Explanatory Notes Relating to the Income Tax Act, Excise Tax Act, Excise Act, 2001 and Related Texts

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Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*¸ *Excise Tax Act*, *Excise Act, 2001*, and related texts. These explanatory notes describe these proposed amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

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

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Part 1 – Amendments to the Income Tax Act and to Related Legislation

Amendments to the Income Tax Act

Clause 2

Derivatives

ITA
10(15)

Section 10 of the *Income Tax Act* (the “Act”) sets out rules for the valuation of property held as inventory for the purposes of computing a taxpayer’s income or loss from a business.

New subsection 10(15) provides that property that is a financial derivative instrument is deemed not to be inventory of a taxpayer for the purposes of section 10.

New subsection 10(15) is intended to ensure that financial derivative instruments are valued in accordance with the general principles of profit computation under section 9 rather than by using one of the valuation methods described in subsection 10(1).

This amendment applies to agreements entered into on or after March 22, 2016.

Clause 3

Depreciable property

ITA
13

Section 13 of the Act provides rules relating to depreciable property. As a result of the repeal of the eligible capital property rules in section 14 of the Act and the creation of new Class 14.1 of depreciable property under section 1100 of the *Income Tax Regulations* (the “Regulations”), property that was previously eligible capital property will be depreciable property in new Class 14.1 and the rules in section 13 will apply to this property after 2016. As with the eligible capital property rules, there will be a separate expenditure pool in respect of each business of a taxpayer. Each cumulative eligible capital pool of a taxpayer will be replaced by a new undepreciated capital cost pool.

The eligible capital property (ECP) rules in section 14 of the Act govern the tax treatment of certain expenditures (outlays and expenses described in the definition “eligible capital expenditure” in subsection 14(5)) and receipts (amounts described by E in the definition “cumulative eligible capital” in subsection 14(5)) that are not otherwise accounted for as business revenues or expenses, or under the rules relating to capital property.

The ECP rules are repealed and replaced by new Class 14.1 of Schedule II to the Regulations, effective on January 1, 2017. Property that was ECP will be depreciable property and expenditures and receipts that were accounted for under the ECP rules will be accounted for under the rules for depreciable capital property.

Depreciation

New Class 14.1 generally includes goodwill, property that was ECP before 2017 and property acquired on or after January 1, 2017, the cost of which would be treated as an eligible capital expenditure under the ECP rules. The full cost of property of the new class acquired on or after January 1, 2017 is added to the undepreciated capital cost (UCC) of the class, instead of only 75% of the cost being added to cumulative eligible capital (CEC) under the ECP rules.

To account for the increase in the portion of the cost of property that is allowed to be depreciated from 75% to 100%, new subparagraph 1100(1)(a)(xii.1) of the Regulations provides that capital cost allowance in respect of the new class may be taken at a 5% rate on a declining balance basis under paragraph 20(1)(a) of the Act, instead of 7% on a declining balance basis under former paragraph 20(1)(b).

Subsection 1101(1) of the Regulations provides for a separate class in respect of each business of a taxpayer. This is consistent with the ECP rules, which provided for a separate CEC pool in respect of each business of a taxpayer. As a result, there is a separate new Class 14.1 in respect of each CEC pool of a taxpayer.

Recapture

Amounts deducted in respect of property of the new class under paragraph 20(1)(a) are subject to recapture under subsection 13(1) of the Act. The reduction in the UCC of the class from the disposition of property is generally equal to the lesser of the proceeds of disposition of the property and the capital cost of the property. The amount of any negative UCC balance is included in income under subsection 13(1) as recapture.

Taxation of gains

Gains from the disposition of property of the new class are taxable under subdivision c of Division B of Part I of the Act. When a capital property is disposed of, the amount by which the proceeds of disposition exceed the cost of the property generally results in a capital gain, 50% of which is included in income as a taxable capital gain.

Expenditures and receipts not related to property

The definition “property” in subsection 248(1) of the Act is broad and includes, for example, a right of any kind whatever. As a result, most, but not all, expenditures and receipts that would be eligible capital expenditures or eligible capital receipts under the ECP rules relate to the acquisition or disposition of a property and, consequently, such amounts result in an adjustment to the UCC of the new CCA class when the property is acquired or disposed of.

New subsections 13(34) to (37) of the Act provide special rules for expenditures and receipts of a business that do not relate to property and that would adjust the CEC of the business under the ECP rules. Such an expenditure or receipt is accounted for by adjusting the capital cost of the goodwill of the business. Subsection 13(34) provides that every business is considered to have goodwill property associated with it, even if there has not been an expenditure to acquire goodwill. Subsections 13(34) and (35) provide that an expenditure that does not relate to property increases the capital cost of the goodwill of a business and, consequently, the UCC of the new CCA class.

Subsections 13(34) and (37) provide that a receipt that does not relate to property reduces the capital cost of the goodwill of a business and, consequently, the UCC of the new CCA class, by the lesser of the capital cost of the goodwill (which could be nil) and the amount of the receipt. If the amount of the receipt exceeds the capital cost of the goodwill, the excess results in a capital gain. Previously deducted depreciation is recaptured to the extent that the reduction to the capital cost of goodwill results in a negative UCC balance.

Transitional rules – additional depreciation

New subparagraph 1100(1)(c.1)(i) of the Regulations provides that, for taxation years that end before 2027, the depreciation rate for the new CCA class is 7 per cent in respect of expenditures incurred before January 1, 2017 instead of the 5 per cent rate provided by new subparagraph 1100(1)(a)(xii.1).

Transitional rules – undepreciated capital cost balance

New paragraphs 13(38)(a) to (d) generally provide that the UCC of the new class in respect of a business at the beginning of January 1, 2017 is equal to the amount that would have been the CEC balance in respect of the business at the beginning of January 1, 2017.

- First, paragraph 13(38)(a) deems the total capital cost of all property in Class 14.1 at the beginning of that day to be, generally, 4/3 of the total of the amount that would have been the CEC balance at the beginning of that day and past depreciation claimed under paragraph 20(1)(b) that has not been recaptured before that day.
- Second, paragraph 13(38)(b) provides rules for allocating that total capital cost as between goodwill property and each identifiable property in the new class that was an eligible capital property.
- Third, paragraph 13(38)(c) deems an amount to have been allowed as capital cost allowance under paragraph 20(1)(a) before January 1, 2017, such that the UCC balance at the beginning of January 1, 2017 is equal to the amount that would have been the CEC balance at the beginning of January 1, 2017.

The determination of the total capital cost and the allocation of the capital cost of each property that was an eligible capital property before January 1, 2017 is relevant to the calculation of recaptured capital cost allowance and any capital gains in respect of the disposition of such a property on or after January 1, 2017. It is not necessary to determine the total capital cost, or to allocate a capital cost to each property, to determine the amount that may be deducted under 20(1)(a) in respect of the new class.

Transitional rules – deemed gain immediately before January 1, 2017

Paragraph 13(38)(d) provides rules for including an amount in a taxpayer's income in a taxation year that straddles January 1, 2017. The amount of the income inclusion, if any, is relevant to the calculation of the final CEC balance for the purpose of determining the total capital cost of the class under paragraph 13(38)(a). An income inclusion may be required, for instance, if a taxpayer receives proceeds in that taxation year and prior to January 1, 2017, such that there would have been an income inclusion under paragraph 14(1)(b) if the taxation year had instead ended immediately before January 1, 2017. A taxpayer may choose to have the income inclusion reported as business income or as a taxable capital gain.

An election to defer this income inclusion is available in a manner that is conceptually similar to the manner in which income inclusions could be deferred under the ECP rules. Where, on or after January 1, 2017 and in that taxation year, a taxpayer acquires a property of the new class or is deemed by subsection 13(35) to have acquired goodwill, the taxpayer may elect to reduce the income inclusion under paragraph 13(38)(d), by up to half of the capital cost of the new property. In this case, the capital cost of the new property is then reduced by twice the amount by which the income inclusion is reduced.

Transitional rules – Dispositions of former ECP

New subsection 13(39) is intended to ensure that receipts related to expenditures incurred before January 1, 2017 do not result in excess recapture when applied to reduce the balance of the new CCA class. Subsection 13(39) provides, in effect, that certain qualifying receipts reduce the UCC of the new CCA class at a 75% rate (the rate at which eligible capital expenditures were added to CEC). Receipts that qualify for the 75% rate are generally receipts from the disposition of a property that was an ECP and receipts that do not represent the proceeds of disposition of property. This is achieved by increasing the UCC of the new class by, generally, 25% of the lesser of the proceeds of disposition and the cost of the property disposed of.

Transitional rules – Non-arm's length dispositions of former ECP

Although subsection 13(39) increases the UCC balance of the new class for, generally, 25% of the proceeds of disposition of property that was ECP before January 1, 2017, new subsection 13(40) is intended to prevent the use of non-arm's length transfers to increase the amount that can be depreciated in respect of the new class. Subsection 13(40) generally provides that where a taxpayer acquires a property of the new class, in effect only 3/4 of the capital cost of the property is included in the UCC in respect of the class if

- the property or a similar property was previously an eligible capital property of the taxpayer or a person or partnership not dealing at arm's length with the taxpayer; and
- subsection 13(39) applied to increase the UCC in respect of an earlier disposition of the property or similar property by the taxpayer or the non-arm's length person or partnership.

This effect is achieved by deeming the taxpayer to have claimed CCA in respect of the new class equal to the lesser of 1/4 of the cost of the property acquired and the amount that was deemed by subsection 13(39) to have been added to the UCC of the new class of the taxpayer or another person or partnership.

Replacement property

ITA
13(4.3)(d)

Subsection 13(4) of the Act allows a taxpayer, who is required under subsection 13(1) to include in income recaptured depreciation resulting from the disposition of certain depreciable property (a "former property"), to elect to defer tax on the recapture to the extent that the taxpayer reinvests the proceeds of disposition in a replacement property within a certain period of time. Subsection 13(4.3) provides rules that apply when a joint election has been made under

subsection 13(4.2) in respect of a property that is a franchise, concession or license for a limited period that is wholly attributable to the carrying on of a business at a fixed place.

There may be circumstances where, but for an election under subsection 13(4.2), a portion of the consideration given by a transferee upon the sale of a limited period franchise, license or concession might reasonably be considered to be an eligible capital amount to the transferor and an eligible capital expenditure to the transferee. For instance, a portion of the consideration may reasonably relate to the preferred status that the transferee may receive in obtaining a new property at the end of the term. Where an election under subsection 13(4.2) is made, subsection 13(4.3) provides that such an amount will be neither an eligible capital amount to the transferor, nor an eligible capital expenditure to the transferee, but will instead be included in the cost to the transferee and proceeds of disposition of the transferor of the former property.

Subsection 13(4.3) is amended, consequential on the repeal of the eligible capital property rules, to remove references to “eligible capital expenditure” and “eligible capital amount”. It is also amended to provide that any amount that would, if the Act were read without reference to subsection 13(4.3), be included in the cost of a property of the transferor included in Class 14.1 of Schedule II to the Regulations (including a deemed acquisition under subsection 13(35)) or included in the proceeds of disposition of a property of the transferee included in Class 14.1 (including a deemed disposition under subsection 13(37)) in respect of the disposition or termination of the former property by the transferor is deemed to be neither included in the cost nor the proceeds of disposition of property included in Class 14.1.

This amendment applies in respect of dispositions and terminations that occur after 2016.

Deemed capital cost

ITA
13(7.41)

Subsection 14(10) of the Act provides that the repayment of government assistance increases the eligible capital expenditure of a taxpayer if the repayment is made before the taxpayer has ceased to carry on business. New subsection 13(7.41) provides that, if a taxpayer has repaid government assistance that has been deducted from the taxpayer’s eligible capital expenditures because of paragraph 14(10)(c) and the taxpayer has not ceased to carry on business, the amount of the repayment is considered to have been repaid immediately before January 1, 2017 for the purposes of new subsection 13(38).

This amendment comes into force on January 1, 2017.

Timing of deductions

ITA
13(7.42)

New subsection 13(7.42) of the Act provides that amounts may be deducted under paragraph 20(1)(a) in respect of an amount of repaid assistance referred to in new subsection 13(7.41) starting in the year in which the assistance is repaid.

This amendment comes into force on January 1, 2017.

Goodwill

ITA
13(34)

Subsection 13(34) of the Act ensures that the determination of whether a property is depreciable property is made before determining whether the cost of the property is eligible for deduction under sections 66 to 66.4, applicable to taxation years that end after 1987 and before December 6, 1996. Paragraph 1102(1)(a) of the Regulations provides the same result for taxation years that end after December 5, 1996.

Subsection 13(34) is replaced as of January 1, 2017.

Consequential on the repeal of the ECP rules and the creation of new Class 14.1 of depreciable property, new subsection 13(34) provides rules for determining the cost of goodwill acquired and disposed of. It is necessary to determine the cost of the goodwill of a business in order to calculate capital gains, the undepreciated capital cost balance of the new class, and the recapture of depreciation previously claimed.

Subsection 13(34) is intended to recognize that goodwill is not a separately identifiable property and can only be disposed of as part of the sale of a business as a going concern. The definition "property" in subsection 248(1) is concurrently amended to provide that the goodwill of a business is property for the purposes of the Act. Goodwill is also included in new Class 14.1 of Schedule II to the Regulations.

The combined effect of subsections 13(34) to (37) and the existing rules relating to depreciable property includes the following:

- Each identifiable property included in the new class has the cost that is identifiable (as applies to other depreciable property).
- Capital expenditures that do not relate to an identifiable property (or that are to acquire goodwill) are pooled into the cost of a single goodwill property of the business.
- If a taxpayer receives a capital receipt that does not relate to an identifiable property:
    - the receipt is deemed to be the proceeds of disposition of a portion of the goodwill property of the business;
    - the cost of the property disposed of is the cost in the pool (not exceeding the amount of the proceeds); and
    - where the taxpayer continues to carry on the remaining business, the taxpayer is deemed to still have a goodwill property in respect of the business, but the new cost of that property (if any) is the old cost less the proceeds just received.

In particular, paragraph 13(34)(a) deems there to be a single goodwill property in respect of a particular business.

Paragraph 13(34)(b) provides that if a taxpayer who carries on a particular business acquires goodwill as part of the acquisition of another business that is carried on, after the acquisition, as part of the particular business (or if the taxpayer is deemed by new subsection 13(35) to acquire goodwill in respect of the particular business), the cost of the goodwill acquired is added to the

cost of the goodwill in respect of the particular business. That is, a taxpayer is considered to own a single goodwill property in respect of a business, and if goodwill is acquired as a result of a business acquisition (such that the second business becomes part of the first), the taxpayer still has only one goodwill property in respect of the continuing business.

Paragraph 13(34)(c) provides that if a taxpayer who carries on a particular business

- is deemed by subsection 13(37) to dispose of goodwill in respect of the particular business; or
- disposes of goodwill as part of the sale of a portion of the particular business, receives proceeds of disposition a portion of which is attributable to goodwill, and continues to carry on the remaining business,

then:

- the taxpayer is deemed to have disposed of a portion of the goodwill in respect of the particular business having a cost equal to the lesser of the cost of the single goodwill property in respect of the particular business and the proceeds attributable to goodwill; and
- the cost of the goodwill property in respect of the particular business is reduced by the amount determined to be the cost of the portion of the goodwill disposed of.

This recognizes that a taxpayer may sell a portion of a business and receive proceeds in respect of goodwill. However, if the remaining business continues, the taxpayer still has a goodwill property in respect of that business.

If a taxpayer makes more than one disposition of goodwill at the same time, paragraph 13(34)(d) provides that paragraph 13(34)(c) and subsection 13(39) apply as if each disposition had occurred separately. Subsection 13(39) provides a transitional rule that may apply to increase a taxpayer's undepreciated capital cost when the taxpayer disposes of certain property included in new Class 14.1.

Example

A taxpayer acquires a business and as part of the acquisition, the taxpayer acquires goodwill at a cost of $100. The $100 is added to the undepreciated capital cost of new Class 14.1 in respect of the business.

After a few years, the taxpayer decides to expand his business by acquiring a new business. The new business is not carried on as separate business but is combined with the existing business. As part of the acquisition of the new business, the taxpayer acquires goodwill at a cost of $200. Paragraph 13(34)(a) deems the taxpayer to have a single goodwill property in respect of the business and paragraph 13(34)(b) provides that the cost of that single goodwill property is $300 (i.e., $100+$200). As well, $200 is added to the undepreciated capital cost of new Class 14.1 in respect of the business, resulting in an undepreciated capital cost of $300 (assuming no deductions have been taken under paragraph 20(1)(a)).

After a few more years, the taxpayer decides to sell a portion of the business.

Scenario 1

As part of the sale, the taxpayer receives proceeds from the sale of goodwill of $50. Paragraph 13(34)(c) provides that the cost of the goodwill disposed of is $50, which is the lesser of the cost of the single goodwill property in respect of the business ($300) and the proceeds from the disposition of the goodwill disposed of ($50). This results in a $50 reduction in the undepreciated capital cost balance, resulting in an undepreciated capital cost of $250 (assuming no deductions have been taken under paragraph 20(1)(a)). As well, the cost of the goodwill of the remaining business is reduced by $50, resulting in a cost of $250 (i.e., $300-$50).

Scenario 2

The taxpayer instead receives proceeds from the sale of goodwill of $500. Paragraph 13(34)(c) provides that the cost of the goodwill disposed of is $300 (the lesser of the cost of the single goodwill property ($300) and the proceeds of the goodwill disposed of ($500)). This results in a $300 reduction of the undepreciated capital cost balance (to nil) and a $200 capital gain. As well, the cost of the single goodwill property of the remaining business is reduced by $300, to nil.

Scenario 3

The taxpayer disposes of two portions of the business at the same time, and receives proceeds of $500 from two dispositions of goodwill (one for proceeds of $50 and one for proceeds of $450). Paragraph 13(34)(d) allows the taxpayer to designate the order in which the goodwill is disposed of for the purposes of paragraph 13(34)(c). If the taxpayer designates the $50 goodwill to have been disposed of first, there is

(i) a $50 reduction of the undepreciated capital cost balance from that disposition (and the remaining goodwill now has a cost of $250); and

(ii) an additional $250 reduction of the undepreciated capital cost balance from the other disposition. On this second disposition there is also a $200 capital gain, being the difference between the $450 proceeds and the $250 cost of the remaining goodwill property.

A similar result would occur if the taxpayer designated the $450 portion to have been disposed of first, except that there would be two capital gains: $150 for the first, and $50 for the second.

In either case, if the taxpayer continues to carry on the remaining business, the new cost of the goodwill property in respect of the remaining business would be nil.

Outlays not relating to property

ITA
13(35)

New subsection 13(35) of the Act deems a taxpayer to have acquired goodwill in respect of a business with a cost equal to the amount of certain capital expenditures incurred in respect of the business. The language in subsection 13(35) is based in principle on the definition “eligible capital expenditure” in former subsection 14(5). A main difference is that subsection 13(35) does not apply to expenditures to acquire property.

Property (for example, customer lists and licences, franchise rights and farm quotas of indefinite duration), the cost of which would previously have been treated as an eligible capital

expenditure, is generally included in new Class 14.1 in Annex II to the Regulations. Goodwill that is acquired, i.e. when a business is acquired, is a property that is included in new Class 14.1. This is distinguishable from the deemed acquisition of goodwill under subsection 13(35), which relates to capital expenditures that are not incurred to acquire an identifiable property. However, the cost of goodwill deemed acquired under subsection 13(35) is added to the cost of the single goodwill property of the business as a result of new subsection 13(34), and to the undepreciated capital cost of the class in respect of the business as a result of variable A of the definition "undepreciated capital cost" in subsection 13(21).

Subject to paragraphs 13(35)(a) to (e), subsection 13(35) provides that if a taxpayer makes or incurs an outlay or expense, at any time on or after January 1, 2017, on account of capital for the purpose of gaining or producing income from a business carried on by the taxpayer, the taxpayer is deemed to acquire property at that time that is goodwill in respect of the business with a cost equal to the amount of the outlay or expense. (As with eligible capital expenditures, subsection 13(35) does not apply to an outlay or expense that is made for the purpose of gaining or producing income from property.)

Paragraphs 13(35)(a) to (e) provide conditions that must be met in order for subsection 13(35) to apply to an outlay or expense.

Paragraph 13(35)(a) provides that subsection 13(35) does not apply to an outlay or expense if any portion of the amount is the cost, or any part of the cost of property. In order for the cost of property to be added to the undepreciated capital cost of the new class, the property must be prescribed in Class 14.1.

Paragraph 13(35)(b) provides that subsection 13(35) does not apply to an outlay or expense if any portion of the amount would be deductible in computing the taxpayer's income from the business if subsection 13(35) did not apply.

Paragraph 13(35)(c) provides that subsection 13(35) does not apply to an outlay or expense if any portion of the amount is not deductible in computing the taxpayer's income from the business because of any provision of the Act (other than paragraph 18(1)(b)) or the Regulations. An outlay or expense that is made or incurred for the purpose of gaining or producing exempt income, for example, does not meet the condition in paragraph 13(35)(b) since the deduction of such an outlay or expense is specifically not deductible because of paragraph 18(1)(c).

Paragraph 13(35)(d) provides that subsection 13(35) does not apply to an outlay or expense if any portion of the amount is paid or payable to a creditor of the taxpayer as, on account of or in lieu of payment of, any debt, or on account of the redemption, cancellation or purchase of any bond or debenture.

Paragraph 13(35)(e) provides that subsection 13(35) does not apply to an outlay or expense if any portion of the amount is, where the taxpayer is a corporation, partnership or trust, paid or payable to a person as a shareholder, partner or beneficiary, as the case may be, of the taxpayer.

Subsection 13(35) comes into force on January 1, 2017.

No addition to goodwill

ITA
13(36)

Paragraph 88(1)(c) of the Act provides that the cost to a parent corporation of each capital property distributed to it on the winding-up of its subsidiary is equal to the subsidiary's proceeds of disposition of the property plus, where the capital property is not an “ineligible property”, an amount determined under paragraph 88(1)(d) in respect of the property (referred to as the “bump”). An ineligible property includes depreciable property.

New subsection 13(36) is introduced in order to clarify that in share purchase transactions, the amount of consideration for the shares cannot be allocated to goodwill, even if the purchased shares no longer exist at the time the payment is made. New subsection 13(36) provides that no amounts paid or payable may be included in new Class 14.1 if the amount is

- in consideration for the purchase of shares, or
- in consideration for the cancellation of an obligation for payment for the purchase of shares.

This amendment comes into force on January 1, 2017.

Receipts not relating to property

ITA
13(37)

Subsection 13(37) of the Act deems a taxpayer to dispose of goodwill for proceeds equal to the amount of certain capital amounts received in respect of a business. The language in subsection 13(37) is based in principle on variable E of the definition “cumulative eligible capital” in former subsection 14(5). A main difference is that subsection 13(37) does not generally apply to proceeds from the disposition of property.

Subsection 13(37) does not apply to proceeds of disposition of property that is goodwill from the sale of a business as a going concern. Goodwill is deemed to be property under amended subsection 248(1). Proceeds from goodwill are subject to rules that apply generally to the disposition of depreciable property.

Goodwill is included in new Class 14.1 of Schedule II to the Regulations. The deemed disposition of goodwill under subsection 13(37) can result in a decrease in the undepreciated capital cost of the class in respect of the business as a result of new subsection 13(34) and variable F of the definition “undepreciated capital cost” in subsection 13(21).

Subject to paragraphs 13(37)(a) to (c), subsection 13(37) provides that if a taxpayer has or may become entitled to receive an amount on account of capital in respect of a business carried on or formerly carried on by the taxpayer (a “receipt”), the taxpayer is deemed to dispose of goodwill of the business for proceeds of disposition equal to the amount by which the amount the taxpayer has or may become entitled to receive exceeds all outlays or expenses that were not otherwise deductible in computing the taxpayer’s income and were made or incurred by the taxpayer for the purpose of obtaining the amount.

Paragraphs 13(37)(a) to (c) provide conditions that must be met in order for subsection 13(37) to apply to a receipt.

Paragraph 13(37)(a) provides that subsection 13(37) does not apply to a receipt that is included in computing the taxpayer's income, or deducted in computing any balance of undeducted outlays, expenses or other amounts for the year or a preceding taxation year.

Paragraph 13(37)(b) provides that subsection 13(37) does not apply to a receipt that reduces the cost or capital cost of a property or the amount of an outlay or expense.

Paragraph 13(37)(c) provides that subsection 13(37) does not apply to a receipt that is included in computing any gain or loss of the taxpayer from a disposition of a capital property.

Subsection 13(37) comes into force on January 1, 2017.

Class 14.1 – transitional rules

ITA
13(38) to (41)

Overview

Subsections 13(38) to (41) of the Act provide transitional rules that apply consequential on the repeal of the ECP rules and the creation of new Class 14.1 of depreciable property.

Subsection 13(38) provides rules where a taxpayer incurs an eligible capital expenditure in respect of a business before January 1, 2017. Subsection 13(38) effectively transfers a taxpayer's existing cumulative eligible capital balance in respect of a business to the undepreciated capital cost balance of the new class in respect of the business.

Paragraphs 13(38)(a) to (c) generally provide that the undepreciated capital cost of the new class in respect of a business at the beginning of January 1, 2017 is equal to the amount that would have been the cumulative eligible capital (CEC) balance in respect of the business at the beginning of January 1, 2017.

- First, paragraph 13(38)(a) deems the total capital cost of all property in Class 14.1 at the beginning of that day to be, generally, the total of 4/3 of the amount that would have been the CEC balance at the beginning of that day and 4/3 of the amount of past depreciation claimed under paragraph 20(1)(b) that has not been recaptured before that day.
- Second, paragraph 13(38)(b) provides rules for allocating that total capital cost as between goodwill property and each identifiable property in the new class that was an eligible capital property.
- Third, paragraph 13(38)(c) deems an amount to have been allowed as capital cost allowance under paragraph 20(1)(a) before January 1, 2017, such that the UCC balance at the beginning of January 1, 2017 is equal to the amount that would have been the CEC balance at the beginning of January 1, 2017.

For taxpayers with a taxation year that straddles January 1, 2017 (i.e., no taxation year ends immediately before January 1, 2017), paragraph 13(38)(d) also provides for an income inclusion where there would be an income inclusion under 14(1)(b) if the taxation year had ended

immediately before January 1, 2017. This income inclusion can be deferred or offset in certain circumstances.

Subsection 13(39) provides that, where certain property that was eligible capital property before January 1, 2017 is disposed of on or after January 1, 2017, the undepreciated capital cost of the new class is increased to prevent excess recapture as a result of the effective transfer of the CEC pools under subsection 13(38).

Subsection 13(40) prevents the use of subsection 13(39) to "step-up" the undepreciated capital cost of the new class by means of a non-arm's length transfer of property that was eligible capital property before January 1, 2017. Subsection 13(40) provides that where such a property is acquired by a taxpayer from a person that does not deal at arm's length with the taxpayer, the undepreciated capital cost of the new class is decreased. Generally, subsection 13(40) applies to acquisitions of property, the cost of which is attributable to an amount in respect of which subsection 13(39) applied.

Subsection 13(41) provides that, for the purposes of subsections 13(38) to (40) and 40(13) to (16), the definitions "cumulative eligible capital", "eligible capital expenditure", "eligible capital property" and "exempt gains balance" have the same meanings that would be assigned to those expressions if the Act read as it did immediately before January 1, 2017.

ITA
13(38)(a)

Paragraph 13(38)(a) of the Act provides the total capital cost (at the beginning of January 1, 2017) of all property of a taxpayer included in Class 14.1 of Schedule II to the Regulations in respect of the business, each of which was an eligible capital property of the taxpayer immediately before January 1, 2017 or is the goodwill property in respect of the business.

The total capital cost is important for determining the amount of gains or recapture but is not required to be calculated in order to determine the amount that may be deducted under 20(1)(a) since the undepreciated capital cost on January 1, 2017 will equal the amount that would be the cumulative eligible capital on January 1, 2017.

At the beginning of January 1, 2017, the total capital cost is deemed to be equal to the formula $4/3(A + B - C)$. The formula is generally equal to the amount of receipts a taxpayer could have received under the ECP rules without resulting in an income inclusion under paragraph 14(1)(b).

Variable A is equal to the positive balance, if any, of the taxpayer's cumulative eligible capital in respect of the business at the beginning of January 1, 2017. The positive balance of a taxpayer's undepreciated capital cost on January 1, 2017 is equal to the positive balance of the taxpayer's cumulative eligible capital on January 1, 2017.

Variable B is equal to the amount determined for F in the definition "cumulative eligible capital" in former subsection 14(5) at the beginning of January 1, 2017. This amount is generally equal to the amount of deductions taken from the cumulative eligible capital pool that have not been recaptured.

Variable C is equal to the negative balance, if any, of the taxpayer's cumulative eligible capital in respect of the business at the beginning of January 1, 2017. The negative balance of a

taxpayer's cumulative eligible capital is equal to the amount by which the total of all amounts determined, in respect of the business, for variables E or F in the definition "cumulative eligible capital" in former subsection 14(5), exceeds the total of all amounts determined for variables A to D.1 in that definition in respect of the business at the beginning of January 1, 2017. This amount includes any adjustment required by subparagraph 13(38)(d)(i) as a result of a deemed gain or income inclusion under paragraph 13(38)(d). Variable C will generally only be positive if a taxation year of the taxpayer straddles January 1, 2017 (i.e., no taxation year ends immediately before January 1, 2017) and the taxpayer receives an eligible capital amount in the taxation year and before January 1, 2017. A negative cumulative eligible capital balance will become the negative undepreciated capital cost balance on January 1, 2017, the amount of which generally result in recapture under subsection 13(1) at the end of the taxation year unless amounts are added to the undepreciated capital cost of the class before the end of the year (e.g., the taxpayer acquires a property of the new class).

This amendment comes into force on January 1, 2017.

ITA
13(38)(b)

Paragraph 13(38)(b) of the Act deems the capital cost of each property of the taxpayer that is included in the new class and that is goodwill in respect of the business or was an eligible capital property of the taxpayer immediately before January 1, 2017. The capital cost of these properties is relevant to the calculation of the recapture of depreciation and capital gain upon the disposition of property of the new class but is not required to be determined in order to calculate the amount that can be deducted under paragraph 20(1)(a) in respect of the class.

Subparagraph 13(38)(b)(i) provides that the taxpayer must designate the order in which the capital cost of each property that is not the goodwill property is determined, and that if the taxpayer does not designate an order, the Minister may designate the order.

Subparagraph 13(38)(b)(ii) provides that the capital cost of a particular property in respect of a business (other than goodwill) is deemed to be the lesser of the eligible capital expenditure of the taxpayer in respect of the particular property and the amount by which the total capital cost of the class, as determined by paragraph 13(38)(a), exceeds the total of all amounts each of which is an amount deemed by subparagraph 13(38)(b)(ii) to be the capital cost of a property that is determined in advance of the determination of the capital cost of the particular property. This allows taxpayers to assign available capital cost to each property in the order designated under subparagraph 13(38)(b)(i).

Subparagraph 13(38)(b)(iii) deems the capital cost of the goodwill property in respect of the business to be the amount by which the total capital cost of the class exceeds the total of all amounts each of which is an amount deemed by subparagraph 13(38)(b)(ii) to be the capital cost of a property. The capital cost of each property of the class (other than goodwill) in respect of the business must be determined under subparagraph 13(38)(b)(ii) before the capital cost of the goodwill property can be determined.

Although the determination of the total capital cost of the class under paragraph 13(38)(a) and the capital cost of a particular property under paragraph 13(38)(b) applies as of January 1, 2017,

these determinations are generally not required to be calculated until property of the class is disposed of, because the total capital cost and individual capital costs are not required to be known in order to calculate the undepreciated capital cost of the new class (and likewise the amount that is allowed to be deducted under paragraph 20(1)(a)). This is because paragraph 13(38)(c) ensures that the undepreciated capital cost of the new class at the beginning of January 1, 2017 is equal to the amount that would be the cumulative eligible capital balance in respect of the business at the beginning of January 1, 2017.

This amendment comes into force on January 1, 2017.

Example 1 – Deemed Capital Cost

<u>Before January 1, 2017</u>

In a taxation year ending before January 1, 2017, a taxpayer incurred an eligible capital expenditure of $100, resulting in a cumulative eligible capital balance of $75 (i.e., 3/4 x $100), to acquire a government licence of unlimited duration. In taxation years ending before January 1, 2017, the taxpayer deducted a total of $35 from cumulative eligible capital under paragraph 20(1)(b), resulting in a cumulative eligible capital balance of $40.

<u>On January 1, 2017</u>

The government licence and goodwill are property included in new Class 14.1 of Schedule II to the Regulations.

Paragraph 13(38)(a) provides that the total capital cost of property of the new class at the beginning of January 1, 2017 that is goodwill or that was eligible capital property before January 1, 2017 is 4/3 of the amount that would be the cumulative eligible capital at the beginning of January 1, 2017; plus 4/3 of the amount of deductions taken that have not been recaptured; less 4/3 of any negative cumulative eligible capital balance at the beginning of January 1, 2017. The total capital cost of the class is equal to $100 (i.e., 4/3($40+$35-$0)). Subparagraph 13(38)(b)(ii) deems the capital cost of the government licence to be $100 and subparagraph 13(38)(b)(iii) deems the capital cost of the goodwill of the business to be nil.

Example 2 – Deemed Capital Cost

<u>Before January 1, 2017</u>

In a taxation year ending before January 1, 2017, a taxpayer incurred an eligible capital expenditure of $100 to acquire a government licence of unlimited duration, an eligible capital expenditure of $150 to acquire a customer list and an eligible capital expenditure of $50 for incorporation expenses, resulting in a cumulative eligible capital balance of $225 (i.e., 3/4 x ($100+$150+$50)). In taxation years ending before January 1, 2017, the taxpayer deducted a total of $45 from cumulative eligible capital under paragraph 20(1)(b), resulting in a cumulative eligible capital balance of $180 (i.e., $225 – $45). Also in a taxation year ending before January 1, 2017, the taxpayer disposed of the customer list for $112, resulting in a cumulative eligible capital balance of $96 (i.e., $180 – 3/4($112)).

<u>On January 1, 2017</u>

The government licence and goodwill would be property included in new Class 14.1 of Schedule II to the Regulations. The customer list and the incorporation expenses would not be property of the new class: the customer list was disposed of before January 1, 2017 and the incorporation expenses were not the cost of an acquisition of property.

Paragraph 13(38)(a) provides that the total capital cost of property of the new class at the beginning of January 1, 2017 that is goodwill property or that was eligible capital property before January 1, 2017 is 4/3 of the amount that would be the cumulative eligible capital at the beginning of January 1, 2017; plus 4/3 of the amount of deductions taken that have not been recaptured; less 4/3 of any negative cumulative eligible capital balance at the beginning of January 1, 2017. The total capital cost equals $188 (i.e., 4/3($96+$45-$0)). Subparagraph 13(38)(b)(ii) deems the capital cost of the government licence to be $100 (i.e., the lesser of the total capital cost and the eligible capital expenditure to acquire the licence) and subparagraph 13(38)(b)(iii) deems the capital cost of the goodwill of the business to be $88 (i.e., $188-$100).

ITA
13(38)(c)

Paragraph 13(38)(c) of the Act ensures that the undepreciated capital cost of the new class in respect of a business at the beginning of January 1, 2017 is equal to the amount that would otherwise be the cumulative eligible capital in respect of the business at the beginning of January 1, 2017. Paragraph 13(38)(c) also ensures that any negative cumulative eligible capital balance is reflected in the calculation of the undepreciated capital cost of the new class.

Paragraph 13(38)(c) deems an amount to have been allowed to the taxpayer in respect of the class under regulations made under paragraph 20(1)(a) in computing the taxpayer's income for taxation years ending before January 1, 2017, equal to the amount by which the total capital cost of the class (determined by the formula in paragraph 13(38)(a)) and the amount of any negative cumulative eligible capital balance (determined by variable C of the formula in paragraph 13(38)(a)) exceeds the positive cumulative eligible capital balance (determined by variable A of the formula in paragraph 13(38)(a)).

This amendment comes into force on January 1, 2017.

Example 3 – Undepreciated Capital Cost Balance

<u>Before January 1, 2017</u>

In a taxation year ending before January 1, 2017, a taxpayer incurred an eligible capital expenditure of $100, resulting in a cumulative eligible capital balance of $75 (i.e., 3/4 x $100) to acquire a government licence of unlimited duration. In taxation years ending before January 1, 2017, the taxpayer deducted a total of $35 from cumulative eligible capital under paragraph 20(1)(b), resulting in a cumulative eligible capital balance of $40.

<u>On January 1, 2017</u>

The government licence and goodwill are property included in new Class 14.1 of Schedule II to the Regulations.

Paragraph 13(38)(a) provides that the total capital cost of property of the new class at the beginning of January 1, 2017 that is goodwill or that was eligible capital property before January 1, 2017 is 4/3 of the amount that would be the cumulative eligible capital at the beginning of January 1, 2017; plus 4/3 of the amount of deductions taken that have not been recaptured; less 4/3 of any negative cumulative eligible capital balance at the beginning of January 1, 2017. The total capital cost would equal $100 (i.e., 4/3($40+$35-$0)). As a result, the amount described by A in the definition "undepreciated capital cost" in subsection 13(21) would be $100.

Paragraph 13(38)(c) would deem an amount to have been allowed to the taxpayer under paragraph 20(1)(a) for taxation years ending before January 1, 2017, equal to the amount by which total capital cost and any negative cumulative eligible capital balance exceed any positive cumulative eligible capital balance. In this example, this excess equals $60 (i.e., $100+$0-$40). This is, therefore, the amount determined by E in the definition "undepreciated capital cost" in subsection 13(21).

As a consequence, the undepreciated capital cost of the new class at the beginning of January 1, 2017 is $40, which is equal to the amount that would be the CEC balance at the beginning of January 1, 2017.

ITA
13(38)(d)

If a taxation year of a taxpayer straddles January 1, 2017 (i.e., it does not end at the end of 2016), paragraph 13(38)(d) of the Act deems the taxpayer to have for that year a capital gain (or, where a taxpayer elects under subparagraph 13(38)(d)(iii), an income inclusion in respect of a business) if the taxpayer would have had an income inclusion under paragraph 14(1)(b) if the taxpayer's taxation year had ended immediately before January 1, 2017. This paragraph is intended to ensure that the rules applying to eligible capital property apply to dispositions before January 1, 2017.

Subparagraph 13(38)(d)(i) provides that, for the purposes of the formula in paragraph 13(38)(a), the cumulative eligible capital in respect of a business is increased by 3/2 of the amount that would be included in income under 14(1)(b). This subparagraph effectively reduces the negative cumulative eligible capital balance to account for any taxable capital gain or income inclusion under subparagraphs 13(38)(d)(ii) or (iii).

Subparagraph 13(38)(d)(ii) provides that the taxpayer is deemed to dispose of a capital property in respect of the business immediately before January 1, 2017 for proceeds of disposition equal to twice the amount that would be the income inclusion under 14(1)(b) resulting in a taxable capital gain equal to the amount that would be the income inclusion under 14(1)(b).

Subparagraph 13(38)(d)(iii) allows a taxpayer to elect that, instead of subparagraph (ii) applying, an amount is to be included in computing the taxpayer's income from the business for the particular year equal to the amount that would be the income inclusion under paragraph 14(1)(b).

Subparagraph 13(38)(d)(iv) allows a taxpayer to elect to defer the taxable capital gain or income inclusion under subparagraph 13(38)(d)(ii) or (iii) if, on or after January 1, 2017 and in the taxation year that includes January 1, 2017, the taxpayer acquires a property included in the class in respect of the business or is deemed by subsection 13(35) to acquire goodwill in respect of the business. Where a taxpayer makes this election, the taxable capital gain (or income inclusion) is reduced by the lesser of the amount of the taxable capital gain (or the income inclusion) and 1/2 of the capital cost of the property or goodwill acquired. To account for the reduction in the taxable capital gain or income inclusion, the capital cost of the property or goodwill acquired is decreased by twice the amount of the reduction.

Subparagraph 13(38)(d)(v) deems the capital gain under subparagraph 13(38)(d)(ii) to be attributable to the disposition of a qualified farm or fishing property to the extent that the income inclusion that would have occurred under paragraph 14(1)(b) is attributable to the disposition of a qualified farm or fishing property.

This amendment comes into force on January 1, 2017.

Example – Deemed Gain - Taxation year not ending immediately before January 1, 2017

Before January 1, 2017

In a taxation year ending before January 1, 2017, a taxpayer incurred an eligible capital expenditure of $100, resulting in a cumulative eligible capital balance of $75 (i.e., 3/4 x $100) to acquire a government licence of unlimited duration. In taxation years ending before January 1, 2017, the taxpayer deducted a total of $35 from cumulative eligible capital under paragraph 20(1)(b), resulting in a cumulative eligible capital balance of $40.

The taxation year of the taxpayer that includes December 31, 2016 does not end on that day, and the taxpayer disposes of the government licence in that taxation year and before January 1, 2017 for $300.

Variable E of the definition cumulative eligible capital in former subsection 14(1) reduces the cumulative eligible capital of taxpayer by 3/4 of the proceeds of disposition, which equals $225 (i.e., 3/4 x $300). This results in a negative cumulative eligible capital balance of -$185 (i.e., $40-$225).

Immediately before January 1, 2017

Subparagraph 13(38)(d)(ii) deems the taxpayer to have a capital gain immediately before January 1, 2017 equal to the amount that would be included in income under 14(1)(b) if the taxation year ended immediately before January 1, 2017 (unless the taxpayer elects under subparagraph 13(38)(e)(iii) to have an income inclusion from business rather than a capital gain). The taxpayer therefore has a deemed capital gain equal to 4/3 of the amount by which the negative cumulative eligible capital balance exceeds the amount of deductions for depreciation that have been taken and not recaptured. This capital gain is $200 (i.e., 4/3($185-$35)).

On January 1, 2017

The government licence is not included in new Class 14.1, since it was disposed of before January 1, 2017.

Subparagraph 13(38)(a) provides that the total capital cost of property of the class at the beginning of January 1, 2017 that was eligible capital property before January 1, 2017 is 4/3 of the amount that would be the cumulative eligible capital at the beginning of January 1, 2017; plus 4/3 of the amount of deductions taken that have not been recaptured; less 4/3 of any negative CEC balance. The total capital cost in this example is therefore nil (i.e., 4/3($0+$35-$35)). As a result, the amount described by A in the definition "undepreciated capital cost" in subsection 13(21) is nil and subparagraph 13(38)(b)(iii) deems the capital cost of the goodwill of the business to be nil.

Paragraph 13(38)(c) deems an amount to have been allowed to the taxpayer under paragraph 20(1)(a) for taxation years ending before January 1, 2017, equal to the amount by which total capital cost and any negative cumulative eligible capital balance at the beginning of January 1, 2017 exceeds any positive cumulative eligible capital balance at the beginning of January 1, 2017. This amount equals $35 (i.e., $0+$35-$0). As a result, the amount determined by E in the definition "undepreciated capital cost" in subsection 13(21) would be $35.

As a consequence, the undepreciated capital cost of the new class is negative, negative $35, at the beginning of January 1, 2017, which is equal to the amount that would be the negative cumulative eligible capital balance on January 1, 2017.

The negative undepreciated capital cost balance is included in income as recaptured capital cost allowance under subsection 13(1) at the end of the taxation year unless the undepreciated capital cost balance of the class is increased before the end of the year (e.g., by the acquisition of another property of the class).

Class 14.1 – transitional rule

ITA
13(39)

Consequential on the repeal of the ECP rules and the creation of new Class 14.1 of depreciable property, expenditures that would previously increase the cumulative eligible capital of a taxpayer in respect of a business at a 75% rate will, subject to subsection 13(40) of the Act, now increase the undepreciated capital cost of the new class at a 100% rate. Receipts that would previously reduce the cumulative eligible capital of a taxpayer in respect of a business at a 75% rate will, subject to subsection 13(39), now reduce the undepreciated capital cost fully.

Subsection 13(39) increases the undepreciated capital cost of new Class 14.1 to the extent necessary to prevent excess recapture when a taxpayer disposes of certain property included in the class. Subsection 13(39) is intended to ensure that a receipt from the disposition of property the cost of which was included in cumulative eligible capital or undepreciated capital cost at a 75% rate does not reduce the undepreciated capital cost at a 100% rate.

To increase the undepreciated capital cost of the class, subsection 13(39) deems a taxpayer to have acquired a depreciable property of the class with a capital cost equal to the least of three amounts: the first two of these are 1/4 of the proceeds of disposition of the property that is disposed of and 1/4 of the capital cost of that property. The third amount is determined under paragraphs 13(39)(a) to (e).

Paragraphs 13(39)(a) to (d) describe four types of property. Paragraph 13(39)(e) is "nil", and applies if the property disposed of is not described in any of paragraphs 13(39)(a) to (d). In effect, if the property disposed of is not described in any of paragraphs 13(39)(a) to (d), then subsection 13(39) does not apply to decrease the reduction (by the proceeds of disposition) of the undepreciated capital cost of the class.

Subsection 13(39) also does not apply if one of the following rollover provisions applies in respect of the disposition: subsection 24(2), 70(5.1), 73(3.1), 85(1), 88(1), 98(3) or (5), 107(2) or 107.4(3).

Paragraph 13(39)(a), which applies to property (other than goodwill) that is acquired before January 1, 2017, provides that the capital cost of the property deemed to be acquired under subsection 13(39) is limited to 1/4 of the capital cost of the property that is disposed of.

Paragraph 13(39)(b) applies to a disposition of property if:

- the property is not goodwill;
- the property was acquired on or after January 1, 2017 by the taxpayer; and
- subsection 13(40) deemed an amount to have been allowed to a person under paragraph 20(1)(a) in respect of the taxpayer's acquisition of the property.

If paragraph 13(39)(b) applies, the capital cost of the property deemed to be acquired under subsection 13(39) is limited to the amount that subsection 13(40) deemed to have been allowed to a person under paragraph 20(1)(a) in respect of the taxpayer's acquisition of the property.

Paragraph 13(39)(c) applies to a disposition of property if:

- the property is not goodwill;
- the property was acquired on or after January 1, 2017 by the taxpayer;
- one of the following "rollover" provisions applied in respect of the acquisition of the property: subsection 24(2), 70(5.1), 73(3.1), 85(1), 88(1), 98(3) or (5), 107(2) or 107.4(3); and
- the property was acquired from a person or partnership that would have been deemed under subsection 13(39) to have acquired a property if none of those rollover subsections had applied.

If paragraph 13(39)(c) applies, the capital cost of the property deemed to have been acquired under subsection 13(39) is limited to the amount of the capital cost of the property that would have been deemed under subsection 13(39) to have been acquired by the person or partnership.

Paragraph 13(39)(d) applies to a disposition of goodwill and applies in a manner similar to paragraphs 13(39)(a) to (c). That is, the capital cost of the property deemed to have been acquired under subsection 13(39) is limited to the amount by which the total of

- generally, 1/4 of the deemed capital cost of goodwill as at the beginning of January 1, 2017;
- the amount, if any, deemed by subsection 13(40) to have been allowed to a person in respect of the taxpayer's acquisition of goodwill on or after January 1, 2017; and

- if the taxpayer acquires goodwill on or after January 1, 2017 to which one of the rollover provisions applies, the corresponding amount, if any, that would have been deemed by subsection 13(39) to have been the cost of a property acquired by a person or partnership if none of those rollover provisions had applied

exceeds

- the total of all amounts deemed under subsection 13(39) to have been a capital cost of goodwill in respect of a previous disposition of goodwill.

The interaction of subsections 13(39) and (40) is generally as follows:

- Subsection 13(39) is a relieving measure that may reduce the rate at which proceeds of a disposition reduce the undepreciated capital cost balance of the class, from 100% of proceeds to 75%, if a related eligible capital expenditure was made prior to January 1, 2017.
- To put a non-arm's length transferee in a similar position to a transferor to which subsection 13(39) applies, subsection 13(40) may decrease the rate at which an expenditure increases the undepreciated capital cost balance of the class of the transferee, from 100% of the expenditure to 75%, to the extent that subsection 13(39) applied to the transferor. However, subsection 13(39) may provide relief to the transferee when the transferee subsequently disposes of the property.
- Subsection 13(39) does not apply if a rollover provision applies to deem the proceeds of a transferor to be an amount. In such a case, 100% of the proceeds will be relevant in computing the transferor's undepreciated capital cost, but at the same time that amount will be added to the transferee's undepreciated capital cost. However, subsection 13(39) may provide relief to the transferee when the transferee subsequently disposes of the property.

This amendment comes into force on January 1, 2017.

Example – Disposition of former ECP after January 1, 2017

Before January 1, 2017

In a taxation year ending before January 1, 2017, a taxpayer incurred an eligible capital expenditure of $100, resulting in a cumulative eligible capital balance of $75 (i.e., 3/4 x $100) to acquire a government licence of unlimited duration. In taxation years ending before January 1, 2017, the taxpayer deducted a total of $35 from cumulative eligible capital under paragraph 20(1)(b), resulting in a cumulative eligible capital balance of $40.

On January 1, 2017

The government licence is included in new Class 14.1 of Schedule II to the Regulations.

Paragraph 13(38)(a) provides that the total capital cost of property of the new class on January 1, 2017 that is goodwill or that was eligible capital property before January 1, 2017 is 4/3 of the amount that would be the cumulative eligible capital at the beginning of January 1, 2017; plus 4/3 of the amount of deductions taken that have not been recaptured; less 4/3 of any negative cumulative eligible capital balance at the beginning of January 1, 2017. The total capital cost in this example equals $100 (i.e., 4/3($40+$35-$0)). As a result, the amount described by A in the definition "undepreciated capital cost" in subsection 13(21) is $100. Subparagraph 13(38)(b)(ii) deems the capital cost of the government licence to be $100 and subparagraph 13(38)(b)(iii) deems the capital cost of the goodwill of the business to be nil.

Paragraph 13(38)(c) deems an amount to have been allowed to the taxpayer under paragraph 20(1)(a) for taxation years ending before January 1, 2017. This amount equals the amount by which total capital cost and any negative cumulative eligible capital balance exceed any positive cumulative eligible capital balance, or $60 (i.e., $100+$0-$40). As a result, the amount determined by E in the definition "undepreciated capital cost" in subsection 13(21) is $60.

As a consequence, the undepreciated capital cost of the new class at the beginning of January 1, 2017 is $40, which is equal to the amount that would be the CEC balance at the beginning of January 1, 2017.

After January 1, 2017

If the government licence is disposed of after January 1, 2017 for proceeds of disposition of $300, the amount by which the proceeds of disposition of the property exceeds the capital cost of the property results in a capital gain. In this case the taxpayer would have a $200 capital gain ($300-$100), resulting in a taxable capital gain of $100.

The undepreciated capital cost of the class would be reduced by the lesser of the capital cost and the proceeds of disposition, in this case $100, which would reduce the undepreciated capital cost from $40 to negative $60.

Since the government licence was acquired by the taxpayer before January 1, 2017, paragraph 13(39)(a) would deem a property to have been acquired by the taxpayer with a capital cost equal to $25 (i.e., 1/4 of the lesser of the capital cost of the government licence and the proceeds of disposition), resulting in an increase in the amount determined for A in the definition "undepreciated capital cost" in subsection 13(21).

As a consequence, the undepreciated capital cost of the new class after the disposition of the government licence would be negative $35 (i.e., -$60+$25).

The negative undepreciated capital cost balance will be included in income as recapture under subsection 13(1) at the end of the taxation year, unless the undepreciated capital cost balance of the class is increased before the end of the year (e.g., the taxpayer increases the undepreciated capital cost by acquiring another property of the class).

Class 14.1 – transitional rule

ITA
13(40)

Subsection 13(40) of the Act decreases the undepreciated capital cost of the class in certain circumstances where a taxpayer acquires property included in new Class 14.1. Although subsection 13(39) increases the undepreciated capital cost balance of the new class by, generally, 25% of the proceeds of disposition of property that was ECP before January 1, 2017, new subsection 13(40) is intended to prevent taxpayers from increasing the depreciable base of a property through the use of a non-arm's length transfer of depreciable property that was an eligible capital property.

Paragraph 13(40) applies to an acquisition of property if:

- a taxpayer acquires a property included in Class 14.1;
- the acquisition of the property is part of a transaction or series of transactions or events that includes a prior disposition of the property or a similar property by the taxpayer or a person or partnership that does not deal at arm's length with the taxpayer; and
- subsection 13(39) applies in respect of the prior disposition.

Where subsection 13(40) applies to an acquisition, an amount is deemed to have been allowed to the taxpayer in respect of the property under regulations made under paragraph 20(1)(a) in computing the taxpayer's income for taxation years ending before the acquisition of the property, generally equal to 1/4 of the capital cost of the property. (However, this amount will not exceed the amount, if any, deemed by subsection 13(39) to be an addition to the undepreciated capital cost of the non-arm's length vendor of the property.)

To prevent excess recapture when the property is disposed of by the taxpayer, paragraph 13(39)(b) provides that where a taxpayer disposes of a property to which subsection 13(40) applied, the taxpayer is deemed to have acquired a depreciable property, at the time the taxpayer disposes of the property, equal to the lesser of the amount deemed by subsection 13(40) to have been allowed in respect of the acquisition of the property and 1/4 of the lesser of the proceeds of disposition of the property and the capital cost of the property.

This amendment comes into force on January 1, 2017.

Example – Acquisition of former ECP from a non-arm's length person

<u>After January 1, 2017</u>

A taxpayer acquires a government licence of unlimited duration from a non-arm's length person at a cost of $100. The government licence was an eligible capital property of the person and when the person disposed of the property to the taxpayer, the person was deemed by subsection 13(39) to have acquired a property with a cost of $25, which increased the undepreciated capital cost balance of the person by $25.

When the taxpayer acquires the government licence, the government licence is included in new Class 14.1 and the amount described by A in the definition "undepreciated capital cost" in subsection 13(21) in respect of the business of the taxpayer is increased, in this example by $100 (the capital cost of the licence).

Subsection 13(40) applies to deem the taxpayer to have been allowed $25 under 20(1)(a) in previous taxation years, which reduces the taxpayer's undepreciated capital cost by $25, to $75, as a result of variable E of the definition "undepreciated capital cost".

However, when the taxpayer eventually disposes of the property, paragraph 13(39)(b) may apply to effectively increase the undepreciated capital cost of the taxpayer.

Class 14.1 – transitional rule

ITA
13(41)

Subsection 13(41) of the Act provides that, for the purposes of subsections 13(38) to (40), paragraph 20(1)(hh.1), subsections 40(13) to (16) and paragraph 79(4)(b), the definitions "cumulative eligible capital", "eligible capital expenditure", "eligible capital property" and "exempt gains balance" have the same meanings that would be assigned to those expressions if the Act read as it did immediately before January 1, 2017. This is intended to ensure that in determining the meaning of those terms, the Act is to be read as if the ECP rules were not repealed.

This amendment comes into force on January 1, 2017.

Non-Arm's length transfers

ITA
13(42)

Subsection 13(42) of the Act provides rules consequential on the repeal of the eligible capital property rules where a taxpayer owns property included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of a business at the beginning of January 1, 2017, that was an eligible capital property in respect of the business immediately before January 1, 2017.

This amendment comes into force on January 1, 2017.

Class 14.1 – transitional rule

ITA
13(42)(a)

Paragraph 13(42)(a) of the Act provides a special rule where the taxpayer's cost was reduced as a result of variable A in the formula in the definition "cumulative eligible capital" in former subsection 14(5) in respect of a property and the property has not been disposed of.

The formula in variable A in the definition "cumulative eligible capital" in subsection 14(5) generally provided for a reduction in the amount otherwise included in cumulative eligible capital in respect of an eligible expenditure, generally equal to 1/2 of the gain under paragraph 14(1)(b) or 38(a) of a non-arm's length transferor in respect of the property. (Where the transferor has claimed a capital gains exemption in respect of the transfer under subsection 110.6, subsection 14(3) reduced the taxpayer's eligible capital expenditure accordingly. The reduction in Variable A therefore did not include 1/2 of the amount of that claim.) Where the transferor has realized such a gain in a taxation year in respect of more than one property, the amount of the gain of the transferor for the purposes of this calculation is that proportion of the

gain that the proceeds of disposition of the eligible capital property acquired by the taxpayer is of the total proceeds of disposition of all such property disposed of in the transferor's taxation year. This reduction is intended to ensure that the taxpayer's pool includes only the taxable portion of the gain realized by the non-arm's length transferor of eligible capital property. The reduction only applies to the period of time before the taxpayer disposes of the property.

To account for properties in respect of which a reduction applies, paragraph 13(42)(a) provides that for the purposes of the Act, other than sections 13 and 20 and any regulations made for the purposes of paragraph 20(1)(a), the taxpayer's capital cost of the property is deemed to be increased by 4/3 of the amount of the reduction by the formula in variable A in the definition "cumulative eligible capital" in subsection 14(5).

A reduction in respect of depreciable property, that is similar to the reduction variable A in the definition "cumulative eligible capital" in subsection 14(5), is provided by paragraph 13(7)(e).

ITA
13(42)(b)

Paragraph 13(42)(b) of the Act provides that, for the purposes of sections 13 and 20 and any regulations made for the purpose of paragraph 20(1)(a), where the taxpayer was deemed by subsection 14(12) to continue to own eligible capital property in respect of a business and not to have ceased to carry on the business until a time that is after 2016, the taxpayer is deemed to continue to own the property and to continue to carry on the business until the time that is immediately before the first time one of the events described by paragraphs 14(12)(c) to (g) would occur (as the Act read immediately before 2017 and if the reference to "eligible capital property" in paragraph 14(12)(*d*) were a reference to "eligible capital property or capital property").

As a result, a terminal loss that was deferred by 14(12) will be deferred by subsection 13(21.2).

ITA
13(42)(c)

Paragraph 13(42)(c) of the Act provides that, for the purposes of the descriptions of D.1 and K in the definition "undepreciated capital cost" in subsection (21), a taxpayer is deemed not to have paid or received any amounts before 2017 as or on account of an existing or proposed countervailing or anti-dumping duty in respect of depreciable property of the class.

ITA
13(42)(d)

Paragraph 13(42)(d) of the Act provides that subsection 13(7.1) does not apply to assistance that a taxpayer received or is entitled before 2017 in respect of a property that was an eligible capital property immediately before 2017.

Subsections 14(10) and (11) provide that government assistance for eligible capital property, or a repayment of such assistance, results in a decrease or increase, as the case may be, in the eligible capital expenditure in respect of that property. Subsections 13(7.1) and (7.2) provide similar rules in respect of depreciable property.

This amendment comes into force on January 1, 2017.

Clause 4

ITA
14

The eligible capital property (ECP) rules in section 14 of the Act govern the tax treatment of certain expenditures (certain outlays and expenses described in the definition “eligible capital expenditure” in subsection 14(5)) and receipts (amounts described by E in the definition “cumulative eligible capital” in subsection 14(5)) that are not otherwise accounted for as business revenues or expenses, or under the rules relating to capital property.

Eligible capital property includes goodwill, customer lists and licences, franchise rights and farm quotas of indefinite duration. The cost of eligible capital property is recognized, for income tax purposes, in a pool system similar to the capital cost allowance (CCA) system for depreciable property. Unlike for CCA, however, only 3/4 of the cost is added to the pool, and only 3/4 of the proceeds of disposition of eligible capital properties is credited against the pool. A deduction from the cumulative eligible capital pool is allowed under paragraph 20(1)(b) at a 7% rate on a declining balance basis. A negative balance at the end of a taxation year results in an income inclusion for the year under subsection 14(1), which may be comprised of a portion analogous to recaptured CCA deductions under paragraph 14(1)(a) and a portion analogous to a taxable capital gain under 14(1)(b).

The ECP rules are repealed and replaced by new Class 14.1 of depreciable property under the capital cost allowance (CCA) regulations. As a consequence, property that was ECP is capital property and expenditures and receipts that were accounted for under the ECP rules are accounted for under the rules for depreciable property and capital property.

Section 14 is repealed as of January 1, 2017.

Clause 5

ITA
15

Subsection 15(2) generally requires that certain indebtedness be included in the income of a debtor in the year in which the indebtedness arose. Where the debtor is a non-resident, subsection 15(2) works in conjunction with subsection 214(3) to deem a dividend that is subject to non-resident withholding tax under Part XIII of the Act. Subsection 15(2) and related rules (referred to as the “shareholder loan rules”) are intended to prevent a person or partnership, that is directly or indirectly a shareholder of a particular corporation or that is connected with a shareholder of the particular corporation, from avoiding tax by receiving property from the corporation as an otherwise non-taxable loan, rather than as a taxable dividend or other taxable amount.

The shareholder loan rules are amended to add new “back-to-back loan” rules, in subsections 15(2.16) to (2.192), which are modelled on the back-to-back loan rules in Part XIII of the Act. These amendments are intended to ensure that the application of subsection 15(2), and the related rule in subsection 80.4(2), is not avoided where a particular corporation – rather than providing debt funding directly to its shareholder, or to a connected person or partnership – provides debt funding indirectly through one or more intermediaries. These new rules apply, for

example, where a particular corporation lends funds to an arm's length person on condition that the person makes a loan to a shareholder of the particular corporation (a so-called "back-to-back loan" arrangement).

Where they apply, the rules generally deem the particular corporation to make a loan to its shareholder (or to a connected person or partnership) for the purposes of sections 15 and 80.4, in an amount equal to the funding indirectly provided by the particular corporation to the shareholder. The new back-to-back loan rules also include "deemed repayment" rules, which generally deem a repayment on a loan that was previously deemed to be made under these new rules to occur when the amount of funding indirectly provided by a particular corporation to its shareholder is reduced.

New subsection 15(2.16) sets out the conditions for the application of the operative "deemed loan" rule in subsection 15(2.17). Subsection 15(2.18) sets out the conditions for the application of the rule for deemed repayments in subsection 15(2.19). Subsection 15(2.191) provides a separate rule for deemed repayments in certain special circumstances. Subsection 15(2.192) contains definitions for the purposes of new subsections 15(2.16) to (2.192).

The new back-to-back rules apply in respect of loans received and indebtedness incurred, and specified rights granted, after March 21, 2016. However, these rules also apply in respect of any portion of a particular loan received or indebtedness incurred or specified right granted before March 22, 2016 that remains outstanding on that date, as if that portion were a separate loan or indebtedness received or incurred, or specified right granted, as the case may be, on March 22, 2016, in the same manner and on the same terms as the particular loan or indebtedness or specified right. The multiple intermediary component of the rules applies as of January 1, 2017.

Back-to-back arrangement – application

ITA
15(2.16)

In order for the operative rule in new subsection 15(2.17) of the Act to apply at any time, the four conditions set out in paragraphs 15(2.16)(a) to (d) must be satisfied.

The first condition, in paragraph 15(2.16)(a), requires that a person or partnership (referred to as the "intended borrower") have an amount outstanding as or on account of a debt or other obligation to pay an amount (referred to as the "shareholder debt") to a person or partnership (referred to as the "immediate funder"). As clarified by paragraph 15(2.16)(d), in combination with the definition "ultimate funder" in subsection 15(2.192), the intended borrower is, essentially, the shareholder of a particular corporation (or the person or partnership connected with a shareholder) that receives funding indirectly from the particular corporation through a back-to-back loan arrangement that includes the shareholder debt.

The second condition, in paragraph 15(2.16)(b), requires that subsection 15(2) would not apply to the shareholder debt, in the absence of subsections 15(2.16) and (2.17). The purpose of the second condition is to ensure that subsection 15(2.17) does not apply to deem the intended borrower to receive a loan in respect of an amount that is otherwise subject to subsection 15(2).

The third condition, in paragraph 15(2.16)(c), is satisfied in either of two ways. The first way is if, at a time when the shareholder debt is outstanding, a funder (which is defined in new

subsection 15(2.192) and includes the immediate funder, which is defined in paragraph (a)) in respect of a particular funding arrangement (which is also defined in subsection 15(2.192) and includes the shareholder debt), has an amount outstanding on account of a debt or other obligation owing to a person or partnership that meets one of the following conditions:

- recourse in respect of the debt or other obligation is limited in whole or in part, either immediately or in the future and either absolutely or contingently, to a funding arrangement (clause 15(2.16)(c)(i)(A)); or
- the particular funding arrangement was entered into or permitted to remain outstanding because either all or a portion of the debt or other obligation was entered into or was permitted to remain outstanding, or the funder anticipated that all or a portion of the debt or other obligation would become owing or remain outstanding (clause 15(2.16)(c)(i)(B)).

The condition in subparagraph 15(2.16)(c)(i) will not be met if the debt or other obligation owing by the funder, in respect of the particular funding arrangement, is one to which subsection 15(2) already applies (or would already apply, if the debt or obligation were not a pertinent loan or indebtedness, as defined in subsection 15(2.11)). The purpose of this exception is to prevent double taxation, by ensuring that subsection 15(2.17) does not apply to deem a loan in respect of a funding arrangement to which subsection 15(2) already applies – for example, where a Canadian corporation makes a loan to a non-resident shareholder (to which subsection 15(2) applies), and the non-resident shareholder in turn makes a loan to a related non-resident that otherwise meets the conditions in clause 15(2.16)(c)(i)(A) or (B)).

The condition in clause 15(2.16)(c)(i)(A) is intended to address situations where a funder is not fully bearing the risk of the amount it is owed (or the specified right it has granted) under a funding arrangement.

The second way in which the third condition, in paragraph 15(2.16)(c), may be satisfied is if all of the following conditions are met at the time the shareholder debt is outstanding:

- a funder, in respect of a particular funding arrangement, has a specified right in respect of a particular property;
- the specified right was granted directly or indirectly by a person or partnership; and
- either the existence of the specified right is required under the terms and conditions of the particular funding arrangement, or it can reasonably be concluded that all or a portion of the particular funding arrangement was entered into, or was permitted to remain in effect, because the specified right was granted or the funder anticipated that the specified right would be granted.

For this purpose, subsection 18(5) defines a specified right, at any time in respect of a property, to mean a right to, at that time:

- mortgage, hypothecate, assign, pledge or in any way encumber the property to secure payment of an obligation (other than the particular debt or other obligation or a “connected” debt or other obligation described in subparagraph 18(6)(d)(ii)), or
- use, invest, sell or otherwise dispose of, or in any way alienate, the property.

It is intended that the definition of "specified right" in subsection 18(5) be read with such changes as are required by the context of subsection 15(2.16). In particular, it is intended that a specified right will not exist if it is established that all of the net proceeds from exercising the right, or that would be received if the right were exercised, in respect of the property must be applied to reduce the shareholder debt. As such, an immediate funder will not be considered to have received a specified right in respect of a property solely by virtue of having been granted a security interest in the property, if the security interest merely secures payment in respect of the shareholder debt and does not in-and-of-itself provide a means for the immediate funder to raise funds that may be used for a purpose other than to reduce an amount owing to it in respect of the shareholder debt.

The design of paragraph 15(2.16)(c) is similar to that of paragraph 212(3.1)(c) in the back-to-back loan rules in Part XIII (as amended in the manner outlined in the commentary on paragraph 212(3.1)(c)). For further information, see the commentary on paragraph 212(3.1)(c).

Since a funder is defined (in new subsection 15(2.192)) to include the immediate funder, and a funding arrangement is defined (in new subsection 15(2.192)) to include the shareholder debt, the requirements of paragraph 15(2.16)(c) will, in effect, be satisfied whenever the immediate funder receives debt funding, or a specified right, that is connected to the shareholder debt in the manner described in paragraph 15(2.16)(c).

The fourth condition, in paragraph 15(2.16)(d), is that, at the time the shareholder debt is outstanding, one or more funders is an ultimate funder. The term "ultimate funder" is defined in subsection 15(2.192) to mean, in effect, a person or partnership that meets the following two conditions: (i) the person or partnership is a funder (as defined in subsection 15(2.192), and (ii) if the person or partnership were the debtor under the shareholder debt, 15(2) would apply to the shareholder debt. Thus, the condition in paragraph 15(2.16)(d) ensures that the operative rule in subsection 15(2.17) does not apply in respect of every back-to-back loan arrangement that includes the shareholder debt. Rather, subsection 15(2.17) applies only where one or more of the funders, that fund the shareholder debt through a back-to-back arrangement, is a person or partnership a loan from which directly to the intended borrower is one to which subsection 15(2) would have applied.

The terms "funder" and "funding arrangement" are defined in new subsection (2.192). For more information, see the commentary on that subsection.

Back-to-back arrangement – consequences

ITA
15(2.17)

New subsection 15(2.17) of the Act is the operative rule providing the consequences when the conditions in subsection 15(2.16) are satisfied. If subsection 15(2.17) applies at a particular time, then, for the purposes of sections 15 and 80.4, it deems the intended borrower to receive a loan from a particular ultimate funder (as defined in subsection 15(2.192)) at the particular time. If there are multiple ultimate funders that have funded the shareholder debt indirectly through the back-to-back arrangement, then subsection 15(2.17) generally deems the intended borrower to receive loans from each of those ultimate funders.

The amount of the loan that the intended borrower is deemed to receive from a particular ultimate funder is determined by the following formula: A x B/C – (D – E).

Variable A is the lesser of the following two amounts:

- the amount outstanding as or on account of the shareholder debt at the particular time when subsection 15(2.17) applies; and
- the total of all amounts, each of which is, at the particular time
  - an amount outstanding as or on account of a debt or other obligation that is owed by a funder (other than an ultimate funder) to an ultimate funder under a funding arrangement in respect of the shareholder debt, or
  - the fair market value of a particular property in respect of which an ultimate funder has granted a specified right to a funder (other than an ultimate funder) under a funding arrangement in respect of the shareholder debt.

Thus, variable A is, in effect, the lesser of the amount outstanding on the shareholder debt, and the aggregate amount of funding contributed by all of the ultimate funders to the back-to-back loan arrangement that includes the shareholder debt. Variable A is used as the starting point for determining the amount of the deemed loan by a particular ultimate funder under subsection 15(2.17), to ensure that the amount of the deemed loan(s) under that subsection does not exceed the amount that is funded indirectly by ultimate funders (in the form of debt and specified rights) to the intended borrower. This represents the extent to which the shareholder debt has been funded in a manner that (absent these new back-to-back loan rules) avoids subsection 15(2).

In calculating the total under paragraph (b) in variable A, debts owing by one ultimate funder to another ultimate funder, and specified rights granted by one ultimate funder to another ultimate funder, are excluded. This is intended to prevent "double counting" where, for example, one ultimate funder made a loan to another ultimate funder, which in turn used the proceeds of the first loan to provide debt funding to an intended borrower indirectly through a back-to-back arrangement.

Variable B is the total of all amounts, each of which is, at the particular time,

- an amount outstanding as or on account of a debt or other obligation that is owed by a funder (other than an ultimate funder) to the particular ultimate funder under a funding arrangement in respect of the shareholder debt; or
- the fair market value of a particular property in respect of which the particular ultimate funder has granted a specified right to a funder (other than an ultimate funder) under a funding arrangement in respect of the shareholder debt.

Variable C is the total amount determined under paragraph (b) in the description of A.

The reason for multiplying variable A by B/C in the formula is to effectively prorate the portion of the shareholder debt that is funded indirectly by all the ultimate funders (i.e., variable A) among the ultimate funders. This ensures that the loan an intended borrower is deemed under subsection 15(2.17) to receive from a particular ultimate funder reflects only the portion of the shareholder debt funded indirectly by that particular ultimate funder.

Variable D is the total of all amounts, each of which is, in respect of the shareholder debt, an amount that the intended borrower has been deemed by subsection 15(2.17) to have received from the particular ultimate funder as a loan at any time before the particular time.

Variable D is intended to prevent double taxation. It reflects the fact that, pursuant to subsection 15(2.16), subsection 15(2.17) applies at any time when the conditions set out in subsection 15(2.16) are met. Since a back-to-back loan arrangement will generally satisfy the conditions in subsection 15(2.16) at every moment during which it remains outstanding, subsection 15(2.17) applies at each such moment. Therefore, it is necessary to reduce the amount of the deemed loan under subsection 15(2.17) by the amount determined for variable D (as reduced by the amount determined for variable E), to ensure that, where the funding provided by the particular ultimate funder under the back-to-back arrangement has not changed from moment to moment, that subsection does not deem an additional loan at each moment.

Variable E is the amount of any repayments deemed by subsections 15(2.19) and (2.191) to have occurred before the particular time, in respect of any of the deemed loans referred to in the description of D. These are loans that the intended borrower has been deemed by subsection 15(2.17) to have received from the particular ultimate funder.

Back-to-back arrangement – conditions for deemed repayment

ITA
15(2.18)

New subsection 15(2.18) of the Act sets out the conditions that must be satisfied in order for new subsection 15(2.19) to apply at a particular time to deem an intended borrower to repay all or a portion of one or more deemed loans to a particular ultimate funder at that time.

The first condition, in paragraph 15(2.18)(a), is that, prior to the particular time at which the repayment is deemed to occur, subsection 15(2.17) has applied in respect of a shareholder debt to deem one or more loans to have been received by the intended borrower from the particular ultimate funder. It is one or more of these deemed loans that subsection 15(2.19) deems to be repaid, in whole or in part, if the conditions in subsection 15(2.18) are satisfied.

The second condition, in paragraph (2.18)(b), is that, at that particular time, one of the following events must occur:

- an amount owing on a shareholder debt is repaid in whole or in part;
- an amount owing on a debt or other obligation owing to the particular ultimate funder by a funder (other than an ultimate funder) under a funding arrangement in respect of the shareholder debt is repaid, in whole or in part; or
- there is either a decrease in the fair market value of a property in respect of which a specified right was granted by the particular ultimate funder to a funder (other than an ultimate funder) under a funding arrangement in respect of the shareholder debt, or an extinguishment of such a specified right.

In effect, in order for the deemed repayment rule in subsection 15(2.19) to apply, it is sufficient that a reduction occur either in the amount outstanding on the shareholder debt, or in the funding contributed (whether as debt or in the form of a specified right) by the particular ultimate funder

under the back-to-back arrangement that includes the shareholder debt; it is not necessary to reduce both.

Back-to-back arrangement – deemed repayment

ITA
15(2.19)

New subsection 15(2.19) of the Act applies where the conditions in subsection 15(2.18) are satisfied in respect of an intended borrower and a particular ultimate funder at a particular time. The rule is intended to ensure that existing relief, for repayments of debts to which subsection 15(2) has applied, is available in respect of loans that are deemed to be made under subsection 15(2.17), in circumstances where it is appropriate to consider amounts repaid on those deemed loans.

For the purposes of section 15, paragraph 20(1)(j), section 80.4 and subsection 227(6.1), paragraph 15(2.19)(a) deems the intended borrower to repay at the particular time, in whole or in part, one or more loans it has been deemed under subsection 15(2.17) to have received from the particular ultimate funder prior to the particular time. The total amount deemed to be repaid, at the particular time, in respect of all of these loans is determined pursuant to the formula in paragraph 15(2.19)(b). It is intended that, consistent with existing administrative policy of the Canada Revenue Agency, the repayment will occur on a “first-in, first-out” (“FIFO”) basis and, to the extent this deemed repayment amount exceeds the amount outstanding on a particular deemed loan, repayments will be considered to be made on multiple deemed loans.

As in the case of any repayment of a loan to which subsection 15(2) has applied, a deemed repayment under subsection 15(2.19) is not sufficient to qualify for relief under subsection 15(2.6), paragraph 20(1)(j) or subsection 227(6.1); these provisions set out additional requirements – in particular, that it must be established that the deemed repayment was not part of a series of loans or other transactions and repayments.

Paragraph 15(2.19)(b) provides that the total amount of deemed repayments referred to in paragraph 15(2.19)(a) is determined by the formula A – B – C.

Variable A is the total amount of all the loans deemed by subsection 15(2.17) to have been received, at any time before the particular time at which subsection 15(2.17) applies, by the intended borrower from the particular ultimate funder in respect of the shareholder debt. This aggregation reflects the fact that subsection 15(2.19) does not deem a repayment of a single deemed loan but rather deems a repayment in respect of all of the deemed loans, in respect of the shareholder debt, that are deemed to have been paid from the particular ultimate funder to the intended borrower.

Variable B is the total of all amounts deemed by subsection 15(2.19) to have been repaid, at any time before the particular time, by the intended borrower on any of the deemed loans referred to in the description of A.

Thus, the difference between variables A and B can be viewed as representing the net amount by which the intended borrower is treated, under the shareholder loan rules, as being funded, immediately before the particular time, by the particular ultimate funder indirectly under the back-to-back loan arrangement that includes the shareholder debt. This amount is then reduced

by the amount determined for variable C – which, in effect, represents the amount by which the intended borrower is funded, immediately after the particular time, by the particular ultimate funder under that same arrangement – in order to determine the amount deemed to be repaid at the particular time.

Variable C is, more specifically, the amount determined by the formula D x E/F.

Variable D is the lesser of the following two amounts:

- the amount outstanding on the shareholder debt, immediately after the particular time; and
- the total of all amounts, each of which is, immediately after the particular time:
    - o an amount outstanding as or on account of a debt or other obligation that is owed by a funder (other than an ultimate funder) to an ultimate funder under a funding arrangement in respect of the shareholder debt, or
    - o the fair market value of a particular property in respect of which an ultimate funder has granted a specified right to a funder (other than an ultimate funder) under a funding arrangement in respect of the shareholder debt.

Thus, variable D represents the total amount by which the shareholder debt is funded indirectly by all of the ultimate funders, immediately after the particular time. This total amount is then multiplied by the proportion E/F, to determine the portion of that total amount, immediately after the particular time, that is attributable to funding arrangements, in respect of the shareholder debt, under which the particular ultimate funder is a creditor or a grantor of a specified right.

Variable E is the total of all amounts, each of which is, immediately after the particular time:

- an amount outstanding as or on account of a debt or other obligation that is owed by a funder (other than an ultimate funder) to the particular ultimate funder under a funding arrangement in respect of the shareholder debt; or
- the fair market value of a particular property in respect of which the particular ultimate funder has granted a specified right to a funder (other than an ultimate funder) under funding arrangement in respect of the shareholder debt.

Variable F is the amount determined under subparagraph (ii) in the description of D. This represents the total amount of funding indirectly provided by all of the ultimate funders under funding arrangements, immediately after the particular time.

Example

- *Parentco, a non-resident corporation, owns all of the shares of Canco, and Canco owns all of the shares of CanSub.*
- *On January 1, 2017, CanSub loans $200,000 to Canco, and Canco places $500,000 on deposit with Bank (the Bank deposit), a bank that deals at arm's length with Canco and CanSub.*
- *On January 2, 2017, Bank loans $1,000,000 to Parentco (the "Parentco debt"). At the same time, CanSub grants Bank certain rights in respect of its property (the fair market value of which is $250,000) in order to secure the loan to Parentco, including a right to*

sell the property and use the proceeds at the Bank's discretion, at any time during the term of the loan and regardless of whether there has been an event of default on the loan. These constitute "specified rights" (as defined in subsection 18(5)).

- *On January 1, 2018, Canco deposits another $250,000 with Bank.*
- *On December 1, 2018, Canco withdraws $600,000 from Bank, reducing its deposit with Bank to $150,000.*

Analysis

Transactions on January 2, 2017

The Parentco debt is a "shareholder debt"(within the meaning assigned by paragraph 15(2.16)(a)) in respect of which the conditions in subsection 15(2.16) are met on January 2, 2017:

- *The condition in paragraph (2.16)(b) is met, as subsection 15(2) would not apply to the Parentco debt in the absence of subsections 15(2.16) and (2.17), since the Parentco debt is between arm's length parties.*
- *The conditions in paragraph 15(2.16)(c) are also satisfied:*
    - *Bank (as the "immediate funder", within the meaning assigned by paragraph 15(2.16)(a)) is a "funder" in respect of a "funding arrangement" (being the Parentco debt), according to paragraph (a) in the definitions of both of those terms in subsection 15(2.192); and*
    - *clause 15(2.16)(c)(i)(B) would be satisfied if it is reasonable to conclude that the Parentco debt was entered into because the Bank deposit was entered into (which is the case in this example). Although this is sufficient to satisfy the requirements of paragraph 15(2.16)(c), it should be noted that clause 15(2.16)(c)(ii)(B) would also be satisfied if it is reasonable to conclude that (all or a portion of) the Parentco debt was entered into because the specified right was granted by CanSub, or the Bank anticipated that this would occur.*
- *Paragraph 15(2.16)(d) is also satisfied because Canco and CanSub are both funders (according to paragraph (b) of that definition in subsection 15(2.192)) and ultimate funders, as defined in subsection 15(2.192) because subsection 15(2) would apply to the Parentco debt if either Canco or CanSub were the creditor under that debt.*

Therefore, subsection 15(2.17) applies in respect of the Parentco debt on January 2, 2017, with the result that, for the purposes of sections 15 and 80.4:

- *Parentco is deemed to receive a loan from Canco in the amount of $500,000 (i.e., A x B/C – (D – E)=$750,000 x $500,000/$750,000 – (0 – 0)=$500,000); and*
- *Parentco is deemed to receive a loan from CanSub in the amount of $250,000 (i.e., $750,000 x $250,000/$750,000 – (0 – 0)=$250,000).*
- *Parentco is not, however, deemed to receive a loan from CanSub in respect of CanSub's $200,000 loan to Canco, because debts between ultimate funders are not taken into consideration in determining the deemed loan amount under subsection 15(2.17).*

Transaction on January 1, 2018

The conditions in subsection 15(2.16) are also met, in respect of the Parentco debt, as a result of the further Bank deposit made by Canco on January 1, 2018:

- *The conditions in paragraphs 15(2.16)(a), (b) and (d) continue to be satisfied for the same reasons as on January 2, 2017.*
- *Paragraph 15(2.16)(c) is also satisfied, assuming it is determined that, based on the facts, it is reasonable to conclude that the Parentco debt was entered into in anticipation that the second Bank deposit would be made, or was permitted to remain outstanding because the second Bank deposit was made.*

Therefore, subsection 15(2.17) applies in respect of the Parentco debt on January 1, 2018, with the result that Parentco is deemed to receive a loan from Canco on that date, in the amount of $250,000 (i.e., A x B/C – (D – E)=$1,000,000 x $750,000/$1,000,000 – ($500,000 – 0)=$250,000).

Repayment on December 1, 2018

The withdrawal by Canco of $600,000 of the Bank deposit, on December 1, 2018, satisfies the conditions in subsection 15(2.18). Therefore, subsection 15(2.19) deems Parentco to make a repayment to Canco on that date, for the purposes of sections 15 and 80.4, paragraph 20(1)(j) and subsection 227(6.1). The total amount Parent is deemed to repay to Canco is $600,000 (i.e, the amount determined by the formula: A – B – C=$750,000 – 0 – $150,000=$600,000).

Thus, on a first-in-first-out (FIFO) basis, Parentco is deemed to repay all of the amount outstanding on the $500,000 loan it was deemed to have received from Canco on January 2, 2017, as well as $100,000 of the $250,000 outstanding on the loan Parentco was deemed to have received from Canco on January 1, 2018. In order to qualify for relief under subsection 15(2.6), however, it must be established that the repayment was not part of a series of loans or other transactions and repayments.

Negative amounts

ITA
15(2.191)

New subsection 15(2.191) of the Act applies where the formula in subsection 15(2.17) would result in a negative amount at a particular time in the absence of section 257. This could arise in certain circumstances where the proportion of the total funding under a back-to-back loan arrangement that is provided by a particular ultimate funder changes. This proportion is represented by B/C in the formula in subsection 15(2.17).

In these circumstances, for the purposes of section 15, paragraph 20(1)(j), section 80.4 and subsection 227(6.1), paragraph 15(2.191)(a) deems the intended borrower to repay, in whole or in part, one or more of the loans deemed by subsection 15(2.17) to have been received by the intended borrower from the particular ultimate funder before the particular time. This deemed repayment occurs in a similar manner to that in subsection 15(2.19). For more information, see the commentary on that subsection.

Paragraph 15(2.191)(b) provides that the amount of the deemed repayment under paragraph 15(2.191)(a) is equal to the absolute value of the negative amount.

Back-to-back arrangement – definitions

ITA
15(2.192)

New subsection 15(2.192) of the Act sets out the relevant definitions that apply in subsections 15(2.16) to (2.192).

“funder”

Paragraph (a) defines “funder”, in respect of a funding arrangement, to mean the immediate funder if the funding arrangement is one described in paragraph (a) of the definition “funding arrangement” (i.e., the shareholder debt).

Paragraph (b) defines “funder”, in respect of a funding arrangement, to mean the creditor in respect of the debt or other obligation or the grantor of the specified right, as the case may be, if the funding arrangement is one described in paragraph (b) of the definition “funding arrangement” (i.e., each debt or other obligation or specified right, owing by or granted to a funder, in respect of a particular funding arrangement, if the debt or other obligation or specified right meets the conditions in subparagraph 15(2.16)(c)(i) or (ii) in respect of a funding arrangement).

For more information regarding the operation of the definition, see the example provided in the commentary on the definition of “funding arrangement”.

Paragraph (c) defines “funder”, in respect of a funding arrangement, to mean a person or partnership that does not deal at arm’s length with a person or partnership referred to in paragraphs (a) and (b).

“funding arrangement”

Paragraph (a) provides that the shareholder debt (within the meaning of subsection 15(2.16)) is a “funding arrangement”.

Paragraph (b) provides that each debt or other obligation or specified right, owing by or granted to a funder, in respect of a particular funding arrangement is a “funding arrangement”, if the debt or other obligation or specified right meets the conditions in subparagraph 15(2.16)(c)(i) or (ii) in respect of a funding arrangement.

Example

Assume that Aco loans $100 to Bco, which loans $100 to Cco, which loans $100 to Dco, a non-resident corporation.

For the purposes of subsection 15(2.16), Dco is the intended borrower, Cco is the immediate funder and the loan from Cco to Dco is the shareholder debt. Cco deals at arm’s length with each of Aco, Bco and Dco. Dco wholly owns Bco and Bco wholly owns Aco.

The shareholder debt owing by Cco to Dco is a funding arrangement because of paragraph (a) of the definition. Cco is a “funder” because of paragraph (a) of the definition of “funder”.

In order to determine whether the loan from Bco to Cco is a funding arrangement, it is necessary to determine whether it meets the conditions in subparagraph 15(2.16)(c)(i) or (ii) in respect of a

funding arrangement (i.e., the shareholder debt). Assuming that it does, the loan from Bco to Cco will be a funding arrangement (and Bco will be a "funder" because of paragraph (b) of the definition of "funder").

Likewise, in order to determine whether the loan from Aco to Bco is a funding arrangement, it is necessary to determine whether it meets the conditions in subparagraph 15(2.16)(c)(i) or (ii) in respect of a funding arrangement (i.e., the shareholder debt or the loan from Bco to Cco). Assuming that it does, the loan from Aco to Bco will be a funding arrangement (and Aco will be a "funder" because of paragraph (b) of the definition of "funder").

Aco and Bco would both be "ultimate funders" in respect of the shareholder debt, provided that subsection 15(2) would apply if the creditor under the shareholder debt had been Aco or Bco, respectively.

"specified right"

The term "specified right" has the same meaning as in subsection 18(5).

"ultimate funder"

An "ultimate funder" means a funder, if subsection 15(2) or 80.4(2) would apply to the shareholder debt if it were made by the funder instead of the immediate funder.

For more information regarding the operation of the definition, see the example provided in the commentary on the definition of "funding arrangement".

Clause 6

Derivatives – lower of cost and market

ITA
18(1)(x)

New paragraph 18(1)(x) of the Act provides that no amount shall be deducted in a year in respect of any reduction in the value of a property of a taxpayer if

- the taxpayer uses the lower of cost and fair market value method to value the property at the end of the year for purposes of computing the taxpayer's profit from a business or property,
- the property is a financial derivative instrument described in new subsection 10(15), and
- the property is not disposed by the taxpayer in the year.

This amendment applies to agreements entered into on or after March 22, 2016.

ITA
18(1)(y)

New paragraph 18(1)(y) of the Act provides that an amount referred to in subsection 13(36) cannot be deducted as a business expense. These are amounts paid or payable as consideration for the purchase of shares or in consideration for the cancellation of an obligation for payment for the purchase of shares.

This amendment applies in respect of expenses incurred after 2016.

Clause 7

Deductions

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from business or property.

Allowance from cumulative eligible capital

ITA
20(1)(b)

Paragraph 20(1)(b) of the Act provides a deduction in calculating a taxpayer's income from a business of up to 7 per cent of the taxpayer's cumulative eligible capital property pool at the end of the year.

Paragraph 20(1)(a) of the Act and Parts XI and XVII and Schedules II to VI to the Regulations provide similar rules in respect of depreciable property. Paragraph 20(1)(a) provides for the deduction of such an amount in respect of the capital cost to the taxpayer of property, if any, as is allowed by regulation. As a result of the creation of new Class 14.1 of Schedule II to the Regulations, property that was eligible capital property under the eligible capital property rules will be depreciable property of the new class. New subparagraph 1100(1)(a)(xii.1) of the Regulations provides that deductions in respect of property in Class 14.1 are allowed at a 5% rate. As well, for taxation years that end before 2027, new paragraph 1100(1)(c.1) generally allows an additional 2% deduction in respect of that portion of the undepreciated capital cost of the class that relates to expenditures incurred before January 1, 2017.

Paragraph 20(1)(b) of the Act is repealed, consequential on the repeal of the eligible capital property rules.

This repeal comes into force on January 1, 2017.

New paragraph 20(1)(b) provides rules allowing the deduction of incorporation expenses of up to $3,000 per corporation. Incorporation expenses in excess of $3,000 will be included in new class 14.1.

New paragraph 20(1)(b) applies to incorporation expenses incurred after 2016.

Repayment of obligation

ITA
20(1)(hh.1)

Paragraph 20(1)(hh.1) of the Act allows a deduction for the repayment of assistance received by a taxpayer in respect of eligible capital property related to a business carried on by the taxpayer. The deduction (equal to 3/4 of the amount so repaid) applies only where the taxpayer ceases to carry on the business prior to repayment.

Under the eligible capital property rules, amounts of assistance that are repaid while a business is still ongoing are added to the eligible capital expenditures of that business under paragraph 14(10)(b). Paragraph 20(1)(hh.1) is amended, consequential on the repeal of the eligible capital property rules, to reflect the fact that subsection 14(10) is repealed. Consequential on the repeal of the eligible capital property rules, such repayments of assistance are dealt with under new subsection 13(7.41).

This amendment comes into force on January 1, 2017.

Former eligible capital property

ITA
20(4.2) and (4.3)

Subsection 20(4.2) of the Act provides a deduction in computing income of a taxpayer for a bad debt on account of proceeds of disposition of eligible capital property. The deduction is reduced to the extent that the taxpayer has sheltered an income inclusion in respect of eligible capital property using the capital gains exemption in section 110.6 or the taxpayer's exempt gains balance.

Subsection 20(4.3) provides that where a taxpayer's deduction under subsection 20(4.2) is reduced to recognize the taxpayer's use of a capital gains deduction to offset an income inclusion under subsection 14(1), the taxpayer is deemed to have an allowable capital loss. The allowable capital loss, in effect, restores the capital gains deduction that was used up in sheltering a gain on what turned out to be a bad debt.

Subsection 20(4) generally provides a deduction in computing income of a taxpayer where it is established that an amount owing to the taxpayer as or on account of proceeds of disposition of depreciable property has become a bad debt in the taxation year. The deduction is equal to the lesser of the amount owing to the taxpayer and the amount, if any, by which the capital cost to the taxpayer exceeds the amount realized on account of the proceeds of disposition.

Consequential on the repeal of the eligible capital property rules, subsections 20(4.2) and (4.3) are replaced with new subsection 20(4.2), which provides that, in respect of dispositions to which new subsection 13(39) applies, the amount otherwise deductible under subsection 20(4) is reduced by ¼.

This amendment applies in respect of dispositions that occur after 2016.

Sales of Linked Notes

ITA
20(14.2)

Subsection 20(14) of the Act provides that accrued interest to the time of sale of a debt obligation is included in the income of the vendor and an offsetting deduction is permitted to the purchaser when it later receives the interest.

A linked note is a debt obligation, most often issued by a financial institution, the return on which is linked in some manner to the performance of one or more reference assets or indexes over the term of the obligation. New subsection 20(14.2) is introduced to ensure that any positive

return on a linked note retains the same character whether it is earned at maturity or reflected in a secondary market sale. Specifically, it deems, for the purposes of subsection 20(14), all or a portion of any gain realized on the sale of a debt obligation that is, at any time, described in paragraph 7000(1)(d) of the *Income Tax Regulations* to be accrued interest to the time of sale of the debt obligation. The amount of accrued interest is determined by the formula A – B.

Variable A is the price for which the debt obligation was assigned or otherwise transferred at the time of sale.

Variable B is the amount by which the price for which the debt obligation was issued exceeds the portion, if any, of the principal amount of the debt obligation that was repaid by the issuer on or before the time of sale.

The price for which a debt obligation was issued will normally be its original principal amount. This amount will be reduced by any partial repayments of principal made on or before the time of sale. Thus, variable B will normally equal the remaining principal amount of the debt obligation at the time of sale.

In cases where the vendor of the debt obligation determines its Canadian tax results in Canadian currency and the debt obligation is denominated in a foreign currency, each variable of the above formula is converted to Canadian currency using the exchange rate at the time of sale.

In cases where the vendor of the debt obligation has made a functional currency election and the debt obligation is denominated in a currency other than the vendor's elected functional currency, each variable of the above formula is converted to the elected functional currency using the exchange rate at the time of sale. In particular, paragraph 261(5)(c) will provide that the price for which the debt was transferred is converted to the vendor's elected functional currency using the exchange rate at the time of sale. Similarly, subparagraph 261(5)(f)(i) and paragraph 261(5)(g) will provide that the amount determined for B in subsection 20(14.2) is converted to the vendor's elected functional currency using the exchange rate at the time of sale.

This amendment applies to transfers that occur after 2016.

Example – Return of capital note

A "return of capital note" with a term of 5 years is issued for $100. The return on the note is only payable at maturity and is equal to 100% of the percentage change in the value of an underlying index between the issue date and the maturity date. The note also provides for an annual partial repayment of 2% of the principal amount of the note (return of capital).

The holder sells the note one week prior to its maturity date. At the time of sale, the underlying index has increased 30% in value.

If the note is sold for a price equal to $122, then variable A is equal to $122.

Variable B, which is the amount by which the price for which the note was issued ($100) exceeds the portion, if any, of the principal amount of the debt obligation that was repaid by the issuer on or before the sale ($8, that is, 4 x (2% of $100)) is equal to $92.

The deemed interest accrued on the note at the time of sale is therefore equal to $30 ($122-$92).

Example – Note denominated in a foreign currency

A note with a term of 6 years is denominated in US dollars and is issued for US$100 when the Canadian dollar is at par with the US dollar. The return on the note is only payable at maturity and is equal to 100% of the percentage change in the value of an underlying index between the issue date and the maturity date.

The holder sells the note one week prior to its maturity date. At the time of sale, the underlying index has increased 20% in value. At that time, the Canadian dollar has increased in value and C$1 = US$1.50.

If the note is sold for a price equal to US$120, then variable A is equal to C$80, that is, US$120 converted to Canadian dollars using the foreign exchange rate at the time of the sale.

Variable B is equal to C$66.66, that is, the price of US$100 for which the note was issued, converted to Canadian dollars using the foreign exchange rate at the time of sale.

The deemed interest accrued on the note at the time of sale is equal to C$13.33, which is equivalent to the variable return of US$20, converted to Canadian dollars using the foreign exchange rate at the time of sale.

Non-application of subsection (16)

ITA
20(16.1)

Subsection 24(1) of the Act provides a deduction, in computing the income of a taxpayer for the year in which the taxpayer ceased to carry on a business, in respect of the residual cumulative eligible capital of the taxpayer in respect of the business.

Subsection 20(16) provides a similar deduction in respect of a class of depreciable property at the end of the year in which the taxpayer no longer owns any property of the class.

Subsection 20(16.1) provides that subsection 20(16) does not apply in certain circumstances.

Consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1, new paragraph 20(16.1)(c) provides that the deduction under subsection 20(16) does not apply in respect of Class 14.1 unless the taxpayer has ceased to carry on the business to which the class relates.

This amendment comes into force on January 1, 2017.

Clause 8

Ceasing to carry on business

ITA
24

Section 24 of the Act provides rules relating to eligible capital property when an individual ceases to carry on a business.

ITA
24(1)

Subsection 24(1) of the Act provides a deduction, in computing the income of a taxpayer for the year in which the taxpayer ceased to carry on a business, in respect of the residual cumulative eligible capital of the taxpayer in respect of the business.

Subsection 20(16) provides a similar deduction in respect of a class of depreciable property at the end of the year in which the taxpayer no longer owns any property of the class.

Consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1, subsection 24(1) is repealed.

This amendment comes into force on January 1, 2017.

Business carried on by spouse or common-law partner or controlled corporation

ITA
24(2)

Subsection 24(2) of the Act provides a rollover of the cumulative eligible capital of a business of an individual who ceases to carry on the business in circumstances where all of the eligible capital property in respect of the business is acquired by the individual’s spouse or common-law partner or by a corporation controlled by the individual who carries on the business after the acquisition.

Consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1, subsection 24(2) is amended to provide a rollover of property included in new Class 14.1 in respect of a business of an individual who ceases to carry on the business in circumstances where all such property in respect of the business is acquired by the individual’s spouse or common-law partner or by a corporation controlled by the individual who carries on the business after the acquisition.

This amendment comes into force on January 1, 2017.

Where partnership has ceased to exist

ITA
24(3)

Subsection 24(3) of the Act provides that, where a partnership has been dissolved in circumstances where neither subsection 98(3) nor 98(5) applies, each former member of the partnership may deduct an amount equal to that former member’s proportion of the amount that would be deductible under subsection 24(1) by the partnership had the partnership not ceased to exist.

Subsection 24(3) is repealed, consequential on the repeal of subsection 24(1).

This amendment comes into force on January 1, 2017.

Clause 9

Dispositions in the extended fiscal period

ITA
25(3)

Section 25 of the Act provides that, where an individual who is a resident of Canada disposes of a business carried on as a sole proprietorship, the individual may elect to extend the fiscal year-end of the business to the date on which it would have ended if the business had not been disposed of. Subsection 25(3) provides that any recapture of capital cost allowance, or any terminal loss, and any income arising from the disposal of eligible capital property after the individual ceases to carry on the business, will be included as income of the business for that extended fiscal period.

Paragraph 25(3)(b) is repealed consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1. Subsection 25(3) is further reorganized to move the text in paragraph (a) to the body of subsection (3).

This amendment comes into force on January 1, 2017.

Clause 10

Emissions allowances

ITA
27.1

New section 27.1 of the Act provides rules relating to the tax treatment of transactions involving emissions allowances.

New section 27.1 applies in respect of emissions allowances acquired in taxation years that begin after 2016. However, if a taxpayer elects in their income tax return for the 2016 or 2017 taxation year, then new section 27.1 - along with the related amendments with respect to emissions allowances in subsection 248(1) (including to the definition “inventory”) and section 7300 of the *Income Tax Regulations* - will apply to taxation years that end after 2012.

ITA
27.1(1)

New subsection 27.1(1) of the Act overrides the “lower of cost and market” rules in section 10 in respect of emissions allowances. It provides that, for the purposes of computing a taxpayer’s income from a business, an emission allowance must be valued at its cost to the taxpayer.

Determination of cost of emissions allowances

ITA
27.1(2)

New subsection 27.1(2) of the Act provides that the cost of identical emissions allowances of a taxpayer shall be determined based on the average cost of all of the identical emissions allowances of the taxpayer. Generally, this will result in identical properties having the same

cost, which will allow the gain on identical emissions allowances to be determined without having to identify which particular emissions allowance was disposed of.

Emissions allowances will be considered identical for the purposes of 27.1(2) when two or more emissions allowances can be used to settle the same emissions obligation. Therefore, for example, if an emissions allowance can only be used to settle an emissions obligation in one province and another emissions allowance can only be used to settle an emissions obligation in another province, they will not be identical. In addition, for emissions allowances to be considered identical, they must align temporally. For example, if an emissions allowance that is issued in 2017 can be used to settle the same emissions obligations that an allowance issued in 2018 can be used to settle, then the emissions allowances will be considered identical. However, if an emissions allowance that is issued in 2017 can settle an emissions obligation in both 2017 and 2018, but an emissions allowance issued in 2018 cannot be used to settle an emissions obligation in 2017, then the two emissions allowances would not be considered identical.

Expenses restriction

ITA
27.1(3)

New subsection 27.1(3) of the Act generally provides that, in computing a taxpayer's income from a business for a taxation year, the total amount deductible in respect of a particular emissions obligation for a taxation year is limited to the cost of the emissions allowances that are (or could be) used to satisfy it. In particular, the amount deductible cannot exceed

- the taxpayer's total cost of emissions allowances either
    - used by the taxpayer to settle the particular emissions obligation in the year, or
    - held by the taxpayer at the end of the taxation year that can be used to satisfy the particular emissions obligation in the year, and
- the fair market value of emissions allowances (tested at the end of the taxation year) that would need to be acquired to settle the obligation where the taxpayer does not have sufficient emissions allowances on hand in order to settle the obligation.

Example

- *A taxpayer has one emissions allowance that was issued in 2017 at no cost and that can be used in respect of emissions obligations in either 2017 or 2018.*
- *This taxpayer purchases an emissions allowance in 2018 at a cost of $10 and that can be used in respect of obligations in 2018 (but not in respect of emissions obligations in 2017).*
- *The taxpayer has an emissions obligation to surrender one emissions allowance in respect of emissions in 2017.*
- *The taxpayer also has an obligation to surrender one emissions allowance in 2018 in respect of emissions in 2018.*
- *The emissions allowances required in respect of the 2017 and 2018 emissions obligations are required to be surrendered in 2019.*

The two allowances held by the taxpayer in these circumstances are not identical because they cannot be used to settle the same emissions obligations. Therefore the costs of the two allowances will not be determined based on their average cost.

In 2018, for the purposes of determining the deduction available in respect of the taxpayer's 2017 emissions obligation, only the 2017 emissions allowance can be used to settle this obligation, meaning the deductible expense with respect to the 2017 emissions obligation is nil. For the purposes of the expense for the 2018 emissions obligation, however, both of the 2017 and the 2018 emissions allowances could be used. The fact, however, that the 2017 emission allowance must be used in respect of the 2017 obligation means that only the 2018 emissions allowance is available to be used in respect of the 2018 emissions obligation. Therefore the deductible expense in respect of this emissions obligation is $10.

Income inclusion in following year

ITA
27.1(4)

New subsection 27.1(4) of the Act provides that where a taxpayer deducts an amount in a taxation year in respect of an emissions obligation that is to be settled in a future year, the taxpayer will be required to include the deducted amount in income in the immediately following taxation year. This deduction-inclusion cycle in respect of the emissions obligation continues until such time that the emissions obligation is ultimately settled.

Proceeds of disposition

ITA
27.1(5)

New subsection 27.1(5) of the Act is intended to ensure that a taxpayer will not realize a gain or loss on an emissions allowance that is used to settle an emissions obligation. Specifically, the subsection provides that if a taxpayer surrenders an emissions allowance to settle an emissions obligation, the taxpayer's proceeds from the disposition of the emissions allowance are deemed to be equal to the taxpayer's cost of the emissions allowance.

Loss restriction event

ITA
27.1(6)

New subsection 27.1(6) of the Act provides that, at the end of a taxpayer's last taxation year before a change in control, an emissions allowance must be valued at the lower of its cost and its fair market value at the end of that year. After that time, that lower amount is deemed to be the cost at which the property was acquired by the taxpayer.

Clause 11

Farming or fishing business

ITA
28

Section 28 of the Act provides rules concerning the computation of income for a taxpayer who uses the cash-basis method of accounting for income tax purposes in respect of a farming or fishing business.

ITA
28(1)(d)

Paragraph 28(1)(d) of the Act adds to a taxpayer's income the total of all amount included in income under subsection 14(1) as well as other amounts. Paragraph 28(1)(d) is amended to remove the reference to subsection 14(1), consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
28(1)(g)

Paragraph 28(1)(g) of the Act subtracts from a taxpayer's income the total of all amounts deducted from income under paragraph 20(1)(b) and subsection 24(1) as well as other amounts. Paragraph 28(1)(g) is amended to remove the references to paragraph 20(1)(b) and subsection 24(1), consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 12

Taxable Capital Gain – Gift of Securities

ITA
38(a.1)(ii)

Subparagraph 38(a.1)(ii) of the Act, as it applies for the 2016 and later taxation years, provides that a taxpayer's taxable capital gain from the disposition of a qualifying security is nil if the disposition by the taxpayer is deemed by section 70 to have occurred immediately before the taxpayer's death and the security is the subject of a gift, to which subsection 118.1(5.1) applies, that is made by the taxpayer's graduated rate estate. For this purpose, a qualifying security is a security referred to in subparagraph 38(a.1)(i), including, for example, a share listed on a designated stock exchange and a unit of a mutual fund trust.

Clause 38(a.1)(ii)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the subparagraph to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. The effect of these amendments is that subparagraph 38(a.1)(ii) applies to a gift if the other requirements of the subparagraph are met and:

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (i.e., where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

For further information, see the commentary on subsection 118.1(5.1).

This amendment applies to the 2016 and subsequent taxation years.

Taxable Capital Gain – Ecological Gift

ITA
38(a.2)(ii)

Subparagraph 38(a.2)(ii) of the Act, as it applies for the 2016 and later taxation years, provides that a taxpayer's taxable capital gain from the disposition of a property is nil if the disposition by the taxpayer is deemed by section 70 to have occurred immediately before the taxpayer's death and the property is the subject of an ecological gift, to which subsection 118.1(5.1) applies, that is made by the taxpayer's graduated rate estate to a qualified donee (other than a private foundation).

Clause 38(a.2)(ii)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the subparagraph to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. The effect of these amendments is that subparagraph 38(a.2)(ii) applies to a gift if the other requirements of the subparagraph are met and:

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (i.e., where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

For further information, see the commentary on subsection 118.1(5.1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 13

Meaning of capital gain and capital loss

ITA
39

Section 39 of the Act sets out the meanings of capital gain, capital loss and business investment loss.

ITA
39(1)(a)(i)

Subparagraph 39(1)(a)(i) of the Act provides that no capital gain arises on the disposition of eligible capital property. This subparagraph is repealed, consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
39(1)(a)(i.1)(B)

Paragraph 39(1)(*a*) of the Act describes a taxpayer's capital gain for a taxation year from the disposition of property. A taxpayer's gain from the disposition of property described in any of subparagraphs 39(1)(*a*)(i) to (v) does not give rise to a capital gain. Subparagraph 39(1)(*a*)(i.1) describes certified cultural property that is disposed of to designated institutions and public authorities. Under clause 39(1)(*a*)(i.1)(B), as it applies for the 2016 and later taxation years, a taxpayer has no capital gain from the disposition of such a property if the disposition is deemed by subsection 70 to have occurred and the property is the subject of a gift, to which subsection 118.1(5.1) applies, that is made by the taxpayer's graduated rate estate to an institution that is, at the time the gift is made by the estate, a designated institution or public authority.

Clause 39(1)(a)(i.1)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the clause to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. The effect of these amendments is that clause 39(1)(a)(i.1)(B) applies to a gift if the other requirements of the subparagraph are met and:

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (i.e., where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

For further information, see the commentary on subsection 118.1(5.1).

ITA
39(1)(b)(ii)

Paragraph 39(1)(b) of the Act defines a taxpayer's capital loss for a taxation year from the disposition of property. Certain property is excluded from the definition, with the consequence that there is no capital loss from its disposition. Consequential on the repeal of the eligible capital property rules, subparagraph 39(1)(b)(ii) is amended to delete the reference to subparagraph 39(1)(a)(i).

This amendment comes into force on January 1, 2017.

Deemed gain – parked obligation

ITA
39(2.01)

New subsections 39(2.01) to (2.03) of the Act are intended to counter the "parking" of a debt obligation denominated in a foreign currency that is undertaken to avoid the realization of a foreign exchange gain on the repayment of the debt obligation.

In general terms, for the purposes of subsection 39(2), where a debt obligation denominated in a foreign currency becomes a parked obligation at a particular time, new subsection 39(2.01) deems the debtor to have made, at that time, the gain, if any, that it otherwise would have made if it had paid an amount in satisfaction of the debt obligation equal to:

- if the debt obligation has become a parked obligation at the particular time as a result of its acquisition by the holder of the debt obligation, the amount paid by the holder to acquire the debt obligation; and
- in any other case, the fair market value of the debt obligation at the particular time.

This amendment is deemed to have come into force on March 22, 2016. However, it does not apply to a debt obligation at the time that the obligation meets the conditions to become a parked obligation because of a written agreement entered into before March 22, 2016 if that time is before 2017.

Parked obligation

ITA
39(2.02)

New subsection 39(2.02) of the Act sets out certain conditions that must be met for a debt obligation owing by a debtor to be a parked obligation at a particular time for the purposes of new subsection 39(2.01).

First, new paragraph 39(2.02)(a) requires that both:

- at the particular time, the holder of the debt obligation does not deal at arm's length with the debtor or where the debtor is a corporation, has a significant interest in the debtor; and
- at any previous time, a person who held the debt obligation dealt at arm's length with the debtor and, where the debtor is a corporation, did not have a significant interest in the debtor.

In general terms, a debt obligation will meet the conditions in new paragraph 39(2.02)(a) if, for example, the debt obligation is acquired by a person with which the debtor does not deal at arm's length from a creditor that dealt at arm's length with the debtor. A debt obligation could also meet the conditions in new paragraph 39(2.02)(a), without it being acquired by a new creditor, if there is a change of status between the debtor and the current holder of the debt obligation, from dealing at arm's length to not dealing at arm's length or, where the debtor is a corporation, from

the current holder of the debt obligation not having a significant interest in the debtor to having a significant interest in the debtor.

Second, new paragraph 39(2.02)(b) requires that it can reasonably be considered that one of the main purposes of the transaction or event or series of transactions or events that resulted in the debt obligation meeting the condition in new subparagraph 39(2.02)(a)(i) – either by the acquisition of the debt obligation by its current holder or by a change of status between the current holder and the debtor – is to avoid the application of subsection 39(2).

This amendment is deemed to have come into force on March 22, 2016. However, it does not apply to a debt obligation at the time that the obligation meets the conditions to become a parked obligation because of a written agreement entered into before March 22, 2016 if that time is before 2017.

Interpretation

ITA
39(2.03)

New subsection 39(2.03) of the Act provides that the following provisions apply for the purposes of new subsections 39(2.01) and 39(2.02):

- paragraph 80(2)(j) (which provides assumptions relevant for the purposes of determining whether two or more persons are related to each other and whether any person is controlled by another person); and
- paragraph 80.01(2)(b) (which sets out the circumstances in which a person has a "significant interest" in a debtor corporation).

This amendment is deemed to have come into force on March 22, 2016. However, it does not apply to a debt obligation at the time that the obligation meets the conditions to become a parked obligation because of a written agreement entered into before March 22, 2016 if that time is before 2017.

Clause 14

Reduction of capital gain

ITA
39.1(2)

Subsection 39.1(2) of the Act allows an individual with an exempt capital gains balance in respect of a flow through entity to claim a reduction in the capital gain otherwise determined for a taxation year from a subsequent disposition of an interest in, or share of, the capital stock of the flow-through entity. The reduction is limited to the individual's exempt capital gains balance for the year in respect of the entity.

Subparagraph (b)(ii) of the description of B in subsection 39.1(2) of the Act relates to amounts claimed under subsection 39.1(5). Subparagraph (b)(ii) is repealed consequential on the repeal of the eligible capital property rules and the repeal of subsection 39.1(5). Paragraph (b) is further reorganized to move the text in subparagraph (i) to the body of paragraph (b).

This amendment applies in respect of taxation years that begin after 2016.

Reduction in a share of partnership income from a business

ITA
39.1(5)

Subsection 39.1(5) of the Act allows an individual who is a member of a partnership to shelter, with his or her exempt capital gains balance in respect of the partnership, that part of his or her share of the partnership's income from a business that is attributable to an amount included under paragraph 14(1)(b) in computing the partnership's income from the business, which relates to eligible capital property.

Subsection 39.1(5) is repealed consequential on the repeal of the eligible capital property rules.

This repeal applies in respect of taxation years that begin after 2016.

Clause 15

Capital gain and capital loss

Section 40 provides rules for determining a taxpayer's gain or loss from the disposition of capital property.

Class 14.1 — transitional rules

ITA
40(13) and (14)

Subsection 40(14) of the Act reduces the capital gain of a taxpayer from the disposition of a property included in Class 14.1 in certain circumstances. This reduction is related to the 1988 conversion of the cumulative eligible capital pool from a 1/2 to a 3/4 inclusion rate. Variable C of the formula in paragraph 14(1)(b) – which is to be repealed consequential on the repeal of the eligible capital property rules – provides for a similar reduction.

Subsection 40(13) provides that subsection 40(14) applies in respect of a disposition by a taxpayer of a property included in new Class 14.1 if

(a) the property was an eligible capital property of the taxpayer immediately before January 1, 2017,

(b) the amount determined for Q in the definition "cumulative eligible capital" in former subsection 14(5) immediately before January 1, 2017 is greater than nil,

(c) the amount determined for B in the definition "cumulative eligible capital" in former subsection 14(5) immediately before January 1, 2017 is nil, and

(d) no amount is included in the taxpayer's income for a taxation year because of paragraph 13(38)(d).

Where subsection 40(14) applies in respect of a disposition, a taxpayer's capital gain from the disposition is reduced by such amount as the taxpayer claims, not exceeding 2/3 of the amount determined for Q in the definition "cumulative eligible capital" in subsection 14(5) in respect of the business immediately before January 1, 2017. The cumulative amount claimed under 40(14) in respect of all dispositions of a taxpayer in respect of a business therefore cannot exceed 2/3 of

the amount determined for Q in the definition "cumulative eligible capital" in subsection 14(5) in respect of the business immediately before January 1, 2017.

Subsections 40(13) and (14) come into force on January 1, 2017.

<u>Example</u>

Before 1988, a taxpayer

- *Incurs an eligible capital expenditure of $100 for goodwill (resulting in CEC of $50); and*
- *Deducts $12 from CEC (resulting in CEC of $38).*

In 1988 the CEC is increased by 50% (resulting in CEC of $57).

After 1988 the taxpayer deducts $18 (resulting in CEC of $39).

The taxpayer disposes of the business with $300 of the proceeds of disposition allocated to goodwill.

<u>Current Rules</u>

Under the current rules, 3/4 of the proceeds would reduce CEC (resulting in CEC of negative $186).

At the end of the taxation year, paragraph 14(1)(a) requires $30 (the lesser of $186 and $30) to be included in income as recapture and paragraph 14(1)(b) requires $100 (2/3 x ($186-$30-$6)) to be included in income.

<u>Proposed Rules</u>

The goodwill of the business would be deemed to have a capital cost of $92 (4/3 x $39+4/3 x $30) by new subsection 13(38).

The UCC of the business would be $39 (equal to CEC). The proceeds would reduce the UCC to negative 30 ($39-3/4($92)), resulting in an income inclusion under subsection 13(1) of $30.

There would also be a capital gain of $208 ($300-$92), which new subsection 40(14) would reduce by $8, resulting in a taxable capital gain of $100.

Class 14.1 — transitional rules

ITA
40(15) and (16)

Subsection 40(16) of the Act reduces the capital gain of a taxpayer from the disposition of a property included in Class 14.1 in certain circumstances. This reduction is related to the 1994 elimination of the $100,000 lifetime capital gains exemption. Variable D of the formula in paragraph 14(1)(b) – which is to be repealed consequential on the repeal of the eligible capital property rules – provides for a similar reduction.

Subsection 40(15) provides that subsection 40(16) applies in respect of a disposition by an individual of a property included in new Class 14.1 if

(a) the property was an eligible capital property of the taxpayer immediately before January 1, 2017, and

(b) the individual's exempt gains balance in respect of the business is greater than nil for the taxation year that includes January 1, 2017.

Where subsection 40(16) applies in respect of a disposition, the individual's capital gain from the disposition is reduced by such amount as the taxpayer claims, not exceeding twice the amount of the individual's exempt gains balance in respect of the business for the taxation year that includes January 1, 2017. The cumulative amount of reductions under 40(16) in respect of all dispositions of an individual in respect of a business therefore cannot exceed twice the amount of the individual's exempt gains balance in respect of the business for the taxation year that includes January 1, 2017. As well, the cumulative amount of reductions is reduced by the amount determined for D in paragraph 14(1)(b) for the purposes of paragraph 13(38)(d) if paragraph 13(38)(d) applied in respect of the business for the individual's taxation year that includes January 1, 2017.

Subsections 40(15) and (16) come into force on January 1, 2017.

Clause 16

Adjusted cost base

ITA
53(1)

Subsection 53(1) of the Act sets out a number of amounts that are required to be added, in computing the adjusted cost base to a taxpayer of property, to the taxpayer's cost of the property. Paragraph 53(1)(e) provides for additions in computing the adjusted cost base to a taxpayer of property that is an interest in a partnership. Subparagraph 53(1)(e)(iii) provides for the addition of the taxpayer's share of certain proceeds of a life insurance policy received by the partnership, as a beneficiary under the policy, because of the death of a life insured under the policy. The addition applies only to the extent that those proceeds exceed the adjusted cost basis of the policy to the partnership immediately before the death. In effect, the partnership's policy adjusted cost basis is not included in the amount added to the adjusted cost base to a taxpayer of property that is an interest in the partnership.

Subparagraph 53(1)(e)(iii) is amended so that the policy adjusted cost basis limit described above also applies in cases where the partnership is not a policyholder of the policy. Specifically, where the death that gives rise to the insurance proceeds received by the partnership occurs after March 21, 2016, the adjusted cost basis limit is the total of all amounts each of which is the adjusted cost basis to a policyholder of the policyholder's interest in the policy.

Subparagraph 53(1)(e)(iii) is also amended to impose two further limits on the amount of the proceeds received by the partnership that is added to the adjusted cost base to a taxpayer of property that is an interest in the partnership. New clauses 53(1)(e)(iii)(C) and (D) impose these limits, which apply in the case where

- an interest in the policy was disposed of after 1999 and before March 22, 2016,
- the disposing policyholder was not a taxable Canadian corporation,
- subsection 148(7) applied to the disposition,
- an amount of consideration was given in respect of the disposition,

- the fair market value of the consideration given exceeds the proceeds of disposition determined in respect of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition), and
- the death that gives rise to the proceeds occurs after March 21, 2016.

The amount of the limit under clause 53(1)(e)(iii)(C) is the amount by which the fair market value of the consideration exceeds the greater of

(i) the proceeds of disposition determined in respect of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition), and

(ii) the adjusted cost basis to the disposing policyholder of the interest immediately before the disposition time.

In general terms, the limit imposed by clause 53(1)(e)(iii)(C) reflects the amount, if any, of the consideration's value that would have been included as income (under subsection 148(1)) of the disposing policyholder had the excess described in the clause been included in determining the proceeds of the disposition of the interest.

The amount of the limit under clause 53(1)(e)(iii)(D) is the amount, if any, determined by the formula A – B. Element A of the formula is the amount by which the lesser of two amounts – the first being the adjusted cost basis to the disposing policyholder of the interest immediately before the disposition time and the second being the fair market value at the disposition time of consideration given for the interest –exceeds the proceeds of disposition determined in respect of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition). Element B of the formula is the absolute value of the negative amount of the adjusted cost basis, at the time immediately before the death, of the interest determined without reference to section 257 of the Act (*i.e.*, the amount that would be the interest's "negative" adjusted cost basis, if any, to the policyholder at that time).

These amendments are deemed to come into force on March 22, 2016.

Clause 17

Capital gain - definitions

ITA
54

Section 54 of the Act provides definitions for the purposes of the rules for the calculation of taxable capital gains and allowable capital losses.

"eligible capital property"

The definition "eligible capital property" in section 54 is repealed, consequential on the repeal of the eligible capital property rules and the creation of new Class 14. The definition "eligible capital property" in subsection 248(1) is also repealed.

This repeal comes into force on January 1, 2017.

"proceeds of disposition"

The definition “proceeds of disposition” in section 54 is relevant for the purpose of determining a taxpayer’s capital gain or loss from the disposition of property. Under paragraph (k) of the definition, the portion of those proceeds (otherwise determined) that is deemed to be a dividend under subsection 84(1.1), 212.1(1) or 212.2(2) is excluded in determining a taxpayer’s proceeds of disposition.

Paragraph (k) of the definition is amended to replace the reference to subsection 212.1(1) with subsection 212.1(1.1). This amendment is consequential on the purely structural change whereby subsection 212.1(1) is divided into conditions of application, which remain in that subsection, and consequences of application, which are moved to new subsection 212.1(1.1). This amendment ensures that paragraph (k) continues to apply in respect of a dividend that is deemed under section 212.1.

For further information, see the commentary on subsections 212.1(1) and (1.1).

This amendment applies in respect of dispositions that occur after March 21, 2016.

Clause 18

Restrictive covenant

ITA
56.4

Section 56.4 of the Act sets out rules with respect to amounts that are received or receivable in respect of a restrictive covenant.

Definitions

ITA
56.4(1)

Subsection 56.4(1) of the Act provides definitions that are relevant for the purpose of computing the amount, if any, that a taxpayer is required to include in income, or in proceeds of disposition in respect of certain capital property, in respect of amounts received or receivable for a restrictive covenant.

“goodwill amount”

“Goodwill amount”, of a taxpayer, is an amount that the taxpayer has or may become entitled to receive that is required by the description of E in the definition “cumulative eligible capital” in subsection 14(5) to be included in computing the cumulative eligible capital of a business carried on through a permanent establishment located in Canada. This definition is relevant for the purpose of applying subsection 56.4(7).

The definition “goodwill amount” is amended, consequential on the repeal of the eligible capital property rules, to provide that the goodwill amount of a taxpayer is an amount the taxpayer has or may become entitled to receive that would, if this Act were read without reference to section 56.4, be required to be included in the proceeds of disposition of property included in Class 14.1 of Schedule II to the Regulations, or is an amount to which subsection 13(38) applies, in respect of a business carried on by the taxpayer through a permanent establishment located in Canada.

This amendment comes into force on January 1, 2017.

Non-application of subsection (2)

ITA
56.4(3)(b)

Subsection 56.4(3) of the Act provides three exceptions to the income inclusion rule in subsection 56.4(2)

Paragraph 56.4(3)(b) provides that subsection 56.4(2) does not generally apply to an amount that would, if the Act were read without reference to section 56.4, be required by the description of E in the definition "cumulative eligible capital" in subsection 14(5) to be included in computing the taxpayer's cumulative eligible capital in respect of the business to which the restrictive covenant relates.

Paragraph 56.4(3)(b) is amended, consequential on the repeal of the eligible capital property rules, to provide that subsection 56.4(2) does not generally apply to an amount that would, if the Act were read without reference to section 56.4, be required to be included in the proceeds of disposition of property included in Class 14.1, or is an amount to which subsection 13(38) applies, in respect of the business to which the restrictive covenant relates.

This amendment comes into force on January 1, 2017.

Treatment of purchaser

ITA
56.4(4)(b)

Subsection 56.4(4) of the Act provides rules that apply to an amount paid or payable by a purchaser of a restrictive covenant in certain circumstances.

Paragraph 56.4(4)(b) provides that if an election has been made under paragraph 56.4(3)(b) in respect of the amount, the amount is to be considered to be an outlay incurred by the purchaser on account of capital for the purpose of applying the definition "eligible capital expenditure" in subsection 14(5) and not to be an amount paid or payable for all other purposes of the Act.

Paragraph 56.4(4)(b) is amended, consequential on the repeal of the eligible capital property rules, to no longer apply in respect of eligible capital expenditures and instead to provide that if an election has been made under paragraph 56.4(3)(b) in respect of the amount, the amount is to be considered to be an outlay incurred by the purchaser on account of capital for the purpose of determining the cost of the property or for the purposes of subsection 13(35), as the case may be, and not to be an amount paid or payable for all other purposes of the Act.

This amendment comes into force on January 1, 2017.

Clause 19

Idem

ITA
69(5)(d)

Section 69 of the Act provides a series of rules dealing primarily with transactions between non-arm's length persons or between persons on non-arm's length terms. Subsection 69(5) provides

rules on the winding-up of a corporation where property of the corporation has been appropriated to the benefit of a shareholder.

Paragraph 69(5)(d) provides that subsections 13(21.2), 14(12), 18(15) and 40(3.4) and (3.6) do not apply in respect of any property subject to a deemed disposition by the corporation on the winding up.

Paragraph 69(5)(d) is amended, consequential on the repeal of the eligible capital property rules, to remove the reference to subsection 14(12).

This amendment comes into force on January 1, 2017.

Clause 20

Death of a taxpayer

ITA
70

Section 70 of the Act provides rules relating to the transfer or distribution of property at the time of the death of a taxpayer.

Exception

ITA
70(3.1)

Subsection 70(2) of the Act requires the value of certain rights or things to be included in computing the income of a taxpayer in the year in which the taxpayer died. Subsection 70(3.1) provides a list of exclusions from the term "rights or things" for the purposes of section 70. Subsection 70(3.1) provides that "rights or things" do not include eligible capital property.

Subsection 70(3.1) is amended to remove the reference to eligible capital property consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property in Schedule II to the Regulations. Subsection 70(2) provides that "rights or things" do not include capital property, including depreciable property.

This amendment comes into force on January 1, 2017.

Transfer or distribution – Class 14.1

ITA
70(5.1)

Subsection 70(5.1) of the Act provides rules with respect to the transfer of eligible capital property on the death of a taxpayer to a beneficiary. The beneficiary is generally deemed to have acquired an eligible capital property at 4/3 of the cumulative eligible capital of the taxpayer's cumulative eligible capital of the deceased prorated using the fair market values of all eligible capital properties.

Subsection 70(5.1) is amended, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

Subsections 70(5) and 70(6) provide rules similar to the rules in subsection 70(5.1) that generally provide that a capital property, including a depreciable property, is deemed to be disposed on death for proceeds of disposition equal to the fair market value unless the property is transferred to a spouse or common law partner.

Amended subsection 70(5.1) provides for tax deferral similar to the tax deferral provided by subsection 70(6) where property included in Class 14.1 is transferred to a beneficiary on the death of a taxpayer.

This amendment comes into force on January 1, 2017.

Election

ITA
70(6.2)

Subsection 70(6.2) of the Act allows a deceased taxpayer’s legal representative to make an election, in respect of property of the taxpayer which would otherwise be eligible for rollover treatment under subsection 70(6) or (6.1), to have the general rules in subsection 70(5) apply to the disposition of the property.

Subsection 70(6.2) is amended to provide that the election also applies to amended subsection 70(5.1).

This amendment comes into force on January 1, 2017.

Leased farm and fishing property

ITA
70(9.8)

Subsection 70(9.8) of the Act treats, for the purposes described in that subsection (including for the purposes of subsection 14(1) and paragraph 20(1)(b)), property owned by a taxpayer as having been used by the taxpayer in the business of farming or fishing, as the case may be, if it is used principally in the business of farming or fishing in Canada by a family farming or fishing corporation, or a family farming or fishing partnership, of

- the taxpayer,
- the taxpayer's spouse or common-law partner, or
- any of the taxpayer's children.

Subsection 70(9.8) is amended to remove references to subsection 14(1) and paragraph 20(1)(b), consequential to the repeal of those provisions.

This amendment comes into force on January 1, 2017.

Clause 21

***Inter vivos* transfers by individuals**

ITA
73

Section 73 of the Act provides rules for the tax treatment of certain *inter vivos* transfers of property.

***Inter vivos* transfer of farm or fishing property to a child**

ITA
73(3) and (3.1)

Subsection 73(3.1) of the Act provides a tax-deferral for *inter vivos* transfers of certain farm or fishing property by a taxpayer to a child of the taxpayer. Subsection 70(3) provides the circumstances in which tax-deferral under subsection 70(3.1) will be available.

Paragraph 70(3)(a) provides that the tax-deferral is only available in respect of property that is land in Canada, depreciable property in Canada of a prescribed class, or any eligible capital property in respect of a fishing or farming property carried on in Canada. Paragraphs 70(3.1)(c), (f) and (g) provide rules for the tax-deferred transfer of eligible capital property to a child of the taxpayer.

Paragraph 70(3)(a) is amended to remove the reference to eligible capital property and paragraphs 70(3.1)(c), (f) and (g) are repealed consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of Schedule II to the Regulations.

This amendment comes into force on January 1, 2017.

Clause 22

Surrender of property – debtor

ITA
79(4)(b)

Section 79 of the Act provides rules for debtors in connection with foreclosures, conditional sale repossessions and similar transactions.

Subsection 79(4) provides a rule in the event that a debtor subsequently pays a debt included in the debtor’s proceeds of disposition of surrendered property. Paragraph 79(4)(b) provides that where the property is eligible capital property, the amount paid is deemed to be a repayment in respect of a property to which paragraph 20(1)(hh.1) applies. Paragraph 79(4)(d) provides that where the property is depreciable property, the amount paid is deemed to be a repayment in respect of a property to which paragraph 20(1)(hh) applies.

Paragraph 79(4)(b) is amended, consequential on the repeal of the eligible capital property rules, to provides that where the property was eligible capital property at the time the expenditure was made, the amount paid is deemed to be a repayment in respect of a property to which paragraph 20(1)(hh.1) applies.

This amendment comes into force on January 1, 2017.

Clause 23

Debt forgiveness

ITA
80

Sections 80 to 80.04 of the Act set out the rules that apply when a commercial debt obligation is settled or extinguished for less than its principal amount or the amount for which it was issued. When such an obligation is settled or extinguished, it gives rise to a "forgiven amount" as defined in subsection 80(1). A forgiven amount in respect of a commercial debt obligation issued by a debtor is required to be applied against certain tax pools of the debtor, in a specified order, as provided in subsections 80(3) to (12). In general, subsection 80(13) requires that one half of any remaining unapplied portion of the forgiven amount be included in computing the debtor's income, unless it can be transferred to another taxpayer under section 80.04.

Subsections 80(5) and (6) generally provide that the remaining unapplied portion of a debtor's forgiven amount (after the forgiven amount has reduced non-capital losses and capital losses) in respect of an obligation settled at any time may be applied to reduce immediately after that time capital costs of depreciable property and the undepreciated capital cost of depreciable property.

Subsection 80(7) provides that the remaining unapplied proportion of a debtor's forgiven amount (after the forgiven amount has been reduced under subsections 80(5) and (6)) is multiplied by ¾ and then applied, to the extent designated by the debtor, to reduce the debtor's cumulative eligible capital. Only 3/4 of the unapplied forgiven amount in respect of an obligation is applied to reduce cumulative eligible capital of the taxpayer since only ¾ of a debtor's eligible capital expenditures are added in computing the debtor's cumulative eligible capital. Under paragraph 80(2)(f), the portion of the forgiven amount applied in this respect is considered to be 4/3 of the reduction of the cumulative eligible capital.

Paragraph 80(2)(f) and subsection 80(7) are repealed consequential on the repeal of the eligible capital property rules. Due to the repeal of the eligible capital property rules and the introduction of new Class 14.1 of Schedule II to the Regulations, all eligible capital properties will be prescribed as depreciable properties under the regulations. As a result, subsections 80(5) and (6) will apply to these properties.

Paragraph 80(2)(c) and subsections (7), (9), (10), (11), (12), (13), (14.1) and (15) and are also amended to remove references to subsection 80(7)

These amendments come into force on January 1, 2017.

Clause 24

Back-to-back arrangement

ITA
80.4(2)

Subsection 80.4(2) of the Act provides a rule in respect of certain low-interest or non-interest bearing indebtedness extended by a corporation to a shareholder of the corporation, a connected person or partnership or a member of a partnership or a beneficiary of a trust that is a shareholder of the corporation. Where the loan or indebtedness was extended by virtue of such shareholding, a benefit is deemed to be received by the debtor.

New "back-to-back loan" rules, which are being added to the shareholder loan rules in subsection 15(2) and related provisions, apply also for the purposes of section 80.4. Generally, these new rules seek to ensure that the application of subsections 15(2) and 80.4(2) is not

avoided by financing arrangements in which a particular corporation – rather than providing debt funding directly to its shareholder, or a connected person or partnership – provides debt funding indirectly through one or more intermediaries.

New subsection 15(2.17) deems a person or partnership that is directly or indirectly a shareholder of a particular corporation, or that is connected with a shareholder of the particular corporation, to receive a loan from the particular corporation for purposes of section 80.4, where the conditions in new subsection 15(2.16) are met. New subsection 15(2.19) deems the person or partnership to repay the loan, in whole or in part, to the particular corporation for the purposes of section 80.4, where the conditions in new subsection 15(2.18) are met. For further information, see the commentary on new subsections 15(2.16) to (2.192).

New subsections 15(2.16) to (2.192), along with the related amendments to paragraph 80.4(2)(e) and subsection 80.4(7), apply in respect of loans received and indebtedness incurred and specified rights granted after March 21, 2016. However, these rules also apply in respect of any portion of a particular loan received or indebtedness incurred or specified right granted before March 22, 2016 that remains outstanding on that date, as if that portion were a separate loan or indebtedness received or incurred, or specified right granted, as the case may be, on March 22, 2016, in the same manner and on the same terms as the particular loan or indebtedness or specified right.

Idem

ITA
80.4(2)(e)

The amount of the benefit deemed by subsection 80.4(2) of the Act is equal to the amount by which the amount determined under paragraph 80.4(2)(d) exceeds the amount determined under paragraph 80.4(2)(e). Paragraph 80.4(2)(d) represents the aggregate interest for the year, computed at the prescribed rate, on all loans and debts to which subsection 80.4(2) applies. Paragraph 80.4(2)(e) represents the amount of interest for the year paid on all such loans and debts not later than 30 days after the later of the end of the year and December 31, 1982.

Consequential on the introduction of the back-to-back loan rules in subsections 15(2.16) to 15(2.192), which generally apply also for purposes of section 80.4, paragraph 80.4(2)(e) is amended to provide that, in respect of loans that are deemed to have been made under subsection 15(2.17), the amount determined under that paragraph is equal to the specified interest amounts (as defined in subsection 80.4(7)) in respect of the deemed loans.

Definitions

ITA
80.4(7)

Subsection 80.4(7) of the Act provides definitions for the purposes of section 80.4.

“specified interest amount”

The definition “specified interest amount” is added to subsection 80.4(7). This new definition provides a formula for calculating the amount to be included under paragraph 80.4(2)(e) in respect of a loan that is deemed to be made under subsection 15(2.16).

The “specified interest amount”, for a year, in respect of a loan (the “deemed loan”) deemed under subsection 15(2.17) to have been made by an “ultimate funder” (as defined in subsection 15(2.192)), is the amount determined by the formula A x B/C.

Variable A is the amount of interest for the year, paid not later than 30 days after the end of the year, on all debts – owing by one or more “funders” (that are not “ultimate funders”) under one or more “funding arrangements” to the ultimate funder – that gave rise to the deemed loan. The relevant terms are defined in new subsection 15(2.192))

Variable B is the average amount outstanding for the year in respect of the deemed loan.

Variable C is the total of all amounts each of which is the average amount outstanding in the year as or on account of an amount owing under a debt described in variable A.

Clause 25

Deemed Dividend

ITA
84(1)(c.3)(i)

Subsection 84(1) of the Act deems a dividend to be paid by a corporation on the shares of a class of its capital stock where the paid-up capital of the class is increased by the corporation, unless one of the exceptions set out in that subsection applies.

One exception, contained in subparagraph 84(1)(c.3)(i), applies if a corporation converts into paid-up capital in respect of a class of shares of its capital stock any contributed surplus that arose on the issuance of shares of that class (or shares of another class for which the shares of that class were substituted), other than an issuance to which any of certain enumerated provisions of the Act applied. These provisions are section 51, 66.3, 84.1, 85, 85.1, 86 and 87, subsection 192(4.1) and 194(4.1) and section 212.1. If the exception applies, a deemed dividend is not triggered by the conversion.

Subparagraph 84(1)(c.3)(i) is amended to replace the reference to section 212.1 with a reference to subsection 212.1(1.1). This amendment is not a substantive change and is consequential on the purely structural change whereby subsection 212.1(1) is divided into conditions of application, which remain in that subsection, and consequences of application, which are moved to new subsection 212.1(1.1). This amendment ensures that the exception in subparagraph 84(1)(c.3)(i) is unavailable if subsection 212.1(1.1) applied to the issuance of shares.

For further information, see the commentary on subsections 212.1(1) and (1.1).

This amendment comes into force on March 22, 2016.

Clause 26

ITA
85

Section 85 of the Act provides rules for tax-deferred transfers of certain types of properties by a taxpayer to a taxable Canadian corporation in exchange for shares.

ITA
85(1)

Subsection 85(1) of the Act provides tax deferral for the transfer of “eligible property” by a taxpayer to a taxable Canadian corporation for consideration that includes shares of the corporation’s capital stock. In general, tax deferral may be achieved if the taxpayer and the corporation jointly elect that the proceeds of disposition of the taxpayer and the eligible capital expenditure of, or cost to, the corporation are deemed to be less than the fair market value of the property transferred.

ITA
85(1)(d) to (d.12)

Paragraph 85(1)(d) of the Act provides that the amount of the elected proceeds of disposition, in respect of an eligible capital property cannot be less than the least of:

- 4/3 of the taxpayer’s cumulative eligible capital in respect of the business immediately before the disposition;
- the cost to the taxpayer of the property; and
- the fair market value of the property at the time of the disposition.

Paragraph 85(1)(e) provides a similar rule in respect of depreciable property.

Paragraph 85(1)(d.1) provides rules related to the 1988 change of the rate of income inclusion and expenditure deductibility from 1/2 to 3/4.

Paragraph 85(1)(d.11) generally applies to ensure that an amount that would have been recaptured eligible capital property deductions to the taxpayer under subsection 14(1), if the taxpayer had disposed of the eligible capital property for an amount greater than the taxpayer’s cumulative eligible capital at the time of the disposition, is subject to recapture in the hands of the corporation upon a subsequent sale of the property.

Paragraph 85(1)(d.12) of the Act ensures that a disposition of other eligible capital property by the taxpayer does not result in recapture of depreciation under paragraph 14(1)(a) when the resulting gain from that disposition should have been taxed at a lower rate under paragraph 14(1)(b) because of the previous application of paragraph 85(1)(d.11) to a disposition of the taxpayer.

Paragraph 85(1)(*d*) to (d.12) are repealed consequential on the repeal of the eligible capital property rules and the creation of new class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

ITA
85(1)(e.1)

Paragraph 85(1)(e.1) of the Act provides generally that where more than one property described by paragraph (d) or (e) is disposed of at the same time, they are treated as being disposed of separately and the taxpayer may designate the order in which they are disposed of.

Paragraph 85(1)(e.1) is amended to remove a reference to paragraph 85(1)(d), consequential on the repeal of paragraph 85(1)(d).

This amendment comes into force on January 1, 2017.

ITA
85(1)(e.3)

Paragraph 85(1)(e.3) of the Act provides generally that where the elected amount would be deemed under paragraphs (c.1), (d) or (e) to be an amount that is greater or less than the amount that would be deemed, subject to paragraph (c), to be the elected amount under paragraph (b), the elected amount is deemed to be the greater of the two amounts.

Paragraph 85(1)(e.3) is amended to remove a reference to paragraph 85(1)(d), consequential on the repeal of paragraph 85(1)(d).

This amendment comes into force on January 1, 2017.

ITA
85(1.1)(e)

Subsection 85(1.1) of the Act lists the types of property that are eligible for the election under subsection 85(1). Paragraph 85(1.1)(e) provides that eligible capital property is eligible for the election. Paragraph 85(1.1)(a) provides a similar rule for depreciable property.

Paragraph 85(1.1)(e) is repealed, consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 27

Amalgamations

ITA
87

Section 87 of the Act provides rules that apply where there has been an amalgamation of two or more taxable Canadian corporations to form a new corporation. The new corporation is generally treated as a continuation of each predecessor corporation for the purposes of the Act.

Eligible capital property

ITA
87(2)(f)

Paragraphs 87(2)(d) and (d.1) of the Act provide rules in respect of depreciable property and paragraph (f) provides rules in rules in respect of eligible capital property.

Paragraph 87(2)(f) provides that, where there has been an amalgamation of two or more taxable Canadian corporations, for the purposes of determining any amount relating to cumulative eligible capital, an eligible capital amount, and eligible capital expenditure or eligible capital property, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation.

Paragraph 87(2)(f) is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Superficial losses

ITA
87(2)(g.3)

Paragraph 87(2)(g.3) of the Act treats a new corporation formed on an amalgamation as a continuation of each of its predecessors for the purposes of applying subsections 13(21.2), 14(12), 18(15) and 40(3.4) to property disposed of before the amalgamation took place. Those subsections apply where property is transferred to a person with whom the transferor is affiliated and the tax cost of the property to the transferor exceeds its value at the time of the transfer. Where these conditions exist, any loss that would otherwise arise on the disposition is denied, but can be subsequently recognised when, for example, the transferred property is sold to a person that is not affiliated with the transferor.

Paragraph 87(2)(g.3) is amended to remove the reference to subsection 14(12) consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 28

Winding-up

ITA
88(1)

Section 88 of the Act deals with the tax consequences arising from the winding-up of a corporation. Subsection 88(1) provides rules that apply where a subsidiary has been wound up into its parent corporation in circumstances where both the parent and the subsidiary are taxable Canadian corporations and the parent owns at least 90% of the issued shares of each class of the capital stock of the subsidiary.

ITA
88(1)(c.1)

Subparagraph 88(1)(a)(iii) of the Act generally provides that property of a subsidiary corporation is deemed to have been disposed of on its winding-up for proceeds of disposition equal to its cost amount to the subsidiary immediately before the winding-up. Under subparagraph 88(1)(c)(ii) of the Act, the cost of such property to the parent corporation is equal to such proceeds of disposition.

Paragraph 88(1)(c.1) generally reduces, for the parent that has acquired an eligible capital property, the gain that would be included in income under paragraph 14(1)(b) of the Act on a subsequent disposition of the property. This adjustment takes into account the 1988 change of the rate of income inclusion and expenditure deductibility from 1/2 to 3/4, by adjusting the calculation of variable Q in the definition “cumulative eligible capital” in subsection 14(5) of the Act. Paragraph 88(1)(c.1) also applies similarly to the application of paragraph 85(1)(d.11) of the Act to a shareholder in respect of a disposition of an eligible capital property to a corporation.

Paragraph 88(1)(c.1) is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
88(1)(d.1)

Paragraph 88(1)(d.1) provides that certain rules in the Act and in the *Income Tax Application Rules* do not to apply to a winding-up governed by subsection 88(1). Consequential on the repeal of the eligible capital property rules, paragraph 88(1)(d.1) is amended to delete the reference to subsection 14(12).

This amendment comes into force on January 1, 2017.

Clause 29

Definitions

ITA
89(1)

Subsection 89(1) of the Act contains the definitions “capital dividend account” and “paid-up capital”, which are relevant for many purposes of the Act.

Capital dividend account

ITA
89(1)

The definition “capital dividend account” is part of a mechanism for allowing certain tax-free amounts to flow through a private corporation without attracting an extra level of tax.

Paragraph (c.1) of the definition “capital dividend account” generally requires the inclusion in the capital dividend account of 1/2 of all amounts required by paragraph 14(1)(b) of the Act to be included in the corporation's income for taxation years that end after February 27, 2000 and before October 18, 2000.

Paragraph (c.2) of the definition requires the inclusion of the amount required by paragraph 14(1)(b) to be included for taxation years that end after October 17, 2000.

Both of these amounts are reduced to take into account the appropriate portion of bad debts in respect of dispositions of eligible capital property. The calculation of the reduction for bad debts is complicated by the interaction of different inclusion rates for capital gains that may be relevant during the period.

Consequential on the repeal of section 14, these paragraphs are amended to provide that they apply to amounts required by paragraph 14(1)(b) to be included in the corporation's income as paragraph 14(1)(b) read before 2017.

Paragraph (c.2) is also amended to provide for the inclusion of amounts required by new subparagraph 13(38)(d)(iii) to be included in the taxpayer’s income.

These amendments come into force on January 1, 2017.

Paragraph (d) of the definition permits a corporation to add to its capital dividend account the amount of proceeds of a life insurance policy received by the corporation, as a beneficiary under the policy, in consequence of the death of an individual whose life is insured under the policy.

The addition applies only to the extent that those proceeds exceed the adjusted cost basis of the policy to the corporation immediately before the death. In effect, the corporation's policy adjusted cost basis is not included in the amount added to the capital dividend account.

Subparagraph (d)(iii) of the definition is amended so that the policy adjusted cost basis limit described above also applies in cases where the corporation is not a policyholder of the policy. Specifically, where the death that gives rise to the insurance proceeds received by the corporation occurs after March 21, 2016, the adjusted cost basis limit is the total of all amounts each of which is the adjusted cost basis to a policyholder of the policyholder's interest in the policy.

New subparagraphs (d)(v) and (vi) of the definition imposes three further limits on the amount of the insurance proceeds received by the corporation that is added to its capital dividend account. The limits apply where

- an interest in the policy was disposed of after 1999 and before March 22, 2016,
- the disposing policyholder was not a taxable Canadian corporation,
- subsection 148(7) applied to the disposition,
- an amount of consideration was given in respect of the disposition,
- the fair market value of the consideration given exceeds the proceeds of disposition determined in respect of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition), and
- the death that gives rise to the proceeds occurs after March 21, 2016.

Under subparagraph (d)(v) of the definition:

- The first additional limit is the amount by which the fair market value of any consideration given for the disposition exceeds the total of two other amounts. The first other amount is the amount by which the fair market value of the consideration given in respect of the disposition exceeds the greater of (i) the proceeds of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition) and (ii) the adjusted cost basis to the disposing policyholder of the interest immediately before the disposition. In general terms, this first other amount reflects the amount, if any, that would have been included as income of the disposing policyholder (under subsection 148(1)) had the excess described in the clause been included in determining the proceeds of the disposition of the interest. The second other amount is the amount of any paid-up capital (of shares of the capital stock of a corporation) that arose in respect of the disposition and that was not extracted tax-free from the corporation before March 22, 2016. This remaining paid-up capital amount – to the extent that it exceeds the proceeds from the disposition – is the amount that is reduced at the start of March 22, 2016 by operation of paragraph 148(7)(c) or subparagraph 148(7)(f)(iii).

- The second additional limit applies if the disposition was by way of a contribution of capital to a corporation, that capital was subsequently converted on a tax-free basis to paid-up capital (of shares of the corporation's capital stock) and that paid-up capital was subsequently extracted from the corporation before March 22, 2016. In this case, the limit is the amount of that paid-up capital extracted from the corporation before March 22, 2016.

Under subparagraph (d)(vi) of the definition, the third limit is the amount, if any, determined by the formula A – B. Element A of the formula is the amount by which the lesser of two amounts – the first being the adjusted cost basis to the disposing policyholder of the interest immediately before the disposition time and the second being the fair market value at the disposition time of consideration given for the interest – exceeds the proceeds of the disposition (in this case being the policy's value, as defined in subsection 148(9), at the time of the disposition). Element B of the formula is the absolute value of the negative amount of the adjusted cost basis , at the time immediately before the death, of the interest determined without reference to section 257 of the Act (i.e., the amount that would be the interest's "negative" adjusted cost basis, if any, to the policyholder at that time).

These amendments to paragraph (d) of the definition are deemed to come into force on March 22, 2016.

"paid-up capital"

Paragraph (b) of the "paid-up capital" definition defines "paid-up capital" in respect of a class of shares of the capital stock of a corporation. Subparagraph (b)(iii) of the definition provides that, after March 31, 1977, paid-up capital is to be calculated without reference to any provisions of the Act other than those listed in the subparagraph.

Subparagraph (b)(iii) is amended to add a reference to subsection 148(7). Paragraphs 148(7)(c) and (f) contain certain rules regarding the computation of paid-up capital of certain shares of a class of the capital stock of a corporation where an interest in a life insurance policy is transferred to the corporation in circumstances in which subsection 148(7) applies.

This amendment is deemed to have come into force on March 22, 2016.

Clause 30

Excluded Provisions

ITA
94(4)(b)

Section 94 of the Act sets out rules that apply in determining whether paragraph 94(3)(a) deems a non-resident trust to be resident in Canada for a number of purposes. Subsection 94(4) provides that the deemed residence of a trust under paragraph 94(3)(a) does not apply for certain enumerated purposes.

Paragraph 94(4)(b) is amended to provide that paragraph 94(3)(a) will also not apply for purposes of the definition "investment fund" in subsection 251.2(1). An investment fund can

satisfy the Canadian residence requirement set out in that definition only if it is factually resident in Canada.

For further information, see the commentary on the definition “investment fund” in subsection 251.2(1).

This amendment is deemed to have come into force on March 21, 2013, except that before July 2015 it is to be read without reference to the definition “eligible trust” in subsection 135.2(1), and for taxation years that end before 2016 it is to be read without reference to the definition “qualified disability trust” in subsection 122(3).

Clause 31

Determination of certain components of foreign accrual property income

ITA
95(2)

Subsection 95(2) of the Act provides a number of rules for determining the income, of a foreign affiliate of a taxpayer resident in Canada, from a particular source.

ITA
95(2)(d.1)(ii)(B)

Paragraph 95(2)(d.1) of the Act provides for the rollover of property on a foreign merger of two or more predecessor foreign corporations, where certain conditions are met. Clause 95(2)(d.1)(ii)(B) provides continuity rules to give proper application to the various loss “suspension” rules in sections 13, 14, 18 and 40.

Clause 95(2)(d.1)(ii)(B) is amended to remove a reference to subsection 14(12), which is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
95(2)(e)(v)(A)(II)

Paragraphs 95(2)(e) of the Act provides rules that apply where a foreign affiliate of a taxpayer is liquidated and dissolved and property is distributed to shareholders that include other foreign affiliates of the taxpayer. Subclause 95(2)(e)(v)(A)(II) provides continuity rules to give proper application to the various loss “suspension” rules in sections 13, 14, 18 and 40.

Subclause 95(2)(e)(v)(A)(II) is amended to remove a reference to subsection 14(12), which is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
95(2)(f.11)(ii)(A)

Paragraph 95(2)(f) of the Act provides that, except as otherwise provided in subdivision i of Division B of Part I of the Act and except to the extent that the context otherwise requires, a foreign affiliate of a taxpayer is deemed to be at all times resident in Canada for the purposes of

determining, in respect of the taxpayer for a taxation year of the foreign affiliate, each amount that is the foreign affiliate's

(i) capital gain, capital loss, taxable capital gain or allowable capital loss from a disposition of a property, or

(ii) income or loss from a property, from a business other than an active business or from a non-qualifying business.

Clause 95(2)(f.11)(ii)(A) provides that in determining an amount described in paragraph 95(2)(f) for a taxation year of a foreign affiliate of a taxpayer, or the amount of income or loss from a property other than an active business or from a non-qualifying business, the Act is to be read without reference to certain provisions, including subsections 14(1.01) to 14(1.03).

Clause 95(2)(f.11)(ii)(A) is amended to delete references to subsections 14(1.01) to 14(1.03), which are repealed as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 32

Partnerships

ITA
96

Section 96 of the Act provides rules for determining the income or loss of a partnership and its members.

Gains and losses

ITA
96(1.7)

Subsection 96(1.7) of the Act adjusts the amount of a taxable capital gain or allowable capital loss included in a taxpayer’s income as an allocation from the partnership when the taxpayer’s capital gains inclusion rate for the taxpayer’s taxation year in with the partnership’s fiscal period ends is different from the partnership’s inclusion rate used to calculate the partnership’s taxable capital gain or allowable capital loss. The adjusted capital gain or allowable capital loss reflects the taxpayer’s inclusion rate for the taxpayer’s taxation year in which the fiscal period of the partnership ends.

Subsection 96(1.7) specifies that it does not apply to amounts that can reasonably be attributable to an amount deemed under subsection 14(1.1) to be a taxable capital gain.

Subsection 96(1.7) is amended to remove the reference to subsection 14(1.1) consequential on the repeal of subsection 14(1.1) as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Agreement or election of partnership members

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member had authority to act for the partnership. Subsection 96(3) applies to elections relating to eligible capital property under subsections 14(1.01), (1.02) and (6).

Subsection 96(3) is amended to remove the references to subsections 14(1.01), (1.02) and (6) consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Foreign partnerships

ITA
96(8)(d)

Subsection 96(8) of the Act applies where a partnership, none of the partners of which are Canadian residents, acquires a Canadian resident as a partner. This can occur when a Canadian resident become a member of such a partnership, or when a person who is a member of such a partnership becomes a resident of Canada. Subsection 96(8) contains a number of rules that apply in computing the income of the partnership for fiscal periods ending after the time at which the partnership acquires a Canadian resident partner.

Paragraph 96(8)(d), which deals with cumulative eligible capital of such a partnership, provides that where 4/3 of the cumulative eligible capital of a business carried on outside Canada by the partnership at the time it acquires a Canadian partner is greater than the total of the fair market value of the related eligible capital property, the partnership is deemed to have disposed of and received proceeds for an eligible capital property equal to the excess.

A similar rule in paragraph 96(8)(a) applies to depreciable property.

Paragraph 96(8)(d) is repealed consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

Clause 33

Rules if election by partners

ITA
97(2)

Subsection 97(2) of the Act provides rules that allow a person to transfer certain types of property on a tax-deferred "rollover" basis to a partnership. Subsection 97(2) provides that it applies to eligible capital property as well as capital property (including depreciable property).

Subsection 97(2) is amended to remove the reference to eligible capital property, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

Clause 34

Disposition of partnership property

ITA
98

Section 98 of the Act provides rules relating to the taxation of partnership properties and partnership interests where the partnership has ceased to exist.

Rules applicable where partnership ceases to exist

ITA
98(3)

Subsection 98(3) of the Act is an elective provision permitting (provided certain conditions are met) property of a Canadian partnership which has ceased to exist to be distributed to its members on a tax-deferred or "rollover" basis. This provision also allows a special increase or "bump-up" in the tax value of the distributed partnership property where the adjusted cost base of a member's partnership interest exceeds the amount of money and the cost amount to the partnership of the property that the member has received upon the dissolution of the partnership.

ITA
98(3)(b)(i.1)

Paragraph 98(3)(b) of the Act provides rules for determining the cost to each member of partnership property. Subparagraph 98(3)(b)(i.1) provides a rule for determining the cost to each member of eligible capital property.

Subparagraph 98(3)(b)(i.1) is repealed, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

ITA
98(3)(g)

Subparagraph 98(3)(g) of the Act provides rules where property that is eligible capital property is distributed.

Paragraph 98(3)(g) is repealed, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

Partnership business carried on as sole proprietorship

ITA
98(5)

Subsection 98(5) of the Act allows for a tax-deferred transfer or "rollover" of a Canadian partnership's property where the partnership has ceased to exist and the transfer is to one

member of the partnership who continues to carry on the business of the partnership as a sole proprietorship.

ITA
98(5)(b)(i.1)

Paragraph 98(5)(b) of the Act provides rules for determining the proprietor's proceeds of disposition of the proprietor's interest in the partnership. Subparagraph 98(5)(b)(i.1) applies in respect of eligible capital property.

Subparagraph 98(5)(b)(i.1) is repealed, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

ITA
98(5)(h)

Subparagraph 98(5)(h) of the Act provides rules where property received by the proprietor is eligible capital property.

Paragraph 98(5)(h) is repealed, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

Clause 35

Deduction in Computing Income of Trust

ITA
104(6)(b)

Subsection 104(6) generally permits a trust to deduct, in computing its income for a taxation year, an amount not exceeding the portion of its income otherwise determined for the year that became payable in the year to a beneficiary under the trust. Paragraph 104(6)(b) applies to trusts in cases where paragraphs 104(6)(a) to (a.4) do not apply.

Paragraph 104(6)(b), as it applies for the 2016 and later taxation years, calculates the maximum deductible amount under that paragraph as the formula A – B. The description of A of that formula is the part of the trust's income for the year – determined without reference to the deductions under subsection 104(6) and (12) – that became payable to, or was included under subsection 105(2) in the income of, a beneficiary. Subparagraph (i) of the description of B of the formula denies a trust a deduction for any part of its income that became payable to a beneficiary, other than a particular individual whose death determines a day of the trust under paragraph 104(4)(a) or (a.4), on or before the day of that death. Those trusts are alter ego trusts, joint spousal and common-law partner trusts, post-1971 spousal and common-law partner trusts and trusts to which property has been transferred by the beneficiary in circumstances described in subparagraph 73(1.02)(b)(ii) or subsection 107.4(1).

Subparagraph (i) of the description of B of the formula is amended so that the deduction denial under that subparagraph applies to a trust in computing its income for a taxation year if the death of the particular individual has not occurred before the start of the year.

This amendment is consequential on new paragraph 104(13.4)(b.1), which in turn limits the application of paragraph 104(13.4)(b) to only certain testamentary post-1971 spousal or common-law partner trusts. Given this limit on paragraph 104(13.4)(b), the amendment to element B of paragraph 104(6)(b) is required to ensure that subsection 104(6) continues to apply:

- Under clause (i)(A) of element B, for each taxation year of the trust that starts before the death of the individual (*i.e.*, including the year in which the death occurs), so that no deduction is available under paragraph 104(6)(b) in respect of any amount (*i.e.*, any part of the trust's income that became payable to, or was included under subsection 105(2) in the income of, a beneficiary) described in A of the formula in respect of a beneficiary other than the particular individual; and
- Under clause (i)(B) of element B, for the taxation year of the trust in which the particular individual's death occurs, so that no deduction is available under paragraph 104(6)(b) in respect of any amount, described in A of the formula, that is in respect of the particular individual and that arises from the application of any of subsections 12(10.2) or 104(4) to (5.2). This limit – together with the limit in clause (i)(A) – denies the trust a deduction under paragraph 104(6)(b) for the year in which the particular individual dies in respect of amounts from those sources. However, the limit under clause (i)(B) of element B does not apply in the case of a testamentary post-1971 spousal or common-law partner trust to which paragraphs 104(13.4)(b) and (b.1) apply.

This amendment applies to the 2016 and subsequent taxation years.

Death of a Beneficiary – Spousal and Similar Trusts

ITA
104(13.4)

Subsection 104(13.4) of the Act provides rules that apply, for the 2016 and later taxation years, to a trust for a particular taxation year of the trust if a particular beneficiary under the trust dies on a day in the particular year and that day is, as a result of the death, a day determined in respect of the trust under any of paragraphs 104(4)(a), (a.1) and (a.4). Those trusts are alter ego trusts, joint spousal and common-law partner trusts, spousal and common-law partner trusts, and trusts to which property has been transferred by the beneficiary for the beneficiary's exclusive benefit in circumstances described in subparagraph 73(1.02)(b)(ii) or subsection 107.4(1).

Paragraph 104(13.4)(a) deems the particular year to end at the end of the day on which that death occurs. Paragraph 104(13.4)(b) deems the trust's income for the particular year to have become payable to the particular beneficiary in the particular year, with the result that all of the trust's income for the particular year is required by subsection 104(13) to be included in computing the

particular beneficiary's income for the beneficiary's taxation year (i.e., the beneficiary's final taxation year) in which the particular year ends.

Paragraph 104(13.4)(b) is amended, and paragraph 104(13.4)(b.1) is added, to provide that paragraph 104(13.4)(b) does not apply to a trust unless:

- the particular beneficiary is resident in Canada immediately before the particular beneficiary's death;
- the trust is immediately before the death a testamentary trust that is a post-1971 spousal or common-law partner trust and that was created by the will of a taxpayer who dies before 2017;
- the trust and the particular individual's graduated rate estate jointly elect in prescribed form that paragraph (b) apply; and
- the T3 income tax return of the trust for the particular year, and the T1 income tax return of the individual for the individual's year of death, both include a copy of the joint election.

The information requirements in the prescribed form containing the joint election will include a requirement for the individual's Social Insurance Number and the trust's tax account number (i.e., the number found in box 14 of the T3 information slip and also identified as the "Trust account number" on the first page of the trust's T3 return of income).

Paragraph 104(13.4)(c) provides that the filing-due date, by which a trust must file with the Minister of National Revenue the trust's return of income under Part I for the particular year and issue its T3 information slips in respect of the particular year, is the day that is 90 days after the calendar year in which the particular year ends. Under that paragraph, the trust's balance-due day, by which the trust is normally required to pay any balance of taxes payable for a taxation year, is also the day that is 90 days after the calendar year in which the particular year ends.

Paragraph 104(13.4)(c) is amended to replace a reference to paragraph (a) of the definition "balance-due day" in subsection 248(1) with a reference to subparagraph (a)(ii) of that definition. This amendment is consequential on an amendment to the definition "balance-due day".

These amendments apply to the 2016 and subsequent taxation years.

Clause 36

Disposition by a taxpayer of a capital interests

ITA
107

Section 107 of the Act provides certain rules relating to the acquisition and disposition of a capital interest in a trust.

Distribution by personal trust

ITA
107(2)

Subsection 107(2) of the Act applies where a personal trust or a prescribed trust described in section 4800.1 of the Regulations distributes property to a beneficiary and there is a resulting disposition of part or all of the beneficiary's capital interest in the trust.

ITA
107(2)(b.1)

Subparagraph 107(2)(b.1)(ii) of the Act provides rules where the property distributed is eligible capital property, while subparagraph 107(2)(b.1)(iii) provides corresponding rules for depreciable property.

Subparagraph 107(2)(b.1)(ii) is repealed consequential on the repeal of the eligible capital property rules and the creation of a new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

ITA
107(2)(f)

Paragraph 107(2)(f) of the Act provides rules where the property distributed is eligible capital property.

Paragraph 107(2)(f) is repealed consequential on the repeal of the eligible capital property rules and the creation of a new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

No rollover on election by a trust

ITA
107(2.001)

Subsection 107(2.001) of the Act allows a trust to elect out of the rules in subsection 107(2) in respect of distributions of property to a beneficiary in satisfaction of the beneficiary's capital interest in the trust in certain circumstances.

Subsection 107(2.001)(c) is amended to remove the reference to eligible capital property, consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 37

Tax consequences of qualifying dispositions

ITA
107.4(3)(e)

Subsection 107.4(3) of the Act generally provides for a rollover where a property is transferred by way of qualifying disposition. As set out in subsection 107.4(1), a qualifying disposition is a

disposition that does not result in any change of beneficial ownership of the property and that otherwise meets the conditions set out in that subsection.

Paragraph 107.4(3)(e) provides for a rollover where the property transferred is eligible capital property.

Paragraph 107.4(3)(e) is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 38

Testamentary trust not disqualified

ITA
108(1.1)

Subsection 108(1) of the Act defines a testamentary trust as being a trust that arises on and as a consequence of the death of an individual, except where certain events occur that cause the trust to be re-characterized as an *inter vivos* trust. One of these exceptions is where a contribution is made to a trust that would otherwise qualify as a testamentary trust.

New paragraph 108(1.1)(b) provides that, for the purpose of the testamentary trust definition, a payment made to, or on behalf of, an individual's estate will not be considered a contribution to the estate if the following conditions are met:

- the payment is made by a testamentary trust
  - that is a post-1971 spousal or common-law partner trust of which the individual was the beneficiary whose death resulted in a day to be determined for the trust under subsection 104(4) for a year, and
  - in respect of which paragraphs 104(13.4)(b) and (b.1) apply for the year;
- the estate is the individual's graduated rate estate determined without reference to the payment; and
- the payment is on account of, and does not exceed, the portion of the income tax payable - by the individual for the individual's final taxation year - that is attributable to the amount included in the individual's income for the year under paragraph 104(13.4)(b) because of an election made under paragraph 104(13.4)(b.1) jointly by the individual's legal representative and that spousal or common-law partner trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 39

Lifetime capital gains exemption

ITA
110.6

Section 110.6 of the Act sets out the rules for calculating the entitlement of an individual to the lifetime capital gains exemption.

Definitions

ITA
110.6(1)

Subsection 110.6(1) of the Act provides definitions that apply for the purposes of the rules in section 110.6 for the lifetime capital gains exemption.

“qualified farm or fishing property”

Subsection 110.6(2) provides to individuals an exemption of up to $1,000,000 for capital gains realized on the disposition of “qualified farm or fishing property”. Paragraph (d) of the definition provides that eligible capital property can be qualified farm or fishing property.

Paragraph (d) of the definition is amended, consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property, to provide that property included in new Class 14.1 can be qualified farm or fishing property.

This amendment comes into force on January 1, 2017.

Clause 40

Loss restriction event – CEC computation

ITA
111(5.2)

Section 111 of the Act provides rules relating to the treatment of losses, and in particular establishes the extent to which a taxpayer is permitted to deduct, in computing taxable income for a taxation year, losses of other years.

Subsection 111(5.2) provides that, where there is an acquisition of control of a corporation, the corporation is required to deduct under paragraph 20(1)(b) in computing its income for the year ending immediately before the change of control, the amount by which its cumulative eligible capital in respect of a business immediately before the acquisition of control exceeds the total of:

> (a) the amount deducted by the corporation under paragraph 20(1)(b) in respect of its cumulative eligible capital in respect of a business; and
>
> (b) three quarters of the fair market value at that time of its eligible capital property in respect of the business.

Subsection 111(5.1) provides a similar rule for depreciable property.

Subsection 111(5.2) is repealed consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1 of depreciable property.

This amendment comes into force on January 1, 2017.

Clause 41

ITA
116(5.2)

Section 116 sets out rules that apply when a non-resident person disposes of certain types of property. Subsection 116(5.2) allows a non-resident vendor to obtain a certificate of compliance in respect of the disposition or proposed disposition of, among other things, depreciable property that is a taxable Canadian property. Consequential on the repeal of the eligible capital property rules, subsection 116(5.2) is amended to delete the reference to eligible capital property that is a taxable Canadian property.

This amendment comes into force on January 1, 2017.

Clause 42

Definitions – Charitable Donations Tax Credit

ITA
118.1(1)

Section 118.1 of the Act provides a tax credit to individuals in respect of certain gifts made to qualified donees or, in the case of certain gifts of cultural property, to certain designated institutions or public authorities. Subsection 118.1(1) contains a number of definitions that apply for the purposes of section 118.1.

"total charitable gifts"

Subparagraph (c)(i) of the definition "total charitable gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total charitable gifts of an individual other than a trust. One of the requirements is, where the gift is made by the individual's graduated rate estate, that subsection 118.1(5.1) apply to the gift.

Clause (c)(i)(C) of the definition is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the clause to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. Amended clause (c)(i)(C) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. However, the effect of these amendments is that the requirement in clause (c)(i)(C) of the definition is met if

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (*i.e.*, where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate,

the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

Subparagraph (c)(ii) of the definition "total charitable gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total charitable gifts of a trust.

Clause (c)(ii)(B) of the definition permits a graduated rate estate to include in its total charitable gifts for a particular taxation year the eligible amount of a gift to which subsection 118.1(5.1) applies that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate.

Clause (c)(ii)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the requirement that the trust be a graduated rate estate in the year the gift is made with a requirement that the trust be an estate in that year. Amended clause (c)(ii)(B) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. The amended clause also continues to require that - for the eligible amount to be added to the estate's total charitable gifts for the particular year - the estate be a graduated rate estate for the particular year. The effect of these amendments is that the requirement in clause (c)(ii)(B) of the definition is met in respect of a gift if

- the gift is made no more than 36 months after a taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (*i.e.*, where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

This amendment permits a graduated rate estate to allocate the eligible amount of a gift among any of (i) the estate's taxation year in which the gift is made (*i.e.*, under clause (c)(ii)(A) of the definition), (ii) any of the 5 following taxation years (*i.e.*, under clause (c)(ii)(A) of the definition), and (iii) any of the estate's taxation years that precede the year in which the gift is made and in which it is a graduated rate estate (*i.e.*, under clause (c)(ii)(B) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total charitable gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

Clause (c)(ii)(C) of the definition is introduced to provide that, subject to the other conditions of the definition, a trust's total charitable gifts for a particular taxation year includes the eligible amount of a gift if:

- the end of the particular year is determined under paragraph 104(13.4)(*a*) – *i.e.*, a beneficiary under the trust dies on a day in the particular year and that day is, as a result of the death, a day determined in respect of the trust under any of paragraphs 104(4)(*a*), (*a.1*) and (*a.4*), meaning the trust is an *alter ego* trust, joint spousal and common-law partner trust, spousal and common-law partner trust, or a trust to which property has been transferred by the beneficiary for the beneficiary's exclusive benefit (*i.e.*, in circumstances described in subparagraph 73(1.02)(*b*)(ii) or subsection 107.4(1));
- the gift is made after the particular year and on or before the trust's filing-due date (as determined under paragraph 104(13.4)(*c*)) for the particular year – *i.e.*, the gift is made on or before the day that is 90 days after the end of the calendar year in which the death occurs; and
- the subject of the gift is property that the trust held at the time of the death, or property substituted for that property.

This amendment permits the trust to allocate the eligible amount of the gift among any of (i) the trust's taxation year in which the gift is made (*i.e.*, under clause (*c*)(ii)(A) of the definition), (ii) any of the 5 following taxation years (*i.e.*, under clause (*c*)(ii)(A) of the definition), and (iii) the trust's taxation year that ends as determined under paragraph 104(13.4)(*a*) (*i.e.*, under clause (*c*)(ii)(C) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total charitable gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

For further information, see the commentary on subsections 118.1(5.1).

These amendments apply to the 2016 and subsequent taxation years.

"total cultural gifts"

Subparagraph (c)(i) of the definition "total cultural gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total cultural gifts of an individual other than a trust. One of the requirements is, where the gift is made by the individual's graduated rate estate, that subsection 118.1(5.1) apply to the gift.

Clause (c)(i)(C) of the definition is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the clause to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. Amended clause (c)(i)(C) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. However, the effect of these amendments is that the requirement in clause (c)(i)(C) of the definition is met if

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (*i.e.*, where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more

than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

Subparagraph (c)(ii) of the definition "total cultural gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total cultural gifts of a trust.

Clause (c)(ii)(B) of the definition permits a graduated rate estate to include in its total cultural gifts for a particular taxation year the eligible amount of a gift to which subsection 118.1(5.1) applies that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate.

Clause (c)(ii)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the requirement that the trust be a graduated rate estate in the year the gift is made with a requirement that the trust be an estate in that year. Amended clause (c)(ii)(B) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. The amended clause also continues to require that - for the eligible amount to be added to the estate's total cultural gifts for the particular year - the estate be a graduated rate estate for the particular year. The effect of these amendments is that the requirement in clause (c)(ii)(B) of the definition is met in respect of a gift if

- the gift is made no more than 36 months after a taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (*i.e.*, where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

This amendment permits a graduated rate estate to allocate the eligible amount of a gift among any of (i) the estate's taxation year in which the gift is made (*i.e.*, under clause (c)(ii)(A) of the definition), (ii) any of the 5 following taxation years (*i.e.*, under clause (c)(ii)(A) of the definition), and (iii) any of the estate's taxation years that precede the year in which the gift is made and in which it is a graduated rate estate (*i.e.*, under clause (c)(ii)(B) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total cultural gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

Clause (c)(ii)(C) of the definition is introduced to provide that, subject to the other conditions of the definition, a trust's total cultural gifts for a particular taxation year includes the eligible amount of a gift if

- the end of the particular year is determined under paragraph 104(13.4)(a) – *i.e.*, a beneficiary under the trust dies on a day in the particular year and that day is, as a result of the death, a day determined in respect of the trust under any of paragraphs 104(4)(a), (a.1) and (a.4), meaning the trust is an *alter ego* trust, joint spousal and common-law partner trust, spousal and common-law partner trust, or a trust to which property has been transferred by the beneficiary for the beneficiary's exclusive benefit (*i.e.*, in circumstances described in subparagraph 73(1.02)(b)(ii) or subsection 107.4(1));
- the gift is made after the particular year and on or before the trust's filing-due date (as determined under paragraph 104(13.4)(c)) for the particular year – *i.e.*, the gift is made on or before the day that is 90 days after the end of the calendar year in which the death occurs; and
- the subject of the gift is property that the trust held at the time of the death, or property substituted for that property.

This amendment permits the trust to allocate the eligible amount of the gift among any of (i) the trust's taxation year in which the gift is made (*i.e.*, under clause (c)(ii)(A) of the definition), (ii) any of the 5 following taxation years (*i.e.*, under clause (c)(ii)(A) of the definition), and (iii) the trust's taxation year that ends as determined under paragraph 104(13.4)(a) (*i.e.*, under clause (c)(ii)(C) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total cultural gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

For further information, see the commentary on subsections 118.1(5.1).

These amendments apply to the 2016 and subsequent taxation years.

"total ecological gifts"

Subparagraph (c)(i) of the definition "total ecological gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total ecological gifts of an individual other than a trust.

Clause (c)(i)(A) of the definition "total ecological gifts", as it applies for the 2016 and later taxation years, is amended to correct a drafting error introduced by a previous amendment. The reference in that clause to "five preceding taxation years" is replaced with "10 preceding taxation years".

Clause (c)(i)(C) of the definition is amended, consequential on amendments to subsection 118.1(5.1), to replace the reference in the clause to the taxpayer's graduated rate estate with a reference to the taxpayer's estate. Amended clause (c)(i)(C) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. However, the effect of these amendments is that the requirement in clause (c)(i)(C) of the definition is met if

- the gift is made no more than 36 months after the taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (i.e., where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

Subparagraph (c)(ii) of the definition "total ecological gifts", as it applies for the 2016 and later taxation years, sets out part of the requirements for an eligible amount of a gift to be included in the total ecological gifts of a trust.

Clause (c)(ii)(B) of the definition permits a graduated rate estate to include in its total ecological gifts for a particular taxation year the eligible amount of a gift to which subsection 118.1(5.1) applies that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate.

Clause (c)(ii)(B) is amended, consequential on amendments to subsection 118.1(5.1), to replace the requirement that the trust be a graduated rate estate in the year the gift is made with a requirement that the trust be an estate in that year. Amended clause (c)(ii)(B) of the definition continues to require that the gift be one to which subsection 118.1(5.1) applies. The amended clause also continues to require that - for the eligible amount to be added to the estate's total ecological gifts for the particular taxation year - the estate be a graduated rate estate for the particular year. The effect of these amendments is that the requirement in clause (c)(ii)(B) of the definition is met in respect of a gift if

- the gift is made no more than 36 months after a taxpayer's death by the taxpayer's graduated rate estate, or
- the gift is made more than 36 months, but no more than 60 months, after the taxpayer's death by the taxpayer's former graduated rate estate (*i.e.*, where the taxpayer's estate ceases to be the taxpayer's graduated rate estate because it remains in existence for more than 36 months after the taxpayer's death and, at the time the gift is made by the estate, the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate).

This amendment permits a graduated rate estate to allocate the eligible amount of a gift among any of (i) the estate's taxation year in which the gift is made (*i.e.*, under clause (c)(ii)(A) of the definition), (ii) any of the 10 following taxation years (*i.e.*, under clause (c)(ii)(A) of the definition), and (iii) any of the estate's taxation years that precede the year in which the gift is made and in which it is a graduated rate estate (*i.e.*, under clause (c)(ii)(B) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total ecological gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

Clause (c)(ii)(C) of the definition is introduced to provide that, subject to the other conditions of the definition, a trust's total ecological gifts for a particular taxation year includes the eligible amount of a gift if

- the end of the particular year is determined under paragraph 104(13.4)(a) – i.e., a beneficiary under the trust dies on a day in the particular year and that day is, as a result of the death, a day determined in respect of the trust under any of paragraphs 104(4)(a), (a.1) and (a.4), meaning the trust is an alter ego trust, joint spousal and common-law partner trust, spousal and common-law partner trust, or a trust to which property has been transferred by the beneficiary for the beneficiary's exclusive benefit (i.e., in circumstances described in subparagraph 73(1.02)(b)(ii) or subsection 107.4(1));
- the gift is made after the particular year and on or before the trust's filing-due date (as determined under paragraph 104(13.4)(c)) for the particular year – i.e., the gift is made on or before the day that is 90 days after the end of the calendar year in which the death occurs; and
- the subject of the gift is property that the trust held at the time of the death, or property substituted for that property.

This amendment permits the trust to allocate the eligible amount of the gift among any of (i) the trust's taxation year in which the gift is made (i.e., under clause (c)(ii)(A) of the definition), (ii) any of the 10 following taxation years (i.e., under clause (c)(ii)(A) of the definition), and (iii) the trust's taxation year that ends as determined under paragraph 104(13.4)(a) (i.e., under clause (c)(ii)(C) of the definition). This allocation is subject to the general limitation in the definition that an eligible amount is included in an individual's total ecological gifts for a taxation year only to the extent that it is not otherwise included in determining a tax credit claimed under subsection 118.1(3) by the individual, or by any other individual, for any taxation year.

For further information, see the commentary on subsections 118.1(5.1).

These amendments apply to the 2016 and subsequent taxation years.

Gifts by Graduated Rate Estate

ITA
118.1(5.1)

Subsection 118.1(5.1) applies, for the 2016 and later taxation years, to a gift made by an individual's graduated rate estate if the individual dies after 2015 and either the gift is an eligible transfer to which subsection 118.1(5.2) applies or the property that is the subject of the gift was acquired by the estate on and as a consequence of the death (or is property that was substituted for that property).

Subsection 118.1(5.1) is amended so that it also applies to a gift, that meets the other requirements of the subsection, that is made by the individual's estate at a time

- that is more than 36 months, but no more than 60 months, after the taxpayer's death;
- after which it ceased to be the taxpayer's graduated rate estate because the time is more than 36 months after the taxpayer's death; and
- at which the estate continues to meet the other requirements set out in the definition "graduated rate estate" in subsection 248(1) to be the taxpayer's graduated rate estate.

For further information, see the commentary on clauses 38(*a.1*)(ii)(B), 38(*a.2*)(ii)(B) and 39(1)(*a*)(i.1)(B) and clauses (*c*)(i)(C) the definitions "total charitable gifts", "total cultural gifts" and "total ecological gifts" in subsections 118.1(1).

This amendment applies to the 2016 and subsequent taxation years.

Excepted gift

ITA
118.1(19)

Subsection 118.1(19) of the Act defines an excepted gift. An excepted gift is not subject to the limits imposed by subsection 118.1(13) in respect of the gift of a non-qualifying security. For a gift to be an excepted gift, paragraph 118.1(19)(c) requires that the donor deal at arm's length with the donee.

Paragraph 118.1(19)(c) is amended to provide that if the gift is made by an individual's graduated rate estate

- the individual is required to deal at arm's length with the donee immediately before the individual's death, and
- the graduated rate estate is required to deal at arm's length with the donee determined without regard to paragraph 251(1)(b) of the Act.

This amendment applies to the 2016 and subsequent taxation years.

Clause 43

Canada child benefit indexation

ITA
122.61(5)

Subsections 122.61(5) to (7) provide for the indexing of the various amounts used in the calculation of the Canada child benefit.

This amendment applies as of July 1, 2020.

Clause 44

Small business deduction

ITA
125

Section 125 of the Act contains rules concerning the small business deduction that may be claimed by a Canadian-controlled private corporation (CCPC) in respect of its income from carrying on an active business in Canada.

Small business deduction

ITA
125(1)

Subsection 125(1) of the Act provides the basic rules for the calculation of the small business deduction that is available to a Canadian-controlled private corporation (CCPC) on its income from carrying on an active business in Canada. Under the deduction, a CCPC can reduce its tax otherwise payable on such income by an amount equal to the small business deduction rate multiplied by the least of three amounts.

The first amount determines the portion of the CCPC's active business income for a taxation year that can be eligible for the deduction (paragraph 125(1)(a)). In general terms, this amount is equal to the sum of the portion of the CCPC's income from an active business carried on in Canada for a taxation year (excluding income earned by the CCPC from a business carried on by it as a member of a partnership), and the corporation's "specified partnership income" (as defined in subsection 125(7)).

Paragraph 125(1)(a) is amended to limit the portions of a CCPC's income from an active business carried on in Canada that are eligible for the small business deduction. Subparagraph 125(1)(a)(i) is amended by inserting clauses (A) to (C) which indicate the portions, if any, of a CCPC's income from an active business that are not eligible for the deduction.

New clause 125(1)(a)(i)(A) refers to the portion of a CCPC's income that is described in paragraph (a) of the description of A in the definition "specified partnership income" in subsection 125(7) for the year. This portion is, in general, the total of all amounts each of which is an amount in respect of an active business carried on in Canada by the CCPC as a member of a partnership as well as income of the CCPC for the year from providing property or services (directly or indirectly, in any manner whatever) to a partnership as a designated member (as defined in subsection 125(7)). Such portion of a CCPC's income is eligible for the small business deduction only to the extent determined under the definition "specified partnership income", in which case it is included under subparagraph 125(1)(a)(ii) - see the explanatory notes accompanying the amended definition "specified partnership income" under subsection 125(7).

New clause 125(1)(a)(i)(B) refers to the portion of a CCPC's income that is described in subparagraph (a)(i) of the new definition "specified corporate income" in subsection 125(7) for the year. This portion is in general the total of all amounts each of which is income of a CCPC from an active business carried on in Canada by it from the provision of property or services (directly or indirectly, in any manner whatever) to a private corporation if certain conditions are met. Such portion of a corporation's income is eligible for the small business deduction only to

the extent determined under the definition “specified corporate income”, in which case it is included under new subparagraph 125(1)(a)(ii.1) - see the explanatory notes accompanying the new definition “specified corporate income” in subsection 125(7).

New clause 125(1)(a)(i)(C) refers to the portion of a CCPC’s income that is paid or payable to the CCPC by an associated corporation that is deemed by subsection 129(6) to be income of the corporation for the year from an active business where the associated corporation is not a CCPC or is a CCPC that made an election under subsection 256(2). Such portion of income would be taxed at the federal general corporate income tax rate and not the small business tax rate that is obtained through the small business deduction.

In general terms, under subsection 129(6), income from property of a CCPC is deemed to be active business income eligible for the small business deduction if it was paid or payable by a corporation with which the CCPC is associated in the course of an active business carried on in Canada by the associated corporation, to the extent that the amount was or may be deductible in computing the income of the associated corporation.

A CCPC could earn such income from property from an associated corporation that is a third corporation under subsection 256(2) in situations where the third corporation has relied upon one of the exceptions to break their association relationship for the purposes of section 125 (either the third corporation is not a CCPC or is a CCPC that files an election to break the association relationship). As a result, the CCPC could claim the small business deduction on the income based on a full business limit as if the CCPC and the third corporation were not associated, while maintaining the benefit of their actual association for the purposes of converting property income into active business income eligible for the small business deduction.

The above result is inconsistent with the objective of the small business deduction – for example, to the extent that the third corporation would not be eligible for the small business deduction because it is not a CCPC or it is a CCPC that files an election. New clause 125(1)(a)(C) excludes from the income of a CCPC that is eligible for the small business deduction the portion of the CCPC’s income that is paid or payable to the CCPC by an associated corporation that is deemed by subsection 129(6) to be income of the CCPC for the year from an active business where the associated corporation is not a CCPC or is a CCPC that makes an election under subsection 256(2). For more information, see the explanatory notes accompanying amended subsection 256(2).

These amendments apply to taxation years that begin after March 21, 2016.

Reduction - small business limit

ITA
125(3.1)

Under the small business deduction provided under subsection 125(1) of the Act, a Canadian-controlled private corporation (CCPC) can reduce its tax otherwise payable on income from an active business carried on in Canada by an amount equal to the small business deduction rate multiplied by the least of three amounts. One of the amounts is the CCPC’s small business limit for the year, which is generally determined under subsections 125(2) and (3).

New subsection 125(3.1) provides that a CCPC's small business limit for the year must be reduced by any portion of the CCPC's limit for the year that the CCPC assigns to another CCPC under new subsection 125(3.2). New subsection 125(3.2) provides for an assignment by a CCPC of its small business limit to another CCPC that has earned active business income from providing services or property to the CCPC in circumstances where the new specified corporate income rules apply. For more information, see the explanatory notes for the amendments to subsection 125(1), for new subsection 125(3.2) and for the new definition "specified corporate income" under subsection 125(7).

This new subsection applies to taxation years that begin after March 21, 2016.

Assignment

ITA
125(3.2)

Under new subsection 125(3.2) of the Act, a Canadian-controlled private corporation (CCPC), (the "first CCPC"), can assign all or any portion of its business limit (generally determined under subsections 125(2) and (3)) to another CCPC (the "second CCPC") if the second CCPC has an amount of income for its taxation year that is referred to in subparagraph (a)(i) of the new definition "specified corporate income" in subsection 125(7). Paragraph (a) provides that the income of the second CCPC must be from the provision of services or property directly to the first CCPC.

Subparagraph (a)(i) of the definition "specified corporate income" refers to the total of all amounts each of which is income of the second CCPC from an active business carried on in Canada by it from the provision of property or services directly to the first CCPC if certain conditions are met. In the case of a second CCPC that has active business income from providing property or services indirectly to the first CCPC, such income can be specified corporate income, but the first CCPC cannot make any assignment to the second CCPC – this is to prevent the possibility that the second CCPC could receive two assignments in respect of its income and, as a result, have a higher amount of specified corporate income on which it could claim the small business deduction. See the explanatory notes accompanying the new definition "specified corporate income" in subsection 125(7).

The assignment by the first CCPC of its business limit to the second CCPC makes the income that the second CCPC has from the first CCPC eligible for the small business deduction, which income would otherwise be ineligible though the application of new clause 125(1)(a)(i)(B), new subparagraph 125(1)(a)(ii.1) and the new definition "specified corporate income" in subsection 125(7). For more information, see the explanatory notes for the amendments to subsection 125(1) and for the new definition "specified corporate income".

The first CCPC can assign a portion of its small business limit for a year that ends in the taxation year of the second CCPC during which the second CCPC has income from the first CCPC due to paragraph (b).

The maximum amount that the first CCPC can assign to the second CCPC is determined under paragraph (c). It cannot exceed the amount determined by the formula A – B.

- A is the income that the second CCPC has for its taxation year from the first CCPC in the circumstances indicated above.
- B is the portion of the amount described in A that is deductible by the first CCPC in respect of the amount of income of the first CCPC referred to in clauses 125(1)(a)(i)(A) or (B) for the year. This reduction is intended to ensure that any portion of income of the first CCPC that would not be eligible for the small business deduction under the constraints of the specified partnership income rules or specified corporate income rules does not become eligible for the small business deduction in the hands of a second CCPC by way of the assignment mechanism.

Paragraph (d) provides that both CCPCs must file a prescribed form with the Minister of National Revenue for their respective taxation years for the assignment to be valid.

New subsection 125(3.2) applies to taxation years that begin after March 21, 2016. However, a person that is entitled to make an assignment to a corporation can make such an assignment in respect of the person's taxation year that begins before March 22 and ends after March 21, 2016 if the assignment is made to the corporation for its taxation year that begins after March 21, 2016.

Special rules for business limit

ITA
125(5)

Subsection 125(5) of the Act provides special rules in determining the business limit of a corporation for a particular taxation year that is otherwise determined under subsections 125(2) to (4). A corporation's entitlement to the small business deduction for a particular taxation year is determined by reference to the business limit of the corporation for the particular taxation year that is determined based on subsections 125(2) to (4), which business limit can be reduced on a straight-line basis under subsection 125(5.1).

Subsection 125(5) of the Act is amended to clarify that the special rules provided in the subsection apply in respect of the business limit of a corporation for a particular taxation year that is otherwise determined under subsections 125(2), (3) and (4). This amendment is consequential on the introduction of new subsections 125(3.1) and (3.2) – under these subsections, a corporation can assign a portion of its business limit that is based on subsections (2), (3), (4), (5) and (5.1) to another corporation if certain conditions are met. See the explanatory notes accompanying amended subsection 125(1), new subsections 125(3.1) and (3.2), and the new definition "specified corporate income" in subsection 125(7).

This amendment applies to taxation years that begin after March 21, 2016.

Business limit reduction

ITA
125(5.1)

In broad terms, under subsection 125(5.1) of the Act, the business limit of a corporation for a particular taxation year is reduced on a straight-line basis if the total of the taxable capital of the corporation and, if applicable, of other corporations with which the corporation is associated exceeds $10 million. A corporation's entitlement to the small business deduction for a particular taxation year is determined by reference, among other things, to the business limit of the corporation for the particular taxation year that is otherwise determined under subsections 125(2) to (5).

Subsection 125(5.1) of the Act is amended to clarify that the subsection applies to reduce the business limit of a corporation for a particular taxation year otherwise determined under subsections 125(2), (3), (4) and (5). This amendment is consequential on the introduction of new subsections 125(3.1) and (3.2). Under these subsections, a corporation can assign a portion of its business limit that is based on subsections (2), (3), (4), (5) and (5.1) to another corporation if certain conditions are met. See the explanatory notes accompanying amended subsection 125(1), new subsections 125(3.1) and (3.2), and the new definition "specified corporate income" in subsection 125(7).

This amendment applies to taxation years that begin after March 21, 2016.

Definitions

ITA
125(7)

Subsection 125(7) of the Act contains definitions that are relevant for the purposes of the small business deduction under section 125.

"designated member"

The new definition "designated member" is relevant for determining whether income earned by a Canadian-controlled private corporation (CCPC) from providing services or property to a partnership is "specified partnership income" for the purposes of determining the portion of the CCPC's income that is eligible for the small business deduction under subsection 125(1). This definition is intended to address structures that avoid the specified partnership income rules and to prevent the inappropriate multiplication of the small business deduction.

The definition "specified partnership income" is used to calculate the portion of a CCPC's income from an active business carried on in Canada as a member of a partnership that is eligible for the small business deduction, and is expanded to apply to corporations that are "designated members" of the partnership. For more information, see the explanatory notes for the amendment to the definition "specified partnership income" under subsection 125(7).

In general terms, a CCPC is a designated member in respect of a partnership if it provides property or services (directly or indirectly, in any manner whatever) to a partnership at any time in the CCPC's taxation year if, at any time in the year, the CCPC is not a member of the partnership (paragraph (a) of the definition) and one of the following tests is met:

- One of the shareholders of the CCPC holds a direct or indirect interest in the partnership.

- The CCPC does not deal at arm's length with a person that holds a direct or indirect interest in the partnership, and it is not the case that all or substantially all of the CCPC's income for the year from an active business is from providing property or services to persons or other partnerships with which the CCPC deals at arm's length. This second condition is intended to ensure that a CCPC will be excluded where the services or property it provides to the partnership form a small part of its *bona fide* business of providing property or services to arm's length persons. A partnership in which a person that does not deal at arm's length with the CCPC holds a direct or indirect interest is not considered to be a partnership with which the CCPC deals at arm' length for the purpose of determining whether the CCPC has earned income from arm's length parties.

This new definition applies to taxation years that begin after March 21, 2016.

"specified corporate income"

The new definition "specified corporate income" is relevant in determining the portion of a Canadian-controlled private corporation's (CCPC's) income from an active business carried on in Canada that is eligible for the small business deduction under subsection 125(1). This definition is intended to address structures that avoid the specified partnership income rules and to prevent the inappropriate multiplication of the small business deduction.

Under the small business deduction rule in subsection 125(1), a CCPC can reduce its tax otherwise payable on income from carrying on an active business in Canada by an amount equal to the small business deduction rate multiplied by the least of three amounts. The first of the amounts determines the portion of the corporation's active business income for a taxation year that can be eligible for the deduction (paragraph 125(1)(a)). Subparagraph 125(1)(a)(i) is amended by inserting clauses (A) to (C), which clauses indicate the portions, if any, of a CCPC's income from an active business that is not eligible for the deduction.

New clause 125(1)(a)(i)(B) refers to the portion of the CCPC's income that is described in subparagraph (a)(i) of the definition "specified corporate income" in subsection 125(7). This portion of a CCPC's income is eligible for the small business deduction only to the extent determined under the definition "specified corporate income", in which case it is included under new subparagraph 125(1)(a)(ii.1). For more information, see the explanatory notes for the amendments to subsection 125(1).

Under this new definition of "specified corporate income", a CCPC can have specified corporate income for a taxation year if the CCPC has income from an active business carried on in Canada by it from the provision of property or services to a private corporation (directly or indirectly, in any manner whatever) and if the conditions in clauses (a)(i)(A) and (B) of the definition are met:

- The condition in clause (a)(i)(A) is that, at any time in the year, one of the following persons holds a direct or indirect interest in the private corporation:
  - the CCPC,
  - one of the shareholders of the CCPC, or
  - a person who does not deal at arm's length with the CCPC or one of the CCPC's shareholders;

- The condition in clause (a)(i)(B) is intended to ensure that a CCPC will not be considered to have specified corporate income where the services or property it provides to the private corporation form a small part of its *bona fide* business of providing property or services to arm's length persons. The specific condition is that it is not the case that all or substantially all of the CCPC's income for the year from an active business is from the provision of services or property to either:
    - persons (other than the private corporation) with which the CCPC deals at arm's length, or
    - partnerships with which the CCPC deals at arm's length, other than a partnership in which a person that does not deal at arm's length with the CCPC holds a direct or indirect interest.

If the conditions in subparagraph (a)(i) are met, the CCPC's specified corporate income for the year is the lesser of the following amounts:

- An amount that is the lesser of
    - the total amounts each of which is income from an active business of the CCPC for the year from the provision of services or property (directly or indirectly, in any manner whatever) to the private corporation, and
    - the total of all amounts each of which is the portion, if any, of the business limit of the private corporation that it assigns to the CCPC under new subsection 125(3.2) – for more information, see the explanatory notes accompanying new subsection 125(3.2). See subparagraph (a)(ii) of the definition "specified corporate income".
- An amount that the Minister determines to be reasonable in the circumstances. See paragraph (b) of the definition "specified corporate income". The Minister could determine a lower amount than the above amount to be the reasonable amount if, for example, the higher amount includes income that is reasonable to consider to be attributable to or derive from income that would not be eligible for the small business deduction.

This new definition applies to taxation years that begin after March 21, 2016.

"specified partnership business limit"

The new definition "specified partnership business limit" establishes the maximum amount of income that a member or a designated member of a partnership earns from the partnership and that is eligible for the small business deduction under the definition "specified partnership income".

This maximum amount is currently provided under paragraph (b) of the description of A in the definition "specified partnership income". By virtue of amended paragraph (b) of the description of A, the income that a Canadian-controlled private corporation (CCPC) earns from a partnership as a member, or as a designated member, that is eligible for the small business deduction cannot exceed the proportionate share of the notional small business limit of the partnership as determined under subparagraphs (b)(i) and (b)(ii), which is based on the new concept of "specified partnership business limit".

- New subparagraph (b)(i) provides that a CCPC that is a member of the partnership has a proportionate share of the notional small business limit of a partnership equal to the CCPC's specified partnership business limit for the year.
- New subparagraph (b)(ii) provides that the proportionate share of a designated member is nil unless an actual member of the partnership assigns any portion of its specified partnership business limit to the designated member under new subsection 125(8).

In general terms, the definition "specified partnership business limit" is based on the wording of current paragraph (b) of the description of A, except that any person that is a member of a partnership has a specified partnership business limit and that limit is reduced by any portion of the limit that the person decides to assign to a CCPC under new subsection 125(8), and taking into account amendments made to the definition "specified partnership income".

More specifically, the specified partnership business limit of a person for a taxation year means the amount determined by the formula (K/L) x M – T:

- K is the total of all amounts each of which is the person's share of the income of a partnership of which the person was a member for a fiscal period ending in the year from an active business carried on in Canada.
- L is the total of all amounts each of which is the income of the partnership for a fiscal period referred to in paragraph (a) of the description of A in the definition "specified partnership income" from an active business carried on in Canada, which paragraph includes income that a corporation earns from a partnership as a member or as a designated member.
- M represents the proportionate share of the member of the notional small business limit of the partnership. The member's share of the limit is the lesser of the annual small business limit indicated in subsection 125(2) for corporations that are not associated with any CCPC and the product of the daily portion of that annual small business limit multiplied by the number of days of the fiscal period of the partnership that ends in the year of the member.
- T is the total of all amounts each of which is an amount, if any, assigned by the member to a CCPC under new subsection 125(8). For more information, see the explanatory notes accompanying new subsection 125(8).

This new definition applies to taxation years that begin after March 21, 2016.

"specified partnership income"

The definition "specified partnership income" is used for determining the portion of a Canadian-controlled private corporation's (CCPC's) income from an active business carried on in Canada as a member of a partnership that is eligible for the small business deduction. The specified partnership income rules are intended to eliminate the multiplication of the small business deduction in respect of a partnership of corporations that are not associated with each other. In such a case, a single small business limit applies with respect to the partnership's business. Without these rules, each CCPC that is a member of a partnership could claim a separate small business deduction of up to $500,000 in respect of the portion of the partnership's active business income allocated to it.

Currently, a CCPC's specified partnership income for a taxation year is the total of two amounts, in the descriptions of A and B in the definition. These descriptions apply to the extent that a corporation is a member of a partnership (as indicated in the opening words of the description of A and paragraph (a) of the description, as well as in paragraph (b) in the description of B).

- The description of A is the lesser of
  - Paragraph (a): the CCPC's net partnership income for the partnership's fiscal period that ends in the year as a member of the partnership (determined by the formula G – H), and
  - Paragraph (b): that proportion of the maximum business limit under section 125 (variable M) that the CCPC's share of the partnership's Canadian-source active business income for that fiscal period as a member of the partnership (variable K) is of the partnership's total of such income for the period (variable L).
- The description of B is the lesser of:
  - Paragraph (a): the CCPC's Canadian-source active business losses for the year (other than a loss from an active business carried on in Canada as member of a partnership) plus its "specified partnership loss" for the year, and
  - Paragraph (b): the amount, if any, by which the CCPC's net partnership income for the partnership's fiscal period that ends in the year (variable N) exceeds the proportion of the maximum business limit under section 125 that the CCPC's share of the partnership's Canadian-source active business income for that fiscal period as a member of the partnership is of the partnership's total of such income for the period (variable O).

The definition "specified partnership income" is amended to expand its application to prevent the multiplication of the small business deduction.

First, the definition is amended to apply to CCPCs that are "designated members" of the partnership, as newly defined in subsection 125(7). In general terms, a CCPC that is not a member of a partnership at any time in the CCPC's taxation year can be a designated member of the partnership if the CCPC provides services or property to the partnership (directly or indirectly, in any manner whatever) in the year as an independent contractor and, at any time in the year, a shareholder of the CCPC holds a direct or indirect interest in the partnership or the CCPC does not deal at arm's length with a person that owns a direct or indirect interest in the partnership. For more information, see the explanatory notes for the new definition "designated member" in subsection 125(7). This change is made because, under the current rule, a CCPC that is not a member of the partnership can claim a full small business deduction on its active business income earned in respect of the partnership even if a shareholder of the CCPC is a member of the partnership.

Second, the following amendments are made to the descriptions of A and B in the definition "specified partnership income" to expand the application of this definition to a CCPC that is a "designated member" of a partnership:

- The description of A and its paragraph (a) are amended to add a reference to a CCPC that is a designated member of the partnership.

- The description of G is amended to add three subparagraphs, so that the amount determined for G will be the total of all amounts each of which is described in new subparagraphs (i) to (iii):
    - New subparagraphs (i) and (iii) refer to amounts currently referred to in the description of G, which are respectively the CCPC's share of the income (determined in accordance with subdivision j of Division B) of the partnership for a fiscal period and an amount included in the CCPC's income for the year under any of subsections 34.2(2), (3) and (12).
    - New subparagraph (ii) refers to an amount that is income of the CCPC for the year from the provision (directly or indirectly, in any manner whatever) of services or property to the partnership. The effect of this provision is to make income earned by a CCPC as a designated member subject to the small business deduction limitations provided for under the definition "specified partnership income".
- The amount determined for H is subtracted from the amount determined for G in the description of A. The description of H currently includes amounts that are deducted in computing the CCPC's income from the year from the business carried on as a member of the partnership (other than amounts that were already deducted in computing the member's share of the income of the partnership under the description of G) or in respect of the business under subsection 34.2(4) or (11). The description of H is amended to include a reference to amounts that are deducted in computing the CCPC's income for the year from the business carried on as a designated member of a partnership (other than amounts that were already deducted in computing the designated member's income under the description of G).

- Paragraph (b) of the description of A is amended to provide the proportionate share of the maximum small business limit under section 125 of a member or a designated member of the partnership in respect of income earned from the partnership. In general, the amendment does not affect the share of the small business limit of a corporate member (unless the member assigns any portion of its share of the limit to another corporation under new subsection 125(8)). A designated member will not have any small business limit in respect of the income from the partnership unless a person that is a member of the partnership assigns a portion of the person's "specified partnership business limit" in respect of the partnership under new subsection 125(8). For more information, see the explanatory notes for the new definition "specified partnership business limit" under subsection 125(7) and for new subsection 125(8).

    - Subparagraph (b)(i) provides that the proportionate share of the notional small business limit of a partnership, in the case of a corporation that is a member of the partnership, is equal to the corporation's specified partnership business limit for the year. In general terms, the definition "specified partnership business limit" mirrors current paragraph (b) of the description of A, except that any person that is a member of a partnership has a specified partnership business limit and that limit is reduced by

any portion of the limit which the person decides to assign to a CCPC under new subsection 125(8).

  - Subparagraph (b)(ii) provides that a CCPC that is a designated member of a partnership can have a small business deduction in respect of the designated member's income from the partnership only to the extent of an amount that is assigned to the designated member for the year under new subsection 125(8).

- Paragraph (b) of the description of A in the definition "specified partnership income" is amended to refer to amounts in respect of a partnership of which a corporation is a member or a designated member and to reflect changes made to the description of A.
  - The opening words of paragraph (b) are amended to include a reference to a corporation that is a designated member of a partnership.
  - The description of N in paragraph (b) is not amended.
  - The description of O in paragraph (b) is amended to refer to amounts determined in respect of a partnership, as provided under subparagraphs (b)(i) and (ii) of the description of A. The amount under subparagraph (b)(i) of the description A of the definition is relevant for a corporation that is a member of the partnership and the amount is equal to the specified partnership business limit of the corporation for the year in respect of the partnership. The amount under subparagraph (b)(ii) of the description A is relevant for a corporation that is a designated member of the partnership and the amount is equal to the amount of any specified partnership business limit that an actual member of the partnership has assigned to the designated member.

Third, the amount determined in the description of A in the definition "specified partnership income" is amended to refer to "the least of" three amounts, instead of "the lesser of" two amounts. This amendment is consequential on the addition of new paragraph (c) in the description of A. This paragraph is introduced in relation to the expansion of the specified partnership income rules to prevent the multiplication of the small business deduction, including the introduction of the specified corporate incomes rules that are intended to address structures that avoid the specified partnership income rules.

New paragraph (c) in the description of A of the definition "specified partnership income" provides that the amount for this description is nil if the conditions in new subparagraphs (c)(i) and (ii) are met. Subparagraph (c)(i) requires that the CCPC be a member or a designated member of a partnership (including directly or indirectly through one or more partnerships) in the CCPC's year. In general, the test in subparagraph (c)(ii) is met if the partnership provides services or property to either a private corporation or a partnership, and if the two parties are sufficiently linked and the property or services are not provided as a small part of the partnership's *bona fide* business of providing property or services to arm's length persons or partnerships. More particularly, the test is met if the partnership provides services or property to either:

- a private corporation (clause (c)(ii)(A)) in the year, if

  - the CCPC (or one of its shareholders) or a person who does not deal at arm's length with the CCPC (or one of its shareholders) holds a direct or indirect interest in the private corporation (see subclause (c)(ii)(A)(I)), and
  - it is not the case that all or substantially all of the partnership's income for the year from an active business is from the provision of services or property to (subclause (c)(ii)(A)(I)):
    - persons (other than the private corporation) that deal at arm's length with the partnership and each person that holds a direct or indirect interest in the partnership, or
    - partnerships with which the partnership deals at arm's length, other than a partnership in which a person that does not deal at arm's length with the corporation holds a direct or indirect interest; or
- a particular partnership (clause (c)(ii)(B)) in the year, if
  - the CCPC (or one of its shareholders) does not deal at arm's length with the particular partnership or a person that holds a direct or indirect interest in the particular partnership (subclause (c)(ii)(B)(I)), and
  - it is not the case that all or substantially all of the partnership's income for the year from an active business is from the provision of services or property to (subclause (c)(ii)(B)(II)):
    - persons that deal at arm's length with the partnership and each person that holds a direct or indirect interest in the partnership, or
    - other partnerships (excluding the particular partnership) with which the partnership deals at arm's length, other than a partnership in which a person that does not deal at arm's length with the corporation holds a direct or indirect interest.

These amendments apply to taxation years that begin after March 21, 2016.

Assignment – specified partnership business limit

ITA
125(8)

New subsection 125(8) of the Act is relevant for the purpose of the definition "specified partnership business income" under subsection 125(7).

A Canadian-controlled private corporation (CCPC) that earns income in a taxation year in respect of an active business carried on in Canada as a designated member of a partnership cannot claim the small business deduction on any portion of that income unless an amount is assigned to the CCPC for the year under new subsection 125(8). For more information, see the explanatory notes accompanying the amendment to paragraph (b) of the description of A in the definition "specified partnership income" under subsection 125(7).

In general terms, under new subsection 125(8), a person can assign an amount to the CCPC only if the person is an actual member of the partnership in a taxation year and is either a shareholder of the CCPC who holds a direct interest in the partnership, or a person who holds a direct interest in the partnership and who does not deal at arm's length with the CCPC (paragraph (a)). Such a

person may assign to the CCPC (for a taxation year of the CCPC) all or any portion of the person's specified partnership business limit in respect of the partnership for the person's taxation year.

The specified partnership business limit that the person can assign to the CCPC must be in respect of the person's limit for the fiscal period of the partnership that ends in the CCPC's taxation year (paragraph (b)).

For the assignment to be valid, both the CCPC and the person making the assignment must file a prescribed form for their relevant taxation years (paragraph (c)).

The amount that the person assigns to the CCPC under new subsection 125(8) reduces the person's specified partnership business limit in respect of the partnership under the description of T in the new definition "specified partnership business limit" in subsection 125(7).

This new subsection applies to taxation years that begin after March 21, 2016. However, a person that is entitled to make an assignment to a corporation can make such an assignment in respect of the person's taxation year that begins before March 22 and ends after March 21, 2016 if the assignment is made to the corporation for their taxation year that begins after March 21, 2016.

Anti-avoidance rule

ITA
125(9)

New subsection 125(9) of the Act is an anti-avoidance rule for the purpose of the small business deduction in respect of specified partnership income and specified corporate income.

Under new subsection 125(9), an amount of a corporation's income from an active business carried on in Canada that consists of the provision of services or property to a person or partnership is not eligible for the small business deduction (because such amount cannot be included in the total determined under paragraph 125(1)(a)) if the following conditions are met:

- The person or partnership holds a direct or indirect interest in a particular partnership or corporation; and
- One of the reasons for the provision of the services or property to the person or partnership, instead of to the particular partnership or corporation, is to avoid the application of subparagraphs 125(1)(a)(ii) and (ii.1), which refer to the rules constraining specified partnership income and specified corporate income.

This new subsection applies to taxation years that begin after March 21, 2016.

Computational rule – specified corporate income

ITA

125(10)

New subsection 125(10) of the Act provides a computational rule regarding certain amounts that a corporation receives from another corporation to which the corporation is associated and that may be eligible for the small business deduction under subsection 125(1).

Under subsection 125(1) of the Act, a Canadian-controlled private corporation (CCPC) can reduce its tax otherwise payable on its income from carrying on an active business in Canada by an amount equal to the small business deduction rate multiplied by the least of three amounts. In general terms, the first amount is provided in paragraph 125(1)(a) and corresponds to the sum of amounts or income determined in subparagraphs 125(1)(a)(i) to (ii.1). In general terms, under amended subparagraph 125(1)(a)(i), the portions of the CCPC's active business income that is not described in clauses 125(1)(a)(i)(A) to (C) is eligible for the small business deduction. However, the portions described in clauses (A) and (B) can be eligible for the deduction if they are, respectively, specified partnership income under subparagraph 125(1)(a)(ii) or specified corporate income under subparagraph 125(1)(a)(ii.1). See the explanatory notes accompanying amended subsection 125(1).

Under new subsection 125(10) of the Act, the amount of income of a CCPC from an active business of the corporation for a taxation year that is from the provision of services or property to another corporation with which the CCPC is associated, in circumstances described in the definition "specified corporate income", is excluded in certain cases from the amounts determined in respect of the CCPC under clauses 125(1)(a)(i)(B) and subparagraph 125(1)(a)(ii.1). This exclusion applies only to the extent that the amount of income is not deductible by the associated corporation in respect of an amount of income of the associated corporation that is referred to in clauses 125(1)(a)(i)(A) to (C) or that is reasonable to consider as being attributable to or derived from an amount referred to in clause 125(1)(a)(i)(C).

If the conditions of new subsection 125(10) are met, then the CCPC does not have to reduce its active business income for its taxation year by the amount of income received from the associated corporation, and that amount of income can be eligible for the small business deduction without the limitations of the specified corporate income rules.

This amendment applies to taxation years that begin after March 21, 2016.

Clause 45

Dispositions ignored

ITA
126(4.4)(a)

Section 126 of the Act provides rules under which a taxpayer may deduct, from tax otherwise payable, amounts the taxpayer has paid in respect of foreign tax.

Subsection 126(4.4) provides that certain dispositions and acquisitions of property are effectively ignored for the purposes of the foreign tax credit limitations in subsections 126(4.1) and (4.2) and the definition "economic profit" in subsection 126(7).

The references to subsections 14(14) and 14(15) are repealed, consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules

This amendment comes into force on January 1, 2017.

Clause 46

Changes in residence

ITA
128.1

Section 128.1 of the Act sets out the income tax effects of becoming or ceasing to be resident in Canada.

Immigration

ITA
128.1(1)(b)(iii)

Subsection 128.1(1) of the Act provides rules that apply where a taxpayer becomes resident in Canada. Paragraph 128.1(1)(b) treats a taxpayer who becomes resident in Canada as having disposed of property owned by the taxpayer, for proceeds equal to fair market value. In the case of an individual, the deemed disposition does not apply to certain properties listed in subparagraphs 128.1(1)(b)(i) to (iv).

Subparagraph 128.1(1)(b)(iii) excludes eligible capital property from the deemed disposition rule.

Consequential on the repeal of the eligible capital property rules and the creation of new class 14.1, the reference to eligible capital property in subparagraph 128.1(1)(b)(iii) is replaced by reference to property included in Class 14.1 of Schedule II to the Regulations.

This amendment comes into force on January 1, 2017.

Emigration

ITA
128.1(4)(b)(ii)

Subsection 128.1(1) of the Act provides rules that apply where a taxpayer ceases to be resident in Canada. Paragraph 128.1(4)(b) treats a taxpayer who ceases to be resident in Canada as having disposed of the taxpayer's property for proceeds equal to its fair market value. In the case of an individual, the deemed disposition does not apply to certain properties listed in subparagraphs 128.1(4)(b)(i) to (v).

Subparagraph 128.1(4)(b)(ii) excludes capital property used in, and eligible capital property in respect of, a business carried on by the taxpayer through a permanent establishment.

Consequential on the repeal of the eligible capital property rules and the introduction of new Class 14.1, the reference to eligible capital property in subparagraph 128.1(4)(b)(ii) is replaced by a reference to property included in Class 14.1 that is in respect of the business.

This amendment comes into force on January 1, 2017.

Clause 47

Application of subsections 131(1) to (3.2), (4.1) and (6)

ITA
130(2)

Subsection 130(2) of the Act, which adapts the capital gains dividend rules for mutual fund corporations (subsections 131(1) to (3.2)) to investment corporations, is amended to provide that new subsection 131(4.1) also applies to investment corporations. As a result, sections 51, 85, 85.1, 86 and 87 may not be available to shareholders of certain investment corporations in the event of a disposition of a share of an investment corporation.

This rule comes into force on January 1, 2017.

Clause 48

Switch funds

ITA
131(4.1)

This rule is introduced to ensure the appropriate recognition of capital gains on shares of mutual fund corporations that are organized as multi-class funds (often called "switch funds"). These funds typically offer different types of asset exposure in different funds, but generally each fund is structured as a separate class of shares within the same mutual fund corporation. By virtue of specific provisions that permit the exchange of shares of a corporation to occur on a tax deferred basis (such as section 51 of the Act), shares that are "switched" are generally deemed not to be disposed of or to be disposed of at their adjusted cost base for the purposes of the Act.

New subsection 131(4.1) of the Act ensures that, notwithstanding sections 51, 85, 85.1, 86 and 87, a taxpayer exchanging or otherwise disposing of a share of a mutual fund corporation for a share of a mutual fund corporation is considered to have disposed of that share for proceeds of disposition that are equal to the fair market value of the share (if such share is of a class of shares that is recognized under Canadian securities law as an investment fund or as part of such a fund). However, two exceptions to this rule are provided.

The first exception is an exchange of a share of the corporation that occurs in the course of a capital reorganization described in subsection 86(1) or an amalgamation described in subsection 87(1), if none of the reasons for which the capital reorganization or amalgamation was undertaken was to permit shareholders to make class "switches" on a tax-deferred basis that would otherwise be taxable. More specifically, in order to qualify for this exception, all of the shares of that class of shares must be exchanged, the initial share and the share acquired on the exchange must derive their value in the same proportion from the same property or group of properties, and the reorganization or amalgamation should be undertaken solely for *bona fide* purposes (*i.e.*, not to cause this exception to apply).

Example

An investment fund manager manages various investment funds that are each established as a different class of shares within a single mutual fund corporation. The shares of the different classes have voting rights and this necessitates calling an annual general meeting to deal with approval of routine corporate matters. To avoid the expense associated with mailing notices and

holding the annual meeting, investors in the funds will exchange their voting shares for new shares that do not have a right to vote in these corporate matters, but otherwise are identical and continue to represent an interest in the same investment fund as before. The articles will also be amended to create a new class of common shares that have voting rights which will be issued to the manager. Provided all of the conditions for the application of section 86 are otherwise met in respect of the shareholders of the mutual fund corporation, subsection (4.1) would not apply and the shareholders will benefit from a deferral of the taxation of any capital gain or loss arising on the disposition.

The second exception applies where the share exchanged and the share received on the exchange are from the same class (determined without reference to subsection 248(6), so that different series within the same class will be considered to be in the same class) of shares of the mutual fund corporation. To qualify, the shares must derive their value in the same proportion from the same property or group of properties that are allocated by the mutual fund corporation to that class of shares. In addition, under Canadian security laws, the class of shares must be recognized as a single investment fund or as part of such a fund, so that the share exchanged and the share received are shares of the same fund.

Example

The Class C shares of a mutual fund corporation derive 100% of their value from a Canadian equity fund. Series A and B shares of Class C are available: the corporation pays to the manager of the fund a standard annual management fee in respect of the net asset value represented by Class C Series A shares but a lower annual management fee in respect of the net asset value represented by Class C Series B shares, which are only available to certain investors.

In 2015, a shareholder acquired 50 shares of Class C Series A of that mutual fund corporation and in 2016 acquired an additional 75 Class C Series A shares. In 2017, the shareholder is now able to exchange the 50 shares acquired in 2015 for Class C Series B shares of equivalent net asset value. Since both series are from the same class – which represents a single investment fund for securities law purposes – and they derive their value in the same proportion from the same group of properties allocated to that class, the proposed exchange of 50 shares would not be subject to subsection 131(4.1) and consequently section 51 could be available to permit a tax-deferred exchange.

These rules apply to transactions and events that occur after 2016.

ITA
131(6)

The “capital gains redemptions” of a mutual fund corporation for a year are used in determining the mutual fund corporation’s capital gains refund for the year.

The description of A in the definition “capital gains redemptions” is amended, consequential on the introduction of subsection 131(4.1), to take into account taxable “switches” made by shareholders in the year. These are exchanges of shares that are described in new subsection

131(4.1) and not excluded under paragraphs (a) and (b) of that subsection. For more information regarding the taxation of shares that are "switched", see the commentary for subsection 131(4.1).

This rule comes into force on January 1, 2017.

Election to be a mutual fund corporation

ITA
131(8.01)

New subsection 131(8.01) of the Act is intended to provide relief where a newly formed corporation has difficulty qualifying as a mutual fund corporation due to the introduction of new subsection 131(4.1).

This rule provides that where a corporation was incorporated after 2014 but before March 22, 2016, would have been a mutual fund corporation if, on March 22, 2016, it could have elected to be a public corporation under paragraph (b) of the definition "public corporation" in subsection 89(1) of the Act (had the conditions prescribed in paragraph 4800(1)(*b*) of the Regulation been satisfied), and had at least one class of shares recognized under Canadian securities law as an investment fund at that time, the corporation is deemed to be a mutual fund corporation from the date it was incorporated until the earlier of the date the corporation qualifies as a mutual fund corporation under subsection 131(8) of the Act and December 31, 2017, if the corporation so elects in writing in its return of income associated with the first taxation year of the corporation that ends after March 21, 2016.

This rule comes into force on January 1, 2017.

Clause 49

Mutual fund trust – elected year-end

ITA
132.11(1)(b)

Section 132.11 generally allows a mutual fund trust to elect to have taxation years that end on December 15, rather than on December 31. If a trust makes the election, each taxation year of the trust is, subject to limited exceptions, deemed by paragraph 132.11(1)(b) to end at the end of December 15 of the calendar year following the calendar year in which it began.

Paragraph 132.11(1)(b) is amended to add to the list of exceptions references to paragraphs 128.1(4)(a) and 249(4)(a). As a result, in the event that the trust ceases to be resident in Canada or is subject to a loss restriction event, those paragraphs apply to deem the trust's taxation year to end at the time determined under those paragraphs and not on December 15.

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

Clause 50

Demutualization of insurance corporations

ITA
139.1

Section 139.1 of the Act contains rules regarding the “demutualization” of insurance companies. Demutualization is a process where a mutual insurance corporation converts into a corporation with share capital

Consequences of demutualization

ITA
139.1(4)(b)

Subsection 139.1(4) of the Act sets out various consequences of a demutualization, including the treatment of benefits received by policyholders pursuant to a demutualization. Paragraph 139.1(4)(b) clarifies that an amount paid or payable to a stakeholder in connection with the disposition, alteration or dilution of the stakeholder's ownership interest is not an eligible capital expenditure.

Consequential on the repeal of the eligible capital property rules and the introduction of new subsection 13(35), paragraph 139.1(4)(b) is amended to provide that no amount paid or payable to a stakeholder in connection with the disposition, alteration or dilution of the stakeholder's ownership interest may be included in new Class 14.1.

This amendment comes into force on January 1, 2017.

Acquisition of control

ITA
139.1(18)

Subsection 139.1(18) of the Act provides, in general, that the acquisition of shares by a holding corporation of an insurance corporation on the demutualization of the insurance corporation will not be considered to result in an acquisition of control of the insurance corporation.

Subsection 139.1(18) is amended to remove a reference to subsection 14(12), consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 51

Winding up of a Canadian affiliate: stop loss

ITA
142.7(13)

Section 142.7 of the Act provides tax-deferred rollover treatment on the conversion of the Canadian banking business of a foreign bank from a subsidiary to a branch.

Subsection 142.7(13) modifies the application of certain of the stop-loss rules in the Act where an election is made either to: (i) transfer property from a Canadian affiliate to an entrant bank on a rollover basis; or (ii) transfer losses of the affiliate to the bank on the wind-up of the affiliate.

ITA
142.7(13)(a)(ii)

Paragraph 142.7(13)(a) of the Act provides that, in respect of any direct or indirect transfer of property by a Canadian affiliate to its entrant bank or a person dealing at non-arm's length with the bank, each of the enumerated stop-loss rules is to be read without reference to the portion of the particular rule that permits recognition of a suspended loss on the wind-up of a transferor.

Subparagraph 142.7(13)(a)(ii), which applies for the purpose of subsection 14(12), is repealed, consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

ITA
142.7(13)(c)

Paragraph 142.7(13)(c) of the Act provides that, in applying the enumerated stop-loss rules to any property disposed of by a wound-up Canadian affiliate, the entrant bank is deemed to be the same corporation as, and a continuation of, the affiliate.

Paragraph 142.7(13)(c) is amended to remove a reference to subsection 14(12), consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 52

Registered retirement savings plans

ITA
146(1)

“earned income”

Section 146 of the Act provides rules relating to registered retirement savings plans (RRSPs). Subsection 146(1) defines a number of terms that apply for the purposes of the rules in section 146. The definition “earned income” in subsection 146(1) is relevant in determining the maximum tax-deductible contributions that a taxpayer may make to RRSPs.

Paragraph (h) of the definition, which provides that an amount determined under subparagraph 14(1)(b) is not included in the determination of “earned income”, is repealed, consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 53

Dispositions at non-arm’s length and similar cases

ITA
148(7)

Subsection 148(7) of the Act applies to certain dispositions of an interest in a life insurance policy, including a disposition by way of non-arm's length transfer (to which none of subsections 148(8) to (8.2) apply), by way of gift and by way of distribution from a corporation. Subsection 148(7) deems the proceeds of the disposition to the disposing policyholder to be the value (as defined in subsection 148(9)) of the interest at the time of the disposition. The subsection also deems the cost of the interest to the acquiring policyholder to be an amount equal to the proceeds of the interest determined for the disposing policyholder.

Subsection 148(7) is amended to ensure that amounts are not inappropriately received tax-free by a policyholder as a result of a disposition of an interest in a life insurance policy. Paragraph 148(7)(a) provides that for dispositions after March 21, 2016 to which subsection 148(7) applies the proceeds of the disposition are the amount that is the greatest of (i) the fair market value of any consideration given for the interest, (ii) the interest's value and (iii) the adjusted cost basis to the disposing shareholder of the interest. For dispositions before March 22, 2016, the proceeds of the disposition are the amount that is the value of the interest.

Under paragraph 148(7)(b), the cost of the interest to the acquiring policyholder continues to be the amount equal to the proceeds of the interest determined for the disposing policyholder in respect of the disposition.

New paragraphs 148(7)(c) to (e) provide that, in connection with a disposition of an interest to which subsection 148(7) applies:

- If consideration is given for the interest, the amount by which the paid-up capital of shares of the capital stock of a corporation may be increased is limited to the amount by which the proceeds of the disposition determined under paragraph 148(7)(a) is attributable to the fair market value of the consideration represented by shares of that capital stock.
- The amount of a contribution of capital to a corporation or partnership is, for the purpose of applying paragraphs 53(1)(c) and (e) in determining the adjusted cost base of property that is shares of the capital stock of the corporation or an interest in the partnership, ignored to the extent that the contributed amount exceeds the value of the interest (i.e., the amount determined under paragraph subparagraph 148(7)(a)(i) in respect of the disposition). That excess is not intended to be added to the adjusted cost base to a taxpayer of such a property.
- Similarly, any contributed surplus of a corporation is, for the purpose of applying subsection 84(1), ignored to the extent that the contributed amount exceeds the value of the interest. The conversion of that excess amount into paid-up capital of shares of the capital stock is intended to result in a taxable dividend.

New paragraph 148(7)(f) contains special rules that apply to a disposition of an interest in a policy that occurs after 1999 and before March 22, 2016 where a person whose life was insured under the policy before March 22, 2016 is alive on March 22, 2016. For these cases:

- The adjustments set out in paragraphs 148(7)(c) to (e), described above, apply only as of the start of March 22, 2016.
- Under subparagraph 148(7)(f)(iii), if the disposition resulted in contributed surplus of a corporation that was subsequently converted, before March 22, 2016, on a tax-free basis into paid-up capital of a class of capital stock of a corporation, that paid-up capital is, as of the start of March 22, 2016, limited to the proceeds arising from the disposition (i.e., the amount of the value of the interest at the disposition time, as described in subparagraph 148(7)(a)(i)).
- Under subparagraph 148(7)(f)(iv), if a share of the capital stock of a corporation was given as consideration for the interest and the share (or a substitute share) is later disposed of (the "share sale") in circumstances to which section 84.1 applies, then the adjusted cost base of the share (for the purposes of applying section 84.1 to the share sale) is reduced, generally to reflect the fair market value of the interest (as represented by the fair market value of total consideration given for the interest) that was not included in the proceeds of the disposition of the interest and for which consideration was given other than in the form of shares of that capital stock.

The adjustments that apply at the start of March 22, 2016 in respect of a disposition of an interest in a policy that occurs before March 22, 2016 are relevant to determining the portion of any future proceeds in respect of the policy that may be added to the capital dividend account of a corporate beneficiary under the policy. For more information, see the commentary on the definition "capital dividend account" in subsection 89(1).

Clause 54

Becoming or ceasing to be exempt

ITA
149(10)(d)

Section 149 of the Act provides that certain persons are exempt from tax under Part I of the Act on their taxable income for the period in a taxation year during which the person qualifies for exempt status under section 149.

Subsection 149(10) sets out the tax treatment of a corporation that either become or ceases to be exempt from tax under Part I of the Act on its taxable income (otherwise than by reason of the exemption for certain insurers in paragraph 149(1)(t)).

Paragraph 149(10)(d) imposes a restriction on the extent to which a corporation may carry forward losses in respect of eligible capital expenditures incurred before a change in its tax status for deduction after the change. Paragraph 149(10)(d) reduces the cumulative eligible capital in respect of a business to the extent that the cumulative eligible capital exceeds 75 percent of the fair market value of eligible capital property in respect of the business (only 75 percent of expenditures on eligible capital property are added to cumulative eligible capital).

Paragraph 149(10)(b) provides a similar rule with respect to the undepreciated capital cost balance of depreciable property.

Paragraph 149(10)(d) is repealed consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 55

Alternative Basis for Assessment

ITA
152(9)

Subsection 152(9) of the Act is intended to ensure that, subject to other limitations in the Act, the Minister of National Revenue may advance alternative arguments in support of an income tax assessment after the normal reassessment period has expired.

A recent court decision held that, while the basis of an assessment can be changed after the expiration of the normal reassessment period, each source of income is to be considered in isolation and the amount of the assessment in respect of any particular source of income cannot increase.

This subsection is amended to clarify that the Minister may advance alternative arguments in support of all or any portion of the total amount determined on assessment to be payable or remittable by a taxpayer under this Act at any time where the assessment is under objection or appeal. The alternative arguments may result in an increase or adjustment to an amount included in the assessment that is under objection or appeal in respect of a particular source of income, provided that the total amount determined on assessment to be payable or remittable by a taxpayer under this Act does not increase.

This amendment comes into force on Royal Assent except that it does not apply in respect of appeals instituted on or before Royal Assent.

Clause 56

Failure to furnish foreign based information

ITA
162(10)

Subsection 162(10) of the Act levies a penalty on persons and partnerships who, knowingly or under circumstances amounting to gross negligence, fail to file information returns required to be filed under sections 233.1 to 233.4, whether or not a demand is served for the returns.

The penalty under subsection 162(10) applies in two mutually exclusive situations described by paragraphs 162(10)(a) and (b). The first situation applies where a person or partnership, knowingly or under circumstances amounting to gross negligence, fails to file an information return as and when required by any of sections 233.1 to 233.4 and 233.8. Where no demand has been served for the return, the penalty is $500 per month for up to 24 months. If a demand is served and not complied with, the penalty is $1,000 per month.

Subsection 162(10) is amended so that it applies to persons and partnerships who fail to file the “country-by-country report” information return required by new section 233.8.

The amendment to subsection 162(10) applies to "reporting fiscal years" of "MNE groups" (both as defined in new subsection 233.8(1)) that begin on or after January 1, 2016.

Clause 57

Back-to-Back Loan Arrangements

ITA
212(3.1) to (3.81)

Subsections 212(3.1) to (3.3) of the Act ensure that withholding tax applicable under Part XIII of the Act is not avoided by a financing arrangement in which a non-resident of Canada, instead of providing debt funding directly to a taxpayer that is a resident of Canada, provides it through an intermediary – for example, by lending funds to another person on condition that the other person make a loan to the taxpayer, a so-called "back-to-back" loan. The rules effectively treat as direct loans, from a non-resident to the taxpayer, certain variations of back-to-back loans and their economic equivalents. These back-to-back loan rules largely parallel the rules in subsections 18(6) and (6.1), which are targeted at similar financing arrangements that may otherwise circumvent the thin capitalization rules. Subsection 212(3.1) provides the conditions for the application of subsection 212(3.2), which is the operative rule.

The back-to-back loan rules in subsections 212(3.1) to (3.3) are amended to clarify the manner in which they apply to certain multiple-intermediary arrangements – that is, arrangements that include two or more intermediaries. Although the existing back-to-back rules can apply to such arrangements, and such arrangements raise similar tax policy concerns as single-intermediary arrangements, the manner in which the existing rules apply to multiple-intermediary arrangements may not be entirely clear in all cases. In order to clarify their application to multiple-intermediary arrangements, amendments are made to the existing rules in subsections 212(3.1) to (3.3). In addition to the clarifying amendments to subsection 212(3.1) to (3.3), new subsections 212(3.21), (3.22), (3.4), (3.5) and (3.81) are added, along with new definitions in subsection 212(3.8).

The back-to-back loan rules are also amended by adding "character substitution" rules in new subsections 212(3.6) and (3.7). These rules are intended to prevent the avoidance of the back-to-back loan rules through the substitution of an economically similar arrangement of a different legal character from a debt (e.g., a royalty agreement or an equity investment), between an intermediary and another party to the arrangement.

The amendments in subsections 212(3.1) to (3.81) apply in respect of amounts paid or credited as, on account or in lieu of payment of, or in satisfaction of interest after 2016.

ITA

212(3.1)

Subsection 212(3.1) of the Act sets out the conditions of application for subsection 212(3.2). As part of the changes in relation to multiple-intermediary arrangements, subsection 212(3.1) is amended by substituting the term "the immediate funder" for "the intermediary", in recognition that there may be multiple intermediaries (or "funders").

In addition, changes are made to paragraph 212(3.1)(c). Under the existing rules, paragraph 212(3.1)(c) requires a certain connection between the particular debt or other obligation referred to in paragraph 212(3.1)(a) and an arrangement under which the "intermediary" (i.e., the creditor under the particular debt or other obligation) is either the debtor or the holder of a specified right. Paragraph 212(3.1)(c) is modified to instead require the same kind of connection as under the existing rules, but between a particular "relevant funding arrangement" (or, in the case where the connection is in the form of a limited-recourse debt, any relevant funding arrangement) and an arrangement under which the "relevant funder", in respect of the particular relevant funding arrangement, is the debtor or the holder of a specified right. For these purposes, a "relevant funder" is defined in new subsection 212(3.8) to include the immediate funder, and a "relevant funding arrangement" is defined in subsection 212(3.8) to include the particular debt or other obligation referred to in paragraph 212(3.1)(c). Accordingly, the requirements of paragraph 212(3.1)(c) will be satisfied whenever the immediate funder receives debt funding, or a specified right, that is connected to the particular debt or other obligation in the manner described in paragraph 212(3.1)(c). Further, in that case, the debt owing by, or specified right held by, the immediate funder is itself a relevant funding arrangement (under paragraph (b) of that definition, in subsection 212(3.8)), and the creditor under that debt, or the grantor of that specified right, is also a relevant funder (under paragraph (b) of that definition, in subsection 212(3.8)). Any debt owing by, or specified right held by, the latter relevant funder that is connected to another relevant funding arrangement is also a relevant funding arrangement (under paragraph (b) of that definition, in subsection 212(3.8)). It is through this iterative application of the definitions "relevant funding arrangement" and "relevant funder" that the rules, as amended, apply to multiple-intermediary arrangements.

Paragraph 212(3.1)(d) is also amended to add a reference to "any ultimate funder". As a result, the condition in that paragraph is now satisfied if there is at least one ultimate funder – out of all of the ultimate funders that have, directly or indirectly, funded the particular debt or other obligation – to which the payment or crediting of the particular amount referred to in paragraph 212(3.1)(a) would have resulted in greater tax payable under Part XIII than is actually payable in respect of the particular amount paid to the immediate funder. An "ultimate funder" is defined in subsection 212(3.8) and means, in effect, a relevant funder (other than the immediate funder) that is the original source of funding (in the form of either debt financing or the granting of a specified right) that indirectly (through one or more intermediaries) funds the particular debt or other obligation. Thus, any relevant funder, within the back-to-back arrangement that includes the particular debt or other obligation, that acts solely as an intermediary or conduit for funding originating from another relevant funder within the arrangement, is not an ultimate funder. It is necessary to apply the Part XIII withholding tax rate comparison in paragraph 212(3.1)(d) with respect to each ultimate funder since, where the conditions in subsection 212(3.1) are met, amended subsection 212(3.2) deems the taxpayer to pay interest to each ultimate funder (in an amount determined under the formula in subsection (3.2)).

Minor changes are also made to the *de minimis* rule in paragraph 212(3.1)(e), to reflect the above-noted introduction of the term "immediate funder" in subsection 212(3.1) and the general clarifying changes with respect to multiple-intermediary arrangements. Also, language is added at the beginning of paragraph 212(3.1)(e), clarifying the original intent that the condition in that paragraph is satisfied if the 25% threshold is met at any time during the relevant period.

Back-to-back loan arrangements
ITA

212(3.2)

Subsection 212(3.2) of the Act is the operative rule setting out the consequences, for purposes of the withholding tax rule in paragraph 212(1)(*b*), when the conditions in subsection 212(3.1) are satisfied.

Subsection 212(3.2) is amended as part of the changes to the back-to-back loan rules, clarifying the manner in which they apply to certain multiple-intermediary arrangements. The first change is that, if subsection 212(3.2) applies, the taxpayer is deemed for the purposes of paragraph 212(1)(b) to pay interest to each "ultimate funder" (a new term that is defined in new subsection 212(3.8)). For more information on this definition, see the commentary on subsections 212(3.1) and (3.8).

Changes are also made to the formula and variables in subsection 212(3.2) to clarify the computation of deemed interest amounts in the case of multiple-intermediary arrangements. As a result of these changes, the amount of interest deemed to be paid to a particular ultimate funder is determined by the formula $(A – B) \times C/D \times (E – F)/E$.

Variable A is the particular amount referred to in paragraph 212(3.1)(a). This is unchanged under the current amendments.

Variable B is the portion, if any, of the particular amount deemed by subsection 214(16) to have been paid by the taxpayer as a dividend rather than as interest. Variable B is the amount that was previously in variable D. Moving this amount from variable D to variable B does not constitute a substantive change.

The proportion C/D in the formula represents the proportion of the particular debt or other obligation referred to in paragraph 212(3.1)(c) that is ultimately funded by the particular ultimate funder. Thus, the amount of interest that the particular ultimate funder is deemed to receive from the taxpayer under subsection 212(3.2) is determined by reference to the proportion of the particular debt or other obligation funded by the particular ultimate funder.

More specifically, variable C is the average of all amounts each of which is, at a particular time during the relevant period (the "relevant period" refers to the period during which the interest paid or credited accrued), the amount determined by the formula $G – H$.

Variable G is the least of the following amounts:

- the amount of the particular debt or other obligation referred to in paragraph 212(3.1)(a) outstanding at the particular time; and
- the total of all amounts each of which is, at that particular time,
    - an amount outstanding as or on account of a debt or other obligation that is owed to the particular ultimate funder under a relevant funding arrangement,
    - the fair market value of a particular property referred to in subparagraph 212(3.1)(c)(ii) in respect of which the particular ultimate funder has granted a specified right under a relevant funding arrangement, or

  - if there is neither a debt, nor a particular property, described in subparagraph (b)(i) or (b)(ii) of variable G at that particular time, nil.

In effect, variable G represents the portion of the particular debt or other obligation that has been indirectly funded by the particular ultimate funder providing debt funding, or granting specified rights, under one or more relevant funding arrangements (which are, by the definition of that term in subsection 212(3.8), arrangements that are part of a back-to-back loan arrangement that includes the particular debt or other obligation). In order to determine the portion of the particular debt or other obligation of which the particular ultimate funder is the ultimate source of funding, however, the amount in variable G must be reduced by the amount in variable H.

Variable H represents the aggregate amount of funding received by the particular ultimate funder, effectively acting as an intermediary (or "conduit") under the back-to-back loan arrangement that includes the particular debt or other obligation. Specifically, variable H is the total of all amounts each of which is:

- an amount outstanding as or on account of a debt or other obligation that is owed by the particular ultimate funder under a relevant funding arrangement (whereas subparagraph (b)(i) in variable G refers to amounts owing to (and not by) the particular ultimate funder),
- the fair market value of a particular property in respect of which the particular ultimate funder has a specified right under a relevant funding arrangement, or
- if there is neither a debt, nor a particular property, described in paragraph (a) or (b) of variable H at that particular time, nil.

Variable D is the average of all amounts each of which is the amount of the particular debt or other obligation outstanding at a time in the relevant period. Although, under the current amendments, this amount is moved from variable C to variable D in the formula, this does not constitute a substantive change.

The only changes to variables E and F under the current amendments involve replacing the reference to "the non-resident person" with "the particular ultimate funder", and the intermediary" with "the immediate funder". These changes are consistent with the changes in terminology throughout the back-to-back loan rules, as part of the amendments relating to multiple-intermediary arrangements. As a result, variable E is now the rate of tax (determined without reference to subsection 214(16)) that would be imposed under Part XIII on the particular amount if the particular amount were paid by the taxpayer to the particular ultimate funder at the time when it is actually paid to the immediate funder.

Variable F is the rate of tax (determined without reference to subsection 214(16)) imposed under Part XIII on the immediate funder in respect of all or the portion of the particular amount paid or credited to the immediate funder.

Back-to-back arrangement – election

ITA

212(3.21)

New subsections 212(3.21) and (3.22) of the Act provide for an election that is intended to relieve a compliance burden that may otherwise result where subsection 212(3.2) deems a taxpayer to make interest payments to two or more ultimate funders for the purposes of paragraph 212(1)(b). The election effectively provides relief from the reporting requirements that otherwise apply in respect of the separate interest payments otherwise deemed under subsection 212(3.2) to be made by the taxpayer to each of the ultimate funders. In general, the election allows the taxpayer and two or more of the ultimate funders to elect that the interest payments that would otherwise be deemed in respect of each of the electing ultimate funders instead be deemed to have been made by the taxpayer to a single ultimate funder designated in the election, provided that the rate of withholding tax on interest paid to the designated ultimate funder is not less than the rate for any of the electing ultimate funders.

Subsection 212(3.21) sets out the conditions for the application of the operative rule in subsection 212(3.22). Subsection 212(3.21) provides that subsection 212(3.22) applies in respect of a taxpayer and two or more ultimate funders (referred to as the "electing ultimate funders") at any time if the conditions in paragraphs 212(3.21)(a) to (e) are satisfied.

The first condition (contained in paragraph 212(3.21)(a)) is that, at that time, subsection 212(3.2) applies in respect of the taxpayer.

In general, the second and third conditions (contained in paragraphs 212(3.21)(b) and (c), respectively) set out the requirement for the taxpayer and the electing ultimate funders to file an election designating one of the electing ultimate funders to be treated as the recipient of the interest payments that would otherwise be deemed by subsection 212(3.2) to be made by the taxpayer to the electing ultimate funders. Paragraph 212(3.21)(b) requires that the taxpayer and the electing ultimate funders jointly file an election. There is no requirement that all of the ultimate funders file the election; any ultimate funders that are not electing ultimate funders will simply be deemed by subsection 212(3.2) to receive interest payments as they would in the absence of an election. Paragraph 212(3.21)(c) requires that the election designate one of the electing ultimate funders to be the recipient of the deemed interest payments under subsection 212(3.22).

The fourth condition (contained in paragraph 212(3.21)(d)) effectively provides that the designated ultimate funder cannot be subject (*i.e.*, because of an applicable tax treaty) to withholding tax in respect of interest payments at a rate that is less than the rate applicable to any of the other electing ultimate funders. This ensures that an election to designate a particular electing ultimate funder to be the recipient of the interest payments cannot result in a reduction to the total withholding tax payable under Part XIII in respect of the interest payments that the taxpayer is otherwise deemed by subsection 212(3.2) to make to the ultimate funders.

The fifth condition (contained in paragraph 212(3.21)(e)) is that the election has not been revoked prior to the time at which subsection 212(3.2) applies in respect of the taxpayer.

Back-to-back arrangement – election

ITA

212(3.22)

Subsection 212(3.22) sets out the consequences that apply where the conditions in subsection 212(3.21) are satisfied. In particular, if subsection 212(3.22) applies at any time in respect of a taxpayer and two or more electing ultimate funders, then each interest payment that would, in the absence of that subsection, have been deemed under subsection 212(3.2) to have been made at that time by the taxpayer to an electing ultimate funder, and received by the electing ultimate funder from the taxpayer, is deemed to have instead been made by the taxpayer to the designated ultimate funder, and received by the designated ultimate funder from the taxpayer.

The policy objective of the election in subsections 212(3.21) and (3.22) is to relieve a compliance burden that may otherwise result where subsection 212(3.2) deems a taxpayer to make an interest payment to two or more ultimate funders. For more information, see the commentary on subsection 212(3.21).

Excess funding
ITA

212(3.3)

Subsection 212(3.3) of the Act ensures that, where subsection 212(3.2) deems a taxpayer to pay interest to multiple non-resident persons in respect of a particular debt or other obligation referred to in paragraph 212(3.1)(a), the total amount of interest deemed to be paid to those non-residents under subsection 212(3.2) does not exceed the amount of interest actually paid on the particular debt or other obligation. To prevent such excess, subsection 212(3.3) effectively allows the taxpayer to designate, in a reasonable manner, amounts by which to reduce the amounts of funding considered to have been provided by one or more of the non-resident persons, provided that the total of such reductions cannot be greater than the amount of the excess.

Subsection 212(3.3) is replaced by new subsections 212(3.3) and (3.4), which address circumstances similar to those addressed by the previous version of subsection 212(3.3), but which are both broader in their scope of application and more prescriptive (in particular, they do not allow the taxpayer to designate amounts). These changes are part of the clarifying amendments for multiple-intermediary arrangements.

New subsections 212(3.3) and (3.4) are intended to ensure that subsection 212(3.2) deems interest payments to ultimate funders in the appropriate amounts in cases where a relevant funder has received more funding under relevant funding arrangements – which arrangements are, by their definition in subsection 212(3.8), part of the back-to-back arrangement that includes the particular debt or other obligation – than the relevant funder has provided under relevant funding arrangements (i.e., the funding “into” the relevant funder exceeds the funding “out”). In these circumstances, absent subsections 212(3.3) and (3.4), the aggregate of the amounts that would be determined for variable C in subsection 212(3.2) in respect of ultimate funders (generally representing the funding that ultimate funders are, collectively, considered to contribute, under relevant funding arrangements, to the particular debt or other obligation) would generally exceed the amount outstanding on the particular debt or other obligation. As a result, the aggregate amount of interest those ultimate funders would be deemed to receive under subsection 212(3.2) would generally exceed the particular amount of interest referred to in paragraph 212(3.1)(a). This would be an inappropriate result.

Subsection 212(3.3) provides the conditions of application for subsection 212(3.4). Specifically, subsection 212(3.4) applies in respect of a particular relevant funder if the amount determined by formula is greater than nil. The formula is A – B, where

- Variable A is the total of all amounts each of which is the amount owing by the particular relevant funder under a relevant funding arrangement, or the fair market value of a property in respect of which the particular relevant funder has a specified right under a relevant funding arrangement; and
- Variable B is the total of all amounts each of which is the amount owed to the particular relevant funder, or the fair market value of a property in respect of which the particular relevant funder has granted a specified right, under a relevant funding arrangement.

Thus, variable A comprises amounts owing by, and specified rights held by, the particular relevant funder, whereas variable B comprises amounts owing to, and specified rights granted by, the particular relevant funder.

Excess funding – deemed funding allocation
ITA

212(3.4)

In general terms, subsection 212(3.4) of the Act applies where more funding goes into a particular relevant funder than it provides.

If subsection 212(3.4) applies in respect of a particular relevant funder, then, for the purposes subsections 212(3.2) to (3.4) (to avoid circularity, other than for the purpose of applying subsections 212(3.3) and (3.4) in respect of the particular relevant funder), each amount that is owed by the particular relevant funder under a relevant funding arrangement, or that is the fair market value of a property in respect of which the particular relevant funder has been granted a specified right under a relevant funding arrangement, is deemed to be the amount determined by the formula C/D x E.

Variable C is the amount owing or the fair market value of the property, as the case may be. This reflects that subsection 212(3.4) applies on a debt-by-debt, and property-by-property, basis.

Variable D is the amount determined for variable A in subsection 212(3.3), which, as noted, represents the total funding provided to the particular relevant funder under relevant funding arrangements.

Variable E is the amount determined for variable B in subsection 212(3.3), which, as noted, represents the total funding provided by the particular relevant funder under relevant funding arrangements.

In effect, for the purposes of subsections 212(3.2) to (3.4), subsection 212(3.4) reduces the amount of each of the debts owing by the particular relevant funder under relevant funding arrangements, and the fair market value of each property in respect of which the particular relevant funder has received a specified right under a relevant funding arrangement, to an amount equal to the proportion, of the total funding provided by the particular relevant funder under relevant funding arrangements, that that debt owing or the fair market value of the property, as the case may be, is of the total of all the amounts owing and the fair market values of

the properties. The end result is that the aggregate of all of the amounts of funding received by the particular relevant funder under relevant funding arrangements is deemed to be equal to the total amount of funding provided by the particular relevant funder under relevant funding arrangements.

Multiple funding arrangements
ITA

212(3.5)

New subsection 212(3.5) of the Act addresses cases where a debt, or a specified right granted in respect of property, funds (indirectly, through back-to-back arrangements) more than one particular debt or other obligation referred to in paragraph 212(3.1)(a). This can occur where the debt or the specified right is a relevant funding arrangement in respect of more than one particular debt or other obligation – in other words, where it is part of more than one back-to-back loan arrangement. To ensure that the full amount of the debt, or the full fair market of the property in respect of which the specified right is granted, is not considered (for purposes of subsections 212(3.2) to (3.4)) to fund each of the particular debts or other obligations, subsection 212(3.5) effectively allocates the amount of the debt or the fair market value of the property, as the case may be, between the particular debts or other obligations on a *pro rata* basis.

Specifically, subsection 212(3.5) applies if an amount owing by a relevant funder, or a specified right held by the relevant funder, is a relevant funding arrangement in respect of more than one particular debt or other obligation referred to in paragraph 212(3.1)(a). Where this condition is met, for the purposes of subsections 212(3.2) to (3.4), subsection 212(3.5) deems the amount owing, or the fair market value of the property in respect of which the specified right is granted, to be – in respect of each of the particular debts or other obligations in respect of which the amount owing or the specified right is a relevant funding arrangement – the amount determined by the formula A/B x C.

Variable A is the total of all amounts each of which is an amount owing to the relevant funder, or the fair market value of a property in respect of which the relevant funder has granted a specified right, under a relevant funding arrangement in respect of the particular debt or other obligation. Thus, variable A represents the total amount of funding provided by the relevant funder under relevant funding arrangements that are part of the back-to-back arrangement that includes the particular debt or other obligation in respect of which the deemed amount under subsection 212(3.5) is being determined.

Variable B is the total of all amounts each of which is an amount owing to the relevant funder, or the fair market value of a property in respect of which the relevant funder has granted a specified right, under all relevant funding arrangements, in respect of all of the particular debts or other obligations. Thus, variable B represents the total amount of funding provided by the relevant funder under relevant funding arrangements that are part of back-to-back arrangements that include any particular debts or other obligations referred to in paragraph 212(3.1)(a).

Variable C is the amount owing by the relevant funder, or the fair market value of the property in respect of which the relevant funder holds the specified right.

In effect, subsection 212(3.5) allocates each funding amount received by a relevant funder (whether in the form of debt funding or a specified right), as between all of the particular debts or other obligations referred to in paragraph 212(3.1)(a) that are part of back-to-back arrangements that include that funding amount. The portion of a funding amount that is allocated to a particular debt or other obligation is determined based on the proportion that the total funding provided by the relevant funder under relevant funding arrangements in respect of a particular debt or other obligation is of the total funding provided by the relevant funder under relevant funding arrangements in respect of all of the particular debts or other obligations.

Back-to-Back Loan Arrangements – Character substitution
ITA

212(3.6) and (3.7)

New subsections 212(3.6) and (3.7) of the Act are intended to address back-to-back arrangements that raise the same policy concerns as back-to-back loans – in that they can be used to avoid or reduce withholding tax on interest payments – but in respect of which the back-to-back loan rules in subsections 212(3.1) and (3.2) would otherwise not apply (or would not apply with appropriate results) because one or more of the arrangements comprising the back-to-back arrangement is legally not a debt (or a specified right). In particular, the "character substitution" rules in subsections 212(3.6) and (3.7) apply where a Canadian taxpayer has paid a particular amount of interest in respect of a particular debt or other obligation, and the back-to-back loan rules may otherwise be avoided by substituting shares or a lease, license or similar agreement in place of a debt or other obligation within a back-to-back arrangement.

New subsection 212(3.6) provides that new subsection 212(3.7) applies in respect of shares (other than specified shares) of a particular relevant funder, in respect of a particular relevant funding arrangement, or in respect of a specified royalty arrangement, where certain conditions are met. In the case of shares, paragraph 212(3.6)(a) sets out the following two conditions:

- First, at any time at or after the time when the particular debt or other obligation referred to in paragraph 212(3.1)(a) was entered into, the particular relevant funder, in respect of the particular relevant funding arrangement, must have an obligation to pay or credit an amount as, on account of or lieu of payment of, or in satisfaction of a dividend on the shares – either immediately or in the future and either absolutely or contingently – to a person or partnership. Subsection 212(3.8) defines a "relevant funder," in respect of a relevant funding arrangement, to mean the creditor in respect of the debt, or the grantor in respect of the specified right, that is the relevant funding arrangement (and, if the relevant funding arrangement is the particular debt or other obligation referred to in paragraph 212(3.1)(a), the relevant funder is the immediate funder referred to in that paragraph). Thus, the first condition requires that either the immediate funder in respect of the particular debt or other obligation referred to in paragraph 212(3.1)(a), or the creditor under a debt – or grantor of a specified right – that is part of a back-to-back arrangement that includes the particular debt or other obligation, have an obligation to pay a dividend.
- Second, one of the following two conditions must also be met:

- the amount of the dividend is determined, in whole or in part, by reference to an amount of interest paid or credited, or an obligation to pay or credit interest, under a relevant funding arrangement, or
- it can reasonably be concluded that the particular relevant funding arrangement was entered into or was permitted to remain in effect because
  - the shares were issued or were permitted to remain issue and outstanding, or
  - it was anticipated that the shares would be issued or would be permitted to remain issue and outstanding.

The character substitution rules in subsections 212(3.6) and (3.7) do not apply to specified shares (*i.e.*, certain shares with debt-like characteristics) because a specific rule in subsection 212(3.81) ensures that the back-to-back loan rules apply to these types of shares. For more information, see the commentary on the definition "specified shares" in subsection 212(3.8) and on subsection 212(3.81).

In the case of a specified royalty arrangement – defined in subsection 212(3.94) to mean a lease, license or similar agreement, an assignment or an instalment sale (which definition applies because of the cross-reference in subsection 212(3.8)) – paragraph 212(3.6)(b) sets out the following three conditions for the application of subsection 212(3.7), which largely parallel the conditions for shares in paragraph 212(3.6)(a):

- First, a particular relevant funder, in respect of a particular relevant funding arrangement, must be a "specified licensee" under the specified royalty arrangement (defined in subsection 212(3.8) to mean a lessee, licensee or grantee of a right similar to a right granted under a lease or licence, an assignor or a purchaser).
- Second, the particular relevant funder must have an obligation to pay or credit an amount under the specified royalty arrangement – either immediately or in the future and either absolutely or contingently – to a person or partnership.
- Third, one of the following two conditions must also be met:
  - the amount that the particular relevant funder is obligated to pay or credit under the specified royalty arrangement is determined, in whole or in part, by reference to an amount of interest paid or credited, or an obligation to pay or credit interest, under a relevant funding arrangement, or
  - it can reasonably be concluded that the particular relevant funding arrangement was entered into or was permitted to remain in effect because
    - the specified royalty arrangement was entered into or was permitted to remain in effect, or
    - it was anticipated that the specified royalty arrangement would be entered into or remain in effect.

If subsection 212(3.7) applies in respect of a specified royalty arrangement (under which a particular relevant funder is a specified licensee), or in respect of shares of a particular relevant funder, it provides deeming rules that are intended to ensure that the specified royalty arrangement or the shares, as the case may be, are treated under the back-to-back loan rules as though they were instead a relevant funding arrangement. To achieve this result, subsection 212(3.7) provides the following deeming rules, for the purposes of subsections 212(3.1) to (3.8):

- the specified royalty arrangement, or the holding of the shares, as the case may be, is deemed to be a funding arrangement;
- the specified licensor (defined in subsection 212(3.8)) under the specified royalty arrangement, or the shareholder of the shares of the particular relevant funder, as the case may be, is deemed to be a relevant funder, in respect of the relevant funding arrangement that is deemed under paragraph 212(3.7)(a);
- the conditions in paragraph 212(3.1)(c) are deemed to be met in respect of the relevant funding arrangement, in order to ensure that, if the conditions in subsection 212(3.6) are met, the conditions in paragraph 212(3.1)(c) are also met; and
- the relevant funder (that is deemed under paragraph 212(3.7)(b)) is deemed to be owed, under the relevant funding arrangement and by the particular relevant funder (i.e., the specified licensee under the specified royalty arrangement, or the issuer of the shares), a debt the outstanding amount of which is determined by the formula (A – B) x C/D.

Variable A in the formula is the total, at the particular time, of all of the amounts outstanding on debts or other obligations owed to the particular relevant funder under relevant funding arrangements, and the fair market values of all the properties in respect of which the particular relevant funder has granted specified rights under relevant funding arrangements.

Thus, variable A represents all of the funding provided by the particular relevant funder under relevant funding arrangements. This amount is reduced by the amount in variable B, which represents the total funding provided to the particular relevant funder under actual relevant funding arrangements (as opposed to relevant funding arrangements deemed under paragraph 212(3.7)(a)). This reflects the assumption that, to the extent the particular relevant funder has received amounts of funding under actual relevant funding arrangements, such amounts are the source of the funding provided by the particular relevant funder under relevant funding arrangements. Therefore, the difference A – B represents the portion (if any) of the funding provided by the particular relevant funder under relevant funding arrangements that is not sourced from funding received by the particular relevant funder under actual relevant funding arrangements. This portion is effectively allocated – by multiplying (A – B) by C/D – as between the one or more relevant funding arrangements that are deemed to exist under paragraph 212(3.7)(a), in proportion to the relative fair market values of the shares or specified royalty arrangements underlying those deemed relevant funding arrangements.

Specifically, the remaining variables are as follows:

- Variable B is the total, at the particular time, of all of the amounts outstanding on debts or other obligations owed by the particular relevant funder under relevant funding arrangements, and the fair market values of all the properties in respect of which the particular relevant funder has been granted specified rights under relevant funding arrangements. As noted, however, any amounts under relevant funding arrangements that are deemed to exist under paragraph 212(3.7)(a) are excluded from variable B.
- Variable C is the fair market value of either the shares of the particular relevant funder (described in paragraph 212(3.6)(a)), or the specified royalty arrangement (described in paragraph 212(3.6)(b)).
- Variable D is the total of all amounts each of which is the fair market value of shares of the particular relevant funder in respect of which subsection 212(3.7) applies, or the fair

market value of a specified royalty arrangement (under which the particular relevant funder is a specified licensee) in respect of which subsection 212(3.7) applies.

Back-to-back loan arrangement – definitions

ITA
212(3.8)

New subsection 212(3.8) of the Act sets out the relevant definitions that apply in the back-to-back loan rules in subsections 212(3.1) to (3.81).

“relevant funder”

A “relevant funder”, in respect of a relevant funding arrangement (also defined in this subsection), refers to the creditor in respect of a debt or other obligation, or the grantor of a specified right, as the case may be. In the case where the relevant funding arrangement is the particular debt or other obligation referred to in paragraph 212(3.1)(c), the relevant funder is the “immediate funder” referred to in paragraph 212(3.1)(a). Any person or partnership that does not deal at arm’s length with a relevant funder that deals at arm’s length with the taxpayer is also a relevant funder.

“relevant funding arrangement”

The term “relevant funding arrangement”, together with the term “relevant funder”, is introduced as part of the amendments clarifying the application of the back-to-back loan rules to multiple-intermediary arrangements (for more information, see the commentary on subsection 212(3.1)).

A “relevant funding arrangement” is defined to mean the particular debt or other obligation referred to in paragraph 212(3.1)(a), as well as each debt or other obligation owing by, or specified right granted to, a relevant funder, that meets the conditions in subparagraphs 212(3.1)(c)(i) or (ii) in respect of a relevant funding arrangement. Thus, the definition applies iteratively in the context of a back-to-back loan arrangement comprising multiple intermediaries, such that all of the debts (or specified rights) within the back-to-back loan arrangement are relevant funding arrangements. For more information, see the commentary on the definition of “funding arrangement” in new subsection 15(2.192).

“specified licensee”

The definition “specified licensee” is relevant for the purposes of the “character substitution” rules in subsections 212(3.6) and (3.7) of the back-to-back loan rules. A specified licensee is a party to a specified royalty arrangement (also defined in this subsection) that is a lessee, licensee or grantee of a right similar to a right granted under a lease or licence, an assignee or a purchaser. The reference to “a lessee, licensee or grantee of a right similar to a right granted under a lease or licence” parallels the reference in paragraph 212(1)(d) to “rent, royalty or similar payment”.

“specified licensor”

Like the definition “specified licensee”, the definition “specified licensor” is relevant for the purposes of the “character substitution” rules in subsections 212(3.6) and (3.7) of the back-to-back loan rules. The specified licensor is the other party to a specified royalty arrangement – i.e.,

the lessor, licensor or grantor of a right similar to a right granted under a lease or licence, the assignor or the seller.

"specified right"

The term "specified right" has the same meaning as in subsection 18(5).

"specified royalty arrangement"

The definition "specified royalty arrangement" has the meaning assigned by subsection 212(3.94), which sets out definitions relevant to the back-to-back royalty rules. For more information, see the commentary on subsection 212(3.94).

This definition is relevant for the purposes of the "character substitution" rules in subsections 212(3.6) and (3.7), which are intended to ensure that the back-to-back loan rules are not avoided by the inclusion, within a back-to-back arrangement, of an arrangement of a different legal character from debt. In that context, "specified royalty arrangement" refers to a class of agreements or arrangements that, when substituted for a debt or other obligation, are effectively treated under the back-to-back loan rules as if they were a debt.

"specified share"

In the context of the back-to-back loan rules, a "specified share" refers to a share with debt-like features, which – in order to ensure that the rules cannot be avoided through the use of such shares – is treated similarly to debts under those rules.

More specifically, a specified share of a corporation is one where, under the terms and conditions, or any agreement or arrangement relating to, the share

- the holder of the share may cause the share to be redeemed, acquired or cancelled;
- the issuer is, or may be, required to redeem, acquire or cancel the share at a specific time; or
- the share is convertible or exchangeable into a share in respect of which the holder or the issuer have such rights or obligations.

"ultimate funder"

The definition "ultimate funder" is added as part of the amendments clarifying the application of the back-to-back loan rules to multiple-intermediary arrangements. It is relevant mainly for the purposes of paragraph 212(3.1)(d) and subsection 212(3.2).

An ultimate funder is, in effect, a relevant funder (other than the immediate funder referred to in paragraph 212(3.1)(a)) that is the ultimate source of funding (in the form of either debt financing or the granting of a specified right) that indirectly (through one or more intermediaries) funds the particular debt or other obligation referred to in paragraph 212(3.1)(a). Any relevant funder, within the back-to-back arrangement that includes the particular debt or other obligation, that acts solely as an intermediary (or "conduit") for funding originating from another relevant funder within the arrangement is not an ultimate funder.

More specifically, there are two situations in which a relevant funder is an ultimate funder under this definition. The first, set out in paragraph (a) of the definition, is where the relevant funder is not a debtor, or a holder of a specified right, under a relevant funding arrangement. A relevant

funder meeting this condition is an ultimate source of funding under the back-to-back arrangement, since the relevant funder necessarily has provided funding under a relevant funding arrangement, but without having received any funding that is connected to the back-to-back arrangement. The second situation, set out in paragraph (b) of the definition, is where, although the relevant funder is a debtor, or holder of a specified right, under a relevant funding arrangement, the amount that would – if the relevant funder were an ultimate funder – be determined for C in the formula in subsection 212(3.2) is greater than nil. The amount determined for C would be greater than nil only if the total funding provided by the relevant funder under relevant funding arrangements (not exceeding the amount outstanding on the particular debt or other obligation referred to in paragraph 212(3.1)(a)) is greater than the total amount of funding received by the relevant funder under relevant funding arrangements.

Specified shares

ITA
212(3.81)

New subsection 212(3.81) of the Act provides deeming rules that apply for the purposes of subsections 212(3.1) to (3.7) and (3.81) to ensure that the back-to-back loan rules cannot be avoided through the use of "specified shares", which, for the purposes of the back-to-back loan rules, are defined in subsection 212(3.8) generally as shares with debt-like characteristics. For more information, see the commentary on the definition "specified share" in subsection 212(3.8).

Paragraph 212(3.81)(a) deems specified shares of a relevant funder, in respect of a relevant funding arrangement, held at any time by a person or partnership to be a debt of the relevant funder owing to the person or partnership. Paragraph 212(3.81)(b) provides that the amount outstanding at that time on the deemed debt is deemed to be equal to the fair market value of the specified shares at that time. The intended effect of these deeming rules is to treat specified shares in the same manner as a debt for purposes of the back-to-back loan rules.

ITA
212(3.9) to (3.94)

Part XIII of the Act imposes an income tax (commonly referred to as "non-resident withholding tax") on various types of property income earned by non-residents from sources in Canada. Paragraph 212(1)(d) describes various amounts, generally in the nature of rent, royalties and similar payments, on which non-resident withholding tax is imposed.

Section 212 is amended to add new "back-to-back royalty" rules that apply with respect to the various amounts described in paragraph 212(1)(d). These new rules, set out in subsections 212(3.9) to (3.94), are modelled on the back-to-back loan rules, also contained in Part XIII of the Act. These amendments are intended to ensure that non-resident withholding tax is not avoided in respect of payments subject to paragraph 212(1)(d), by an arrangement in which an intermediary entity is interposed between a Canadian-resident payor and a non-resident payee.

These new rules may apply, for example, where a Canadian resident makes a royalty payment to a non-resident person (referred to as the "immediate licensor") and another non-resident (referred to as an "ultimate licensor") receives a payment from the immediate licensor under a sufficiently

connected license agreement (referred to as a “relevant royalty arrangement”). If the ultimate licensor deals at arm’s length with the Canadian resident, the rules will apply only if it can reasonably be concluded that one of the main purposes of the relevant royalty arrangement was to reduce or avoid the tax payable under Part XIII in respect of the royalty payment or to avoid the application of the rules.

In addition, the rules apply only if the back-to-back arrangement results in a reduction of the non-resident withholding tax that would be payable if the payment were made directly to the ultimate licensor instead of the immediate licensor.

Where applicable, the new rules generally deem the Canadian resident to make a rent, royalty or similar payment to one or more ultimate licensors. The amount of the deemed payment is determined by reference to the amount of non-resident withholding tax that was avoided by making the payment to the immediate licensor instead of directly to the ultimate licensor.

New subsection 212(3.9) sets out the conditions for the application of the operative “deemed payment” rule in subsection 212(3.91). New subsections 212(3.92) and (3.93) set out rules that apply where non-resident withholding tax may otherwise be avoided by substituting an arrangement of a different legal character in place of a lease, licence or similar agreement between an intermediary entity and another party to an arrangement. New subsection 212(3.94) contains definitions for the purposes of new subsections 212(3.9) to (3.94).

New subsections 212(3.9) to (3.94) apply in respect of amounts paid or credited as, on account or in lieu of payment of, or in satisfaction of, rent, royalty or similar payments after 2016

Back-to-back arrangement – rents, royalties, similar payments

ITA
212(3.9)

In order for the operative rule in new subsection 212(3.91) of the Act to apply at any time in respect of a taxpayer, the conditions set out in subsection 212(3.9) must be satisfied.

The first condition, in paragraph 212(3.9)(a), requires that a taxpayer pay or credit a particular amount at the time as, on account, or in lieu of payment of, or in satisfaction of, rent, royalty or similar payment, in respect of a particular lease, licence or similar agreement, to a non-resident person or a partnership any member of which is a non-resident person (referred to as the “immediate licensor”). The term “rent, royalty or similar payment” is defined in subsection 212(3.94) to mean a payment to which paragraph 212(1)(d) applies, and “lease, licence or similar agreement” is defined in the same subsection to mean an agreement under which such a payment is or could be made.

Paragraph 212(3.9)(b) sets out three conditions, two in subparagraph 212(3.9)(b)(i) and one in subparagraph 212(3.9)(b)(ii). The first condition in subsection 212(3.9)(b)(i) is that (at any time at or after the time when the particular lease, licence or similar agreement referred to in paragraph (3.9)(a) was entered into) a relevant licensor in respect of a particular relevant royalty arrangement has an obligation to pay or credit an amount (either immediately or in the future and either absolutely or contingently) to a person or partnership in respect of a specified royalty arrangement. For these purposes, a “relevant licensor” is defined in new subsection 212(3.94) to include the immediate licensor. In addition, a specified royalty arrangement is defined as a lease,

license or similar agreement, an assignment or an instalment sale. Accordingly, the first condition in subparagraph 212(3.9)(b)(i) will be satisfied whenever the immediate licensor has an obligation to pay or credit an amount under such an agreement or arrangement.

The second condition in subparagraph 212(3.9)(b)(i) is that the specified royalty arrangement (or the payment under that arrangement) under which a relevant licensor (e.g., the immediate licensor) has the obligation to pay or credit an amount must be connected to a relevant royalty arrangement in either of the following two ways. The first way (contained in clause 212(3.9)(b)(i)(A)) is if the amount that the relevant licensor is obligated to pay or credit is determined, in whole or in part, by reference to either

- an amount paid or credited, or an obligation to pay or credit an amount, in respect of a relevant royalty arrangement; or
- one or more of the fair market value of, any revenue, profits, income or cash flow from, or any other similar criteria in respect of, a particular property, if a right in respect of the property is granted under the particular lease, licence or similar agreement.

The second way (contained in clause 212(3.9)(b)(i)(B)) in which a required connection can be established between the specified royalty arrangement and a particular relevant royalty arrangement is if it can reasonably be concluded that the particular relevant royalty arrangement was entered into, or was permitted to remain in effect, because either the specified royalty arrangement was entered into or was permitted to remain in effect, or it was anticipated that the specified royalty arrangement would be entered into or remain in effect.

The design of subparagraph 212(3.9)(b)(i) is similar to that of paragraph 212(3.1)(c) in the back-to-back loan rules. For more information, see the commentary on paragraph 212(3.1)(c)).

The third condition, contained in subparagraph 212(3.9)(b)(ii), depends on whether the taxpayer making the rent, royalty or similar payment deals at arm’s length with the person or partnership to whom the relevant licensor has an obligation to pay or credit an amount in respect of the specified royalty arrangement.

If the taxpayer and the person or partnership do not deal at arm’s length, then the condition in subparagraph 212(3.9)(b)(ii) is met. If, however, the taxpayer and the person or partnership are dealing at arm’s length, the condition will only be met if it can reasonably be concluded that one of the main purposes of the specified royalty arrangement was:

- to reduce or avoid the tax payable under Part I in respect of the particular amount paid or credited by the taxpayer to the immediate licensor in respect of a rent, royalty or similar payment (subclause 212(3.9)(b)(ii)(B)(I)); or
- to avoid the application of the operative rule in subsection 212(3.91) (subclause 212(3.9)(b)(ii)(B)(II)).

The policy objective of the additional requirement in clause 212(3.9)(b)(ii)(B) is to ensure that the rules do not apply to ordinary, arm’s length commercial transactions that do not have, as one of their main purposes, the reduction or avoidance of the tax that would otherwise be payable under Part XIII or the avoidance of these rules.

The final condition, in paragraph 212(3.9)(c), is that the tax that would be payable under Part XIII in respect of the particular amount described in paragraph (3.9)(a), if the particular amount

were paid or credited to an ultimate licensor rather than the immediate licensor, is greater than the tax payable under Part XIII (determined without reference to subsections 212(3.9) and (3.91) in respect of the particular amount). The term "ultimate licensor" is defined in subsection 212(3.94) to mean a relevant licensor (other than the immediate licensor), in respect of a relevant royalty arrangement, that is not, under a relevant royalty arrangement, a lessee, a licensee or a grantee of a right similar to a right granted under a lease or licence, an assignee or a purchaser. In other words, an ultimate licensor is a relevant licensor that does not act as an intermediary within the back-to-back arrangement.

Back-to-back arrangement – rents, royalties, similar payments

ITA
212(3.91)

New subsection 212(3.91) of the Act is the operative rule providing the consequences when the conditions in subsection 212(3.9) are satisfied. If subsection 212(3.91) applies to a taxpayer at a particular time, then, for the purposes of paragraph 212(1)(d), the taxpayer is deemed to pay an amount – of the same character as the particular amount referred to in paragraph 212(3.9)(a) – to each particular ultimate licensor. By providing that the deemed payment has the same character as the particular amount, the rule is intended to ensure that the withholding tax result under the rules is effectively the same result that would have occurred had the particular amount instead been paid directly to the ultimate licensor(s).

The amount that each particular ultimate licensor is deemed to receive from the taxpayer is determined by the following formula:

$$(A \times B/C) \times (D - E)/D$$

Variable A is the particular amount referred to in paragraph 212(3.9)(a). This is the amount paid or credited by the taxpayer to the immediate licensor. Variable A reflects the fact that subsection 212(3.91) applies separately with respect to each particular amount paid or credited by the taxpayer.

Variable B is, first, the portion of the particular amount referred to in paragraph 212(3.9)(a) that is demonstrated, to the satisfaction of the Minister of National Revenue, to be reasonably allocable to the particular ultimate licensor (paragraph (a) of the description of B). If there is one ultimate licensor, all of the amount will be allocated to it. If there is more than one ultimate licensor (e.g., because of the co-ownership of licensed property), a reasonable allocation must be made. The reasonableness of a particular allocation is intended to be determined having regard to relevant factors, such as the relative amounts of payments received by the ultimate licensors under relevant funding arrangements. If no such allocation is established, to the satisfaction of the Minister, as being reasonable, then variable B is one (paragraph (b) of the description of B). Setting this value at one (together with the corresponding rule in paragraph (b) of the description of C) provides an automatic mechanism to allocate evenly between the ultimate licensors.

The amount determined for variable C is linked to the amount determined for variable B; if the amount determined for variable B is under its paragraph (a), then the amount determined for variable C will similarly be determined under its paragraph (a). Paragraph (a) will apply only if it is established, to the satisfaction of the Minister, that the amount referred to in paragraph

212(3.9)(a) has been reasonably allocated between the ultimate licensors. If this requirement is met, then variable C is the total of all of the amounts allocable to the ultimate licensors.

If an amount is not demonstrated, to the satisfaction of the Minister, to be reasonably allocable to each particular ultimate funder, the amount for variable C is equal to the number of ultimate licensors (paragraph (b) of the description of C). Together with the result under paragraph (b) of variable B, this effectively allocates the amount referred to in paragraph 212(3.9)(a) evenly between the ultimate licensors.

The amount determined for variable D also is linked to the amounts determined for variables B and C. If the latter amounts were determined under paragraph (a) of variables B and C, then the amount determined for variable D will be under its paragraph (b). In that case, the amount will be equal to the rate of tax that would be imposed under Part XIII on the particular amount referred to in paragraph 212(3.9)(a) if the particular amount were paid by the taxpayer to the particular ultimate licensor. Otherwise, if paragraph (a) of the description of D applies, then the amount for variable D is equal to the highest rate of tax that would be imposed under Part XIII on the particular amount referred to in paragraph 212(3.9)(a) if the particular amount were paid by the taxpayer to any of the ultimate licensors at that time. As a result, where there is one ultimate licensor, no allocation is necessary.

Variable E is the rate of tax imposed under Part XIII on the immediate licensor in respect of the particular amount referred to in paragraph 212(3.9)(a).

Example

Assumptions

- *Forco, a non-resident corporation that resides in Country 1, with which Canada does not have a tax treaty, owns a patent that Canco, a corporation resident in Canada, wishes to use in its business. Forco and Canco deal with each other at arm's length.*
- *Forco and Canco enter into a licensing agreement under which Forco grants to Canco the right to use the patent in exchange for periodic royalty payments.*
- *Rather than having those payments made directly to Forco, Forco assigns to Subco, a non-resident subsidiary of Forco that resides in Country 2 (with which Canada has a tax treaty), its rights and obligations under the licensing agreement – including the right to receive periodic payments from Canco. Under the assignment, Subco is required to pay to Forco an amount equal to 90% of any payment received from Canco.*
- *Forco assigns its rights and obligations – including the right to receive periodic royalty payments – in respect of most of its licensing agreements with arm's length persons resident in Canada to Subco. One of the main purposes of these assignments is to reduce the amount of tax under Part XIII of the Act in respect of the periodic royalty payments.*
- *Canco makes a $50,000 payment in respect of the licensing agreement directly to Subco. Canco does not withhold and remit any portion of this payment on account of tax under Part XIII of the Act, since the treaty between Canada and Subco's country of residence exempts (qualifying) payments for the right to use a patent. Upon receipt by Subco, the $50,000 payment is intermingled with other funds in Subco's accounts and is available to*

be used for a variety of Subco's purposes, at Subco's sole discretion. However, due to the assignment agreement, Subco is required to pay $45,000 to Forco.

Analysis

- *The $50,000 payment made by Canco to Subco in respect of the licensing agreement is an amount paid as a royalty. As such, the conditions in paragraph 212(3.9)(a) are satisfied.*

  The condition in subclause 212(3.9)(b)(i)(A)(I) is also satisfied since, at a time after the licensing agreement was entered into, a relevant licensor (i.e., Subco, as the "immediate licensor") has an obligation to pay an amount to a person (i.e., Forco) in respect of a specified royalty arrangement (i.e., the assignment agreement), and the amount is determined by reference to an amount paid in respect of a relevant royalty arrangement (i.e., 90% of the $50,000 payment received from Canco in respect of the licensing agreement, which is equal to $45,000).
- *The condition in subclause 212(3.9)(b)(ii)(B)(I) is satisfied because Forco and Canco are dealing at arm's length and one of the main purposes of assigning to Subco the rights and obligations of Forco under its licensing agreement with Canco is to reduce the amount of tax under Part XIII of the Act in respect of the periodic royalty payments.*
- *The condition in paragraph 212(3.9)(c) is also satisfied since the tax that would be payable under Part XIII if the $50,000 payment were instead made from Canco to Forco (i.e., 25% of $50,000, which is equal to $12,500) is greater than the tax that is payable under Part XIII in respect of the payment from Canco to Subco (i.e., nil, assuming the payment is a qualifying payment), determined without reference to subsections 212(3.9) and (3.91). Because all of the conditions in subsection 212(3.9) are met, subsection 212(3.91) will apply in respect of the $50,000 payment made by Canco to Subco in respect of the licensing agreement.*
- *In applying subsection 212(3.91), Forco is the only person or partnership that is an ultimate licensor in respect of the $50,000 payment, since Forco is the only relevant licensor that is not – under any relevant royalty arrangement – a lessee, a licensee, or a grantee of a right similar to a right granted under a lease or licence, an assignee or a purchaser.*
- *Under paragraph (a) in the description of B in subsection 212(3.91), the entire amount referred to in paragraph 212(3.9)(a) (i.e., $50,000) is reasonably allocable to Forco, because Forco is the sole ultimate licensor. Note that Forco does not need to demonstrate that an amount is reasonably allocable to it because if it does not, the amount determined for B/C would be 1/1, which is equivalent to $50,000/$50,000.*
- *Therefore, under the formula in subsection 212(3.91), Canco is deemed to have made a royalty payment (for the use of a patent) of $50,000 to Forco for the purpose of paragraph 212(1)(d) (i.e., ($50,000 × $50,000/$50,000) × (25% – 0%)/25%)).*

Back-to-back arrangement – character substitution

ITA
212(3.92) and (3.93)

New subsections 212(3.92) and (3.93) of the Act are intended to address back-to-back arrangements that raise the same policy concerns as back-to-back royalty arrangements – in that these arrangements attempt to avoid or reduce withholding tax on rents, royalties or similar payments, by transacting through one or more intermediaries – but in respect of which the back-to-back royalty rules in subsections 212(3.9) and (3.91) would otherwise not apply (or would not apply with appropriate results) because one or more of the arrangements comprising the back-to-back arrangement is legally not a lease, licence or similar or similar agreement (or a specified royalty arrangement). In particular, the "character substitution" rules in subsections 212(3.92) and (3.93) apply in respect of shares or a debt or other obligation that are part of a back-to-back royalty arrangement.

New subsection 212(3.92) provides that new subsection 212(3.93) applies in respect of shares of a particular relevant licensor, in respect of a particular relevant royalty arrangement, or in respect of an amount outstanding as or on account of a debt or other obligation to pay an amount, where certain conditions are met.

In the case of shares, paragraph 212(3.92)(a) sets out the following three conditions:

- First, the particular relevant licensor, in respect of the particular relevant royalty arrangement, must have an obligation to pay or credit a dividend on the shares – either immediately or in the future and either absolutely or contingently – to a person or partnership.
- Second, one of the following two conditions must also be met:
  - the amount of the dividend is determined, in whole or in part, by reference to
    - an amount of rent, royalty or similar payment, or an obligation to pay or credit rent, royalty or similar payment, under a relevant royalty arrangement, or
    - one or more of the fair market value of, any revenue profits, income or cash flow from, or any other similar criteria in respect of a particular property, if a right in respect of the property is granted under the particular lease, licence or similar agreement, or
  - it can reasonably be concluded that the particular relevant royalty arrangement was entered into or was permitted to remain in effect because
    - the shares were issued or were permitted to remain issued and outstanding, or
    - it was anticipated that the shares would be issued or would be permitted to remain issued and outstanding.
- Third, one of the following two conditions must also be met:
  - the person or partnership does not deal at arm's length with the taxpayer referred to in paragraph 212(3.9)(a), or
  - the person or partnership deals at arm's length with the taxpayer and it can reasonably be concluded that one of the main purposes of the issuance of the shares was either:
    - to reduce or avoid the tax otherwise payable under Part XIII in respect of the particular amount referred to in paragraph (3.9)(a), or
    - to avoid the application of subsection (3.91).

The condition in subparagraph 212(3.92)(a)(ii) is similar to that in subparagraph 212(3.9)(b)(ii). As with the latter subparagraph, the additional requirement in clause 212(3.92)(a)(ii)(B) ensures that the character substitution rules do not apply to ordinary, arm's length commercial transactions that do not have, as one of their main purposes, the reduction or avoidance of the tax that would otherwise be payable under Part XIII or the avoidance of subsection 212(3.91).

In the case of an amount outstanding as or on account of a debt or other obligation to pay an amount, paragraph 212(3.92)(b) sets out the following three conditions for the application of subsection 212(3.93), which largely parallel the conditions for shares in paragraph 212(3.92)(a):

- First, a particular relevant licensor, in respect of a particular relevant royalty arrangement, must have an obligation to pay or credit an amount as, on account or in lieu of payment of, or in satisfaction of, interest under a debt or other obligation – either immediately or in the future and either absolutely or contingently – to a person or partnership.
- Second, one of the following two conditions must also be met:
  - the amount of interest is determined, in whole or in part, by reference to
    - an amount of rent, royalty or similar payment, or an obligation to pay or credit rent, royalty or similar payment, under a relevant royalty arrangement, or
    - one or more of the fair market value, of any revenue profits, income of cash flow from, or any other similar criteria in respect of a particular property, if a right in respect of the property is granted under the particular lease, licence or similar agreement, or
  - it can reasonably be concluded that the particular relevant royalty arrangement was entered into or was permitted to remain in effect because
    - the debt or other obligation was entered into or was permitted to remain in effect, or
    - it was anticipated that the debt or other obligation would be entered into or remain in effect.
- Third, one of the following two conditions in subparagraph 212(3.92)(b)(ii) must also be met:
  - the person or partnership does not deal at arm's length with the taxpayer referred to in paragraph 212(3.9)(a), or
  - the person or partnership deals at arm's length with the taxpayer and it can be reasonably concluded that one of the main purposes of entering into the debt or other obligation was either:
    - to reduce or avoid the tax otherwise payable under Part XIII in respect of the particular amount referred to in paragraph (3.9)(a), or
    - to avoid the application of subsection (3.91).

The condition in subparagraph 212(3.92)(b)(ii) is similar to that in subparagraph 212(3.9)(b)(ii) and, like that subparagraph, ensures that the character substitution rules do not apply to ordinary, arm's length commercial transactions. For example, assume a Canadian-resident taxpayer pays

rent on real property situated in Canada to an arm's length non-resident person, who financed the acquisition of the real property using a loan from an arm's length third party. The rental payment may be subject to tax under Part XIII or, if an election is filed under section 216, under Part I. In either case, provided it is not the case that one of the main purposes of the loan is to reduce or avoid the withholding tax in respect of the rental payment or to avoid the application of subsection 212(3.91), subsection 212(3.93) should not apply.

If subsection 212(3.93) applies in respect of a debt or other obligation (under which a particular relevant licensor is a debtor), or in respect of shares of a particular relevant licensor, it provides deeming rules that are intended to ensure that the debt or other obligation or the shares, as the case may be, are treated under the back-to-back royalty rules as though they were instead a relevant royalty arrangement. To achieve this result, subsection 212(3.93) provides the following deeming rules, for the purposes of subsections 212(3.9) to (3.94):

- the debt or other obligation, or the holding of the shares, as the case may be, is deemed to be a relevant royalty arrangement;
- the creditor, or the shareholder of the shares of the particular relevant licensor, as the case may be, is deemed to be a relevant licensor, in respect of the relevant royalty arrangement (that is deemed under paragraph 212(3.93)(a)); and
- the conditions in paragraph 212(3.9)(b) are deemed to be met in respect of the relevant royalty arrangement, in order to ensure that, if the conditions in subsection 212(3.92) are met, the conditions in paragraph 212(3.9)(b) are also met.

Example

Assumptions

- *Forco, a non-resident corporation that resides in Country 1, with which Canada does not have a tax treaty, owns industrial equipment that Canco, a corporation resident in Canada, wishes to use in its business. Forco and Canco deal at arm's length with each other.*
- *Rather than leasing the industrial equipment directly to Canco, Forco lends an amount to Subco, a non-resident subsidiary of Forco that resides in Country 2, with which Canada has a tax treaty. Subco uses the borrowed funds to acquire the industrial equipment from Forco under a sale agreement (that is not an instalment sale, and therefore is not a specified royalty arrangement as defined in subsection 212(3.94)).*
- *One of the main purposes of the borrowing and the acquisition of the industrial equipment was to reduce the withholding tax that would apply to rental payments from persons resident in countries that have a tax treaty with Country 2 (including Canada).*
- *Subco and Canco enter into a leasing agreement under which Subco grants to Canco the right to use the industrial equipment in exchange for periodic rental payments.*
- *Pursuant to the leasing agreement, Canco makes periodic $10,000 rental payments directly to Subco. Canco withholds and remits 10% from each rental payment on account of tax under Part XIII of the Act, which is the withholding rate in respect of qualifying*

payments under the treaty between Canada and Country 2. Upon receipt by Subco, these rental payments are intermingled with other funds in Subco's accounts and used for a variety of Subco's purposes, at Subco's sole discretion.

- *The amount of interest payable by Subco under the loan agreement between Subco and Forco is determined as 95% of the amount Canco is obligated to pay as rent under the leasing agreement.*

Analysis

- *Any payment made by Canco to Subco in respect of the leasing agreement is an amount paid as, on account or in lieu of payment of, or in satisfaction of, rent. As such, the conditions in paragraph 212(3.9)(a) are satisfied.*
- *In the absence of subsections 212(3.92) and (3.93), the conditions in paragraph 212(3.9)(b) would not be satisfied since the interest payments made by Subco to Forco are not paid in respect of a specified royalty arrangement.*
- *The conditions in paragraph 212(3.92)(b) are satisfied, however. First, Subco (as the immediate licensor) is a relevant licensor in respect of a relevant royalty arrangement (i.e., the leasing agreement with Canco) that has an obligation to pay interest under the debt owing to Forco. Second, the condition in subclause 212(3.92)(b)(i)(A) is met, as the amount of interest is determined by reference to the amount of the rental payment. Note that the condition in subclause 212(3.92)(b)(ii)(B) would also be satisfied if, having regard to the facts – including, in particular, that Subco used the funds it borrowed from Forco to acquire the property it subsequently rented to Canco – it can reasonably be concluded that the leasing agreement was entered into because the loan was entered into. Third, the condition in subclause 3.92(b)(ii)(B)(I) is satisfied because Forco and Canco are dealing at arm's length and one of the main purposes of the loan to Subco is to reduce the amount of tax under Part XIII of the Act in respect of the periodic rental payments made by Canco.*
- *Subsection 212(3.93) therefore applies, with the result that, for the purposes of subsections 212(3.9) to (3.94), the loan agreement between Subco and Forco is deemed to be a relevant royalty arrangement; Forco is deemed to be a relevant licensor in respect of that relevant royalty arrangement; and the relevant royalty arrangement is deemed to be a specified royalty arrangement in respect of which the conditions in paragraph (3.9)(b) are met.*
- *The condition in paragraph 212(3.9)(c) is also satisfied, since the tax that would be payable under Part XIII if the rental payment were instead made from Canco to Forco (i.e., 25% of the rental payment) is greater than the tax that is payable under Part XIII in respect of the rental payment from Canco to Subco (i.e., 10%, assuming the rental payment is a qualifying payment), determined without reference to subsections 212(3.9) and (3.91).*
- *Therefore, subsection 212(3.91) applies to deem Canco to make a rental payment to Forco (i.e., the sole ultimate licensor in this case) in respect of each of the periodic rental payments made by Canco to Subco under the leasing agreement. In determining the*

amount of each deemed rental payment, all of the amount referred to in paragraph 212(3.9)(a) (i.e., $10,000) is reasonably allocable to Forco (variable B in subsection 212(3.91)), because Forco is the sole ultimate licensor.

- *Therefore, under the formula in subsection 212(3.91) and for the purpose of paragraph 212(1)(d), Canco is deemed in respect of each of the rental payments it makes to Subco, to make a rental payment of $6,000 to Forco (i.e., ($10,000 × $10,000/$10,000) × (25% – 10%)/25%)).*

Back-to-back arrangement – definitions

ITA
212(3.94)

New subsection 212(3.94) of the Act sets out the relevant definitions that apply in subsections 212(3.9) to (3.94).

"lease, licence or similar agreement"

A "lease, licence or similar agreement" means an agreement under which a "rent, royalty or similar payment" (also defined in this subsection) is or could be made.

"relevant licensor"

A relevant licensor, in respect of a relevant royalty arrangement (also defined in this subsection), refers to

- the lessor,
- the licensor or the grantor of a right similar to a right granted under a lease or license,
- the assignor, or
- the seller (in the case of an instalment sale).

If the relevant royalty arrangement is the particular lease, licence or similar agreement referred to in paragraph 212(3.9)(a), the relevant licensor is the immediate licensor referred to in that paragraph.

"relevant royalty arrangement"

A "relevant royalty arrangement" is defined to mean the particular lease, license or similar agreement referred to in paragraph 212(3.9)(a), as well as each specified royalty arrangement (under which a relevant licensor has an obligation to pay or credit an amount) that

- meets, in respect of a relevant royalty arrangement, the conditions in clause (3.9)(b)(i)(A) or (B); and
- is an arrangement in respect of which the person or partnership referred to in subparagraph 212(3.9)(b)(ii) meets the conditions in clause 212(3.9)(b)(ii)(A) or (B).

Thus, the definition applies iteratively in the context of a back-to-back loan arrangement comprising multiple intermediaries, such that all of the specified royalty arrangements within the back-to-back arrangement are relevant royalty arrangements. For more information, see the commentary on the definition "funding arrangement" in new subsection 15(2.192).

“rent, royalty or similar payment”

A “rent, royalty or similar payment” means a rent, royalty or similar payment described in paragraph 212(1)(d). For greater certainty, the term has the same inclusions and exclusions as in paragraph 212(1)(d). These inclusions are described in subparagraphs 212(1)(d)(i) to (v) and the exclusions are described in subparagraphs 212(1)(d)(vi) to (xii).

“specified royalty arrangement”

A “specified royalty arrangement” means a lease, license or similar agreement, an assignment or an instalment sale.

“ultimate licensor”

An “ultimate licensor” means a relevant licensor (other than the immediate licensor), in respect of a relevant royalty arrangement, that is not, under a relevant royalty arrangement, a lessee, a licensee or a grantee of a right similar to a right granted under a lease or licence, an assignee or a purchaser. It therefore represents the final link in the back-to-back chain.

Clause 58

Non-arm’s length sales of shares by non-residents

ITA
212.1(1)

Subsection 212.1(1) of the Act is an anti-avoidance rule designed to prevent the removal of corporate surplus – which would otherwise be subject to withholding tax under Part XIII of the Act upon distribution to a non-resident shareholder – as a tax-free return of capital or as proceeds from the disposition of the corporation’s shares giving rise to a capital gain that is not subject to tax in Canada.

Subsection 212.1(1) currently sets out the conditions of application, and the consequences that apply, where shares of a Canadian corporation (the “subject corporation”) held by a non-resident person, a non-resident-owned investment corporation or a designated partnership are transferred to another Canadian corporation (the “purchaser corporation”) with which the transferor does not deal at arm’s length and, immediately after the disposition, the subject corporation is connected (within the meaning that would be assigned by subsection 186(4), with certain modifications) with the purchaser corporation.

Subsection 212.1(1) is amended in three ways. The first, purely structural, change is to divide subsection 212.1(1) into conditions of application, which remain in that subsection, and consequences of application, which are moved to new subsection 212.1(1.1).

Second, subsection 212.1(1) is amended to remove the reference to non-resident owned investment corporations, because these corporations no longer exist for taxation years ending after 2003.

Finally, subsection 212.1(1) is modified such that the non-resident person or designated partnership that transferred the shares of the subject corporation to the purchaser corporation is referred to as the “non-resident person” only in subsections 212.1(1) to (1.2). This change is

intended to ensure that the references to a non-resident person in subsections 212.1(3) and (4) are not limited to the transferor non-resident person referred to in subsections 212.1(1) to (1.2). For further information, see the commentary on subsections 212.1(3) and (4).

This amendment applies in respect of dispositions that occur after March 21, 2016.

Non-arm's length sales of shares by non-residents

ITA
212.1(1.1)

New subsection 212.1(1.1) of the Act sets out the operative rule that applies if the conditions in subsection 212.1(1) are satisfied. The addition of this new subsection is a purely structural change, resulting from the division of subsection 212.1(1) into conditions of application, which remain in subsection 212.1(1), and consequences of application, which are moved from subsection 212.1(1) to new subsection 212.1(1.1). The content is unchanged, except in relation to new subparagraph 212.1(1.1)(a)(i).

If the conditions in subsection 212.1(1) are satisfied, paragraph 212.1(1.1)(a) deems a dividend equal to the amount, if any, by which the fair market value of any consideration (other than any share of the purchaser corporation) received by the non-resident person from the purchaser corporation for the subject shares exceeds the paid-up capital in respect of the subject shares immediately before the disposition. Under the existing rules, the dividend is deemed to be paid at the time of the disposition by the purchaser corporation to the non-resident person and received at that time by the non-resident person from the purchaser corporation.

The rules are amended (through the addition of new clause 212(1.1)(a)(i)(A)) to deem the dividend to be paid to the non-resident person by the subject corporation (instead of by the purchaser corporation) if, immediately before the disposition, the purchaser corporation controlled the non-resident person. In those circumstances, new clause 212.1(1.1)(a)(i)(B) similarly deems the dividend to be received by the non-resident person from the subject corporation. These amendments are intended to ensure that, in appropriate circumstances, the non-resident person can qualify for a lower rate of dividend withholding tax that may be available under a tax treaty between Canada and the non-resident person's country of residence.

Subparagraph 212.1(1.1)(a)(ii) provides that, in any other case, the dividend is deemed to be paid by the purchaser corporation to the non-resident person, and received by the non-resident person from the purchaser corporation.

These amendments apply in respect of dispositions that occur after March 21, 2016.

Deemed consideration

ITA
212.1(1.2)

New subsection 212.1(1.2) of the Act provides a deemed consideration rule for the purposes of subsections 212.1(1) and (1.1), clarifying the application of those rules in situations where it may otherwise be uncertain whether consideration has been received by the non-resident person from

the purchaser corporation in respect of the disposition by the non-resident person of the subject shares.

New subsection 212.1(1.2) applies if, in the absence of that subsection, no consideration would be received by the non-resident person from the purchaser corporation for the subject shares. If applicable, subsection 212.1(1.2) deems the non-resident person to receive consideration, other than shares of the purchaser corporation, from the purchaser corporation for the subject shares. Further, the fair market value of this consideration is deemed to be equal to the amount, if any, by which the fair market value of the subject shares disposed of by the non-resident person exceeds the amount of any increase because of the disposition in the fair market value of the shares of the purchaser corporation.

This amendment applies in respect of dispositions that occur after March 21, 2016.

Idem

ITA
212.1(2)

If the conditions in subsection 212.1(1) of the Act are satisfied, the operative rule – now contained in new paragraph 212.1(1.1)(b) – provides for a reduction to the paid-up capital of shares of the purchaser corporation that are received by the non-resident person.

Subsection 212.1(2) provides for an increase to the paid-up capital of the shares of a particular class of a corporation to the extent that a reduction of paid-up capital under section 212.1 has the effect of increasing the amount of any dividend deemed to have been paid by the purchaser corporation under subsections 84(3) to (4.1) on a redemption, acquisition, cancellation or reduction of capital of its shares.

Consequential on the purely structural change that involves moving the consequences of application (including the paid-up capital reduction) from subsection 212.1(1) to new 212.1(1.1), the references to subsection 212.1(1) in subsection 212.1(2) are changed to refer instead to new subsection 212.1(1.1).

This amendment applies in respect of dispositions that occur after March 21, 2016.

Idem

ITA
212.1(3)

Subsection 212.1(3) of the Act sets out certain interpretive rules for the purposes of applying section 212.1.

Paragraph 212.1(3)(a) contains a rule that expands the concept of non-arm's length dealing for purposes of section 212.1, by deeming certain persons to not deal at arm's length for these purposes. Specifically, it deems – in respect any disposition described in subsection 212.1(1) by a non-resident person of subject shares to a purchaser corporation – the non-resident person not to deal at arm's length with the purchaser corporation if the non-resident person was:

- immediately before the disposition, one of a group of less than 6 persons that controlled the subject corporation; and
- immediately after the disposition, one of a group of less than 6 persons that controlled the purchaser corporation, each member of which was a member of the group that previously controlled the subject corporation.

For these purposes, paragraph 212.1(3)(b) also provides rules that deem a non-resident person to own shares that are owned by certain other (generally, related) persons or partnerships.

Paragraphs 212.1(3)(a) and (b) are amended by removing superfluous wording and by adding references to designated partnerships. These changes are related to the change to subsection 212.1(1), which has the effect that references to the "the non-resident person" are considered to refer to the non-resident person or designated partnership that transferred the shares of the subject corporation to the purchaser corporation only when those references appear in subsections 212.1(1) to (1.2).

These changes are intended to ensure that the references to a non-resident person (and designated partnership) in subsections 212.1(3) and (4) are not limited to the transferor non-resident person (or designated partnership) referred to in subsections 212.1(1) to (1.2), but rather to any non-resident person (or designated partnership). For further information, see the commentary on subsections 212.1(3) and (4).

This amendment applies in respect of dispositions that occur after March 21, 2016.

Where section does not apply

ITA
212.1(4)
Subsection 212.1(4) of the Act provides a relieving exception to the rules in section 212.1 that applies in respect of a disposition by a non-resident corporation of shares of a subject corporation to a purchaser corporation that immediately before the disposition controlled the non-resident corporation.

The purpose of this rule is to permit a Canadian-resident purchaser corporation that acquires shares of a non-resident corporation that itself owns shares of a Canadian corporation to simplify its corporate structure, but only in the limited circumstances where the conditions in paragraph 212.1(4)(a) and new paragraph 212.1(4)(b) are met.

Subsection 212.1(4) is amended to clarify that the exception in that subsection is unavailable – and thus subsection 212.1 (1.1) applies – unless the conditions in new paragraph 212.1(4)(b) are met. Specifically, in order to qualify for the exception, it must not be the case that, at the time of the disposition (or as part of a transaction or event or series of transactions or events that includes the disposition), a non-resident person or designated partnership both

- owns, directly or indirectly, shares of the purchaser corporation; and
- does not deal at arm's length with the purchaser corporation.

This amendment applies in respect of dispositions that occur after March 21, 2016.

Clause 59

Deemed dividend

ITA
212.2(1)(b)

Section 212.2 of the Act is an anti-avoidance rule designed, in the context of the demutualization of insurance corporations, to discourage transactions designed to distribute corporate surplus to non-residents free of tax under Part XIII.

Pursuant to paragraph 212.2(1)(b), the deemed dividend rule in subsection 212.2(2) does not apply in respect of a disposition to which subsection 212.1(1) applies.

Consequential on the purely structural change that involves moving the consequences of application from subsection 212.1(1) to new 212.1(1.1), paragraph 212.2(1)(b) is amended to replace the reference to 212.1(1) with 212.1(1.1).

This amendment applies in respect of dispositions that occur after March 21, 2016.

Clause 60

Where subsection (1) to (4) do not apply

ITA
225.1(6)

Section 225.1 of the Act describes those collection activities of the Minister of National Revenue, in respect of an amount assessed under the Act, that are generally restricted until after a specified time. Subsection 225.1(6) provides that these collection restrictions do not apply in respect of certain types of amounts that are assessed.

Subsection 225.1(6) is amended to add new paragraph (a.1), which adds the new "Common Reporting Standard" penalty proposed in section 281 of the Act to the list of debts that are not subject to these collection restrictions

For more information, see the commentary on new section 281.

This amendment comes into force on July 1, 2017.

Clause 61

Country by Country Report

ITA
233.8

New section 233.8 of the Act sets out the reporting requirements for the country-by-country report that was developed by the Organisation for Economic Co-operation and Development (OECD) to enhance transparency for tax administrations by providing adequate information to assess high-level transfer pricing and other base erosion and profit-shifting related risks.

New section 233.8 applies to reporting fiscal years of MNE groups that begin on or after January 1, 2016.

Definitions

ITA
233.8(1)

New subsection 233.8(1) of the Act contains definitions that apply for the purposes of section 233.8.

“business entity”

A “business entity” means a person (including a trust, but not including a natural person) or partnership. It is also defined to include a business that is carried on through a permanent establishment (i.e., a branch), if a separate financial statement for that business is prepared for financial reporting, regulatory, tax reporting or internal management control purposes.

“consolidated financial statements”

“Consolidated financial statements” means the financial statements in which the assets, liabilities, income, expenses and cash flows of the members of a group are presented as those of a single economic entity consistent with generally accepted accounting principles.

“constituent entity”

A “constituent entity”, of an MNE group, means a business entity within the MNE group that is included in the consolidated financial statements of the MNE group for financial reporting purposes (or that would be required to be included if equity interests in any of the business entities in the MNE group were traded on a public securities exchange). It also includes any business entity that is excluded from the MNE group’s consolidated financial statements solely for size or materiality reasons.

“excluded MNE group”

An MNE group will be exempt from country-by-country reporting for a reporting fiscal year in which it qualifies as an excluded MNE group. An “excluded MNE group” for a particular year means an MNE group that has total consolidated group revenue of less than €750 million during the fiscal year immediately preceding the particular fiscal year, as reflected in its consolidated financial statements for the preceding fiscal year.

“fiscal year”

A fiscal year of an MNE group means an annual accounting period with respect to which the ultimate parent entity of the MNE group prepares its financial statements

“multinational enterprise group” or “MNE group”

The definition “multinational enterprise group” or “MNE group” contains three elements. The first element in paragraph (a) sets out the conditions for two or more entities to form a group based on requirements to prepare consolidated financial statements. The second element described in paragraph (b) sets out the requirement that the group is multinational by virtue of it having business entities operating in more than one jurisdiction. Finally, the third element in paragraph (c) provides an exclusion from the definition for “excluded MNE groups”, which are groups that had consolidated group revenue of less than €750 million during the immediately preceding fiscal year.

“permanent establishment”

“Permanent establishment” has the same meaning as in section 8201 of the *Income Tax Regulations.*

“qualifying competent authority agreement”

A “qualifying competent authority agreement” is an agreement that requires the automatic exchange of country-by-country reports between jurisdictions. It is between authorized representatives of those jurisdictions that are parties to a “listed international agreement”, which is defined in subsection 248(1) to mean the *Convention on Mutual Administrative Assistance in Tax Matters* or a comprehensive tax information exchange agreement (a “TIEA”) that Canada has entered into, and that has effect, in respect of another country or jurisdiction.

“reporting fiscal year”

A “reporting fiscal year” is a fiscal year, if the financial and operational results of the fiscal year are reflected in the country-by-country report.

“surrogate parent entity”

A “surrogate parent entity” is a constituent entity of an MNE group that has been appointed by the MNE group, in substitution for the ultimate parent entity, to file the country-by-country report on behalf of the MNE group. In order for a surrogate parent entity to be entitled to file the country-by-country report on behalf of its MNE group, one or more of the conditions in subparagraph (3)(b)(ii) must apply.

“systemic failure”

A jurisdiction will be in a position of “systemic failure” if it has a qualifying competent authority agreement in effect with Canada, but it has suspended automatic exchange (for reasons other than those that are in accordance with the terms of the agreement) or it has persistently failed to automatically provide country-by-country reports in its possession — in respect of MNE groups that have constituent entities in Canada — to Canada.

“ultimate parent entity”

An “ultimate parent entity” is generally the constituent entity of an MNE group that is at the top of the ownership chain within the MNE group. It must be required to prepare consolidated financial statements under accounting principles generally applied in its jurisdiction of residence (or that would be so required if its equity interests were traded on a public securities exchange in its jurisdiction of residence).

Determination of residence - ultimate parent entity

ITA
233.8(2)

New subsection 233.8(2) of the Act contains a rule to deem the residency of an ultimate parent entity that is a partnership (which would not ordinarily have a residency for Canadian tax purposes). In such a case, the partnership is deemed to be resident in another jurisdiction if it is resident there for tax purposes under the laws of that other jurisdiction. In any other case, it will be resident in the jurisdiction under the laws of which it was organized.

Filing obligations

ITA
233.8(3)

New subsection 233.8(3) of the Act provides that references to the country-by-country report in section 233.8 are references to the prescribed report required to be filed in subsection (3) and to substantially similar reports to the Canadian country-by-country report that are required to be filed in other jurisdictions.

Subsection 233.8(3) sets out the conditions for when the country-by-country report must be filed. It will generally be required to be filed - in prescribed manner with the Minister on or before the date specified in subsection (6) - by the ultimate parent entity of the MNE group, if it is resident in Canada in the reporting fiscal year.

The country-by-country report will also be required to be filed by a Canadian-resident constituent entity of an MNE group that is not the ultimate parent entity of the MNE group if one of the following conditions is satisfied:

- the ultimate parent entity of the MNE group is not obligated to file a country-by-country report in its jurisdiction of tax residence,
- the jurisdiction of tax residence of the ultimate parent entity of the MNE group does not have a qualifying competent authority agreement in effect to which Canada is a party on or before the time specified in subsection (6) for filing the country-by-country report for the reporting fiscal year, or
- there has been a systemic failure of the jurisdiction of tax residence of the ultimate parent entity and the Minister has notified the constituent entity of the systemic failure.

Designation for multiple constituent entities

ITA
233.8(4)

New subsection 233.8(4) of the Act provides that if there is more than one constituent entity (that is not the ultimate parent entity) of an MNE group in Canada that is required to file a country-by-country report in respect of a reporting fiscal year, one of those constituent entities may be designated - on or before the date specified in subsection (6) in respect of the reporting fiscal year - so that it is entitled to file a country-by-country report for the reporting fiscal year with the Minister on behalf of all such constituent entities in the MNE group.

Surrogate filing

ITA
233.8(5)

New subsection 233.8(5) of the Act provides rules that allow a surrogate parent entity to file a country-by-country report instead of the ultimate parent entity. If the conditions in this subsection are met, a Canadian-resident constituent entity that is not the ultimate parent entity is

not required to file a country-by-country report with the Minister with respect to a reporting fiscal year.

To qualify, a surrogate parent entity of the MNE group must file a country-by-country report in respect of the reporting fiscal year with the tax authority of its jurisdiction of tax residence on or before the date specified in subsection (6). In addition, the jurisdiction of tax residence of the surrogate parent entity must meet certain requirements. In particular, it must

- require filing of country-by-country reports;
- have a qualifying competent authority agreement in effect to which Canada is a party on or before the time specified in subsection (6) for filing the country-by-country report in respect of the reporting fiscal year;
- not be in a position of systemic failure; and
- have been notified by the surrogate parent entity that it is filing as the surrogate parent entity.

Time for filing

ITA
233.8(6)

New Subsection 233.8(6) of the Act provides the deadline for filing the country-by-country report. It generally provides that a country-by-country report in respect of a reporting fiscal year of an MNE group must be filed by 12 months after the last day of the reporting fiscal year. However, if notification of systemic failure has been received by the constituent entity, this deadline can be extended to 30 days after receipt of the notification. This takes into account situations where a constituent entity has been informed of a systemic failure beyond the period within which it could meet the 12-month deadline.

Clause 62

Transfer pricing

ITA
247(1) "transfer pricing capital adjustment"

Section 247 of the Act provides rules concerning transfer pricing and related matters. Subsection 247(1) defines a number of terms for the purpose of section 247.

The definition "transfer pricing capital adjustment" in subsection 247(1) represents the transfer pricing adjustments made under subsection 247(2) that are in respect of capital property and eligible capital property of the taxpayer.

Subparagraphs (a)(ii) and (b)(ii), which relate to eligible capital property, are repealed, consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 63

Definitions

ITA
248(1)

Subsection 248(1) of the Act provides a number of definitions that apply for the purposes of the Act.

“adjustment time”

The definition “adjustment time” in subsection 248(1), which relates to the eligible capital property rules, is repealed consequential to the repeal of section 14, including the definition “adjustment time” in subsection 14(5).

This amendment comes into force on January 1, 2017.

“balance-due day”

A taxpayer’s balance-due day is the day by which the taxpayer is normally required to pay any balance of taxes payable under Part I for the year. Paragraph (a) of the definition “balance-due day” provides that the balance-due day of a trust for a taxation year is the day that is 90 days after the end of year.

Paragraph (a) of the definition is amended to introduce rules that apply in determining the balance-due day of a trust that is subject to a loss restriction event at a particular time. In this case, paragraph 249(4)(a) deems the trust’s taxation year (the “pre-LRE year”) that otherwise includes the particular time to end immediately before the particular time and a new taxation year (the “new taxation year”) to begin at the particular time.

New subparagraph (a)(i) defines the balance due-day for a trust’s pre-LRE year. The subparagraph identifies three cases.

The first case, under clause (a)(i)(A) of the definition, applies where the pre-LRE year ends in a calendar year after December 15 and the trust is a mutual fund trust that has elected to have an ordinary taxation year end of December 15. This case applies to each pre-LRE year of the trust that ends after December 15 in that calendar year. In this case, the balance-due day of the trust’s pre-LRE year is the day that is the balance-due day for the trust’s ordinary taxation year that ends on December 15 of that calendar year.

The second case, under clause (a)(i)(B) of the definition, applies in any case (other than a case to which clause (A) applies) in which the trust’s new taxation year ends in the same calendar year as the pre-LRE year. In this case, the balance-due day of the trust’s pre-LRE year is the day that is the balance-due day for that new taxation year. For example, under this case:

- If a trust’s new taxation year ends on December 31, 2016 and the pre-LRE year ends on August 31, 2016, its balance-due day for the pre-LRE year is March 31, 2017 (*i.e.*, 90 days after the end of that new taxation year, as determined under subparagraph (a)(ii) of the definition). Similarly, in the case of a mutual fund trust that has elected for a December 15 year-end, if the trust’s new taxation year ends on December 15, 2016 and

the pre-LRE year ends on May 15, 2016, the trust's balance-due day for the pre-LRE year is March 15, 2017 (*i.e.*, the day that is 90 days after that new taxation year as determined under subparagraph (a)(ii) of the definition).

- If the trust is subject to two or more loss restriction events in a calendar year (for example, its first pre-LRE year ending on February 1, 2016 and its second LRE year ending on April 1, 2016), and its new taxation year (*i.e.*, the taxation year that begins at the time of the last of the second of those loss restriction events) ends in that calendar year, the trust's balance-due day for the pre-LRE years is its balance-due day for that new taxation year (*i.e.*, March 31, 2017, or in the case of a mutual fund trust the ordinary taxation year of which ends on December 15, 2016, March 15, 2017).
- If the trust's new taxation year ends in the same calendar year as the pre-LRE year but at a time other than December 15 or December 31, then the trust's balance-due day for its pre-LRE tax year is the balance-due day for that new taxation year (*i.e.*, the day that is 90 days after that new taxation year as determined under subparagraph (a)(ii) of the definition). This case may arise because the trust's new taxation year is subject to a deemed year end under another income tax provision or, for the 2016 and later taxation years, because the trust is a graduated rate estate without a calendar year taxation year.

The third case, under clause (a)(i)(C) of the definition, applies in the case (other than a case where clause (A) applies) where the trust's pre-LRE year and the new taxation year do not end in the same calendar year. This case would be expected to arise only for a graduated rate estate without a calendar year taxation year. In this case, the trust's balance-due day for the pre-LRE year is the day that is 90 days after the end of the calendar year in which the pre-LRE year ends.

Subparagraph (a)(i) of the definition applies in conjunction with subsection 251.2(7). Together those provisions are generally intended to provide that the time at which the income taxes payable, and any returns required to be made, under Part I (and certain other income tax rules) by a trust, in respect of a pre-LRE year, is determined as though the loss restriction event had not resulted in the pre-LRE year ending immediately before the loss restriction event. Those provisions do not, however, suspend the requirements to pay those amounts and to make those filings. In cases where the requirements are not met, the ordinary interest and penalty provisions continue to apply. For further information, see the commentary on subsection 251.2(7).

Consequential on the introduction of subparagraph (a)(i), subparagraph (a)(ii) now defines the balance-due day for a taxation year of a trust in cases where the trust is not subject to a loss restriction event. In this case, the balance-due day of the trust for a taxation year is the day that is 90 days after the end of the taxation year.

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

"cost amount"

The definition "cost amount" is used throughout the Act, particularly in provisions relating to the transfer of properties to and from corporations, trusts and partnerships.

Paragraph (d) of the definition, which provides the cost amount of eligible capital property, is repealed consequential on the repeal of the eligible capital property rules and the creation of new class 14.1 of depreciable property. Paragraph (a) provides similar rules in respect of depreciable property.

This amendment comes into force on January 1, 2017.

“cumulative eligible capital”

The definition “cumulative eligible capital” in subsection 248(1), which relates to the eligible capital property rules, is repealed consequential on the repeal of the eligible capital property rules, including the definition “cumulative eligible capital” in subsection 14(5).

This amendment comes into force on January 1, 2017.

“eligible capital amount”

The definition “eligible capital amount” in subsection 248(1), which relates to the eligible capital property rules, is repealed consequential on the repeal of the eligible capital property rules, including the definition “eligible capital amount” in subsection 14(1).

This amendment comes into force on January 1, 2017.

“eligible capital expenditure”

The definition “eligible capital expenditure” in subsection 248(1), which relates to the eligible capital property rules, is repealed consequential on the repeal the eligible capital property rules, including the definition “eligible capital expenditure” in subsection 14(5).

This amendment comes into force on January 1, 2017.

“eligible capital property”

The definition “eligible capital property” in subsection 248(1) is repealed consequential on the repeal of the eligible capital property rules, including the definition “eligible capital property” in section 54.

This amendment comes into force on January 1, 2017.

“emissions allowance”

An “emissions allowance” is an allowance, credit or similar instrument that represents a unit of emissions that can be used to satisfy a requirement under the laws of Canada or a province governing the emissions of a regulated substance, such as greenhouse gas emissions.

The new definition “emissions allowance” comes into force on January 1, 2017. However, if a taxpayer elects in their income tax return for the 2016 or 2017 taxation year, then the new definition “emissions allowance” – along with new section 27.1 and the amendment to section 7300 of the *Income Tax Regulations* - will apply to taxation years that end after 2012.

“emissions obligation”

An “emissions obligation” is an obligation to surrender an emissions allowance, or an obligation that can otherwise be satisfied through the use of an emissions allowance, under a law of Canada or a province governing emissions of a regulated substance such as greenhouse gas emissions.

The new definition “emissions obligation” comes into force on January 1, 2017. However, if a taxpayer elects in their income tax return for the 2016 or 2017 taxation year, then the new definition “emissions obligation” – along with new section 27.1 and the amendment to section 7300 of the *Income Tax Regulations* - will apply to taxation years that end after 2012.

“inventory”

The definition of “inventory” in subsection 248(1) generally provides that “inventory” means a description of property the cost or value of which is relevant in computing a taxpayer’s income from a business for a taxation year. It also specifically includes all of the livestock held in the course of carrying on a farming business.

The definition of inventory is amended to move the inclusion relating to livestock into new paragraph (a) and to add paragraph (b), which provides that an emissions allowance will be included as inventory.

For more information, see the commentary to new section 27.1 and section 7300 of the *Income Tax Regulations.*

The amendment to the definition of “inventory” comes into force or is deemed to have come into force on January 1, 2017, except that paragraph (b) of the definition inventory in subsection 248(1) of the Act, as enacted by subsection (2), does not apply in respect of emissions allowances acquired in taxation years that begin before 2017.. In addition, if a taxpayer elects in their income tax return for the 2016 or 2017 taxation year, then the amendment to the definition of “inventory” in subsection 248(1) – along with new section 27.1 and the amendment to section 7300 of the *Income Tax Regulations* - will apply to taxation years that end after 2012.

“property”

The definition “property” in subsection 248(1) is amended to provide that the goodwill of a business is property for the purposes of the Act consequential on the repeal of the eligible capital property rules and the introduction of new Class 14.1.

This amendment comes into force on January 1, 2017.

“taxable Canadian property”

The definition “taxable Canadian property” in subsection 248(1) of the Act is relevant primarily in relation to the taxation of non-residents.

Paragraph (b) of the definition provides that taxable Canadian property generally includes eligible capital property in respect of a business carried on in Canada as well as property used or held by the taxpayer in, or property described in an inventory of, a business carried on in Canada.

Consequential on the repeal of the eligible capital property rules and the introduction of new Class 14.1, the reference to eligible capital property is replaced by reference to property included in Class 14.1.

This amendment comes into force on January 1, 2017.

Substantive gift

ITA
248(39)

Subsection 248(39) of the Act prevents a donor from avoiding the application of subsection 248(35) by disposing a property to a qualified donee and donating the proceeds, rather than donating the property itself. Paragraph 248(39)(c) applies in respect of gifts of eligible capital property.

Subsection 248(39) is amended, consequential on the repeal of the eligible capital property rules, to delete a reference to “eligible capital property” in the opening words of the subsection and to repeal paragraph 248(39)(c).

This amendment comes into force on January 1, 2017.

Clause 64

Year-end on certain events

ITA
249(4)

Subsection 249(4) of the Act provides that if a taxpayer (*i.e.*, corporation or trust) is subject to a loss restriction event at any time, the taxpayer is deemed to have a year-end immediately before that time, and to start a new taxation year at that time. However, if that time is within seven days of the end of the taxpayer’s preceding taxation year, paragraph 249(4)(b) permits the taxpayer (unless the taxpayer is subject to an intervening loss restriction event during those seven days) to elect to extend that preceding taxation year to include those additional days.

Paragraph 249(4)(b) is amended so that the election is not available where the taxpayer is a trust.

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

Clause 65

Loss Restriction Event

ITA
251.2

Section 251.2 of the Act contains rules for determining when a taxpayer is subject to a loss restriction event. A taxpayer’s ability to carry over certain undeducted amounts for income tax purposes is constrained if the taxpayer is subject to a loss restriction event.

Section 251.2 is amended to provide that the acquisition, or disposition, of equity in certain types of investment trusts will not be treated as a loss restriction event of the trusts if certain conditions are met.

These amendments are deemed to have come into force on March 21, 2013. However, if a trust so elects in writing and files the election with the Minister of National Revenue on or before the trust's filing-due date for its last 2014 taxation year, the amendments (other than new subsection 251.2(7)) are deemed to have come into force in respect of the trust:

- on the first day of the trust's first 2014 taxation year, if the election is to have paragraph 251.2(3)(f) apply to the trust only as of that day; and
- on the first day of the trust's first 2015 taxation year, if the election is to have paragraph 251.2(3)(f) apply to the trust only as of that day.

Definitions

ITA
251.2(1)

Subsection 251.2(1) of the Act contains definitions that apply for purposes of section 251.2. Two of those definitions are amended.

"investment fund"

An investment fund at any particular time means a trust that meets two sets of requirements as of the particular time.

The first requirement must be met throughout the period that ends at the particular time and that starts at the beginning of the calendar year (or, in the case of a trust created before 2016, that starts immediately following the day that is 90 days) following the year in which the trust was created (or, in the case of a trust that existed at the time the trust loss restriction event rules were first announced on March 21, 2013, that starts on that date). The requirement is that an outstanding class of units of the trust has been qualified for distribution, or lawfully distributed, to the public as described in paragraph 4801(a) of the *Income Tax Regulations*. In effect, the trust must, on an ongoing basis, be subject to the investor protections provisions of federal or provincial securities laws.

The second set of requirements must be met at all times at which the trust exists at and before the particular time (or, in the case of a trust that existed at the time that the trust loss restriction event rules were first announced on March 21, 2013, at all times on and after that date until the particular time). These requirements are that the trust be a non-discretionary unitized trust that is factually resident in Canada and that the trust

- limit its undertaking to the investing of its funds in property;
- follow a reasonable policy of investment diversification;
- not hold property that is used in carrying on a business carried on by it or a non-arm's length person or partnership;
- not hold property that is real property, Canadian or foreign resource property or an interest, or right, in such property;

- not legally control, alone or as part of a group of persons or partnerships, a corporation; and
- not hold more than 20% of any class of securities of an issuer, unless
    - the issuer is a trust that is an investment fund (or mutual fund corporation that would be an investment fund if it were at trust), or
    - the total fair market value of the trust's property that is equity of the issuer does not exceed 10% of the issuer's equity value and the total fair market value of the trust's property that is liabilities of the issuer does not 10% of the total fair market value of all of the issuer's liabilities.

The final two requirements are subject to an anti-avoidance rule contained in paragraph 251.2(5)(c).

For further information, see the commentary on paragraphs 251.2(3)(f) and (5)(c) and subsection 251.2(7).

"majority interest beneficiary"

The definition "majority-interest beneficiary" in subsection 251.2(1) is amended so that it applies in section 251.2 with the same meaning as in subsection 251.1(3), but read without reference to the words "if any" in the definition in subsection 251.1(3). As a result, in section 251.2, a majority-interest beneficiary of a trust at any time means a person that is at that time both a beneficiary under the trust and a majority-interest beneficiary (as defined in subsection 251.1(3)) of the trust.

Loss restriction event

ITA
251.2(3)(f)

Subsection 251.2(3) of Act describes certain transactions and events in respect of which, for the purpose of determining whether a particular trust is subject to a loss restriction event, a person (or group of persons) is deemed not to become a majority-interest beneficiary (or majority-interest group of beneficiaries) of the particular trust.

Paragraph 251.2(3)(f) of the Act is amended to provide that the acquisition or disposition of equity in a trust that is an investment fund is not a loss restriction event of the trust. This result is subject to the requirement that the acquisition or disposition, as the case may be, not be part of a series of transactions or events under which the trust ceases to qualify as an investment fund.

For further information, see the commentary on the definition "investment fund".

Trusts – special rules of application

ITA
251.2(5)(c)

Subsection 251.2(5) of the Act contains rules of application for the purpose of determining whether a trust is subject to a loss restriction event at any time.

New paragraph 251.2(5)(c) contains an anti-avoidance rule that applies in determining whether a trust is an investment fund. To qualify as an investment fund a trust must not control, alone or as part of a group, a corporation, and the trust must not hold more than 20% of the securities of any class of securities of an issuer (or hold, measured on a fair market value basis, more than 10% of the equity or liabilities of the issuer). Paragraph 251.2(5)(c) provides, in respect of both of those requirements, that the requirement is deemed not be met if a person acquires a security of an issuer and it can reasonably be concluded that one of the reasons for the acquisition or any agreement in respect of the acquisition was to cause the requirement to be met.

Filing and other deadlines

ITA
251.2(7)

New subsection 251.2(7) applies to various deadlines of a trust that is subject to a loss restriction event and, as a result of which, paragraph 249(4)(a) of the Act applies to deem the trust's taxation year (the "pre-LRE year") to end before the loss restriction event. Subsection 251.2(7), applies in conjunction with new paragraphs (a)(i) and (ii) of the definition "balance-due day" in subsection 248(1). Together, those provisions are intended to provide that the time at which the income taxes payable, and any returns required to be made, under Part I (and certain other income tax rules) by a trust, in respect of a pre-LRE year, is determined as though the loss restriction event had not resulted in the pre-LRE year ending before the loss restriction event. Those provisions do not, however, eliminate the requirements to pay those amounts and to make those filings. In cases, where the requirements are not met, the ordinary interest and penalty provisions under the income tax rules continue to apply.

Subsection 251.2(7) provides that the filing-due date by which the trust must file with the Minister of National Revenue the trust's return of income for a pre-LRE year of the trust, and send its T3 information slips in respect of the pre-LRE year, is its balance-due day for the year (*i.e.*, the day by which the trust is normally required to pay any balance of taxes payable under Part I for a taxation year). New subparagraphs (a)(i) and (ii) of the amended definition "balance-due day" in subsection 248(1) contain rules that apply in this case. Generally, the trust's balance-due day for a pre-LRE year of the trust is the balance-due day of its ordinary taxation year (*i.e.*, 90 days after what would have been the trust's taxation year-end if subsection 249(4) did not apply). For further information, see the commentary on the definition "balance-due day" in subsection 248(1).

Subsection 251.2(7) applies to a number of other requirements, that must ordinarily be met within 90 days after the end of the taxation year to which they relate, in respect of a pre-LRE year of the trust. Specifically, the deadlines for the following requirements are extended to the trust's balance-due day for the pre-LRE year:

- the requirement to send an NR4 return (where the deadline for doing so is determined under subsection 202(8) of the *Income Tax Regulations*);
- the requirement under subsection 210.2(5) that the trust include a T3 Schedule 10 return required in respect of Part XII.2 tax with its T3 tax return for the pre-LRE year;
- the requirement under subsection 221(2) of the *Income Tax Regulations* that a trust make a prescribed filing if it claims that an interest as beneficiary under the trust is a qualified investment for certain registered plans;
- where the trust is a registered investment, its requirement under subsection 204.7(1) to file a T3RI return under Part X.2 of the Act; and
- the requirement under subsection 132(6.1) of the Act that the trust, in order to elect to be treated as a mutual fund trust from the beginning of its first taxation year to the time at which it first becomes a mutual fund trust, must become a mutual fund trust within 90 days after the end of the trust's first taxation year.

Subsection 251.2(7) also provides that in computing interest on a mutual fund trust's capital gains refund for a pre-LRE year, the relevant period will be determined by reference to the later of the trust's balance-due day for the pre-LRE year and, in cases where the T3 tax return for the pre-LRE year is filed after that day, the day on which the return is filed.

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

Clause 66

Investments in limited partnerships

ITA
253.1(1)

Subsection 253.1(1) of the Act applies for specified provisions of the Act and Regulations where a trust or corporation holds an interest as a limited partner in a limited partnership. It provides that the trust or corporation will not, solely because of its acquisition and holding of the limited partnership interest, be considered to carry on any business or other activity of the partnership.

Subsection 253.1(1) is amended so that it applies for the purpose of the definition "investment fund" in subsection 251.2(1), subparagraph (*b*)(iv) of which requires that a trust, in order to qualify as an investment fund, limit its undertaking to the investing of its funds in property.

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

Clause 67

Corporations associated through a third corporation

ITA
256(2)

Subsection 256(2) of the Act applies for the purpose of determining if two or more corporations are associated with each other. This rule applies for the purposes of the Act, and is relevant for determining whether corporations must share a single business limit and whether this limit must be reduced based on their aggregate taxable capital (taxable capital limit) for the purpose of the small business deduction provided for Canadian-controlled private corporations (CCPC's) under subsection 125(1). Subsection 256(2) is part of a set of rules that strikes a balance between allowing different family members to carry on businesses through separate CCPC's eligible for the small business deduction and addressing tax planning arrangements used by a single economic group as an attempt to multiply the small business deduction.

In general terms, two corporations that would not be associated with each other are deemed to be associated with each other at a particular time under subsection 256(2) if, at that time, each corporation is associated with the same third corporation. As a result, the two corporations and the third corporation are deemed to be associated with each other for the purposes of the Act, including for the purposes of sharing a single business limit and taxable capital limit under section 125.

However, if either of the two following exceptions applies, the third corporation is deemed not to be associated with either of the two corporations in the third corporation's taxation year for the purposes of section 125 and its business limit is deemed to be nil:

- The third corporation is not a CCPC at that time.
- The third corporation is a CCPC at that time and elects, in prescribed form, not to be associated with either of the two corporations in the taxation year that includes that time.

Subsection 256(2) is amended to prevent the misuse of the current exceptions to multiply access to the small business deduction.

First, subsection 256(2) is divided into paragraphs (a) and (b). Paragraph (a) applies for the purposes of the Act, while paragraph (b) contains exceptions that apply only for the purposes of section 125.

Second, new paragraph 256(2)(a) provides that, subject to paragraph (b), two corporations are deemed to be associated with each other at a particular time if they would not otherwise be associated at that time but are associated with the same third corporation, or would be deemed to be associated with the same third corporation under subsection 256(2).

Third, for the purpose of section 125, new paragraph 256(2)(b) limits the scope of the exceptions to the deeming rule in new paragraph 256(2)(a).

- If the third corporation is not a CCPC at the particular time, the other two corporations are deemed not to be associated with each other at the time (new subparagraph 256(2)(b)(i)). Consequently, each of the two corporations remains associated with the

third corporation (and *vice versa*). The current reference to the third corporation's business limit being nil is removed because such a corporation cannot have a business limit (a corporation must be a CCPC throughout a taxation year to be eligible for the small business deduction).

- If the third corporation is a CCPC at the particular time and elects in prescribed form for its taxation year that includes that time, the other two corporations are deemed not to be associated with each other at the particular time and the business limit of the third corporation for that taxation year is deemed to be nil (new subparagraph 256(2)(b)(ii)). Consequently, each of the other two corporations remains associated with the third corporation.

Finally, a related amendment is made to subsection 125(1) in respect of income from property (such as interest and rent) of a CCPC that is deemed under subsection 129(6) to be active business income eligible for the small business deduction where one of the exceptions to the deeming rule in subsection 256(2) applies. For more information, see the explanatory notes for the amendments to subsection 125(1).

The amendments to subsection 256(2) apply to taxation years that begin after March 21, 2016.

Deemed exercise of right

ITA
256(8)

Subsection 256(8) applies – if a taxpayer acquires a right referred to in paragraph 251(5)(b) with respect to shares, and it can reasonably be concluded that one of the main purposes of the acquisition of the right is to avoid the application of certain income tax provisions that are triggered on an acquisition of control – to treat the taxpayer as having exercised the right in question for a number of provisions for the purpose of determining whether control of the relevant corporation is acquired or whether the corporation is controlled by any person or group of persons. For example, in any case where subsection 256(8) applies in respect of a right acquired at any time, the right is deemed to be exercised at that time for the purpose of determining whether control of the relevant corporation is acquired for purposes of paragraph 251.2(2)(a), which determines for purposes of the Act the time at which a corporation is subject to a loss restriction event.

The list of the provisions in the post-amble to subsection 256(8) is amended by adding a reference to paragraph (b) of the definition "investment fund" in subsection 251.2(1), which provides that a trust is disqualified as an investment fund under section 251.2 if it controls, alone or as part of a group, a corporation.

These amendments are deemed to have come into force on March 21, 2013.

ITA
256(8)(b)

Subsection 256(8) of the Act extends the circumstances in which an acquisition of control is considered to have occurred for the purposes of a number of provisions of the Act. If a taxpayer acquires a right referred to in paragraph 251(5)(b) with respect to shares, and it can reasonably be concluded that one of the main purposes of the acquisition of the right is to avoid the application of certain income tax provisions that are triggered on an acquisition of control, subsection 256(8) applies to treat the right as having been exercised. Consequential on the repeal of the eligible capital property rules, paragraph 256(8)(b) is amended to delete the reference to subsection 111(5.2).

This amendment comes into force on January 1, 2017.

Clause 68

ITA
256.1(1)

A “specified provision” is defined to be any of various provisions in the Act that generally restrict the deductible amount of certain corporate tax attributes on an acquisition of control of the corporation. The definition “specified provision” is relevant for the purpose of applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control of a corporation to have occurred in certain circumstances. Consequential on the repeal of the eligible capital property rules, the definition “specified provision” in subsection 256.1(1) is amended to delete the reference to subsection 111(5.2).

This amendment comes into force on January 1, 2017.

Clause 69

Canadian currency requirement

ITA
261(2)(b)

Subsection 261(2) of the Act is a general rule that applies to taxpayers that do not elect into the functional currency tax reporting regime. Paragraph 261(2)(a) provides that Canadian currency is to be used in determining the Canadian tax results of such a taxpayer. Paragraph 261(2)(b) provides that if a particular amount that is relevant in computing those Canadian tax results is expressed in a foreign currency, the particular amount is – subject to certain listed provisions – to be converted to Canadian currency using the relevant spot rate for the day on which the particular amount arose.

Paragraph 261(2)(b) is amended to add new subsection 20(14.2) to its listed provisions given that new subsection 20(14.2) departs in certain circumstances from the general rule in paragraph 261(2)(b) by requiring that, if a debt obligation is denominated in a foreign currency, the amounts described in each variable of its formula are converted to Canadian currency using the exchange rate at the time of sale.

This amendment comes into force on January 1, 2017.

Functional currency tax reporting

ITA
261(5)(c)

Subsection 261(5) of the Act provides a number of rules for taxpayers that have elected into the functional currency tax reporting regime.

Paragraph 261(5)(c) provides that if a particular amount that is relevant in computing the taxpayer's Canadian tax results is expressed in a currency other than the taxpayer's elected functional currency, the particular amount is – subject to certain listed provisions – to be converted to an amount expressed in the taxpayer's elected functional currency using the relevant spot rate for the day on which the particular amount arose.

Paragraph 261(5)(c) is amended to add new subsection 20(14.2) to its listed provisions given that new subsection 20(14.2) departs in certain circumstances from the general rule in paragraph 261(5)(c) by requiring that, if a debt obligation is denominated in a foreign currency, the amounts described in each variable of its formula is converted the vendor's elected functional currency using the exchange rate at the time of sale.

This amendment comes into force on January 1, 2017.

ITA
261(5)(f)(i)

Subparagraph 261(5)(f)(i) of the Act provides a reading rule for certain provisions of the Act and the Regulations. The reading rule replaces references to "Canadian currency" with references to "the taxpayer's elected functional currency".

Subparagraph 261(5)(f)(i) is amended to add new subsection 20(14.2) to its listed provisions, as this new provision contains references to Canadian currency.

This amendment comes into force on January 1, 2017.

Converting Canadian currency amounts

ITA
261(7)(d)(i)

Subsection 261(7) of the Act sets out various rules for converting tax attributes from Canadian currency to a taxpayer's elected functional currency, where a taxpayer has elected into the functional currency tax reporting regime. Paragraph 261(7)(d) deals with certain amounts that are added to or deducted from a pool amount of a taxpayer.

Subparagraph 261(7)(d)(i) is amended to remove the reference to cumulative eligible capital in respect of a business, consequential on the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Debt parking – foreign exchange

ITA

261(10.1)

Subsection 261(10) of the Act applies if a taxpayer has, at any time in a functional currency year or reversionary year, made a payment on account of the principal amount of a pre-transition debt. Subsection 261(10) provides that where the taxpayer would have made a gain or sustained a loss (or have had income or a loss) if the pre-transition debt had been settled by the taxpayer repaying the debt immediately before the end of its last Canadian currency year, the taxpayer is deemed to have made a gain or sustained a loss (or to have had income or a loss) in proportion to any amount of the principal that is subsequently repaid.

New subsection 261(10.1) provides that, for the purposes of determining a taxpayer's gain under subsection 261(10), if a pre-transition debt that is denominated in a foreign currency becomes a parked obligation at a particular time, the debtor is deemed to have made, at that time, a particular payment on account of the principal amount of the debt equal to:

- if the debt has become a parked obligation at that particular time as a result of its acquisition by the holder of the debt, the portion of the amount paid by the holder to acquire the debt that can reasonably be considered to relate to the principal amount of the debt at the particular time; and
- in any other case, the portion of the fair market value of the debt that can reasonably be considered to relate to the principal amount of the debt at the particular time.

This amendment is deemed to have come into force on March 22, 2016. However, it does not apply to a pre-transition debt at the time that the debt meets the conditions to become a parked obligation because of a written agreement entered into before March 22, 2016 if that time is before 2017.

Debt parking – foreign exchange

ITA
261(14.1)

Subsection 261(14) of the Act contains rules that apply if a taxpayer has, at any time in in a reversionary year, made a payment on account of the principal amount of a pre-reversion debt. These rules are analogous to the rules in subsection 261(10) that apply to pre-transition debts. Subsection 261(14) provides that where the taxpayer would have made a gain or sustained a loss (or have had income or a loss) if the pre-reversion debt had been settled by the taxpayer repaying the debt immediately before the end of its last functional currency year, the taxpayer is deemed to have made a gain or sustained a loss (or to have had income or a loss) in proportion to any amount of the principal that is subsequently repaid.

New subsection 261(14.1) provides that, for the purposes of determining a taxpayer's gain under subsection 261(14), if a pre-reversion debt that is denominated in a foreign currency becomes a parked obligation at a particular time, the debtor is deemed to have made, at that time, a particular payment on account of the principal amount of the debt equal to:

- if the debt has become a parked obligation at that particular time as a result of its acquisition by the holder of the debt, the portion of the amount paid by the holder to acquire the debt that can reasonably be considered to relate to the principal amount of the debt at the particular time; and
- in any other case, the portion of the fair market value of the debt that can reasonably be considered to relate to the principal amount of the debt at the particular time.

This amendment is deemed to have come into force on March 22, 2016. However, it does not apply to a pre-reversion debt at the time that the debt meets the conditions to become a parked obligation because of a written agreement entered into before March 22, 2016 if that time is before 2017.

Clause 70

Due diligence - general

ITA
265

Paragraphs 265(2)(c) and (3)(b) of the Act set out the due diligence requirements required to be followed by financial institutions in order to identify accounts that are required to be reported pursuant to the rules in Part XVIII. Currently, these paragraphs permit financial institutions to apply the due diligence procedures applicable to pre-existing individual accounts to new individual accounts.

Paragraphs 265(2)(c) and (3)(b) are amended to eliminate the ability for financial institutions to apply the due diligence procedures for pre-existing individual accounts to new individual accounts consistent with the due diligence procedures proposed in new Part XIX.

This amendment comes into force on July 1, 2017.

Clause 71

Automatic exchange of financial account information in tax matters

The following new Part implements the reporting and due diligence standards of the Common Reporting Standard (CRS) developed by the Organisation for Economic Co-operation and Development that underpins the automatic exchange of financial account information. Implementation of the CRS entails the introduction of rules that require financial institutions to report certain information to the Canada Revenue Agency and to follow due diligence procedures as set out in this Part.

New Part XIX of the Act comes into force on July 1, 2017.

Definitions

ITA
270

Section 270 defines certain terms for purposes of Part XIX of the Act, and sets our certain rules relating to the interpretation and application of the provisions in this Part.

ITA
270(1)

Subsection 270(1) sets out a number of definitions for the purposes of this Part.

“account holder”

An “account holder” means

- the person listed or identified as the holder of a financial account by the financial institution that maintains the account other than a person (other than a financial institution) holding a financial account for the benefit of, or on behalf of, another person as agent, custodian, nominee, signatory, investment advisor or intermediary; and
- in the case of a cash value insurance contract or an annuity contract,
    - any person entitled to access the cash value or change the beneficiary, and
    - if no person can access the cash value or change the beneficiary,
        - any person named as the owner in the contract,
        - any person with a vested entitlement to payment under the terms of the contract, and
    - upon maturity of the cash value insurance contract or annuity contract, each person entitled to receive a payment under the contract.

“active NFE”

An “active NFE” is a non-financial entity that meets any of the following criteria at any time:

- less than 50% of the its gross income for the preceding fiscal period is passive income and less than 50% of the assets that it held during the preceding fiscal period are assets that produce or are held for the production of passive income;
- either interests in the NFE are regularly traded on an established securities market or the NFE is a related entity of such an entity;
- the NFE is
    - a governmental entity,
    - an international organization,
    - a central bank, or
    - an entity wholly owned by a governmental entity, international organization or central bank;
- both
    - all or substantially all of the activities of the NFE consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more of its subsidiaries that engage in trades or businesses other than the business of a financial institution, and
    - the NFE does not function as (and is not represented or promoted to the public as) an investment fund, including
        - a private equity fund,
        - a venture capital fund,

        - a leveraged buyout fund, and
        - an investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes;
- the NFE
    - is not yet operating a business,
    - has no prior operating history,
    - is investing capital into assets with the intent to operate a business other than that of a financial institution, and
    - was initially organized no more than 24 months prior to that time;
- the NFE has not been a financial institution in any of the past five years and is in the process of liquidating its assets or is reorganizing with the intent to continue or recommence operations in a business other than that of a financial institution;
- the NFE primarily engages in financing and hedging transactions with, or for, related entities that are not financial institutions, and does not provide financing or hedging services to any entity that is not a related entity, provided that the group of those related entities is primarily engaged in a business other than that of a financial institution; and
- the NFE meets all of the following requirements:
    - it
        - is established and operated in its jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural, athletic or educational purposes, or
        - is established and operated in its jurisdiction of residence and it is a professional organization, business league, chamber of commerce, labour organization, agricultural or horticultural organization, civic league or an organization operated exclusively for the promotion of social welfare,
    - it is exempt from income tax in its jurisdiction of residence,
    - it has no shareholders or members who have a proprietary or beneficial interest in its income or assets,
    - the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents do not permit any income or assets of the NFE to be distributed to, or applied for the benefit of, a private person or non-charitable entity other than pursuant to the conduct of the NFE's charitable activities, or as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property which the NFE has purchased; and
    - the applicable laws of the NFE's jurisdiction of residence or the NFE's formation documents require that, upon the NFE's liquidation or dissolution, all of its assets be distributed to a governmental entity or other non-profit organization, or escheat to the government of the NFE's jurisdiction of residence or any political subdivision thereof.

"annuity contract"

An "annuity contract" is a contract under which the issuer agrees to make payments for a period of time determined in whole or in part by reference to the life expectancy of one or more individuals and includes a contract

- that is considered to be an annuity contract in accordance with the law, regulation or practice of the jurisdiction in which the contract was issued; and
- under which the issuer agrees to make payments for a term of years.

"anti-money laundering and know your customer procedures" or "AML/KYC procedures"

The terms "Anti-money laundering and know your customer procedures" and "AML/KYC procedures" refer to the record keeping and verification of identity procedures that are required of a reporting financial institution under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. These procedures include identifying and verifying the identity of the customer (including the beneficial owners of the customer), understanding the nature and purpose of the account and on-going monitoring.

"broad participation retirement fund"

A "broad participation retirement fund" is a fund that is established to provide retirement, disability or death benefits to beneficiaries that are current or former employees (or persons designated by those employees) of one or more employers in consideration for services rendered, provided that the fund

- does not have a single beneficiary with a right to more than 5% of the fund's assets;
- is subject to government regulation and provides information reporting to the Minister of National Revenue; and
- satisfies at least one of the following requirements:
    - the fund is generally exempt from tax on investment income, or taxation of investment income is deferred or taxed at a reduced rate, due to its status as a retirement or pension plan,
    - the fund receives at least 50% of its total contributions (other than transfers of assets from broad participation retirement funds, narrow participation retirement funds or from retirement and pension accounts described in paragraph (a) of the definition "excluded account") from the sponsoring employers,
    - distributions or withdrawals from the fund are
        - allowed only upon the occurrence of specified events related to retirement, disability or death (except rollover distributions to broad participation retirement funds, narrow participation retirement funds and pension funds of a governmental entity, international organization or central bank or retirement and pension accounts described in paragraph (a) of the definition "excluded account"), or
        - subject to penalties if they are made before such specified events, and
    - contributions (other than permitted make-up contributions) by an employee to the fund
        - are limited by reference to the employee's remuneration, or

      - may not exceed 50,000 USD annually, applying the rules set forth in subsection 277(3).

“Canadian financial institution”

A “Canadian financial institution” is a financial institution that is

- either
  - resident in Canada, but excluding any branch of the financial institution that is located outside Canada, or
  - a branch of a financial institution that is not resident in Canada, if the branch is located in Canada; and
- a listed financial institution as defined in subsection 263(1) of the Act.

The requirement that a financial institution be a listed financial institution, as defined for the purposes of Part XVIII, is intended to restrict the types of financial institutions that are subject to the reporting and due diligence rules under this Part.

“cash value”

The “cash value” of a contract held by a policyholder is the greater of the amount that the policyholder is entitled to receive upon surrender or termination of the contract (determined without reduction for any surrender charge or policy loan) and the amount the policyholder can borrow under or with regard to (for example, by pledging as collateral) the contract, but does not include an amount payable under an insurance contract

- solely by reason of the death of an individual insured under a life insurance contract;
- as a personal injury or sickness benefit or other benefit that provides indemnification of an economic loss incurred upon the occurrence of an event insured against;
- as a refund of a previously paid premium (less any cost of insurance charges whether or not actually imposed) under an insurance contract (other than an investment-linked life insurance or annuity contract) due to the cancellation or termination of the contract, a decrease in risk exposure during the effective period of the contract or arising from the correction of a posting or similar error with regard to the premium for the contract;
- as a policyholder dividend (other than a termination dividend) provided that the dividend relates to an insurance contract under which the only benefits payable are personal injury or sickness benefits or other benefits that provide indemnification of an economic loss incurred upon the occurrence of an event insured against. For this purpose, the reference to “other benefits” does not include any benefit payable under an investment-linked insurance contract, which is an insurance contract under which benefits, premiums or the period of coverage are adjusted to reflect the investment return or market value of assets associated with the contract; or
- as a return of an advance premium or premium deposit for an insurance contract for which the premium is payable at least annually, if the amount of the advance premium or premium deposit does not exceed the next annual premium that will be payable under the contract.

“cash value insurance contract”

A “cash value insurance contract” is an insurance contract (other than an indemnity reinsurance contract between two insurance companies) that has a cash value.

“central bank”

A “central bank” is an institution that is, by law or government sanction, the principal authority, other than the government of the jurisdiction itself, issuing instruments intended to circulate as currency. Such an institution is generally the custodian of the banking reserves of the jurisdiction under whose law it is organized. This term may include an instrumentality that is separate from the government of the jurisdiction, whether or not owned in whole or in part by the jurisdiction.

“controlling persons”

The “controlling persons” in respect of an entity are the natural persons (i.e., individuals other than trusts) who exercise control over the entity, and includes

- in the case of a trust,
    - its settlors,
    - its trustees,
    - its protectors (if any),
    - its beneficiaries (for this purpose, a discretionary beneficiary of a trust will only be considered a beneficiary of the trust in a calendar year if a distribution has been paid or made payable to the discretionary beneficiary in the calendar year), and
    - any other natural persons exercising ultimate effective control over the trust; and
- in the case of a legal arrangement other than a trust, persons in equivalent or similar positions to those described above.

This definition is intended to correspond to the term “beneficial owner” as described in “Recommendation 10” and the “Interpretative Note on Recommendation 10” of the Financial Action Task Force Recommendations (as adopted in February 2012 and as amended from time to time - *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*, The FATF Recommendations, FATF/OECD, Paris), and is to be interpreted in a manner consistent with such Recommendations, with the aim of protecting the international financial system from misuse, including with respect to tax crimes.

“custodial account”

A “custodial account” is an account (other than an insurance contract or annuity contract) that holds one or more financial assets for the benefit of another person.

“custodial institution”

A "custodial institution" is an entity, if the entity's gross income attributable to the holding of financial assets for the account of others and related financial services equals or exceeds 20% of the entity's gross income during the shorter of

- the three-year period that ends at the end of the entity's last fiscal period; and
- the period during which the entity has been in existence.

"depository account"

A "depository account" includes

- any commercial, chequing, savings, time or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness or other similar instrument maintained by a financial institution in the ordinary course of a banking or similar business; and
- an amount held by an insurance company under a guaranteed investment contract or similar agreement to pay or credit interest on the contract.

An account that is evidenced by a passbook would generally be considered a depository account. Negotiable debt instruments that are traded on a regulated market or over-the counter market and distributed and held through financial institutions are financial assets that would not generally be considered depository accounts.

"depository institution"

A "depository institution" is any entity that accepts deposits in the ordinary course of a banking or similar business.

"documentary evidence"

"Documentary evidence" includes

- a certificate of residence issued by an authorized government body (such as a government or agency thereof, or a municipality) of the jurisdiction in which the payee claims to be a resident;
- with respect to an individual (other than a trust), any valid identification issued by an authorized government body that includes the individual's name and is typically used for identification purposes;
- with respect to an entity, any official documentation issued by an authorized government body that includes the name of the entity and either the address of its principal office in the jurisdiction in which it claims to be resident or the jurisdiction in which the entity was incorporated or organized; and
- any audited financial statement, third-party credit report, bankruptcy filing or securities regulator's report.

"entity"

An “entity” is a person (other than a natural person) or a legal arrangement, including a corporation, a partnership, a trust or a foundation.

The definition of entity is meant to be broad in scope and includes, for instance, a unit, business or office of a financial institution that is treated as a branch under the regulatory regime of a jurisdiction, or that is otherwise regulated under the laws of a jurisdiction as separate from other offices, units or branches of the financial institution. For this purpose, all units, businesses or offices of a reporting financial institution in a single jurisdiction are to be treated as a single branch.

“equity or debt interest”

An “equity or debt interest” includes, in the case of a partnership that is a financial institution, either a capital or profits interest in the partnership. In the case of a trust that is a financial institution, an equity interest is deemed to be held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust, and a reportable person will be treated as being a beneficiary of a trust if the reportable person has the right to receive directly or indirectly (for example, through a nominee) a mandatory distribution from the trust or may receive, directly or indirectly, a discretionary distribution from the trust.

“established securities market”

An “established securities market” is a stock exchange that

- is officially recognized and supervised by a governmental authority in which the market is located; and
- has an annual value of shares traded on the exchange (or a predecessor exchange) exceeding one billion USD during each of the three calendar years immediately preceding the calendar year in which the determination is being made. For this purpose, if a stock exchange has more than one tier of market level on which stock may be separately listed or traded, each of those tiers must be treated as a separate stock exchange.

“excluded account”

An “excluded account” is

- a *retirement or pension account* that satisfies the following requirements:
    - the account is
        - subject to regulation as a personal retirement account, or
        - part of a registered or regulated retirement or pension plan for the provision of retirement or pension benefits (including disability or death benefits),
    - the account is tax-favoured in that

        - contributions to the account that would otherwise be subject to tax are deductible or excluded from the gross income of the account holder or taxed at a reduced rate, or
        - taxation of investment income within the account is deferred or investment income within the account is taxed at a reduced rate,
    - information reporting to the Minister of National Revenue is required with respect to the account,
    - withdrawals are
        - conditioned on reaching a specified retirement age, disability or death, or
        - subject to penalties if made before retirement age, disability or death, and
    - after applying the aggregation rules in subsection 277(3) to all similar accounts, annual contributions to the account are limited to 50,000 USD or less or there is a maximum lifetime contribution limit to the account of 1,000,000 USD or less (and an account that otherwise satisfies this requirement will not fail to satisfy this requirement solely because the account may receive assets or funds transferred from one or more accounts that meet the requirements of a retirement or pension account described above, or a non-retirement tax-favoured account described immediately below or from one or more broad participation retirement funds, narrow participation retirement funds or pension funds of a governmental entity, international organization or central bank);
- a *non-retirement tax favoured account* that satisfies the following requirements:
    - the account is
        - subject to regulation as an investment vehicle for purposes other than for retirement and regularly traded on an established securities market, or
        - subject to regulation as a savings vehicle for purposes other than for retirement,
    - the account is tax-favoured in that
        - contributions to the account that would otherwise be subject to tax are deductible or excluded from the gross income of the account holder or taxed at a reduced rate, or
        - taxation of investment income within the account is deferred or investment income within the account is taxed at a reduced rate,
    - withdrawals are
        - conditioned on meeting specific criteria related to the purpose of the investment or savings account (including the provision of educational or medical benefits), or
        - subject to penalties if made before the specific criteria related to the purpose of the investment or savings account are met (including the provision of educational or medical benefits), and
    - annual contributions are, after applying the rules in subsection 277(3) to all similar accounts, limited to 50,000 USD or less (and an account that otherwise satisfies this requirement will not fail to satisfy this requirement solely because the account may receive assets or funds transferred from one or more accounts that meet the requirements of a retirement or pension account, or a non-retirement tax-favoured account described above, or from one or more broad participation

retirement funds, narrow participation retirement funds or pension funds of a governmental entity, international organization or central bank);

- a *term life insurance contract* with a coverage period that ends before the insured individual attains age 90, provided that the contract satisfies the following requirements:
  - periodic premiums, which do not decrease over time, are payable at least annually until the earlier of
    - the end of the period in which the contract is in existence, and
    - the date that the insured attains age 90,
  - the contract has no contract value that any person can access (by withdrawal, loan or otherwise) without terminating the contract,
  - the amount (other than a death benefit) payable upon cancellation or termination of the contract cannot exceed the amount determined by the formula

$$A - (B + C)$$

where

A is the aggregate premiums paid for the contract,

B is the total of all mortality, morbidity and expense charges (whether or not actually imposed) for the period or periods of the contract's existence, and

C is the total of all amounts paid prior to the cancellation or termination of the contract, and

  - the contract has not been acquired by a transferee for value;
- an *estate account* held solely by an estate of a deceased individual, if the documentation for the account includes a copy of the will or death certificate of the individual;
- an *escrow account* established in connection with any of the following:
  - a court order or judgement,
  - a sale, exchange or lease of property, provided that the account satisfies the following requirements:
    - the account is funded
      - solely with a down payment, earnest money, deposit in an amount appropriate to secure an obligation directly related to the transaction or a similar payment, or
      - with a financial asset that is deposited in the account in connection with the sale, exchange or lease of the property,
    - the account is established and used solely to secure the obligation of
      - the purchaser to pay the purchase price for the property,
      - the seller to pay any contingent liability, or
      - the lessor or lessee to pay for any damages relating to the leased property as agreed under the lease,
    - the assets of the account, including the income earned on the account, will be paid or otherwise distributed for the benefit of the purchaser, seller, lessor or lessee (including to satisfy such person's obligation) when the property is sold, exchanged or surrendered or the lease terminates,

        - the account is not a margin or similar account established in connection with a sale or exchange of a financial asset, and
        - the account is not associated with a depository account due to not-returned overpayments described below,
    - an obligation of a financial institution servicing a loan secured by real or immovable property to set aside a portion of a payment solely to facilitate the payment of taxes or insurance related to the property at a later time, or
    - an obligation of a financial institution solely to facilitate the payment of taxes at a later time;
- a *depository account due to not-returned overpayments* that satisfies the following requirements:
    - the account exists solely because a customer makes a payment in excess of a balance due with respect to a credit card or other revolving credit facility and the overpayment is not immediately returned to the customer, and
    - after June 2017, policies and procedures are in effect relating to overpayments (for this purpose, a customer overpayment does not include credit balances to the extent of disputed charges but does include credit balances resulting from merchandise returns) to either
        - prevent a customer from making an overpayment in excess of 50,000 USD, or
        - ensure that any customer overpayment in excess of 50,000 USD is refunded to the customer within 60 days; and
- the following accounts that are prescribed in section 9006 of the *Income Tax Regulations* to be excluded accounts:
    - a registered retirement savings plan;
    - a registered retirement income fund;
    - a pooled registered pension plans;
    - a registered pension plan;
    - a registered disability savings plan;
    - a registered education savings plan;
    - a deferred profit sharing plan;
    - a net income stabilization account, including a NISA Fund No. 2;
    - an eligible funeral arrangement;
    - a dormant account if the balance or value of the account does not exceed 1,000 USD; and
    - a TFSA.

“exempt collective investment vehicle”

An “exempt collective investment vehicle” is an investment entity that is regulated as a collective investment vehicle, provided that all of the interests in the collective investment vehicle are held by or through individuals or entities (other than a passive NFE with a controlling person who is a reportable person) that are not reportable persons.

The term collective investment vehicle is used to describe funds that are widely-held, hold a diversified portfolio of securities and are subject to investor-protection regulation in the country in which they are established. The term would include "master" and "feeder" funds that are part of "funds of funds" structures where the master fund holds a diversified portfolio of investments. However, for example, private equity funds and hedge funds would generally not fall within the definition of collective investment vehicle.

"financial account"

A "financial account" is an account (other than an excluded account) maintained by a financial institution, and includes

- a depository account,
- a custodial account,
- in the case of a financial institution that is an investment entity, any equity or debt interest in the financial institution, except that it does not include any equity or debt interest in an entity that is an investment entity solely because it (for the purpose of investing, managing, or administering financial assets deposited in the name of the customer with a financial institution other than such entity)
    - renders investment advice to, and acts on behalf of, a customer, or
    - manages portfolios for, and acts on behalf of, a customer,
- equity or debt interests in a custodial institution, depository institution, investment entity (other than an investment advisor or an investment manager), or specified insurance company, that were established with a purpose of avoiding reporting,
- any cash value insurance contract and any annuity contract issued or maintained by a financial institution, other than a non-investment-linked, non-transferable immediate life annuity that is issued to an individual and monetizes a pension or disability benefit provided under an account that is an excluded account, and
- an account that is a client name account maintained by a person or entity that is authorized under provincial legislation to engage in the business of dealing in securities or any other financial instruments, or to provide portfolio management or investment advising services.

"financial asset"

The definition "financial asset" is intended to encompass any assets that may be held in an account maintained by a financial institution, and includes

- a security, such as
    - a share of the capital stock of a corporation,
    - an income or capital interest in a widely held or publicly traded trust, or
    - a note, bond, debenture or other evidence of indebtedness,
- a partnership interest,
- a commodity,

- a swap (such as interest rate swaps, currency swaps, basis swaps, interest rate caps, interest rate floors, commodity swaps, equity swaps, equity index swaps and similar agreements),
- an insurance contract or annuity contract, and
- any interest (including a futures or forward contract or option) in a security, partnership interest, commodity, swap, insurance contract or annuity contract.

A financial asset, however, does not include a non-debt, direct interest in real or immovable property.

Negotiable debt instruments that are traded on a regulated market (or on an over-the-counter market and distributed and held through financial institutions) and shares or units in a real estate investment trust, would generally be considered financial assets.

“financial institution”

A “financial institution” is an entity, other than a passive NFE, that is a custodial institution, a depository institution, an investment entity or a specified insurance company. Each of these is defined in this subsection.

“governmental entity”

A “governmental entity” is the government of a jurisdiction, any political subdivision of a jurisdiction (which, for greater certainty, includes a state, province, county or municipality), a public body performing a function of government in a jurisdiction (i.e. an aboriginal government) or any agency or instrumentality of a jurisdiction wholly owned by one or more of the foregoing, unless it is not an integral part or a controlled entity of a jurisdiction (or a political subdivision of a jurisdiction) and for these purposes

- an integral part of a jurisdiction means any person, organization, agency, bureau, fund, instrumentality or other body, however designated, that constitutes a governing authority of a jurisdiction, and where the net earnings of the governing authority are credited to its own account or to other accounts of the jurisdiction, with no portion inuring to the benefit of any private person, except that an integral part does not include any individual who is a sovereign, official or administrator acting in a private or personal capacity; and
- a controlled entity means an entity that is separate in form from the jurisdiction or that otherwise constitutes a separate juridical entity, provided that
    - the entity is wholly owned and controlled by one or more governmental entities directly or indirectly through one or more controlled entities,
    - the entity’s net earnings are credited to its own account or to the accounts of one or more governmental entities, with no portion of its income inuring to the benefit of any private person, and
    - the entity’s assets vest in one or more governmental entities upon liquidation and dissolution.

For the purposes of this definition, income is not considered to inure to the benefit of private persons if such persons are the intended beneficiaries of a governmental program, and the program activities are performed for the general public with respect to the common welfare or relate to the administration of government.

However, income is considered to inure to the benefit of private persons if the income is derived from the use of a governmental entity to conduct a commercial business that provides financial services to private persons.

“group annuity contract”

A “group annuity contract” is an annuity contract under which the obligees are individuals who are associated through an employer, trade association, labour union or other association or group.

“group cash value insurance contract”

A “group cash value insurance contract” is a cash value insurance contract that

- provides coverage on individuals who are associated through an employer, trade association, labour union or other association or group; and
- charges a premium for each member of the group (or member of a class within the group) that is determined without regard to the individual health characteristics other than age, gender and smoking habits of the member (or class of members) of the group.

“high value account”

A “high value account” is a preexisting individual account with an aggregate balance or value that exceeds 1 million USD on June 30, 2017 or on December 31 of any subsequent year.

Once an account becomes a high value account, it maintains such status until the date of its closure and, therefore, can no longer be considered a lower value account.

“insurance contract”

An “insurance contract” is a contract (other than an annuity contract) under which the issuer agrees to pay an amount upon the occurrence of a specified contingency involving mortality, morbidity, accident, liability or property risk.

“international organization”

An “international organization” is any intergovernmental organization (or wholly-owned agency or instrumentality thereof), including a supranational organization,

- that is comprised primarily of governments;
- that has in effect a headquarters or substantially similar agreement with a jurisdiction; and

- the income of which does not inure to the benefit of private persons.

“investment entity”

Generally, an “investment entity” means an entity the business of which is primarily comprised of carrying on investment activities or operations on behalf of other persons

Specifically, an “investment entity” is any entity (other than an entity that is an “active NFE” because of any of paragraphs (d) to (g) of that definition)
- that primarily carries on as a business one or more of the following activities or operations for or on behalf of a customer
    - trading in money market instruments (such as cheques, bills, certificates of deposit and derivatives), foreign exchange, transferable securities or commodity futures, exchange, interest rate and index instruments,
    - individual and collective portfolio management, or
    - otherwise investing, administering or managing financial assets or money on behalf of other persons; or
- the gross income of which is primarily attributable to investing, reinvesting or trading in financial assets, if the entity is managed by another entity that is
    - a depository institution,
    - a custodial institution,
    - a specified insurance company, or
    - an entity that primarily conduct as a business investment activities or operations on behalf of other persons.

The definition “investment entity” is to be interpreted in a manner consistent with similar language set forth in the definition of “financial institution” in the Financial Action Task Force Recommendations (FATF/OECD (2013), *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation).*

“lower value account”

A “lower value account” is a preexisting individual account with an aggregate balance or value as of June 30, 2017 that does not exceed 1 million USD.

“narrow participation retirement fund”

A “narrow participation retirement fund” is a fund that is established to provide retirement, disability or death benefits to beneficiaries who are current or former employees (or persons designated by those employees) of one or more employers in consideration for services rendered, provided that
- the fund has fewer than 50 participants;
- the fund is sponsored by one or more employers that are not investment entities or passive NFEs;

- the employee and employer contributions to the fund (other than transfers of assets from retirement and pension accounts described in paragraph (a) of the definition "excluded account") are limited by reference to the employee's remuneration;
- participants that are not resident in Canada are not entitled to more than 20% of the fund's assets; and
- the fund is subject to government regulation and provides information reporting to the Minister of National Revenue.

"natural person"

A "natural person" is an individual other than a trust.

"new account"

A "new account" is a financial account maintained by a reporting financial institution opened after June 2017.

"new entity account"

A "new entity account" is a new account held by one or more entities.

"new individual account"

A "new individual account" is a new account held by one or more individuals (other than trusts).

"non-financial entity" or "NFE"

An entity is a "non-financial entity" or "NFE" if

- in the case of an entity that is resident in Canada, it is not a Canadian financial institution; and
- in the case of a non-resident entity, it is not a financial institution.

An NFE can be either a passive NFE or an active NFE.

"non-reporting financial institution"

A "non-reporting financial institution" is a Canadian financial institution that is

- the Bank of Canada;
- a governmental entity or international organization, other than with respect to a payment that is derived from an obligation held in connection with a commercial financial activity of a type engaged in by a specified insurance company, custodial institution or depository institution;

- a broad participation retirement fund, a narrow participation retirement fund, a pension fund of a governmental entity, international organization or central bank, or a qualified credit card issuer;
- an exempt collective investment vehicle;
- a trust if a trustee of the trust is a reporting financial institution and reports all information required to be reported under this Part with respect to all reportable accounts of the trust; or
- a prescribed entity (which are prescribed under section 9005 of the *Income Tax Regulations*).

"participating jurisdiction"

The term "participating jurisdiction" is used in respect of jurisdictions where there is an information agreement in place to share the information that is collected pursuant to the Common Reporting Standard. In Part XIX , a "participating jurisdiction" means Canada and each jurisdiction that will be identified by the Minister of National Revenue on the Internet website of the Canada Revenue Agency (cra-arc.gc.ca) or by any other means that the Minister considers appropriate.

"participating jurisdiction financial institution"

A "participating jurisdiction financial institution" is either

- a financial institution that is resident in a participating jurisdiction, but excludes a branch of that financial institution that is located outside a participating jurisdiction; or
- a branch of a financial institution that is not resident in a participating jurisdiction, if that branch is located in a participating jurisdiction.

"passive NFE"

A "passive NFE" is

- a non-financial entity that is not an active NFE; and
- an entity that is
    - any entity (other than an entity that is an "active NFE" because of any of paragraphs (d) to (g) of that definition) the gross income of which is primarily attributable to investing, reinvesting or trading in financial assets, if the entity is managed by another entity that is
        - a depository institution,
        - a custodial institution,
        - a specified insurance company, or
        - an entity that primarily conduct as a business investment activities or operations on behalf of other persons, and
    - not a participating jurisdiction financial institution.

"pension fund of a government entity, international organization or central bank"

A "pension fund of a government entity, international organization or central bank" is a fund that is established by a governmental entity, international organization or central bank to provide retirement, disability or death benefits to beneficiaries or participants

- that are current or former employees (or persons designated by those employees), or
- that are not current or former employees, if the benefits provided to them are in consideration of personal services performed for the governmental entity, international organization or central bank.

"preexisting account"

A "preexisting account" is either

- a financial account maintained by a reporting financial institution on June 30, 2017, or
- any other financial account of an account holder, regardless of the date the financial account was opened, if
  - the account holder also holds with the reporting financial institution (or with a related entity within Canada) a financial account maintained by the reporting financial institution on June 30, 2017,
  - the reporting financial institution (and, as applicable, the related entity within Canada) treats both the financial accounts maintained by the reporting financial institution on June 30, 2017, and any other financial accounts of the account holder that benefit from this additional inclusion as preexisting accounts despite being opened after June 30, 2017, as a single financial account for the purposes of satisfying the standards and knowledge requirements set forth in subsection 277(1), and for the purposes of determining the balance or value of any of the financial accounts, when applying any of the account thresholds (such as the determination of whether the account is a high value account after applying the account aggregation rules),
  - with respect to a financial account that is subject to AML/KYC procedures, the reporting financial institution is permitted to satisfy those AML/KYC procedures for the financial account by relying upon the AML/KYC procedures performed for the pre-existing account maintained by the reporting financial institution on June 30, 2017, and
  - the opening of the financial account does not require the provision of new, additional or amended customer information by the account holder other than for purposes of this Part.

"preexisting entity account"

A "preexisting entity account" is a preexisting account held by one or more entities.

"preexisting individual account"

A "preexisting individual account" is a preexisting account held by one or more individuals.

“qualified credit card issuer”

A “qualified credit card issuer” is a financial institution that satisfies the following requirements:

- the financial institution is a financial institution solely because it is an issuer of credit cards that accepts deposits only when a customer makes a payment in excess of a balance due with respect to the card and the overpayment is not immediately returned to the customer; and
- the financial institution has policies and procedures either to prevent a customer from making an overpayment in excess of 50,000 USD or to ensure that any customer overpayment in excess of 50,000 USD is refunded to the customer within 60 days, in each case applying the rules set forth in subsection 277(3) for account aggregation, and for the purposes of this definition, a customer overpayment does not refer to credit balances to the extent of disputed charges but does include credit balances resulting from merchandise returns.

“related entity”

An entity is a “related entity” in respect of another entity if either entity controls the other entity or the two entities are under common control. In the case of two investment entities described under paragraph (b) of the definition “investment entity”, the two entities are “related entities” if they are under common management and such management fulfils the due diligence obligations of the investment entities). For this purpose, control includes direct or indirect ownership of

- in the case of a corporation, shares of the capital stock of a corporation that
    - give their holders more than 50% of the votes that could be cast at the annual meeting of the shareholders of the corporation, and
    - have 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;
- in the case of a partnership, an interest as a member of the partnership that entitles the member to more than 50% of
    - the income or loss of the partnership, or
    - the assets (net of liabilities) of the partnership if it were to cease to exist; and
- in the case of a trust, an interest as a beneficiary under the trust with a fair market value that is greater than 50% of the fair market value of all interests as a beneficiary under the trust.

“reportable account”

A “reportable account” is an account held by one or more reportable persons or by a passive NFE with one or more controlling persons that is a reportable person, provided it has been identified as such pursuant to the due diligence procedures described in sections 272 to 277.

“reportable jurisdiction”

A “reportable jurisdiction” is a jurisdiction other than Canada and the United States of America.

“reportable jurisdiction person”

A “reportable jurisdiction person” is a natural person or entity that is resident in a reportable jurisdiction under the tax laws of that jurisdiction or an estate of an individual who was a resident of a reportable jurisdiction under the tax laws of that jurisdiction immediately before death. For this purpose, an entity that has no residence for tax purposes is deemed to be resident in the jurisdiction in which its place of effective management is situated.

“reportable person”

A “reportable person” is a reportable jurisdiction person other than

- a corporation the stock of which is regularly traded on one or more established securities markets;
- any corporation that is a related entity of a corporation the stock of which is regularly traded on one or more established securities markets;
- a governmental entity;
- an international organization;
- a central bank; or
- a financial institution.

“reporting financial institution”

A “reporting financial institution” is a Canadian financial institution that is not a non-reporting financial institution.

“specified insurance company”

A “specified insurance company” is any entity that is an insurance company (or the holding company of an insurance company) that issues, or is obligated to make payments with respect to, cash value insurance contracts or annuity contracts.

“TIN”

A “TIN” is a unique combination of letters or numbers, however described, assigned by a jurisdiction to an individual or an entity and used to identify the individual or entity for purposes of administering the tax laws of such jurisdiction.

In particular, a TIN is

- in respect of Canada, the number used by the Minister of National Revenue to identify an individual or entity, including
  - a social insurance number,
  - a business number, and
  - an account number issued to a trust; and

- in respect of a jurisdiction other than Canada, a taxpayer identification number used in that jurisdiction to identify an individual or entity (or a functional equivalent in the absence of a taxpayer identification number).

“USD”

In Part XIX, various thresholds and limits are described in USD, which is defined to mean dollars of the United States of America.

Interpretation

ITA
270(2)

Subsection 270(2) provides an interpretive rule that applies for the purposes of Part XIX. This Part is drafted in a manner that is intended to be generally consistent with the model Common Reporting Standard. This forms the context in which the text of the provisions is to be interpreted.

This rule clarifies that taxpayers should interpret the provisions of Part XIX, unless the context otherwise requires, consistently with the model Common Reporting Standard and associated commentary that was published by the Organisation for Economic Co-Operation and Development (and as amended from time to time), available at http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/. These are relevant in addition to the guidance to be published by the Canada Revenue Agency.

Interpretation – investment entity

ITA
270(3)

Subsection 270(3) provides an interpretive rule that applies for the purposes of the definition of “investment entity”.

Specifically subsection 270(3) provides that an entity will be considered to primarily carry on as a business one or more of the activities described in paragraph (a) of the definition “investment entity”, or an entity’s gross income will be considered to be primarily attributable to investing, reinvesting, or trading in financial assets for the purposes of paragraph (*b*) of that definition, if the entity’s gross income attributable to the relevant activities equals or exceeds 50% of the entity’s gross income during the shorter of

- the three-year period that ends at the end of the entity’s last fiscal period; and
- the period during which the entity has been in existence

Equity or debt interest – deeming rule

ITA
270(4)

Subsection 270(4) provides a deeming rule that applies to a trust that is a financial institution for the purposes of determining whether an equity or debt interest is held in the trust. Specifically, it provides that

- an equity interest is deemed to be held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust, and
- a reportable person is treated as a beneficiary of a trust if the reportable person has the right to receive directly or indirectly (such as through a nominee) a mandatory distribution from the trust or may receive, directly or indirectly, a discretionary distribution from the trust.

General reporting requirements

ITA
271

Section 271 contains the general reporting requirements applicable to reporting financial institutions. Subsections (1) and (2) specify the information to be reported as a general rule, while subsections (3) and (4) provide a series of exceptions.

ITA
271(1)

Subject to subsections 271(3) and (4), subsection 271(1) requires that each reporting financial institution report the following information to the Minister with respect to each of its reportable accounts:

- the name, address, jurisdiction of residence, TIN and date of birth (in the case of a natural person) of each reportable person that is an account holder of the account;
- in the case of any entity that is an account holder of the account and that, after applying the due diligence procedures in sections 275 to 277, is identified as having one or more controlling persons that is a reportable person,
  - the name, address, jurisdiction of residence and TIN of the entity, and
  - the name, address, jurisdiction of residence, TIN and date of birth of each of those controlling person;
- the account number (or functional equivalent in the absence of an account number) of the account;
- the name and identifying number (if any) of the reporting financial institution;
- the account balance or value (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value)
  - at the end of the relevant calendar year or other appropriate reporting period, or

  - if the account was closed during the relevant calendar year or period, on closure of the account;
- in the case of any custodial account,
  - the total gross amount of interest, the total gross amount of dividends and the total gross amount of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period, and
  - the total gross proceeds from the sale or redemption of financial assets paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution acted as a custodian, broker, nominee or otherwise as an agent for the account holder;
- in the case of any depository account, the total gross amount of interest paid or credited to the account during the calendar year or other appropriate reporting period; and
- in the case of any account other than a custodial account or a depository account, the total gross amount paid or credited to the account holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the reporting financial institution is the obligor or debtor, including the aggregate amount of any redemption payments made to the account holder during the calendar year or other appropriate reporting period.

Currency

ITA
271(2)

Subsection 271(2) provides that the information reported must identify the currency in which each amount is denominated.

TIN and date of birth

ITA
271(3)

Subsection 271(3) provides an exception to the reporting requirements in paragraphs (1)(a) and (b) for preexisting accounts that the TIN or date of birth is not required to be reported if the TIN or date of birth (as appropriate)

- are not in the records of the reporting financial institution, and
- are not otherwise required to be collected by the reporting financial institution under the Act.

However, even if the exception provided in this subsection applies, a reporting financial institution is required to use reasonable efforts to obtain the TIN and date of birth with respect to a preexisting account by the end of the second calendar year following the year in which the pre-existing account is identified as a reportable account.

Exceptions

ITA
271(4)

Subsection 271(4) provides an exception that a TIN of a reportable person is not required to be reported if

- the relevant reportable jurisdiction does not issue TINs; or
- the domestic law of the relevant reportable jurisdiction does not require the collection of the TIN issued by such reportable jurisdiction.

General due diligence rules

ITA
272

Section 272 contains general rules relating to the due diligence procedures in this Part.

ITA
272(1)

Subsection 272(1) provides that an account is treated as a reportable account beginning as of the date it is identified as a reportable account under the due diligence procedures in sections 272 through 277.

Timing – determination of balance or value

ITA
272(2)

While the balance or value of an account is part of the information to be reported, it is also relevant for other purposes, such as the due diligence procedures for preexisting entity accounts and the account balance aggregation rules. Subsection 272(2) provides that the balance or value of an account is determined on the last day of the calendar year or other appropriate reporting period.

Determination - balance or value

ITA
272(3)

Subsection 272(3) provides that for the purpose of determining whether the balance or value of an account exceeds a particular threshold on the last day of a calendar year, the balance or value must be determined on the last day of the last reporting period that ends on or before the end of the calendar year.

Service provider

ITA
272(4)

Subsection 272(4) provides that while a reporting financial institution may use service providers to fulfil its reporting and due diligence obligations imposed, these obligations shall remain the responsibility of the reporting financial institution.

Optional due diligence procedures

ITA
272(5)

Subsection 272(5) provides that a reporting financial institution may, either with respect to all preexisting accounts or, separately, with respect to any clearly identified group of those accounts, apply the due diligence procedures

- for new accounts to preexisting accounts (with the other rules for preexisting accounts continuing to apply); and
- for high value accounts to lower value accounts.

Documentation of due diligence procedures

ITA
272(6)

Subsection 272(6) requires that a reporting financial institution establish, maintain and document its due diligence procedures.

Due diligence procedures for pre-existing individual accounts

ITA
273

This section contains the due diligence procedures for the purposes of identifying reportable accounts among preexisting individual accounts. It distinguishes between lower value accounts and high value accounts, with enhanced due diligence procedures provided for the latter.

ITA
273(1)

Subsection 273(1) provides that a preexisting individual account that is a cash value insurance contract or an annuity contract is not required to be reviewed, identified or reported, provided the

reporting financial institution is effectively prevented by law from selling those contracts to residents of a reportable jurisdiction.

Lower value accounts

ITA
273(2)

Subsection 273(2) provides the review procedures that apply with respect to lower value accounts that are preexisting individual accounts.

Residence address test

Paragraph 273(2)(a) provides an alternate test for determining the jurisdiction of residence of an individual account holder if the reporting financial institution has in its records the address of the individual account holder's current residence (in this section, their "current residence address"). Specifically, it provides that a reporting financial institution may treat an individual as being a resident for tax purposes of the jurisdiction in which an address is located if:

- the reporting financial institution has in its records a residence address for the individual account holder;
- the residence address is current; and
- the residence address is based on documentary evidence.

Electronic record search

Paragraph 273(2)(b) provides that if the reporting financial institution does not rely on a current residence address as described in paragraph (a), the reporting financial institution must review electronically searchable data maintained by the reporting financial institution for any of the following indicia and apply paragraphs (c) through (f):

- identification of the account holder as a resident of a reportable jurisdiction,
- current mailing or residence address (including post office box) in a reportable jurisdiction,
- one or more telephone numbers in a reportable jurisdiction and no telephone number in the jurisdiction of the reporting financial institution,
- standing instructions (other than with respect to a depository account) to transfer funds to an account maintained in a reportable jurisdiction,
- currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction, and
- a hold mail instruction or in-care-of address in a reportable jurisdiction if the reporting financial institution does not have any other address on file for the account holder.

Effect of finding indicia

Paragraph 273(2)(c) provides that if none of the indicia listed in paragraph (b) are discovered in the electronic search, then no further review is required until the earlier of:

- a change in circumstances that results in one or more of the indicia referred to in paragraph (b) being associated with the account, or
- the account becomes a high value account.

Paragraph 273(2)(d) provides that if any of the indicia listed in paragraph (b) (except for a hold mail instruction or in care of instruction described in subparagraph (b)(vi)) are discovered in the electronic search or if there is a change in circumstances that results in one or more of the indicia in paragraph (b) being associated with the account, then the reporting financial institution must treat the account holder as a resident for tax purposes of each reportable jurisdiction for which an indicium is identified, unless one of the exceptions in paragraph (f) applies with respect to that account.

A "change in circumstances" includes any change that results in the addition of information relevant to a person's status or otherwise conflicts with such person's status. In addition, a "change in circumstances" includes any change or addition of information to the account holder's account (including the addition, substitution, or other change of an account holder) or any change or addition of information to any account associated with such account (applying the account aggregation rules) if such change or addition of information affects the status of the account holder.

Paragraph 273(2)(e) provides a special rule in case a hold mail instruction or in-care-of address is discovered in the electronic search and none of the other indicia and no other address (within such indicia) are identified for the account holder in the electronic search.

Paragraph 273(2)(e) provides that if a hold mail instruction or in-care-of address in a reportable jurisdiction is discovered in the electronic search and no other address and none of the other indicia listed in subparagraphs 273(2)(b)(i) to (v) are identified for the account holder, then

- the reporting financial institution must do one (if the relevant information is obtained, then there is no need to do both) or both (in the order most appropriate to the circumstances) of the following:
  - apply the paper record search described in paragraph 273(3)(b) (which applies for high value accounts), and
  - seek to obtain from the account holder a self-certification or documentary evidence to establish the residence for tax purposes of the account holder, and
- if the paper record search fails to establish an indicium and the attempt to obtain the self-certification or documentary evidence is not successful, then the reporting financial institution must report the account as an undocumented account.

Procedure for curing a finding of indicia

Paragraph 273(2)(f) contains a procedure for curing a finding of indicia under paragraph 273(2)(b). Specifically, it provides that notwithstanding the discovery of indicia under paragraph 273(2)(b), a reporting financial institution is not required to treat an account holder as a resident of a reportable jurisdiction if

- both
    - the account holder information contains
        - a current mailing or residence address in the reportable jurisdiction,
        - one or more telephone numbers in the reportable jurisdiction (and no telephone number in the jurisdiction of the reporting financial institution), or
        - standing instructions (with respect to financial accounts other than depository accounts) to transfer funds to an account maintained in a reportable jurisdiction, and
    - the reporting financial institution obtains, or has previously reviewed and currently maintains a record of,
        - a self-certification from the account holder of the jurisdictions of residence of the account holder that does not include the reportable jurisdiction, and
        - documentary evidence establishing the account holder's non-reportable status in relation to that jurisdiction, or
- both
    - the account holder information contains a currently effective power of attorney or signatory authority granted to a person with an address in the reportable jurisdiction, and
    - the reporting financial institution obtains, or has previously reviewed and currently maintains a record of,
        - a self-certification from the account holder of the jurisdictions of residence of the account holder that does not include the reportable jurisdiction, or
        - documentary evidence establishing the account holder's non-reportable status.

A self-certification or documentary evidence that has been previously reviewed may be relied upon for purposes of the curing procedure unless the reporting financial institution knows or has reasons to know that the self-certification or documentary evidence is incorrect or unreliable.

Enhanced review procedures – high value account

ITA
273(3)

Subsection 273(3) contains the enhanced review procedures that apply with respect to high value accounts. These procedures are the electronic record search, the paper record search and the relationship manager inquiry.

Electronic record search

Paragraph 273(3)(a) provides that a reporting financial institution must review electronically searchable data maintained by the reporting financial institution for any of the indicia described in paragraph 273(2)(b).

Paper record search

Paragraph 273(3)(b) provides that, subject to paragraph (c), the reporting financial institution must review for any of the indicia described in paragraph (2)(b)

- the current customer master file, and
- the following documents associated with the account, and obtained by the reporting financial institution within the last five years, to the extent that they are not contained in the current customer master file:
    - the most recent documentary evidence collected with respect to the account,
    - the most recent account opening contract or documentation,
    - the most recent documentation obtained by the reporting financial institution pursuant to AML/KYC procedures or for other regulatory purposes,
    - any power of attorney or signature authority forms currently in effect, and
    - any standing instructions (other than with respect to a depository account) to transfer funds currently in effect.

Paragraph 273(3)(c) provides that a reporting financial institution is not required to perform the paper record search described in paragraph (b) to the extent that the reporting financial institution's electronically searchable information includes the following:

- the account holder's residence status,
- the account holder's residence address and mailing address currently on file with the reporting financial institution,
- the account holder's telephone number currently on file, if any, with the reporting financial institution,
- in the case of financial accounts other than depository accounts, whether there are standing instructions to transfer funds in the account to another account (including an account at another branch of the reporting financial institution or another financial institution),
- whether there is a current in-care-of address or hold mail instruction for the account holder, and
- whether there is any power of attorney or signatory authority for the account.

Relationship manager inquiry

Paragraph 273(3)(d) provides that in addition to the electronic and paper record searches described above, the reporting financial institution must treat as a reportable account any high value account assigned to a relationship manager (including any financial accounts aggregated with that high value account pursuant to the rules in section 277) if the relationship manager has actual knowledge that the account holder is a reportable person.

A “relationship manager” is an officer or other employee of a reporting financial institution who is assigned responsibility for specific account holders on an on-going basis (including as an officer or employee that is a member of a reporting financial institution’s private banking department), advises account holders regarding their banking, investment, trust, fiduciary, estate planning, or philanthropic needs, and recommends, makes referrals to, or arranges for the provision of financial products, services, or other assistance by internal or external providers to meet those needs.

Effect of finding indicia

Paragraph 273(3)(e) provides that with respect to the enhanced review of high value accounts described above

- if none of the indicia listed in paragraph (2)(b) are discovered in the enhanced review and the account is not identified as being held by a reportable person in paragraph (*d*), then further action is not required until there is a change in circumstances that results in one or more indicia being associated with the account,
- if any of the indicia listed in subparagraphs (2)(b)(i) through (v) are discovered in the enhanced review, or if there is a subsequent change in circumstances that results in one or more indicia being associated with the account, then the reporting financial institution must treat the account as a reportable account with respect to each reportable jurisdiction for which an indicium is identified unless one of the exceptions in paragraph 2(f) applies with respect to that account,
- if a hold mail instruction or in care of address is discovered in the enhanced review and no other address or other indicia listed in (2)(b)(i) through (v) are identified for the account holder, then the reporting financial institution must
    - obtain from the account holder a self-certification or documentary evidence to establish the residence for tax purposes of the account holder, and
    - if the reporting financial institution cannot obtain a self-certification or documentary evidence, report the account as an undocumented account.

An indicium discovered in one review procedure, such as the paper record search or the relationship manager inquiry, cannot be used to cure an indicium identified in another review procedure such as the electronic record search. For example, a current residence address in a reportable jurisdiction within the knowledge of the relationship manager cannot be used to cure a different residence address currently on file with the reporting financial institution discovered in the paper record search.

Additional procedures

Paragraph 273(3)(f) provides that if a preexisting individual account is not a high value account on June 30, 2017, but becomes a high value account as of the last day of a subsequent calendar year,

- the reporting financial institution must complete the enhanced review procedures for high value accounts described in subsection 273(3) with respect to the account within the calendar year following the year in which the account becomes a high value account, and
- if, based on this review, the account is identified as a reportable account, the reporting financial institution must report the required information about the account with respect to the year in which it is identified as a reportable account (and subsequent years on an annual basis, unless the account holder ceases to be a reportable person).

Paragraph 273(3)(g) provides that if a reporting financial institution applies the enhanced review procedures described in this subsection to a high value account in a year, then the reporting financial institution is not required to re-apply those procedures – other than the relationship manager inquiry described in paragraph (d) – to the same high value account in any subsequent year unless the account is undocumented, in which case the reporting financial institution must re-apply them annually until the account ceases to be undocumented.

Paragraph 273(3)(h) provides that if there is a change of circumstances with respect to a high value account that results in one or more indicia described in paragraph (2)(b) being associated with the account, then the reporting financial institution must treat the account as a reportable account with respect to each reportable jurisdiction for which an indicium is identified unless

- the reporting financial institution applies paragraph (2)(f), and
- one of the exceptions in paragraph (2)(f) applies with respect to that account.

Finally, paragraph 273(3)(i) provides that a reporting financial institution must implement procedures to ensure that a relationship manager identifies any change in circumstances of an account.

Timing of review

ITA
273(4)

Subsection 273(4) provides a rule governing the timing of the review procedures for identifying reportable accounts among preexisting individual accounts.

Specifically, each preexisting individual account must be reviewed in accordance with subsection 273(2) or (3) before

- 2019, if the account is a high value account; or
- 2020, if the account is a lower value account.

Reportable pre-existing individual accounts

ITA
273(5)

Subsection 273(5) provides that any preexisting individual account that has been identified as a reportable account under this section must be treated as a reportable account in all subsequent years, unless the account holder ceases to be a reportable person.

Due diligence procedures for new individual accounts

ITA
274

Section 274 contains the due diligence procedures for new individual accounts and provides for the collection of a self-certification (and confirmation of its reasonableness).

ITA
274(1)

Subsection 274(1) provides that upon opening a new individual account, the reporting financial institution must obtain a self-certification (which may be a part of the account opening documentation) that allows the reporting financial institution to

- determine the account holder's residence for tax purposes; and
- confirm the reasonableness of the self-certification taking into account information obtained by the reporting financial institution in connection with the opening of the account, including any documentation collected pursuant to the AML/KYC procedures.

Determination of reportable account

ITA
274(2)

Subsection 274(2) provides that if the self-certification for a new individual account establishes that the account holder is resident for tax purposes in a reportable jurisdiction, then

- the reporting financial institution must treat the account as a reportable account; and
- the self-certification must also include the account holder's TIN with respect to the reportable jurisdiction (subject to subsection 271(4)) and date of birth.

Requirement to obtain new self-certification

ITA
274(3)

Subsection 274(3) provides that if there is a change in circumstances with respect to a new individual account that causes the reporting financial institution to know, or have reason to know, that the original self-certification is incorrect or unreliable, then the reporting financial institution

- cannot rely on the original self-certification; and

- must obtain a valid self-certification that establishes the residence for tax purposes of the account holder.

Due diligence procedures for pre-existing entity accounts

ITA
275

This section describes the due diligence procedures for preexisting entity accounts.

ITA
275(1)

Subsection 275(1) provides that unless the reporting financial institution elects otherwise — either with respect to all preexisting entity accounts or, separately, with respect to any clearly identified group of those accounts — a preexisting entity account with an aggregate account balance or value that does not exceed 250,000 USD on June 30, 2017 is not required to be reviewed, identified or reported as a reportable account until the aggregate account balance or value exceeds 250,000 USD on the last day of any subsequent calendar year.

Application of subsection (4)

ITA
275(2)

Subsection 275(2) provides that the review procedures set forth in subsection (4) apply to a preexisting entity account if it has an aggregate account balance or value that exceeds 250,000 USD on

- June 30, 2017; or
- the last day of any subsequent calendar year.

Determination of reportable accounts

ITA
275(3)

Subsection 275(3) provides that with respect to preexisting entity accounts described in subsection (2), the only accounts that shall be treated as reportable accounts are accounts that are held by

- one or more entities that are reportable persons; or
- passive NFEs with one or more controlling persons who are reportable persons.

Review procedures – preexisting entity accounts

ITA
275(4)

Subsection 275(4) contains the review procedures to identify reportable accounts among preexisting entity accounts. Specifically, it requires that a reporting financial institution must apply the following review procedures to determine whether the account is held by one or more reportable persons or by passive NFEs with one or more controlling persons who are reportable persons:

- review information maintained for regulatory or customer relationship purposes (including information collected pursuant to AML/KYC procedures) to determine whether the information indicates that the account holder is resident in a reportable jurisdiction, and if so, the reporting financial institution must treat the account as a reportable account unless it
  - obtains a self-certification from the account holder to establish that the account holder is not a reportable person, or
  - reasonably determines, based on information in its possession or that is publicly available, that the account holder is not a reportable person; and
- with respect to an account holder of a preexisting account (including an entity that is a reportable person), the reporting financial institution must determine whether the account holder is a passive NFE with one or more controlling persons who are reportable persons, and for the purposes of
  - determining whether the account holder is a passive NFE, the reporting financial institution must obtain a self certification from the account holder to establish its status, unless it has information in its possession or information is publicly available, based on which it can reasonably determine that the account holder is
    - an active NFE, or
    - a financial institution other than an entity described in paragraph (*b*) of the definition "investment entity" that is not a participating jurisdiction financial institution,
  - determining the controlling persons of an account holder, a reporting financial institution may rely on information collected and maintained pursuant to AML/KYC procedures, and
  - determining whether a controlling person of a passive NFE is a reportable person, a reporting financial institution may rely on
    - information collected and maintained pursuant to AML/KYC procedures in the case of a preexisting entity account held by one or more NFEs with an aggregate account balance or value that does not exceed 1 million USD, or
    - a self-certification from the account holder or the controlling person indicating the jurisdiction in which the controlling person is resident for tax purposes.

Timing of review

ITA
275(5)

Subsection 275(5) contains the rules governing the timing of the review procedures for identifying reportable accounts among pre-existing entity accounts. Each preexisting entity account must be reviewed in accordance with subsection (4)

- before 2020, if the account has an aggregate account balance or value that exceeds 250,000 USD on June 30, 2017; or
- if not, before the end of the calendar year following the year in which the aggregate account balance or value exceeds 250,000 USD on December 31.

Change of circumstances

ITA
275(6)

Subsection 275(6) provides that if there is a change of circumstances with respect to a preexisting entity account that causes the reporting financial institution to know, or have reason to know, that the self-certification or other documentation associated with the account is incorrect or unreliable, the reporting financial institution must re-determine the status of the account in accordance with subsection (4).

Due diligence procedures for new entity accounts

ITA
276

This section describes the due diligence procedures for new entity accounts.

ITA
276(1)

Subsection 276(1) provides that, for new entity accounts, a reporting financial institution must apply the following review procedures to determine whether the account is held by one or more reportable persons or by passive NFEs with one or more controlling persons who are reportable persons:

- the reporting financial institution must
    - obtain a self-certification (which may be part of the account opening documentation) that allows the reporting financial institution to determine the account holder's residence for tax purposes and confirm the reasonableness of the self-certification based on the information obtained by the reporting financial institution in connection with the opening of the account, including any documentation collected pursuant to AML/KYC procedures, and
    - if the self-certification that is obtained indicates that the account holder is resident in a reportable jurisdiction, treat the account as a reportable account unless it

reasonably determines, based on information in its possession or information that is publicly available, that the account holder is not a reportable person with respect to the reportable jurisdiction; and

- with respect to an account holder of a new entity account (including an entity that is a reportable person), the reporting financial institution must determine whether the account holder is a passive NFE with one or more controlling persons who are reportable persons and if so, treat the account as a reportable account, and for the purposes of
    - determining whether the account holder is a passive NFE, the reporting financial institution must obtain a self-certification from the account holder to establish its status, unless it has information in its possession or information is publicly available, based on which it can reasonably determine that the account holder is
        - an active NFE, or
            - a financial institution other than an entity that is an "investment entity" because of paragraph (b) of that definition, and is not a participating jurisdiction financial institution,
    - determining the controlling persons of an account holder, a reporting financial institution may rely on information collected and maintained pursuant to AML/KYC procedures, and
    - determining whether a controlling person of a passive NFE is a reportable person, a reporting financial institution may rely on a self-certification from the account holder or the controlling person.

If there is a change in circumstances with respect to a new entity account that causes the reporting financial institution to know, or have reason to know, that the self-certification or other documentation associated with an account is incorrect or unreliable, the reporting financial institution must re-determine the status of the account in accordance with the procedures for a pre-existing entity account.

Special due diligence procedures

ITA
277

This section contains special due diligence rules that reporting financial institutions are required to apply.

ITA
277(1)

Subsection 277(1) provides that a reporting financial institution may not rely on a self-certification or documentary evidence if the reporting financial institution knows or has reason to know that the self-certification or documentary evidence is incorrect or unreliable.

Exception – individual beneficiary receiving death benefit

ITA
277(2)

Subsection 277(2) provides that a reporting financial institution may presume that an individual beneficiary (other than the owner) of a cash value insurance contract or an annuity contract receiving a death benefit is not a reportable person and may treat the financial account as other than a reportable account unless it has actual knowledge, or reason to know, that the beneficiary is a reportable person.

Aggregation rules

ITA
277(3)

Subsection 277(3) contains the account aggregation rules that reporting financial institutions must follow for purposes of determining the aggregate balance or value of financial accounts.

Specifically, paragraph 277(3)(a) provides that, for the purposes of determining the aggregate balance or value of financial accounts held by an individual or entity,

- a reporting financial institution is required to aggregate all financial accounts maintained by the reporting financial institution, or by a related entity, to the extent that the reporting financial institution's computerized systems
    - link the financial accounts by reference to a data element such as a client number or TIN, and
    - allow account balances or values to be aggregated, and
- each holder of a jointly held financial account is attributed the entire balance or value of the jointly held financial account.

Paragraph 277(3)(b) provides that for the purposes of determining the aggregate balance or value of financial accounts held by an individual in order to determine whether a financial account is a high value account, a reporting financial institution is also required — in the case of any financial accounts that a relationship manager knows, or has reason to know, are directly or indirectly owned, controlled or established (other than in a fiduciary capacity) by the same individual — to aggregate all such accounts.

Dealer accounts

ITA
277(4) and (5)

Subsections 277(4) and (5) provide for the purposes of Part XIX equivalent rules to the rules in subsections 265(7) and (8) which apply for the purposes of Part XVIII. Subsection 277(4) provides that subsection 277(5) applies to a reporting financial institution in respect of a client name account maintained by the institution if the property recorded in the account is also recorded in a related account maintained by a dealer and the dealer has advised the institution

whether the related account is a reportable account, unless the institution can reasonably conclude that the dealer has failed to comply with its due diligence obligations under this Part. If subsection 277(5) applies, the institution is not required to comply with the due diligence obligations under subsections 272 to 276 in respect of the account and shall rely on the determination of the dealer in determining whether the account is a reportable account.

Group insurance and annuities

ITA
277(6)

Subsection 277(6) provides an alternative procedure that applies to certain group insurance contracts and group annuity contracts.

Specifically, subsection 277(6) provides that a reporting financial institution may treat a financial account that is a member's interest in a group cash value insurance contract or group annuity contract as a financial account that is not a reportable account until the day on which an amount becomes payable to the employee, certificate holder or beneficiary, if the financial account meets the following requirements:

- the group cash value insurance contract or group annuity contract is issued to an employer and covers 25 or more employees or certificate holders;
- the employees or certificate holders are entitled to
  - receive any contract value related to their interest, and
  - to name beneficiaries for the benefit payable upon the employee or certificate holder's death; and
- the aggregate amount payable to any employee or certificate holder or beneficiary does not exceed 1 million USD.

Reporting

ITA
278(1)

Subsection 278(1) requires every reporting financial institution that maintains a reportable account at any time during a calendar year and after June 30, 2017 to file an information return with the Minister of National Revenue before May 2 of the next year.

Electronic filing

ITA
278(2)

Subsection 278(2) requires every reporting financial institution that is required to file an information return under subsection 278(1) to file the return electronically.

Record keeping

ITA
279(1)

Subsection 279(1) requires every reporting financial institution to maintain adequate records, including self-certifications and records of documentary evidence, to enable the Minister of National Revenue to determine whether the institution has complied with its obligations under Part XIX.

Form of records

ITA
279(2)

Subsection 279(2) requires every reporting financial institution that keeps records in an electronic format to retain the records in an electronically readable format for the retention period referred to in subsection 279(3).

Retention of records

ITA
279(3)

Subsection 279(3) requires every reporting financial institution that keeps, obtains or creates records for the purpose of complying with Part XIX to retain those records for, in the case of a self-certification, six years following the day on which the related financial account is closed, or in the case of any other record, six years from the end of the last calendar year in respect of which the record is relevant.

Anti-avoidance

ITA 280

Section 280 provides an anti-avoidance rule. This rule provides that where a person enters into an arrangement or engages in a practice, the primary purpose of which is to avoid an obligation under Part XIX, the person is subject to the obligation as if the person had not entered into the arrangement or engaged in the practice.

Production of TIN

ITA
281(1)

New subsection 281(1) of the Act provides that a reportable person's taxpayer identification number, or "TIN" (the number used by the Minister to identify an individual or entity), must be provided at the request of any person required to make an information return requiring the TIN.

New subsection 281(1) comes into force on July 1, 2017.

Confidentiality of TIN

ITA
281(2)

New subsection 281(2) of the Act provides that a person that is required to make an information return requiring a reportable person's TIN shall not knowingly use, communicate or allow to be communicated, otherwise than as required or authorized under the Act or regulations, the TIN, without written consent of the reportable person.

New subsection 281(2) comes into force on July 1, 2017.

Penalty for failure to provide TIN

ITA
281(3)

New subsection 281(3) of the Act provides a $500 penalty for a failure by a reportable person to provide on request their TIN to any person that is required to make an information return in respect of the reportable person.

This new penalty will not apply where

- an application is made for the TIN within 90 days of the request and the number is subsequently provided to the requesting person within 15 days of receipt, or
- the reportable person is not eligible to obtain a TIN from the relevant reportable jurisdiction (for instance because the relevant reportable jurisdiction does not issue TINs).

New subsection 281(3) comes into force on July 1, 2017.

Assessment

ITA
281(4)

New subsection 281(4) of the Act empowers the Minister of National Revenue to assess the penalty provided for under subsection 281(3) and provides that the administrative provisions of Division I and J will apply. However, by excluding subsection 164(1.1) to (1.3), reportable persons will not be entitled to any repayment of a penalty in dispute by filing an objection.

New subsection 281(4) comes into force on July 1, 2017.

Amendments to the Income Application Rules

Clause 72

Depreciable Property

ITAR
20

Section 20 of the *Income Tax Application Rules* provides transitional rules for depreciable property acquired by a taxpayer before 1972.

Consequential on the repeal of the eligible capital property rules in the *Income Tax Act* and the introduction of the new Class 14.1 of Schedule II to the *Income Tax Regulations*, subsections 20(1) and (1.3) to (2) are amended to provide that they do not apply to property that was, at any time, eligible capital property.

These amendments come into force on January 1, 2017.

Clause 73

Goodwill and other nothings

ITAR
21

Section 21 of the *Income Tax Application Rules* provides transitional rules for the disposition of an eligible capital property that was owned before 1972. The rules no longer apply other than to certain property that is a “government right”.

Subsection 21(1) is amended to delete those portions that relate to property other than government rights.

Consequential on the repeal of section 14 of the *Income Tax Act* as part of the repeal of the eligible capital property rules, subsections 21(1) and (2.1) of the *Income Tax Application Rules* are amended to provide that the subsection applies for the purposes of sections 13 and 39 of the *Income Tax Act*, rather than section 14.

These amendments come into force on January 1, 2017.

Amendments to the Income Tax Regulations

Clause 74

Investment Income

ITR
201(1)(g)

Subsection 201(1) of the Regulations imposes a requirement on certain persons to provide annual information returns to the Canada Revenue Agency and taxpayers in respect of interest and dividend payments.

New paragraph 201(1)(g) provides that, where a person that is a financial company for the purposes of section 211 (whether acting as principal or as agent for the transferee) pays the portion of the price for which a debt obligation was transferred that is deemed by new subsection 20(14.2) of the Act to be interest that accrued on the debt obligation, that person is required to make an information return.

This amendment comes into force on January 1, 2017.

Annual interest accrual

ITR
201(4)

Subsection 201(4) of the Regulations requires every person or partnership that is indebted under certain "investment contracts" to which subsection 12(4) of the Act and paragraph 201(1)(b) apply to file an annual information return. Subsection 12(4) of the Act generally applies in respect of accrued interest on investment contracts held by individuals. Paragraph 201(1)(b) describes certain payments made as or on account of interest in respect of which the payor is required to file an information return under subsection 201(1).

Amended subsection 201(4) clarifies that it does not apply to an amount to which paragraph 201(1)(g) applies.

This amendment comes into force on January 1, 2017.

Clause 75

Security transactions

ITR
230(1)

"security"

Section 230 of the Regulations provides for a reporting requirement in respect of transactions in securities.

Subsection 230(1) contains a definition of "security". This definition is amended to include in new paragraph 230(1)(c.1) a debt obligation that is, at any time, described in paragraph 7000(1)(d).

This amendment comes into force on January 1, 2017.

Clause 76

Elections

ITR
600

Section 600 of the Regulations prescribes provisions of the *Income Tax Act* for the purposes of obtaining permission to amend, revoke or extend the time to file an election, which Ministerial discretion may be exercised under subsection 220(3.2) of the Act.

Paragraph 600(a) is amended to remove a reference to subsection 14(6), consequential on the repeal of section 14 as part of the repeal of the eligible capital property rules.

This amendment comes into force on January 1, 2017.

Clause 77

Allowances in respect of investment in property in Canada

ITR
808(2)

Part XIV of the Act imposes a tax on non-resident corporations carrying on a business in Canada through a branch. The purpose of this tax is to put those non-resident corporations in a similar position for Canadian tax purposes as are non-residents that carry on business in Canada indirectly through a Canadian subsidiary.

Branch tax is levied at a flat rate of 25% on a non-resident corporation's taxable income from Canadian sources, with certain adjustments, including an allowance for its investment in property in Canada. A corporation's allowance for investment in property in Canada is computed under section 808 of the Regulations.

Subsection 808(1) of the Regulations computes the allowance for investment in property in Canada for all non-resident corporations for the purpose of paragraph 219(1)(j) of the Act. Subsection 808(2) of the Regulations computes the amount of a corporation's "qualified investment in property in Canada" for the purposes of subsection 808(1).

ITR
808(2)(c)

Paragraph 808(2)(c) of the Regulations adds to a corporation's "qualified investment in property in Canada" an amount equal to 4/3 of the cumulative eligible capital of the corporation immediately after the end of the year in respect of each business carried on by it in Canada.

Paragraph 808(2)(b) provides a similar rule in respect of depreciable property based on the cost amount of the depreciable property.

Paragraph 808(2)(c) is repealed consequential on the repeal of the eligible capital property rules. As a result, amounts previously added to a corporation's "qualified investment in property in Canada" under paragraph 808(2)(c) will generally be included under paragraph 808(2)(b).

This amendment comes into force on January 1, 2017.

ITR
808(2)(l)(iii)

Subparagraph 808(2)(l)(iii) of the Regulations deducts from a corporation's "qualified investment in property in Canada" an amount equal to each amount owing by the corporation on account of an eligible capital expenditure made or incurred by the corporation before the end of the year in respect of a business carried on by it in Canada.

Subparagraph 808(2)(l)(i) provides a similar rule in respect of depreciable property based on the purchase price of the property.

Subparagraph 808(2)(l)(iii) is repealed consequential on the repeal of the eligible capital property rules. As a result, amounts previously deducted from a corporation's "qualified investment in property in Canada" under subparagraph 808(2)(l)(iii) will generally be deducted under subparagraph 808(2)(l)(i).

This amendment comes into force on January 1, 2017.

Clause 78

Capital cost allowance

ITR
1100

Part XI of the Regulations provides rules relating to capital cost allowance.

Rates

ITR
1100(1)(a)(xii.1)

Subsection 1100(1) of the Regulations sets out the rates of capital cost allowance that taxpayers may claim under paragraph 20(1)(a) of the Act with respect to specified classes of depreciable property.

New subparagraph 1100(1)(a)(xii.1) provides that (subject to subsection 1100(2), which provides the half-year rule) a taxpayer is allowed to deduct an amount, in respect of property of new Class 14.1, not exceeding 5% of the undepreciated capital cost to the taxpayer at the end of the taxation year of property of the class.

An additional allowance is also available under new paragraph 1100(1)(c.1) in respect of Class 14.1 property acquired before January 1, 2017. For more information, see the commentary under paragraph 1100(1)(c.1).

Subparagraph 1100(1)(a)(xii.1) comes into force on January 1, 2017.

Additional allowances – Class 14.1

ITR
1100(1)(c.1)

New paragraph 1100(1)(c.1) of the Regulations provides an additional allowance in respect of Class 14.1 property of a business acquired before January 1, 2017. For taxation years that end before 2027, paragraph 1100(1)(c.1) allows a taxpayer an additional allowance of 2% of the undepreciated capital cost (UCC) of the class at the beginning of January 1, 2017, less the total of any amounts deducted under this paragraph in preceding taxation years and three times any amounts added to the UCC of the class under subsection 13(39) of the Act (which represents the amount of reductions to the UCC as a result of amounts received to which the relieving provision in subsection 13(39) applies – for further information, see the commentary on subsection 13(39) of the Act).

Further, if the total of that additional allowance and the amount deductible under subparagraph 1100(1)(a)(xii.1) is less than $500, the additional allowance may be increased to allow $500 total

capital cost allowance for the class. However, in no case may the additional allowance for a taxation year exceed the UCC of the class at the beginning of January 1, 2017 (net of additional allowances for preceding years), nor may the additional allowance cause the total amount deductible under paragraph 20(1)(a) of the Act for the year in respect of the class to exceed the UCC balance (before taking any such deduction).

Paragraph 1100(1)(c.1) comes into force on January 1, 2017.

Clause 79

Canadian renewable and conservation expense

ITR
1219(2)(b)(iv) and (v)

Section 1219 of the Regulations defines “Canadian renewable and conservation expense” (CRCE) for the purposes of subsection 66.1(6) of the Act. Subsection 1219(2) excludes certain listed amounts from being CRCE under subsection 1219(1).

Subparagraph 1219(2)(b)(iv) provides that a CRCE does not include an expense that, but for section 1219, would be included in the capital cost of depreciable property, except as provided by paragraph 1219(1)(b), (d), (e), (f), or (g).

Subparagraph 1219(2)(b)(iv) is amended to provide that it does not apply in respect of depreciable property described in Class 14.1 of Schedule II to the Regulations.

Subparagraph 1219(2)(b)(v) provides that a CRCE does not include an expense that, but for section 1219, would be an eligible capital expenditure, except as provided by any of paragraphs 1219(1)(a) to (e). The reference to eligible capital expenditure in subparagraph 1219(2)(b)(v) is replaced by a reference to property described in Class 14.1 of Schedule II to the Regulations.

These amendments are consequential on the repeal of the eligible capital property rules and the creation of new Class 14.1.

These amendments come into force on January 1, 2017.

Clause 80

Insurer – net investment revenue

ITR
2411(4)

Subsection 2411(4) of the Regulations sets out the rules for determining an insurer's net investment revenue for the purposes of computing the insurer's minimum net revenue in subsections 2411(1) and (3) of the Regulations.

Paragraph (h) of the description of A in subsection 2411(4) and paragraph (h) of the description of B in subsection 2411(4), which are related to income inclusions under subsection 14(1) and deductions under paragraph 20(1)(b), are repealed consequential on the repeal of the eligible capital property rules and the introduction of new Class 14.1.

Similar rules in respect of depreciable property are provided under paragraphs (c) and (e) of the description of A in subsection 2411(4) and paragraphs (a) and (d) of the description of B in subsection 2411(4).

These repeals come into force on January 1, 2017.

Clause 81

Prescribed amounts

ITR
7300

Section 7300 of the Regulations prescribes certain amounts for the purposes of paragraph 12(1)(x) of the Act. An inducement, reimbursement or other form of benefit that is prescribed is not included in computing the income of a business or property under paragraph 12(1)(x).

Section 7300 is amended by adding paragraph (d), to include an emissions allowance issued to a taxpayer under the laws of a government of Canada or a province.

The amendment to section 7300 applies in respect of emissions allowances acquired in taxation years that begin after 2016. However, if a taxpayer elects in their income tax return for the 2016 or 2017 taxation year then the amendment to section 7300 - as well as the amendments in respect of emissions allowances in section 248(1) (including to the definition “inventory”)and new section 27.1 - will apply to taxation years that end after 2012.

Clause 82

Permanent establishment

ITR
8201

Section 8201 of the Regulations provides a definition of the term “permanent establishment” for the purposes of various provisions in the Act.

Section 8201 is amended to add a reference to new section 233.8 of the Act. For more information, see the commentary on new section 233.8.

The amendment to section 8201 applies to “reporting fiscal years” of “MNE groups” (both as defined in new subsection 233.8(1) of the Act) that begin on or after January 1, 2016.

Clause 83
Prescribed non-reporting financial institution

ITR
9005

New section 9005 of the *Income Tax Regulations* prescribes as non-reporting financial institutions for the purposes of the definition “non-reporting financial institution” in subsection 270(1) of the Act, the following entities:

- a labour-sponsored venture capital corporation as prescribed in section 6701;
- a registered retirement savings plan;

- a registered retirement income fund;
- a pooled registered pension plan;
- a deferred profit sharing plan;
- a registered disability savings plan;
- a registered education savings plan;
- a registered pension plan; and
- a trust governed by a registered pension plan;
- a trust described in paragraph 149(1)(o.4) of the Act (*i.e.*, certain master trusts), if all of the interests in the trust as a beneficiary are held by one or more registered pension plans;
- a corporation described in clause 149(1)(o.1)(i)(A) or subparagraphs 149(1)(o.1)(ii) or 149(1)(o.2)(i) of the Act (*i.e.*, certain pension corporations);
- a corporation described in any of subparagraphs 149(1)(o.2)(ii) to (iii) of the Act (*i.e.*, certain pension corporations), if all of the shares of the corporation are held by
  - one or more registered pension plans or trusts governed by registered pension plans,
  - one or more trusts described above where all of the interests in the trusts are held by one or more pension plans, or
  - one or more corporations described in paragraph (l), or described in clause 149(1)(o.1)(i)(A) or subparagraphs 149(1)(o.1)(ii) or 149(1)(o.2)(i) of the Act;
- a trust, if all of the interests in the trust as a beneficiary are held by one or more
  - trusts governed by a registered pension plan
  - corporations described in clause 149(1)(o.1)(i)(A) or subparagraphs 149(1)(o.1)(ii) or 149(1)(o.2)(i) of the Act;
  - corporations described in any of subparagraphs 149(1)(o.2)(ii) to (iii) of the Act, if all of the shares of the corporation are held by
    - one or more registered pension plans or trusts governed by registered pension plans,
    - one or more trusts described above where all of the interests in the trusts are held by one or more pension plans, or
    - one or more corporations described in paragraph (l), or described in clause 149(1)(o.1)(i)(A) or subparagraphs 149(1)(o.1)(ii) or 149(1)(o.2)(i) of the Act;
- a central cooperative credit society, as defined in section 2 of the *Cooperative Credit Association Act* and whose accounts are maintained for member financial institutions; and
- a TFSA.

This amendment to the *Income Tax Regulations* comes into force on July 1, 2017.

Prescribed excluded accounts

ITR
9006

New section 9006 of the *Income Tax Regulations* prescribes as excluded accounts for the purposes of the definition “excluded account” in subsection 270(1) of the Act, the following accounts:

- a registered retirement savings plan;
- a registered retirement income fund;
- a pooled registered pension plans;
- a registered pension plan;
- a registered disability savings plan;
- a registered education savings plan;
- a deferred profit sharing plan;
- a net income stabilization account, including a NISA Fund No. 2;
- an eligible funeral arrangement;
- a dormant account if the balance or value of the account does not exceed 1,000 USD; and
- a TFSA

This amendment to the *Income Tax Regulations* comes into force on July 1, 2017.

Clause 84

Capital cost allowance – prescribed classes

ITR
Schedule II

Schedule II to the Regulations lists the properties that can be included in each capital cost allowance (CCA) class. A portion of the capital cost of depreciable property is deductible as CCA each year. CCA rates for each type of property, identified by their CCA classes, are set out in section 1100 of the Regulations.

New Class 14.1 (5% CCA rate) applies to certain intangible properties that would otherwise not be included in any other class. The description of property in the class is based in principle on the definition “eligible capital expenditure” in former subsection 14(5) of the Act. This class includes goodwill and property that was eligible capital property of the taxpayer immediately before January 1, 2017 and owned by the taxpayer at the beginning of January 1, 2017.

The class also includes property, in respect of a business, acquired on or after January 1, 2017, other than

(i) property that is tangible property or corporeal property,
(ii) property that is not acquired for the purpose of gaining or producing income from business,
(iii) property in respect of which any amount is deductible (otherwise than as a result of being included in this class) in computing the taxpayer’s income from the business,
(iv) property in respect of which any amount is not deductible in computing the taxpayer’s income from business because of any provision of the Act (other than paragraph 18(1)(b)) or the Regulations,
(v) an interest in a trust,
(vi) an interest in a partnership,

(vii) a share, bond, debenture, mortgage, hypothecary claim, note, bill or other similar property, or

(viii) an interest in, or for civil law a right in, or a right to acquire a property described in any of (i) to (vii).

Subsection 1101(1) of the Regulations provides for a separate class in respect of each business of a taxpayer. This is consistent with the application of the former eligible capital property rules, which provided for a separate cumulative eligible capital pool for each business of a taxpayer.

This amendment comes into force on January 1, 2017.

Amendments to Related Legislation

Clause 85

Canada Pension Plan Regulations

The definition "child tax benefit" in subsection 37(1) of the *Canada Pension Plan Regulations* is repealed and the definition "Canada child benefit" is added consequential to the introduction of the Canada child benefit.

This amendment is deemed to have come into force on July 1, 2016.

Clause 86

Replacement of "Child Tax Benefit"

Employment Insurance Act

The references to "Child tax benefit" are replaced by "Canada child benefit" in the *Employment Insurance Act* consequential to the introduction of the Canada child benefit.

Clause 87

Replacement of "Child Tax Benefit" or "Canada child tax benefit"

Various Regulations

Subsection 87(1) amends the *Canada Pension Plan Regulations* to replace "Child tax benefit" with "Canada child benefit" consequential to the introduction of the Canada child benefit.

Subsection 87(2) amends the *Employment Insurance Regulations* to replace "Child tax benefit" with "Canada child benefit" consequential to the introduction of the Canada child benefit.

Subsection 87(3) amends the *Immigration and Refugee Protection Regulations* to replace "Canada child tax benefit" with "Canada child benefit" consequential to the introduction of the Canada child benefit.

Clause 88

These amendments in clauses 86 and 87 are deemed to have come into force on July 1, 2016.

Part 2 – Amendments to the Excise Tax Act and Other Related Texts
Excise Tax Act

Clause 89

Definitions

ETA
123(1)

Subsection 123(1) of the *Excise Tax Act* (the Act) defines terms used in Part IX of the Act and in the Schedules to the Act relating to the goods and services tax/harmonized sales tax (GST/HST).

Subclauses 89(1)

Definition "capital property"

ETA
123(1)

The existing definition "capital property" for GST/HST purposes in the Act largely parallels the definition "capital property" in the *Income Tax Act*. As a result, property of a person is capital property for GST/HST purposes if the property is also capital property for income tax purposes or would be capital property for income tax purposes if the person were a taxpayer under the *Income Tax Act*, except for property belonging to Class 12, 14, or 44 of Schedule II to the *Income Tax Regulations*. Since property that is currently eligible capital property (ECP) is effectively excluded from capital property under the *Income Tax Act*, ECP is also currently excluded from capital property for GST/HST purposes.

Changes to the *Income Tax Act* to repeal the current ECP regime and replace it with a new capital cost allowance class – Class 14.1 – will result in all ECP becoming capital property under the *Income Tax Act* effective January 1, 2017. As a result, without amending the definition "capital property" for GST/HST purposes, these changes would also make ECP become capital property for GST/HST purposes.

The definition "capital property" for GST/HST purposes in the Act is amended to exclude property described in new Class 14.1 of Schedule II to the *Income Tax Regulations*. This amendment provides for property that was ECP under the *Income Tax Act* immediately prior to January 1, 2017 to remain excluded from the definition of capital property for GST/HST purposes as of January 1, 2017.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Subclauses 89(2) and (3)

Definition “qualifying subsidiary”

ETA
123(1)

The definition “qualifying subsidiary” in subsection 123(1) of the Act is relevant for the concept of closely related corporations contained in section 128 of the Act. The definition “qualifying subsidiary” is amended to add a new requirement for determining whether a subsidiary corporation is a qualifying subsidiary of a parent corporation. This new requirement stipulates that the parent corporation must, in addition to meeting the existing requirements, hold qualifying voting control in respect of the subsidiary corporation in order for the subsidiary corporation to be considered a qualifying subsidiary. This amendment and the meaning of qualifying voting control are further explained in the commentary on subsections 128(1), (1.1) and (4).

This amendment applies as of March 22, 2017. It also applies as of March 23, 2016 in respect of an election under subsection 150(1) or 156(2) of the Act that is to become effective on a day that is after March 22, 2016 but before March 22, 2017, unless the election is filed on or before March 22, 2016. It also applies as of March 23, 2016 for the purpose of applying paragraphs 4(3)(b) and (c) of the *Financial Services and Financial Institutions (GST/HST) Regulations* in respect of a supply of a service if two conditions are satisfied. First, the agreement for the supply must be entered into after March 22, 2016 but before March 22, 2017. Second, it must not be the case that all or substantially all of the service will be performed before March 22, 2017.

Clause 90

Closely related corporations

ETA
128

Section 128 of the Act contains rules for determining whether two corporations are considered to be closely related for the purposes of Part IX of the Act.

Subclause 90(1)

Closely related corporations

ETA
128(1)

Existing subsection 128(1) states that a corporation is considered to be closely related to another corporation if there is a degree of common ownership of at least 90 per cent.

Subsection 128(1) is amended to add a new requirement that must be satisfied in order for a particular corporation to be considered closely related to another corporation. As a result of this amendment, in addition to the existing requirements, the particular corporation will be closely

related to the other corporation if qualifying voting control in respect of the other corporation is held by:

- the particular corporation;
- a qualifying subsidiary (as defined in subsection 123(1) of the Act) of the particular corporation;
- another corporation of which the particular corporation is a qualifying subsidiary;
- a qualifying subsidiary of a corporation of which the particular corporation is a qualifying subsidiary; or
- any combination of the above corporations or subsidiaries.

This amendment and the meaning of qualifying voting control are further explained in the commentary on subsections 128(1.1) and (4).

This amendment applies as of March 22, 2017. It also applies as of March 23, 2016 in respect of an election under subsection 150(1) or 156(2) of the Act that is to become effective on a day that is after March 22, 2016 but before March 22, 2017, unless the election is filed on or before March 22, 2016. It also applies as of March 23, 2016 for the purpose of applying paragraphs 4(3)(b) and (c) of the *Financial Services and Financial Institutions (GST/HST) Regulations* in respect of a supply of a service if two conditions are satisfied. First, the agreement for the supply must be entered into after March 22, 2016 but before March 22, 2017. Second, it must not be the case that all or substantially all of the service will be performed before March 22, 2017.

Subclauses 90(2) and (3)

Qualifying voting control

ETA
128(1.1) and (4)

Section 128 is amended by adding new subsections 128(1.1) and (4) that together set out the rules for the new concept of qualifying voting control. Concurrently with these amendments, subsection 128(1) of the Act is amended to incorporate the concept of qualifying voting control into the test for determining closely related status under that subsection. Similarly, the definition of qualifying subsidiary in subsection 123(1) of the Act, subsection 156(1.1) of the Act and section 3 of the *Closely Related Corporations (GST/HST) Regulations* are also amended to incorporate the concept of qualifying voting control into the tests for determining closely-related status under those provisions.

New subsection 128(1.1) applies for the purposes of Part IX of the Act. It stipulates that a person or a group of persons holds qualifying voting control in respect of a corporation if the person or the group, as the case may be, satisfies the requirements under paragraph 128(1.1)(a). Alternatively, under paragraph 128(1.1)(b), a person or a group of persons is considered to hold

qualifying voting control in respect of a corporation if the person or the group, as the case may be, is a prescribed person or group in relation to the corporation. Currently, no person or group is proposed to be prescribed.

Under new paragraph 128(1.1)(a), a person or a group of persons holds qualifying voting control in respect of a corporation if that person, or the members of the group collectively, as the case may be, own shares of the corporation to which are attached not less than 90 per cent of the shareholder votes that may be cast in respect of each matter of the corporation, other than two types of excluded matters. The first type of excluded matter, described in subparagraph 128(1.1)(a)(i), is any matter for which a statute of a country, or of a state, province, or other political subdivision of a country, that applies to the corporation provides, in respect of the vote of the shareholders of the corporation on the matter, that any shareholder of the corporation has voting rights that are different from the voting rights that the shareholder would otherwise have under the constating instruments of the corporation. This includes any matter for which a statute of a country, or of a state, province, or other political subdivision of a country, that applies to the corporation provides that holders of a class or series of shares of the corporation are entitled to vote separately as a class or series. The second type of excluded matter, described in subparagraph 128(1.1)(a)(ii), is any prescribed matter or any matter that meets prescribed conditions or arises in prescribed circumstances. Currently, no matter is proposed to be prescribed.

New Subsection 128(4) contains a rule that applies in determining whether a person or group of persons holds qualifying voting control in respect of a corporation under new subsection 128(1.1) in certain circumstances where the voting rights held by the person or group are controlled by another person.

For the purposes of making such a determination, new subsection 128(4) deems a particular person not to own a share of the corporation at a particular time if certain conditions are satisfied. The conditions are satisfied if another person that is not closely related to the particular person at the particular time has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to control the voting rights attached to the share. However, the conditions are not satisfied if the right is not exercisable at the particular time because exercise of the right is contingent on the death, bankruptcy or permanent disability of an individual.

New subsections 128(1.1) and (4) are deemed to have come into force on March 23, 2016.

Clause 91

Closely related persons

ETA
156(1.1)

Subsection 156(1.1) of the Act contains rules for determining whether two Canadian partnerships, or a Canadian partnership and a corporation, are closely related for the purposes of section 156. Paragraph 156(1.1)(a) provides the rules for determining whether two Canadian

partnerships are closely related. Paragraph 156(1.1)(b) provides the rules for determining whether a Canadian partnership is closely related to a corporation.

Certain portions of subsection 156(1.1) contain a test that is based on a degree of common ownership of at least 90 per cent. Those portions of subsection 156(1.1) are amended to add the concept of qualifying voting control as a requirement in determining closely related status for the purposes of section 156. These amendments are made to ensure consistency with the closely related corporations rules in section 128 of the Act that are concurrently amended to introduce and incorporate the concept of qualifying voting control. These amendments and the meaning of qualifying voting control are further explained in the commentary on subsections 128(1), (1.1), and (4).

These amendments apply as of March 22, 2017. They also apply as of March 23, 2016 in respect of an election under subsection 156(2) that is to become effective on a day that is after March 22, 2016 but before March 22, 2017, unless the election is filed on or before March 22, 2016.

Clause 92

Period for assessment

ETA
298

Existing section 298 of the Act sets out the limitation periods for assessments and reassessments under Part IX of the Act.

The amendments to section 298 described below come into force on the day on which the Act implementing this clause receives royal assent, except that they do not apply in respect of appeals instituted on or before that day.

Subclause 92(1)

Exception

ETA
298(3)

Existing subsection 298(3) overrides the normal limitation period for reassessments made to give effect to a decision on an objection or an appeal and for reassessments made for the purpose of disposing of a person’s appeal with their written consent.

Subsection 298(3) is amended by adding new paragraph (c), which provides that the normal limitation period is also overridden to give effect to an alternative basis or argument advanced by the Minister of National Revenue under amended subsection 298(6.1).

Subclause 92(2)

Alternative basis or argument

ETA
298(6.1)

Existing subsection 298(6.1) provides in certain circumstances that the Crown has the right, on an appeal of a GST/HST assessment, to advance an alternative argument in support of that assessment even if the normal reassessment period has expired.

In light of a recent court decision that called into question the scope of this right, subsection 298(6.1) is amended to clarify that an alternative basis or argument may be advanced in support of an assessment of a person or in support of all or any portion of the total amount determined on assessment to be payable or remittable by a person under Part IX of the Act. This would allow, for instance, a reduced liability in relation to one item included in the computation of an assessment to be offset by an increased liability in relation to another item. The existing protection for taxpayers under subsection 298(6.1), which provides that an alternative basis or argument nevertheless cannot be advanced to the prejudice of the right of a taxpayer to introduce relevant evidence to rebut the alternative basis or argument, is unaffected by this amendment.

Subclause 92(3)

Limitation

ETA
298(6.2)

New subsection 298(6.2) sets out a limitation in relation to a reassessment of a person that is made to give effect to an alternative basis or argument in support of a particular assessment of a person advanced by the Minister of National Revenue under subsection 298(6.1). Under this limitation rule, if the reassessment of the person is made at any time after the normal reassessment period under subsection 298(1) or (2), the Minister shall not reassess for an amount that is greater than the total amount of the particular assessment.

Exception

ETA
298(6.3)

New subsection 298(6.3) sets out an exception to the rule in new subsection 298(6.2). In particular, subsection (6.3) provides that, if the following condition is met in relation to any portion of an amount determined on reassessment to be payable or remittable, subsection (6.2) does not apply to that portion. The condition to be met is that, if Part IX of the Act were read without reference to subsection 298(6.1), the Minister of National Revenue would be entitled to reassess the portion of the amount after the normal reassessment period under subsection 298(1) or (2). In other words, if the Minister is permitted under Part IX to reassess an amount without the application of the rule in subsection (6.1), which allows the Minister to advance an

alternative basis or argument after the normal reassessment period, then subsection (6.2) does not prevent the Minister from reassessing that amount.

Clause 93

Call centre services

ETA
Sch. VI, Pt. V, section 23.1

New section 23.1 of Part V of Schedule VI to the Act has the effect of zero-rating a supply of a service of rendering to individuals technical or customer support by means of telecommunications (e.g., by telephone, email or web chat) if the service is supplied to an unregistered non-resident person that is not a consumer of the service.

Section 23.1 excludes certain agents' services and advisory, consulting and professional services. Instead, such supplies may be zero-rated under existing sections 5 and 23 of Part V of Schedule VI to the Act, respectively, if the conditions under the relevant section are satisfied.

New section 23.1 applies to any supply made after March 22, 2016 and to any supply made on or before that day if the supplier did not, on or before that day, charge, collect or remit an amount as or on account of tax under Part IX of the Act in respect of the supply.

Clause 94

Transitional provision

ETA
150

This provision includes a transitional rule that adds an exception in subsection 150(2) of the Act in respect of elections made under subsection 150(1) in certain circumstances. Subsection 150(1) entitles two corporations that are members of the same closely related group that includes a listed financial institution to make an election to treat certain supplies of property and services between them as exempt supplies of financial services. As a result of the application of the transitional rule, subsection 150(1) does not apply to a supply made between a person and a corporation that made an election under that subsection if certain conditions are satisfied.

First, the election must have been in effect on March 22, 2016 and on the day on which the agreement for the supply is entered into. Second, the agreement for the supply must have been entered into after March 22, 2016 but before March 22, 2017. Third, if the supply is a supply of a service, it must not be the case that all or substantially all of the service will be performed before March 22, 2017. Alternatively, the third condition is satisfied if the supply is a supply of property by way of lease, licence or similar arrangement and it is not the case that all or substantially all of the property will be delivered or made available to the recipient of the supply before March 22, 2017. The final condition is satisfied if the person and the corporation are not members of the same closely related group at any time that is after the day on which the agreement for the supply is entered into but that is before March 22, 2017. Alternatively, this

final condition is satisfied if the person and the corporation are not members of the same closely related group on March 22, 2017.

Closely Related Corporations (GST/HST) Regulations

Clause 95

Prescribed corporations

Closely Related Corporations (GST/HST) Regulations
3

Section 3 of the *Closely Related Corporations (GST/HST) Regulations* (the Regulations) contains rules for determining whether two corporations are considered to be prescribed as closely related for purposes of Part IX of the Act. Portions of section 3 rely on a test that is based on a degree of common ownership of at least 90 per cent. Those portions of Section 3 are amended to add the concept of qualifying voting control as a requirement in determining closely related status under Part IX of the Act. The meaning of qualifying voting control is further explained in the commentary on subsections 128(1), (1.1) and (4).

These amendments apply as of March 22, 2017. They also apply as of March 23, 2016 in respect of an election under subsection 150(1) or 156(2) of the Act that is to become effective on a day that is after March 22, 2016 but before March 22, 2017, unless the election is filed on or before March 22, 2016. They also apply as of March 23, 2016 for the purpose of applying paragraphs 4(3)(b) and (c) of the *Financial Services and Financial Institutions (GST/HST) Regulations* in respect of a supply of a service if two conditions are satisfied. First, the agreement for the supply must be entered into after March 22, 2016 but before March 22, 2017. Second, it must not be the case that all or substantially all of the service will be performed before March 22, 2017.

Streamlined Accounting (GST/HST) Regulations

Clause 96

Definitions

Streamlined Accounting (GST/HST) Regulations
2(1)

Existing subsection 2(1) of the *Streamlined Accounting (GST/HST) Regulations* (the “Regulations”) contains definitions of terms used in the Regulations.

“eligible capital property”

The definition “eligible capital property” in subsection 2(1) of the Regulations is repealed. This repeal is made as a consequence of the repeal of the eligible capital property rules under the *Income Tax Act*, including the repeal of the definition “eligible capital property” in subsection 248(1) of that Act, and the creation of a new capital cost allowance class under that Act (i.e., Class 14.1 in Schedule II to the *Income Tax Regulations*). Under the existing GST/HST streamlined accounting rules, “eligible capital property” and “capital assets”, as defined in

subsection 2(1), are subject to similar treatment. Accordingly, to maintain this similar treatment subsequent to the repeal of the definition “eligible capital property”, property that was formerly included under that definition will now be included under the definition “capital asset”.

This amendment applies in respect of supplies made after 2016.

“capital asset”

The definition “capital asset” in subsection 2(1) of the Regulations is amended by setting out the existing meaning of “capital asset” under new paragraph (a) of the definition and by adding new paragraph (b). As a result of the creation of new Class 14.1 in Schedule II of the *Income Tax Regulations*, property that was formerly included in the definition “eligible capital property” in subsection 2(1) will become capital property within the meaning of the *Income Tax Act* and therefore will now be included under paragraph (a) of the definition “capital asset”.

New paragraph (b) includes certain other property within the meaning of capital asset. In particular, if a supply of property was made at any time before January 1, 2017 and the property was considered eligible capital property at that time within the meaning of the *Income Tax Act*, the property would not have been considered capital property within the meaning of that Act. As a result, the property would not fall under paragraph (a) of the definition “capital asset”. Accordingly, to maintain consistency under the GST/HST streamlined accounting rules for such property that was formerly included in the repealed definition “eligible capital property”, paragraph (b) results in the property being included in the definition “capital asset”.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Basic Threshold Amount

Streamlined Accounting (GST/HST) Regulations
2(2)

Existing subsection 2(2) of the Regulations sets out the formula to calculate the basic threshold amount for a reporting period of a registrant for the purposes of the Regulations. For a registrant that is using the Quick Method of Accounting, the basic threshold amount is relevant in determining the quick-method remittance rate of the registrant under subsection 15(5) of the Regulations.

The descriptions of A and B in the formula are amended to remove references to “eligible capital property” as a consequence of the repeal of the definition “eligible capital property” in subsection 2(1).

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Total Threshold Amount

Streamlined Accounting (GST/HST) Regulations
2(3)

Existing subsection 2(3) of the Regulations sets out the formulas to determine the total threshold amount for a reporting period of a registrant for the purposes of the Regulations. The total threshold amount is relevant in ascertaining the registrant's eligibility under section 16 of the Regulations to determine its net tax using the Quick Method of Accounting.

The descriptions of A and B in the formula in paragraph 2(3)(a) are amended to remove references to "eligible capital property" as a consequence of the repeal of the definition "eligible capital property" in subsection 2(1). Similarly, the descriptions of D and E in the formula in paragraph 2(3)(b) are amended to remove references to "eligible capital property" as a consequence of the repeal of the same definition.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Clause 97

Definitions

Streamlined Accounting (GST/HST) Regulations
15(1)

Existing subsection 15(1) of the Regulations contains definitions of terms used in Part IV of the Regulations, which relates to the Quick Method of Accounting for GST/HST.

"specified property"

The definition "specified property" in subsection 15(1) of the Regulations is amended to remove a reference to "eligible capital property" as a consequence of the repeal of the definition "eligible capital property" in subsection 2(1) of the Regulations.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

"specified supply"

Paragraph (a) of the definition "specified supply" in subsection 15(1) of the Regulations is amended to remove a reference to "eligible capital property" as a consequence of the repeal of the definition "eligible capital property" in subsection 2(1) of the Regulations.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Clause 98

Definitions

Streamlined Accounting (GST/HST) Regulations
19(1)

Existing subsection 19(1) of the Regulations contains definitions of terms used in Part V of the Regulations, which relates to the Special Quick Method of Accounting for GST/HST.

“specified property”

The definition “specified property” in subsection 19(1) of the Regulations is repealed. This repeal is made as a consequence of the repeal of the definition “eligible capital property” in subsection 2(1) of the Regulations. Other than eligible capital property, the existing meaning of specified property includes only capital assets of a registrant. Therefore, the defined term “specified property” is no longer needed and existing references to “specified property” in Part V of the Regulations are replaced with references to capital assets.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

“designated supply”

Paragraph (a) of the definition “designated supply” in subsection 19(1) of the Regulations is amended to remove a reference to “eligible capital property” as a consequence of the repeal of the definition “eligible capital property” in subsection 2(1) of the Regulations.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

“specified supply”

Paragraphs (b) and (c) of the definition “specified supply” in subsection 19(1) of the Regulations are amended to replace references to “specified property” with references to “capital assets” as a consequence of the repeal of the definition “specified property” in subsection 19(1) of the Regulations.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Special Quick-Method Rate – University or Public College

Streamlined Accounting (GST/HST) Regulations
19(3)(c)(i)

The description of B in the formula in subparagraph 19(3)(c)(i) of the Regulations is amended to replace a reference to “specified property” with a reference to “capital assets” as a consequence of the repeal of the definition “specified property” in subsection 19(1).

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Clause 99

Calculation of Net Tax

Streamlined Accounting (GST/HST) Regulations
21(1)

Existing subsection 21(1) of the Regulations sets out the calculation that generally applies to determine the net tax for a reporting period of a registrant if the registrant has elected to

determine its net tax using the Special Quick Method of Accounting set out under Part V of the Regulations.

Subparagraphs (a)(ii) and (iii) of the description of C in the first formula in subsection 21(1) are amended to replace references to “specified property” with references to “capital assets” as a consequence of the repeal of the definition “specified property” in subsection 19(1) of the Regulations.

This amendment comes into force, or is deemed to have come into force, on January 1, 2017.

Part 3 – Amendments to the Excise Act, 2001

Excise Act, 2001

Clause 100

Limitation period for assessments

EA, 2001
191

Existing section 191 of the *Excise Act, 2001* (the "Act") sets out the limitation periods for assessments and reassessments under the Act.

The amendments to section 191 described below come into force on the day on which the Act implementing this clause receives royal assent, except that they do not apply in respect of appeals instituted on or before that day.

Subclause 100(1)

Exception

EA, 2001
191(3)

Existing subsection 191(3) overrides the normal limitation period for reassessments made to give effect to a decision on an objection or an appeal and for reassessments made for the purpose of disposing of a person's appeal with their written consent.

Subsection 191(3) is amended by adding new paragraph (c), which provides that the normal limitation period is also overridden to give effect to an alternative basis or argument advanced by the Minister of National Revenue under amended subsection 191(7).

Subclause 100(2)

Alternative basis or argument

EA, 2001
191(7)

Existing subsection 191(7) provides in certain circumstances that the Crown has the right, on an appeal of an excise assessment, to advance an alternative argument in support of that assessment even if the normal reassessment period has expired.

In light of a recent court decision that called into question the scope of this right, subsection 191(7) is amended to clarify that an alternative basis or argument may be advanced in support of an assessment of a person or in support of all or any portion of the total amount determined on assessment to be payable or remittable by a person under the Act. This would allow, for instance, a reduced liability in relation to one item included in the computation of an assessment to be offset by an increased liability in relation to another item. The existing protection under

subsection 191(7), which provides that an alternative basis or argument nevertheless cannot be advanced to the prejudice of the right of a person to introduce relevant evidence to rebut the alternative basis or argument, is unaffected by this amendment.

Subclause 100(3)

Limitation

EA, 2001
191(7.1)

New subsection 191(7.1) sets out a limitation in relation to a reassessment of a person that is made to give effect to an alternative basis or argument in support of a particular assessment of a person advanced by the Minister of National Revenue under subsection 191(7). Under this limitation rule, if the reassessment of the person is made at any time after the normal reassessment period under subsection 191(1) or (2), the Minister shall not reassess for an amount that is greater than the total amount of the particular assessment.

Exception

EA, 2001
191(7.2)

New subsection 191(7.2) sets out an exception to the rule in new subsection 191(7.1). In particular, subsection (7.2) provides that, if the following condition is met in relation to any portion of an amount determined on reassessment to be payable or remittable, subsection (7.1) does not apply to that portion. The condition to be met is that, if the Act were read without reference to subsection 191(7), the Minister of National Revenue would be entitled to reassess the portion of the amount after the normal reassessment period under subsection 191(1) or (2). In other words, if the Minister is permitted under the Act to reassess an amount without the application of the rule in subsection (7), which allows the Minister to advance an alternative basis or argument after the normal reassessment period, then subsection (7.1) does not prevent the Minister from reassessing that amount.