proposal.

The measure is described in detail in the accompanying technical notes, *Sales Tax: Measure Relating to the Treatment of Marketing and Distribution Costs* under separate cover.

Wholesaler Licence Provisions

Persons who purchase goods subject to sales tax for resale are generally required to acquire the goods on a tax-paid basis. Where the goods are resold under exempt conditions, the reseller may file a refund claim to recover the tax previously paid. To reduce the administrative burden for Revenue Canada and wholesalers, the Excise Tax Act permits wholesalers who make the majority of their sales under exempt conditions to operate under a wholesaler's licence. These licences allow them to purchase goods for resale on a tax-free basis, thereby eliminating the need for numerous refund claims.

In order to be granted a wholesaler's licence, the Excise Tax Act currently requires that 50 per cent of the person's sales in the three-month period preceding the date of the application for the licence be made under tax-exempt conditions. However, once licensed, the holder is not required to continue to meet the licensing prerequisites on an ongoing basis and no authority is provided to the Minister of National Revenue to cancel a wholesaler's licence when the circumstances under which it was issued no longer exist. This gives a licensee who no longer meets the licensing prerequisites an unfair competitive advantage over competitors who are not licensed. As well, no discretion is given to the Minister to grant a wholesaler's licence where the qualifying requirements have not been met,

but are likely to be met in the near future, as, for example, in the case of a newly formed company. Finally, the amount of security required from wholesalers who apply for a licence is inadequate to protect the government's interest in the inventory of goods held on a tax-free basis.

The government proposes to introduce legislation to correct these deficiencies and inequities in the current system. First, the granting of a wholesaler's licence will be limited to situations in which the applicants have sold at least 50 per cent of their taxable goods under exempt conditions in any six-month period ending in the 12 months preceding the application. The Minister will also be given the discretion to grant a licence to a business that has not satisfied the qualifying criteria at the time the application for the licence is made, where the Minister is satisfied that the applicant's sales of taxable goods under exempt conditions in any six-month period ending in the next 12 months are likely to constitute at least 50 per cent of the applicant's total sales of taxable goods. This discretion will generally be used to grant licences to new businesses or businesses that result from amalgamations or reorganizations. A business that has been granted a discretionary licence will be required to meet the qualifying criteria in that 12-month period. Otherwise, the licence will be cancelled.

Licensees will be required to file an annual report by February 15 in each year which will indicate the portion of their sales of taxable goods made under exempt conditions for the preceding calendar year. To retain the licence, licensees will be required to have sold at least 45 per cent of their taxable goods under exempt conditions during any six-month period ending in the calendar year covered by the report. Where a licensee has not satisfied these criteria, the legislation will provide for the cancellation of the licence. Persons whose licences have been cancelled will be required to pay the taxes on their tax-free inventory in 12 equal monthly instalments commencing April 30 in the year of cancellation. The Minister will also be authorized to cancel a licence where the licensee fails to file an annual report, to pay the taxes or to furnish adequate security as required.

The Minister of National Revenue will be given discretionary authority to extend the licence for an additional year where a licensee does not meet the criteria for retaining a licence during a year due to special circumstances. For example, where a licensee has obtained an abnormally large contract to sell goods under taxable conditions during a particular year, the licensee may have fallen below the threshold of sales of taxable goods under exempt conditions for that year. Such businesses should not be penalized. However, the licensee will be required to meet the qualifying criteria during that additional year in order to retain the licence.

Finally, the amount of security that a licensee is required to provide will be increased to not less than \$5,000 and not more than \$100,000.

These changes will come into force on November 1, 1988. Transitional rules will require all current licensees to file an annual report by December 31, 1988 for the 12-month period ending October 31, 1988. Where licensees do not meet the new criteria for maintaining their licence, the licence will be cancelled effective April 1, 1989. Taxes on inventory held at the time the licence is cancelled will be payable in 12 equal monthly instalments, commencing April 30, 1989.

Fuel Tax Increase

Motive fuels are now subject to specific rates of federal sales and excise taxes. The budget proposes that, effective April 1, 1988, the excise tax on gasoline and aviation gasoline will be raised by one cent per litre. The excise tax on diesel fuel will not be increased.

To ensure that gasoline used by farmers, fishermen and other primary producers will not be affected by the increase, the existing fuel tax rebate available for such users will be increased concurrently by one cent per litre.

This proposal will raise approximately \$300 million per year.

Exemption for Original Prints

Legislation will be introduced to exempt original prints – such as serigraphs, woodcuts, lithographs and engravings – from the federal sales tax, effective after February 10, 1988. This implements a recommendation made by the House of Commons Standing Committee on Communications and Culture in its report on Taxation of Artists and the Arts.

The exemption will not extend to photomechanical reproductions of artwork originally produced in another medium. Other forms of original art, including oil paintings, water colours and sculptures, are already exempt from the tax.

Certified Public Institutions

The Excise Tax Act provides for refund of federal sales tax to public institutions such as nursing homes for the elderly, day care centres for children and rehabilitation centres for the mentally and physically handicapped. However, the Act is unclear as to the conditions under which such refunds are to be made, with the result that some institutions may not receive refunds to which they should be entitled while others may receive refunds to which they should not be entitled. Amendments are being proposed to clarify these refund provisions.

The Act authorizes the Minister of National Health and Welfare to certify public institutions that may obtain the sales tax refund. The issuance of certificates to non-profit and public institutions was limited to institutions established for purposes other than profit. The law will be amended to specifically require that, in order to be certified, institutions qualify as non-profit organizations or charities within the meaning of the Income Tax Act. The requirement that the institution be in receipt of financial aid from the government of Canada or of a province will be dropped.

Institutions currently are not certified unless their principal purpose is to provide care. Care must be provided within the premises of the institution. Personnel must be qualified and sufficient in number to adequately provide the type of care

offered by the institution. Care must be provided on a regular and ongoing basis. The law will be amended to incorporate these requirements and to provide authority for the governor in council to make regulations relating to the care that is required to be provided by an institution in order to be certified for purposes of the federal sales tax refund provisions.

Further amendments will clarify that a separate certificate must be obtained with respect to each specific address where an institution carries on its activities, and will define more clearly when the tax refund will start to apply for newly certified institutions. Organizations whose sole purpose is to provide administration services to certified institutions will become eligible to claim the tax refund.

The Minister of National Health and Welfare will be authorized to decertify an institution when it ceases to meet the requirements of the legislation. The institution's eligibility for a refund of federal sales tax will terminate on the date it ceases to meet the requirements for certification and any amount paid to the institution after that date will have to be repaid to the government.

Transportation Cost Deduction

Costs incurred by a manufacturer in delivering goods to a purchaser from the manufacturer's premises are currently excluded from the value on which sales tax is calculated. For many years, Revenue Canada has interpreted the provision, in the case of goods taxed at the manufacturer's trade level, as permitting the deduction of the costs of shipping goods from the manufacturing facility to the manufacturer's last storage site. Recent court decisions have cast doubt on the correctness of this interpretation. For this reason, amendments effective from February 11, 1988 will be introduced to ensure that the transportation cost deduction remains available.

Increase in Tax Threshold for Periodic and Seasonal Filers

To reduce the paper burden for small businesses in filing federal sales tax returns, the budget proposes to broaden the provision that allows small firms to file returns less frequently than larger businesses. At present, where the amount of tax payable annually is less than \$2,400, taxpayers may file their returns quarterly or semi-annually, rather than on the monthly basis that normally applies. A similar provision is available to taxpayers who operate seasonal businesses. The budget proposes to increase this annual tax threshold to \$4,800. For taxpayers who file on a seasonal basis, the threshold of average taxes payable for the equivalent period in the preceding calendar year will increase from \$200 to \$400 per month. Over 2,000 licensees will benefit from these changes.

IV Tariff Measures

The budget includes several tariff amendments responding to requests from the business community and individuals. Duties are being removed on a range of equipment used by the oil-sands industry, certain differentials and compressors for motor vehicles, steel rods for the construction of farm silos, recording tapes used to make "master" tapes which in turn are used to make cassettes for the blind, model glider kits and electrically-powered model vehicle kits, and burial shrouds. The Notice of Ways and Means Motion also provides for a few technical amendments to the Customs Tariff to ensure continued duty-free entry for facsimile transmission equipment and for diesel engines used in certain construction equipment. None of the products covered by these changes is manufactured in Canada.

V Federal Revenue Impact of Budget Tax Measures

	Effective date	Federal revenue impact		
		1988	Tax year 1989	1990
		(millions of dollars)		
Major tax measures				
Increase in excise tax on gasoline	April 1, 1988	225	300	300
National Strategy on Child Care:	1988 tax year			
• Increase in the child care expense deduction		- 40	- 40	- 40
• Increase in the child tax credit		- 170	- 340	- 340
Other income tax measures				
Amend associated corporation rules	mainly tax years commencing after 1988	preventive		
Expand labour-sponsored funds tax credit	1988 tax year	small revenue impact		
Amend tax treatment of alimony and maintenance payments	1986 tax year	small revenue impact		
Allow a deduction for support payments to a common-law spouse	orders made after Feb. 10, 1988	small revenue impact		
Clarify deductible social assistance payments	1982 tax year	small revenue impact		
Modify the minimum tax treatment of northern allowance and block averaging	1987 tax year	small revenue impact		
Modify the definition of mineral resource	1988 tax year	small revenue impact		
Modify calculation of resource allowance	July 1, 1988	no revenue impact		
Restrict the use of accelerated CCA for energy conservation equipment	Feb. 10, 1988	preventive		
Extend exemption from non-resident withholding tax:				
• for TV film and video tape royalties	1986 tax year	small revenue impact		
• for interest	1989 tax year	extension of existing provision		

	Effective date	Federal revenue impact		
		1988	Tax year 1989	1990
		(millions of dollars)		
Alter rules on non-resident-owned investment corporations	Feb. 10, 1988	preventive		
Other sales and excise tax measures				
Adjust value for sales tax calculation	Nov. 1, 1988	preventive		
Modify licensed wholesaler provisions	Nov. 1, 1988	up to \$200 million one-time increase over 1989 and 1990 taxation years		
Introduce an exemption for original prints	Feb. 11, 1988	small revenue impact		
Clarify rules for refund of federal sales tax to certified public institutions	various dates	small revenue impact		
Clarify rules for the deduction of transportation costs	Feb. 11, 1988	clarification		
Increase tax threshold for periodic and seasonal filers	April 1, 1988	small revenue impact		

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

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

That it is expedient to amend the Income Tax Act to provide among other things:

Associated Corporations

(1) That, in accordance with proposed amendments to the Act announced by the Minister of Finance on February 10, 1988, effective for the taxation years and fiscal periods described therein,

(a) the entitlement of one or more corporations to the small business deduction not be increased through the use of one or more partnerships, and

(b) the associated corporation rules be amended to extend the circumstances under which corporations will be considered to be associated.

National Labour-sponsored Venture Capital Corporations

(2) That for the 1988 and subsequent taxation years, an individual (other than a trust) who acquires in the year or within 60 days after the end of the year an eligible share of a prescribed national labour-sponsored venture capital corporation, be entitled to a federal tax credit equal to 20% of the purchase price of the share to the extent that the aggregate of all federal tax credits relating to investments by the individual in labour-sponsored venture capital corporations does not exceed \$700 for the year.

Child Care Expenses

(3) That for the 1988 and subsequent taxation years, the annual family limit of \$8,000 for the child care expense deduction be removed and the maximum amount deductible for the year be increased from \$2,000 to \$4,000 in respect of an eligible child who, at the end of the year, is either under 7 years of age or has a severe and prolonged mental or physical impairment.

Refundable Child Tax Credit

(4) That the provisions of the Act relating to the refundable child tax credit be amended,

(a) for the 1988 and subsequent taxation years, to establish the family income threshold for the purposes of the prepayment for a taxation year of the credit at $\frac{2}{3}$ of the family income threshold for the year for the purposes of the credit,

(b) for the 1988 and subsequent taxation years, to increase the maximum amount of the credit in respect of an eligible child under 7 years of age at the end of the year by the amount, if any, by which \$200

(\$100 for 1988) exceeds 25% of the aggregate of the child care expense deductions allowed for the year in respect of the child, and

(c) commencing with the 1990 taxation year, to adjust the amount of \$200 referred to in this paragraph by reference to the annual increase in the Consumer Price Index in excess of 3%.

**Alimony and Maintenance
Payments**

(5) That, with respect to certain third-party alimony or maintenance payments made pursuant to a decree, order or judgment of a competent tribunal or a written separation agreement made

(a) before March 28, 1986 on the basis that subsections 56.1(2) and 60.1(2) of the Act would not apply to such payments,

(i) for the 1986 and 1987 taxation years, such payments be deductible to the extent permitted by paragraphs 60(b), (c) and (c.1) of the Act in computing the payor's income for the year and not be included in computing the beneficiary's income for the year, and

(ii) for the 1988 and subsequent taxation years, such payments not be deductible in computing the payor's income for the year nor be included in computing the beneficiary's income for the year,

(b) after March 27, 1986 and before January 1, 1988, for the 1986 and subsequent taxation years, such payments be deductible in computing the payor's income for the year and included in computing the beneficiary's income for the year, as provided under sections 56 and 60 of the Act, and

(c) after December 31, 1987, for the 1988 and subsequent taxation years, such payments be deductible in computing the payor's income for the year and included in computing the beneficiary's income for the year only where the parties jointly elect to have the provisions of subsections 56.1(2) and 60.1(2) of the Act apply.

**Support Payments – Common-
Law Spouses**

(6) That allowances paid under a court order made under provincial law after February 10, 1988 for support of a separated common-law spouse be deductible in computing the income of the payor and included in computing the income of such spouse and, where the parties jointly elect, similar treatment apply to allowances paid, under such an order made on or before that date, in the taxation year in which the election is made and in subsequent years.

Social Assistance Payments

(7) That for the 1982 and subsequent taxation years,

(a) the deduction allowed in computing taxable income in respect of social assistance payments be allowed only to those persons in respect of whom such assistance was paid, and

(b) social assistance in respect of a foster child not be required by paragraph 56(1)(u) of the Act to be included in income.

Social Insurance Numbers

(8) That for the 1987 and subsequent taxation years, a Social Insurance Number be required on any return in which an individual claims the refundable child tax credit or the federal sales tax credit.

Block Averaging

(9) That for the 1987 and subsequent taxation years, block averaging calculations be made without reference to the provisions of the Act relating to the minimum tax.

Northern Allowance

(10) That for the 1987 and subsequent taxation years, the special deduction for individuals residing in a prescribed area be applied after all other deductions in computing an individual's taxable income and be deductible in computing the individual's adjusted taxable income for the purposes of the minimum tax.

Mineral Resource

(11) That for the 1988 and subsequent taxation years, the definition of a mineral resource be amended to include a deposit in respect of which the principal product extracted is kaolin.

**Non-Resident Withholding
Tax: Interest**

(12) That the exemption from non-resident withholding tax for interest paid on certain government and long-term corporate debt obligations be extended to such debt obligations issued after 1988.

**Non-Resident Withholding
Tax: Film and Video Tape**

(13) That

(a) the non-resident withholding tax in respect of payments for a right in or to the use of a film or video tape for use or reproduction in Canada in connection with television be extended to amounts paid or credited after 1988 with respect to other means of reproduction, and

(b) an exemption from non-resident withholding tax be provided in respect of payments made after 1985 for a right in or to the use of a film, video tape or other means of reproduction for use or reproduction in connection with a television news program produced in Canada.

**Non-Resident-Owned
Investment Corporations**

(14) That the rules in section 212.1 of the Act be extended to non-arm's length dispositions of shares after February 9, 1988 by non-resident-owned investment corporations.

**Provincial Taxes Deducted at
Source**

(15) That after Royal Assent to any measure giving effect to this paragraph, the amount deducted at source by any person in respect of provincial income tax that is collected under a tax collection agreement by the Department of National Revenue be treated, notwithstanding the *Bankruptcy Act*, as separate from the estate of any person in the event of any liquidation, assignment, receivership or bankruptcy of or by that person.

Jeopardy Collections

(16) That after Royal Assent to any measure giving effect to this paragraph, the power under section 225.2 of the Act of the Minister of National Revenue to take collection action forthwith, in cases where the collection of

taxes may reasonably be considered to be in jeopardy, be made subject to prior judicial authorization.

Prosecutions

(17) That after Royal Assent to any measure giving effect to this paragraph, subsection 244(4) of the Act be amended to clarify that the Deputy Minister of National Revenue for Taxation and prescribed officials, as well as the Minister of National Revenue, may acquire the knowledge, formulate the opinion and issue the certificate needed to initiate a prosecution beyond the 5 year limitation period.

Certificates

(18) That a certificate made by the Minister of National Revenue after 1971 under section 223 of the Act and registered in the Federal Court of Canada for an amount payable under the Act, or a document issued by the Court after 1977 evidencing such a certificate, be treated under a province's enforcement of judgment and land registry legislation as if it were a judgment or document evidencing a judgment of the superior court of the province, except that with respect to the effect of a certificate or document evidencing a certificate that was the subject of a court decision given on or before February 10, 1988 or of an action pending before a court on that date, section 223 of the Act be read as it was at the time the certificate was registered or the document was issued.

**Notice of Ways and Means Motion
to Amend the Canada Pension Plan**

Notice of Ways and Means Motion to Amend the Canada Pension Plan

That it is expedient to apply to the *Canada Pension Plan*, with such modifications as the circumstances require, the provisions of the *Income Tax Act* relating to certificates made by the Minister of National Revenue for amounts payable under the Act as proposed to be amended in paragraph (18) of the Notice of Ways and Means Motion to amend the *Income Tax Act* tabled in the House of Commons on February 10, 1988 effective as provided in that paragraph.

**Notice of Ways and Means Motion
to Amend the Unemployment Insurance Act, 1971**

Notice of Ways and Means Motion to Amend the Unemployment Insurance Act, 1971

That it is expedient to amend the *Unemployment Insurance Act, 1971* to provide that the provisions relating to certificates made by the Minister of National Revenue for amounts payable under the Act reflect the corresponding changes proposed in paragraph (18) of the Notice of Ways and Means Motion to amend the *Income Tax Act* tabled in the House of Commons on February 10, 1988 and that the amendment be made effective as provided in that paragraph.

**Draft Legislation
Relating to Associated Corporations**

Draft Legislation

Relating to Associated Corporations

1.(1) Subsection 125(6) of the said Act is repealed and the following substituted therefor:

Specified Partnership Income of Corporate Partner

“(6) Where in a taxation year a corporation is a member of a particular partnership and in the year the corporation or a corporation with which it is associated in the year is a member of one or more other partnerships and it may reasonably be considered that one of the main reasons for the separate existence of the partnerships is to increase the amount of a deduction of any corporation under subsection (1), the specified partnership income of the corporation for the year shall, for the purposes of this section, be computed in respect of those partnerships as if all amounts each of which is the income of one of the partnerships for a fiscal period ending in the year from an active business carried on in Canada were nil except for the greatest of such amounts.

Corporation Deemed Member of a Partnership

(6.1) For the purposes of this section, a corporation which is a member, or is deemed by this subsection to be a member, of a partnership that is a member of another partnership shall be deemed to be a member of the other partnership and the corporation's share of the income of the other partnership for a fiscal period shall be deemed to be equal to the amount of such income to which the corporation was directly or indirectly entitled.

Specified Partnership Income Deemed Nil

(6.2) Notwithstanding any other provision of this section, where a corporation is a member of a partnership that was controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, by one or more public corporations (other than a prescribed venture capital corporation) or by any combination thereof at any time in its fiscal period ending in a taxation year of the corporation, the income of the partnership for that fiscal period from an active business carried on in Canada shall, for the purposes of computing the specified partnership income of a corporation for the year, be deemed to be nil.

Partnership Deemed to be Controlled

(6.3) For the purposes of subsection (6.2), a partnership shall be deemed to be controlled by one or more persons at any time if the aggregate of the shares of such person or persons of the income of the partnership from any source for the fiscal period of the partnership that includes that time exceeds 1/2 of the income of the partnership from that source for that period.

(2) Subsection (1) is applicable to fiscal periods of partnerships commencing after February 10, 1988, except that subsections 125(6.2) and (6.3) of the said Act, as enacted by subsection (1), are applicable with respect to fiscal periods of partnerships commencing after 1988.

2.(1) Subsections 247(2) and (3) of the said Act are repealed.

(2) Subsection (1) is applicable

(a) for taxation years commencing after 1988, and

(b) to the 1989 taxation year commencing in 1988 of a corporation

(i) that was incorporated, or formed as a result of an amalgamation, after February 10, 1988,

(ii) that acquired after February 10, 1988 from a person with whom the corporation did not deal at arm's length all or substantially all of the assets used by it in its business, or

(iii) where that taxation year did not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

3.(1) All that portion of subsection 251(5) of the said Act preceding paragraph (c) thereof is repealed and the following substituted therefore:

**Control by Related Groups,
Options, etc.**

“(5) For the purposes of paragraph 125 (7) (b) and subsection (2),

(a) where a related group is in a position to control a corporation, it shall be deemed to be a related group that controls the corporation whether or not it is part of a larger group by whom the corporation is in fact controlled;

(b) a person who has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently

(i) to, or to acquire, shares in a corporation, or to control the voting rights of shares in a corporation, shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed to have the same position in relation to the control of the corporation as if he owned the shares, or

(ii) to cause a corporation to redeem, acquire or cancel any shares of its capital stock owned by other shareholders of the corporation shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed to have the same position in relation to the control of the corporation as if the shares were redeemed, acquired or cancelled by the corporation; and”

(2) Subsection (1) is applicable

(a) for taxation years commencing after 1988, and

(b) to the 1989 taxation year commencing in 1988 of a corporation

(i) that was incorporated, or formed as a result of an amalgamation, after February 10, 1988,

(ii) that acquired after February 10, 1988 from a person with whom the corporation did not deal at arm's length all or substantially all of the assets used by it in its business, or

(iii) where that taxation year did not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

4.(1) Subsections 256(1) and (2) of the said Act are repealed and the following substituted therefor:

Associated Corporations

"256.(1) For the purposes of this Act, one corporation is associated with another in a taxation year if at any time in the year,

(a) one of the corporations controlled, directly or indirectly in any manner whatever, the other,

(b) both of the corporations were controlled, directly or indirectly in any manner whatever, by the same person or group of persons,

(c) each of the corporations was controlled, directly or indirectly in any manner whatever, by a person and the person who so controlled one of the corporations was related to the person who so controlled the other, and either of those persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof,

(d) one of the corporations was controlled, directly or indirectly in any manner whatever, by a person and that person was related to each member of a group of persons that so controlled the other corporation, and that person or that group of persons owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof, or

(e) each of the corporations was controlled, directly or indirectly in any manner whatever, by a related group and each of the members of one of the related groups was related to all of the members of the other related group, and either of the related groups owned, in respect of each corporation, not less than 25% of the issued shares of any class, other than a specified class, of the capital stock thereof.

Specified Class

(1.1) For the purposes of subsection (1), "specified class" means a class of shares of the capital stock of a corporation where under the terms or conditions of the shares or any agreement in respect thereof

- (a) the shares are not convertible or exchangeable,
- (b) the shares are non-voting,
- (c) the amount of each dividend payable on the shares is calculated as a fixed amount or by reference to a fixed percentage of their paid-up capital,
- (d) the annual rate of the dividend on the shares cannot in any event exceed 15% of their paid-up capital, and
- (e) the amount that any holder of the shares is entitled to receive on the redemption, cancellation or acquisition of the shares by the corporation or by any person with whom the corporation does not deal at arm's length cannot exceed the paid-up capital of the shares plus the amount of any unpaid dividends thereon.

Control and Ownership of Shares

(1.2) For the purposes of this section,

- (a) a group of persons means any two or more persons each of whom owns shares of the capital stock of the same corporation,
- (b) for greater certainty, a corporation may be controlled or deemed to be controlled by a person or group of persons notwithstanding that the corporation may also be controlled or deemed to be controlled by another person or group of persons,
- (c) a corporation shall be deemed to be controlled by another corporation, a person or a group of persons at any time where
 - (i) shares of the capital stock of the corporation having a fair market value of more than 50% of the fair market value of all the issued and outstanding shares of the capital stock of the corporation, or
 - (ii) common shares of the capital stock of the corporation having a fair market value of more than 50% of the fair market value of all the issued and outstanding common shares of the capital stock of the corporation
 are owned at that time by the other corporation, the person or the group of persons, as the case may be,
- (d) for greater certainty, a corporation is controlled by another corporation, a person or a group of persons at any time where, at that time, the other corporation, the person or the group of persons, as the case may be, has any direct or indirect influence that, if exercised, would result in control in fact of the corporation,
- (e) where shares of the capital stock of a corporation are owned, or deemed by this subsection to be owned, at any time by another

corporation (in this paragraph referred to as the "holding corporation"), such shares shall be deemed to be owned at that time by any shareholder of the holding corporation in a proportion equal to the proportion of all such shares that

(i) the fair market value of the shares of the capital stock of the holding corporation owned at that time by the shareholder

is of

(ii) the fair market value of all the issued shares of the capital stock of the holding corporation outstanding at that time,

(f) where shares of the capital stock of a corporation are held, or deemed by this subsection to be owned, at any time by a partnership, such shares shall be deemed to be owned at that time by any partner thereof in a proportion equal to the proportion of all such shares that

(i) the partner's share of the income or loss of the partnership for its fiscal period that includes that time

is of

(ii) the income or loss of the partnership for its fiscal period that includes that time,

(g) where shares of the capital stock of a corporation are owned, or deemed by this subsection to be owned, at any time by a trust,

(i) in the case of a testamentary trust under which one or more beneficiaries were entitled to receive all of the income of the trust that arose before the date of death of one or the last surviving of such beneficiaries (hereinafter in this paragraph referred to as the "distribution date") and no other person could, before the distribution date, receive or otherwise obtain the use of any of the income or capital of the trust,

(A) where any such beneficiary's share of the income or capital therefrom depends upon the exercise by any person of, or the failure by any person to exercise, any discretionary power, such shares shall be deemed to be owned at any time before the distribution date by the beneficiary, and

(B) where clause (A) does not apply, such shares shall be deemed to be owned at any time before the distribution date by any such beneficiary in a proportion equal to the proportion of all such shares that the fair market value of the beneficial interest in the trust of the beneficiary is of the fair market value of the beneficial interests in the trust of all such beneficiaries,

(ii) where a beneficiary's share of the accumulating income or capital therefrom depends upon the exercise by any person of, or the failure by any person to exercise, any discretionary power, such shares shall be deemed to be owned at that time by the beneficiary, except where subparagraph (i) applies and that time is before the distribution date,

(iii) in any case where subparagraph (ii) does not apply, a beneficiary shall be deemed at that time to own the proportion of such shares that the fair market value of the beneficial interest in the trust of the beneficiary is of the fair market value of all beneficial interests in the trust, except where subparagraph (i) applies and that time is before the distribution date, and

(iv) in the case of a trust referred to in subsection 75(2), the person referred to therein from whom property of the trust or property for which it was substituted was directly or indirectly received shall be deemed to own such shares at that time, and

(h) in determining the fair market value of a share of the capital stock of a corporation, all issued and outstanding shares of the capital stock of the corporation shall be deemed to be non-voting.

Parent Deemed to Own Shares

(1.3) Where shares of the capital stock of a corporation are owned at any time by a child who was under 18 years of age, such shares shall be deemed to be owned at that time by each parent of such child for the purposes of determining if the corporation is associated at that time with any other corporation that is controlled, directly or indirectly in any manner whatever, by that parent or by a group of persons of which that parent is a member.

Options and Rights

(1.4) For the purposes of determining if a corporation is associated at any time with any other corporation that is controlled, directly or indirectly in any manner whatever, by a person, or by a group of persons of which the person is a member, where the person, or any partnership in which the person has an interest, has a right at any time under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently,

(a) to, or to acquire, shares of the capital stock of the corporation, or to control the voting rights of shares of the capital stock of the corporation, the person or partnership shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed to own the shares at that time and the shares shall be deemed to be issued and outstanding at that time, or

(b) to cause the corporation to redeem, acquire or cancel any shares of its capital stock owned by other shareholders of the corporation, the person or partnership shall, except where the contract provided that the right is not exercisable until the death of an individual designated therein, be deemed at that time to have the same position in relation to

control of the corporation and ownership of shares of its capital stock as if the shares were redeemed, acquired or cancelled by the corporation.

Person Related to Himself

(1.5) For the purposes of this section, where a person owns shares in two or more corporations, he shall as shareholder of one of the corporations be deemed to be related to himself as shareholder of each of the other corporations.

Exception

(1.6) For the purposes of subsection (1.2) and notwithstanding subsection (1.4), any share that is

(a) described in paragraph (e) of the definition “term preferred share” in subsection 248(1) during the applicable time referred to in that paragraph, or

(b) a share of a specified class within the meaning of subsection (1.1)

shall be deemed not to have been issued and outstanding and not to be owned by any shareholder and an amount equal to the paid-up capital of the share shall be deemed to be a liability of the corporation.

Association With Third Corporation

(2) Where two corporations

(a) would, but for this subsection, not be associated with each other at any time, and

(b) are associated, or are deemed by this subsection to be associated, with the same corporation (hereinafter in this subsection referred to as the “third corporation”) at that time,

they shall, for the purposes of this Act, be deemed to be associated with each other at that time except where the third corporation is not a Canadian-controlled private corporation at that time or elects, in prescribed form, for its taxation year that includes that time not to be associated with either of the other two corporations for the purposes of section 125, in which case, for the purposes of this subsection, the third corporation shall be deemed not to be associated with either of the other two corporations in that taxation year and, for the purposes of section 125, its business limit for that taxation year shall be deemed to be nil.

Anti-Avoidance

(2.1) For the purposes of this Act, where, in the case of two or more corporations, it may reasonably be considered that one of the main reasons for the separate existence of those corporations in a taxation year is to reduce the amount of taxes that would otherwise be payable under this Act or to increase the amount of refundable investment tax credit under section 127.1, the two or more corporations shall be deemed to be associated with each other in the year.”

(2) Subsection (1) is applicable

(a) for taxation years commencing after 1988, and

(b) to the 1989 taxation year commencing in 1988 of a corporation

(i) that was incorporated, or formed as a result of an amalgamation, after February 10, 1988,

(ii) that acquired after February 10, 1988 from a person with whom the corporation did not deal at arm's length all or substantially all of the assets used by it in its business, or

(iii) where that taxation year did not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

Explanatory Notes
Associated Corporations

Explanatory Notes

Associated Corporation

Specified Partnership Income **Clause 1**

ITA
125(6) to (6.3)

Subsection 125(6) is an anti-avoidance provision designed to prevent multiple access to the small business deduction where a business is carried on through two or more partnerships of which a corporation or a corporation associated with it is a member. Where it applies, it reduces the amount of the partnership income that can qualify for the small business deduction in the hands of a corporate partner. The amendments to this subsection do not alter its substance. The condition contained in existing paragraph 125(6)(a) has been repealed as it is effectively subsumed by the condition contained in existing paragraph 125(6)(b) which is substantially re-enacted.

New subsection 125(6.1) provides that, for purposes of the provisions in section 125 relating to the small business deduction, a corporation that is a member of a partnership which in turn is a member of another partnership shall be deemed to be a member of the second partnership and its share of income therefrom shall be deemed to be the amount to which it is directly or indirectly entitled through those partnerships of which it is a member. This new provision is intended to effectively “look through” tiers of partnerships.

New subsection 125(6.2) provides that the income of a partnership that is controlled, directly or indirectly in any manner whatever, by any combination of non-resident persons or public corporations cannot qualify for the small business deduction. The purpose of this rule is to ensure that the income of such a partnership is treated in the same way as if the business were carried on by a corporation, in which case the corporation would not qualify for the small business deduction because it would not qualify as a “Canadian-controlled private corporation”.

With the exception of new subsection 125(6.3), precise rules as to when a partnership will be considered to be controlled, directly or indirectly in any manner whatever, are not proposed. Rather, it is expected that factual determinations will be made in individual cases depending upon the relevant facts and circumstances. Under new subsection 125(6.3) a partnership will be treated as being controlled by one or more persons whenever their share of the income of the partnership from any source exceeds 50%.

New subsections 125(6) and (6.1) will be effective with respect to fiscal periods of partnerships commencing after February 10, 1988 and new

subsections 125(6.2) and (6.3) will be effective with respect to fiscal periods of partnerships commencing after 1988.

Anti-Avoidance Rule

ITA
247(2) and (3)

Clause 2

Subsection 247(2) of the Act sets out an anti-avoidance rule that treats two or more corporations as being associated corporations where one of the main reasons for their separate existence was for tax purposes.

The repeal of subsections 247(2) and (3) is merely consequential as subsection 247(2) is substantially re-enacted in section 256 – the section of the Act in which the other rules are located for determining the circumstances in which corporations will be regarded as associated.

The repeal will be effective for taxation years commencing after 1988. It will be applicable also to the 1989 taxation year commencing in 1988 of a corporation in any case where it was incorporated or formed as a result of an amalgamation after February 10, 1988, where it acquired after February 10, 1988 from a person with whom it was not dealing at arm's length all or substantially all of the assets used by it in its business or where its 1989 taxation year does not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

Related Persons

ITA
251(5)

Clause 3

Section 251 of the Act deals with the concept of arm's length and defines the circumstances in which persons, including corporations, will be regarded as related for tax purposes. Subsection 251(5) sets out three special rules that are relevant for these purposes.

Two amendments have been made to subsection 251(5). The first is merely consequential and effectively provides, by deleting the reference to section 256, that the special rules in subsection 251(5) do not apply for the purposes of the associated corporation rules because similar special rules for the purposes of the associated corporation provisions are set out in new subsections 256(1.2), (1.4) and (1.5) and are discussed in the commentary on those provisions.

The second amendment expands the scope of paragraph 251(5)(b). That paragraph currently applies in certain circumstances to treat a person who has a right to acquire shares in a corporation or control the voting rights of shares in a corporation as being in the same position in relation to the control of the corporation as if he owned the shares. New subparagraph 251(5)(b)(ii) applies a similar rule to a person who has a right to cause a corporation to redeem, acquire or cancel shares of its capital stock owned by other shareholders of the corporation. In such a case, that person will be treated as being in the same position in relation to the control of the

corporation as if the shares were redeemed, cancelled or acquired by the corporation.

The amendment will be effective for taxation years commencing after 1988. It will also be applicable to the 1989 taxation year commencing in 1988 of a corporation in any case where it was incorporated or formed as a result of an amalgamation after February 10, 1988, where it acquired after February 10, 1988 from a person with whom it did not deal at arm's length all or substantially all of the assets used by it in its business, or where its 1989 taxation year did not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

Associated Corporations

Clause 4

ITA
256(1) to (2.2)

Subsection 256(1) contains the basic rules for determining the circumstances under which two corporations are considered to be associated with each other for purposes of the Act.

Under subsection 256(1), the essential test relies on control. The new rules extend the use of the concept of control to control *directly or indirectly in any matter whatever*. Under the existing rules, control of a corporation generally exists by virtue of the ability to elect a majority of the directors of the corporation. Under the new rules, in addition to being able to exercise control in such manner, it is intended that corporations will be associated when control can be exercised in any manner whatever including circumstances where control in fact exists by virtue of a person having any direct or indirect influence. Such manner of control is sometimes referred to as *de facto* or actual control. An example of *de facto* control would be where a person held a special category of indebtedness or preferred shares retractable on demand in such amount and in such circumstances that it could reasonably be concluded that such person controlled the corporation notwithstanding that he might not have voting control. Another example might be a situation where a person held 49% of the voting control of a corporation and the balance was widely dispersed among many employees of the corporation or was held by persons who could reasonably be considered to act in respect of the corporation in accordance with his wishes. Whether a person can be said to be in actual control of a corporation, notwithstanding that he does not legally control more than 50% of its voting shares, will depend in each case on all of the circumstances.

Paragraphs 256(1)(c), (d) and (e) have been further amended in three respects. First, the references therein to ownership "directly or indirectly" have been deleted in light of the explicit rules relating to indirect ownership as set out in new paragraphs 256(1.2)(e), (f) and (g) and new subsections 256(1.3) and (1.4). Second, the cross-ownership threshold for the purposes of the special rules for related persons has been increased from 10% to 25% of the shares of any class. Third, specified classes of shares, as defined in new

subsection 256(1.1), will be exempted from the cross-ownership test. A class of shares will be a specified class for this purpose if

- (1) the shares are neither convertible nor exchangeable,
- (2) the shares are non-voting,
- (3) dividends payable on the shares are fixed in amount or rate,
- (4) the annual rate of the dividend on the shares cannot exceed 15% of their paid-up capital, and
- (5) the amount that a holder of the shares is entitled to receive on their redemption, cancellation or acquisition by the corporation or a person with whom the corporation does not deal at arm's length cannot exceed their paid-up capital plus any unpaid dividends.

These changes will permit a person to invest funds in a corporation controlled by a related person – such as a spouse or child – without subjecting his own corporation to a reduced small business deduction, provided that the investment takes the form of fixed-rate, non-voting, preferred shares or constitutes less than 25% of the issued shares of any class.

New subsection 256(1.2) contains special rules for the purposes of determining whether a corporation will be considered to be controlled for purposes of the new associated corporation rules.

New paragraph (1.2)(a) provides that in determining whether a corporation is controlled by a group of persons, a group means *any* two or more persons each of whom owns shares of the corporation.

New paragraph (1.2)(b) provides that a corporation can be considered to be controlled by a person or group of persons notwithstanding that the corporation is also controlled by another person or group of persons. As a consequence, under this paragraph, a corporation can be considered to be controlled at the same time by several persons or groups of persons. This is similar to the rule in paragraph 251(5)(a) for the purposes of determining whether persons are related to each other.

New paragraph (1.2)(c) represents a substantial change from the existing rules and provides that a person or group of persons will be treated as controlling a corporation where the person or group owns shares representing more than 50% of the fair market value of all the issued and outstanding shares of the corporation, or common shares representing more than 50% of the fair market value of all the issued and outstanding common shares of the corporation. For purposes of making this valuation, paragraph 256(1.2)(h) and new subsection 256(1.6) described below, provide that voting rights and shares that qualify under paragraph (e) of the definition “term preferred share” (financial difficulty shares) or under new subsection (1.1) (specified shares) are to be disregarded.

New paragraph (1.2)(d) complements the extended meaning of control provided in new subsection (1) by clarifying that where a person or group of persons has any direct or indirect influence that, if exercised, would result in control in fact of a corporation, that person or group of persons controls the corporation.

New paragraph (1.2)(e) provides a “look through” or attribution rule where shares are held by one corporation in another corporation. It treats a shareholder of a corporation that holds shares of another corporation as owning such of those shares as is proportionate to the value of his holdings in the holding corporation. For the purpose of determining that proportion, voting rights, financial difficulty shares and specified shares are to be disregarded.

New paragraph (1.2)(f) provides a similar “look-through” rule for shares owned by a partnership. It treats a member of a partnership that holds shares of a corporation as owning such of those shares as is proportionate to his income interest in the partnership.

New paragraph (1.2)(g) provides a similar “look-through” rule where shares are held by a trust. It treats shares of a corporation held by a trust to be owned by its beneficiaries and, in one case, by the person from whom trust property was received. In the case of a testamentary trust under which some beneficiaries are entitled to all income of the trust prior to the death of one or all of them and no other person is entitled to any capital of the trust before that time, the shares are deemed to be owned by such beneficiaries before that time. In the case of a discretionary trust, all discretionary beneficiaries are deemed to own the shares. In any other case, each beneficiary is deemed to own a proportion of the shares based on the fair market value of his interest in the trust. In addition, where a trust is one referred to in subsection 75(2) of the Act – such as a “reversionary” trust – the person from whom property of the trust was received is also deemed to own the shares. The result of the application of these provisions may be that more than one person can be deemed to own the same shares at the same time. In addition, of course, the shares are actually held by the trustees of the trust and the new rules do not negate this fact.

New paragraph (1.2)(h) provides that the various fair market valuations that may be required to be made under the new “look-through” or attribution rules are to be made without regard to the voting attributes of all shares of the capital stock of a corporation. Particularly in the case of closely held private corporations, assigning a value to such voting rights could be very difficult and result in inappropriate consequences.

New subsection 256(1.3) is an attribution rule which provides that shares of a corporation owned by a child, or treated as being owned by a child under one of the other provisions of the section, shall be treated as being owned by each parent of the child for the purposes of determining whether the corporation is associated with any other corporation controlled by that parent or controlled by a group of persons of which that parent is a member.

New subsection 256(1.4) incorporates into the provisions relating to associated corporations, the special rules in existing paragraph 251(5)(b) of the Act dealing with rights to acquire shares. It provides, in paragraph (a), that anyone having an option or right to acquire shares, or to control the voting rights of shares, shall be treated as owning those shares, except where the option or right is not exercisable until the death of an individual. New paragraph 256(1.4)(b) applies a similar rule to a person who has a right to cause a corporation to redeem, acquire or cancel shares of its capital stock owned by other shareholders of the corporation. In such a case, that person will be treated as being in the same position in relation to control of the corporation and ownership of its shares as if the shares were redeemed, acquired or cancelled by the corporation.

New subsection 256(1.5) will re-enact, for the purposes of section 256, existing paragraph 251(5)(c) of the Act. This subsection treats a person as being related to himself in his capacity as shareholder of two or more corporations.

New subsection 256(1.6) provides that shares described in paragraph (e) of the definition “term preferred share” in subsection 248(1) of the Act (financial difficulty shares) and shares of a specified class within the meaning of new subsection (1.1) are to be disregarded for purposes of making the fair market valuations required in subsection 256(1.2). An amount equal to the paid-up capital of such shares will be treated as a liability of the corporation.

New subsection 256(2) is similar to the existing rule that treats two otherwise unassociated corporations to be associated with each other if they are both associated with the same third corporation. However, the new rule provides an exception, for the purposes of the small business deduction, where the third corporation does not claim a small business deduction, either because it explicitly elects not to qualify for that deduction or because it in fact does not qualify for the small business deduction because it is not a “Canadian-controlled private corporation”.

New subsection 256(2.1) is substantially similar to existing subsection 247(2). The existing procedure requiring Ministerial direction is unnecessarily cumbersome and will be repealed. In addition, the business purpose test for the separate existence of corporations contained in existing paragraph 247(2)(a) will be repealed as it is effectively subsumed by the condition contained in existing paragraph 247(2)(b) which will be substantially re-enacted. This anti-avoidance rule is intended to apply where two or more corporations are not otherwise associated but one of the main reasons for their separate existences may reasonably be considered to be to duplicate the small business deduction or increase their refundable investment tax credits. This provision would apply, for example, where two parts of what could reasonably be considered to be one business, such as the manufacturing and sales activities of a single business, were carried on by two corporations each of which was controlled by different persons. In such a case, where it is

reasonable to conclude that the separate existence of the corporations was mainly tax motivated, the corporations will be treated as associated with each other. As a result, only one small business deduction will be allowed in respect of the income generated by the business.

The special exceptions from the associated corporation rules contained in existing subsections 256(3) to (6) – where control exists to protect the position of lenders or preferred shareholders or where shares are held by a trustee – are not altered.

All of the new associated corporation rules will be effective for taxation years commencing after 1988 except in circumstances where existing corporations change their established year-ends or transfer their businesses to new corporations in order to extend the period that they are subject to the existing rules. Accordingly, the new rules will also be applicable to the 1989 taxation year commencing in 1988 of a corporation that was incorporated or formed as a result of an amalgamation after February 10, 1988, that acquired after February 10, 1988 from a person with whom it did not deal at arm's length all or substantially all of the assets used by it in its business or where its 1989 taxation year does not end on the same date as that, if any, on which a 1987 taxation year of the corporation ended.

**Notice of Ways and Means Motion
to Amend the Excise Tax Act (1)**

Notice of Ways and Means Motion to Amend the Excise Tax Act (1)

That it is expedient to introduce a measure to amend the Excise Tax Act and to provide among other things:

Excise Tax on Gasoline

1. That the rate of excise tax on gasoline and aviation gasoline be increased by one cent per litre.

2. That the amount of the fuel tax rebate in respect of the excise tax imposed on gasoline sold to or imported by farmers on or after April 1, 1988 be calculated at the rate of five cents per litre and in respect of the excise tax imposed on gasoline sold to or imported by fishermen and other primary producers on or after April 1, 1988 be calculated at the rate of two cents per litre.

Transportation Deduction

3. That the exclusion from sale price, for purposes of determining the consumption or sales tax on goods manufactured or produced in Canada, of the cost of transporting goods to the purchaser thereof be extended, in the case of goods other than those referred to in the definition "manufacturer or producer" in subsection 2(1) of the Act other than paragraph (a), (b), (c) or (f) thereof, to include the cost of transporting the goods from the place of final manufacture of the goods to the place from which the goods are delivered to the purchaser.

Certified Institutions

4. That the meaning of "certified institution" in section 44.25 of the Act be limited to non-profit organizations and charities.

5. That "non-profit organizations" and "charity" be given the same meaning as in paragraphs 149(1)(l) and 149.1(1)(d) of the Income Tax Act.

6. That no amount equal to the amount of tax may be paid under section 44.25 of the Act to a certified institution in respect of goods purchased for the sole use of the institution where at the time the goods were purchased the institution was not a "non-profit organization" or a "charity" within the meaning of the Income Tax Act.

7. That the requirement that an institution be in receipt of government aid to be eligible for certification for purposes of section 44.25 of the Act be repealed.

8. That where an organization operates institutions at more than one location, each such institution be required to be separately certified for purposes of section 44.25 of the Act.

9. That the Minister of National Health and Welfare be authorized to issue certificates for purposes of section 44.25 of the Act to organizations that provide administrative services solely to one or more certified institutions.

10. That the authority of the Minister of National Health and Welfare to issue certificates to public institutions for purposes of section 44.25 of the Act be limited to issuing certificates to institutions that provide care

(a) within the premises of the institution,

(b) by personnel that are qualified and sufficient in number considering the type of care provided,

(c) to persons in need of care on a regular and ongoing basis, and

(d) as may be prescribed by regulation of the Governor in Council on the joint recommendation of the Minister of National Health and Welfare and the Minister of Finance.

11. That the Minister of National Health and Welfare be authorized to cancel a certificate issued to an institution for purposes of section 44.25 of the Act where the institution ceases to meet the eligibility requirements for being issued the certificate.

12. That where an institution ceases to meet the eligibility requirements for being issued a certificate under section 44.25 of the Act, no amount equal to tax be payable to the institution under that section in respect of goods purchased after the day on which the institution ceased to meet those requirements.

13. That where an institution has received a payment under section 44.25 of the Act in respect of goods purchased at a time when the institution did not meet the eligibility requirements for being issued a certificate, that institution be required to repay forthwith the amount of that payment to Her Majesty and, upon default in repayment of such amount by the end of the month following the month in which the certificate is cancelled pursuant to any enactment founded on paragraph 11 of this motion, the institution be required to pay forthwith a penalty of one-half of one percent and interest at the prescribed rate for each month or fraction of a month during which the default continues, calculated on the total amount, penalty and interest outstanding in that month or fraction of a month.

14. That in the French version of section 44.25 of the Act, the requirement that, to be eligible for certification, the principal purpose of an institution be to provide care "aux invalides" be replaced with the requirement that the principal purpose be to provide care "aux personnes incapables de subvenir à leurs besoins".

15. That the definition "specified day" in section 44.25 of the Act be clarified.

Original Prints

16. That original engravings, prints and lithographs produced directly in black and white or in colour of one or of several plates wholly executed by hand by the artist, other than such articles produced by any mechanical or photomechanical process, be exempt from the consumption or sales tax.

Periodic Returns

17. That the monetary limits below which returns for periods of between one and six months may be authorized by the Minister of National Revenue be increased,

(a) for taxpayers that file on a periodic basis, from \$2,400 to \$4,800 of taxes payable for the preceding calendar year, and

(b) for seasonal filers, from \$200 to \$400 of average taxes payable per month for the equivalent period in the preceding calendar year.

Effective Dates

18. That any enactment founded on

(a) paragraph 6 of this motion apply in respect of goods purchased on or after July 1, 1987,

(b) paragraphs 4 and 5 of this motion come into force on July 1, 1987, and any such enactment also apply in respect of any application for a certificate referred to in the definition "certified institution" received on or after July 1, 1987 in respect of any period prior to July 1, 1987,

(c) paragraphs 3, 7 to 10 and 14 to 16 of this motion come into force on February 11, 1988, and

(d) paragraphs 1, 2 and 17 of this motion come into force on April 1, 1988.

**Notice of Ways and Means Motion
to Amend the Excise Tax Act (2)**

Notice of Ways and Means Motion to Amend the Excise Tax Act (2)

That it is expedient to introduce a measure to amend the Excise Tax Act and to provide among other things:

Marketing and Distribution Costs

1. That in respect of goods that are subject to sales tax at the manufacturer's trade level at the 12 per cent rate, a deduction from sale price or duty paid value of the costs incurred

(a) in the case of goods manufactured in Canada, by the manufacturer who is liable for the tax, or

(b) in the case of imported goods, by the importer or exporter,

in marketing and distributing the goods in Canada be allowed where such costs are included in the sale price or duty paid value of the goods, and that the amount so determined be increased by 25 per cent to establish the value of the goods for purposes of calculating the sales or excise tax.

Wholesaler Licences

2. That the rules relating to wholesaler licences be modified

(a) to relate the criteria for qualifying for a licence to sales of taxable goods under exempt conditions,

(b) to lengthen the three month period for qualifying for a licence to six months,

(c) to require a licensee to file an annual report of his total sales of taxable goods and sales of taxable goods under exempt conditions,

(d) to provide for the cancellation of a licence where the licensee no longer meets the qualifying criteria,

(e) to provide authority for the Minister of National Revenue to issue a provisional licence or delay cancellation of a licence where he is satisfied that the person is likely to meet the qualifying criteria within a reasonable period of time,

(f) to increase the amount of security that a licensee may be required to provide,

(g) to provide for the payment of taxes on goods held in inventory in equal amounts over a twelve month period following cancellation of a licence, and

(h) to provide transitional rules relating to the cancellation of an existing licence and payment of taxes on goods held in inventory where the licensee cannot qualify for a licence under the new criteria.

Effective Date

3. That any enactment founded on this motion come into force on November 1, 1988.

Notice of Ways and Means Motion to Amend the Customs Tariff

2017-04-18/18

Notice of Ways and Means Motion to Amend the Customs Tariff

1. That the *Customs Tariff* be amended by striking out paragraphs 20.(2)(b) and 20.(2)(c) and by substituting the following therefor:

“(b) spirits, within the meaning of the *Excise Act*, of an alcoholic strength by volume exceeding 22.9 per cent volume, of tariff item No. 2204.21.29, 2204.29.29, 2205.10.20, 2205.90.20, 2206.00.20, 2206.00.69 or 2206.00.90,

(c) spirits, within the meaning of the *Excise Act*, of heading No. 22.07 or 22.08, other than of tariff item No. 2207.20.11, 2207.20.90, 2208.10.00, 2208.90.50 or 2208.90.91, and”.

2. That the said Act be further amended by striking out in subsection 76.(1) the reference to “section 77” and by substituting therefor a reference to “section 78”.

3. That Schedule I to the said Act be amended by striking out tariff item Nos. 7308.90.20, 8517.82.10, 8517.82.20, 8525.10.00, 8525.20.10, 8527.90.00, 8529.90.10 and 9503.20.10 and the description of goods and rates of duty accompanying each of those items and by inserting in Schedule I to the said Act, the tariff item Nos., description of goods and rates of duty specified in Schedule I to this motion.

4. That Schedule II to the said Act be amended by striking out code 1095, code 1530 and the preamble thereto, and code 2410 and the provisions and rates of duty accompanying each of those codes and by inserting in Schedule II to the said Act, the codes, preamble, provisions and rates of duty specified in Schedule II to this motion.

5. That Schedule II to the said Act be further amended by striking out in code 2450 the reference to “Air compressors, of a capacity of 0.00342 m³/s or more but not exceeding 0.01133 m³/s;”.

6. That Schedule II to the said Act be further amended by striking out in code 2455 the reference to “Air compressors, of a capacity of less than 0.00342 m³/s or exceeding 0.01133 m³/s;” and by substituting therefor a reference to “Air compressors;”.

7. That Schedule II to the said Act be further amended by striking out in the preamble to codes 2480, 2481 and 2482 the reference to “Differentials (including axle housings) and sintered powdered metal parts, for transmission assemblies;”

and by substituting therefor a reference to "Axle housings and sintered powdered metal parts, for transmission assemblies;"

8. That any enactment founded on paragraphs 1 to 7 of this motion shall be deemed to have come into force on the 11th day of February, 1988 and to have been applied to all goods mentioned therein imported on or after that day and to goods previously imported that had not been accounted for under section 32 of the *Customs Act* before that day.

SCHEDULE I

Tariff Item	Description of Goods	Most-Favoured-Nation Tariff	General Preferential Tariff	Rates in Effect Prior to Rates Proposed in this Motion	
				Most-Favoured-Nation Tariff	General Preferential Tariff
73.08	Structures (excluding prefabricated buildings of heading No. 94.06) and parts of structures (for example, bridges and bridge-sections, lock-gates, towers, lattice masts, roofs, roofing frameworks, doors and windows and their frames and thresholds for doors, shutters, balustrades, pillars and columns), of iron or steel; plates, rods, angles, shapes, sections, tubes and the like, prepared for use in structures, of iron or steel.				
7308.90	- Other				
	--- Fabricated building components for the construction or repair of silos for storing ensilage:				
7308.90.21	---- <i>Rods</i>	Free	Free	6.8%	4.5%
7308.90.29	---- <i>Other</i>	6.8%	4.5%	6.8%	4.5%
85.17	Electrical apparatus for line telephony or line telegraphy, including such apparatus for carrier-current line systems.				
	- Other apparatus:				
8517.82	-- Telegraphic				
8517.82.10	--- <i>Facsimile apparatus</i>	Free	Free	Free	Free
8517.82.20	--- Stock ticker terminals	10.2%	Free	10.2%	Free
85.25	Transmission apparatus for radio-telephony, radio-telegraphy, radio-broadcasting or television, whether or not incorporating reception apparatus or sound recording or reproducing apparatus; television cameras.				
8525.10	- Transmission apparatus				
8525.10.10	--- <i>Facsimile apparatus</i>	Free	Free	Free	Free
8525.10.90	--- <i>Other</i>	9.5%	Free	9.5%	Free
		BPT Free		BPT Free	

Tariff Item	Description of Goods	Most-Favoured-Nation Tariff	General Preferential Tariff	Rates in Effect Prior to Rates Proposed in this Motion	
				Most-Favoured-Nation Tariff	General Preferential Tariff
8525.20	-Transmission apparatus incorporating reception apparatus				
8525.20.10	---Designed for use on the amateur bands of the radio frequency as defined by regulations made pursuant to the <i>Radio Act</i> ; <i>facsimile apparatus</i>	Free	Free	Free	Free
85.27	Reception apparatus for radio-telephony, radio-telegraphy or radio-broadcasting, whether or not combined, in the same housing, with sound recording or reproducing apparatus or a clock.				
8527.90	-Other apparatus				
8527.90.10	--- <i>Facsimile apparatus</i>	Free	Free	Free	Free
8527.90.90	--- <i>Other</i>	9.5% BPT Free	Free	9.5% BPT Free	Free
85.29	Parts suitable for use solely or principally with the apparatus of heading Nos. 85.25 to 85.28.				
8529.90	-Other				
8529.90.10	---Of the goods of tariff item No. 8525.10.10, 8525.20.10, 8525.30.10, 8527.11.10, 8527.19.00, 8527.21.00, 8527.29.00, 8527.31.10, 8527.32.10, 8527.39.10, 8527.90.10 or 8528.20.10	Free	Free	Free	Free
95.03	Other toys; reduced-size ("scale") models and similar recreational models, working or not; puzzles of all kinds.				
9503.20	-Reduced-size ("scale") model assembly kits, whether or not working models, excluding those of subheading No. 9503.10				
9503.20.10	---Of self-propelled vehicles powered by combustion engines; of <i>radio-controlled self-propelled vehicles powered by electric motors</i> ; of <i>radio-controlled gliders</i> ; parts and accessories for static model assembly kits	Free	Free	12.7% Free	8% Free

SCHEDULE II

Code	Provision	Rates in Effect Prior to Rates Proposed in this Motion			
		Most-Favoured-Nation Tariff	General Preferential Tariff	Most-Favoured-Nation Tariff	General Preferential Tariff
1095	Prayer shawls of tariff item No. 6117.10.00 or of heading No. 62.14 and parts thereof (including prayer shawl fringes) of tariff item No. 6117.90.00 or 6217.90.00; prayer shawl bags of tariff item No: 6307.90.92; <i>burial shrouds of subheading No. 6307.90</i>	Free	Free	Various	Various
	The following to be employed in <i>mining</i> , recovering and producing crude oil from shales, oil-sands, or tar-sands:				
1530	<p><i>The following track-laying machines and parts thereof:</i></p> <p><i>Bridge conveyor systems of heading No. 84.28 and parts thereof of heading No. 84.31;</i></p> <p><i>Mechanical shovels, with a bucket capacity exceeding 12.3 m³, of tariff item No. 8429.52.99 and parts thereof of heading No. 84.31;</i></p> <p><i>Multi-bucket excavators (reclaimers) of heading No. 84.29 and parts thereof of heading No. 84.31;</i></p> <p><i>Ceramic parts (including wear blocks) of heading No. 69.09, for centrifuges;</i></p> <p><i>Non-electric flexible tubing of heading No. 83.07;</i></p> <p><i>Vertical slurry pumps of cantilever shaft design, having a pump discharge flange size of a diameter of 50.8 cm or more, and parts thereof, of heading No. 84.13;</i></p> <p><i>Reciprocating gas compressors and parts thereof of heading No. 84.14;</i></p> <p><i>Centrifuges, capable of separating liquids from other liquids, and parts thereof, of heading No. 84.21;</i></p> <p><i>Coke cutters, powered by an air motor, and parts thereof, of heading No. 84.24;</i></p> <p><i>Hydraulic "walking legs" and parts thereof of heading No. 84.79, for conveyor head stations;</i></p> <p><i>Hydraulically-operated slide gate valves and parts thereof of heading No. 84.81, for cokers;</i></p> <p><i>Rail-mounted, self-propelled cable reel cars and parts thereof of Section XVI or XVII;</i></p> <p><i>Oil film content monitors and parts thereof of Chapter 90</i></p>	Free	Free	Various	Various

Code	Provision	Most-Favoured-Nation Tariff	General Prefer-ential Tariff	Rates in Effect Prior to Rates Proposed in this Motion	
				Most-Favoured-Nation Tariff	General Prefer-ential Tariff
2410	Compression-ignition internal combustion piston engines (diesel or semi-diesel engines) of tariff item No. 8408.90.90 and parts thereof of tariff item No. 8409.99.93 for use in self-propelled <i>track-laying</i> bulldozers, front-end shovel loaders or pipelayers.....	Free	Free	Free 9.2%	Free Free (on and after July 1, 1988)
2543	<i>Prepared unrecorded magnetic tapes of heading No. 85.23 for producing master tapes used in the production of cassettes for the blind</i>	Free	Free	6.9%	4.5%
2645	<i>Electric motors of tariff item No. 8501.10.00 or subheading No. 8501.31 of a kind used with self-propelled vehicle assembly kits of tariff item No. 9503.20.10</i>	Free	Free	9.3%	6%