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

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Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*, *Excise Tax Act*, *Excise Act, 2001* and related legislation. 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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Income Tax Act

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NISA Receipts

ITA
12(10.2)

Subsection 12(10.2) of the Act requires that a taxpayer's NISA receipts from a NISA Fund No. 2 be included in income, as provided for under the description A of the formula (A – B) in that subsection. The description of B of the formula in that subsection provides a reduction in the income inclusion, otherwise determined under that subsection, to the extent that the taxpayer has been previously deemed to receive amounts from the taxpayer's NISA Fund No. 2. One such deeming rule is subsection 104(14.1), which allows a spousal or common-law partner trust that holds a NISA Fund No.2 to elect with the legal representative of the deceased spouse or common-law partner beneficiary to treat certain deemed NISA Fund No. 2 receipts as having been received by the beneficiary and not the trust.

The description of B in subsection 12(10.2) is amended consequential on the repeal of subsection 104(14.1). For further information, see the commentary on subsection 104(14.1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 3

Eligible Capital Property

ITA
14

Section 14 of the Act provides rules concerning the tax treatment of expenditures and receipts of a taxpayer in respect of eligible capital properties. The definitions "qualified farm property" and "qualified fishing property" in subsection 110.6(1) are repealed and the new definition "qualified farm or fishing property" is introduced in order to better accommodate taxpayers involved in a combination of farming and fishing. Several consequential amendments are made to section 14, applicable to dispositions and transfers that occur in the 2014 and subsequent taxation years.

Election re Capital Gain

ITA
14(1.01) and (1.02)

Subsection 14(1.01) of the Act permits a taxpayer to elect, in the taxpayer's return of income for a taxation year, to report a capital gain on the disposition of a particular eligible capital property if the taxpayer can identify the cost of the particular property. Where a taxpayer makes the election, the taxpayer is deemed to have disposed of a capital property (with an adjusted cost base equal to that cost) for proceeds of disposition equal to the actual proceeds in respect of the particular property.

Subsection 14(1.01) does not allow a taxpayer to elect under that subsection in respect of property acquired before 1972. Subsection 14(1.02) allows a taxpayer to make a similar election in respect of property that would, if an outlay or expenditure were made after 1971 to acquire the property, be eligible for the election under subsection 14(1.01).

Paragraphs 14(1.01)(*c*) and (1.02)(*c*) provide that, where the eligible capital property is qualified farm property or qualified fishing property (within the meaning assigned by subsection 110.6(1)), the capital property deemed by subsections 14(1.01) or (1.02) to be disposed of is also deemed to be, at the time of the disposition, a qualified farm property or a qualified fishing property of the taxpayer. Paragraphs 14(1.01)(*c*) and (1.02)(*c*) are amended in order to replace those references with references to “qualified farm or fishing property”.

Deemed Taxable Capital Gain

ITA
14(1.1) and (1.2)

Subsections 14(1.1) and (1.2) of the Act deem certain amounts, included in an individual’s income in respect of eligible capital property and attributable to qualified farm property or qualified fishing property, to be taxable capital gains of the individual for the purposes of the capital gains exemption in section 110.6.

Subsection 14(1.1) is amended in order to replace certain references to “qualified farm property” and “qualified fishing property” with references to “qualified farm or fishing property”. Other references to “qualified farm property” (within the meaning of section 110.6) are retained, and references to “qualified fishing property” are added, because subsection 14(1.1) may apply in respect of dispositions that occur before the taxation year in respect of which the subsection applies. For this purpose, the terms “qualified farm property” and “qualified fishing property” will continue to have, in respect of dispositions of property in taxation years prior to 2014, the meaning they had at the time of the disposition.

Subsection 14(1.2) is repealed as section 14(1.1) now deals with both farming property and fishing property.

Clause 4

Partnerships

ITA
15(2.14)

Subsection 15(2.14) of the Act provides rules relating to partnerships for the purposes of the rules in subsection 15(2.11) and section 17.1 regarding pertinent loans or indebtedness.

Subsection 15(2.14) is amended to apply also for the purposes of subsection 18(5), which provides an exception from the thin capitalization rules for a loan or debt that funds a pertinent loan or indebtedness.

This amendment applies to taxation years that end after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Clause 5

Amount Owing by Non-Resident

ITA
17(1)

Subsection 17(1) of the Act generally applies where: a non-resident owes an amount to a corporation resident in Canada at any time in a particular taxation year of the corporation; the amount owing remains outstanding for more than one year; and the corporation does not include, in computing its income for the particular year, interest, computed at a reasonable rate, on the amount for the period in the particular year during which the amount was owing to the corporation. If subsection 17(1) applies, the corporation is treated as having received interest, computed by reference to a prescribed rate, on the amount owing for the period in the particular year during which the amount was owing to the corporation.

Subsection 17(1) is amended in three respects:

- First, it is restructured in order to improve its readability, by converting its paragraphs (*a*) and (*b*) into formula descriptions A and B, and by moving the conditions for its application into new subsection 17(1.1). For further information, please see the commentary on subsection 17(1.1).
- Second, it is amended to correct an ambiguity in existing subparagraph 17(1)(*b*)(iii) (new paragraph (*c*) of the description B in amended subsection 17(1)), which is the rule that generally reduces the interest income imputed to a taxpayer under subsection 17(1) by an amount that is included in computing the taxpayer's income under subsection 91(1) and is in respect of interest on a debt that is related to the amount owing to which subsection 17(1) applies. This amendment, described more fully below, ensures that this rule provides an appropriate reduction in calculating the imputed income under subsection 17(1) where interest income is included in the foreign accrual property income (FAPI) of a controlled foreign affiliate (CFA) of the taxpayer.
- Third, subsection 17(1) is amended to clarify that existing subparagraph 17(1)(*b*)(iii) (i.e., new paragraph (*c*) of the description B in amended subsection 17(1)) may apply to reduce the imputed income under subsection 17(1) by the amount of interest on a portion of a debt where only that portion, and not the whole debt, is indirectly funded by a loan or transfer of property from the Canadian taxpayer. This amendment is consequential on the proposed amendment to subsection 17(2). For further information, please see the commentary on that subsection.

With regard to the second amendment described above, subparagraph 17(1)(*b*)(iii) is intended to provide for a reduction in the income inclusion under subsection 17(1) in situations where subsection 17(1) applies to a corporation resident in Canada (Canco) in respect of an amount equal to an amount owing to a CFA of Canco by a non-resident person because the latter amount is deemed under subsection 17(2) to be an amount owing to Canco by the non-resident person. The reduction under subparagraph 17(1)(*b*)(iii) is intended to equal the amount of FAPI of CFA included in Canco's income for the particular year or a subsequent year under subsection 91(1) that can reasonably be attributed to the interest income of CFA derived from the amount owing to CFA by the non-resident person for the period in the particular year of Canco during which that amount was so owing to CFA and during which an amount equal to that amount owing to CFA was deemed to be owing to Canco by the non-resident person.

The second amendment to subsection 17(1) is meant to correct an ambiguity identified in a comfort letter dated September 3, 2002, and thus ensure that it provides the intended reduction to the income inclusion under subsection 17(1). Subparagraph 17(1)(*b*)(iii) provides relief only in respect of FAPI amounts that can reasonably be attributed to interest on "the amount owing" by the non-resident person referred to in subsection 17(1) to the corporation resident in Canada. However, in cases where the indirect loan rule in subsection 17(2) applies, and the particular person referred to in that subsection is a CFA of the Canadian-resident corporation and is the creditor in respect of an interest-bearing loan, the amount deemed by subsection 17(2) to be owing by the non-resident person to the corporation resident in Canada, to which subsection 17(1) applies, is not the actual amount owing by the non-resident person to the CFA, but rather an amount equal to the actual amount owing.

Since it is the interest on that actual amount owing by the non-resident to the CFA that is included in the affiliate's FAPI, there is ambiguity as to whether such FAPI can reasonably be attributed to interest on the amount deemed under subsection 17(2) to be owing by the non-resident person to the Canadian-resident corporation, as required in order to claim the reduction under the current version of paragraph 17(1)(*b*)(iii).

A similar issue can arise in certain circumstances where the back-to-back loan rule in subsection 17(11.2) applies to deem a loan to have been made by the "initial lender" to the "intended borrower" referred to in that subsection. Subsection 17(2) in turn applies to deem an amount equal to the deemed loan under subsection 17(11.2) to be owing by the intended borrower to a corporation resident in Canada. In that case, if the initial lender is a CFA of the corporation resident in Canada and has made an interest-bearing loan to the "intermediate lender" referred to in subsection 17(11.2), it is the interest on this actual loan that is included in the initial lender's FAPI. Consequently, ambiguity exists as to whether such FAPI can reasonably be attributed to interest on the amount deemed under subsection 17(2) to be owing by the intended borrower to the Canadian-resident corporation, as required under existing paragraph 17(1)(*b*)(iii).

The amendments to subparagraph 17(1)(*b*)(iii) are intended to resolve these ambiguities. First, the terms "debt" and "original debt" are introduced. The "debt" refers to the amount deemed by subsection 17(2) to be owing by the non-resident to the Canadian-resident corporation. The "original debt" refers to an actual amount owing (as opposed to a deemed amount). Where the conditions in subparagraphs (*c*)(i) to (iii) in the description B in subsection 17(1) are satisfied, the amendments allow the income imputed to the taxpayer under that subsection to be reduced by an amount included in computing the taxpayer's income under subsection 91(1) that can reasonably be attributed to interest on an original debt – or, if the original debt exceeds the amount of the debt, a portion of the original debt equal to the amount of the debt – to the extent that such interest is paid or payable for the period in the year during which the debt (i.e., the deemed amount owing under subsection 17(2)) was outstanding. The conditions in subparagraphs (*c*)(i) to (iii) in the description B are as follows:

- Without the existence of the original debt, subsection 17(2) would not have deemed the debt to be owed to the Canadian-resident corporation by the non-resident person referred to in new paragraph 17(1.1)(*a*). This condition is generally satisfied where the original debt is the amount owing by a non-resident person to a particular person or partnership described in paragraph 17(2)(*a*) or, where subsection 17(11.2) applies in respect of the original debt, the amount owing by the initial lender to the intermediate lender or by the intermediate lender to the intended borrower referred to in subsection 17(11.2).
- The original debt was owed by a non-resident person or a partnership each member of which is a non-resident person. This ensures that interest on any amount owing to CFA by a Canadian resident does not qualify for the relief under this provision.
- If subsection 17(11.2) applies to the original debt, an amount determined under that subsection in respect of the original debt must be an amount referred to in paragraph 17(2)(*a*) as owing by a non-resident person to a particular person or partnership, and it must also be the case that, because of that amount owing, subsection 17(2) applies to deem the debt to be owed by the non-resident person referred to in paragraph 17(1.1)(*a*). These conditions are met where the original debt is owing by an intermediate lender to an initial lender, or by an intended borrower to an intermediate lender (within the meanings assigned by subsection 17(11.2)), and paragraph 17(11.2)(*a*) applies to deem a loan to have been made by the initial lender to the intended borrower. The conditions are also met where paragraph 17(11.2)(*b*) applies to reduce the amount of the loan made by the initial lender to the intermediate lender by the amount of the deemed loan under paragraph 17(11.2)(*a*), and the loan so reduced is an amount referred to in paragraph 17(2)(*a*), with the result that subsection 17(2) applies to deem the intermediate lender to owe an amount to a corporation resident in Canada equal to all or a portion of the loan.

The restructuring of subsection 17(1) and the amendments to clarify the operation of existing subparagraph 17(1)(*b*)(iii) apply to taxation years that begin after February 23, 1998.

The amendment to clarify the operation of subsection 17(1) where only a portion of a debt is indirectly funded by a loan or transfer of property applies to taxation years that begin after July 12, 2013.

ITA
17(1.1)

New subsection 17(1.1) of the Act sets out the conditions for the application of subsection 17(1). These conditions are currently in subsection 17(1) but are being moved to subsection 17(1.1) in order to improve readability.

Subsection 17(1.1) provides that subsection (1) applies to a corporation resident in Canada in respect of an amount owing to the corporation if all the following conditions are satisfied:

- A non-resident person owes the amount to the corporation.
- The amount has been or remains outstanding for more than a year.
- The amount that would be determined under B in subsection 17(1), if that subsection applied, for the year in respect of the amount owing is less than the amount of interest that would be included in computing the corporation's income for the year in respect of the amount owing if that interest were computed at a reasonable rate for the period in the year during which the amount was outstanding.

New subsection 17(1.1) applies to taxation years that begin after February 23, 1998.

Indirect Loan

ITA
17(2)

Subsection 17(2) of the Act is an anti-avoidance rule intended to prevent the use of indirect arrangements to circumvent the application of subsection 17(1). Subsection 17(2) generally provides that – where a corporation resident in Canada (Canco) makes a loan or transfers property and, because of that loan or transfer, a loan or transfer of property is made to a non-resident person (the final debtor) – the final debtor is treated for the purposes of section 17 as if it owes to Canco an amount equal to the amount owing by the final debtor.

Subsection 17(2) is amended to modernize its language and to ensure that it applies appropriately where only a portion of the amount loaned or property transferred to the final debtor is loaned or transferred because of the loan or transfer of property by Canco. In that situation, the amount deemed by subsection 17(2) to be owed by the final debtor to Canco is equal to that portion.

This amendment applies to taxation years that begin after July 12, 2013.

Clause 6

Definitions

ITA
18(5)

Subsection 18(5) of the Act defines certain terms for the purposes of subsections (4) to (6).

The opening words of subsection 18(5) are amended to provide that its definitions apply for the purposes of new subsection 18(6.1). As well, the definitions "security interest" and "specified right" are introduced. These new terms are relevant for the back-to-back loan rules in subsections 18(6) and (6.1) (and are cross-referenced in new subsection 212(3.1)).

These amendments apply to taxation years that begin after 2014.

In certain circumstances, the thin capitalization rules deny a corporation's deduction of interest expense. The application of the rules depends, in part, on the amount of the corporation's outstanding debts to specified non-residents (as defined in subsection 18(5)).

Paragraph (*b*) of the definition "outstanding debts to specified non-residents" in subsection 18(5) provides exclusions for certain obligations owing to non-resident insurers and authorized foreign banks. The paragraph is amended to provide a new exclusion that addresses the interaction between the thin capitalization rules and the pertinent loan or indebtedness (PLOI) rules, which are related to the Act's foreign affiliate dumping rules. For further information on the foreign affiliate dumping rules, see the commentary on section 212.3.

The new exclusion is for a debt obligation described in subparagraph (ii) of the description of A in paragraph 17.1(1)(*b*) to the extent that the proceeds of the debt obligation can reasonably be considered to directly or indirectly fund, in whole or in part, an amount owing to the corporation, or another corporation resident in Canada that does not deal at arm's length with the corporation, that is a PLOI (as defined in subsection

212.3(11)). The reference to “a debt obligation described in subparagraph (ii) of the description of A in paragraph 17.1(1)(*b*)” is to a debt obligation entered into as part of a series of transactions or events that includes the transaction by which the PLOI arises.

The amendment ensures that the thin capitalization rules do not impede the ability of a non-resident corporation that controls a corporation resident in Canada (a CRIC) to use debt to finance the CRIC or another corporation resident in Canada that does not deal at arm’s length with the CRIC, if the CRIC in turn uses the borrowed funds to lend to its foreign affiliate and elects to have the PLOI regime apply to the latter debt. Absent the amendment, the thin capitalization rules could, in certain circumstances, deny the CRIC or the other corporation a deduction for the interest it pays in respect of its debt owing to the non-resident that controls it. At the same time, the CRIC would, by virtue of having made the PLOI election in respect of its loan to its foreign affiliate, be required to include in its taxable income an amount that is equal to the greater of a prescribed amount of interest income in respect of the debt owing by the foreign affiliate and the interest payable by it (or certain non-arm’s length persons) on the debt that funds the PLOI. Subjecting interest payable on such debt owing by the CRIC, or the other corporation, to the thin capitalization rules is not necessary while the PLOI is outstanding because the PLOI rules ensure that the interest income included in the CRIC’s income in respect of the PLOI is at least equal to the interest payable on the debt owing by the CRIC or the other corporation.

This amendment applies to taxation years that end after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Back-to-Back Loan Arrangements

ITA
18(6)

Subsection 18(6) of the Act ensures that the disallowance of interest expense under subsection 18(4) is not circumvented by lending arrangements in which a specified non-resident shareholder of a corporation or a specified beneficiary of a trust, instead of making a loan directly, makes it through an intermediary – for example, by lending funds to another person on condition that the other person make a loan to the corporation or the trust, as the case may be.

Subsection 18(6) is amended, and subsection 18(6.1) is introduced, to expand the types of financing arrangements that are treated as direct loans from a specified non-resident shareholder (or a specified non-resident beneficiary) of a taxpayer to the taxpayer for purposes of subsection 18(4). The amendments ensure that variations of “back-to-back” debts, and certain economic equivalents, cannot be used to circumvent subsection 18(4).

Subsection 18(6) is amended to set out the conditions for the application of subsection 18(6.1), which is now the operative rule. In order for subsection 18(6.1) to apply, four conditions, set out in paragraphs 18(6)(*a*) to (*d*), must be satisfied. The first condition (set out in paragraph 18(6)(*a*)) is that the taxpayer has a particular amount outstanding as or on account of a particular debt or other obligation to pay an amount to a person (the “intermediary”). The intermediary may be either a resident of Canada or a non-resident.

The second condition (set out in paragraph 18(6)(*b*)) is that the intermediary is neither a person resident in Canada with whom the taxpayer does not deal at arm’s length nor a person that is, in respect of the taxpayer, described in subparagraph 18(*a*)(i) of the definition “outstanding debts to specified non-residents” in subsection 18(5) (in these notes referred to as a “connected non-resident”). As a result, subsection 18(6.1) will not apply if:

- the intermediary is a related Canadian resident that is itself subject to the thin capitalization rules on its amount directly owing to the specified non-resident shareholder or the specified non-resident beneficiary, or
- the amount owed by the taxpayer to the intermediary is already subject to the thin capitalization rules because the intermediary is a specified non-resident shareholder, or a specified non-resident beneficiary, of the taxpayer.

For this purpose, where the particular debt or other obligation is owing by the taxpayer to a partnership, the conditions in subparagraph 18(6)(*b*)(i) will not be satisfied to the extent members of that partnership are persons resident in Canada with whom the taxpayer does not deal at arm’s length, and the condition in subparagraph 18(6)(*b*)(ii) will not be satisfied to the extent members are specified non-resident shareholders, or specified non-resident beneficiaries, of the taxpayer.

The third condition (set out in paragraph 18(6)(*c*)) may be satisfied in one of two ways. The first, under subparagraph 18(6)(*c*)(i), is if the intermediary, or a person that does not deal at arm’s length with the intermediary, has an amount outstanding as or on account of a debt or other obligation to pay an amount to a connected non-resident, and the debt or other obligation meets a condition in either clause 18(6)(*c*)(i)(A) or (B) (an “intermediary debt”). The condition in clause 18(6)(*c*)(i)(A) is that 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 the particular debt (owed by the taxpayer to the intermediary). If this condition is satisfied, it demonstrates that the intermediary is not fully bearing the risk of the amount it is owed by the taxpayer.

The condition in clause 18(6)(*c*)(i)(B) is that it can reasonably be concluded that all or a portion of the particular amount became owing, or was permitted to remain owing, because either some or all of the debt or other obligation was entered into or was permitted to remain outstanding, or the intermediary anticipated that some or all of the debt or other obligation would become owing or remain outstanding. .

The second way in which paragraph 18(6)(*c*) may be satisfied (set out in subparagraph 18(6)(*c*)(ii)) is if the following conditions are met:

- the intermediary, or a person that does not deal at arm’s length with the intermediary, has a specified right in respect of a particular property;
- that specified right was granted directly or indirectly by a connected non-resident; and
- either the existence of the specified right is required under the terms and conditions of the particular debt or other obligation, or it can reasonably be concluded that some or all of the particular amount became owing, or was permitted to remain owing, because the specified right was granted or the intermediary 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 of the taxpayer 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.

The exception for a right to encumber a property to secure the particular debt or other obligation (or a connected debt or other obligation) ensures that the intermediary’s right to, for example, place a lien on a property to secure a debt owing to it by the taxpayer does not constitute a specified right. Nor does the right of the intermediary to use cash – received from the taxpayer or another member of the taxpayer’s group – by applying the cash against the balance owing on the particular debt or other obligation, or a debt or other obligation owing to the intermediary by another member of the taxpayer’s group, in and of itself constitute a specified right of the intermediary. In addition, a specified right will not exist if it is established by the taxpayer that all of the net proceeds received from exercising the right, or that would be received if the right were exercised, in respect of the property must be applied to reduce either the particular amount owing by the taxpayer, or an amount owing in respect of a “connected” debt or other obligation described in subparagraph 18(6)(*d*)(ii). As such, an intermediary will not be considered to have 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 particular debt or other obligation owed to it by the taxpayer and does not in-and-of-itself provide a means for the intermediary to raise funds that may be used by it for a purpose other than to reduce an amount owing to it in respect of the particular debt or other obligation, or a “connected” debt or other obligation.

Example 1: Specified right and subparagraph 18(6)(c)(ii)

Assumptions

- *Forco, a non-resident corporation, owns all the shares of Canco, a corporation resident in Canada. Canco requires $50 million in order to expand its business.*
- *Rather than lend $50 million directly to Canco, Forco arranges with a third-party bank for the bank to lend $50 million to Canco (the particular loan). This is the only amount owing to the intermediary bank by Canco or a person that does not deal at arm’s length with Canco.*
- *Under the arrangement with the bank, Forco agrees to acquire $50 million of marketable securities, which Forco is required to hold through an account with a subsidiary of the bank that is a securities dealer. The securities dealer will have the right to pledge or assign the securities (i.e., as a means of raising capital for the bank or the securities dealer) to secure funding for itself and will also have full discretion over the use of proceeds received.*

Analysis

- *The particular loan is an amount outstanding as or on account of a particular debt or other obligation owed to the bank (the intermediary), and the intermediary is neither a connected non-resident nor a person resident in Canada with whom Canco does not deal at arm’s length. As such, the conditions in paragraphs 18(6)(a) and (b) are satisfied in respect of the particular loan. The condition in paragraph 18(6)(d) is also satisfied because the fair market value of the securities is equal to 100% of the amount outstanding in respect of the particular loan.*
- *Forco is a connected non-resident in respect of Canco, and the marketable securities are property in which the securities dealer (i.e., a person that does not deal at arm’s length with the intermediary bank) has a specified right that was granted by Forco. The conditions in subparagraph 18(6)(c)(ii) will be satisfied, and subsection 18(6.1) will therefore apply, if the existence of the specified right is required under the terms and conditions of the particular loan, or if it can reasonably be concluded that all or a portion of the particular amount (i.e., $50 million owed by Canco in respect of the particular loan) became owing because the specified right was granted or it was anticipated that the specified right would be granted.*
- *The acquisition of $50 million of securities by Forco, with the agreement that those securities be held through a subsidiary of the intermediary bank where the subsidiary has a specified right over the property, can be considered a substitute for a direct loan that Forco might have otherwise made to the bank in order for the bank to on-lend to Canco. Subparagraph 18(6)(c)(ii) is intended to address those scenarios where a non-resident person, rather than making a loan to an intermediary (i.e., in a manner in which subparagraph 18(6)(c)(i) would be met), grants a specified right in a property to the intermediary (or a person related thereto) that provides that person with, for example, rights of disposition over the property, resulting in an economic equivalent to a loan.*

Example 2: Specified right and subparagraph 18(6)(c)(ii)

Assumptions

- *Forco, a non-resident corporation, owns all the shares of Canco, a corporation resident in Canada. Canco requires $50 million in order to expand its business and borrows $50 million (the Loan) from a third party lender.*
- *The terms and conditions of the Loan require that Forco grant a security interest in a particular property owned by Forco to secure payment of the Loan. A lien is placed on that property in order to*

ensure that Forco cannot dispose of the property without the lender's consent. Further, pursuant to the terms of the Loan, the lender has additional rights to dispose of the property in an event of default. The net proceeds of such a disposition must, however, be applied as a credit against amounts owing in respect of the Loan (with the excess, if any, going to the non-resident).

Analysis

- *A specified right at a given time includes 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. While the lien on the property may be an encumbrance, it is a right that secures payment of the particular debt or other obligation. As such, it is not a specified right.*
- *The additional right to dispose of the property in an event of default is a contingent right that is available only upon the occurrence of a future event (i.e., a future event of default), and does not provide the intermediary with a right to "deal" in the property <u>at that time.</u> As such, this is not a specified right <u>at that time</u>. Further, if an event of default were to occur at a particular time, such that at that time the intermediary is considered to have a right to "deal" in the property, this would not be a specified right at that time, on the assumption that the taxpayer can establish that the intermediary is required to apply all net proceeds received from exercising the right first as a reduction to the amount owing in respect of the particular debt or other obligation.*

Example 1 illustrates a situation where rights in respect of property granted to an intermediary can reasonably be considered as an economic equivalent of a back-to-back loan. In that case, the right in respect of the marketable securities granted by Forco would be a specified right. Example 2 illustrates a scenario where the granting of rights over property is not the economic equivalent of a back-to-back loan. In that example, the lien on the property, and the rights arising under an event of default (where the intermediary's ability to apply the funds is restricted to crediting the amount owing in respect of the particular debt or other obligation) are not rights that, (at that time or even at any future time), provide the intermediary with a means to raise funds to be used by the intermediary at its discretion.

The final condition for the application of subsection 18(6.1) is in paragraph 18(6)(*d*), which contains a *de minimis* rule. The condition is satisfied where the total of all amounts – each of which is, in respect of the particular debt owed by the taxpayer to the intermediary, an amount outstanding as or on account of an intermediary debt (*i.e.*, a debt described in subparagraph 18(6)(*c*)(i)) or the fair market value of a particular property (*i.e.*, a property in which a specified right described in subparagraph 18(6)(*c*)(ii) was granted) – is equal to at least 25% of the total of two amounts.

The first amount is the particular amount (*i.e.*, the amount outstanding in respect of the particular debt owed by the taxpayer to the intermediary). In other words, subsection 18(6.1) will not apply if the total of the amounts outstanding on all intermediary debts and the fair market values of all particular properties, in respect of the particular debt represents less than 25% of the amount of the particular debt. This ensures that subsection 18(6.1) does not apply where the particular debt is funded by the intermediary mainly from sources other than a connected non-resident in respect of the taxpayer.

The second amount is the total of all amounts (other than the particular amount) that the taxpayer, or a person that does not deal at arm's length with the taxpayer, has outstanding as or on account of a debt or other obligation to pay an amount to the intermediary under the agreement, or a connected agreement, under which the particular debt was entered into where

- the intermediary is granted a security interest in respect of a property that is either the intermediary debt (which is a property held by the connected non-resident) or the particular property, as the case may be, and the security interest secures the payment of two or more debts or other obligations that include the debt or other obligation and the particular debt, and

- every security interest that secures the payment of a debt or other obligation referred to in clause 18(6)(*d*)(ii)(A) secures the payment of every debt or other obligation referred to in that clause.

A security interest in respect of a property is defined in subsection 18(5) to mean an interest in, or for civil law a right in, the property that secures payment of an obligation. The inclusion of the second amount, under subparagraph 18(6)(*d*)(ii), is intended to provide possible relief where an intermediary enters into multiple cross-collateralized debts owing to the intermediary by multiple group entities, including the taxpayer.

Example 3: Cross-collateralized loans and paragraph 18(6)(d)

Assumptions

- *Forco, a non-resident corporation, owns all the shares of the capital stock of Canco, a corporation resident in Canada, as well as all the shares of the capital stock of two non-resident corporations (Forco1 and Forco2).*
- *The group, consisting of Forco, Forco1, Forco2 and Canco, enters into a credit facility with a third-party bank. Under the facility, any member of the group may borrow from the bank, subject to an agreed upon overall group borrowing limit. Each group member provides the bank with a cross-guarantee and a general security interest against all property held by that member, which secures payment of all of the interest and principal owed by all the group members.*
- *Forco1 and Forco2 collectively borrow $450 million, and Canco borrows $50 million, against the facility.*
- *Under the terms of the facility, the group is required to maintain with the intermediary a cash balance of 5% of the total amount on loan to the group, which Forco maintains in a segregated bank account with the bank. Forco has $25 million on deposit with the bank at any given time to satisfy this loan condition.*

Analysis

Paragraphs 18(6)(a) and (b) are satisfied in respect of the $50 million amount owing by Canco to the bank. In this instance, the amount required to be kept on deposit with the bank would, depending on the facts and circumstances, likely represent an intermediary debt that satisfies the conditions in subparagraph 18(6)(c)(i), or would likely be property that satisfies the conditions in subparagraph 18(6)(c)(ii).

Even if this is the case, paragraph 18(6)(d) must also be satisfied in order for subsection 18(6.1) to apply. For purposes of paragraph 18(6)(d), to the extent that the amount on deposit represents property in which the intermediary has a security interest that secures payment of all amounts owing under the same credit facility under which the particular debt arose, then the total of all amounts each of which is an amount owing under the credit facility (i.e., the $450 million total amount borrowed by Forco1 and Forco2, plus the $50 million particular amount), is to be included in applying the 25% de minimis test in paragraph 18(6)(d). As such, the $25 million on deposit is less than 25% of the total of the $50 million (the particular amount and the $450 million owing by Forco1 and Forco2. Therefore, paragraph 18(6)(d) is not satisfied and subsection 18(6.1) does not apply.

Example 4: Notional cash pooling arrangement

Assumptions

- *Forco, a non-resident corporation, owns all the shares of the capital stock of Canco, a corporation resident in Canada, as well as all the shares of the capital stock of Forco1, a non-resident corporation.*
- *The group consisting of Forco, Forco1, and Canco enter into a notional cash pooling arrangement with a third-party bank. Under the arrangement, the total borrowings of the group cannot exceed the overall group borrowing limit of $20 million plus the total of all amounts placed on deposit by members of the group.*
- *All amounts placed on deposit with the bank by group members secure payment of all amounts lent by the bank to net borrowers under the arrangement.*

- *Forco1 borrows $40 million from the bank and Canco borrows $60 million. Forco has $80 million on deposit with the bank in support of these amounts.*

Analysis

The conditions in paragraphs 18(6)(a) and (b) are satisfied in respect of the $60 million amount owing by Canco to the bank. Paragraph 18(6)(c) is also satisfied, as the $80 million placed on deposit with the bank is an intermediary debt as described in subparagraph 18(6)(c)(i). The cash on deposit may also represent property described in subparagraph 18(6)(c)(ii).

Paragraph 18(6)(d) applies if the amount of an intermediary debt (i.e., the $80 million owed to Forco by the bank) is at least 25% of the total of the amounts described in subparagraphs 18(6)(d)(i) and (ii). Subparagraph 18(6)(d)(i) is the particular debt (i.e., $60 million). If the deposit Forco has with the bank is a property in which the bank has a security interest that secures payment of both the particular debt and the $40 million owed by Forco1 (i.e., an amount arising under the same agreement as the agreement under which the particular debt arose), then, under subparagraph 18(6)(d)(ii), the $40 million is also included in applying the de minimis test. However, the amount of the intermediary debt ($80 million) is more than 25% of the total of the particular amount ($60 million) and the amount of debts described in subparagraph 18(6)(d)(ii) ($40 million). As such, the condition in paragraph 18(6)(d) is satisfied and subsection 18(6.1) applies in respect of this arrangement.

Back-to-Back Loan Arrangements

ITA
18(6.1)

New subsection 18(6.1) of the Act is the operative rule setting out the consequences, for purposes of the thin capitalization rules in subsections 18(4) and (5), when the conditions in subsection 18(6) are satisfied. If subsection 18(6.1) applies in respect of an intermediary debt described in subparagraph 18(6)(*c*)(i) or a particular property referred to in subparagraph 18(6)(*c*)(ii), paragraph 18(6.1)(*a*) deems all or a portion of the particular amount (*i.e.*, the amount outstanding on the particular debt owing by the taxpayer to the intermediary) to be outstanding as or on account of a debt or other obligation owing to the particular non-resident person (*i.e.*, the creditor in respect of the intermediary debt or the grantor of the specified rights in respect of the particular property, as the case may be), and not to the intermediary. This portion of the particular amount is equal to the lesser of the following two amounts:

- the amount outstanding on the intermediary debt or the fair market value of the particular property, as the case may be (clause 18(6.1)(*a*)(i)(A)); and
- the proportion of the particular amount that the amount outstanding on the intermediary debt or the fair market value of the particular property, as the case may be, is of the total of all amounts each of which is either
    - an amount outstanding as or on account of an intermediary debt in respect of the particular debt or other obligation, owed to the particular non-resident or any other non-resident person that is a specified non-resident shareholder in respect of the taxpayer, or
    - the fair market value of a particular property referred to in subparagraph 18(6)(*c*)(ii) in respect of the particular debt or other obligation (clause 18(6.1)(*a*)(i)(B)).

Subsection 18(6.1) will not deem more than the particular amount (owing by the taxpayer to the intermediary) to be owed to a particular non-resident. The apportionment in clause 18(6.1)(*a*)(i)(B) ensures that, where there are multiple intermediary debts and/or particular properties in respect of a particular debt or other obligation, and the total of the amounts outstanding on those intermediary debts and the fair market values of those properties exceeds the particular amount, then the particular amount is effectively allocated to the particular non-residents based on the amount outstanding on the intermediary debts owing to them or the fair market value of the particular properties in respect of which they have granted specified rights.

Where subparagraph 18(6.1)(*a*)(i) deems a portion of a particular amount to be an amount owing by the taxpayer to a particular non-resident for the purposes of subsections 18(4) and (5), subparagraph 18(6.1)(*a*)(ii) deems a portion of the interest paid or payable by the taxpayer – in respect of a period throughout which subparagraph 18(6.1)(*a*)(i) deems a portion of the particular amount to be outstanding to the particular non-resident – on the particular debt or other obligation, to be paid or payable by the taxpayer to the particular non-resident, and not to the intermediary, as interest for the period on that portion of the particular amount. The amount so deemed is essentially the proportion of the interest actually paid or payable to the intermediary that the amount deemed by subparagraph 18(6.1)(*a*)(i) to be outstanding to the particular non-resident is of the particular amount outstanding to the intermediary in respect of which the interest is paid or payable. Specifically, the deemed amount is determined by the formula A × B/C, where:

- A is the interest paid or payable by the taxpayer in respect of the period on the particular debt or other obligation;
- B is the average of all amounts each of which is an amount that is deemed by subparagraph 18(6.1)(*a*)(i) to be outstanding to the particular non-resident at a time during the period; and
- C is the average of all amounts each of which is the particular amount outstanding at a time during the period.

Where paragraph 18(6.1)(*a*) applies, the amount deemed by subparagraph 18(6.1)(*a*)(i) to be outstanding to the particular non-resident is included in the taxpayer's "outstanding debts to specified non-residents" for purposes of subparagraph 18(4)(*a*)(i), and the interest amount deemed by subparagraph 18(6.1)(*a*)(ii) to be paid or payable to the particular non-resident is included in the amount of interest paid or payable by the taxpayer on outstanding debts to specified non-residents, in respect of which subsection 18(4) may, in certain circumstances, deny a deduction in whole or in part.

Paragraph 18(6.1)(*b*) ensures that, to the extent that subsection 18(4) applies to deny the taxpayer a deduction in respect of any portion of the interest deemed by subparagraph 18(6.1)(*a*)(ii) to be paid or payable to the particular non-resident, that non-deductible portion is subject to the rules in Part XIII, including subsections 214(16) and (17). These subsections generally deem the amount to be paid as a dividend instead of as interest. As a result, for Part XIII purposes, the non-deductible portion of the interest is deemed, under subsection 214(16), to be paid by the taxpayer as a dividend, and not as interest, to the particular non-resident.

In order to integrate this deemed dividend under subsection 214(16) with the deemed interest payment for purposes of Part XIII provided, in certain circumstances, by the back-to-back loan arrangement rules in new subsections 212(3.1) and (3.2), references to subsection 214(16) are included in those new subsections. The general effect is to allow subsection 214(16) to apply in the manner described above in priority to subsections 212(3.1) and (3.2). For further information, see the commentary on subsections 212(3.1) and (3.2).

These amendments apply to taxation years that begin after 2014.

Example

Assumptions

- *Forco, a non-resident corporation, owns all the shares of Canco, a corporation resident in Canada.*
- *Canco has a $100 million loan (the "Canco debt") owing, throughout a particular taxation year, to a foreign bank that deals at arm's length with Canco. The interest paid and payable by Canco on the Canco debt in respect of the particular taxation year is equal to $3 million. There are no other debts owing to the foreign bank by any members of the Forco group.*

- *During the first 3 months of Canco's particular taxation year, Forco has an amount on deposit with the foreign bank that is an "intermediary debt" within the meaning of subparagraph 18(6)(c)(i). The amount on deposit is $35 million during the first month, $30 million during the second month and $25 million during the third month. The deposit is withdrawn by Forco after the third month.*
- *There are no other intermediary debts, and no specified rights, in respect of the Canco debt*

Analysis

- *For the first three months of Canco's particular taxation year, all of the conditions in subsection 18(6) are met in respect of the Canco debt. Therefore, subsection 18(6.1) applies in respect of Canco during this three-month period.*
- *For the purposes of the thin capitalization rules in subsections 18(4) and (5), subparagraph 18(6.1)(a)(i) deems the following amounts to be outstanding as or on account of a debt or other obligation of Canco to pay an amount to Forco, and not to the foreign bank: $35 million during the first month, $30 million during the second month and $25 million during the third month of Canco's particular taxation year.*
- *Subparagraph 18(6.1)(a)(ii) deems a portion of the interest paid by Canco to the foreign bank on the Canco debt, in respect of the period throughout which subparagraph 18(a)(i) applies, to instead be paid by Canco to Forco on the debt Canco is deemed by subparagraph 18(6.1)(a)(i) to owe to Forco. The interest paid by Canco on the Canco debt, in respect of the three-month period throughout which subparagraph 18(a)(i) applies, is $750,000 (i.e., ¼ of the $3 million interest Canco paid in respect of the entire year). The portion of this interest that Canco is deemed to instead pay to Forco is determined by the formula A X B/C, where A is equal to $750,000; B is equal to $30 million (i.e., the average of $35 million, $30 million and $25 million); and C is equal to $100 million. Thus, Canco is deemed by subparagraph 18(6.1)(a)(ii) to pay $225,000 of the interest to Forco, and not to the foreign bank, for the three-month period during which subparagraph 18(6)(a)(i) applies and on the amount subparagraph 18(6)(a)(i) deems Canco to owe to Forco during that period.*

Clause 7

Farming or Fishing Business

ITA
28(1)(g)

Subsection 28(1) of the Act provides for a method of accounting, known as the cash-basis method, that may be used for computing income or loss from the business of farming or fishing.

Paragraph 28(1)(*g*) is amended to add a reference to new subsection 80.3(4.1), so that amounts deducted with respect to the sale of breeding bees due to drought or flood/excess moisture conditions are taken into account for a farmer who computes income from farming using cash-basis accounting.

This amendment applies to the 2014 and subsequent taxation years.

Clause 8

Additional Business Income

ITA
34.1(1)(*a*) and 34.1(2)(*a*)

Section 34.1 of the Act provides the rules for computing the additional business income for a taxation year of an individual (including a trust other than a testamentary trust) who carries on an unincorporated business in the year for which an election to have an off-calendar fiscal period is filed under subsection 249.1(4) (*i.e.*, the "alternative fiscal-period method"). The alternative fiscal-period method is available, on a business-by-business basis, to individuals and to partnerships all the members of which are individuals.

Paragraphs 34.1(1)(*a*) and 34.1(2)(*a*) are amended so that if it is a trust that is carrying on the business in the year, the trust will be exempt from the rules only if it is a graduated rate estate. For further information, see the commentary on the new definition "graduated rate estate" in subsection 248(1).

These amendments apply to the 2016 and subsequent taxation years.

Clause 9

Taxable Capital Gain – Gift of Securities

ITA
38(*a.1*)(ii)

Subparagraph 38(*a.1*)(ii) of the Act 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 made by the taxpayer by the taxpayer's will (*i.e*., a gift to which subsection 118.1(5) applies) to a qualified donee. 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.

Subparagraph 38(*a.1*)(ii) is amended consequential on amendments to section 118.1. Amended subparagraph 38(*a.1*)(ii) continues to provide that a taxpayer's taxable capital gain from the disposition of a qualifying security is nil if the disposition is deemed by section 70 to have occurred immediately before the taxpayer's death and other requirements are met. The requirement that the property be the subject of a gift made by the taxpayer under subsection 118.1(5), however, is replaced with requirements that the property be the subject of a gift that is made by the taxpayer's graduated rate estate and that the gift is one to which subsection 118.1(5.1) applies.

In this context, a gift to which subsection 118.1(5.1) applies refers to a gift of property that was acquired by the taxpayer's graduated rate estate on and as a consequence of the taxpayer's death after 2015. In addition, in respect of a taxpayer who dies after 2015, a gift is considered under subsections 118.1(4.1) and (5) to be made by the estate of the taxpayer if the estate makes the gift or the gift is made by the taxpayer by the taxpayer's will. Finally, subparagraph 38(*a.1*)(i) applies to determine whether the graduated rate estate's taxable capital gain, if any, from its disposition of the qualifying security on the actual making of the gift is also nil.

For further information, see the commentary on subsections 118.1(4.1) to (5.1) and on the new definition "graduated rate estate" in subsection 248(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 provides that a taxpayer's taxable capital gain from the disposition of a property is nil if the disposition is deemed by section 70 to have occurred immediately before the taxpayer's death and the property is the subject of an ecological gift made by the taxpayer by the taxpayer's will (*i.e*., a gift to which subsection 118.1(5) applies) to a qualified donee (other than a private foundation).

Subparagraph 38(*a.2*)(ii) is amended consequential on amendments to section 118.1. Amended subparagraph 38(*a.2*)(ii) continues to provide that a taxpayer's taxable capital gain from the disposition is nil if the disposition is deemed by section 70 to have occurred immediately before the taxpayer's death and other requirements are met. The requirement that the property be the subject of an ecological gift made by the taxpayer under subsection 118.1(5), however, is replaced with a requirement that the property be the subject of an ecological gift that is made by the taxpayer's graduated rate estate and that the gift is one to which subsection 118.1(5.1) applies.

In this context, a gift to which subsection 118.1(5.1) applies refers to a gift of property that was acquired by the taxpayer's graduated rate estate on and as a consequence of the taxpayer's death after 2015. In addition, in respect of a taxpayer who dies after 2015, a gift is considered under subsections 118.1(4.1) and (5) to be made by the estate of the taxpayer if the estate makes the gift or the gift is made by the taxpayer by the taxpayer's will. Finally, subparagraph 38(*a.2*)(i) applies to determine whether the estate's taxable capital gain, if any, from its disposition of the property on the actual making of the gift is also nil.

For further information, see the commentary on subsections 118.1(4.1) to (5.1) and the new definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 10

Capital Gain – Gift of Cultural Property

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

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)(A), a taxpayer has no capital gain from the disposition of such a property if the taxpayer gifts the property by the taxpayer's will and the gift is effected by the taxpayer's estate within 36 months after the taxpayer's death (or such longer period of time as the Minister of National Revenue considers reasonable).

Subparagraph 39(1)(*a*)(i.1) is amended to replace the requirements in existing clause 39(1)(*a*)(i.1)(A) with requirements that the disposition be deemed by subsection 70 to have occurred and that the property be the subject of a gift, to which subsection 118.1(5.1) applies, 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. Subparagraph 39(1)(*a*)(i.1) is also restructured so that these new requirements are in clause 39(1)(*a*)(i.1)(B).

In this context, a gift to which subsection 118.1(5.1) applies refers to a gift of property that was acquired by the taxpayer's graduated rate estate on and as a consequence of the taxpayer's death after 2015. In addition, in respect of a taxpayer who dies after 2015, a gift is considered under subsections 118.1(4.1) and (5) to be made by the estate of the taxpayer if the estate makes the gift or the gift is made by the taxpayer by the taxpayer's will. Finally, amended clause 39(1)(*a*)(i.1)(A) applies to determine whether the estate's gain, if any, from its disposition of the property on the actual making of the gift gives rise to a capital gain.

For more information, see the commentary on section 118.1 and the new definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Meaning of Capital Gain and Capital Loss

ITA
39(1)(*c*)(vii)

Section 39 of the Act defines a taxpayer's capital gain, capital loss and business investment loss and sets out a number of provisions relating to the taxation of capital gains and losses.

Paragraph 39(1)(*c*) defines a taxpayer's business investment loss for a taxation year in respect of certain dispositions of shares or debt of a small business corporation. A taxpayer's business investment loss is generally the taxpayer's capital loss from the disposition less certain other amounts, including in the case of a share issued before 1972, the amount of any taxable dividends received or receivable after 1971 on the share by the taxpayer or, if the taxpayer is an individual, the taxpayer's spouse or common-law partner or a trust under which the taxpayer's spouse or common-law partner is a beneficiary. In the case where the taxpayer is a trust referred to in paragraph 104(4)(*a*) (*e.g.*, an *alter ego* trust, a joint spousal or common-law partner trust, or a post-1971 spousal or common-law partner trust), subparagraph 39(1)(*c*)(vii) extends the reduction for taxable dividends received or receivable after 1971 on a share issued before 1972 to apply to dividends received or receivable by the trust's settlor (as defined in subsection 108(1)) or the settlor's spouse or common-law partner.

Subparagraph 39(1)(*c*)(vii) is amended to apply to the case where the trust is referred to in paragraph 104(4)(*a.4*). That paragraph describes trusts to which property has been transferred on a tax-deferred basis in circumstances described under subparagraph 73(1.02)(*b*)(ii) or subsection 107.4(3). This amendment applies to the 2014 and 2015 taxation years.

Subparagraph 39(1)(*c*)(vii) is also amended by replacing the reference to "settlor" with a reference to the individual whose death gives rise to a deemed disposition of the trust's property under paragraph 104(4)(*a*) or (*a.4*) in respect of the trust or a spouse or common-law partner of the individual. This amendment applies to the 2016 and subsequent taxation years.

Clause 11

Reserve – Property Disposed of to Child

ITA
40(1.1)(*c*)

Subsection 40(1.1) of the Act provides that, where a taxpayer has transferred certain farming property, fishing property, or qualified small business corporation shares to the taxpayer's child, in computing the taxpayer's gain the taxpayer may claim a reserve over a ten-year period.

The definitions "share of the capital stock of a family farm corporation", "share of the capital stock of a family fishing corporation", "interest in a family farm partnership" and "interest in a family fishing partnership" in subsection 70(10) are repealed and the new definitions "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership" are introduced to better accommodate taxpayers involved in a combination of farming and fishing.

Paragraph 40(1.1)(*c*) is amended concurrently with the amendment of subsection 70(10) to replace certain references in the paragraph with references to "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership".

This amendment applies to dispositions and transfers that occur in the 2014 and subsequent taxation years.

Deemed Loss for Certain Partners

ITA
40(3.12)

Subsection 40(3.12) of the Act provides that if a corporation, an individual (other than a trust) or a testamentary trust is a member of a partnership at the end of a fiscal period of the partnership, the member may elect in certain circumstances to treat a positive adjusted cost base as a capital loss from the disposition of the partnership interest at that time. The elected amount may not exceed the amount by which previous gains required to be reported under subsection 40(3.1) exceeds previous losses claimed under subsection 40(3.12).

Subsection 40(3.12) is amended to replace the reference to testamentary trusts with a reference to graduated rate estates. As a result, the only trusts that may elect under the subsection are graduated rate estates. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 12

Inadequate Consideration

ITA
69(1)(*b*)(ii)

Subsection 69(1) of the Act provides rules that deal with gifts and non-arm's length dispositions of property, except where such transactions are expressly addressed by other provisions in the Act. Subparagraph 69(1)(*b*)(ii) deems a taxpayer's proceeds of disposition, from the disposition of any property to another person by way of gift *inter vivos*, to be the property's fair market value at the time of the disposition.

Subparagraph 69(1)(*b*)(ii) is amended to apply to dispositions by way of gift generally.

This amendment applies to the 2016 and subsequent taxation years.

Clause 13

Death of a Taxpayer

ITA
70

Section 70 of the Act provides certain rules that apply on the death of an individual. The definitions "share of the capital stock of a family farm corporation", "share of the capital stock of a family fishing corporation", "interest in a family farm partnership" and "interest in a family fishing partnership" in subsection 70(10) are repealed and the new definitions "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership" are introduced to better accommodate taxpayers involved in a combination of farming and fishing. Several consequential amendments are made to section 70.

When Subsection (9.01) Applies

ITA
70(9)

Subsection 70(9) of the Act identifies the circumstances under which subsection 70(9.01) will apply. Taken together, these subsections allow a deferral of the capital gains that would otherwise arise, and the depreciation claimed that would otherwise be recaptured, on the transfer of certain farm or fishing property from a taxpayer to their child, upon the death of the taxpayer.

The English version of paragraph 70(9)(*a*) is amended so that the reference to farming precedes the reference to fishing, consistent with the definitions "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership" and other instances in the Act where there are references to a farming or fishing business.

This amendment comes into force on January 1, 2014.

When Subsection (9.11) Applies

ITA
70(9.1)

Subsection 70(9.1) of the Act identifies the circumstances under which subsection 70(9.11) will apply. Taken together, these subsections allow a deferral of the capital gains that would otherwise arise, and depreciation claimed that would otherwise be recaptured, on the transfer of certain farm or fishing properties from a spousal or common-law partner trust to a child of a taxpayer, upon the death of the taxpayer's spouse or common-law partner.

The English version of paragraph 70(9.1)(*c*) is amended so that the reference to farming precedes the reference to fishing, consistent with the definitions "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership" and other instances in the Act where there are references to a farming or fishing business.

This amendment comes into force on January 1, 2014.

Transfer of Family Farm and Fishing Corporations and Partnerships

ITA
70(9.2) and (9.21)

Subsection 70(9.2) of the Act identifies the circumstances under which subsection 70(9.21) applies. Taken together, these subsections allow the deferral of the capital gains that would otherwise arise on the transfer of a taxpayer's share of the capital stock of a family fishing corporation or a family farm corporation, or of a taxpayer's interest in a family fishing partnership or a family farm partnership, when the transfer is to the taxpayer's child upon the death of the taxpayer.

Paragraph 70(9.2)(*a*) and subparagraphs 70(9.21)(*a*)(ii) and (*b*)(ii) are amended, consequential on amendments to the definitions in subsection 70(10), to replace existing references in those provisions with references to "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership".

These amendments come into force on January 1, 2014.

Transfer of Family Farm and Fishing Corporations and Partnerships from Trust to Children of Settlor

ITA
70(9.3) and (9.31)

Subsection 70(9.3) of the Act identifies the circumstances under which subsection 70(9.31) applies. Taken together, these subsections allow a deferral of the capital gains that would otherwise arise in respect of certain corporate shares and partnership interests held by a trust when the share or interest is transferred from the trust to a child of the settlor as a consequence of the death of the beneficiary of the trust who is the spouse or common-law partner of the settlor. In the case of a transferred share, the share must have been the share of a family fishing corporation or a family farm corporation of the settlor of the trust immediately before it was transferred to the trust. And in the case of a transferred partnership interest, the partnership interest must have been in a family fishing partnership or an interest in a family farm partnership of the settlor immediately before it was transferred to the trust.

Paragraph 70(9.3)(*a*) and subparagraph 70(9.3)(*c*)(i) are amended, consequential on amendments to the definitions in subsection 70(10), to replace certain references in those provisions with references to "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership". In addition, subparagraph 70(9.3)(*c*)(ii) is repealed and subparagraphs 70(9.31)(*a*)(ii) and 70(9.31)(*b*)(ii) are amended to delete cross-references to the repealed subparagraph. Finally, subparagraph 70(9.3)(*c*)(iii) is amended so that the reference to farming precedes the reference to fishing, consistent with the definitions in 70(10) and with other instances in the Act where there are references to a farming or fishing business.

These amendments come into force on January 1, 2014.

Leased Farm and Fishing Property

ITA
70(9.8)

Subsection 70(9.8) of the Act deems 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 farm corporation, family fishing corporation, family farm partnership, or a family fishing partnership, of

- the taxpayer,
- the taxpayer's spouse or common-law partner, or

- any of the taxpayer's children.

This provision applies for the purposes of subsections 70(9) and 14(1), paragraph 20(1)(*b*), subsection 73(3) and paragraph (*d*) of the definitions "qualified farm property" and "qualified fishing property" in subsection 110.6(1).

The definitions "qualified farm property" and "qualified fishing property" in subsection 110.6(1) are repealed and the new definition "qualified farm or fishing property" is introduced to better accommodate taxpayers involved in a combination of farming and fishing. Subsection 70(9.8) is amended, consequential on those amendments, to refer to paragraph (*d*) of the definition "qualified farm or fishing property".

This amendment applies to dispositions in the 2014 and subsequent taxation years.

Definitions

ITA
70(10)

Subsection 70(10) sets out a number of definitions that apply in section 70 and certain other provisions of the Act. The definitions "interest in a family farm partnership", "interest in a family fishing partnership", "share of the capital stock of a family farm corporation" and "share of the capital stock of a family fishing corporation" are repealed and the new definitions "interest in a family farm or fishing partnership" and "share of the capital stock of a family farm or fishing corporation" are introduced.

These amendments are made to better accommodate taxpayers involved in a combination of farming and fishing, and they apply as of January 1, 2014.

"child"

Subsection 252(1) of the Act provides an extended meaning of persons who are considered to be children of a taxpayer for the purposes of the Act. Subsection 70(10) contains a further extension of the definition "child" for the purposes of the intergenerational rollover rules in section 70 and 73. The extended definition "child" in subsection 70(10) also applies for the purposes of sections 40, 44, 110.6, 148, 212.1, subsection 130(3) and section 12 of Part I of Schedule V, Exempt Supplies – Real Property, in the *Excise Tax Act*.

Under subsection 252(1), a reference to a child of a taxpayer includes the spouse or common-law partner of a child of the taxpayer. However, if the taxpayer's child dies, the spouse or common-law partner of the child is no longer considered a child of the taxpayer. The definition "child" of a taxpayer in subsection 70(10) is amended to include a person who was a child of the taxpayer immediately before the death of the spouse or common-law partner of the person. As a consequence, the death of a person's spouse or common-law partner will not cause the person to cease to be the child of the parent of their deceased spouse or common-law partner.

"interest in a family farm or fishing partnership"

The new definition "interest in a family farm or fishing partnership" is based on the repealed definition "interest in a family farm partnership": the requirement in the former definition that a property of the partnership be used principally in the course of carrying on a farming business in Canada is replaced with a requirement that the property be used principally in the course of carrying on a farming or fishing business in Canada. In addition, the references in the former definition to "share of the capital stock of a family farm corporation" and "interest in a family farm partnership" are replaced with references to "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership".

"share of the capital stock of a family farm or fishing corporation"

The new definition "share of the capital stock of a family farm or fishing corporation" is based on the repealed definition "share of the capital stock of a family fishing corporation": the requirement in the former definition that a property of the corporation be used principally in the course of carrying on a fishing business in Canada is replaced with a requirement that the property be used principally in the course of carrying on a farming or fishing business in Canada. In addition, the references in the former definition to “share of the capital stock of a family fishing corporation” and “interest in a family fishing partnership” are replaced with references to “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership”. Finally, the new definition “share of the capital stock of a family farm or fishing corporation” incorporates a reference from the former definition “share of the capital stock of a family farm corporation” with respect to the ability of farmers who operate a woodlot to rely on a prescribed forest management plan rather than having to be actively engaged on a regular and continuous basis in carrying on the business.

Value of NISA

ITA
70(12)

Subsection 70(12) of the Act deems the fair market value of a net income stabilization account to be nil for the purposes of the definition “share of the capital stock of a family farm corporation” in subsection 70(10).

Subsection 70(12) is amended, consequential on amendments to the definitions in subsection 70(10), to replace the reference to a “share of the capital stock of a family farm corporation” with a reference to “share of the capital stock of a family farm or fishing corporation”.

This amendment is deemed to have come into force on January 1, 2014.

Clause 14

***Inter Vivos* Transfers by Individuals**

ITA
73

Section 73 of the Act provides rules for governing the tax treatment of certain *inter vivos* transfers of property. The definitions “share of the capital stock of a family farm corporation”, “share of the capital stock of a family fishing corporation”, “interest in a family farm partnership” and “interest in a family fishing partnership” in subsection 70(10), which apply for the purposes of section 73, are repealed and the new definitions “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership” are introduced to better accommodate taxpayers involved in a combination of farming and fishing. Consequential amendments are made to section 73 and they apply to transfers that occur in the 2014 and subsequent taxation years.

When Subsection (3.1) Applies

ITA
73(3)

Subsection 73(3) of the Act sets out the circumstances under which subsection 73(3.1) will apply. Taken together, these subsections allow for a deferral of the capital gains that would otherwise arise, and depreciation claimed that would otherwise be recaptured, on the *inter vivos* transfer of certain farming or fishing property from a taxpayer to a child of the taxpayer.

The English version of paragraphs 73(3)(*a*) and (*c*) is amended so that the reference to farming precedes the reference to fishing, consistent with the definitions “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership” in subsection 70(10) and other instances in the Act where there are references to a farming or fishing business.

When Subsection (4.1) Applies

ITA
73(4) and (4.1)

Subsection 73(4) of the Act sets out the circumstances under which subsection 73(4.1) will apply. Taken together, these subsections allow a taxpayer a deferral of the capital gains that would otherwise arise on the *inter vivos* transfer to a child of the taxpayer of shares of the capital stock of a family fishing corporation or family farm corporation, or of an interest in a family fishing partnership or family farm partnership.

Subsection 73(4.1) and paragraph 73(4)(*b*) are amended, consequential on the amendments to the definitions in subsection 70(10), to replace existing references with references to "share of the capital stock of a family farm or fishing corporation" and "interest in a family farm or fishing partnership".

Clause 15

Lifetime Capital Gains Exemption

ITA
80.03(8)

Subsection 80.03(8) of the Act applies where, as a consequence of the disposition by an individual of qualified farm property or qualified small business corporation shares (as defined in subsection 110.6(1)), the individual is deemed to realize a capital gain under subsection 80.03(2). Where this is the case, the capital gain so determined will be eligible for the lifetime capital gains exemption under section 110.6.

The definitions "qualified farm property" and "qualified fishing property" in subsection 110.6(1) are repealed and the new definition "qualified farm or fishing property" is introduced to better accommodate taxpayers involved in a combination of farming and fishing. Subsection 80.03(8) is amended, consequential on those amendments, to replace existing references with a reference to "qualified farm or fishing property".

This amendment applies to dispositions that occur in the 2014 and subsequent taxation years.

Clause 16

Debt Obligations – Transfer of Forgiven Amounts

ITA
80.04(6)

Section 80.04 of the Act allows a debtor in respect of a settled debt obligation, to enter into an agreement with an eligible transferee (generally a person related to the debtor) to transfer a portion of any unapplied forgiven amount in respect of the obligation, as specified in the agreement, to the transferee. The transferred amount reduces the amount that the debtor is required to include in income, in respect of the settlement of the obligation, under subsection 80(13), while the eligible transferee is required to reduce its tax pools as provided in subsection 80(3) to (12) by the transferred amount.

Subsection 80.04(6) sets out the conditions that must be satisfied for an agreement filed under section 80.04 to be valid. Clause 80.04(6)(*a*)(ii)(B) sets out the date before which the agreement must be filed, which in the case where the debtor is a testamentary trust is determined by reference to the day that is one year after the taxpayer's filing-due date for the year.

Clause 80.04(6)(*a*)(ii)(B) is amended to replace the reference to testamentary trusts with a reference to graduated rate estates. As a result, that clause applies in the case of a trust only if the trust is a graduated rate estate. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 17

Income Deferral

ITA
80.3

Section 80.3 of the Act provides a tax deferral in respect of the proceeds of sales by farmers of certain "breeding animals" due to drought or flood/excess moisture conditions.

Definitions

ITA
80.3(1)

"breeding animals"

The definition of breeding animals specifies the types of livestock in respect of which the tax deferral provided by subsection 80.3(1) applies, including horses that are over 12 months of age and are kept for breeding in the commercial production of pregnant mares' urine. The definition is amended to include all types of horses that are over 12 months of age and kept for breeding.

This amendment applies to the 2014 and subsequent taxation years.

"breeding bee stock"

The new definition "breeding bee stock" applies for the purposes of the tax deferral provided by new subsection 80.3(4.1) for proceeds of sales by farmers of certain bees in prescribed drought or flood/excess moisture areas. Breeding bee stock, at any time, means a reasonable estimate of the quantity of a taxpayer's breeding bees held at that time in the course of carrying on a farming business, using a unit of measurement that is an industry accepted standard.

This amendment applies to the 2014 and subsequent taxation years.

"breeding bees"

ITA
80.3(1)

The new definition "breeding bees" applies for the purposes of the tax deferral provided by subsection 80.3(4.1) for proceeds of sales by farmers of certain bees in prescribed drought or flood/excess moisture areas. The definition of breeding bees specifically includes bee larvae. Bees that are used to pollinate plants in greenhouses (including the larvae of bees that are used to pollinate plants in greenhouses) are excluded from the definition because they are not generally affected by drought or flood⁄excess moisture conditions.

This amendment applies to the 2014 and subsequent taxation years.

Income Deferral

ITA
80.3(4.1)

New subsection 80.3(4.1) of the Act provides a formula for calculating the amount of the deduction available in a taxation year in respect of the proceeds of the sale of breeding bees by a taxpayer who carries on the business of farming in a prescribed drought or flood/excess moisture region. The formula applies if the taxpayer's breeding bee stock has been reduced by at least 15%.

The portion of such proceeds which may be deducted is, generally,

- 30%, if the taxpayer's breeding bee stock has been reduced by less than 30% in the drought or flood/excess moisture year; and

- 90%, if the breeding bee stock has been reduced by 30% or more in the year.

The proceeds of sale of breeding bees to which the formula applies is net of amounts paid to acquire breeding bees in the year and does not include any amount that has been deducted under 20(1)(*n*) as a reserve for proceeds of sale not due until a later year.

Subsection 80.3(4.1) applies to the 2014 and subsequent taxation years.

Inclusion of Deferred Amount

ITA
80.3(5)

Subsection 80.3(5) of the Act provides that the amount deducted in respect of breeding animals under subsection 80.3(4) for a drought or flood/excess moisture year is deemed to be income of the taxpayer from the business for the year following the drought or flood/excess moisture year, or the year immediately following a series of consecutive drought or flood/excess moisture years.

Subsection 80.3(5) is amended to add a reference to subsection 80.3(4.1), so that an amount deducted under subsection 80.3(4.1) in respect of breeding bees is also deemed to be income of the taxpayer from the business for the year following the drought or flood/excess moisture year, or the year immediately following a series of consecutive drought or flood/excess moisture years.

This amendment applies to the 2014 and subsequent taxation years.

Where Not Applicable

ITA
80.3(6)

Subsection 80.3(6) of the Act provides that a deferral of income in respect of a farming business of a taxpayer that is provided by subsection 80.3(2) or (4) does not apply for a year in which the taxpayer dies or at the end of which the taxpayer is neither resident in Canada nor carrying on a farming business through a fixed place of business in Canada.

Subsection 80.3(6) is amended to add a reference to subsection 80.3(4.1), in order to deny the deduction in respect of breeding bees in those circumstances.

This amendment applies to the 2014 and subsequent taxation years.

Measuring Breeding Bee Stock

ITA
80.3(7)

New subsection 80.3(7) of the Act provides that, for the purpose of calculating the tax deduction available under subsection 80.3(4.1), a taxpayer must use the same unit of measurement in determining the taxpayer's breeding bee stock at the beginning, and end, of the year.

Subsection 80.3(7) applies to the 2014 and subsequent taxation years.

Clause 18

Ship or Aircraft of Non-Residents

ITA
81(1)(*c*)

Certain income of non-resident persons earned in Canada from the operation of ships and aircraft is not included in computing their income. Paragraph 81(1)(*c*) of the Act is amended to incorporate the new defined term “international shipping”, which is defined in subsection 248(1). For further information, please see the commentary on the definition “international shipping” in subsection 248(1).

This amendment applies to taxation years that begin after July 12, 2013.

Clause 19

Anti-Avoidance

ITA
87(8.3)

New subsection 87(8.3) of the Act is added to prevent the use of certain structures aimed at circumventing the anti-avoidance rule in subsection 85.1(4). Subsection 85.1(3) generally allows a taxpayer to transfer shares of one of its foreign affiliates to another of its foreign affiliates on a tax-deferred basis if the consideration for the transfer includes shares of the transferee foreign affiliate. Subsection 85.1(4) provides that subsection 85.1(3) does not apply if all or substantially all the property of the transferred foreign affiliate is excluded property (as defined in subsection 95(1)) of that affiliate and the transfer is part of a series of transactions or events for the purpose of disposing of the shares to an arm’s-length person or partnership (other than a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) at the time of the transaction or event or throughout the series, as the case may be).

Subsection 87(8.3) is intended to ensure that certain foreign merger transactions cannot be used to effectively transfer shares of a foreign affiliate (all or substantially all of whose property is excluded property of the affiliate) to an arm’s length person in a manner that is inconsistent with subsection 85.1(4). Subsection 87(8.3) provides that subsection 87(8), which allows certain foreign mergers to qualify for the tax-deferred amalgamation provisions in subsections 87(4) and (5), does not apply in respect of a taxpayer’s shares of a predecessor foreign corporation (as defined in subsection 87(8.1)) in the context of a foreign merger (as defined in subsection 87(8.1)) if all the following conditions are met:

- The new foreign corporation (as defined in subsection 87(8.1)) is, immediately after the foreign merger, a foreign affiliate of the taxpayer (paragraph 87(8.3)(*a*)).
- The shares of the new foreign corporation are, immediately after the foreign merger, excluded property of another foreign affiliate of the taxpayer (paragraph 87(8.3)(*b*)).
- The foreign merger is part of a transaction or event or a series of transactions or events that includes a disposition of the shares of the new foreign corporation (or substituted property) to
    - a person with whom the taxpayer was dealing at arm’s length immediately after the transaction, event or series, other than a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest (within the meaning assigned by paragraph 95(2)(*m*)) at the time of the transaction or event or throughout the series, as the case may be; or
    - a partnership a member of which is, immediately after the transaction, event or series, a person described in subparagraph 87(8.3)(*c*)(i).

Where subsection 87(8.3) applies to a foreign merger, the disposition by the taxpayer of shares of a predecessor foreign corporation on the foreign merger will generally occur on a taxable basis.

The new subsection applies to foreign mergers that occur after July 12, 2013.

Clause 20

Upstream Loan from Eligible Bank Affiliate

ITA
90(8)

Subsection 90(8) of the Act provides some important exceptions to subsection 90(6), the main operative rule in the upstream loan rules in subsections 90(6) to (15). Subsection 90(8) is amended by adding new paragraph 90(8)(*d*), which contains a new exception to subsection 90(6) for an "upstream deposit" owing to an "eligible bank affiliate". By virtue of amended subsection 90(15), these terms have the same meaning as in subsection 95(2.43).

The exception in paragraph 90(8)(*d*) is subject to subsection 90(8.1), which – based on the amount of upstream deposits owing to an eligible bank affiliate – deems the affiliate to have made an upstream loan in certain circumstances. For further information, please see the commentary on subsection 90(8.1).

Upstream Deposit – Eligible Bank Affiliate

ITA
90(8.1)

For the purposes of section 90 of the Act (including, in particular, the upstream loan rules in subsection 90(6) to 90(15)), new subsection 90(8.1) provides rules that deem an eligible bank affiliate of an eligible Canadian bank to make an upstream loan to the bank when the affiliate's upstream deposits with the bank exceed the difference between the affiliate's excess liquidity and all eligible Canadian indebtedness owing to the affiliate. In combination, subsections 90(8) and (8.1) will result in subsection 90(6) not applying to loans made by an eligible bank affiliate to an eligible Canadian bank if 90% of the amount of all upstream deposits owing to the affiliate by the bank does not exceed the available excess liquidity of the affiliate for the year. This is consistent with the policy of the excess liquidity proposals in new subsections 95(2.43) to (2.45).

Specifically, paragraph 90(8.1)(*a*) provides that if an eligible bank affiliate of an eligible Canadian bank is owed an upstream deposit at any time in a particular taxation year or in the immediately preceding taxation year, the affiliate is deemed to make a loan to the bank immediately before the end of the particular year equal to the amount determined by the formula

$$A - B - C$$

For these purposes,

- A is 90% of the average of all amounts each of which is, in respect of a calendar month that ends in the particular year, the greatest total amount at any time in the month of upstream deposits owing to the affiliate. The use of 90% of upstream deposits in effect provides a buffer that allows upstream deposits owing to the affiliate to exceed its excess liquidity (less eligible Canadian indebtedness owing to the affiliate) in recognition of the fact that the affiliate's excess liquidity might fluctuate for reasons beyond the control of either the bank or the affiliate.

- B is the lesser of

    - the amount, if any, by which the affiliate's excess liquidity for the particular year exceeds the average of all amounts each of which is, in respect of a calendar month that ends in the particular year, the greatest total amount at any time in the month of eligible Canadian indebtedness owing to the affiliate (in other words, available excess liquidity after deducting the amount used by the affiliate to acquire eligible Canadian indebtedness), and

    - the amount determined for variable A, and

- C is the amount, if any, by which the amount determined for variable A for the immediately preceding year exceeds the amount determined for variable B for the immediately preceding year.

The subtraction of the eligible Canadian indebtedness owing to the affiliate from its excess liquidity (*i.e.*, in computing variable B) reflects the policy of facilitating the affiliate's use of its excess liquidity to fund the making of upstream deposits and acquisition of eligible Canadian indebtedness. For this purpose, the affiliate's excess liquidity is essentially applied first to eligible Canadian indebtedness owing to the affiliate, and it is only the remaining amount of excess liquidity, if any, that may be applied to reduce the amount otherwise considered as an upstream loan made by the eligible bank affiliate to the bank in respect of its upstream deposits.

The amount determined by A – B is the affiliate's excess loan amount, and is generally deemed to be an upstream loan made by the affiliate to the bank.

The subtraction of variable C in the formula ensures that subsection 90(8.1) deems an affiliate to make an upstream loan in a particular year only to the extent of the incremental year-over-year increase in the excess loan amount. In other words, where in a particular year the difference between the amount of upstream deposits owing to the eligible bank affiliate (as determined in variable A) and the available excess liquidity of the affiliate (as determined in variable B) increases compared to the prior year, for purposes of the upstream loan rules, the amount of this incremental increase is deemed to be the amount of a new upstream loan made by the affiliate immediately before the end of the particular year.

Paragraph 90(8.1)(*a*) also provides that all the amounts referred to in the formula are to be determined in Canadian currency.

Paragraph 90(8.1)(*b*) deems, in certain circumstances, a taxpayer to repay an upstream loan that paragraph 90(8.1)(*a*) had deemed an affiliate to have made to the taxpayer in a prior taxation year. Paragraph 90(8.1)(*b*) applies if the formula in paragraph 90(8.1)(*a*) would (in the absence of section 257) result in a negative amount for the particular year. This would generally apply where, year-over-year, the excess loan amount decreases. Where applicable, paragraph 90(8.1)(*b*)

- deems the taxpayer to repay, immediately before the end of the particular year — in an amount equal to the absolute value of the negative amount calculated using the formula in paragraph 90(8.1)(*a*) for the particular year — loans the affiliate was deemed by paragraph 90(8.1)(*a*) to have made in a prior year and not previously deemed by paragraph 90(8.1)(*b*) to have been repaid. These loans are deemed to have been repaid "in the order in which they arose", *i.e.*, on a "first-in, first-out", or FIFO, basis; and
- deems the repayment to not be part of a series of loans or other transactions and repayments. This ensures that the repayment can qualify for the exception under paragraph 90(8)(*a*) or the deduction under subsection 90(14), as the case may be.

These amendments apply to taxation years of a foreign affiliate that begin after February 27, 2014.

Definitions

ITA
90(15)

Subsection 90(15) of the Act defines the terms "specified amount" and "specified debtor", which are used in subsections 90(6) and (9) and, in the case of "specified amount", also in subsections 90(10), (13) and (14).

Subsection 90(15) is amended to add definitions of the following terms: "eligible bank affiliate"; "eligible Canadian bank"; "eligible Canadian indebtedness"; "excess liquidity"; and "upstream deposit". Each of these terms has the same meaning as in new subsection 95(2.43). These terms are relevant for new subsection 90(8.1).

These amendments apply to taxation years of a foreign affiliate that begin after February 27, 2014

Clause 21

Partnerships

ITA
93.1

Section 93.1 of the Act provides rules that deal with partnerships owning shares of foreign affiliates. Several amendments are made to existing provisions in section 93.1 and new provisions are added to the section, in order to allow various foreign affiliate rules to apply to structures that include partnerships.

Shares Held by Partnership

ITA
93.1(1) and (1.1)

Where a Canadian-resident corporation owns shares of a non-resident corporation through a partnership, subsection 93.1(1) of the Act applies in determining whether the non-resident corporation is a foreign affiliate of the Canadian-resident corporation for the purposes of certain provisions of the Act and *Income Tax Regulations*. In those circumstances, subsection 93.1(1) provides a look-through rule that deems the Canadian corporation to own its proportionate number of the non-resident corporation's shares based on the relative fair market value of its interest in the partnership.

Subsection 93.1(1) is split into two subsections in order to improve readability. New subsection 93.1(1.1) lists the provisions for which the look-through rule in subsection 93.1(1) applies, including all the provisions currently listed in subsection 93.1(1) and four new ones: subsections 93.1(5) and 95(2.2), and sections 93.3 and 233.4. The addition of subsection 93.1(5) and section 93.3 to the list of provisions is consequential on the introduction of new subsections 93.1(5) and (6), and new section 93.3, which, as discussed below, require the determination of foreign affiliate status through a partnership.

The addition of subsection 95(2.2) is made to address a concern identified in a comfort letter, dated April 19, 2006, issued by the Department of Finance. The concern dealt with in the letter was the application of subsection 95(2.2) in situations where the shares of a non-resident corporation are acquired by a partnership. If it applies, subsection 95(2.2) deems a non-resident corporation to be a foreign affiliate of a taxpayer in respect of which the taxpayer has a qualifying interest throughout a year, for the purposes of paragraphs 95(2)(*a*) and (*g*). Subsection 95(2.2) applies where

- as a result of a person or partnership having acquired or disposed of its shares of the non-resident corporation (or the shares of any other corporation), the non-resident corporation either became or ceased to be a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest in the taxation year, and
- the non-resident corporation was, at the beginning of the year or at the end of the year, a foreign affiliate of the taxpayer in respect of which the taxpayer had a qualifying interest.

The reference to an acquisition by a "partnership" was previously added to subsection 95(2.2) in response to the above-noted comfort letter. In certain cases subsection 95(2.2) requires the determination of foreign affiliate status through a partnership. Subsection 93.1(1) is therefore amended to add subsection 95(2.2) to the list of provisions for which subsection 93.1(1) applies.

A reference to section 233.4 is added so that the partnership look-through rule in subsection 93.1(1) applies for the purpose of determining whether a non-resident corporation or trust is a foreign affiliate of a taxpayer or partnership for the purposes of the reporting requirements in subsection 233.4(4). A consequential amendment to section 233.4 ensures that this reference in subsection 93.1(1.1) does not result in multiple reporting requirements for members of a partnership that is already a "reporting entity" for a taxation year for the purposes of that section. For further information, please see the commentary on section 233.4.

The amendments to subsection 93.1(1) and new subsection 93.1(1.1) come into force on July 12, 2013, subject to an election to have them come into force on January 1, 2010, except that the addition of a reference to subsection 95(2.2) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 1999.

Where Dividends Received by a Partnership

ITA
93.1(2)

Subsection 93.1(2) of the Act provides look-through treatment, for the purposes of sections 93 and 113 and related regulations, of dividends paid by a foreign affiliate to a partnership of which either a corporation resident in Canada or another foreign affiliate is a member.

Subsection 93.1(2) is amended in two respects. First, it is amended to allow for tiered partnership structures. Although subsection 93.1(3) provides rules for membership status through a tiered partnership structure, the current version of subsection 93.1(2) does not clearly allocate dividends through such a structure. The amendments to paragraph 93.1(2)(*a*) are made to allocate a dividend to a member based on the proportion of the fair market value of the member's "direct or indirect interests" in the partnership to the fair market value of all the "direct" interests held by members in the partnership. The specific parenthetical carve-out for members of the partnership that are themselves partnerships is made to ensure that the full amount of the partnership dividend, but no more than that amount, is allocated to the partnership's direct and indirect members.

This amendment applies to dividends received after November 1999.

Tiered Partnerships

ITA
93.1(3)

Subsection 93.1(3) of the Act provides look-through rules for tiered partnerships that apply for the purposes of certain provisions of the Act. Subsection 93.1(3) is amended to add a reference to new subsection 87(8.3). For further information on subsection 87(8.3), please see the commentary on that subsection.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that end after July 12, 2013.

Partnership Deemed to be Corporation

ITA
93.1(4)

New subsection 93.1(4) of the Act is introduced to deem, in certain circumstances, a partnership to be a corporation and to be resident in a particular country for the purposes of clause 95(2)(*a*)(ii)(D). This is meant to allow the recharacterization of interest and other deductible payments received by a financing affiliate from a partnership as income from an active business if the partnership is the owner of the "third affiliate" contemplated in clause 95(2)(*a*)(ii)(D).

Paragraph 93.1(4)(*a*) provides that where all the members of a partnership are foreign affiliates of a taxpayer, the partnership is deemed to be a non-resident corporation without share capital and the membership interests in the partnership are deemed to be equity interests in the corporation. In conjunction with the new rule in section 93.2 for non-resident corporations without share capital (described in the commentary on that section), this allows the corporation to be considered a "foreign affiliate" of the taxpayer (as defined in subsection 95(1)) if the relevant equity holding thresholds are met. In particular, subsection 93.1(4) and section 93.2 together allow for the application of the "equity percentage" and "direct equity percentage" concepts in subsection 95(4).

In addition, paragraph 93.1(4)(*b*) deems a partnership to be resident in a particular country if all the members of the partnership are resident in that country and the partnership does not carry on business outside of that country. If this results in the partnership being resident in a designated treaty country, this can potentially allow an amount paid or payable by the partnership that is deemed active business income of the payee foreign affiliate because of clause 95(2)(*a*)(ii)(D) to be included in the exempt earnings (as defined in subsection 5907(1) of the *Income Tax Regulations*) of the payee foreign affiliate.

New subsection 93.1(4) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after July 12, 2013.

Rules for Computing FAPI in Respect of Partnership

ITA
93.1(5) and (6)

New subsections 93.1(5) and (6) of the Act are added to deal with certain applications of the foreign affiliate rules in the context of corporate structures that include partnerships. Subsection 93.1(5) is the operative rule, and subsection 93.1(6) enumerates both the relevant provisions for the purposes of which subsection 93.1(5) applies and the relevant assumptions that are to be made in applying subsection 93.1(5). Like subsection 93.1(4), subsection 93.1(5) hypothesizes that a partnership is a corporation for certain purposes in order to solve issues arising from the application of the foreign affiliate rules to structures involving partnerships.

Subsection 93.1(5) provides a rule in the partnership context that is similar to the one provided by paragraph 95(2)(*n*) in the context of corporate structures. Subsection 93.1(5) deems a non-resident corporation to have the same foreign affiliate and qualifying interest foreign affiliate status in respect of the partnership that the non-resident corporation has in respect of a Canadian-resident corporate member of the partnership that would be related to the partnership if the partnership were a corporation and the other assumptions in paragraph 93.1(6)(*b*) applied.

Subsection 93.1(5) provides deeming rules for the purpose of applying a “relevant provision” in respect of a foreign affiliate of a Canadian-resident taxpayer. These deeming rules apply where all the following conditions are met:

- The relevant taxpayer is a partnership. This may be the case because paragraph 96(1)(*a*) requires certain calculations to be made as if a partnership were a person resident in Canada.
- Either a particular Canadian-resident corporation, or a foreign affiliate of a particular Canadian-resident corporation, is a member of the taxpayer partnership.
- Based on the “relevant assumptions” (set out in paragraph 93.1(6)(*b*)), the particular Canadian-resident corporation and the taxpayer would be related. The relevant assumptions, which hypothesize that the partnership is a corporation, are needed because the definition “related persons” in subsection 251(2) does not contemplate a partnership being related to a person.

More specifically, paragraph 93.1(6)(*b*) provides that the relevant assumptions for the purposes of subsection 93.1(5) are that:

- The taxpayer partnership is a non-resident corporation with a single class of shares, divided into 100 shares each of which has full voting rights.
- Each member of the taxpayer partnership (other than another partnership) owns the proportion of the issued shares of that class that the fair market value of the member’s interest (held directly and indirectly through other partnerships) in the partnership is of the fair market value of all the direct interests in the partnership. The exclusion for members of the partnership that are themselves partnerships is made to ensure that all 100 shares of the class, but no more than that number, are allocated to the partnership’s direct and indirect members.

If the above conditions are satisfied, then each non-resident corporation that is a foreign affiliate of the particular Canadian-resident corporation is deemed to be a foreign affiliate of the taxpayer (paragraph 93.1(5)(*a*)). As well, if the particular Canadian-resident corporation has a qualifying interest in respect of the affiliate (paragraph 93.1(5)(*b*)), the taxpayer is deemed to have a qualifying interest in respect of that foreign affiliate.

Paragraph 93.1(6)(*a*) enumerates the "relevant provisions" for the purposes of which the deeming rules in subsection 93.1(5) apply. The relevant provisions are as follows:

- the inter-affiliate dividend exclusion from FAPI in paragraph (*b*) of the description of A in the definition "foreign accrual property income" in subsection 95(1);
- the description of B in the definition "foreign accrual property income" in subsection 95(1), in determining whether a property of a foreign affiliate of a taxpayer is excluded property of the affiliate;
- the rules in paragraph 95(2)(*a*) that recharacterize, as active business income, certain income from property that would otherwise be FAPI;
- paragraph 95(2)(*g*), which is a provision that deems certain foreign exchange gains and losses of a foreign affiliate to be nil; and
- subsection 95(2.2), which may deem a foreign affiliate of a taxpayer to be a foreign affiliate in respect of which the taxpayer has a qualifying interest throughout a taxation year (for the purposes of paragraphs 95(2)(*a*) and (*g*)), and subsection 95(2.21), which may deem subsection 95(2.2) not to apply (for purposes of paragraph 95(2)(*a*)) in certain cases.

Subsections 93.1(5) and (6) address issues identified in a Department of Finance comfort letter dated May 26, 2011. In particular, they are intended to address the following situation:

Example

Assumptions

1. *FA1, FA2 and FA3 are all non-resident, wholly-owned indirect subsidiaries, and thus foreign affiliates, of a Canadian publicly traded company (Canco);*
2. *FA1 is the general partner of a limited partnership (LP) and has 100% of the voting rights in respect of LP but only a nominal (less than 1%) interest in the profits of LP;*
3. *FA2 and FA3 are limited partners of LP and have a combined interest in LP's profits of 98.2%;*
4. *Arm's length parties own the remaining limited partner interests in LP;*
5. *LP owns 100% of the shares of FA4, which in turn owns 9% of the shares of a non-resident corporation (Forco); and*
6. *FA5, another non-resident wholly-owned indirect subsidiary of Canco that is a sister company of FA1, FA2 and FA3, directly owns 11% of the shares of Forco.*
7. *Forco pays a dividend to FA4.*
8. *FA4 sells the shares it owns of Forco to a third party purchaser and has a capital gain.*

Analysis

As noted in the comfort letter, because LP is the relevant Canadian taxpayer for purposes of determining Forco's FAPI with respect to the 9% equity interest in Forco held by FA4, and there are no rules in the Act to make LP related to any corporate group members (other than FA4), in the absence of new subsections 93.1(5) and (6), Forco would not be considered a foreign affiliate of LP. As a result, the dividend received by FA4 from Forco would be included in computing the FAPI of FA4 as income from property, and ½ of the capital gain on the sale of the Forco shares by FA4 would be included in computing FA4's FAPI.

However, new paragraph 93.1(5)(a) would apply in this case to cause Forco to be a foreign affiliate of LP for the purposes of the provisions enumerated in subsection 93.1(6). This is because all the relevant conditions in subsection 93.1(5) would be met as follows:

- *By virtue of paragraph 96(1)(a), LP is treated as the relevant taxpayer for FAPI purposes in this case.*
- *All the members of LP (i.e., the taxpayer) are foreign affiliates of Canco, a Canadian-resident corporation.*
- *If LP were a corporation with a single class of shares, divided into 100 shares each with full voting rights, then Canco would own, indirectly through FA2 and FA3, over 98% of those shares, and would be related to LP under paragraph 251(2)(b).*
- *Forco is a foreign affiliate of Canco.*

In addition, paragraph 93.1(5)(b) applies to cause Forco to be a foreign affiliate of LP in respect of which LP has a qualifying interest, since Canco has a qualifying interest (as defined in paragraph 95(2)(m)) in respect of Forco by virtue of holding, indirectly through FA5, shares of Forco having more than 10% of votes and value of Forco.

As a result of subsection 93.1(5) applying to make Forco a foreign affiliate of LP in which LP has a qualifying interest in this case,

- *the dividend paid by Forco to FA4 is excluded from FA4's FAPI because of paragraph (b) of the description of A in the definition "foreign accrual property income" in subsection 95(1), and*
- *FA4's capital gain on its disposition of the shares of Forco is not included in FA4's FAPI because the Forco shares are excluded property of FA4 for purposes of the description of B in the definition "foreign accrual property income" in subsection 95(1).*

Subsections 93.1(5) and (6) of the Act apply in respect of taxation years of foreign affiliates of a taxpayer that end after July 12, 2013, subject to an election to have the subsections apply in respect of taxation years of all foreign affiliates of the taxpayer that end after 2010.

Clause 22

Non-Resident Corporations without Share Capital

ITA
93.2

New section 93.2 of the Act addresses certain non-resident entities that are corporations for purposes of the Act but that do not have conventional share capital. A common example would be a U.S. limited liability company (LLC). These rules also facilitate the operation of the new deemed corporation rules for partnerships in subsection 93.1(4). For further information, please see the commentary on subsection 93.1(4).

Definitions

ITA
93.2(1)

New subsection 93.2(1) of the Act provides definitions that apply for the purposes of section 93.2.

"equity interest"

An equity interest in a non-resident corporation without share capital is defined to mean any right, whether absolute or contingent, conferred by the non-resident corporation to receive, either immediately or in the future, an amount that can reasonably be regarded as all or any part of the capital, of the revenue or of the income of the non-resident corporation. However, this does not include a right to receive an amount as creditor. For example, a contingent right, analogous to those of corporate shareholders, to receive a portion of an entity's income for the year, or a share of the entity's capital on its dissolution, would constitute an equity interest.

"non-resident corporation without share capital"

A "non-resident corporation without share capital" is a non-resident corporation that, in the absence of the deeming rules in new subsection 93.2(2), would not have capital divided into shares. For example, the members of a U.S. LLC have membership interests in the LLC and do not own shares of the LLC.

Non-Resident Corporation without Share Capital

ITA
93.2(2)

New subsection 93.2(2) of the Act provides the main rules for deeming a non-resident corporation without share capital to have share capital. First, paragraph 93.2(2)(*a*) deems equity interests in a non-resident corporation without share capital that have identical rights and obligations to be shares of a separate class of the corporation. For these purposes, equity interests are considered to have identical rights and obligations provided any differences in those rights and obligations are proportionate. For example, if one member of a U.S. LLC has, by virtue of its equity interest, a right to 30% of the LLC's income and three votes at a meeting of the partnership's members, and another member has a right to 40% of the LLC's income and four votes at a members meeting, these differences as to income entitlements and votes would not preclude the members' equity interests from being considered to have identical rights and obligations because in this case the differences in income entitlements are proportionate to the differences in number of votes.

Paragraphs 93.2(2)(*b*) and (*c*) together allocate the shares of each class of the corporation among the equity interest holders of that class. Paragraph 93.2(2)(*b*) first deems the corporation to have 100 issued and outstanding shares of each class. Paragraph 93.2(2)(*c*) then allocates, to each equity interest holder that is deemed by paragraph 93.2(2)(*a*) to have shares of a particular class of the corporation, a portion of the 100 shares of that class equal to the relative fair market value of that holder's equity interest of that class.

Paragraph 93.2(2)(*d*) attributes to each share of a particular class that is deemed to exist under paragraph 93.2(2)(*a*) rights and obligations that are the same as those of the corresponding equity interest. For example, the voting rights attaching to the equity interest of a controlling member of a U.S. LLC would be attributed to the corresponding shares and, as a result, the controlling member would control the corporation for purposes of the Act.

Non-Resident Corporation without Share Capital

ITA

93.2(3)

New subsection 93.2(3) of the Act clarifies that certain "rollover" provisions, specifically section 51, subsection 85.1(3), section 86 and paragraph 95(2)(*c*) may apply where shares of a foreign affiliate of a taxpayer, or a debt owing by a foreign affiliate to the taxpayer, are disposed of or exchanged by the taxpayer or foreign affiliate of the taxpayer (referred to as the "vendor") for shares of the capital stock of a non-resident corporation without share capital that is, immediately after the disposition or exchange, a foreign affiliate of the taxpayer. If the disposition results in an increase to the fair market value of a class of shares of the capital stock of the non-resident corporation, paragraph 93.2(3)(*a*) deems, for the purposes of those rollover provisions, the non-resident corporation to have issued, and the vendor to have received, new shares of the class as consideration for the disposition.

Paragraph 93.2(3)(*b*) provides for the ability of the taxpayer to elect to have paragraph 93.2(3)(*a*) not apply to the disposition or exchange, i.e., resulting in a disposition or exchange in respect of which the noted rollover provisions would not apply.

New section 93.2 applies in respect of taxation years of non-resident corporations that end after 1994, but a taxpayer may elect to have the amendment apply after July 12, 2013.

Australian Trusts

ITA
93.3

New section 93.3 of the Act provides a special regime for certain trusts resident in Australia in which a foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest, has a beneficial interest. Where the required conditions set out in the section are met, the Australian trust will be deemed, for the purpose of determining the Canadian tax results of the taxpayer in respect of the shares of a foreign affiliate, and (in the case where the taxpayer is a corporation resident in Canada) for the purpose of applying the foreign affiliate dumping rules in section 212.3 to a non-resident corporation that controls the Canadian corporation, not to be a trust and to instead be a non-resident corporation.

The main objective of this regime is to allow, where the application of these rules results in an Australian trust being treated as a foreign affiliate, distributions from the Australian trust to the foreign affiliate of the taxpayer to be treated as inter-affiliate dividends. In the absence of this regime, distributions from such a trust would be included in the foreign accrual property income (FAPI) of the foreign affiliate that is a beneficiary of the trust even if the earnings out of which the distributions were sourced were attributable to active business profits of the trust. Where applicable, however, these rules generally also result in the trust being treated as a controlled foreign affiliate of the taxpayer, with the consequence that the trust's FAPI is generally attributed to the taxpayer under subsection 91(1). This special regime is limited to Australian trusts as that country has unique tax and commercial law rules that make commercial trusts the preferred entity to carry on certain types of active business activities.

New section 93.3 comes into force on July 12, 2013, and on an elective basis will come into force on January 1, 2006.

Australian trust

ITA
93.3(1)

New subsection 93.3(1) of the Act defines an "Australian trust" for the purposes of new section 93.3. An Australian trust is a trust in respect of which all the following conditions are satisfied:

- The trust would, in the absence of subsection 93.3(3), be an "exempt foreign trust" under paragraph (*h*) of that definition in subsection 94(1). This is, essentially, a non-discretionary commercial trust.
- Under Canadian common law principles, the trust is resident in Australia.
- All beneficial interests in the trust are represented by units.
- All beneficiaries under the trust have limited liability in respect of the trust's activities.

These conditions are meant to identify trusts that are essentially equivalent to Australian-resident corporations.

Conditions for Subsection (3)

ITA
93.3(2)

New subsection 93.3(2) of the Act sets out the conditions for the application, at any time, of subsection 93.3(3) to a taxpayer resident in Canada in respect of a trust. The conditions in subsection 93.3(2) are as follows:

- A non-resident corporation is at that time beneficially interested in the trust.

- The non-resident corporation is at that time a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest.
- The trust is at that time an Australian trust.
- The total fair market value of all fixed interests (as defined in subsection 94(1)) of a class of interests in the trust that are held by that foreign affiliate, or persons or partnership that do not deal at arm's length with the foreign affiliate, must be at least 10% of the total fair market value of all fixed interests of the class.
- Unless the non-resident corporation first acquired a beneficial interest in the trust at that time, subsection 93.3(3) must have applied, immediately before that time
    - to the taxpayer in respect of the trust, or
    - to a corporation resident in Canada, that did not deal at arm's length with the taxpayer at that time, in respect of the trust.

This last condition, in paragraph 93.3(2)(*e*), ensures that, where all the other conditions in subsection 93.3(2) are satisfied, subsection 93.3(3) applies from the time the foreign affiliate of the taxpayer first becomes beneficially interested in the trust to the first time when the conditions in subsection 93.3(2) cease to be satisfied. If a taxpayer ceases to satisfy the conditions at a particular time and then satisfies the conditions once again at a subsequent time, subsection 93.3(3) will not apply at the subsequent time.

By virtue of paragraph 248(25)(*a*), subsection 93.3(2) will also apply in respect of "stacked" or tiered trusts since the rule in that paragraph results in a foreign affiliate being considered to be beneficially interested in a "lower-tier" trust when the affiliate has a right as a beneficiary under a trust to receive any income or capital of that lower-tier trust indirectly through one or more other trusts.

Australian Trusts

ITA
93.3(3)

New subsection 93.3(3) of the Act provides the substantive rules for the elective regime in respect of Australian trusts. Where the conditions in subsection 93.3(2) are satisfied, subsection 93.3(3) deems, for the specified purposes set out in subsection 93.3(4), the following:

- Paragraph 93.3(3)(*a*) deems the trust to be a non-resident corporation resident in Australia, and not to be a trust.
- Paragraph 93.3(3)(*b*) deems each particular class of "fixed interests" (as defined in subsection 94(1)) in the trust to be a separate class of 100 issued shares, of the capital stock of the non-resident corporation, that have the same attributes as the interests of the particular class. The shares of a particular class of the non-resident corporation are deemed to have the same rights and obligations as the corresponding class of trust units.
- Paragraph 93.3(3)(*c*) deems each beneficiary under the trust to hold the number of shares of each separate class described in paragraph 93.3(3)(*b*) equal to the proportion of 100 that the fair market value at that time of that beneficiary's fixed interests in the corresponding particular class of fixed interests in the trust is of the fair market value at that time of all fixed interests in the particular class. This rule is analogous to the rule in subsection 94.2(2).
- Paragraph 93.3(3)(*d*) deems the trust to be controlled by the taxpayer resident in Canada – the foreign affiliate of which is beneficially interested in the trust – that has the greatest equity percentage in the trust.

- Paragraph 94.2(3)(*e*) provides that any particular foreign affiliate of a taxpayer in which the taxpayer has a direct equity percentage (as defined in subsection 95(4)) and that is not a controlled foreign affiliate of the taxpayer is deemed to be a controlled foreign affiliate of the taxpayer if (i) the particular affiliate has an equity percentage (as defined in subsection 95(4)) in the foreign affiliate referred to in paragraph 94.2(2)(*b*), or (ii) the particular affiliate is the foreign affiliate referred to in paragraph 94.2(2)(*b*). This ensures that if the trust is deemed for the specified purposes to be a controlled foreign affiliate, the taxpayer's proportionate share of any foreign accrual property income earned by the trust is included in income under subsection 91(1).
- Paragraph 93.3(3)(*f*) provides that section 94.2 does not apply to the taxpayer resident in Canada (whose foreign affiliate is beneficially interested in the trust) in respect of the trust.

Specified Purposes

ITA
93.3(4)

New subsection 93.3(4) of the Act sets out the "specified purposes" for which the deeming rules in subsection 93.3(3) apply. By virtue of paragraph 93.3(4)(*a*), those rules apply, in respect of interests in an Australian trust, for the purpose of determining the Canadian tax results (as defined in subsection 261(1)) of a taxpayer resident in Canada in respect of shares of a foreign affiliate of the taxpayer. Thus, the trust is deemed to be a controlled foreign affiliate of the taxpayer for, among other purposes, determining the character of trust distributions to a foreign affiliate of the taxpayer that is a beneficiary of the trust.

One of the consequences of these deeming rules is that actual distributions from the trust to the foreign affiliate are subject to the rules of subsection 90(2) in determining whether distributions in respect of units of the trust are treated as dividends. In addition, the surplus regulations in Part LIX of the *Income Tax Regulations* apply in respect of the trust. In this regard, entitlements to trust distributions are intended to fit within the rules for determining "participating percentage" in section 5904 of the *Income Tax Regulations* and surplus entitlements under subsection 5905(10) of the *Income Tax Regulations*.

These rules do not allow a Canadian-resident corporation to directly receive exempt dividends from a trust; they are intended only to allow distributions to pass from a trust to a foreign affiliate (including a trust that is deemed to be a foreign affiliate under section 93.3) as inter-affiliate dividends, and thus to qualify for the deduction from FAPI for inter-affiliate dividends under paragraph (*b*) of the description of A in the definition of FAPI in subsection 95(1) and to retain surplus characteristics, as applicable.

The rules allow the various other rules applicable in respect of foreign affiliates to apply for the purpose of determining the corporation's tax results in respect of the trust, including in particular the rules in paragraph 95(2)(*a*) that recharacterize FAPI as active business income.

In addition, where applicable, these rules generally result in the trust being treated as a controlled foreign affiliate of the taxpayer. Thus, the trust's FAPI is generally attributed to the taxpayer under subsection 91(1) in respect of the shares of a controlled foreign affiliate (or a deemed controlled foreign affiliate, if paragraph 93.3(3)(*e*) applies) of the taxpayer that has a participating percentage in respect of the trust.

Paragraph 93.3(4)(*b*) ensures that the trust is considered a foreign affiliate for the purpose of determining the Canadian taxpayer's reporting obligations under section 233.4 in respect of its foreign affiliates.

Although these rules are primarily intended to affect the taxation of a Canadian resident taxpayer in respect of its indirect interest in the trust, paragraph 93.3(4)(*c*) provides that the deeming rules in subsection 93.3(3) also apply to treat the trust as a foreign affiliate for the purpose of determining the tax payable by a non-resident controller of a corporation resident in Canada under the foreign affiliate dumping rules in section 212.3. For example, one situation where this is relevant is where a foreign-controlled Canadian corporation injects equity into a "good" foreign affiliate (i.e., a foreign affiliate that meets the requirements of the exception in subsection 212.3(16)) that, in turn, uses the funds to acquire an Australian trust in a transaction to which subsection

212.3(2) would have applied had the investment in the Australian trust been made directly by the Canadian corporation. By virtue of the indirect investment rule in subsection 212.3(23) the acquisition of the Australian trust could give rise to consequences under subsection 212.3(2).

Mergers

ITA
93.3(5)

New subsection 93.3(5) of the Act provides continuity rules for the purposes of section 93.3 to ensure that the section continues to apply following an amalgamation or wind-up of a Canadian corporation. Paragraph 93.3(5)(*a*) provides that, in the case of an amalgamation to which subsection 87(1) applies, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation. Paragraph 93.3(5)(*b*) provides that, in the case of a wind-up to which subsection 88(1) applies, the parent is deemed to be the same corporation as the subsidiary that is wound up.

Example 1

Assumptions

1. *Canco is a corporation resident in Canada that owns all the shares of CFA, a non-resident corporation that is a controlled foreign affiliate of Canco.*
2. *CFA acquires all the units of a trust resident in Australia (Austrust) from arm's length parties.*
3. *Austrust carries on an active business in Australia directly and also holds all the units of five other trusts (the Subtrusts) resident in Australia that carry on active businesses in Australia.*

Analysis

If Austrust and the Subtrusts meet the definition of an Australian trust under subsection 93.3(1), Austrust and the Subtrusts (because of paragraph 248(25)(a)) will be treated as foreign affiliates and controlled foreign affiliates of Canco for the specified purposes set out in subsection 93.3(4), with the result that, among other things:

- *An amount will be included in Canco's income under subsection 91(1) in respect of the FAPI, if any, of the trusts.*
- *CFA will be eligible for the inter-affiliate dividend exemption from FAPI in respect of distributions from Austrust (as Austrust will be in respect of distributions it receives from the Subtrusts).*
- *Any active business profits earned in Australia by any of the trusts will be eligible for exempt surplus treatment and, to the extent distributions from CFA are sourced from such surplus of the trusts, such distributions will be deductible under section 113.*

Example 2

Assumptions

1. *Canco is a widely-held public corporation resident in Canada.*
2. *Canco acquires all the units of a trust resident in Australia (Austrust) from arm's length parties.*

Analysis

In this case, subsection 93.3(3) does not apply as there is no non-resident corporation that is beneficially interested in the trust. Even if some of the units of Austrust were held by a foreign affiliate of Canco (in respect of which Canco has a qualifying interest), the deeming rules in subsection 93.3(3) would, by virtue of paragraph 93.3(4)(a), only apply in respect of the units held by the foreign affiliate. Canco could not claim deductions under section 113 in respect of direct distributions from Austrust.

Clause 23

Non-Resident Trusts

ITA
94

Section 94 of the Act sets out rules in respect of certain non-resident trusts in respect of which a Canadian resident, or former Canadian resident, is a contributor. In general, if a Canadian resident contributes property to a non-resident trust (other than an exempt foreign trust), the trust is deemed under paragraph 94(3)(*a*) to be resident in Canada for a number of purposes, and the contributor (except electing contributors), the trust and certain Canadian-resident beneficiaries of the trust may all become jointly and severally, or solidarily, liable to pay Canadian tax on the income of the trust.

Definitions

ITA
94(1)

“connected contributor”

The definition “connected contributor” in subsection 94(1) is relevant in determining whether a beneficiary is, at a particular time, a resident beneficiary under a non-resident trust. A connected contributor at a particular time is any person, including a person that has ceased to exist, that is a contributor to the trust at that time. An exception is provided for a person all of whose contributions to the trust made at or before the particular time were made at a non-resident time of the person. A second exception is provided, under paragraph (*a*) of the definition, for an individual (other than a trust) who was, as of the particular time, resident in Canada for a period of, or periods the total of which is, not more than 60 months.

The definition is amended to repeal the exception found in paragraph (*a*) of the definition.

This amendment generally applies to taxation years that end after February 10, 2014. A transitional rule is provided in the case of a trust where, if a taxation year of the trust had ended at any time in 2014 that is before February 11, 2014, the trust would be a non-resident for the year but would be resident in Canada for purposes of computing its income for the year (if paragraph (*a*) of the definitions “connected contributor” and “resident contributor” were not applicable). In this case, and provided that no contributions are made to the trust at any time in 2014 after February 10, 2014, the amendment applies in respect of the trust only to taxation years that end after 2014.

“resident contributor”

The definition “resident contributor” in subsection 94(1) is relevant in determining whether a trust is treated as resident in Canada for a particular taxation year by virtue of subsection 94(3). A resident contributor to a trust at any time means a person that is, at that time, resident in Canada and a contributor to the trust. An exception is provided, under paragraph (*a*) of the definition, for an individual (other than a trust) who was, at that time, resident in Canada for a period of, or periods the total of which is, not more than 60 months.

The definition is amended to repeal the exception found in paragraph (*a*) of the definition. The definition is also amended to replace a reference to “*inter vivos* trust” with a reference to a “trust”.

This amendment generally applies to taxation years that end after February 10, 2014. A transitional rule is provided in the case of a trust where, if a taxation year of the trust had ended at any time in 2014 that is before February 11, 2014, the trust would be non-resident for the taxation year but would be resident in Canada for purposes of computing its income for the year (if paragraph (*a*) of the definitions “connected contributor” and “resident contributor” were not applicable). In this case, and provided that no contributions are made to the trust at any time in 2014 after February 10, 2014, the amendment applies in respect of the trust only to taxation years that end after 2014.

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 "qualified disability trust" in subsection 122(3). For further information, see the commentary on the definition "qualified disability trust" in subsection 122(3).

This amendment applies to the 2016 and subsequent taxation years.

Deemed Contributor or Resident Contributor

ITA
94(11)

Subsections 94(11) of the Act is part of a set of related anti-avoidance rules that apply where it is reasonable to conclude that one of the reasons for a loan or transfer of property from a trust (the "original trust") to another trust (the "transferee trust") is to avoid or minimize the liability, of any person under Part I of the Act, that arose, or that would otherwise have arisen, because of the application of section 94. Where the subsection applies, the original trust is deemed by subsection 94(12) to be a resident contributor to the transferee trust, with the result that the transferee trust is deemed by subsection 94(3) to be resident in Canada , unless it is an exempt foreign trust.

An original trust includes, under subparagraph 94(11)(*b*)(ii), a trust that is non-resident immediately before the relevant transfer or loan, but would be deemed by subsection 94(3) to be resident in Canada at that time for purpose of computing its income if paragraph (*a*) of the definitions "connected contributor" and "resident contributor" did not apply. Subparagraph 94(11)(*b*)(ii) is amended to refer to those paragraphs as they read for 2013 taxation years. This amendment is consequential on the repeal of those paragraphs, but their continued application in defining an original trust for purposes of the anti-avoidance rules.

This amendment generally applies to taxation years that end after February 10, 2014. A transitional rule is provided in the case of a trust where, if a taxation year of the trust had ended at any time in 2014 that is before February 11, 2014, the trust would be non-resident for the taxation year but would be resident in Canada for purposes of computing its income for the year (if paragraph (*a*) of the definitions "connected contributor" and "resident contributor" were not applicable). In this case, and provided that no contributions are made to the trust at any time in 2014 after February 10, 2014, the amendment applies in respect of the trust only to taxation years that end after 2014.

Clause 24

Investments in Non-Resident Commercial Trusts

ITA
94.2(1)

Section 94.2 of the Act treats certain non-resident trusts as non-resident corporations controlled by certain of their beneficiaries, and where the beneficiary is itself a controlled foreign affiliate of a particular person, by the particular person. The preamble to subsection 94.2(1) provides an exception where the particular person is an individual (other than a trust) who was, as of the relevant time, resident in Canada for a period of, or periods the total of which is, not more than 60 months (a similar exception is provided under subparagraph 94.2(1)(*c*)(i) where the beneficiary is such an individual). Where the exception applies to an individual, section 94.2 does not apply to the individual in respect of the trust.

The definition is amended to repeal the exception found in the preamble to the definition. A related amendment to the definition "connected contributor" in subsection 94(1) has the effect of repealing the similar exception available to beneficiaries under subparagraph 94.2(1)(*c*)(i). For further information, see the commentary on the definition "connected contributor" in subsection 94(1).

This amendment generally applies to taxation years that end after February 10, 2014. A transitional rule is provided in the case of a trust where, if a taxation year of the trust had ended at any time in 2014 that is before February 11, 2014, the trust would be non-resident for the taxation year but would be resident in Canada for purposes of computing its income for the year (if paragraph (*a*) of the definitions "connected contributor" and "resident contributor" were not applicable). In this case, and provided that no contributions are made to the trust at any time in 2014 after February 10, 2014, the amendment applies in respect of the trust only to taxation years that end after 2014.

Clause 25

Section 95 of the Act defines a number of terms and provides rules relating to the taxation of shareholders of foreign affiliates.

Definitions

ITA
95(1)

Subsection 95(1) of the Act defines a number of terms for the purposes of subdivision i of Division B in Part I, which relates to shareholders of non-resident corporations.

The definitions "foreign accrual property income", "foreign accrual tax" and "non-qualifying country" are amended.

"foreign accrual property income"

The definition "foreign accrual property income" (FAPI) is relevant for the purposes of section 91 and for determining the taxable surpluses and deficits of a foreign affiliate of a taxpayer. Section 91 provides rules for determining amounts that a taxpayer must include in computing their income for a particular taxation year as income from a share of a controlled foreign affiliate.

The description of H in the definition of FAPI in subsection 95(1) is relevant where a foreign affiliate of a taxpayer is a member of a partnership that receives a dividend from another foreign affiliate of the taxpayer. It provides that the dividend is not included in the FAPI of the affiliate that is the partnership member.

The description of H is amended in order to ensure that it applies appropriately in situations where a partnership is, because of paragraph 96(1)(*a*), the relevant taxpayer. This situation could arise, for example, where the shares of a foreign affiliate that is a member of a partnership that has received a dividend are owned by a second partnership whose members are Canadian-resident corporations and the second partnership is the relevant taxpayer. In that case, the partnership look-through rule in subsection 93.1(1) would not apply to make the dividend-paying corporation a foreign affiliate of the partnership that is the relevant taxpayer because the subsection only applies for the purpose of determining whether a non-resident corporation is a foreign affiliate of a corporation resident in Canada. Paragraph 93.1(2)(*a*) also would not apply to deem the dividend to have been received by the foreign affiliate that is a member of the partnership that received the dividend, since the paragraph applies only where the corporation that pays the dividend is a foreign affiliate of a corporation resident in Canada.

The description of H is amended to apply where

- the corporation that paid the dividend would be a foreign affiliate of the taxpayer for purposes of sections 93 and 113 if the reference to "corporation resident in Canada" in subsection 93.1(1) were "taxpayer resident in Canada", and

- the dividend would be deemed by paragraph 93.1(2)(*a*) to have been received by the affiliate for purposes of sections 93 and 113 if the reference to “corporation resident in Canada” in subsection 93.1(2) were “taxpayer resident in Canada”.

This amendment applies to taxation years of a foreign affiliate of a taxpayer that end after 2006.

“foreign accrual tax”

The definition “foreign accrual tax” (FAT) in subsection 95(1) of the Act is relevant for determining the offsetting deduction that a taxpayer may claim under subsection 91(4) in respect of taxes paid or deemed to have been paid in respect of the FAPI of a controlled foreign affiliate of the taxpayer.

This definition is amended to address foreign affiliates that are fiscally transparent entities (FTEs) in certain foreign jurisdictions. A common example of an FTE is a limited liability company (LLC) formed under various U.S. state statutes. In recognition of the fact that, under certain foreign tax laws, the shareholder of a FTE, and not the FTE itself, is liable for and pays the income or profits tax in respect of income of the FTE, the FAT definition is amended by renumbering current subparagraph (*a*)(ii) as (*a*)(iii) and by adding a new subparagraph (*a*)(ii). New subparagraph (*a*)(ii) allows FAT to be claimed in certain circumstances in respect of income or profits taxes paid by another foreign affiliate that is a shareholder of the FTE (the shareholder affiliate).

In order for the foreign tax paid by the shareholder affiliate to qualify as FAT, in addition to meeting the general requirements in the FAT definition, subparagraph (*a*)(ii) requires that the shareholder affiliate be another foreign affiliate of the taxpayer and that all the following conditions in clauses (*a*)(ii)(A) to (D) be met:

- The shareholder affiliate must have an equity percentage in the FTE (the particular affiliate).
- The income or profits tax must be paid to a country other than Canada.
- Under the tax laws of the country to which the tax is paid, the shareholder affiliate, and not the particular affiliate, is subject to income taxation in respect of the amount included in the taxpayer’s income as FAPI under subsection 91(1).

Related amendments are also made to paragraph (*b*) of the FAT definition, and to the regulations that prescribe certain amounts to be FAT, to allow certain amounts in respect of the shareholder affiliate to be prescribed as FAT. For further information, please see the commentary on subsections 5907(1.3) to (1.6) of the *Income Tax Regulations*.

In addition to the above changes, the newly renumbered subparagraph (*a*)(iii) (formerly subparagraph (*a*)(ii)) of the FAT definition, which is the rule that generally allows for FAT to be claimed in respect of foreign dividend withholding tax, is amended by adding a reference to the dividend being received by another foreign affiliate “directly or indirectly” from the particular affiliate, and by clarifying that the other affiliate (who pays the tax on the dividend received from the particular affiliate) must have an equity percentage in the particular affiliate.

These amendments apply in respect of taxation years of a foreign affiliate of a taxpayer that end after 2010.

ITA
95(1)

“non-qualifying country”

The term “non-qualifying country” may be relevant in determining the amount prescribed to be foreign accrual property income (FAPI) of a foreign affiliate of a taxpayer for a year. FAPI includes the affiliate’s income for the year from a non-qualifying business of the affiliate. A business of an affiliate that would otherwise be an active business is generally considered a non-qualifying business if the business is carried on by the affiliate through a permanent establishment in a non-qualifying country.

The definition “non-qualifying country” in subsection 95(1) of the Act is amended by adding new paragraph (*a.1*). The effect of the paragraph is to ensure that, at any time after February 2014, a country or other jurisdiction will not be a non-qualifying country if it is one for which the *Convention on Mutual Administrative Assistance in Tax Matters* is at that time in force and has effect. As a consequence of the amendment, a non-qualifying country, at any time after February 2014, is a country or other jurisdiction in respect of which all the following conditions are met:

- Canada does not have a tax treaty at that time with the country or other jurisdiction, nor has Canada, before that time, signed an agreement that will, on coming into effect, be a tax treaty with the country or other jurisdiction.
- The country or other jurisdiction is one for which the *Convention on Mutual Administrative Assistance in Tax Matters* – concluded at Strasbourg on January 25, 1988, as amended from time to time by a protocol, or other international instrument, as ratified by Canada – is at that time not in force and does not have effect.
- Canada does not have a comprehensive tax information exchange agreement with the country or other jurisdiction that is in force and has effect at that time.
- Canada has, more than 60 months before that time, either
    - begun negotiations for a comprehensive tax information exchange agreement with the country or other jurisdiction, or
    - sought, by written invitation, to enter into negotiations for a comprehensive tax information exchange agreement with the country or other jurisdiction.

This amendment comes into force on January 1, 2014.

British Virgin Islands

ITA
95(1.1)

Subsection 95(1.1) of the Act is introduced to deem, for the purposes of paragraph (*b*) of the definition "non-qualifying country" in subsection 95(1), the British Overseas Territory of the British Virgin Islands to have a comprehensive tax information agreement with Canada that is in force and has effect after 2013 and before March 11, 2014. The effect of the subsection is to ensure that the British Overseas Territory of the British Virgin Islands is not a non-qualifying country for the period starting on January 1, 2014 up to and including March 10, 2014.

This amendment comes into force on January 1, 2014.

Active Business Income Recharacterization Rules

ITA
95(2)(*a*)(i)

Paragraph 95(2)(*a*) of the Act recharacterizes, in certain circumstances, amounts that would otherwise be income from property as income from an active business. More particularly, subparagraphs 95(2)(*a*)(i) to (iv) provide that particular income of a foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest throughout a taxation year of the affiliate, from sources in a country (other than Canada) that would otherwise be income from property of the affiliate for the year, are included in computing the income from an active business of the affiliate for the year.

In general terms, subparagraph 95(2)(*a*)(i) allows a particular foreign affiliate of a taxpayer, in respect of which the taxpayer has a qualifying interest, to include, in its income or loss from an active business, its income or loss from property if the following two conditions are met:

- The income or loss from property is derived by the particular foreign affiliate from activities that can reasonably be considered to be directly related to active business activities carried on in a country other than Canada by another foreign affiliate of the taxpayer (where certain criteria are met) or by a life insurance corporation (where certain other criteria are met).

- The income or loss would be included in computing the amount prescribed to be the earnings or loss from an active business carried on in a country other than Canada of the other foreign affiliate or, where certain criteria are met, the life insurance corporation, if the income or loss had been that of the other foreign affiliate or the life insurance corporation, as the case may be.

Subparagraph 95(2)(*a*)(i) is amended to address structures that include partnerships. It is also amended to address situations where the relevant active business activities are carried on by the particular foreign affiliate referenced in paragraph 95(2)(*a*)(i).

To address partnerships, first, clause 95(2)(*a*)(i)(A) is amended so that the income or loss from property of a partnership has access to the recharacterization rule in subparagraph 95(2)(*a*)(i) to the same extent as income or loss from property of a foreign corporation, to the extent that the activities of the partnership from which the income is derived occur while a foreign affiliate of a taxpayer resident in Canada is a qualifying member (as defined in paragraph 95(2)(*o*)) of the partnership. Second, new subclause 95(2)(*a*)(i)(A)(IV) is added to allow the income or loss from property of the affiliate or the partnership to be recharacterized as an active business income or loss by reference to the active business activities of a partnership of which another foreign affiliate of the taxpayer, in respect of which the taxpayer has a qualifying interest throughout the year, is a member, to the extent that the activities of the partnership from which the income is derived occur while the other affiliate is a qualifying member of the partnership.

New subclause 95(2)(*a*)(i)(A)(III) is added consequential to the changes outlined above.

Consequential changes are also made to the surplus regulations in Part LIX of the *Income Tax Regulations*, as described below.

These amendments apply in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013, but a taxpayer may elect to have the amendments apply in respect of taxation years of all foreign affiliates of the taxpayer that end after 2007.

ITA
95(2)(*a*)(ii)

Subparagraph 95(2)(*a*)(ii) of the Act sets out various rules that allow payments from one foreign affiliate to another foreign affiliate that would otherwise be income from property to the payee affiliate to be recharacterized as income from an active business.

Clause 95(2)(*a*)(ii)(D) generally recharacterizes, as income from an active business, income derived by a qualifying interest foreign affiliate (the first affiliate) of a taxpayer from amounts paid or payable by another qualifying interest foreign affiliate (the second affiliate) of the taxpayer as interest on borrowed money used to acquire, or on unpaid purchase price from the acquisition of, shares of another qualifying interest foreign affiliate (the third affiliate) of the taxpayer that are excluded property of the second affiliate, provided that certain conditions set out in the clause are satisfied.

One of the conditions in clause 95(2)(*a*)(ii)(D) is that the second and third foreign affiliates must be resident in the same country. Subclauses 95(2)(*a*)(ii)(D)(IV) and (V) are amended to remove that "same country" requirement, by deleting subclause (IV) and making consequential changes to subclause (V), which is renumbered as subclause (IV).

Consequential changes are also made to the surplus regulations in Part LIX of the *Income Tax Regulations*, as described below.

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after July 12, 2013.

Income from Sale of Property or from Canadian Debt and Lease Obligations

ITA
95(2)(*a.1*) and (*a.3*)

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

Paragraph (2)(*a.1*) is amended in two respects. First, new clause 95(2)(*a.1*)(ii)(C) is introduced so that paragraph 95(2)(*a.1*) does not apply in respect of the sale of an indebtedness, or a lease obligation, of a person resident in Canada or in respect of a business carried on in Canada, that was purchased and sold by the affiliate on its own account. Income earned in respect of the purchase and sale of such property is already addressed in paragraph 95(2)(*a.3*). Therefore, this amendment clarifies that paragraph 95(2)(*a.3*) is the relevant provision to the extent that there is overlap between paragraphs 95(2)(*a.1*) and (*a.3*). Where other provisions of the Act (*e.g.*, subsection 95(2.4)) apply to prevent paragraph 95(2)(*a.3*) from applying in respect of a particular sale of property, this change ensures that paragraph 95(2)(*a.1*) also will not apply in respect of that property. However, this amendment applies only in respect of a sale of property by the affiliate on its own account. Where, for example, the affiliate earns income for acting as agent in respect of the sale of the property, paragraph 95(2)(*a.1*) may still apply.

Second, the portion of paragraph 95(2)(*a.1*) after subparagraph (ii) and before subparagraph (iii) is amended. This portion of the paragraph provides that paragraph 95(2)(*a.1*) does not apply where more than 90% of the affiliate's gross income from the sale of property is derived from the sale of such property (other than property that specifically meets exclusions from 95(2)(*a.1*)) to arm's length persons. This rule is amended to clarify that for this purpose, property the income from the sale of which is not included in computing the income from a business other than an active business of the affiliate under paragraph 95(2)(*a.1*) because of new subsection 95(2.31) is similarly excluded.

Paragraph 95(2)(*a.3*) includes in the income from a business other than an active business (and thus the FAPI) of a foreign affiliate of a taxpayer resident in Canada, income of the affiliate derived directly or indirectly from indebtedness and lease obligations (including income of the affiliate for the year from the purchase and sale of indebtedness and lease obligations on its own account, but not including excluded income) of persons resident in Canada or in respect of businesses carried on in Canada.

The portion of paragraph 95(2)(*a.3*) after subparagraph (ii) and before subparagraph (iii) is amended. This portion of the paragraph provides that paragraph 95(2)(*a.3*) does not apply where more than 90% of the affiliate's gross revenue derived directly or indirectly from indebtedness and lease obligations (other than revenue that specifically meets exclusions to 95(2)(*a.3*)) was derived directly or indirectly from indebtedness and lease obligations of non-resident persons with whom the affiliate deals at arm's length. Like paragraph 95(2)(*a*.1), this provision is amended to clarify that revenue that is not included in computing the income from a business other than an active business of the affiliate under paragraph 95(2)(*a.3*) because of new subsection 95(2.31) is similarly excluded.

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Income from Insurance – Deemed Canadian Risks

ITA
95(2)(*a.21*) and (*a.22*)

New paragraph 95(2)(*a.21*) of the Act deems one or more risks insured by a foreign affiliate of a taxpayer that are not Canadian risks described in subparagraphs 95(*a.2*)(i) to (iii) (the "foreign policy pool") to be risks in respect of a person resident in Canada, for purposes of paragraph 95(2)(*a.2*), when certain conditions are met. Paragraph 95(2)(*a.2*) includes in the income from a business other than an active business (and thus the foreign accrual property income) of a foreign affiliate of a taxpayer resident in Canada, the income of the affiliate from the insurance of risks (including income from the reinsurance of risk) where the risks insured are in respect of any of (i) a person resident in Canada, (ii) a property situated in Canada, or (iii) a business carried on in Canada.

In order for paragraph 95(2)(*a.21*) to apply, all the following conditions must be satisfied:

- The affiliate, or a person or partnership that does not deal at arm's length with the affiliate, enters into one or more agreements or arrangements in respect of the foreign policy pool.
- The affiliate's risk of loss or opportunity for gain or profit in respect of the foreign policy pool, in combination with its risk of loss or opportunity for gain or profit in respect of the agreements or arrangements, can reasonably be considered to be – or could reasonably be considered to be if the affiliate had entered into the agreements or arrangements entered into by the person or partnership that does not deal at arm's length with the affiliate – determined, in whole or in part, by reference to one or more criteria in respect of one or more risks insured by another person or partnership (the "tracked policy pool"). For this purpose, the reference criteria are the fair market value of, the revenue, income, loss or cash flow from, or any similar criteria in respect of, the tracked policy pool. The tracked policy pool may consist of risks insured at a point in time or at different times (*e.g.*, where the insurance policies are turned over from year to year).
- Ten percent or more of the tracked policy pool is comprised of risks in respect of a person resident in Canada, a property situated in Canada or a business carried on in Canada.

For example, if a foreign affiliate of a taxpayer cedes a pool of Canadian risks to a foreign reinsurer, and in return reinsures a pool of foreign risks, and the expected returns from the foreign policy pool, in combination with expected returns from other agreements or arrangements in respect of the foreign policy pool, are such that the net profits are effectively driven in whole or in part off profits or losses in respect of those Canadian risks purportedly ceded, the affiliate can be considered to be, in substance, insuring the risks in the tracked policy pool. Paragraph 95(2)(a.21) may apply in this scenario to the extent the affiliate's risk of loss or opportunity for gain or profit in respect of the foreign policy pool, in combination with the risk of loss or opportunity for gain or profit in respect of the agreements or arrangements, can reasonably be considered to be determined in whole or in part by reference to any of various economic metrics in respect of the tracked policy pool. Where this is the case, and 10% or more of the risks in the tracked policy pool are Canadian risks (*i.e.*, more than a *de minimis* amount), paragraph 95(2)(*a.21*) deems the risks comprising the foreign policy pool to be risks in respect of a person resident in Canada, with the result that the affiliate's income from insuring those risks will be treated as income from the insurance of risks in respect of a person resident in Canada. Under paragraph 95(2)(*a.2*), this income is included in computing the affiliate's income from a business other than an active business (unless certain conditions set out in that paragraph are satisfied).

If the conditions in paragraph 95(2)(*a.21*) are satisfied, paragraph 95(2)(*a.22*) deems the activities performed in connection with the agreements or arrangements described in paragraph 95(2)(*a.21*) to be a separate business other than an active business – and income from that business (including income that is incident to or pertains to that business) to be income from a business other than an active business (and not active business income) – to the extent the activities can reasonably be considered to be performed for the purpose of obtaining the tracking result described in subparagraph 95(2)(*a.21*)(ii) (*i.e.*, in substance, the insurance of the tracked policy pool).

Paragraph 95(2)(*a.22*) ensures that any income or gains earned by a foreign affiliate in respect of the relevant agreements and arrangements, in respect of the foreign policy pool, are included in the affiliate's income from a business other than an active business, in a similar manner to the income in respect of the foreign policy pool.

New paragraphs 95(2)(*a.21*) and (*a.22*) apply to taxation years of a taxpayer that begin after February 10, 2014.

Base Erosion Rules for Income from Services

ITA
95(2)(*b*)

Paragraph 95(2)(*b*) of the Act is one of the "base erosion" rules. Subparagraph 95(2)(*b*)(ii) provides that the income from services of a foreign affiliate of a taxpayer is treated as income from a business other than an active business of the affiliate, and thus FAPI, if the services are performed by a person or partnership described in any of clauses 95(2)(*b*)(ii)(A) to (D). The person or partnership described in clause 95(2)(*b*)(ii)(B) is any other taxpayer who does not deal at arm's length with the affiliate or with any taxpayer of whom the affiliate is a foreign affiliate.

Clause 95(2)(*b*)(ii)(B) is amended to narrow the scope of its application and ensure that it does not cause FAPI to arise where the relevant services are performed outside of Canada by non-residents. This is accomplished by adding a reference to a "relevant person" who does not deal at arm's length with the affiliate, or any taxpayer of whom the affiliate is a foreign affiliate. "Relevant person" is defined for these purposes in new paragraph 95(3.02)(*a*), as discussed in the commentary on that paragraph.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013. A taxpayer may elect to have the amendment apply to taxation years of all the taxpayer's foreign affiliates that begin after February 27, 2004.

Offshore Banks

ITA
95(2)(*l*)

Paragraph 95(2)(*l*) of the Act includes in the income from property, of a foreign affiliate of a taxpayer, the affiliate's income from a business if the principal purpose of the business is to derive income from trading or dealing in certain indebtedness. Where the business of the affiliate is described in subparagraph 95(2)(*l*)(iii) (*e.g.*, as a foreign bank, trust company or credit union, the activities of which are regulated in the country under whose laws the affiliate was formed and in which the business is principally carried on) and the taxpayer is described in any of clauses 95(2)(*l*)(iv)(A) to (C) (*e.g.*, is a bank, trust company or credit union resident in Canada the business activities of which are subject to Canadian regulatory supervision), paragraph 95(2)(*l*) does not apply to the affiliate.

Paragraph 95(2)(*l*) is amended by adding clause 95(2)(*l*)(iv)(D) to reflect the fact that a foreign affiliate could be held through a partnership. With this amendment, paragraph 95(2)(*l*) will not apply if the affiliate's business is described in subparagraph 95(2)(*l*)(iii) and the taxpayer is a partnership, each member of which is a person described in any of clauses 95(2)(*l*)(iv)(A) to (C).

New clause 95(2)(*l*)(iv)(D) applies to taxation years of a taxpayer that begin after 2014.

Qualifying Interest

ITA
95(2)(*n*)

Paragraph 95(2)(*n*) of the Act provides that, for the purposes of certain enumerated provisions, a non-resident corporation is – if the conditions in that paragraph are met – deemed to be a foreign affiliate of a particular corporation resident in Canada and a foreign affiliate in respect of which the particular corporation has a qualifying interest.

Paragraph 95(2)(*n*) is amended to add a reference to new subsection 93.1(5). For further information, please see the commentary on that subsection.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that end after July 12, 2013, subject to an election to have the amendment applying in respect of taxation years of all foreign affiliates of the taxpayer that end after 2010.

Tiered Partnerships

ITA
95(2)(*u*)

Former paragraph 95(2)(*u*) of the Act contained two look-through rules to deal with cases where one partnership (i.e., an upper-tier partnership) was a member of another partnership (i.e., a lower-tier partnership). The first rule in paragraph 95(2)(*u*) deemed a member of an upper-tier partnership to be a member of a lower-tier partnership. The second rule deemed a member of an upper-tier partnership to have certain rights to the income and capital of the lower-tier partnership. This paragraph applied for purposes of enumerated provisions of the Act.

Paragraph 95(2)(*u*) was repealed and replaced by subsection 93.1(3), to the same effect, for foreign affiliate taxation years that end after August 19, 2011. However, the version of paragraph 95(2)(*u*) that existed immediately before its repeal is amended to add subsection 93.1(2) as one of the provisions for which paragraph 95(2)(*u*) applied. Subsection 93.1(2) is a partnership look-through rule that ensures a dividend received by a partnership is considered to be received by a foreign affiliate, or corporation resident in Canada, that is a member of the partnership. Subsection 93.1(2) is also one of the provisions for the purposes of which the new partnership look-through rule in subsection 93.1(3) applies.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 1999. Paragraph 95(2)(*u*) is repealed in respect of taxation years of a foreign affiliate of a taxpayer that end after August 19, 2011. After that time, subsection 93.1(3) will achieve the same result.

Investment Business

ITA
95(2.11)

New subsection 95(2.11) of the Act provides that (for the purposes of the definition "investment business" in subsection 95(1)), a taxpayer or a foreign affiliate of the taxpayer, as the case may be, is deemed not to have established that the requirements in subparagraph (*a*)(i) of that definition have been satisfied throughout a period in a particular taxation year of the affiliate unless certain additional conditions have been met.

The definition "investment business" is relevant in determining whether income from a business carried on by a foreign affiliate of a taxpayer is included in the affiliate's foreign accrual property income. If the business is an investment business, then the income from that business is included in the affiliate's income from property (and thus its foreign accrual property income). A business is generally considered to be an investment business if the principal purpose of the business is to derive income from property, subject to certain exceptions.

One of the exceptions in the definition of investment business is the "regulated foreign financial institution exception". One of the criteria for the application of the regulated foreign financial institution exception is that it must be established by the taxpayer or the foreign affiliate that, throughout the period in the taxation year during which the business is carried on by the affiliate, the business is carried on by it as a foreign bank, a trust company, a credit union, an insurance corporation or a trader or dealer in securities, the activities of which are, in general terms, locally regulated.

Subsection 95(2.11) then ensures that the regulated foreign financial institution exception is not satisfied unless the Canadian taxpayer is primarily a regulated Canadian financial institution or is part of a group of Canadian corporations that are, collectively, primarily regulated Canadian financial institutions. A foreign affiliate of a taxpayer will not qualify for the regulated foreign financial institution exception unless the taxpayer satisfies the conditions in both paragraphs 95(2.11)(*a*) and (*b*).

Paragraph 95(2.11)(*a*) requires that throughout the period the taxpayer must be a corporation or partnership described in any of subparagraphs 95(2.11)(*a*)(i) to (iv). Subparagraph 95(2.11)(*a*)(i) describes a corporation resident in Canada (referred to as the "particular corporation") that is a bank listed in Schedule I to the *Bank Act*, a trust company, a credit union, an insurance corporation or a trader or dealer in securities or commodities that is a registered securities dealer (as defined in subsection 248(1)). The registered securities dealer requirement is intended to ensure that only *bona fide* traders or dealers in securities – *i.e.*, traders or dealers that carry on a substantial business of acting as an intermediary with respect to transactions in securities by their clients, and therefore require registration – qualify for the exception from investment business. In addition, a particular corporation described in subparagraph 95(2.11)(*a*)(i) must be one the business activities of which are subject to the supervision of a regulating authority such as the Superintendent of Financial Institutions, a similar regulating authority of a province or an authority of, or approved by, a province to regulate traders or dealers in securities or commodities (*e.g.*, the Investment Industry Regulatory Organization of Canada).

As well, the particular corporation must not have outstanding, at any time during the period, a class of shares the fair market value of which is determined by reference to (*i.e.*, tracks) any of certain enumerated criteria for underlying property where the fair market value of the underlying property is less than 90% of the fair market value of all property of the corporation. For these purposes, the enumerated criteria are the fair market value of, any revenue, income or cash flow from, any profits or gains from the disposition of, or any other similar criteria in respect of, the underlying property. This restriction is intended to ensure that a third party cannot gain a tax advantage by owning shares of a specific class of the particular corporation when the third party itself would not qualify for the regulated foreign financial institutions exception.

Subparagraph 95(2.11)(*a*)(ii) describes a corporation resident in Canada of which a particular corporation described in subparagraph 95(2.11)(*a*)(i) is a subsidiary controlled corporation – *i.e.*, more than 50% of the issued share capital of the particular corporation (having full voting rights under all circumstances) belongs to the corporation – or a corporation of which such a corporation is a subsidiary wholly-owned corporation (*i.e.*, a corporation that owns all the shares of a corporation described immediately above). Also, as in the case of a particular corporation described in subparagraph 95(2.11)(*a*)(i), the corporation must not have outstanding a class of "tracking" shares.

Subparagraph 95(2.11)(*a*)(iii) describes corporations resident in Canada, each of the shares of which is owned by a corporation that is described in subparagraph 95(2.11)(*a*)(i) or (ii), or by another corporation described in subparagraph 95(2.11)(*a*)(iii).

Subparagraph 95(2.11)(*a*)(iv) sets out conditions for partnerships. Clause 95(2.11)(*a*)(iv)(A) describes partnerships each member of which is either a corporation described in any of subparagraphs 92(2.11)(*a*)(i) to (iv), or another partnership described in subparagraph 95(2.11)(*a*)(iv). Clause 95(2.11)(*a*)(iv)(B) describes a partnership in respect of which the following conditions are satisfied:

- the partnership is a registered securities dealer, the business activities of which are subject to the supervision of a regulating authority described in clause 95(2.11)(*a*)(i)(A), and
- the share of the total income or loss of the partnership, of a majority-interest partner (as defined in subsection 248(1)) of the partnership that is either a Canadian resident corporation or a Canadian partnership (as defined in subsection 248(1)), together with the share of each Canadian resident corporation that is affiliated with the majority-interest partner, is equal to all or substantially all of the total income or loss of the partnership.

Paragraph 95(2.11)(*b*) requires that one of two conditions is satisfied. The first is that throughout the period the Canadian regulated financial institution (*i.e.*, the particular corporation described in subparagraph 95(2.11)(*a*)(i)) has, or is deemed for certain purposes to have, $2 billion or more of equity under (as applicable) the *Bank Act*, the *Trust and Loan Companies Act* or the *Insurance Companies Act*. The second condition is that more than 50% of the total of all amounts each of which is an amount of taxable capital employed in Canada (within the meaning assigned by Part I.3) of the taxpayer, or an affiliated corporation resident in Canada, for the taxation year of the taxpayer or the affiliated corporation, as the case may be, that ends in the particular taxation year of the foreign affiliate is attributable to a business carried on in Canada the activities of which are subject to the supervision of a regulating authority such as the Superintendent of Financial Institutions, a similar regulating authority of a province or an authority of, or approved by, a province to regulate traders or dealers in securities. In determining whether an amount of taxable capital is attributable to a regulated business carried on in Canada, capital must be allocated between the businesses carried on by the taxpayer and affiliated Canadian corporations on a reasonable basis.

New subsection 95(2.11) applies to taxation years of a taxpayer that begin after 2014.

Application of Paragraphs 95(2)(*a.1*) and (*a.3*)

ITA

95(2.31)

New subsection 95(2.31) of the Act provides an exception from the application of paragraphs 95(2)(*a.1*) and (*a.3*) for certain securities transactions between a Canadian-based bank and certain of its foreign affiliates that are carried out in the course of the bank's business of facilitating trades for arm's length customers (as discussed below, new subsection 95(3.01) provides a similar exception from paragraph 95(2)(*b*) for services performed in connection with these types of securities transactions). Subsection 95(2.31) provides that paragraphs 95(2)(*a.1*) and (*a.3*) do not apply to a controlled foreign affiliate (for the purposes of section 17) of an eligible Canadian bank (as defined in subsection 95(2.43)) in respect of activities carried out to earn income from a property where certain conditions are satisfied.

The first condition, in the preamble to this provision, is that the property cannot be a specified property. "Specified property" is defined in subsection 95(2.32) and generally refers to certain types of property that have a Canadian source or nexus and that are owned by the affiliate for more than ten days. For further information, please see the commentary on subsection 95(2.32). Thus, a foreign affiliate that holds these types of securities for more than a reasonable period of time (*i.e.*, ten days) before effecting the trade will not be eligible for this exception.

The second condition, in paragraph 95(2.31)(*a*), is that the affiliate must sell the property, or perform services as an agent in relation to a purchase or sale of the property, and it must be reasonable to conclude that the cost to any person of the property is relevant in computing the income from

- a business carried on by the bank or a person resident in Canada that does not deal at arm's length with the bank, or
- a business carried on in Canada by a non-resident person that does not deal at arm's length with the bank.

The third condition, in paragraph 95(2.31)(*b*), is that the property must have a readily available fair market value and must be a property that

- is listed on a recognized stock exchange,
- would be a mark-to-market property (as defined in subsection 142.2(1)) of the bank if it were owned by the bank, or
- is a debt obligation owing by the bank that would be a mark-to-market property (as defined in subsection 142.2(1)) of the affiliate if the affiliate were the taxpayer referred to in that definition, and the definition "specified debt obligation" in subsection 142.2(1) were read without reference to its paragraph (*d*). This allows an affiliate to qualify for the exception in subsection 95(2.31) in respect of, for example, dispositions of debt instruments issued by a related person, such as its Canadian parent bank.

A property's value can be considered readily available where, for example, a bid-ask price is regularly quoted, and the property is actively traded, on a public market, such as a stock exchange, contemporaneously with the transaction in question. However, if there are no publicly available price quotations in respect of a particular security, and the security was not, or was only nominally, traded in the days leading up to the transaction, a valuation report, whether prepared internally or through external sources, would not be sufficient to consider the property to have a readily available fair market value for the purposes of this subsection.

The fourth condition, in paragraph 95(2.31)(*c*), is that the purchase or sale, or services performed by the affiliate as agent in respect of the purchase or sale, must be made by the affiliate

- on terms and conditions that are substantially the same as the terms and conditions of similar purchases or sales of, or services performed in respect of the purchase or sale of, such property by persons dealing at arm's length,
- in the course of a business that regularly includes the trading or dealing in securities principally with persons with whom the affiliate deals at arm's length and that is principally carried on through a permanent establishment outside of Canada, and
- for the purpose of enabling the purchase or sale of the property by an arm's length person.

The fifth condition, in paragraph 95(2.31)(*d*), is that the affiliate must be a foreign bank or a trader or dealer in securities and the activities of the business must be regulated

- under the laws of the country under whose laws the affiliate is governed and any of exists, was (unless the affiliate was continued in any jurisdiction) formed or organized, or was last continued, and under the laws of each country in which the business is carried on through a permanent establishment in that country,
- under the laws of the country (other than Canada) in which the business is principally carried on, or
- if the affiliate is related to a corporation, under the laws of the country under whose laws that related corporation is governed and any of exists, was (unless that related corporation was continued in any jurisdiction) formed or organized, or was last continued, if those regulating laws are recognized under the laws of the country in which the business is principally carried on and all those countries are members of the European Union.

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Specified Property

ITA
95(2.32)

New subsection 95(2.32) of the Act defines "specified property" of a foreign affiliate for the purposes of subsection 95(2.31) as a property that is owned by the affiliate for more than ten days and that is any of the following:

- a share of a Canadian-resident corporation;
- a property traded on a stock exchange located in Canada and not traded on a stock exchange located in the jurisdiction in which the affiliate is resident;
- a debt obligation
    - of a corporation resident in Canada,
    - of a trust or partnership, units of which are traded on a stock exchange located in Canada, or

- of, or guaranteed by, the Government of Canada, the government of a province, an agent of a province, a municipality in Canada or a municipal or public body performing a function of government in Canada.

If a property is a specified property of an affiliate, the affiliate's income from the sale of that property, or from services performed by the affiliate in relation to the purchase or sale of that property, does not qualify for the exception from paragraphs 95(2)(*a.1*) and (*a.3*) in subsection 95(2.31). This definition effectively requires an affiliate to dispose of a Canadian source property within ten days of acquiring it in order to qualify for the exception in subsection 95(2.31). This limit is intended to allow sufficient time for ordinary course trades in the relevant Canadian securities.

This amendment applies to taxation years of a foreign affiliate that begin after October 31, 2012.

Application of Paragraph 95(2)(*a.3*)

ITA
95(2.4)

In general terms, paragraph 95(2)(*a.3*) includes in the income from a business other than an active business (and thus the foreign accrual property income (FAPI)) of a foreign affiliate of a taxpayer resident in Canada, the income of the affiliate derived directly or indirectly from indebtedness and lease obligations (which includes income of the affiliate for the year from the purchase and sale of indebtedness and lease obligations on its own account, but not excluded income) of persons resident in Canada or in respect of businesses carried on in Canada.

Subsection 95(2.4) provides that paragraph 95(2)(*a.3*) does not apply in respect of income derived by a foreign affiliate of a taxpayer directly or indirectly from indebtedness to the extent that both paragraphs 95(2.4)(*a*) and (*b*) apply. Paragraph 95(2.4)(*b*) requires that the income be derived by the affiliate from trading or dealing in indebtedness (which consists of income from the actual trading or dealing in the indebtedness and interest earned by the affiliate during a short-term holding period on indebtedness acquired by it for the purpose of trading or dealing) with customers with whom the affiliate deals at arm's length. In addition, the customers must be resident in a country other than Canada in which the affiliate and any competitor (which is resident in the country in which the affiliate is resident and regulated in the same manner the affiliate is regulated in the country under whose laws the affiliate was formed or continued and exists and is governed and in which its business is principally carried on) compete and have a substantial market presence.

The French version of subsection 95(2.4) is amended by restructuring its preamble and paragraph 95(2.4)(*a*) so that they are grammatically correct in light of the amendments to paragraph 95(2.4)(*b*).

Paragraph 95(2.4)(*b*) is amended in three respects. First, the customers are no longer required to be resident in the relevant foreign country, but rather can either be resident, or carry on business through a permanent establishment, in the relevant country. Second, the arm's length competitor is no longer required to be resident in the relevant country, but rather can either be resident, or carry on business through a permanent establishment, in the country.

Third, the regulation requirement is made less stringent. The competitor's business activities can now be regulated (in the same manner as the activities of the affiliate's business) under the laws of the relevant country or, where the country is a member of the European Union, any country that is a member of the European Union. Thus, the European Union is to effectively be treated as one country in a manner consistent with the treatment of members of the European Union in paragraph 95(2.4)(*a*).

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Overview

ITA
95(2.43) to (2.45)

New subsections 95(2.43) to (2.45) of the Act – together with new section 125.21 and amendments to the definitions “earnings” and “exempt earnings” in subsection 5907(1) of the *Income Tax Regulations* – are intended to alleviate the tax cost to Canadian-based banks of using excess liquidity of their foreign affiliates in their Canadian operations. Subsections 95(2.43) to (2.45) can be summarized as follows:

- Subsection 95(2.43) defines terms that are relevant for these new provisions.
- Subsection 95(2.44) provides a rule that, in certain circumstances, allows certain foreign affiliates of a Canadian-based bank (namely, “eligible bank affiliates” of “eligible Canadian banks”, as defined in subsection 95(2.43)) to use their excess liquidity to make loans to their Canadian parent bank, or to acquire certain Canadian government debt securities, without the income from such investments being treated as foreign accrual property income (FAPI). As well, subsections 90(8) and (8.1) are related additions made to the upstream loan rules to ensure that, to the extent that an eligible bank affiliate lends amounts to its parent eligible Canadian bank that do not exceed the affiliate’s available excess liquidity, such loans generally will not give rise to the application of subsection 90(6), the main operative provision in the upstream loan rules.
- Subsection 95(2.45) generally provides rules to ensure that the use of a foreign affiliate’s excess liquidity in the Canadian operations of its Canadian parent bank does not cause the affiliate to have an investment business (as defined in subsection 95(1)) or prevent the affiliate’s, or another affiliate’s, shares from being excluded property.

Definitions

ITA
95(2.43)

New subsection 95(2.43) of the Act defines terms that are relevant for the purposes of the rules in new subsections 95(2.44) and (2.45), which are applicable in respect of certain foreign affiliates of Canadian-based banks. The definition “eligible Canadian bank” is also relevant for new subsections 95(2.31) and (3.01). The definitions “upstream deposit”, “eligible Canadian bank” and “eligible bank affiliate” are also used in new section 125.21. The definitions “excess liquidity”, “upstream deposit”, “eligible Canadian bank”, “eligible Canadian indebtedness” and “eligible bank affiliate” are also relevant for the purposes of new subsection 90(8.1). For further information, please see the commentary on those provisions.

“Canadian indebtedness”

Canadian indebtedness, owing to an eligible bank affiliate of an eligible Canadian bank, means indebtedness (other than upstream deposits) owing to the affiliate by persons resident in Canada or in respect of businesses carried on in Canada.

The term is relevant for the purposes of new paragraphs 95(2.45)(*a*) and (*b*). For further information, please see the commentary on those provisions.

“eligible bank affiliate”

An eligible bank affiliate, of an eligible Canadian bank (as defined in this subsection), means a foreign bank (as defined in subsection 95(1)) that is a controlled foreign affiliate (for the purposes of section 17) of the eligible Canadian bank and that is described in subparagraph (*a*)(i) of the definition “investment business” in subsection 95(1).

“eligible Canadian bank”

An eligible Canadian bank is defined as a bank listed in Schedule I to the *Bank Act*.

“eligible Canadian indebtedness”

Eligible Canadian indebtedness, owing to an eligible bank affiliate, means bonds, debentures, notes or similar obligations, owing to the affiliate, of: the Government of Canada; the government of, or an agent of, a province; a Canadian municipality; or a municipal or public body performing a function of government in Canada. However, it does not include debt securities held by the affiliate in respect of which paragraph 95(2)(*a.3*) does not apply because of the exception in subsection 95(2.31).

Eligible Canadian indebtedness is one of the types of investments in respect of which subsection 95(2.44) provides relief from paragraph 95(2)(*a.3*).

“eligible currency hedge”

An eligible currency hedge, of an eligible bank affiliate of an eligible Canadian bank, means an agreement that provides for the purchase, sale or exchange of currency and that

- can reasonably be considered to have been made by the affiliate to reduce its risk of fluctuations in the value of currency with respect to eligible Canadian indebtedness and upstream deposits owing to the affiliate; and
- cannot reasonably be considered to have been made by the affiliate to reduce its risk with respect to property other than eligible Canadian indebtedness and upstream deposits owing to the affiliate.

In order for a currency hedging agreement entered into by an affiliate to be an eligible currency hedge, it must hedge currency risk solely from eligible Canadian indebtedness and upstream deposits owing to the affiliate, and not, either in whole or in part, any other currency risk.

“excess liquidity”

Excess liquidity of an eligible bank affiliate for a taxation year of the affiliate is defined as the amount by which the amount described in paragraph (*a*) of the definition exceeds the amount described in paragraph (*b*). The amount described in paragraph (*a*) is the average of all amounts each of which is the amount of the affiliate’s relationship deposits for a calendar month ending in the 12-month period that begins 60 days prior to the start of the affiliate’s taxation year (or, if the affiliate was formed after the beginning of the 12-month period, in respect of a month that ends in the year).

For example, for an affiliate with an October 31 taxation year-end, the relevant 12-month period is from September to the following August – unless the affiliate was formed after September 1, in which case the 12-month period runs from November to October. This two-month lag between the affiliate’s taxation year and its 12-month measurement period allows the affiliate to better project its excess liquidity for the year when using that excess liquidity to make upstream deposits or acquire eligible Canadian indebtedness.

The amount described in paragraph (*b*) is the average of all amounts each of which is the amount of the affiliate's organic assets for a calendar month ending in the same 12-month period.

For these purposes, the amounts described in both paragraphs (*a*) and (*b*) are to be expressed in the affiliate’s calculating currency for the year (as defined in subsection 95(1)) unless the context requires otherwise. “Relationship deposits” and “organic assets” are defined in the same subsection.

“organic assets”

Organic assets of an eligible bank affiliate of an eligible Canadian bank for a month is defined as the total of all the amounts – in respect of the affiliate – each of which is

- included in the amounts reported as “loans” in the assets section of the consolidated monthly balance sheet filed for the month by the eligible Canadian bank or a related Canadian-resident corporation and accepted by the Superintendent of Financial Institutions, or
- an amount that is owing to the affiliate by a person that is related to the affiliate but that is not included in the “loans” in the assets section of the consolidated monthly balance sheet.

However, the affiliate’s organic assets do not include eligible Canadian indebtedness or upstream deposits owing to the affiliate.

“qualifying indebtedness”

A foreign affiliate’s income from an upstream deposit or eligible Canadian indebtedness may qualify for treatment as active business income under subsection 95(2.44) only if the upstream deposit or indebtedness is qualifying indebtedness. Qualifying indebtedness owing to an eligible bank affiliate of an eligible Canadian bank, means an upstream deposit or eligible Canadian indebtedness owing to the affiliate to the extent the deposit, or the affiliate’s acquisition of the indebtedness, as the case may be, satisfies two conditions. The first condition, in paragraph (*a*) of the definition, is that it must be reasonable to consider that the deposit or acquisition is funded by

- property transferred or lent by a person other than the bank or a person resident in Canada that was not, at the time of the transfer or loan, dealing at arm’s length with the bank;
- a repayment by the bank of all or part of an upstream deposit; or
- the purchase of eligible Canadian indebtedness, from the affiliate, by the bank or a person resident in Canada that was not, at the time of the transfer or loan, dealing at arm’s length with the bank.

The second condition, in paragraph (*b*) of the definition, is that the proceeds of the upstream deposit or the proceeds received by the vendor that sold the eligible Canadian indebtedness to the affiliate, as the case may be, must be used for a purpose other than to fund a transfer or loan of property by the bank – or another person resident in Canada that was not, at the time of the transfer or loan, dealing at arm’s length with the bank – to the affiliate or another foreign affiliate of the bank or of the other person.

The definition “qualifying indebtedness” ensures that subsection 95(2.44) does not apply to the extent that the deposit or the acquisition of indebtedness is funded by the parent bank or a person not dealing at arm’s length with the parent bank, rather than from the affiliate’s excess liquidity. It also ensures the same result to the extent that the proceeds of the deposit or the acquisition of indebtedness are used by the parent bank or another person not dealing at arm’s length with the parent bank to make a transfer or loan to the affiliate (or to another foreign affiliate of the bank or of the other person). This definition reflects the policy intent of allowing a foreign affiliate of a Canadian-based bank to use its excess liquidity to make loans to its Canadian parent bank, or to acquire certain Canadian government debt securities (including from its parent bank), without the related income being included in the affiliate’s FAPI if the proceeds of the loans, or from the sales of securities by the parent bank to the affiliate, are used by the parent bank in its Canadian operations.

Example 1 - Paragraph (a) of the definition “qualifying indebtedness”

Assumptions

- *An eligible bank affiliate of an eligible Canadian bank makes a loan of $1,000 to the bank (i.e., an upstream deposit) in a manner that satisfies the conditions in paragraph (b) of the definition “qualifying indebtedness”.*
- *A week before the affiliate made the upstream deposit, the bank had provided funds to the affiliate (other than as a result of the acquisition of an eligible Canadian indebtedness or as a repayment of an upstream deposit) of $2,000 via a transaction in the affiliate’s ordinary course of business. The funds were transferred into the affiliate’s general operating account. In the week before the upstream deposit*

was made, the affiliate also received funds from numerous customers with which the affiliate dealt at arm's length in the amount of $5,000, which were also transferred into the affiliate's general operating account.

- *The affiliate made the upstream loan out of its general operating account. This account is the one out of which the affiliate makes disbursements in the ordinary course of its business.*

Analysis

Paragraph (a) of the definition "qualifying indebtedness" will be satisfied to the extent that it can reasonably be considered that the upstream deposit is funded by property transferred or lent by a person other than the bank or a person resident in Canada that was not dealing at arm's length with the bank.

In this example, there is no clear tracing of the use of funds received by the eligible bank affiliate, and it may be reasonable to conclude that the $1,000 upstream deposit was funded by some of the $2,000 provided a week before by the bank. However, absent other factors connecting the $2,000 transfer by the bank to the making of the upstream deposit, it is also reasonable to consider that the affiliate fully funded the upstream deposit with part of the $5,000 received from the affiliate's arm's length customers. Therefore, the conditions in paragraph (a) of the definition "qualifying indebtedness" would be satisfied. The fact that an upstream deposit cannot clearly be traced to funds from a source other than the bank or a person resident in Canada with which the bank does not deal at arm's length does not preclude satisfying this test.

Example 2 – Paragraph (b) of the definition "qualifying indebtedness"

Assumptions

- *An eligible bank affiliate of an eligible Canadian bank makes a loan of $1,000 to the bank (i.e., an upstream deposit) in a manner that satisfies the conditions in paragraph (a) of the definition "qualifying indebtedness".*
- *The bank uses $600 of these funds in its Canadian banking business and lends the remaining $400 to a wholly-owned foreign affiliate.*

Analysis

Paragraph (b) of the definition "qualifying indebtedness" will be satisfied to the extent that it can reasonably be considered that the proceeds of the upstream deposit are used for a purpose other than to fund a transfer or loan of property by the bank to the affiliate or another foreign affiliate of the bank. In this example, it would be reasonable to consider that paragraph (b) is satisfied to the extent of the $600 amount – $400 of the $1,000 would not satisfy this condition. The use of the phrase "to the extent that" does not require that the whole amount of the upstream deposit satisfy the condition. Therefore, $600 of the $1,000 amount of the upstream deposit would be considered a "qualifying indebtedness".

"relationship deposits"

Relationship deposits of an eligible bank affiliate of an eligible Canadian bank for a month are defined as the total of all amounts – in respect of the affiliate – reported as "demand and notice deposits" and "fixed term deposits" in the liabilities section of the consolidated monthly balance sheet filed for the month by the eligible Canadian bank or a related Canadian-resident corporation and accepted by the Superintendent of Financial Institutions. However, any deposits that are of a temporary nature – or are made with the affiliate by a person who, at the end of the month, does not deal at arm's length with the affiliate or is resident in Canada – are not included in the affiliate's relationship deposits. Any deposit made with the affiliate that is not connected to a customer relationship of the affiliate, for example, will be considered to be a deposit of a temporary nature.

“total specified indebtedness”

Total specified indebtedness, owing to an eligible bank affiliate of an eligible Canadian bank for a year, means the average of all amounts each of which is, in respect of a month that ends in the year, the greatest total amount at any time in the month that is the total of all amounts each of which is

- the amount of an upstream deposit owing to the affiliate;
- the amount of an eligible Canadian indebtedness owing to the affiliate; or
- the positive or negative fair market value of an eligible currency hedge of the affiliate.

The negative fair market value of an eligible currency hedge refers to a currency hedge that is in a loss position. The positive or negative fair market value of an eligible currency hedge of the affiliate would generally be expected to offset a corresponding foreign exchange loss or gain on the hedged upstream deposit or eligible Canadian indebtedness.

Total specified indebtedness is relevant in computing the proportion of the affiliate’s income from upstream deposits and eligible Canadian indebtedness that is treated as active business income under subsection 95(2.44); this amount is generally reduced to the extent that the affiliate’s total specified indebtedness exceeds its excess liquidity for the year. This definition is similarly relevant in determining whether an affiliate qualifies for the exception in subsection 95(2.45) from the definition “investment business” in subsection 95(1). For further information, please see the commentary on subsections 95(2.44) and (2.45).

“upstream deposit”

An upstream deposit owing to an eligible bank affiliate of an eligible Canadian bank means an indebtedness owing by the bank to the affiliate.

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

FAPI Adjustment – Eligible Bank Affiliate

ITA
95(2.44)

New subsection 95(2.44) of the Act provides a rule that, in certain circumstances, allows certain foreign affiliates of a Canadian-based bank to use their excess liquidity to make loans to their Canadian parent bank, or to acquire certain Canadian government debt securities, without the income from such investments being included in computing their foreign accrual property income (FAPI). In the absence of new subsection 95(2.44), such income would generally be treated as FAPI by virtue of the “base erosion” rule in paragraph 95(2)(*a.3*).

New subsection 95(2.44) applies if two conditions are met. First, the affiliate must be an eligible bank affiliate of an eligible Canadian bank (both as defined in subsection 95(2.43)) throughout the affiliate’s relevant taxation year. Second, the eligible Canadian bank must file an election in respect of the affiliate for the taxation year on or before the bank’s filing-due date for the taxation year of the bank in which the affiliate’s relevant taxation year ends.

Where these two conditions are met, paragraph 95(2.44)(*a*) provides that there is to be deducted in computing the amount determined for variable A in the definition “foreign accrual property income” in subsection 95(1) for the year, the lesser of the amount determined (without reference to paragraph 95(2.44)(*a*)) for variable A in that definition in respect of the affiliate for the year, and the amount determined by the formula

$$A - B - C - D$$

Variable A is the total of all amounts each of which

- is the affiliate’s income for the year from a qualifying indebtedness or from an eligible currency hedge (as each of those terms is defined in subsection 95(2.43)); and

- would, in the absence of subsection 95(2.44), be included in computing the affiliate's income from a business other than an active business (by virtue of the application of paragraph 95(2)(*a.3*)).

The relief under this subsection is limited to income from qualifying indebtedness in order to ensure that only upstream deposits and eligible Canadian indebtedness the funding for which satisfies the requirements of the definition "qualifying indebtedness" in subsection 95(2.43) obtain such relief. For further information, please see the commentary on that definition.

Variable B is the total of all amounts each of which is the affiliate's loss for the year from a property that

- is a qualifying indebtedness owing to, or eligible currency hedge of, the affiliate; and
- would, in the absence of subsection 95(2.44), be deducted in computing the income of the affiliate from a business other than an active business.

Variable C is the total of all amounts each of which is the amount, if any, by which an amount included in computing variable A in respect of an upstream deposit exceeds – or an amount included in computing variable B is less than – the amount that would be the affiliate's income or loss, as the case may be, for the year from the deposit if the interest received or receivable by the affiliate in respect of the deposit were computed at an interest rate equal to the applicable benchmark interest rate. The applicable rate depends on the currency in which a particular upstream deposit is denominated as well as the affiliate's particular circumstances:

- If the deposit is denominated in a qualifying currency (as defined in subsection 261(1)), then the applicable benchmark is the average, for the affiliate's taxation year, of a daily inter-bank offered rate – acceptable to the Minister of National Revenue – for loans denominated in that currency with a term to maturity of three months. It is currently expected that the inter-bank offered rate acceptable to the Minister for these purposes will be the London Inter-bank Offered Rate (LIBOR) for a three-month deposit denominated in the relevant currency. Thus, the applicable benchmark rate is the average of the daily quotations of this LIBOR for the year.
- In any other case, the applicable benchmark interest rate is the average, for the year, of a daily rate – acceptable to the Minister of National Revenue – for Canadian dollar denominated bankers' acceptances with a term to maturity of three months. It is currently expected that the three-month rate acceptable to the Minister for Canadian dollar denominated bankers' acceptances will be the generally accepted Canadian dealer offered rate (CDOR).

The benchmark interest rates acceptable to the Minister are subject to change in the event another rate is determined by the Minister to be a more appropriate benchmark.

In effect, variable C provides that, where the rate of interest charged on an upstream deposit is greater than the benchmark rate acceptable to the Minister, subsection 95(2.44) will not treat the excess amount of interest income in respect of the upstream deposit as active business income.

Variable D is, in general terms, the portion of the income described in variable A (as reduced by the amounts determined for variables B and C) that is derived from upstream deposits and eligible Canadian indebtedness of the affiliate that are, in aggregate (and taking into consideration the value of any related hedging agreements), in excess of its excess liquidity for the year. Thus, variable D is a "cap", which effectively allows a foreign affiliate of a Canadian-based bank to use only its excess liquidity to make loans to its Canadian parent bank, or to acquire certain Canadian government debt securities, without the income therefrom being included in the affiliate's FAPI.

The variable D amount is determined by the formula

$$E \times F/G$$

where

- variable E is the amount, if any, by which the amount determined for variable A exceeds the total of the amounts determined for variables B and C;
- variable F is the amount, if any, by which the total specified indebtedness owing to the affiliate for the year exceeds the affiliate's excess liquidity for the year; and
- variable G is the total specified indebtedness owing to the affiliate for the year.

For further information on the terms "excess liquidity" and "total specified indebtedness", please see the commentary on those definitions under subsection 95(2.43).

Paragraph 95(2.44)(*b*) provides that there is to be included in the affiliate's income from an active business for the year an amount equal to the proportion of the amount computed under the formula in subparagraph 95(2.44)(*a*)(ii) (computed as if each amount referred to in that formula were determined using the affiliate's calculating currency) that the amount that is required to be deducted under paragraph 95(2.44)(*a*) for the year is of the amount described in subparagraph 95(2.44)(*a*)(ii).

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Example 1

Assumptions

- *In respect of a taxation year, an eligible bank affiliate earned income of C$8,000 that is recharacterized under paragraph 95(2)(a.3) as income from a business other than an active business. This income is comprised of:*
    - *C$10,000 of income from qualifying indebtedness (less expenses reasonably allocable thereto), and*
    - *a C$2,000 loss from indebtedness that was not qualifying indebtedness.*
- *The amounts determined for variables B, C and D in the formula in subparagraph 95(2.44)(a)(ii) are each nil, and for all relevant purposes, the relevant exchange rate for the affiliate's foreign calculating currency (FC) is FC$0.90:C$1.00.*
- *The affiliate had no other income that was included in the determination of FAPI for the year.*

Analysis

Under paragraph 95(2.44)(a), there is to be deducted, in computing the amount determined for A in the definition of FAPI, the lesser of (i) the amount determined for variable A in the FAPI definition read without reference to subsection 95(2.44), and (ii) the amount determined by the formula in subparagraph 95(2.44)(a)(ii). The amount determined by the formula is the income from qualifying indebtedness, being C$10,000. The amount otherwise included in variable A of the FAPI definition would be the affiliate's C$8,000 income from the business, other than an active business. As such, paragraph 95(2.44)(a) determines the amount deductible in determining variable A of the definition of FAPI to be C$8,000. (A deduction made by virtue of paragraph 95(2.44)(a) cannot make variable A of the definition of FAPI become negative.)

Pursuant to paragraph 95(2.44)(b), there is to be included, in determining the amount that is the affiliate's income from an active business, an amount equal to the proportion of the amount determined by the formula in subparagraph 95(2.44)(a)(ii)(i.e., FC$9,000, determined in the affiliate's calculating currency) that the amount determined to be deducted under paragraph 95(2.44)(a) (i.e., C$8,000) is of the amount determined under subparagraph 95(2.44)(a)(ii) (i.e., C$10,000). As such, the amount to be added to the income from an active business of the affiliate is FC$7,200 (i.e., FC$9,000 x C$8,000/C$10,000).

Example 2

Assumptions

- *A non-resident corporation, that is an eligible Canadian bank and has elected in respect of an eligible bank affiliate under subsection 95(2.44) for a taxation year of the affiliate, owes its affiliate a US$4 million upstream deposit that is a qualifying indebtedness throughout the taxation year of the affiliate.*
- *The affiliate's income from the indebtedness for the year comprises*
  - *US$100,000 of interest income (after deducting expenses reasonably allocated thereto), which is equivalent to C$105,000, and*
  - *a foreign exchange gain equal to C$8,000, realized on the repayment of the indebtedness at the end of the year.*
- *Had the interest rate applicable to the indebtedness been equal to the average of the daily 3-month US dollar LIBOR for the year, the affiliate's interest income (after deducting expenses reasonably allocated thereto) would have been US$101,000, which would have been equivalent to C$106,050.*
- *The amounts determined for variables B and D in the formula in subparagraph 95(2.44)(a)(ii) are each nil, and the affiliate had no other income that was included in the determination of its FAPI for the year.*

Analysis

Paragraph 95(2.44)(a) provides a deduction, in computing the foreign accrual property income (FAPI) of the affiliate for the year, equal to the lesser of (i) the C$113,000 that is the affiliate's income for the year from a qualifying indebtedness owing to it, and (ii) the amount determined (using Canadian currency) by the formula A-B-C-D. The amount determined, in respect of the indebtedness, for variable A in the formula is C$113,000 and, as noted, the amounts determined for variables B and D are each nil. The amount determined for variable C is equal to the amount by which the amount included, in respect of the indebtedness, in computing A exceeds the amount that would be the affiliate's income for the year from the indebtedness if the interest received by the affiliate in respect of the indebtedness were computed at the relevant benchmark interest rate. In this case, the amount determined for variable C is nil, since the C$113,000 included, in respect of the indebtedness, in computing A does not exceed the C$114,050 (C$106,050 interest plus C$8,000 foreign exchange gain) that would have been the affiliate's income for the year from the indebtedness if the interest had been computed at the relevant benchmark rate. Thus, the deduction under paragraph 95(2.44)(a) in computing the affiliate's FAPI for the year is equal to C$113,000.

Paragraph 95(2.44)(b) includes in the affiliate's active business income for the year an amount equal to the proportion of the amount computed (using the affiliate's calculating currency) under the formula in subparagraph 95(2.44)(a)(ii) that the amount that is required to be deducted under paragraph 95(2.44)(a) for the year is of the amount described in subparagraph 95(2.44)(a)(ii). Thus, in this case, paragraph 95(2.44)(b) includes US$100,000 (i.e., $US100,000 X C$113,000/C$113,000) in the affiliate's active business income for the year.

Investment Business and Excluded Property

ITA
95(2.45)

New subsection 95(2.45) of the Act provides two deeming rules that apply when an election is made under subsection 95(2.44) by an eligible Canadian bank in respect of an eligible bank affiliate of the bank for a taxation year of the affiliate. First, paragraph 95(2.45)(*a*) provides a deeming rule for the purposes of the definition "investment business" in subsection 95(1). In general terms, the significance of a business of a foreign affiliate of a taxpayer being an investment business is that the affiliate's income from that business will be treated as income from property, and thus will be included in computing its FAPI. A foreign affiliate's business will be an investment business, even if it otherwise satisfies the exception contained in paragraphs (*a*) to (*c*) of that definition, if the business is conducted principally with persons with whom the affiliate does not deal at arm's length.

The deeming rule in paragraph 95(2.45)(*a*) generally ensures that, where the applicable conditions are met, the making of upstream deposits by a foreign affiliate to, and the acquisition by the affiliate of Canadian indebtedness from, its Canadian parent bank, or a person resident in Canada that does not deal at arm's length with the bank, do not cause the affiliate to be considered to conduct its business principally with non-arm's length persons and thus to have an investment business. To achieve this result, paragraph 95(2.45)(*a*) deems an eligible Canadian bank and an eligible bank affiliate of the bank to deal with each other at arm's length in respect of the making of such loans or deposits, and the acquisition of such indebtedness, by the affiliate in the course of a business carried on by the affiliate in a taxation year if the affiliate's excess liquidity for the year is equal to at least 90% of the affiliate's total specified indebtedness for the year (as defined in subsection 95(2.43)). The underlying principle is that paragraph 95(2.45)(*a*) applies where excess liquidity is being used to make the relevant investments. The 90% threshold is intended to provide some flexibility in recognition of the fact that the affiliate's excess liquidity might fluctuate for reasons beyond the control of either the bank or the affiliate.

Paragraph 95(2.45)(*b*) contains a separate rule that deems the following for the purposes of paragraph (*b*) of the definition "excluded property" in subsection 95(1):

- The fair market value of each upstream deposit and Canadian indebtedness owing to, and eligible currency hedge of, the affiliate (all as defined in subsection 95(2.43) is deemed to be nil. As a result of this rule, the excluded or non-excluded property status of particular deposits, debts and hedges is not taken into account for the purpose of determining whether shares of the affiliate are excluded property of another foreign affiliate of the bank. As a consequence, the additional deeming rules in subparagraphs 95(2.45)(*b*)(ii) and (iii) will operate to determine the relevance of these properties for the purpose of determining whether shares of the affiliate are excluded property.
- The lesser of the following two amounts is deemed to be the fair market value of a property of the affiliate that is excluded property at a given time:
  - the amount that is the total fair market value, at that time, of the upstream deposits and Canadian indebtedness owing to, and eligible currency hedges of, the affiliate; and
  - the amount, if any, by which
    - the amount by which the affiliate's relationship deposits for the calendar month that is two months prior to the particular time (or if the affiliate was formed less than two months prior to the particular time, for the calendar month that includes the particular time)

      exceeds
    - the amount of the affiliate's organic assets for the calendar month that is two months prior to the particular time (or if the affiliate was formed less than two months prior to the particular time, for the calendar month that includes the particular time).
- The amount, if any, by which the amount in clause 95(2.45)(*b*)(ii)(A) (*i.e.*, the total of the upstream deposits and Canadian indebtedness owing to, and eligible currency hedges of, the affiliate) exceeds the amount deemed by subparagraph 95(2.45)(*b*)(ii) to be the fair market value of a property of the affiliate that is excluded property, is deemed to be the fair market value of a property of the eligible bank affiliate that is not excluded property.

Very generally, for the purposes of paragraph (*b*) of the definition "excluded property" in subsection 95(1), subparagraph 95(2.45)(*b*)(ii) deems an excluded property to exist with a fair market value equal to the aggregate value of the upstream deposits and Canadian indebtedness owing to, and eligible currency hedges of, the affiliate to the extent this does not exceed the affiliate's excess liquidity. This is consistent with the policy of generally permitting eligible Canadian banks to access the excess liquidity of their eligible bank affiliates without adverse tax consequences. Where the aggregate value of the upstream deposits and Canadian indebtedness owing to, and eligible currency hedges of, the affiliate exceeds its excess liquidity, however, subparagraph 95(2.45)(*b*)(iii) deems such excess to be the fair market value of a separate non-excluded property of the eligible bank affiliate.

Paragraph 95(2.45)(*b*) is relevant only for purposes of paragraph (*b*) of the definition of "excluded property" (in subsection 95(1)). As such, this deeming rule is relevant, for example, in determining whether shares of a foreign affiliate of an eligible Canadian bank are excluded property of another foreign affiliate of the bank for the purposes of determining whether shares of a "third affiliate" referred to in subclause 95(2)(*a*)(ii)(D)(III) are excluded property of a "second affiliate" referred to in that subclause. This provision is not relevant in determining whether a particular property is an excluded property in the hands of the eligible bank affiliate itself, nor is it determinative of the tax treatment of dispositions of such property by the eligible bank affiliate.

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Excluded Income and Excluded Revenue

ITA
95(2.5)

Subsection 95(2.5) of the Act provides definitions for the purposes of the "base erosion" rule in paragraph 95(2)(*a.3*), which causes income of a foreign affiliate from certain indebtedness and lease obligations of persons resident in Canada, or in respect of businesses carried on in Canada, to be FAPI in certain circumstances. The terms "excluded income" and "excluded revenue" are among those defined in the subsection. Excluded income of a foreign affiliate is excepted from the application of paragraph 95(2)(*a.3*), and thus is not FAPI of the affiliate. Excluded revenue is not included in computing a foreign affiliate's gross revenue from indebtedness and lease obligations for purposes of the *de minimis* rule in paragraph 95(2)(*a.3*), which generally applies where more than 90% of the affiliate's gross revenue from indebtedness and lease obligations is from indebtedness and lease obligations of arm's length non-resident persons.

The definitions "excluded income" and "excluded revenue" are amended in two respects. First, paragraph (*b*) of the definitions is amended to narrow their scope and prevent an anomalous result from arising under the paragraph. Paragraph (*b*) provides that the income or revenue of a foreign affiliate of a taxpayer are excluded income or excluded revenue, respectively, where they are derived from a lease obligation of a person (other than the taxpayer or a person that does not deal at arm's length with the taxpayer) relating to the use of property outside Canada. However, under the current version of paragraph (*b*), a taxpayer cannot rely on the *de minimis* rule in paragraph 95(2)(*a.3*) in respect of its foreign affiliate where more than 90% of the gross revenue of the affiliate from indebtedness or lease obligations is derived from lease obligations of non-resident persons with whom the affiliate deals at arm's length relating to the use (in the course of carrying on a business outside Canada) of property outside Canada.

In order to correct this anomaly and ensure that a taxpayer can rely on the *de minimis* rule in paragraph 95(2)(*a.3*) in the circumstances described above, paragraph (*b*) is amended to provide that, in order for income or revenue to be excluded income or revenue, respectively, it must be derived from the lease obligation of a person resident in Canada, and that lease obligation must relate to property that is used by the person in the course of carrying on a business through a permanent establishment outside Canada.

The second amendment to subsection 95(2.5) adds new paragraph (*d*) to the definitions "excluded income" and "excluded revenue". It provides that any income or revenue that is included in computing the income or loss from an active business for the year of a foreign affiliate because of subparagraph 95(2)(*a*)(ii) is excluded income or excluded revenue, respectively.

The amendment to paragraph (*b*) applies in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013. A taxpayer may elect to have the amendment apply to taxation years of all the taxpayer's foreign affiliates that begin after 1994 or 1999.

New paragraph (*d*) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after February 27, 2004.

Specified Deposit

ITA
95(2.5)

The definition "specified deposit" in subsection 95(2.5) is relevant for the definitions "excluded income" and "excluded revenue" in subsection 95(2.5), which provide exceptions from the "base erosion" rule in paragraph 95(2)(*a.3*) for, among other things, income and revenue, respectively, derived from a specified deposit with a prescribed financial institution.

The definition "specified deposit" is amended in two ways. First, it is amended to clarify that it applies only in respect of bank deposits of foreign affiliates that are made with foreign branches of Canadian deposit-taking financial institutions. This better reflects the policy intent of treating deposits with those foreign branches in the same manner as deposits with foreign financial institutions. Second, the definition is amended by eliminating existing paragraph (*b*). As such, the specified deposit exception is not available in respect of a business whose principal purpose is to derive income from property or profits from the disposition of investment property.

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Application of Paragraph 95(2)(*b*) – Eligible Canadian bank

ITA
95(3.01)

New subsection 95(3.01) of the Act provides an exception from the "base erosion" rule in paragraph 95(2)(*b*) for services performed in connection with certain securities transactions between a Canadian-based bank and certain of its foreign affiliates. As discussed above, subsection 95(2.31) provides a similar exception from the "base erosion" rules in paragraphs 95(2)(*a.1*) and (*a.3*) for these types of securities transactions. The conditions that must be satisfied in order for subsection 95(3.01) to apply are similar to those in subsection 95(2.31). For further information, please see the commentary on subsection 95(2.31).

These amendments apply to taxation years of a foreign affiliate that begin after October 31, 2012.

Rules for Clause 95(2)(*b*)(ii)(B)

ITA
95(3.02)

New subsection 95(3.02) of the Act applies for the purposes of clause 95(2)(*b*)(ii)(B) and is added to define, in paragraph 95(3.02)(*a*), a "relevant person", and to provide, in paragraph 95(3.02)(*b*), a deeming rule in respect of businesses carried on partly in Canada and partly outside of Canada.

Paragraph 95(3.02)(*a*) defines a relevant person as a person resident in Canada, or a non-resident person if the non-resident person performs the services referred to in subparagraph 95(2)(*b*)(ii) in the course of a business (other than a treaty-protected business as defined in subsection 248(1)) carried on in Canada. This ensures that clause 95(2)(*b*)(ii)(B) does not cause income of a foreign affiliate from services to be FAPI where the services are performed by non-residents outside of Canada. For further information, please see the commentary on paragraph 95(2)(*b*).

Paragraph 95(3.02)(*b*) complements paragraph 95(3.02)(*a*) and, for purposes of clause 95(2)(*b*)(ii)(B), deems any portion of a business carried on by a non-resident person that is carried on in Canada to be a business that is separate from any other portion of the business that is not carried on in Canada.

New subsection 95(3.02) applies in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013. A taxpayer may elect to have the amendment apply to taxation years of all the taxpayer's foreign affiliates that begin after February 27, 2004.

Contract Manufacturing

ITA
95(3.2)

New subsection 95(3.2) of the Act is a deeming rule that, where it applies, allows income of a foreign affiliate of a taxpayer from the sale of property to qualify for the contract manufacturing exception to the base erosion rule in paragraph 95(2)(*a.1*), and thus to not be FAPI of the foreign affiliate.

The contract manufacturing exception in clause 95(2)(*a.1*)(ii)(A) applies where, among other things, property was manufactured in the country under whose laws the foreign affiliate is governed and was formed, and in which the affiliate's business is principally carried on. Subsection 95(3.2) deems property of a particular foreign affiliate of a taxpayer to have been manufactured by the particular affiliate in a particular country if two requirements are met. First, paragraph 95(3.2)(*a*) requires that the property be developed and designed by the particular affiliate in the particular country in the course of an active business carried on by the particular affiliate in that country. Second, paragraph 95(3.2)(*b*) requires that the property be manufactured, produced or processed outside the particular country by another foreign affiliate of the taxpayer – during a period throughout which the taxpayer has a qualifying interest in the other affiliate – under a contract between the particular affiliate and the other affiliate and in accordance with the specifications provided by the particular affiliate. In general terms, subsection 95(3.2) allows a foreign affiliate's income to qualify for that exception where the affiliate that sells the property, and earns the relevant income, contracts with another foreign affiliate of the same taxpayer for the manufacture, production or processing of the property in a different country.

New subsection 95(3.2) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 2008.

Clause 26

Trusts and their Beneficiaries

ITA
104

Section 104 of the Act provides rules that apply to the income taxation of trusts and their beneficiaries.

NISA Fund No. 2

ITA
104(5.1)

Subsection 104(5.1) of the Act provides that a spousal or common-law partner trust that holds an interest in a NISA Fund No. 2 transferred to it in circumstances to which paragraph 70(6.1)(*b*) applies will be considered to have been paid the amount, if any, by which the fund's balance at the end of the day on which the spouse or common-law partner dies exceeds the amount included under subsection 12(10.2) in that individual's income as a result of an election under subsection 104(14.1).

Subsection 104(5.1) is amended and restructured consequential on the repeal of subsection 104(14.1). For further information, see the commentary on subsection 104(14.1).

This amendment applies to the 2016 and subsequent taxation years.

Deduction in Computing Income of Trust

ITA
104(6)

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. Subsection 104(6) is subject to subsections 104(7) to 104(7.1).

Paragraphs 104(6)(*a*) to (*a.4*) apply to various types of trusts. Paragraph 104(6)(*a.3*) applies to a trust that is deemed by subsection 143(1) to be an *inter vivos* trust in existence in respect of a congregation that is a constituent part of a religious organization. The paragraph allows the trust to deduct such part of its income for a taxation year (as determined by reference to subsection 143(2)) as became payable in the year to a beneficiary. Paragraph 104(6)(*a.3*) is amended, consequential on a similar amendment to section 143, to replace the reference to "*inter vivos* trust" with a reference to "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*) calculates the maximum amount a trust may deduct for a taxation year in respect of the part of the "adjusted distributions amount" of its income for the year that became payable to, or was included under subsection 105(2) in the income of, a beneficiary. The adjusted distribution amount of a trust's income is its income determined without reference to the deductions under subsection 104(6) and (12) and by excluding income from certain sources, including amounts arising from the application of subsections 104(4) to (5.2) and 107(4), and receipts from a NISA Fund No. 2 account of the trust. In addition, if the trust is an *alter ego* trust, joint spousal and common-law partner trust or post-1971 spousal and common-law partner trust, the trust cannot deduct any part of its income that became payable to a beneficiary, other than the individual whose death determines a day of the trust under paragraph 104(4)(*a*), on or before the day of that death.

Paragraph 104(6)(*b*) is amended to remove the current limits on deductibility for amounts arising from the application of subsections 12(10.2) and 104(4) to (5.2). The amounts are instead subject to a new rule in subsection 104(13.4). For further information, see the commentary on subsection 104(13.4).

Paragraph 104(6)(*b*) is simplified by presenting the computation of 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.

The description of B of the formula retains the existing restrictions found in subparagraphs 104(6)(*b*)(ii), (ii.1) and (iv). Specifically, an *alter ego* trust, joint spousal and common-law partner trust and post-1971 spousal and common-law partner trust will continue to be denied a deduction for any part of its income that became payable to a beneficiary, other than an individual whose death determines a day of the trust under paragraph 104(4)(*a*), on or before the day of that death. That restriction will also now apply to a trust for which an individual's death determines a day of the trust under paragraph 104(4)(*a.4*) (*i.e.*, a trust to which property has been transferred on a tax-deferred basis in circumstances described in subparagraph 73(1.02)(*b*)(ii) or subsection 107.4(3)).

Amounts arising from the application of subsection 107(4) continue, under the description of B, not to deductible by a trust to the extent that they become payable to a beneficiary other than the individual whose death determines a day of the trust under paragraph 104(4)(*a*) or (*a.4*).

Finally, the amount that a SIFT trust can deduct under paragraph 104(6)(*b*) will, under subparagraph (ii) of the description of B, continue to be limited by reference to the trust's non-portfolio earnings for the year.

These amendments apply to the 2016 and subsequent taxation years.

Limitation – Amounts Claimed as Gift

ITA
104(7.02)

Subsection 104(6) of the Act 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 becomes payable in the year to a beneficiary under the trust. Subsection 104(6) is subject to subsections 104(7) to 104(7.1).

Subsection 104(7.02) is added to deny an estate that arose on and as a consequence of an individual's death a deduction under subsection 104(6) to the extent of any disqualified payment made by the estate. A disqualified payment is one that is a gift in respect of which an amount is deducted under section 118.1 for any taxation year in computing the individual's tax payable under Part I of the Act.

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

Invalid Designation

ITA
104(13.3)

Subsections 104(13.1) and 104(13.2) of the Act permit a trust to designate a portion of its income for a taxation year as not having been paid or become payable to its beneficiaries, with the result that the designated amounts (including in some cases, the portion otherwise treated as a taxable capital gain) are not included under subsection 104(13) or 105(2) in the income of those beneficiaries. The formulas that apply in determining the maximum designation under those subsections apply to limit the designation to the extent of the trust's income otherwise determined for the year for which it does not deduct an amount under subsection 104(6).

Subsection 104(13.3) is introduced to provide that a designation under subsection 104(13.1) or (13.2) is invalid if the trust's taxable income (determined as though the designation were valid) for the year is greater than nil. This amendment will ensure that designations are made only to the extent that the trust's tax balances (*e.g.*, loss carry-forwards) are applied, under the rules that apply in Division C of Part I of the Act, against all of the trust's income for the year determined after the trust claims the maximum amount deductible by it under subsection 104(6).

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 is introduced to provide rules that apply 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*). The trusts referred to in those paragraphs 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 on a tax-deferred basis 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, and for a taxation year and fiscal period to begin at the start of the following day. The trust's income for the particular year will, therefore, include amounts arising from specified events that are deemed to occur on that day: the deemed disposition of certain of its properties under subsection 104(4), (5) and (5.2) and the receipt of NISA Fund No. 2 amounts under subsection 104(5.1).

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. The trust's income for the particular year is also deemed not to have become payable to any other beneficiary, or to be included under subsection 105(2) in computing the particular beneficiary's income, with the result that those other beneficiaries will not be required to include any part of the trust's income in computing their incomes, and no amounts may be designated by the trust for the particular year under subsections 104(13.1), (13.2) and (19) to (22) in respect of any beneficiary other than the particular beneficiary.

Paragraph 104(13.4)(*c*) 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 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. The trust's balance-due day (*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) for the particular year is also extended to that day.

For further information, see the commentary on subsections 104(6), 110.6(12) and 160(1.4).

This amendment applies to the 2016 and subsequent taxation years.

Late, Amended or Revoked Election

ITA
104(14.01) and (14.02)

Subsections 104(14.01) and (14.02) provided transitional relief, for a trust's taxation year that includes February 22, 1994, in respect of the timing requirements of a preferred beneficiary election under subsection 104(14). Subsections 104(14.01) and (14.02) are repealed as they are no longer relevant.

These amendments apply to the 2016 and subsequent taxation years.

NISA Election

ITA
104(14.1)

Subsection 104(14.1) of the Act provides an election in respect of amounts otherwise deemed by subsection 104(5.1) to have been paid out of a NISA Fund No. 2 to a spousal or common-law partner trust at the end of the day on which the spouse or common-law partner beneficiary under the trust dies. If the election is made, the amounts are instead deemed to be paid to the beneficiary on that day, with the result that the amounts are included in the income of the beneficiary and not that of the trust.

Subsection 104(14.1) is repealed consequential on amendments to paragraph 104(6)(*b*) and 104(13.4). Those amendments, in effect, require that the amounts deemed by subsection 104(5.1) to have been paid to the trust be included in the beneficiary's income and allow the trust a corresponding deduction in computing its income.

This amendment applies to the 2016 and subsequent taxation years.

SIFT Deemed Dividend

ITA
104(16)

Subsection 104(16) of the Act recharacterizes as taxable dividends certain amounts that become payable to a beneficiary of a SIFT trust.

Subsection 104(16) is amended, consequential on an amendment to paragraph 104(6)(*b*), by replacing the reference to subparagraph 104(6)(*b*)(iv) with a reference to subparagraph (ii) of the description of B of the formula in that paragraph. For further information, see the commentary to paragraph 104(6)(*b*).

This amendment applies to the 2016 and subsequent taxation years.

Beneficiaries' Taxable Capital Gain

ITA
104(21.2)

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

The definitions "qualified farm property" and "qualified fishing property" in subsection 110.6(1) are repealed and the new definition "qualified farm or fishing property" is introduced to better accommodate taxpayers involved in a combination of farming and fishing. As a consequence, subsection 104(21.2) is amended to replace certain existing references with references to "qualified farm or fishing property". Certain references to "qualified farm property" and "qualified fishing property" are retained because subsection 104(21.2) may apply in respect of dispositions that occur before the taxation year in respect of which the subsection applies. For this purpose, the terms "qualified farm property" and "qualified fishing property" will continue to have, in respect of dispositions of property in taxation years prior to 2014, the meaning they had at the time of the disposition.

This amendment applies to dispositions that occur in the 2014 and subsequent taxation years.

Beneficiaries' Taxable Capital Gain

ITA
104(21.21) to (21.24)

Subsections 104(21.21) to (21.24) of the Act were introduced consequential on the increase in the lifetime capital gains exemption limit from $500,000 to $750,000 of capital gains in respect of property disposed of on or after March 19, 2007. Subsection 104(21.21) to (21.24) are repealed since they are relevant only in respect of the designation of capital gains from the disposition of property in taxation years that include March 19, 2007.

This amendment applies to dispositions that occur in the 2014 and subsequent taxation years.

Deceased Beneficiary of Graduated Rate Estate

ITA
104(23)

Subsection 104(23) of the Act provides rules that apply to testamentary trusts. Paragraph 104(23)(*d*) allows the legal representative of a deceased beneficiary of a testamentary trust to file a separate return of income in respect of the beneficiary's income from the trust, if the beneficiary dies at a time in a calendar year that is after the end of the trust's taxation year that ended in the calendar year.

Paragraph 104(23)(*e*) exempts testamentary trusts from the tax instalment rules.

Subsection 104(23) is amended to, in effect, limit the application of paragraph 104(23)(*d*) to graduated rate estates. Because of a related amendment to paragraph 249(1)(*b*), only testamentary trusts that are graduated rate estates are able to use a taxation year that is not the calendar year. Paragraph 104(23)(*e*) is repealed. Graduated rate estates remain, however, exempt from the tax instalment rules under a related amendment to subsection 156.1(2). For further information, see the commentary on subsection 156.1(2) and the definition "graduated rate estate" in subsection 248(1).

These amendments apply to the 2016 and subsequent taxation years.

Pension Benefits

ITA
104(27)

Subsection 104(27) of the Act allows a testamentary trust that is resident in Canada to flow through to a beneficiary the character of certain pension benefits received by the trust and included in the beneficiary's income.

Subsection 104(27) is amended to limit its application to a trust that is a deceased individual's graduated rate estate. In addition, references in that subsection to the trust's settlor are replaced with references to the deceased individual.

These amendments apply to the 2016 and subsequent taxation years.

DPSP Benefits

ITA
104(27.1)

Subsection 104(27.1) of the Act allows a testamentary trust that is resident in Canada to designate, as eligible amounts for the purpose of paragraph 60(*j*), certain amounts received as a consequence of an individual's death by the trust from a Deferred Profit Sharing Plan (DPSP) and included in computing the income of a beneficiary who was the deceased individual's spouse or common-law partner. The beneficiary is then able to transfer such amounts on a tax-free basis to a Registered Pension Plan or a Registered Retirement Savings Plan.

Subsection 104(27.1) is amended to limit its application to a trust that is a deceased individual's graduated rate estate. In addition, references in that subsection to the trust's settlor are replaced with references to the deceased individual.

These amendments apply to the 2016 and subsequent taxation years.

Death Benefit Deemed Received by Beneficiary

ITA
104(28)

Subsection 104(28) of the Act permits an amount received by a testamentary trust upon or after the death of an employee and, in recognition of employment services, to retain its character when flowed through the trust to a beneficiary. Pursuant to the definition of a "death benefit" in subsection 248(1) and subsection 56(1), the amount of the death benefit over $10,000 is included in the income of the recipient.

Subsection 104(28) is amended to limit its application to a trust that is a deceased individual's graduated rate estate. In addition, references in that subsection to the employee are replaced with references to the deceased individual.

These amendments apply to the 2016 and subsequent taxation years.

Clause 27

Qualifying Disposition

ITA
107.4(1)(*j*)

Subsection 107.4(3) of the Act generally provides for a rollover of property to a trust where the property is transferred to the trust by way of a qualifying disposition as defined in subsection107.4(1). A qualifying disposition is a disposition of property to a trust that does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions set out in that subsection. Paragraph 107.4(1)(*j*) requires that if the transferor of the property is a certain type of trust, that the transferee be the same type of trust. One type of trust referred to in that paragraph is a trust that is deemed by subsection 143(1) to be an *inter vivos* trust in existence in respect of a congregation that is a constituent part of a religious organization.

Paragraph 107.4(1)(*j*) is amended, consequential on a similar amendment to section 143, to replace the reference to *inter vivos* trust with a reference to trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 28

Definitions

ITA
108(1)

Subsection 108(1) sets out a number of definitions that apply in subdivision k of Division B of Part I of the Act, which deals with the taxation of trusts and their beneficiaries.

“qualified farm property”, “qualified fishing property” and “qualified small business corporation share”

The definitions “qualified farm property”, “qualified fishing property” and “qualified small business corporation share” are repealed as they are no longer needed.

This amendment applies to dispositions that occur in the 2014 and subsequent taxation years.

“trust”

The definition “trust” excludes certain trusts from being treated as trusts for a number of specified purposes. Paragraph (*c*) of that definition describes a trust that is deemed by subsection 143(1) to be an *inter vivos* trust in existence in respect of a congregation that is a constituent part of a religious organization. Paragraph (*c*) of the definition is amended, consequential on a similar amendment to section 143, to replace the reference to *inter vivos* trust with a reference to trust.

This amendment applies to the 2016 and subsequent taxation years.

Interests Acquired for Consideration

ITA
108(7)

Subsection 108(7) of the Act contains a rule that, in general terms, provides that a person (or two or more related persons) can contribute property to an *inter vivos* trust and retain a beneficial interest in the trust without the interest being considered, for certain specified purposes, to have been acquired for consideration.

Subsection 108(7) is amended so that the rule applies for those specified purposes in respect of any trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 29

Deduction for Gifts

ITA
110.1

Paragraph 110.1(1)(*a*) of the Act provides a deduction from taxable income to corporations in respect of certain charitable gifts. The paragraph is amended to remove a reference to paragraph 110.1(1)(*b*), consequential on the repeal of that paragraph. Paragraph 110.1(1)(*b*), which provides a similar deduction in respect of Crown gifts, is redundant and is therefore repealed. These amendments apply to the 2016 and subsequent taxation years.

Paragraph 110.1(1)(*d*) provides a deduction in respect of certain ecological gifts. Subparagraph 110.1(1)(*d*)(iii) is amended to clarify that it applies only to an otherwise eligible gift that is made to a qualified donee. This amendment applies to gifts made after February 10, 2014.

Clause 30

Lifetime Capital Gains Exemption

ITA
110.6

Section 110.6 of the Act provides rules for the lifetime capital gains exemption.

The definitions "interest in a family farm partnership", "interest in a family fishing partnership", "qualified farm property", "qualified fishing property", "share of the capital stock of a family farm corporation" and "share of the capital stock of a family fishing corporation" are repealed and the new definitions "interest in a family farm or fishing partnership", "qualified farm or fishing property" and "share of the capital stock of a family farm or fishing corporation" are introduced.

These amendments, and other consequential amendments in section 110.6, are made in order to better accommodate taxpayers involved in a combination of farming and fishing.

These amendments generally apply to dispositions and transfers that occur in the 2014 and subsequent taxation years.

Definitions

ITA
110.6(1)

"annual gains limit"

The annual gains limit of an individual is one of the factors applicable in determining the individual's entitlement to a capital gains exemption for a year.

Paragraph (*b*) of the description A in the definition "annual gains limit" refers to the amount that would be determined in respect of the individual's capital gains and losses in the year if the only gains or losses were those arising on dispositions after 1984 of qualified farm properties, dispositions after June 17, 1987 of qualified small business corporation shares and dispositions after May 2, 2006 of qualified fishing properties.

Paragraph (*b*) of the definition "annual gains limit" is amended, consequential on the introduction of the definition "qualified farm or fishing property", to include gains or losses arising on a disposition of qualified farm or fishing property. References to "qualified farm property" and "qualified fishing property" are retained because dispositions that occur before the taxation year in respect of which the definition "annual gains limit" applies may be relevant to the calculation of the limit. For this purpose, the terms "qualified farm property" and "qualified fishing property" will continue to have, in respect of dispositions of property in taxation years prior to 2014, the meaning they had at the time of the disposition.

In addition, in paragraph (*b*) of the definition "annual gains limit", the references to the dates after which qualifying property must have been disposed of are deleted. They are no longer necessary because the period for carrying forward reserves from the disposition of property prior to the introduction of the definitions "qualified farm property", "qualified fishing property" and "qualified small business corporation shares" have expired.

"interest in a family farm or fishing partnership"

The new definition "interest in a family farm or fishing partnership" is based on the repealed definition "interest in a family farm partnership". The requirement in the former definition relating to the use of property of the partnership principally in the course of carrying on a farming business in Canada is replaced with a requirement relating to the use of property of the partnership principally in the course of carrying on a farming or fishing business in Canada. In addition, the references in the former definition to “share of the capital stock of a family farm corporation” and “interest in a family farm partnership” are replaced with references to “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership”.

“qualified farm or fishing property”

Subsections 110.6(2) and (2.2) provide individuals with an exemption for capital gains realized on the disposition of qualified farm property and qualified fishing property. The new definition “qualified farm or fishing property” is based on the repealed definition “qualified fishing property”. The requirement in paragraph (*a*) of the former definition that the property be used in the course of carrying on a fishing business in Canada is replaced with a requirement that the property be used in the course of carrying on a farming or fishing business in Canada. In addition, the references in the former definition to “share of the capital stock of a family fishing corporation” and “interest in a family fishing partnership” are replaced with references to “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership”.

“share of the capital stock of a family farm or fishing corporation property”

An individual’s share of the capital stock of a family farm corporation or share of the capital stock of family fishing corporation constitutes a qualified farm property or a qualified fishing property, as the case may be, of the individual and, as such capital gains realized on the disposition of the share are eligible for the capital gains deduction provided under subsection 110.6(2) or (2.2).

The new definition “share of the capital stock of a family farm or fishing corporation” is based on the repealed definition “share of the capital stock of a family fishing corporation”. The requirement in the former definition relating to the use of property of the corporation principally in the course of carrying on a fishing business in Canada is replaced with a requirement relating to the use of property of the corporation principally in the course of carrying on a farming or fishing business in Canada. In addition, the references in the former definition to “share of the capital stock of a family fishing corporation” and “interest in a family fishing partnership” are replaced with references to “share of the capital stock of a family farm or fishing corporation” and “interest in a family farm or fishing partnership”.

Value of NISA

ITA
110.6(1.1)

Subsection 110.6(1.1) of the Act ensures that the fair market value of a net income stabilisation account is nil for the purpose of determining whether a share satisfies the definition “qualified small business corporation share” or “share of the capital stock of a family farm corporation”.

Subsection 110.6(1.1) is amended consequential on the repeal of the definition “share of the capital stock of a family farm corporation” and the addition of the new definition “share of the capital stock of a family farm or fishing corporation”, to replace the existing reference with a reference to “share of the capital stock of a family farm or fishing corporation”.

Farming or Fishing Property – Conditions

ITA
110.6(1.2) and (1.3)

For the purposes of the definition “qualified fishing property” in subsection 110.6(1), a property will not be considered to have been used in the course of carrying on the business of fishing in Canada unless the conditions set out in subsection 110.6(1.2) have been met. Similarly, for the purposes of the definition “qualified farm property” in subsection 110.6(1), a property will not be considered to have been used in the course of carrying on the business of farming in Canada unless the conditions set out in subsection 110.6(1.3) have been met.

To better accommodate taxpayers involved in a combination of farming and fishing, subsection 110.6(1.3) is amended to set out the conditions necessary for a property to be considered to have been used in the course of carrying on a farming or fishing business in Canada. Specifically, references to “family farm partnership” are replaced with references to “family farm or fishing partnership” and references to the definition “qualified farm property” are replaced with references to the definition “qualified farm or fishing property”. In addition, references to a farming business in the tests set out in subparagraph 110.6(1.3)(*a*)(ii) are replaced with references to a farming or fishing business. Finally, clause 110.6(1.3)(*a*)(A) is amended to add a reference to a partnership where the provision refers to a person referred to in 110.6(1.3)(*a*)(i).

The requirement in paragraph 110.6(1.3)(*c*) for a property to have been used in a farming business is retained as it applies only in respect of property acquired before June 18, 1987.

Subsection 110.6(1.2) is repealed consequential on the amendments to subsection 110.6(1.3).

Capital Gains Deduction – Qualified Farm or Fishing Property

ITA
110.6(2)

Subsection 110.6(2) of the Act provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm property.

Subsection 110.6(2) is amended by replacing its first reference to “qualified farm property” with a reference to “qualified farm or fishing property”. However, references to “qualified farm property” and “qualified fishing property” are retained in respect of dispositions of property prior to 2014, as these dispositions are taken into account in calculating the amount that an individual may claim for a current year.

In addition, the references in paragraph 110.6(2)(*d*) to the dates after which qualifying property must have been disposed of are deleted. They are no longer necessary because the period for carrying-forward reserves from the disposition of property prior to the introduction of the definitions “qualified farm property”, “qualified fishing property” and “qualified small business shares” have expired.

Capital Gains Deduction – Qualified Small Business Corporation Shares

ITA
110.6(2.1)

Subsection 110.6(2.1) of the Act permits a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable gains from the disposition of qualified small business corporation shares. Paragraph 110.6(2.1)(*d*) provides that the deduction cannot exceed the amount that would be determined in respect of the individual for the year under paragraph 3(*b*) in respect of capital gains and capital losses if the only properties referred to in paragraph 3(*b*) were qualified small business corporation shares disposed of after June 17, 1987. Paragraph 110.6(2.1)(*d*) also provides that, in making that determination, there is not to be included any amounts already included in the amount determined under paragraph (3)(*b*) for the purposes of paragraphs 110.6(2)(*d*) and 110.6(2.2)(*d*) in respect of the individual.

Paragraph 110.6(2.1)(*d*) is amended, consequential on the repeal of subsection 110.6(2.2) and the consolidation of the deduction for farming and fishing property under subsection 110.6(2), to delete the reference to paragraph 110.6(2)(*d*). The reference to June 17, 1987 is also deleted as it is no longer required.

Capital Gains Deduction – Qualified Fishing Property

ITA
110.6(2.2)

Subsection 110.6(2.2) of the Act permits a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable capital gains from the disposition of qualified fishing property.

Subsection 110.6(2.2) is repealed consequential on the introduction of the definition "qualified farming or fishing property" and the amendment of subsection 110.6(2) to apply to this property: a separate deduction in respect of fishing property is no longer necessary.

Capital Gains Deduction – Qualified Fishing Property

ITA
110.6(2.3)

Subsection 110.6(2.3) of the Act provides a transitional rule for taxation years of an individual that include March 17, 2007. That is when the lifetime capital gains exemption limit was increased from $250,000 to $375,000 of capital gains. This subsection is repealed in respect of dispositions and transfers that occur in the 2014 and subsequent taxation years.

Maximum Capital Gains Deduction

ITA
110.6(4)

Subsection 110.6(4) of the Act provides the overall lifetime capital gains exemption limit for an individual. The subsection adopts the limit provided in paragraph 110.6(2)(*a*). As a consequence, notwithstanding any amounts computed as capital gains deductions under subsections 110.6(2) to (2.3), an individual is limited to an overall lifetime limit of $400,000 (indexed to inflation under subsection 117.1(1)) of deductions in respect of taxable capital gains.

Paragraph 110.6(4) is amended, consequential on the repeal of subsections 110.6(2.2) and (2.3), to delete the reference to those subsections.

Deemed Resident in Canada

ITA
110.6(5)

Subsection 110.6(5) of the Act provides that, where an individual is resident in Canada at any time in a particular taxation year, the individual is deemed to be resident in Canada throughout the particular year if the individual is resident in Canada throughout either the immediately preceding taxation year or the immediately following taxation year. Subsection 110.6(5) applies only for the purposes of subsections 110.6(2) to (2.3).

Subsection 110.6(5) is amended, consequential on the repeal of subsections 110.6(2.2) and (2.3), to delete the reference to those subsections.

Failure to Report Capital Gain

ITA
110.6(6)

Subsection 110.6(6) of the Act denies a capital gains exemption for certain unreported net taxable capital gains notwithstanding that an amount that could have been claimed as a capital gains exemption under subsections 110.6(2) to (2.3).

Subsection 110.6(6) is amended, consequential on the repeal of subsections 110.6(2.2) and (2.3), to delete the reference to those subsections.

Deduction Not Permitted

ITA
110.6(7)

Subsection 110.6(7) of the Act is an anti-avoidance rule that prevents, notwithstanding subsections 110.6(2) to (2.3), the conversion of certain corporate capital gains that are taxable into exempt capital gains of an individual.

Subsection 110.6(7) is amended, consequential on the repeal of subsections 110.6(2.2) and (2.3), to delete the reference to those subsections.

Deduction Not Permitted

ITA
110.6(8)

Subsection 110.6(8) of the Act provides that, notwithstanding subsections 110.6(2) to (2.3), an individual may not claim the capital gains exemption with respect to a capital gain realized on a disposition of property if it is reasonable to conclude that a significant portion of the capital gain is attributable to the fact that dividend payments on a share (other than a prescribed share) have either not been made or have been deferred.

Subsection 110.6(8) is amended, consequential to the repeal of subsections 110.6(2.2) and (2.3), to delete the reference to those subsections.

Trust Deduction – Death of Spouse or Common-Law Partner

ITA
110.6(12)

Trusts are not entitled to the lifetime capital gains exemption for a taxation year, subject to an exception under subsection 110.6(12). Under the exception, a trust can claim the exemption, within certain defined limits, if the trust is a spousal or common-law partner trust, a beneficiary under the trust dies on a day in the year and that day is, as a result of the death, a day determined in respect of the trust under paragraph 104(4)(*a*) or (*a.1*). The maximum amount deductible by the trust under subsection 110.6(12) is the lesser of the beneficiary's unused lifetime capital gains exemption limit and the amount of the taxable gains of the trust determined under the subsection.

Paragraph 110.6(12)(*b*) is amended, consequential on the introduction of the definition "qualified farm or fishing property", to include gains or losses arising on a disposition of qualified farm or fishing property. References to "qualified farm property" and "qualified fishing property" are retained because subsection 110.6(12) may apply in respect of dispositions that occur before the taxation year in respect of which the subsection applies. For this purpose, the terms "qualified farm property" and "qualified fishing property" will continue to have, in respect of dispositions of property in taxation years prior to 2014, the meaning they had at the time of the disposition.

For the 2016 and subsequent taxation years, subsection 110.6(12) is repealed consequential on amendments to subsection 104(6) and (13.4). For further information, see the commentary to subsection 104(13.4).

Value of Assets of Corporations

ITA
110.6(15)

Subsection 110.6(15) of the Act provides rules for valuing certain assets for the purposes of the definitions "qualified small business corporation share" and "share of the capital stock of a family farm corporation" in section 110.6, the definition "share of the capital stock of a family farm corporation" in subsection 70(10) and the definition "small business corporation" in subsection 248(1).

Subsection 110.6(15) is amended, consequential on the introduction of the new definitions “share of the capital stock of a family farm or fishing corporation” in subsection 110.6(1) and “share of the capital stock of a family farm or fishing corporation” in subsection 70(10), to replace existing references with references to those new definitions.

Reserve Limit

ITA
110.6(31)

Subsection 110.6(31) of the Act provides that, for a disposition of property that is eligible for a capital gains deduction for the taxation year of disposition, a deduction for a future year is not available in respect of the disposition except to the extent of the remaining lifetime capital gains exemption for the taxation year of the disposition.

In particular, subsection 110.6(31) may apply for a taxation year for which an individual includes in income all or part of a prior year reserve. The capital gains deduction otherwise available is reduced by the difference between the amount the individual would be able to deduct for the year without reference to subsection 110.6(31) and the amount the individual would have been able to deduct in the year if he or she had not claimed any capital gains reserves in prior years and had for those years deducted all amounts that would have been deductible under section 110.6.

Subsection 110.6(31) is amended, consequential on the introduction of the definition “qualified farm or fishing property”, to add a reference to qualified farm or fishing property. References in subsection 110.6(31) to “qualified farm property” and “qualified fishing property” are retained because subsection 110.6(31) may apply in respect of dispositions that occur before the taxation year in respect of which the subsection applies. For this purpose, the terms “qualified farm property” and “qualified fishing property” will continue to have, in respect of dispositions of property in taxation years prior to 2014, the meaning they had at the time of the disposition.

Clause 31

Loss on Share Held by Trust

ITA
112(3.2)(*a*)(iii)

Subsection 112(3.2) of the Act provides a “stop-loss” rule that applies to reduce the loss of a trust (other than a mutual fund trust) on the disposition of a share of the capital stock of a corporation that was held by the trust as capital property. Subsection 112(3.3) applies, and subsection 112(3.2) does not apply, if the share was acquired by the trust because of subsection 104(4).

Paragraph 112(3.2)(*a*) provides that the trust’s loss otherwise determined on the disposition of the share is reduced by certain dividends received by the trust on the share. However, subparagraph 112(3.2)(*a*)(iii) limits this reduction in the case where the trust is an individual’s estate, the share was acquired as a consequence of the individual’s death and the disposition occurs in the first taxation year of the estate. In this case, the loss reduction is reduced by one half of the lesser of the loss otherwise determined and the individual’s capital gain from the disposition of the share immediately before the individual’s death.

Subparagraph 112(3.2)(*a*)(iii) is amended to limit its application to cases involving the graduated rate estate of a deceased individual. For further information, see the commentary on the definition “graduated rate estate” in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 32

Child Fitness Tax Credit

ITA
118.03

Section 118.03 of the Act provides a non-refundable tax credit for eligible fitness expenses paid in a taxation year in respect of each qualifying child of an individual. The credit is calculated by reference to the total of such expenses (to a maximum of $500) multiplied by the appropriate percentage for that taxation year (equal to the lowest tax rate for individuals referenced in subsection 117(2) of the Act).

The limit on eligible fitness expenses is increased to $1,000 for the 2014 taxation year. For the 2015 and subsequent taxation years, section 118.03 is repealed and replaced with new section 122.8 of the Act, which replaces the non-refundable credit with a refundable credit.

Clause 33

Definitions – Qualifying Child

ITA
118.031(1)

Subsection 118.031(1) of the Act sets out definitions that apply for the purposes of the Children's Arts Tax Credit. The definition “qualifying child” has the meaning assigned by subsection 118.03(1) for the purposes of the Child Fitness Tax Credit. The definition is amended to refer to the definition in new subsection 122.8(1) of the Act, consequential to amendments that make the Child Fitness Tax Credit refundable. For further information, see the commentary on subsection 122.8(1).

This amendment applies to the 2015 and subsequent taxation years.

Clause 34

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 purposes of section 118.1.

“total Crown gifts”

The definition “total Crown gifts” is no longer applicable and is, therefore, repealed. This amendment applies to the 2016 and subsequent taxation years.

“total charitable gifts”

An individual’s total charitable gifts for a particular taxation year is defined as the total of the eligible amounts of the individual’s gifts made in the particular year or any of the five preceding taxation years to qualified donees. The eligible amount of a gift is not included in total charitable gifts if it is included in the individual’s total Crown gifts, total cultural gifts or total ecological gifts for the particular year, and an eligible amount is included in total charitable gifts only to the extent that it has not already been included in determining a tax credit claimed under section 118.1 by the individual for an earlier taxation year.

The definition “total charitable gifts” is amended to extend the circumstances in which the eligible amount of a gift is included in an individual’s total charitable gifts for a particular taxation year. Specifically, paragraph (*c*) of the definition is introduced to provide that, subject to the other conditions of the definition, the individual’s total charitable gifts for a particular taxation year includes the eligible amount of a gift

- made by the individual's spouse or common-law partner in the particular year or any of the five preceding taxation years – this is consistent with the Canada Revenue Agency's current administrative practice,
- made by the individual in the taxation year in which the individual dies if the particular year is the immediately preceding year – this maintains a "carry-back" rule that was previously under subsection 118.1(4), or
- made by the individual's graduated rate estate, if subsection 118.1(5.1) applies to the gift and the particular year is the year in which the individual dies or the immediately preceding year – this permits the individual's legal representative to, in effect, claim a charitable donations tax credit, as otherwise permitted under section 118.1, in respect of the eligible amount in those taxation years of the individual.

Paragraph (*c*) also 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 and that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate. Paragraph (*c*) continues to include in an individual's total charitable gifts for a particular taxation year the eligible amount of a gift made by the individual (including a trust or estate) in the particular year or any of the five preceding taxation years.

Under the amended definition, no part of an eligible amount of a gift is included in an individual's total charitable gifts for a particular taxation year if any part of the eligible amount of the gift is included in the total cultural gifts or total ecological gifts of the individual, or of any other individual, for any taxation year. As well, 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.

These amendments apply to the 2016 and subsequent taxation years.

"total cultural gifts"

An individual's total cultural gifts for a particular taxation year is defined as the total of the eligible amounts of the individual's gifts of qualifying cultural property made to a designated institution or public authority.

Paragraph (*c*) of the definition "total cultural gifts" provides that the eligible amount of a gift is included in an individual's total cultural gifts for a particular taxation year only to the extent that it was not already deducted in computing the individual's taxable income for a taxation year that ended before 1988. This rule is no longer relevant and is therefore replaced. Paragraph (*b*) of the definition includes in the total for a particular taxation year the eligible amount of a gift made by the individual (including a trust or estate) in the particular year or any of the five preceding taxation years. The definition is amended to move this rule to amended paragraph (*c*).

Amended paragraph (*c*) also extends the circumstances in which the eligible amount of a gift is included in an individual's total cultural gifts for a particular taxation year. Specifically, paragraph (*c*) provides, subject to the other conditions of the definition, that the individual's total cultural gifts for a particular taxation year includes the eligible amount of a gift

- made by the individual's spouse or common-law partner in the particular year or any of the five preceding taxation years – this is consistent with the Canada Revenue Agency's current administrative practice,
- made by the individual in the taxation year in which the individual dies if the particular year is the immediately preceding year – this maintains a "carry-back" rule that was previously provided for under subsection 118.1(4), or
- made by the individual's graduated rate estate, if subsection 118.1(5.1) applies to the gift and the particular year is the year in which the individual dies or the immediately preceding year – this permits the individual's legal representative to, in effect, claim a charitable donations tax credit, as otherwise permitted under section 118.1, in respect of the eligible amount in those taxation years of the individual.

Paragraph (*c*) also 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 and that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate.

Under paragraph (*d*) of the definition, the eligible amount of a gift is included in the total cultural gifts only to the extent that it was not already included in determining a tax credit claimed under section 118.1 by the individual. Paragraph (*d*) is repealed. The preamble to the definition now provides 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.

These amendments apply to the 2016 and subsequent taxation years.

"total ecological gifts"

An individual's total ecological gifts for a particular taxation year is defined as the total of the eligible amounts of the individual's gifts of qualifying land, certified by the Minister of Environment, to an eligible donee that is the federal government, a provincial or territorial government, a municipality, a municipal or public body performing a function of government or a registered charity approved by the Minister of the Environment. Paragraph (*c*) of the definition includes in an individual's total ecological gifts for a particular taxation year the eligible amount of a gift made by the individual (including a trust or estate) in the particular year or any of the ten preceding taxation years.

The definition "total ecological gifts" is amended in several respects. Paragraph (*b*) of the definition, which contains the requirement that the land be certified, is moved to paragraph (*a*). The eligible donee requirement is moved from paragraph (*c*) to paragraph (*b*).

Paragraph (*c*) is also amended to extend the circumstances in which the eligible amount of a gift is included in an individual's total ecological gifts for a particular taxation year. Specifically, paragraph (*c*) provides, subject to the other conditions of the definition, that the individual's total ecological gifts for a particular taxation year includes the eligible amount of a gift

- made by the individual's spouse or common-law partner in the particular year or any of the ten preceding taxation years – this is consistent with the Canada Revenue Agency's current administrative practice,
- made by the individual in the taxation year in which the individual dies if the particular year is the immediately preceding year – this maintains a "carry-back" rule that was previously provided for under subsection 118.1(4), or
- made by the individual's graduated rate estate, if subsection 118.1(5.1) applies to the gift and the particular year is the year in which the individual dies or the immediately preceding year – this permits the individual's legal representative to, in effect, claim a charitable donations tax credit, as otherwise permitted under section 118.1, in respect of the eligible amount in those taxation years of the individual.

Paragraph (*c*) also 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 and that is made by the estate in the particular year or in a later taxation year in which it is a graduated rate estate.

The preamble of the definition is amended to require that no part of an eligible amount of a gift is included in an individual's total ecological gifts for a particular taxation year if any part of the eligible amount of the gift is included in the total cultural gifts of the individual, or of any other individual, for any taxation year. The amended preamble also provides that an eligible amount is included in an individual's total ecological gifts for a 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.

These amendments apply to the 2016 and subsequent taxation years.

The definition is also amended to clarify that it applies only to an otherwise eligible gift that is made to an eligible donee that is qualified donee. This amendment applies to gifts made after February 10, 2014.

“total gifts”

The amount of an individual’s total gifts for a taxation year is used in determining the maximum amount the individual can claim under subsection 118.1(3) as a charitable donations tax credit for the year. Paragraph (*b*) of the definition “total gifts” in subsection 118.1(1) includes in the total the individual’s total Crown gifts for the year.

Paragraph (*b*) of the definition is repealed consequential on the repeal of the definition “total Crown gifts”.

This amendment applies to the 2016 and subsequent taxation years.

Proof of Gift

ITA
118.1(2)

Subsection 118.1(2) of the Act provides that an eligible amount of a gift is not to be included in the total charitable gifts, total Crown gifts, total cultural gifts and total ecological gifts of an individual unless the gift is evidenced by a receipt (and, in some cases, together with a certificate) filed with the Minister of National Revenue. Subsection 118.1(2) is amended to remove the reference to total Crown gifts, consequential on the repeal of the definition “total Crown gifts”.

This amendment applies to the 2016 and subsequent taxation years.

Ordering

ITA
118.1(2.1)

Subsection 118.1(2.1) of the Act provides that gifts will be considered to have been claimed in determining an individual’s charitable donations tax credits in the order in which they were made. Subsection 118.1(2.1) is amended to remove the reference to total Crown gifts, consequential on the repeal of the definition “total Crown gifts”.

This amendment applies to the 2016 and subsequent taxation years.

Gifts – Deaths Before 2016

ITA
118.1(4)

Existing subsection 118.1(4) of the Act provides a special rule in the case of gifts that are made by an individual in the taxation year in which the individual dies. Under the subsection, a gift made by the individual in that year is generally considered to have been made in the individual’s preceding taxation year, to the extent that the charitable donations tax credit in respect of the amount of the gift is not deducted in computing the individual’s tax for the year of death.

The definitions “total charitable gifts”, “total cultural gifts” and “total ecological gifts” in subsection 118.1(1) now provide for the recognition by an individual, in the taxation year that precedes the individual’s year of death, of a gift made by the individual in the year of death or made by the graduated rate estate of the individual. Subsection 118.1(4) is therefore replaced with a new rule.

New subsection 118.1(4) applies to deaths that occur before 2016. It provides that if subsections 118.1(4), (5), (5.2), (5.3), (7) or (7.1), as they read for the taxation year in which the death occurred, applied to treat a gift (*i.e.*, made by the individual’s will or made as a consequence of the individual’s death) to have been made at a time before the individual’s death, then the gift is deemed to be made by the individual at that time and not by any other taxpayer or at any other time.

This amendment applies to the 2016 and subsequent taxation years.

Gifts – Deaths After 2015

ITA
118.1(4.1) and (5)

Existing subsection 118.1(5) of the Act treats a gift made by an individual's will as having been made by the individual immediately before the individual's death.

Subsection 118.1(5) is replaced by subsections 118.1(4.1) and (5). These subsections apply to a gift made in the context of the death of an individual after 2015. Specifically, subsection 118.1(4.1) provides that subsection 118.1(5) will apply to a gift that is made by the individual by the individual's will or by the individual's estate (whether the estate qualifies as a graduated rate estate or not), and to a gift that is deemed by subsection 118.1(5.2) to have been made in respect of the individual's death. If subsection 118.1(5) applies to the gift, the gift is generally deemed to be made by the individual's estate at the time the property that is the subject of the gift is transferred to the donee, and deemed not to be made by any other taxpayer or at any other time.

These amendments apply to the 2016 and subsequent taxation years.

Gifts by Graduated Rate Estate

ITA
118.1(5.1)

Subsections 118.1(5.1) to (5.3) of the Act deem a gift to be made to a qualified donee by an individual immediately before the individual's death to the extent that the proceeds of a life insurance policy under which the individual's life was insured, or the proceeds of the individual's registered retirement savings plan (RRSP), registered retirement income fund (RRIF) or tax-free savings account (TFSA), are transferred to the donee as a consequence of the death. These eligible transfer rules are amended so that, as they apply for deaths after 2015, they are now found in subsection 118.1(5.2). As a consequence, subsection 118.1(5.1) is replaced with a new rule.

Amended subsection 118.1(5.1) applies 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).

If subsection 118.1(5.1) applies to the gift, all or part of the gift's eligible amount may be included in the individual's total charitable gifts, total cultural gifts and total ecological gifts for that taxation year or the preceding taxation year, or for a taxation year of the individual's graduated rate estate that precedes the year in which the estate makes the gift. In addition, if paragraph 118.1(5.1)(*b*) applies to the gift, subparagraphs 38(*a.1*)(ii) and (*a.2*)(ii) and 39(1)(*a*)(i.1) may apply so that no portion of a gain from the disposition of the property under section 70 is included in the deceased individual's income for the taxation year in which the individual dies.

This amendment applies to the 2016 and subsequent taxation years.

Deemed Gifts – Eligible Transfers

ITA
118.1(5.2) and (5.3)

Subsections 118.1(5.1) to (5.3) of the Act deem a gift to be made to a qualified donee by an individual immediately before the individual's death to the extent that the proceeds of a life insurance policy under which the individual's life was insured, or the proceeds of the individual's registered retirement savings plan (RRSP), registered retirement income fund (RRIF) or tax-free savings account (TFSA), are transferred to the donee as a consequence of the death.

The rules in subsections 118.1(5.1) to (5.3) are now contained, as they apply for deaths that occur after 2015, in subsection 118.1(5.2). Subsection 118.1(5.3) is repealed. In addition, amended subsection 118.1(5.2) applies to treat the transfer as a gift made in respect of the individual's death. Subsections 118.1(4.1) and (5), in turn, deem the gift to have been made by the estate that arose on and as a consequence of the individual's death and not by any other taxpayer.

These amendments apply to the 2016 and subsequent taxation years.

Gift of Capital Property

ITA
118.1(5.4)(*a*)(i) and (ii)

Subsection 118.1(6) of the Act, in conjunction with subsection 118.1(5.4), provides that, if an individual donates capital property to a charity, the individual may designate a value between the adjusted cost base and the fair market value of the donated property to be treated both as the proceeds of disposition for the purpose of calculating the individual's capital gain and the amount of the gift for the purpose of calculating the charitable donations tax credit under subsection 118.1(3).

Subparagraphs 118.1(5.4)(*a*)(i) and (ii) are amended to remove references to gifts made by an individual's will. Subsections 118.1(4.1) and (5) apply to treat, for purposes of subsection 118.1(5.4), a gift made by an individual by the individual's will to be made by the estate that arose on the individual's death after 2015.

This amendment applies to the 2016 and subsequent taxation years.

Gifts of Art

ITA
118.1(7) and (7.1)

Subsection 118.1(7) of the Act provides that, if an artist donates artwork created by the artist and held in the artist's inventory and at the time of the gift the fair market value of the artwork exceeds its cost amount to the artist, the artist may designate a value between the cost amount and the fair market value of the artwork to be treated both as the proceeds of disposition for the purpose of calculating the artist's income and the amount of the gift for the purpose of calculating the charitable donations tax credit under subsection 118.1(3).

If the artwork is certified as a cultural gift, as described in subsection 118.1(1), subsection 118.1(7.1) applies instead of subsection 118.1(7). Under subsection 118.1(7.1), the artist is treated as having received proceeds of disposition equal to the cost amount to the artist of the work of art for the purpose of calculating the artist's income, but the fair market value of the artwork is not affected. As a consequence, the artist is entitled to a charitable donations tax credit based on the fair market value of the donation, but the artist recognizes neither a profit nor a loss on the disposition of the work of art in computing income from a business for income tax purposes.

Subsections 118.1(7) and (7.1) also treat the gift, if it is made as a consequence of the artist's death, to be made by the artist immediately before the artist's death.

Subsections 118.1(7) and (7.1) are amended so that subsection 118.1(7) sets out the conditions for subsection 118.1(7.1) to apply to a gift made by an artist out of the artist's inventory. Subsection 118.1(7.1) then sets out the rules that apply to the gift. Those subsections no longer treat a gift made as a consequence of the artist's death to be made immediately before the death. Instead, subsection 118.1(7) provides that subsection 118.1(7.1) applies where the gift is made by an artist's graduated rate estate out of the artist's inventory. Where subsection 118.1(7.1) applies to a gift made by an individual other than a graduated rate estate, subparagraphs 118.1(7.1)(*a*)(i) and (*b*)(i) and (ii) preserve the rules for cultural gifts and charitable gifts that previously applied under paragraphs 118.1(7)(*d*) and (7.1)(*d*).

Where subsection 118.1(7.1) applies to a gift of artwork made by an artist's graduated rate estate and immediately before the artist's death the fair market value of the artwork exceeds its cost amount to the artist, subparagraphs 118.1(7.1)(*a*)(ii) and (*b*)(iii) and (iv) apply. If the artwork is a cultural gift, subparagraph 118.1(7.1)(*a*)(ii) deems the artist to receive immediately before death proceeds of disposition in respect of the artwork equal to its cost amount to the artist at that time and the graduated rate estate is deemed to have acquired the work of art at a cost equal to those proceeds. As a result, no income in respect of the artwork's value would be recognized under section 70 by the artist for the taxation year of the artist's death.

If the gift of artwork is a charitable gift, the artist's legal representative may, under paragraph 118.1(7.1)(*b*), designate a value between the cost amount and the fair market value of the artwork to be treated as the proceeds of disposition for the purpose of calculating the artist's income in respect of the artwork's value for the artist's year of death. The artist's graduated rate estate is deemed to have acquired the work of art at a cost equal to those proceeds.

The rules in subsections 118.1(5) to (5.2) apply to determine the tax treatment of the gift, including, in conjunction with paragraphs (*c*) of the definitions "total charitable gifts" and "total cultural gifts" in subsection 118.1(1), whether any portion of the eligible amount of the gift can be included in the total charitable gifts or total cultural gifts of the artist for the taxation year in which the artist died or the preceding taxation year.

These amendments apply to the 2016 and subsequent taxation years.

Determination of Fair Market Value

ITA
118.1(10.1)

Subsection 118.1(10.1) of the Act applies to the determination of the fair market value, and the proceeds of disposition, of certain cultural or ecological property that is the subject of a charitable gift made by a taxpayer. Under the subsection, a determination by the Canadian Cultural Property Export Review Board, or the Minister of the Environment, of the fair market value of property is, subject to certain conditions, determinative for certain purposes of the Act. The application of the subsection to determine the taxpayer's proceed of disposition is subject to subsections 110.1(3) and 118.1(6), (7) and (7.1).

Subsection 118.1(10.1) is amended to remove the reference to subsection 118.1(7), consequential on amendments to that subsection and subsection 118.1(7.1).

This amendment applies to the 2016 and subsequent taxation years.

Non-Qualifying Securities

ITA
118.1(13)

Subsection 118.1(13) of the Act provides that an individual's gift at a particular time of a non-qualifying security is ignored for the purposes of the charitable donations tax credit. Non-qualifying security is defined in subsection 118.1(18) and includes a security issued by the individual, the individual's estate or persons with whom the individual or the individual's estate is affiliated or does not deal at arm's length. For the purposes of subsection 118.1(13), where a gift is made by an individual's will, the particular time at which the gift is made is the time immediately before the individual's death (*i.e.*, as determined under subsection 118.1(5) and without regard to subsection 118.1(4)).

Subsection 118.1(13) is amended to remove the reference to subsection 118.1(4). Amended subsection 118.1(5) provides that, for deaths after 2015, where a gift is made by an individual's will (or otherwise deemed by that subsection to be made by the individual's estate), the gift is made at the time at which the property that is the subject of the gift is transferred to the donee. This time is the particular time referred to in subsection 118.1(13). Paragraph 118.1(13)(*a*) then applies to deem the gift not to be made for the purposes of the charitable donations tax credit.

Paragraphs 118.1(13)(*b*) and (*c*) are relevant to the amount to be included in a taxpayer's total charitable gifts or total Crown gifts for the taxation year in which a security, after the particular time described above, ceases to be a non-qualifying security or in which the donee disposes of a non-qualifying security. Paragraphs 118.1(13)(*b*) and (*c*) are amended to remove references to total Crown gifts, consequential on the repeal of the definition "total Crown gifts" in subsection 118.1(1).

These amendments apply to the 2016 and subsequent taxation years.

Options

ITA
118.1(21)

Subsection 118.1(21) of the Act provides that, subject to subsections 118.1(23) and (24), if an individual has granted an option to a qualified donee in a taxation year, no amount in respect of the option is to be included in computing the total charitable gifts, total Crown gifts, total cultural gifts or total ecological gifts in respect of the individual for any year.

Subsection 118.1(21) is amended to remove the reference to total Crown gifts, consequential on the repeal of the definition "total Crown gifts" in subsection 118.1(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 35

Credit for Interest on Student Loan

ITA
118.62

Section 118.62 of the Act provides a tax credit to an individual in respect of interest paid on a loan, or on other amounts owing, by the individual under student-loan legislation described in that section.

The description of B in section 118.62 is amended to apply to interest paid on loans made under the *Apprentice Loans Act*, effective as of the day on which that Act comes into force.

Clause 36

Ordering of Credits

ITA
118.92

Section 118.92 of the Act provides that the tax credits allowed in computing an individual's tax payable for a taxation year are to be applied in a specific order. Section 118.92 is amended to remove a reference to section 118.03, consequential to amendments that make the Child Fitness Tax Credit refundable.

This amendment applies to the 2015 and subsequent taxation years.

Clause 37

Tax on Split Income

ITA
120.4(1)

The definition "split income" describes the type of income to which section 120.4 of the Act applies. Among other things, split income of a specified individual (generally an individual under the age of 18) includes all amounts required to be included in the individual's income in respect of partnership or trust income if the source of the income is the provision of property or services by the partnership or trust to, or in support of, a business carried on by

- a person who is related to the individual,

- a corporation of which a person who is related to the individual is a specified shareholder, or
- a professional corporation of which a person related to the individual is a shareholder.

The definition “split income” is amended to include income that is, directly or indirectly, paid or allocated to a specified individual from a trust or partnership and derived from a business of, or from the rental of property by, a particular partnership or trust, if a person related to the individual

- is actively engaged on a regular basis in the activities of the particular partnership or trust of earning income from a business or the rental of property, or
- has, in the case of a particular partnership, an interest in the particular partnership, whether directly or indirectly through one or more other partnerships.

This amendment applies to the 2014 and subsequent taxation years.

Clause 38

Tax Payable by Trust

ITA
122(1)

Section 122 sets out certain rules that apply in determining the tax payable by a trust under Part I of the Act. Subsection 122(1) generally requires an *inter vivos* trust to pay tax at a rate of 29% on its taxable income for a taxation year. Subsection 122(2) provides that subsection (1) does not apply to certain trusts established before June 18, 1971. Trusts to which subsection 122(2) applies, and testamentary trusts, pay tax under Part I using the graduated rates set out in subsection 117(2).

Subsection 122(1) is amended so that it does not apply (and subsection 117(2) does apply) to a trust that is a graduated rate estate or qualified disability trust for a taxation year. Consequential on amendments to subsection 122(2), subsection (1) now applies (and subsection 117(2) does not apply) to all *inter vivos* trusts. For further information, see the commentary on subsection 122(2) and the definitions “qualified disability trust” in subsection 122(3) and “graduated rate estate” in subsection 248(1).

Subsection 122(1) is also amended to add paragraph 122(1)(*c*). That paragraph provides for a “recovery” of tax in a taxation year of a trust that elected in an earlier taxation year to be a qualified disability trust. The amount recovered is, in effect, the income tax for the earlier year on the trust’s taxable income for the earlier year that is not distributed to an individual who was an “electing beneficiary” of the trust for the earlier year. Subsection 122(2) sets out the circumstances in which paragraph 122(1)(*c*) applies to a trust for the year. For further information on subsection 122(2), see the commentary on that subsection.

If subsection 122(2) applies to the trust for the year, the trust is required to pay under paragraph 122(1)(*c*), in addition to the 29% tax under paragraph 122(1)(*a*) on its taxable income for the year, the amount determined by the formula A – B. In general terms, variable A of the formula computes the total of all amounts each of which is the tax the trust would have paid under Part I for an earlier taxation year if the trust had not been a qualified disability trust for the earlier taxation year and it made payable (*i.e.*, flowed out) in the earlier taxation year to an electing beneficiary under the trust for the earlier year the amount of its taxable income for the earlier year that was subsequently distributed to that beneficiary (*i.e.*, as a capital distribution). Variable B of the formula computes the actual tax paid by the trust on its taxable income for each of those earlier taxation years. The difference between these two amounts is the amount of the tax recovered for the year in which paragraph 122(1)(*c*) applies.

Specifically,

- Variable B is the total of amounts each of which is the tax paid under Part I by the trust on its taxable income for an earlier taxation year for which the trust elected to be a qualified disability trust. If subsection 122(2) previously applied to the trust, the amount for B is determined only for earlier taxation years for which that election is made and that end after the taxation year for which subsection 122(2) last applied.

- Variable A is the total of all amounts determined for variable B for each of those earlier taxation years, subject to two adjustments. The first adjustment requires that the amounts determined for each of those earlier taxation years be determined as though the trust paid tax in each of those earlier taxation years at a rate of 29% (*i.e.*, instead of at the graduated tax rates available under subsection 117(2)). The second adjustment is to reduce the trust's taxable income for each of those earlier taxation years by the portion of each such year's taxable income that can reasonably be considered to have been paid after the year to an individual who is an electing beneficiary of the trust for the earlier taxation year. A reduction is also provided for the portion of the trust's income tax (both federal and provincial) for the earlier year that is reasonably attributable to the reduction in taxable income attributable to payments made to an electing beneficiary. The second adjustment, in effect, reduces (for purposes of determining the amount under A) the trust's taxable income for the earlier year by the trust's pre-tax taxable income for the earlier year that was paid out in a later year (but before the year in which subsection 122(2) applies) to the relevant electing beneficiary. A distribution, transfer or payment on account of any other source of trust property (*e.g.*, a contribution of capital or a loan) would not qualify as an adjusted amount.

Generally, no tax is recovered under paragraph 122(1)(*c*) on the amount of a trust's after-tax retained taxable income for a taxation year if that amount is distributed to one or more individuals during their lifetimes, those individuals were electing beneficiaries of the trust for the taxation year and no capital distributions are made to other beneficiaries before that amount, and similar amounts for other taxation years, are distributed to those individuals.

These amendments apply to the 2016 and subsequent taxation years. The following example illustrates the application of paragraph 122(1)(*c*) and subsection 122(2).

Example: Paragraph 122(1)(c) recovery

Assumptions

- *A trust is a qualified disability trust for each of its 2016 to 2018 taxation years. Olivia is the trust's electing beneficiary for each of those years. The trust has a number of other beneficiaries, none of whom is an electing beneficiary for any year. The trust makes no capital distributions in any of those years. The trust is factually resident in Canada at all times. At no time does Olivia cease to be a beneficiary under the trust.*
- *Assume that for all taxation years a 15% federal tax rate applies on the first $45,000 of the trust's taxable income and a 22% tax rate on the next $45,000 in the trust's taxable income. This example ignores provincial income taxes.*
- *The trust's tax returns for each of the 2016 to 2018 taxation years are assessed on the following basis:*

Tax year	*Total income*	*Income flowed out to beneficiaries in current year*	*Taxable income*	*Federal tax payable*
2016	*$70,000*	*$30,000*	*$40,000*	*$6,000*
2017	*$30,000*	*nil*	*$30,000*	*$4,500*
2018	*$90,000*	*$10,000*	*$80,000*	*$14,450*

- *The trust has no taxable income for the 2019 taxation year. In the trust's 2019 taxation year it makes a $5,000 capital distribution to Olivia. That distribution is made from capital contributed to the trust.*

- *In the trust's 2020 taxation year, the trust's taxable income is $10,000. In 2020, the trust makes a $34,000 distribution to Olivia. That distribution is made from the trust's after-tax retained taxable income (i.e., $40,000 - $6,000) from the 2016 taxation year. The trust also makes, in 2020, a capital distribution of $100,000 to beneficiaries other than Olivia. Of that distribution, $91,050 is made from the trust's after-tax retained taxable income (i.e., $110,000 - $18,950) from the 2017 and 2018 taxation years. The remaining portion of the distribution is made from capital contributed to the trust.*

Analysis

For the 2019 taxation year, subsection 122(2) does not apply to the trust because the only capital distribution made in the year was made to Olivia, who was an electing beneficiary in a preceding taxation year of the trust. Therefore, paragraph 122(1)(c) does not apply to the trust for 2019. Note that the trust qualifies to make an election to be a qualified disability trust for 2019, although the election is not necessary because the trust has no taxable income for the year.

For the 2020 taxation year, subsection 122(2) applies to the trust because a capital distribution is made from the trust to a beneficiary other than Olivia. The trust is, therefore, ineligible to be a qualified disability trust for the year. Accordingly, paragraphs 122(1)(a) and (c) apply to the trust for 2020. The trust would pay tax at 29% on its $10,000 in taxable income for 2020. In addition, paragraph 122(1)(c) would apply to require $12,950 in federal tax payable for 2020: this amount reflects a 29% rate of tax on the trust's taxable income – taxed in the trust at graduated rates in an earlier taxation year on account of Olivia being an electing beneficiary for the year – that is not ultimately distributed to the electing beneficiary Olivia (or in the case of a trust that had more than one electing beneficiary for the earlier taxation year, any of those electing beneficiaries).

Tax year	*Federal tax previously paid (B of formula in 122(1)(c))*	*Taxable income*	*Adjustments to federal tax previously paid (subparagraph (ii) of A of formula in 122(1)(c))*		*Adjusted federal tax payable at 29% (A of the formula)*	*Federal tax payable for 2020 under paragraph 122(1)(c) (A-B of the formula)*
			Taxable income later distributed to Olivia as capital	*Federal tax previously paid attributable to taxable income later distributed to Olivia*		
2016	*$6,000*	*$40,000*	*($34,000)*	*($6,000)*	*Nil*	*nil*
2017	*$4,500*	*$30,000*	*nil*	*nil*	*$8,700*	*$4,200*
2018	*$14,450*	*$80,000*	*nil*	*nil*	*$23,200*	*$8,750*
2019	*nil*	*nil*	*nil*	*nil*	*n/a*	*nil*

Credits Available to Trusts

ITA
122(1.1)

Subsection 122(1.1) of the Act provides that a trust cannot claim the personal tax credits under section 118 in computing its tax payable under Part I. Subsection 122(1.1) is amended to clarify that a trust cannot claim any personal tax credits, unless the credit is enumerated in that subsection. Specifically, a trust will continue to be eligible to claim the dividend tax credit, the credit for charitable gifts and the credit in respect of minimum tax.

This amendment applies to the 2016 and subsequent taxation years.

Qualified Disability Trust – Application of Paragraph 122(1)(*c*)

ITA
122(2)

Subsection 122(2) of the Act exempts certain *inter vivos* trusts established before June 18, 1971 from the flat top-rate taxation otherwise imposed by paragraph 122(1)(*a*). Subsection 122(2) is amended so that it no longer provides an exception from subsection 122(1).

Amended subsection 122(2) sets outs the circumstances in which a trust, that in an earlier taxation year is a qualified disability trust for the year, is subject to the recovery tax imposed under paragraph 122(1)(*c*). Specifically, subsection 122(2) applies to a trust for a year if

- the trust ceases during the year to have among its beneficiaries any individuals who in one or more earlier taxation years of the trust were electing beneficiaries of the trust. This will include the year in which the electing beneficiary of the trust (or if the trust had more than one electing beneficiary, the last of them) dies;
- the trust ceases to be resident in Canada and the year is the taxation year deemed by subsection 128.1(4) to have ended; or
- the trust distributes capital to a beneficiary other than an individual who was an electing beneficiary of the trust in an earlier taxation year. The making by the trust of an amount payable out of the trust's income for a year (*i.e.*, the flowing out of its current income), or the subsequent satisfaction of a beneficiary's right to enforce such an amount, does not trigger the application of subsection 122(2). A payment to a beneficiary in the beneficiary's capacity as a creditor of the trust also does not trigger the application of the subsection.

For further information, see the commentary on subsection 122(1)(*c*) and the definitions "electing beneficiary" and "qualified disability trust" in subsection 122(3).

These amendments apply to the 2016 and subsequent taxation years.

Definitions

ITA
122(3)

Subsection 122(3) of the Act contains definitions that apply for the purposes of section 122. The subsection is amended to add a number of new definitions. This amendment applies to the 2016 and subsequent taxation years.

"beneficiary"

Under this definition, a beneficiary under a trust includes a person beneficially interested in the trust. Therefore, a reference to a beneficiary in section 122 carries the same meaning as in section 108.

"electing beneficiary"

An electing beneficiary of a trust for a taxation year means an individual who is a beneficiary under the trust, who has jointly elected with the trust for the trust to be a qualified disability trust for the year and who is described in (*i.e.*, meets the conditions set out in) paragraph (*b*) of the definition "qualified disability trust". For further information, see the commentary on that definition.

"qualified disability trust"

A qualified disability trust for a taxation year is a testamentary trust that jointly elects, together with one or more beneficiaries under the trust, in its T3 return of income for the year to be a qualified disability trust for the year. In addition, for the trust to be a qualified disability trust for the year:

- the election must include each electing beneficiary's Social Insurance Number;
- each electing beneficiary must, for the beneficiary's taxation year in which the trust's year ends, be eligible for the disability tax credit;
- no beneficiary who elects with the trust to be a qualified disability trust for the year can elect with any other trust for the other trust to be a qualified disability trust for the other trust's taxation year that ends in the beneficiary's taxation year;
- the trust must be factually resident in Canada (*i.e.*, resident determined without regard to section 94 of the Act); and
- subsection 122(2), which sets out the circumstances in which the trust is required to pay a recovery tax under paragraph 122(1)(*c*) for the year, cannot apply to the trust for the year.

This amendment applies to the 2016 and subsequent taxation years.

Clause 39

Child Fitness Tax Credit

ITA
122.8

New subdivision a.2 is added to Division E of Part I of the Act to, in general, move the non-refundable Child Fitness Tax Credit provisions in subsection 118.03 to new section 122.8 and to add new provisions that make the credit refundable.

New subsection 122.8(1) of the Act sets out definitions that apply for the purpose of the Children's Fitness Tax Credit. The definitions "eligible fitness expense", "qualifying child" and "qualifying entity" have the same meaning as was assigned by former subsection 118.03(1). The new definition "return of income" is relevant in that the credit is only available to an individual in a taxation year who has filed a return of income for the year. A return of income means the return (other than a return filed under subsection 70(2) or 104(23), paragraph 128(2)(*e*) or subsection 150(4)) that is required to be filed for the taxation year or that would be required to be filed for the taxation year if the individual had tax payable under Part I.

New subsection 122.8(2) provides that an eligible individual who makes a claim for the Children's Fitness Tax Credit in his or her return of income for the year is deemed to have paid, on account of tax payable under Part I for the year, an amount determined in accordance with a formula. That formula is the same as the formula that applied for the purposes of former section 118.03. The deemed payment is calculated by applying the appropriate percentage for the taxation year to the lesser of $1,000 and the amount obtained when reimbursements and other forms of assistance that any individual is or was entitled to receive in respect of an eligible fitness expense (other than an amount that is included in computing that individual's income and that is not deductible in computing that individual's taxable income) are subtracted from the amount of eligible fitness expenses incurred in respect of a qualifying child.

New subsection 122.8(3) deems an additional $75 (i.e., $500 x 15 per cent) payment on account of tax to have been made by an individual for a taxation year in respect of each qualifying child of the individual that is eligible for the disability tax credit. The additional credit is available where $100 or more of eligible fitness expenses are claimed under the general Children's Fitness Tax Credit in subsection 122.8(2). This provides the same credit as was available under former subsection 118.03(2.1).

New subsection 122.8(4) provides that, where more than one individual is entitled to the Children's Fitness Tax Credit in respect of a qualifying child (for example the individual and the individual's spouse or common-law partner), the total amounts claimed by those individuals cannot exceed the maximum amount that would be allowed if only one individual were claiming the Children's Fitness Tax Credit. If the individuals cannot agree as to what portion of the expense each can claim, the Minister of National Revenue may fix the portions. This provides the same treatment as former subsection 118.03(3).

New subsection 122.8(5) applies where an individual becomes bankrupt in a particular calendar year. It provides that, notwithstanding subsection 128(2), any reference to the taxation year of the individual is deemed to be a reference to the calendar year. The effect is that the last taxation year of the individual that ends in the calendar year is the only year in respect of which the individual may claim a Children's Fitness Tax Credit. However, expenditures incurred throughout the calendar year will qualify for the credit.

New subsection 122.8(6) applies where an individual is resident in Canada throughout only part of a taxation year. The combined effects of subparagraphs 122.8(6)(*a*)(i) and (ii) is to divide the taxation year into two parts. Subparagraph 122.8(6)(*a*)(i) allows the credits in subsections (2) and (3) in respect of qualifying expenditures incurred while the individual was not a resident of Canada, as if that portion of the year were a separate taxation year. However, new subsection 122.8(7) does not allow those credits for the "separate" year unless all or substantially all of the individual's income is included in computing the individual's "taxable income earned in Canada" (which is relevant to the calculation of tax payable by persons who are not resident in Canada at any time in the year). Subparagraph 122.8(6)(*a*)(ii) allows the credits under subsections (2) and (3) in respect of qualifying expenditures incurred while the individual was a resident of Canada. Finally, paragraph 122.8(6)(*b*) ensures that the total amount available under paragraph 122.8(6)(*a*) does not exceed the amount that could be claimed if the individual were resident in Canada throughout the year.

These amendments apply to the 2015 and subsequent taxation years.

Clause 40

Part XIII Tax – Eligible Bank Affiliate

ITA
125.21

New section 125.21 of the Act generally allows a Canadian parent bank a non-refundable credit, applicable against its tax payable under Part I of the Act, for certain amounts of non-resident withholding tax paid in respect of interest on an upstream deposit made by a foreign affiliate of the bank. More specifically, section 125.21 permits a corporation that is an eligible Canadian bank (as defined in subsection 95(2.43)) throughout a taxation year to deduct, in computing its tax payable for the year under Part I, the total of all amounts each of which is the amount by which an amount described in paragraph 125.21(*a*) exceeds an amount described in paragraph 125.21(*b*). An amount described in paragraph 125.21(*a*) is an amount of non-resident withholding tax paid under paragraph 212(1)(*b*) in respect of interest paid or credited in the year by the bank in respect of an upstream deposit (as defined in subsection 95(2.43)) owing to a corporation that is, throughout the year, an eligible bank affiliate (as defined in subsection 95(2.43)) of the bank.

An amount described in paragraph 125.21(*b*) is the total of all amounts each of which is a portion of the non-resident withholding tax amount described in paragraph 125.21(*a*) that is available to the eligible bank affiliate, or any other person or partnership at any time, as a credit, reduction or deduction against an amount otherwise payable to the government of a country other than Canada (or a political subdivision thereof), taking into consideration all of the provisions of that country's (or political subdivision's) laws, any tax treaty of that country with Canada and any other agreements entered into by that country (or political subdivision).

This amendment applies in respect of taxation years that begin after October 31, 2012.

Clause 41

Canadian Film or Video Production Tax Credit

ITA
125.4

Section 125.4 of the Act sets out the rules that apply for the purpose of computing the Canadian film or video production tax credit ("CFVPTC"). Generally, this tax credit is available at a rate of 25% of qualified labour expenditures incurred by a qualified corporation for a production certified by the Minister of Canadian Heritage to be a Canadian film or video production.

Except as noted below, the amendments to subsection 125.4 generally apply in respect of productions for which development commences on or after November 14, 2003 or the first labour expenditures (as determined under subsections 125.4(1) and (2) as they applied before that date – the "old rules") of the production corporation are incurred after 2003. As well, if development commenced before November 14, 2003 and the first labour expenditures (as defined under the old rules) were incurred by the corporation in its taxation year that includes November 14, 2003, the corporation may elect to have the new rules apply. Subject to this election, corporations must continue to claim the CFVPTC under the old rules for productions that qualified under those rules. Where, in the case of a co-production, more than one qualified corporation is eligible to claim a CFVPTC in respect of the production, the election to have the new rules apply must be made jointly. A production cannot qualify under both schemes.

Definitions

ITA
125.4(1)

"assistance"

In computing the CFVPTC, qualified labour expenditures in respect of a film or video production are limited to 48% of the amount by which the cost of the production exceeds any "assistance" in respect of that cost that has not been repaid.

The definition "assistance" is amended to provide that the equity share of a production of a government or other public authority is treated in the same manner as government assistance. This could include, for example, a loan from a government agency where repayment of the loan is dependent on profit from the production.

"Canadian film or video production certificate"

A qualified corporation must file a Canadian film or video production certificate with its tax return for a taxation year in which it claims a Canadian film or video production tax credit in respect of the production. A "Canadian film or video production certificate", as defined in subsection 125.4(1) of the Act, is issued by the Minister of Canadian Heritage. The definition is amended to provide that that Minister will also certify that, generally, a qualified corporation or a related taxable Canadian corporation will retain an acceptable share of revenues from the exploitation of the production in non-Canadian markets. The Minister of Canadian Heritage will issue guidelines as to how these criteria can be met.

This amendment generally applies in respect of Canadian film or video productions for which certificates are issued by the Minister of Canadian Heritage after December 20, 2002.

The definition is also amended to remove the requirement for the Minister of Canadian Heritage to provide estimates relevant to the calculation of the CFVPTC, in respect of certificates issued after 2003.

"investor"

The definition "investor" describes a person who is not actively engaged on a regular, continuous, and substantial basis in a Canadian film or video production business carried on through a permanent establishment in Canada. A CFVPTC may not be claimed in respect of a Canadian film or video production where an investor, or a partnership in which an investor has an interest, may deduct an amount in respect of the production.

The definition of investor is repealed, applicable to taxation years that end after November 14, 2003, as well as to productions in respect of which a qualifying production corporation has, in a return of income filed before November 14, 2003, claimed an amount under subsection 125.4(3) of the Act in respect of a labour expenditure incurred after 1997 in respect of the production.

“labour expenditure”

The definition “labour expenditure” describes the underlying expenditures of a qualified corporation in respect of a film or video production that will be eligible for the CFVPTC. The definition is amended concurrently with the repeal of the definition “investor” in subsection 125.4(1) and the amendment of subsections 125.4(2) and (4) of the Act, to include those production expenditures incurred by the qualified corporation for or on behalf of another person. That is, labour expenditures are no longer limited to those included in the cost to the qualified corporation of the production. The definition is also amended concurrently with the introduction of the definition “production commencement time”, which represents the time after which an eligible expenditure will qualify for the CFVPTC.

Where a particular corporation is a co-producer with another qualified corporation, and that other corporation has incurred expenditures for or on behalf of the taxpayer, new paragraph 125.4(2)(*d*) of the Act prevents the particular corporation from claiming a CFVPTC in respect of those expenditures.

For more information on subsections 125.4(2) and (4) and the definitions “investor” and “production commencement time”, refer to the commentary for those provisions.

“production commencement time”

For the purpose of the definition “labour expenditure” in subsection 125.4(1) of the Act, in order to be eligible for the CFVPTC, expenditures in respect of a film or video production must be incurred by a qualified corporation from the time that is the “final script stage” of the production. The definition “labour expenditure” is amended to instead refer to expenditures incurred after the production commencement time. The new definition “production commencement time” describes the time that is the latest of the following:

1. The time at which a qualified corporation or its parent company first incurs development labour costs for the development of property of the corporation that is script material on which a Canadian film or video production is based.
2. The first time at which the qualified corporation or its parent company acquires a right in respect of the story that is the basis of the final script. Such rights might include a published literary work, play or screenplay.
3. Two years before the date on which principal photography of the production begins.

It is intended that the in-house development labour costs of an initial draft of a script, as well as the cost of modifications, should fall within the period of production for which labour expenditures qualify for the CFVPTC. These in-house costs could include the cost to hire an independent writer to create a script on the basis of some other story or literary work for which the rights have been acquired by the corporation.

Existing conditions on eligible labour expenditures also apply to scriptwriting labour. (See, for example, amounts excluded from the definition “salary and wages” in subsection 125.4(1) of the Act, such as amounts determined by reference to profits or revenues). As well, the cost to acquire an initial script or any other right referred to above will, like other rights, not qualify. Such an expenditure represents the cost of a property, not a labour expenditure.

The new definition “script material” in subsection 125.4(1) is defined for the purpose of the definition “production commencement time”.

“qualified labour expenditure”

The definition “qualified labour expenditure” describes the portion of a qualified corporation’s labour expenditures upon which it can claim a 25% investment tax credit for a Canadian film or video production. Under a formula in the definition, qualified labour expenditures in respect of a production are limited to 48% of the amount by which the cost of the production to the qualified corporation exceeds any “assistance” in respect of that cost that has not been repaid.

Variable A in the formula is amended to increase the maximum amount of labour expenditure that qualify for the CFVPTC from 48% to 60% of the cost of the production. The definition is also amended concurrently with the repeal of the definition “investor” in subsection 125.4(1) and the amendment of subsections 125.4(2) and (4) of the Act, to include in the production cost those production expenditures incurred by the qualified corporation for or on behalf of another person. That is, production expenditures are no longer limited to those included in the cost to the qualified corporation of the production.

Where the taxpayer corporation is a co-producer with another qualified corporation, and that other corporation has incurred expenditures for or on behalf of the taxpayer, those expenditures are excluded from the formula by new paragraph 125.4(2)(*b*) of the Act.

For more information on subsections 125.4(2) and (4) and the definition “investor”, refer to the commentary for those provisions.

“salary or wages”

For the purposes of the Canadian film and video production tax credit, the definition “salary or wages”, which is generally defined in subsection 248(1) of the Act, does not include an amount described in section 7 of the Act (share option benefits) or any amount determined by reference to profits or revenues.

The definition “salary or wages” is amended to provide that it also does not include an amount paid to a person in respect of services rendered by the person at a time when the person was non-resident, unless the person was at that time a Canadian citizen.

“script material”

The new definition “script material” applies for the purpose of determining the “production commencement time” of a production. Script material is written material describing the story on which the production is based and, for greater certainty, includes a draft script, original story, screen story, narration, television production concept, outline or scene-by-scene schematic, synopsis or treatment. These descriptions are terms commonly used in the film production industry.

Rules Governing Labour Expenditure of a Corporation

ITA
125.4(2)

Subsection 125.4(2) of the Act provides rules that apply for the purpose of the definition “labour expenditure” in subsection 125.4(1). Paragraph 125.4(2)(*a*) provides that remuneration does not include remuneration determined by reference to profits or revenues.

Subsection 125.4(2) is amended to provide that it also applies to the definition “qualified labour expenditure” in subsection 125.4(1). In addition, paragraph 125.4(2)(*a*) is amended to provide that remuneration also does not included remuneration in respect of services rendered by a person at a time when the person was non-resident, unless the person was at that time a Canadian citizen.

A film or video production may be produced jointly by two or more qualified corporations. New paragraph 125.4(2)(*d*) of the Act is added to ensure that only one qualified corporation may claim a CFVPTC in respect of any particular expenditure. Where another qualified corporation supplies goods to or renders services for or on behalf of the taxpayer corporation, new paragraph 125.4(2)(*d*) provides that the related expenditure by the taxpayer is not a labour expenditure, a cost or capital cost of the production to the taxpayer. This provision does not affect the calculation of the cost of the production for other purposes of the Act.

Exception

ITA
125.4(4)

Subsection 125.4(4) of the Act provides that a Canadian film or video production tax credit is not available for a production if an investor may deduct an amount in respect of the production in computing its income for any taxation year. An investor is defined in subsection 125.4(1) to include, generally, any person, other than a prescribed person, that does not carry on a film or video production basis in Canada on a substantial basis.

Subsection 125.4(4) is amended concurrently with the repeal of the definition “investor”, to deny the CFVPTC only in circumstances where the production or a person or partnership holding an interest in the production is a tax shelter investment for the purpose of section 143.2 of the Act.

However, section 1106 of the *Income Tax Regulations* includes a requirement that, for a film or video production to qualify as a Canadian film or video production eligible for the CFVPTC, a prescribed taxable Canadian corporation must retain worldwide ownership of copyright.

This amendment applies to taxation years that end after November 14, 2003, or if a qualifying production corporation has, in a return of income filed before November 14, 2003, claimed an amount under subsection 125.4(3) in respect of a labour expenditure incurred after 1997 in respect of the production.

Revocation of a Certificate

ITA
125.4(6)

Subsection 125.4(6) of the Act provides that a Canadian film or video production certificate in respect of a production may be revoked by the Minister of Canadian Heritage. The revocation of a certificate may occur if an incorrect statement or an omission was made in order to obtain the certificate, or if the production is not a Canadian film or video production. A revoked certificate is considered never to have been issued, so a Canadian film or video production tax credit under new subsection 125.4(3) cannot be claimed in respect of the decertified production.

Subsection 125.4(6) is amended, applicable after November 14, 2003, to clarify that a Canadian film or video production certificate may be revoked in respect of one episode of a television series without affecting the eligibility of other episodes in the series and that, in such a case, the expenditures attributable to that episode do not qualify for the CFVPTC.

Guidelines

ITA
125.4(7)

New subsection 125.4(7) of the Act, which applies in respect of Canadian film or video productions for which certificates are issued by the Minister of Canadian Heritage after December 20, 2002, requires the Minister of Canadian Heritage to issue guidelines respecting the circumstances under which new conditions in the definition “Canadian film or video production certificate” in subsection 125.4(1) are met. For further details, see the commentary for that definition.

Clause 42

Investment Tax Credit of Testamentary Trust

ITA
127(7)

Subsection 127(7) of the Act permits a testamentary trust or a communal organization that is treated as an *inter vivos* trust to allocate its investment tax credits to its beneficiaries.

Subsection 127(7) is amended to replace the reference to a testamentary trust with a reference to a graduated rate estate. The subsection is also amended, consequential on a similar amendment to section 143, to replace the reference to *inter vivos* trust with a reference to trust. For further information, see the commentary on section 143 and on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 43

Minimum Amount Determined

ITA
127.51

Section 127.51 of the Act provides for the calculation of an individual's minimum amount for a taxation year, which is used in determining the individual's alternative minimum tax, if any, for the year. The description of C of the formula in that section reduces the minimum amount by reference to the individual's $40,000 basic exemption for the year. Section 127.53 contains additional rules for computing the basic exemption, including a rule that the only trusts that may claim the basic exemption are testamentary trusts and certain *inter vivos* trusts created before June 18, 1971.

Section 127.51 is amended, in conjunction with the repeal of section 127.53, so that the only trusts that may claim the basic exemption are graduated rate estates. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 44

Adjusted Taxable Income Determined

ITA
127.52(1)

Subsection 127.52(1) of the Act provides for the determination of the adjusted taxable income of an individual for a taxation year, for the purpose of determining the individual's minimum tax liability under Part I of the Act.

Subparagraph 127.52(1)(*h*)(i) is amended to remove the reference to repealed subsection 110.6(2.2), applicable to amounts deducted in respect of the 2014 and subsequent taxation years. Subparagraph 127.52(1)(*h*)(i) is also amended to remove the reference to repealed subsection 110.6(12), applicable to amounts deducted in respect of the 2016 and subsequent taxation years.

Clause 45

Basic Exemption

ITA
127.53

Section 127.51 of the Act provides for the calculation of an individual's minimum amount for a taxation year, which is used in determining the individual's alternative minimum tax, if any, for the year. The minimum amount is reduced by reference to the individual's $40,000 basic exemption for the year. Section 127.53 contains additional rules for computing the basic exemption, including a rule that the only trusts that may claim the basic exemption are testamentary trusts and certain *inter vivos* trust created before June 18, 1971.

Section 127.53 is repealed, in conjunction with amendments to section 127.51, so that the only trusts that may claim the basic exemption are graduated rate estates. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 46

Change in Residence

ITA
128.1(1)(*b*)(iv)

Section 128.1 of the Act sets out the income tax effects of a taxpayer becoming, or ceasing to be, resident in Canada. Subsection 128.1(1) provides rules that apply when a taxpayer becomes resident in Canada. Paragraph 128.1(1)(*b*) provides for a deemed disposition of the taxpayer's property (and paragraph 128.1(1)(*c*) provides for a deemed reacquisition). If the taxpayer is an individual, subparagraph 128.1(1)(*b*)(iv) provides that the deemed disposition does not apply to property that is an excluded right or interest, unless that excluded right or interest is a beneficial interest, that was never acquired for consideration, in a non-resident testamentary trust. This type of beneficial interest is described in paragraph (*k*) of the definition "excluded right or interest" in subsection 128.1(10).

Subparagraph 128.1(1)(*b*)(iv) is amended to refer expressly to paragraph (*k*) of the definition "excluded right or interest" in subsection 128.1(10). This amendment, in conjunction with a related amendment to that paragraph, limits the relief under that paragraph to a beneficial interest, that was never acquired for consideration, in a non-resident testamentary trust that is an estate that has been in existence for no more than 36 months. For further information, see the commentary on subsection 128.1(10) and on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Definitions

ITA
128.1(10)

"excluded right or interest"

Section 128.1 of the Act sets out the income tax effects of a taxpayer becoming, or ceasing to be, resident in Canada. Subsection 128.1(4) provides rules that apply when a taxpayer ceases to be resident in Canada. Paragraph 128.1(4)(*b*) provides for a deemed disposition of the taxpayer's property. If the taxpayer is an individual, subparagraph 128.1(4)(*b*)(iii) provides that the deemed disposition does not apply to property that is an excluded right or interest. Subsection 128.1(10) of the Act contains the definition "excluded right or interest". Paragraph (*k*) of the definition refers to a beneficial interest, that was never acquired for consideration, in a non-resident testamentary trust.

Paragraph (*k*) of the definition "excluded right or interest" is amended to limit its description to a beneficial interest, that was never acquired for consideration, in a non-resident testamentary trust that is an estate that has been in existence for no more than 36 months. As a result, beneficial interests in other kinds of non-resident testamentary trusts will no longer qualify under subparagraph 128.1(4)(*b*)(iii) for an exception from the deemed disposition on the interest holder ceasing to be resident in Canada. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 47

Rules Related to Segregated Funds

ITA
138.1(1)

Section 138.1 of the Act provides rules governing the operation of segregated funds established by insurance companies. Paragraph 138.1(1)(*a*) deems an *inter vivos* trust to exist and paragraph 138.1(1)(*b*) deems the property that is part of the segregated fund to be the trust's property.

Paragraph 138.1(1)(*a*) is amended to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 48

Communal Organizations

ITA
143

Section 143 of the Act sets out rules governing the taxation of communal organizations (referred to in that section as "congregations") that do not allow their members to own property in their own right. Paragraph 143(1)(*a*) deems an *inter vivos* trust to exist and paragraph 143(1)(*c*) deems the property of the congregation to be the trust's property. Subsection 143(2) provides an election under which the trust's taxable income is allocated to members of the congregation, provided that all of the congregation's participating members are specified, in accordance with subsection 143(5), in the election.

Paragraph 143(1)(*a*) and subsections 143(2) and (5) are amended to replace the references in those provisions to an *inter vivos* trust with references to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Elections in Respect of Gifts

ITA
143(3.1)

Subsection 143(3.1) of the Act permits a communal organization that makes an election under subsection 143(2) to elect to have its total charitable gifts, total Crown gifts, total cultural gifts and total ecological gifts flowed through to those members of the congregation for whom an amount is included in income for the year under subsection 143(2).

Subsection 143(3.1) is amended to remove the reference to total Crown gifts, consequential on the repeal of the definition "total Crown gifts" in subsection 143(4). It is also amended to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Definitions

ITA
143(4)

Subsection 143(4) of the Act provides definitions for the purposes of section 143. The definition "total Crown gifts" in subsection 143(4) is repealed consequential on the repeal of the definition "total Crown gifts" in subsection 118.1(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 49

Amateur Athlete Trusts

ITA
143.1

Section 143.1 of the Act provides for the tax treatment of certain amounts received by or on behalf of individuals who are amateur athletes and held under a qualifying arrangement. Paragraph 143.1(1.2)(*a*) deems an *inter vivos* trust to exist and paragraph 143.1(1.2)(*b*) deems the property held under the arrangement to be the trust's property.

Paragraph 143.1(1.2)(*a*) is amended to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 50

Registered Retirement Savings Plans

Definitions

ITA
146(1)

Subsection 146(1) of the Act provides definitions that are relevant for the purposes of registered retirement savings plans (RRSPs).

"earned income"

The definition "earned income" is relevant in determining the maximum tax-deductible contributions that an individual may make to their RRSP for a year (*i.e.*, the individual's RRSP contribution limit). The definition is amended in two respects:

- New paragraph (*b.2*) is added to the definition to allow qualifying performance income (as defined in subsection 143.1(1)) of an individual that is contributed to an amateur athlete trust of the individual to be treated as earned income.
- Paragraphs (*a*) and (*c*) of the definition are amended to exclude amounts distributed to the beneficiary of an amateur athlete trust. Such amounts are included in the beneficiary's income from a business or property under paragraph 12(1)(*z*) of the Act. These amendments ensure that an individual's athletics-related income is not counted twice as earned income.

These amendments apply to an individual's 2014 and subsequent taxation years. However, if an election in respect of an individual's 2011, 2012 or 2013 taxation year is filed with the Minister of National Revenue before March 3, 2015, the amendments apply to the individual's taxation year in respect of which the election is filed and subsequent taxation years.

Clause 51

Registered Education Savings Plan

ITA
146.1(11)

Section 146.1 of the Act sets out various rules applicable to registered education savings plans (RESPs). RESPs are exempt from tax on their taxable incomes. The registration of a plan can, however, be revoked, if certain conditions are not met. If an education savings plan is not registered, it is taxable on its taxable income. In this case, subsection 146.1(11) provides that the rate of tax that applies to a trust governed by an education saving plan is the rate determined under subsection 122(1) as though the trust was created after June 17, 1971. In effect, subsection 146.1(11) ensures that the trust will not qualify for the grandfathering from top flat-rate taxation otherwise available under section 122(2) of the Act to certain *inter vivos* trusts.

Subsection 146.1(11) is repealed, as it is no longer necessary, consequential on the amendment of subsection 122(2). A trust governed by a revoked plan will continue to be subject to tax at the rate of 29% on its taxable income.

This amendment applies to the 2016 and subsequent taxation years.

Clause 52

Life Insurance Policies

ITA
148

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

Although "adjusted cost basis", "disposition" and "proceeds of the disposition" are defined in subsection 148(9) for purposes of section 148, subsections 148(1.1) to (7) apply in certain circumstances to deem there to be a disposition of an interest, or to deem an interest's adjusted cost basis or proceeds of a disposition to be a certain amount. In addition, subsections 148(8) to (8.2) provide exceptions from the income inclusion on the disposition of an interest in a life insurance policy, allowing a disposition of an interest to be made on a tax-deferred (*i.e.*, rollover) basis if the transfer is made to a child, or to a current or former spouse or common-law partner, and certain other conditions are met.

Subsections 148(9) and (9.1) define certain terms for purposes of sections 12.2 and 148. Section 148(10) contains a number of deeming rules that apply to life insurance policies, including annuity contracts.

Deemed Proceeds of Disposition

ITA
148(2)

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

New paragraph 148(2)(*e*) applies to a policy issued after 2016 that is an exempt policy, if after its issuance:

- a benefit on death (as defined in subsection 1401(3) of the *Income Tax Regulations*) under a coverage (as defined in subsection 1401(3) of the *Income Tax Regulations*) under the policy is paid at a particular time;
- the payment results in the termination of the coverage but not the policy; and
- the amount of the fund value benefit (as defined in subsection 1401(3) of the *Income Tax Regulations*) paid at that time in respect of the coverage exceeds the maximum fund value benefit – determined on the policy anniversary that is on or that first follows the date of death of an individual whose life is insured under the coverage – that would be payable under the policy if no other coverage were offered (as determined under subclause (A)(I) of variable B of the formula in subparagraph 306(4)(*a*)(iii) of the *Income Tax Regulations*).

In this case, the policyholder whose interest gives rise to an entitlement (on the part of the policyholder, beneficiary or assignee) to receive all or a portion of that excess is deemed to have disposed of a part of the interest at that time and is deemed to be entitled to receive at that time proceeds of the disposition equal to that excess or part, as the case may be. As a result, subsection 148(1) will apply in respect of the disposition to require an amount to be included in the taxpayer's income for the year that includes that time and that amount is under that subsection the amount by which the proceeds of the disposition of the interest exceeds the adjusted cost basis to the taxpayer of the part of the interest immediately before the disposition.

For information on related amendments, see the commentary on subsection 148(4) and the description of variable O of the formula in the definition "adjusted cost basis" in subsection 148(9).

This amendment comes into force on Royal Assent.

Partial Surrender – ACB Prorated

ITA
148(4)

Subsection 148(4) of the Act applies on the partial disposition (other than one involving a policy dividend or a policy loan) of a taxpayer's interest in a life insurance policy. In these circumstances, the adjusted cost basis (ACB) of the interest is prorated: only the portion of the ACB attributable to the part of the interest disposed of is taken into account in determining the amount to be included in the taxpayer's income in respect of the disposition. The ACB to be used is the proportion of the interest's ACB immediately determined before the disposition that the proceeds of the disposition of the part are of the interest's accumulating fund determined immediately before the disposition.

For further information on an interest's accumulating fund, see the commentary on sections 307 and 1401 of the *Income Tax Regulations*. For further information on an interest's ACB, see the commentary on the definition "adjusted cost basis" in subsection 148(9).

Subsection 148(4) is amended to modify the ratio used in determining the portion of a taxpayer's interest's ACB to be taken into account on the partial disposition of the taxpayer's interest in a life insurance policy. The interest's accumulating fund will no longer be used in the case of life insurance policy (other than an annuity contract) issued after 2016. Instead, the ratio will be the proceeds of the disposition of the part to the interest's cash surrender value determined net of the amount payable, immediately before the disposition, by the taxpayer in respect of policy loans in respect of the policy.

This amendment comes into force on Royal Assent.

Repayment of Policy Loan on Partial Surrender

ITA
148(4.01)

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

Definitions

ITA
148(9)

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

"adjusted cost basis"

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

The definition "adjusted cost basis" is amended to clarify its application in the case of certain policy transactions involving the repayment of a policy loan, premiums or cost of insurance charges for ancillary benefits (*i.e.*, benefits other than the benefit on death), capital disability or death benefits (*i.e.*, savings paid as death or disability benefits that do not result in the termination of a coverage) and benefits on death resulting in the termination of a coverage under the policy (but not of the policy itself).

Variable E of the formula in the definition increases the ACB of a taxpayer's interest in a policy by reference to the repayment of a policy loan in respect of the policy. The ACB increase, however, is limited to the total of certain amounts also described in variable E, including the proceeds of the disposition (as defined in subsection 148(9)), if any, of the policy loan. The proceeds of the disposition in respect of a policy loan is, in turn, computed by reference to the amount of the loan, but ignoring the portion of the loan used immediately after the loan to pay a premium under the policy. Accordingly, the repayment of the portion of a policy loan used to pay a premium that does not form part of the proceeds of the policy loan does not result in an increase in the ACB of an interest in the policy.

Variable E of the formula is amended to provide for an ACB increase on the repayment of the portion of a policy loan used immediately after the loan to pay a premium under the policy to the extent that the portion has not reduced the proceeds of disposition of a partial surrender of the interest. This amendment applies to policies issued after 2016. For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), the amendment applies only to the repayment of a policy loan at or after the particular time. Variable E is also amended to present express as a formula the limit set out the limit on the ACB increase.

Variable G.1 of the formula increases the ACB of an interest, that has been the subject of a tax-deferred transfer under subsection 149(8.2) on the death of a policyholder, by the mortality gain, if any, resulting from the death. The description of variable G.1 of the formula is amended to correct a grammatical error, and to modernize its language.

The formula in the definition is also amended to add variables M, N and O, each of which decreases the ACB of an interest in a policy (other than an annuity contract) issued after 2016. A number of terms used in the descriptions of these variables carry the meanings assigned by subsection 1401(3) of the *Income Tax Regulations*. For further information, see the commentary on the definitions "benefit on death", "coverage", "fund value benefit", "fund value of a life insurance policy" and "net premium reserve" in subsection 1401(3) of the *Income Tax Regulations*.

Variable M of the formula reduces the ACB of a taxpayer's interest in a policy by the amount of premiums paid by or on behalf of the taxpayer, or cost of insurance charges incurred by the taxpayer, in respect of ancillary benefits under the policy (*i.e.*, benefits other than a benefit on death). For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), the ACB reduction applies only to premiums paid or costs of insurance charges incurred at or after the particular time. For information on a related amendment, see the commentary on the definition "premium" in subsection 148(9).

Variable N of the formula reduces the ACB of a taxpayer's interest in a policy by reference to the taxpayer's interest in a capital disability or death benefit payment made under the policy. The payments of these types of benefits are considered a return of savings before the termination of a coverage under the policy on the death of the life or lives jointly insured. The ACB reduction under variable N applies only to a benefit on death or a disability benefit that reduces the cash surrender value, if any, or the fund value (as defined in subsection 1401(3) of the *Income Tax Regulations*), if any, of the policy and does not result in the termination of a coverage under the policy. For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), the ACB reduction applies only to capital disability or death benefit payments made at or after the particular time.

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

The ACB reduction itself is reduced under variable U of the formula in variable O to account for the portion of the interest's ACB that was determined under subsection 148(4) in respect of the deemed disposition under paragraph 148(2)(*e*) that arises in respect of the payment of a fund value benefit, if any, on termination.

For further information, see the commentary on paragraph 148(2)(*e*).

The amendments to the definition "adjusted cost basis" come into force on Royal Assent.

"premium"

Paragraph (*c*) of the definition "premium" excludes amounts paid in respect of accidental death benefits and disability benefits provided under a policy or in respect of certain risks under the policy (*e.g.*, risks as a result of insuring a substandard life). The definition is amended so that paragraph (*c*) applies only to annuity contracts, policies issued before 2017 and policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11). For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), only payments made after a specific time (that is determined depending on when the interest was last acquired) and before the particular time are excluded from the definition "premium". For further information, see the commentary on variable M of the definition "adjusted cost basis" in subsection 148(9).

This amendment comes into force on Royal Assent.

"proceeds of the disposition"

The definition "proceeds of the disposition" of an interest in a life insurance policy applies in determining the amount, if any, that the interest holder is required to include in income on a disposition of the interest. Under the definition, the proceeds of the disposition of an interest are the amount of proceeds that the interest holder is entitled to receive on the disposition of the interest. The definition also provides more detailed rules for determining the proceeds of the disposition of an interest, under paragraph (*a*) of the definition in respect of a surrender or maturity of a policy, under paragraph (*b*) of the definition in respect of a policy loan, under paragraph (*c*) in respect of certain dispositions involving payments under certain life annuity contracts, and under paragraph (*d*) in respect of a disposition on the death of a life insured under paragraph 148(2)(*b*).

Paragraph (*a*) of the definition provides that the proceeds of the disposition of an interest on the surrender or maturity of a policy is the cash surrender value of the interest less certain specified amounts, including an amount payable at the time of surrender or maturity by the policyholder in respect of a policy loan in respect of the policy.

Paragraph (*a*) is amended to clarify that the specified amount described in subparagraph (*a*)(i) describes an amount payable in respect of a policy loan in respect of the policy only to the extent that the policy loan is reduced as a consequence of the disposition. That subparagraph is also amended as it applies to determining the proceeds of the disposition of a partial surrender of an interest in a life insurance policy issued after 2016. In the case of such a partial surrender, the specified amount by which the cash surrender value is reduced in respect of a policy loan is only the part of the loan applied, immediately after the loan, to pay a premium under the policy, as provided for under the terms and conditions of the policy. Other parts of a policy loan in respect of such a policy will not apply to reduce the proceeds of the disposition of a partial surrender of an interest. For policies that are deemed to be issued at a particular time after 2016 because of subsection 148(11), the reduction in respect of a policy loan will apply only to a partial surrender of a taxpayer's interest that occurs at or after the particular time.

This amendment comes into force on Royal Assent.

Loss of Grandfathering

ITA
148(11)

New subsection 148(11) of the Act applies in determining whether certain life insurance policies issued before 2017, and not otherwise subject to the new rules for policies issued after 2016, are to be treated as having been issued at a particular time after 2016 for certain purposes of the new rules. The new rules are set out elsewhere in section 148 of the Act and in sections 306, 307, 308, 310, 1401 and 1403 of the *Income Tax Regulations*. Subsection 148(11) does not apply to annuity contracts and does not apply for the purposes of subsection 306(9) of the *Income Tax Regulations* or for the purpose of applying the new rules for purposes of subsection 211.1(3) of the Act (*i.e.*, for determining a life insurer's Canadian life investment income or loss for a taxation year for purposes of the Investment Income Tax under Part XII.3 of the Act).

Subsection 148(11) applies to a policy otherwise issued before 2017 at the first time after 2016 at which life insurance – in respect of a life or two or more lives jointly insured and in respect of which a particular schedule of premium or cost of insurance rates applies – is converted (other than only because of a change in premiums or cost of insurance rates) into another type of life insurance or is added to the policy. In this event, the policy is deemed to be issued at that time. The rule does not apply, in the case of insurance added to the policy, if the added insurance is (i) medically underwritten before 2017, (ii) medically underwritten after 2016 to obtain a reduction in the premium or cost of insurance rates under the policy, (iii) paid for with policy dividends or (iv) reinstated.

Paragraph 1401(5)(*b*) of the *Income Tax Regulations* provides a similar rule for purposes of applying the new rules for purposes of Part XII.3 of the Act.

This amendment comes into force on Royal Assent.

Clause 53

Exception re Investment Income of Certain Clubs

ITA
149(5)

Section 149 of the Act provides that no tax is payable under Part I on the taxable income of certain persons for the period in a taxation year during which the person is a person listed in that section. Paragraph 149(1)(*l*) includes in the list certain non-profit organizations. Subsection 149(5) places a limit on the exemption otherwise available under that paragraph. Specifically, subsection 149(5) subjects to tax the investment income of certain clubs providing dining, recreational or sporting facilities. That subsection deems an *inter vivos* trust to exist and paragraph 149(5)(*c*) deems the property of the club to be the trust's property. The trust is subject to tax on the taxable income determined under the rules set out in that subsection.

Subsection 149(5) is amended to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 54

Definitions

ITA
149.1(1)

"exempt shares"

Section 149.1 of the Act provides the rules that must be met for a charity (including a private foundation) to obtain and keep registered status. A registered charity is exempt from tax on its taxable income and can issue receipts that entitle its donors to claim tax relief for their donations. Under subsection 149.1(4), the Minister of National Revenue may revoke the registration of a charity that is a private foundation if the foundation has a divestment obligation percentage at the end of any taxation year in respect of a class of shares of a corporation.

Subsection 149.1(1) contains a number of definitions that are relevant for the purposes of section 149, including to the determination of a foundation's divestment obligation percentage. In this context, the definition "exempt shares" identifies shares in respect of which no divestment obligation is imposed on a private foundation. Subparagraph (*a*)(iii) of that definition describes certain shares acquired by the foundation by way of a gift made after March 18, 2007 under the terms of an *inter vivos* trust or testamentary trust created before March 19, 2007 and not amended after March 18, 2007.

Subparagraph (*a*)(iii) of the definition "exempt shares" is amended to replace the reference to an *inter vivos* trust or testamentary trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 55

Assessment

ITA
152(1)(*b*)

Subsection 152(1) of the Act lists certain refunds and deemed payments of tax that are to be determined in the course of assessing a taxpayer's tax. Paragraph 152(1)(*b*) is amended consequential to amendments that make the Child Fitness Tax Credit refundable, to add a reference to payments deemed to be made on account of tax under new subsections 122.8(2) and (3).

This amendment applies to the 2015 and subsequent taxation years.

Reassessment with Taxpayer's Consent

ITA
152(4.2)

Subsection 152(4.2) of the Act relates to the reassessment of tax, interest and penalties payable by a taxpayer and to the redetermination of tax deemed to have been paid by a taxpayer. This subsection gives the Minister of National Revenue discretion to make a reassessment or a determination beyond the normal reassessment period of an individual in respect of a taxation year if the individual requests the Minister to do so. The subsection applies only in respect of an individual (other than a trust) or a testamentary trust.

Subsection 152(4.2) is amended consequential to amendments that make the Child Fitness Tax Credit refundable, to add a reference to payments deemed to be made on account of tax under new subsections 122.8(2) and (3). This amendment applies to the 2015 and subsequent taxation years.

Subsection 152(4.2) is also amended so that it applies to a trust in respect of a taxation year only if the trust is a graduated rate estate for the year. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1). This amendment applies to the 2016 and subsequent taxation years.

Clause 56

Instalment Exemption

ITA
156.1(2)

If an individual's tax payable is below a certain threshold, subsection 156.1(2) of the Act relieves the individual from the obligation to make tax instalments.

Paragraph 156.1(2)(*c*) is added to extend the application of subsection 156.1(2) to an individual that is a graduated rate estate for the relevant taxation year. This amendment is consequential on the repeal of paragraph 104(23)(*e*), which for taxation years before 2016 provides an exemption to testamentary trusts from tax instalments.

This amendment applies to the 2016 and subsequent taxation years.

Clause 57

Joint Liability – Spousal and Similar Trusts

ITA
160(1.4)

Subsection 160(1.4) is added consequential on the introduction of subsection 104(13.4). Subsection 104(13.4) provides rules that apply 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*) or (*a.4*). The trusts referred to in those paragraphs 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 on a tax-deferred basis in circumstances described in subparagraph 73(1.02)(*b*)(ii) or subsection 107.4(1). 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.

Subsection 160(1.4) provides that the trust and the particular beneficiary are jointly and severally, or solidarily, liable for the portion of the particular beneficiary's tax payable under Part I because of the inclusion in that income of the amounts described in paragraph 104(13.4)(*b*). Existing subsection 160(2) of the Act empowers the Minister of National Revenue to assess the liability that arises under subsection 160(1.4) against the trust at any time, and it is intended that that the Minister apply subsection 160(2), in respect of an amount owing under subsection 160(1.4), as though the trust were liable in the first instance for that amount.

The particular beneficiary's legal representative (*e.g.*, estate trustee) remains, to the extent provided for under section 159, jointly and severally, or solidarily, liable with the particular beneficiary for amounts payable (including that portion of the tax payable under Part I) by the particular beneficiary under the Act.

For further information, see the commentary on subsection 104(13.4).

This amendment applies to the 2016 and subsequent taxation years.

Clause 58

Contra Interest

ITA
161(2.2)

Subsection 161(2.2) of the Act provides for an offset (generally referred to as "contra interest") in computing arrears interest payable under the Act by a taxpayer if the taxpayer has remitted income tax instalments earlier than the taxpayer was required to or in larger amounts than were required. The contra interest for a taxation year is computed in respect of the period beginning at the start of the year and ending on the day that the taxpayer is required to pay the balance of the taxpayer's estimated taxes for the year. Subsection 161(2.2) does not apply to testamentary trusts.

Subsection 161(2.2) is amended so that it applies to testamentary trusts, except graduated rate estates. Consequential on amendments to paragraph 104(23)(*e*) and subsection 156.1(2), testamentary trusts (other than graduated rate estates) are for the 2016 and subsequent taxation years no longer exempt from the tax instalment rules. For further information, see the commentary on those provisions and on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 59

False Statements or Omissions

ITA
163(2)

Subsection 163(2) of the Act imposes a penalty where a taxpayer knowingly, or in circumstances amounting to gross negligence, participates in or makes a false statement for the purposes of the Act. The penalty is determined with reference to the understatement of tax or the overstatement of amounts deemed to be paid on account of tax.

New paragraph 163(2)(*c.4*) is added to provide that the penalty may apply in the case of an overstatement of an amount deemed to be paid under subsection 122.8(2) or (3) of the Act, consequential to amendments that make the Child Fitness Tax Credit refundable.

This amendment applies to the 2015 and subsequent taxation years.

Clause 60

Refund of Overpayment

ITA
164(1.5)(*a*)

Subsection 164(1.5) of the Act provides generally that the Minister of National Revenue may, in specified circumstances and notwithstanding certain restrictions in subsection 164(1), refund all or any portion of an overpayment of tax on or after mailing a notice of assessment for a taxation year. In particular, paragraph

164(1.5)(*a*) provides that the Minister may do so if the taxpayer is an individual (other than a trust) or a testamentary trust and the taxpayer's return of income for the taxation year is filed on or before the day that is 10 calendar years after the end of the taxation year.

Paragraph 164(1.5)(*a*) is amended so that subsection 164(1.5) applies to a trust in respect of a taxation year only if the trust is a graduated rate estate for the taxation year. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Disposition of Property by Legal Representative

ITA
164(6)

Subsection 164(6) of the Act allows a deceased taxpayer's legal representative to elect to treat certain capital losses and terminal losses of the taxpayer's estate for its first taxation year as losses of the taxpayer for the taxpayer's last taxation year.

Subsection 164(6) is amended so that it applies only if the legal representative is administering the graduated rate estate of the deceased taxpayer. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Realization of Deceased Employee's Options

ITA
164(6.1)

Subsection 164(6.1) of the Act applies to certain employee stock options in respect of which a benefit has been included in a deceased taxpayer's income by reason of paragraph 7(1)(*e*). If the employee stock option is exercised, or disposed of, by the deceased taxpayer's legal representative in the first taxation year of the estate (in the course of administering the deceased taxpayer's estate), the legal representative can elect to carry back certain amounts determined under the subsection to be deducted in computing the deceased taxpayer's income for the deceased's final taxation year.

Subsection 164(6.1) is amended so that it applies only if the legal representative is administering the graduated rate estate of the deceased taxpayer. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 61

Objections to Assessments

ITA
165(1)(*a*)

Subsection 165(1) of the Act allows a taxpayer to object to an assessment within a certain period of time. Paragraph 165(1)(*a*) provides that if the assessment is of an individual (other than trust) or a testamentary trust, the taxpayer who objects must serve notice on the Minister of National Revenue on or before the later of (i) the day that is one year after the taxpayer's filing-due date for the relevant taxation year, and (ii) the day that is 90 days after the day of mailing of the notice of assessment.

Paragraph 165(1)(*a*) is amended so that it applies to a trust in respect of a taxation year only if the trust is a graduated rate estate for the year. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 62

Retirement Compensation Arrangements

ITA
207.6(1)

Section 207.6 of the Act provides a number of rules for the purposes of the provisions of the Act relating to retirement compensation arrangements (RCAs). Subsection 207.6(1) provides rules that apply where an RCA is established without the creation of a trust. In this instance, an *inter vivos* trust is deemed to be created and property held in connection with the RCA is treated as the trust's property.

Subsection 207.6(1) is amended to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

Clause 63

Part XII.2 Tax

ITA
210

Part XII.2 of the Act imposes a special tax on the designated income of certain trusts that are resident in Canada with respect to distributions to designated beneficiaries.

Subsection 210(1) defines "designated beneficiary" for the purpose of Part XII.2. Paragraph (*b*) of the definition treats a non-resident-owned investment corporation (NRO) as a designated beneficiary under a trust. Paragraphs (*d*) and (*e*) of the definition treat a trust or partnership as a designated beneficiary if a beneficiary or member, as the case may be, is an NRO. Since the NRO rules no longer apply, paragraph (*b*) is repealed and paragraphs (*d*) and (*e*) are amended to remove the references to NROs.

These amendments apply on Royal Assent.

Paragraphs (*d*) and (*e*) also treat a particular trust or partnership as a designated beneficiary if a beneficiary or member, as the case may be, of the particular trust or partnership is a trust. However, under subparagraphs (*d*)(iii) and (*e*)(iv), if the trust is a testamentary trust, the particular trust or partnership will not be a designated beneficiary solely because of the testamentary trust being its beneficiary or member. Subparagraphs (*d*)(iii) and (*e*)(iv) are amended to refer only to a graduated rate estate.

These amendments apply to the 2016 and subsequent taxation years.

Paragraph 210(2)(*a*) provides that no tax is payable under Part XII.2 for a taxation year by a trust if the trust is a testamentary trust throughout the year. That paragraph is amended to limit its application to a trust that is a graduated rate estate for the year. For further information, see the commentary on the definition "graduated rate estate" in subsection 248(1).

This amendment applies to the 2016 and subsequent taxation years.

Clause 64

Back-to-Back Loan Arrangements

ITA
212(3.1)

New subsections 212(3.1) to (3.3) of the Act ensure that withholding tax applicable under Part XIII of the Act is not circumvented 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 rules largely parallel the new 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 new subsection 212(3.2), which is the operative rule, and subsection 212(3.3).

In order for subsection 212(3.2) to apply, five conditions, set out in paragraphs 212(3.1)(*a*) to (*e*), must be satisfied. The first condition (set out in paragraph 212(3.1)(*a*)) is that the taxpayer pays or credits a particular amount on account or in lieu of payment of, or in satisfaction of, interest in respect of a particular debt or other obligation to pay an amount to a person or partnership (the "intermediary"). The wording of paragraph 212(3.1)(*a*) is very similar to that of the withholding tax provision in subsection 212(1) since subsection 212(3.2) is intended to apply where an arrangement is used to avoid the application of withholding tax in respect of a payment or credit to which it would otherwise have applied. The particular amount of interest referred to in paragraph 212(3.1)(*a*) is determined without reference to paragraph 18(6.1)(*b*) and subsection 214(16), which are rules that, in certain circumstances involving back-to-back loan arrangements, result in all or a portion of an interest payment being deemed to instead be paid as a dividend. For further information, please see the commentary on paragraph 18(6.1)(*b*).

The second condition (set out in paragraph 212.3(3.1)(*b*)) is that the intermediary is neither a person resident in Canada that does not deal at arm's length with the taxpayer, nor a partnership each member of which is a person resident in Canada that does not deal at arm's length with the taxpayer. This condition ensures that withholding tax does not apply in respect of a "back-to-back" loan if the intermediary is itself a non-arm's length person (or partnership) and Part XIII tax may apply to the extent that interest is paid or credited by it to the non-resident person.

The third condition (set out in paragraph 212(3.1)(*c*)) may be satisfied in one of two ways. The first, under subparagraph 212(3.1)(*c*)(i), is if, at any time in the period during which the interest referred to in paragraph 212(3.1)(*a*) accrued, the intermediary, or a person or partnership that does not deal at arm's length with the intermediary, has an amount outstanding as or on account of a debt or other obligation to pay an amount to a particular non-resident, and the debt or other obligation meets a condition in either clause 212(3.1)(*c*)(i)(A) to (B) (an "intermediary debt"). The condition in clause 212(3.1)(*c*)(i)(A) is that 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 the particular debt (owed by the taxpayer to the intermediary). Satisfying this condition demonstrates that the intermediary is not fully bearing the risk of the amount it is owed by the taxpayer.

The condition in clause 212(3.1)(*c*)(i)(B) is that it can reasonably be concluded that all or a portion of the particular debt or other obligation became owing, or was permitted to remain owing, because either some or all of the debt or other obligation was entered into or was permitted to remain outstanding, or the intermediary anticipated that some or all of the debt or other obligation would become owing or remain outstanding The second way in which paragraph 212(3.1)(*c*) may be satisfied (as set out in subparagraph 212(3.1)(*c*)(ii)) is if the following conditions are met:

- the intermediary, or a person or partnership that does not deal at arm's length with the intermediary, has a specified right in respect of a particular property;
- that specified right was granted directly or indirectly by a non-resident person; and
- either the existence of the specified right is required under the terms and conditions of the particular debt or other obligation, or it can reasonably be concluded that some or all of the particular debt or other obligation became owing, or was permitted to remain owing, because the specified right was granted, or the intermediary 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.

The exception for a right to encumber a property to secure the particular debt or other obligation (or a connected debt or other obligation) ensures that the intermediary's right to, for example, place a lien on a property to secure a debt owing to it by the taxpayer does not constitute a specified right. <u>Nor does the right of the intermediary to use cash – received from the taxpayer or another member of the taxpayer's group – by applying the cash against the balance owing on the particular debt or other obligation, or a debt or other obligation owing to the intermediary by another member of the taxpayer's group, in and of itself constitute a specified right of the intermediary.</u> In addition, a specified right will not exist if it is established by the taxpayer that all of the net proceeds received from exercising a right, or that would be received if it exercised the right, in respect of the property must be applied to reduce either the amount owing by the taxpayer in respect of the particular debt or other obligation, or an amount owing in respect of a "connected" debt or other obligation described in subparagraph 18(6)(*d*)(ii). As such, an intermediary will not be considered to have 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 particular debt or other obligation owed to it by the taxpayer and does not in-and-of-itself provide a means for the intermediary to raise funds that may be used by it for a purpose other than to reduce an amount owing to it in respect of the particular debt or other obligation, or a "connected" debt or other obligation.

The conditions listed in paragraph 212(3.1)(*c*) closely mirror the conditions set out in paragraph 18(6)(*c*) in the thin capitalization rules. For examples as to its application, please see the commentary on paragraph 18(6)(*c*).

A fourth condition (set out in paragraph 212(3.1)(*d*)) for the application of subsection 212(3.2) is that the tax that would be payable under Part XIII in respect of the particular amount of interest, if the particular amount were paid or credited to the non-resident person (*i.e.*, the creditor in respect of the intermediary debt or the grantor of the specified rights in respect of the particular property, as the case may be) rather than the intermediary, is greater than the tax that is payable under Part XIII (determined without reference to subsections 212(3.1) and (3.2)) in respect of the particular amount. In other words, subsection 212(3.2) applies only if the interposition of the intermediary in the financing arrangement would, in the absence of subsection 212(3.2), result in an avoidance of the withholding tax that would have been payable if the interest had been paid or credited directly to the non-resident, and not the intermediary.

The final condition for subsection 212(3.2) to apply is in paragraph 212(3.1)(*e*), which contains a *de minimis* rule. The condition is satisfied where the total of all amounts – each of which is, in respect of the particular debt (owed by the taxpayer to the intermediary), an amount outstanding as or on account of an intermediary debt (*i.e.*, a debt described in subparagraph 212(3.1)(*c*)(i)) or the fair market value of a particular property (*i.e.*, a property in which a specified right was granted that is described in subparagraph 212(3.1)(*c*)(ii)) – is equal to at least 25% of the total of two amounts.

The first amount is the amount outstanding as or on account of the particular debt or other obligation (*i.e.*, the amount outstanding in respect of the particular debt owed by the taxpayer to the intermediary). In other words, subsection 212(3.2) will not apply if the total of the amounts outstanding on all intermediary debts, and the fair market values of all particular properties, in respect of the particular debt represents less than 25% of the amount of the particular debt. This ensures that subsection 212(3.2) does not apply where the particular debt is funded by the intermediary mainly from sources other than the non-resident.

The second amount is the total of all amounts (other than the amount outstanding as or on account of the particular debt or other obligation) that the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, has outstanding as or on account of a debt or other obligation to pay an amount to the intermediary under the agreement, or a connected agreement, under which the particular debt was entered into where

- the intermediary is granted a security interest in respect of a property that is either the intermediary debt (which is a property held by the connected non-resident) or the particular property, as the case may be, and the security interest secures the payment of two or more debts or other obligations that include the debt or other obligation and the particular debt, and
- every security interest that secures the payment of a debt or other obligation referred to in clause 212(3.1)(*e*)(ii)(A) secures the payment of every debt or other obligation referred to in that clause.

A security interest in respect of a property is defined to mean an interest in, or for civil law a right in, the property that secures payment of an obligation. The inclusion of the second amount, under subparagraph 212(3.1)(*e*)(ii), is intended to provide possible relief where an intermediary enters into multiple cross-collateralized debts owing to the intermediary by multiple group entities, including the taxpayer.

Paragraph 212(3.1)(*e*) closely mirrors paragraph 18(6)(*d*) in the thin capitalization rules. For examples as to its application, please see the commentary on paragraph 18(6)(*d*).

Back-to-Back Loan Arrangements

ITA
212(3.2)

New 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. If it applies, subsection 212(3.2) deems, for the purposes of paragraph 212(1)(*b*), the taxpayer to pay interest to a non-resident person referred to in subparagraph 212(3.1)(*c*)(i) or (ii). The amount of the interest is determined by the formula ((A × B/C) – D) × (E – F)/E.

Variable A is the particular amount referred to in paragraph 212(3.1)(*a*). As noted above, this is the amount of the interest paid to the intermediary in respect of the particular debt or other obligation at the time when subsection 212(3.2) applies. The amount is determined without reference to paragraph 18(6.1)(*b*) and subsection 214(16). Variable A reflects the fact that subsection 212(3.2) applies separately with respect to each particular debt or other obligation owed by the taxpayer.

Variable B is the average of all amounts each of which is the lesser of two amounts at a point in time during the relevant period (the “relevant period” refers to the period during which the interest paid or credited accrued). The two amounts are:

- the amount of the particular debt or other obligation referred to in paragraph 212(3.1)(*a*) outstanding at a particular time in the relevant period; and
- the total of all amounts each of which is at that particular time
    - an amount outstanding as or on account of an intermediary debt, in respect of the particular debt or other obligation, that is owed to the non-resident person,
    - the fair market value of a particular property referred to in subparagraph 212(3.1)(*c*)(ii) in respect of the particular debt or other obligation, or
    - if there is neither an intermediary debt nor a particular property, in respect of the particular debt or other obligation, at that particular time, nil.

In determining the amount of interest deemed to be paid by the taxpayer to a given non-resident person, variable B aggregates all the intermediary debts owing by the intermediary to that non-resident, and the particular properties in respect of which that non-resident has granted a specified right, and compares this aggregate amount to the amount outstanding on the particular debt or other obligation. Where there are multiple non-resident group members who have provided funding to the intermediary with respect to the particular debt or other obligation – by providing debt funding to the intermediary or by granting specified rights to the intermediary in respect of property – then subsection 212(3.2) is to be applied separately in respect of each non-resident.

Variable C 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.

Variable D is the portion, if any, of the particular amount deemed by subsection 214(16) to have been paid by the taxpayer as a dividend. This amount arises where the thin capitalization rules in subsection 18(4) apply to deny the taxpayer a deduction in respect of interest that the taxpayer is deemed (for the purposes of the thin capitalization rules) by subparagraph 18(6.1)(*a*)(ii) to pay to the non-resident person. This results in paragraph 18(6.1)(*b*) deeming – for the purposes of Part XIII and subject to subsections 214(16) and (17) – the denied portion of the interest to be paid by the taxpayer to the non-resident. Subsection 214(16) in turn applies to deem the taxpayer to pay that amount as a dividend rather than as interest.

Variable E is 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 non-resident person at the time when it is actually paid to the intermediary.

Variable F is the rate of tax (determined without reference to subsection 214(16)) imposed under Part XIII on the intermediary in respect of all or the portion of the particular amount paid or credited to the intermediary.

Back-to-Back Loan Arrangements

ITA
212(3.3)

New 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, 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. In the absence of subsection 212(3.3), this could occur where multiple non-resident group members provide funding to the intermediary with respect to the particular debt or other obligation – by providing debt funding to the intermediary, or granting specified rights to the intermediary in respect of property – and the total amount of that funding exceeds the amount outstanding on the particular debt or other obligation during the relevant period (*i.e.*, the period during which the interest that was actually paid accrued).

Specifically, subsection 212(3.3) applies where

- at any time, subsection 212(3.2) applies to deem a taxpayer to pay interest at that time to more than one non-resident person referred to in subparagraph 212(3.1)(*c*)(i) or (ii) in respect of a particular debt or other obligation, and
- the total of all amounts determined (without reference to this subsection) for variable B in the formula in subsection 212(3.2) in respect of the particular debt or other obligation, for all of the non-resident persons, exceeds 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.

Where these two conditions are met, then the taxpayer may designate, in a reasonable manner, amounts by which to reduce the amount determined for variable B in respect of one or more of the non-resident persons, provided that the total of such reductions cannot be greater than the amount of the excess.

Subsections 212(3.1) to (3.3) apply in respect of amounts paid or credited after 2014.

Clause 65

Foreign Affiliate Dumping – Conditions for Application

ITA
212.3(1)(*b*)

Subsection 212.3(1) of the Act provides the conditions for the application of subsection 212.3(2), the main operative rule for the foreign affiliate dumping rules. The foreign affiliate dumping rules are designed to deter Canadian subsidiaries of foreign-based multinational groups from making investments in non-resident corporations that are, or become as a result of the investment or a series of transactions that includes the investment, foreign affiliates of the Canadian subsidiary in situations where these investments can result in the inappropriate erosion of the Canadian tax base. By virtue of subsection 212.3(1), subsection 212.3(2) will apply to an investment (as defined in subsection 212.3(10)) in a non-resident corporation (referred to in section 212.3 and in this commentary as the “subject corporation”) by a corporation resident in Canada (referred to in section 212.3 and this commentary as the “CRIC”) where three conditions are met. One of these conditions, in paragraph 212.3(1)(*b*), is that the CRIC must be controlled by a non-resident corporation (referred to in section 212.3 and in this commentary as the “parent”) at the time the investment is made, or become so controlled as part of a series of transactions or events that includes the making of the investment.

Paragraph 212.3(1)(*b*) is amended in three respects. First, it is amended to require that the CRIC be controlled immediately after the time the investment is made, rather than at the time of the investment. This amendment ensures that the condition in paragraph 212.3(1)(*b*) is not satisfied when the investment is made by the CRIC at the same time as an event that causes a non-resident corporation to cease to control the CRIC. This situation could arise, for example, where a non-resident corporation controls the CRIC immediately before the CRIC acquires all the shares of another non-resident corporation from a Canadian-resident vendor and, as a result of the share consideration issued by the CRIC to the vendor, the CRIC ceases to be controlled by the non-resident corporation.

Second, paragraph 212.3(1)(*b*) is amended to ensure that if the parent does not control the CRIC immediately after the investment time, the condition in that paragraph may be satisfied – and subsection 212.3(2) may therefore apply – only if the parent acquires control of the CRIC after the investment time and as part of the series of transactions or events that includes the investment. Subsection 212.3(2) will not apply where the CRIC becomes controlled by a non-resident corporation prior to, and as part of the series of transactions or events that includes the making of the investment provided that

- the CRIC is not controlled by a non-resident corporation immediately after the investment time, and
- the CRIC does not become controlled by a non-resident corporation after the investment time and as part of the series that includes the making of the investment.

The third amendment provides a “safe harbour” from the application of subsection 212.3(2), subject to certain restrictions where the CRIC does not fully participate in (*i.e.*, acquires preferred shares), or has its risk limited in respect of, the investment in the subject corporation. Even with the addition of the safe harbour rule, paragraph 212.3(1)(*b*) will continue to be satisfied where a non-resident corporation controls the CRIC immediately after the investment time because the requirement in new subparagraph 212.3(1)(*b*)(i) would be met.

Where a CRIC is not immediately after the investment time controlled by a non-resident corporation, but subsequently becomes controlled by a non-resident corporation as part of a series of transactions or events, paragraph 212.3(1)(*b*) will apply if the conditions set out in any of subparagraphs 212.3(1)(*b*)(i) to (iii)) are satisfied:

- At the investment time, the parent, either alone or together with persons with whom the parent does not deal at arm’s length and with partnerships of which the parent, or a non-resident person that does not deal at arm’s length with the parent, is a member (other than a limited partner within the meaning assigned by subsection 96(2.4)), owns shares of the CRIC that either give the holders thereof 25% or more of the votes that could be cast at any annual meeting of the shareholders of the CRIC, or have a fair market value of 25% or more of the fair market value of all the shares of the CRIC. For these purposes, ownership of the CRIC's shares by the parent, each person that does not deal at arm's length with the parent and each partnership is to be determined without reference to the partnership look-through rule in paragraph 212.3(25)(*b*) and as if all rights referred to in paragraph 251(5)(*b*) were immediate and absolute and had been exercised.

- The investment is an acquisition of shares of a subject corporation to which subparagraph 212.3(1)(*b*)(ii) applies because of subsection 212.3(19), *i.e.*, the shares are in substance preferred shares and the subject corporation is not a subsidiary wholly-owned corporation.
- Under an arrangement entered into in connection with the investment, a person or partnership, other than the CRIC or a person related to the CRIC, has in any material respect the risk of loss or opportunity for gain or profit with respect to a property that can reasonably be considered to relate to the investment. This condition would be met, for example, where the CRIC's investment is funded by limited-recourse debt from a non-resident corporation that subsequently becomes its parent as part of the series of transactions or events that includes the making of the investment or where the CRIC has a right to sell the investment (*i.e.*, a put right) to the parent, or a person that is not related to the CRIC, at some later time for a predetermined amount.

The purpose of the safe harbour rules is to reduce impediments to corporate takeovers. The rules recognize that, if a non-resident corporation does not own, at the investment time, an equity interest in the CRIC that allows the non-resident corporation to materially influence the CRIC's investment decisions (*i.e.*, 25% or more of the CRIC's equity as measured by votes or value), then the non-resident cannot generally be considered to have caused the CRIC to make an investment in anticipation of the non-resident acquiring control of the CRIC. However, the rules also recognize that if a CRIC has limited risk associated with the making of an investment – by virtue of either the nature or terms of the investment, or risk-mitigating arrangements related to the investment – the CRIC may be prepared to accommodate "dumping" transactions prior to an acquisition of control by a non-resident corporation.

These amendments apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012.

Example 1: Paragraph 212.3(1)(b)

Assumptions

- *NR Co, a non-resident corporation, owns all the shares of Canco 1, a corporation resident in Canada.*
- *As part of a series of transactions and events, the following events occur in sequence:*
    - *Canco 1 acquires all the shares of Canco 2, a corporation resident in Canada, from vendors with which NR Co and Canco 1 deal at arm's length. As a result, Canco 2 becomes controlled by NR Co.*
    - *New shares of Canco 1 are sold through a public offering. As a result of the public offering, NR Co ceases to control Canco 1 and Canco 2.*
    - *Canco 2 acquires all the shares of Forco, a non-resident corporation.*

Analysis

The investment by Canco 2 in the shares of Forco did not occur while Canco 2 was controlled by a non-resident corporation, nor did Canco 2 become controlled by a non-resident corporation after the investment time as part of a series of transactions. Rather, Canco 2 became controlled by NR Co only prior to the investment time and *as part of the series. As such, the conditions in paragraph 212.3(1)(b) are not satisfied, and subsection 212.3(2) will not apply, in respect of the investment by Canco 2 in the shares of Forco.*

Example 2: Paragraph 212.3(1)(b)

Assumptions

- *Canco 1 is a Canadian resident public company. Forco, a wholly owned foreign affiliate of Canco 1, owns an interest in a mining project located outside of Canada. Canco 1 requires funding in order to finance continued exploration and development of the project.*
- *NR Co, a non-resident corporation, in order to partially fund the required investment in the project, acquires shares of Canco 1 that comprise 20% of the votes and value of all the shares of Canco 1. NR Co also advances a loan to Canco 1 with market terms, in order for Canco 1 to make an investment in Forco.*
- *The project turns out to be sufficiently promising such that NR Co (as part of the series of transaction that includes the initial share acquisition and loan) subsequently makes an offer, which is accepted by the shareholders of Canco 1, to acquire a controlling interest in Canco 1.*

Analysis

The investment by Canco 1 in Forco is an investment to which subsection 212.3(2) would apply if the requirements in paragraph 212.3(1)(b) were satisfied. With respect to the safe harbour in paragraph 212.3(1)(b), it will apply if none of the conditions in subparagraphs 212.3(1)(b)(i) to (iii) are satisfied. The condition outlined in subparagraph 212.3(1)(b)(i) is not satisfied because at the investment time NR Co, together with persons with which NR Co does not deal at arm's length, did not own at least 25% of the shares of Canco 1 (as measured by votes or value). As well, the investment in Forco is not an investment described in subparagraph 212.3(1)(b)(ii), nor did the CRIC enter into an arrangement in connection with the investment in Forco that limits its risk of loss or opportunity for gain or profit. Therefore, the investment by Canco 1 in Forco is not an investment that satisfies the requirements of paragraph 212.3(1)(b) and subsection 212.3(2) will not apply.

Example 3: Paragraph 212.3(1)(b)

Assumptions

- *NR Co, a non-resident corporation, is in advanced discussions with the shareholders of Canco 1, a corporation resident in Canada, to acquire all the shares of Canco 1. Canco 1 is not controlled by a non-resident corporation.*
- *Prior to the acquisition of the shares of Canco 1, NR Co agrees to extend a loan to Canco 1 so that Canco 1 can acquire all the shares of Forco, a non-resident corporation, from NR Co. The loan may be settled at any time, at the option of either Canco 1 or NR Co, by Canco 1 transferring the Forco shares back to NR Co.*
- *The shareholders of Canco 1 approve the takeover bid and NR Co acquires all the shares of Canco 1.*

Analysis

Canco 1 becomes controlled by NR Co as part of the series of transactions or events that includes the making of the investment by Canco 1 in Forco. Paragraph 212.3(1)(b) will apply if any of the conditions in subparagraphs 212.3(1)(b)(i) to (iii) are satisfied. The limited-risk repayment terms of the loan are an arrangement entered into in connection with the investment by Canco 1 in Forco under which a person other than Canco 1 (i.e., NR Co) has in a material respect the risk of loss or opportunity for gain or profit with respect to the property (i.e., the shares of Forco) acquired by Canco 1 on the investment. Therefore, the investment by Canco 1 in Forco is an investment that satisfies the requirements of paragraph 212.3(1)(b) and subsection 212.3(2) will apply.

Foreign Affiliate Dumping – Consequences

ITA
212.3(2)(*a*)

Where applicable, paragraph 212.3(2)(*a*) deems a dividend to be paid by a CRIC to its parent in an amount equal to the fair market value of any properties transferred, obligations assumed or incurred, or benefits otherwise conferred, by the CRIC, or property transferred to the CRIC in repayment of an amount owing to the CRIC, that can reasonably be considered to relate to the investment in the subject corporation. The result of a deemed dividend under paragraph 212.3(2)(*a*) is that the parent is subject to Part XIII dividend withholding tax under subsection 212(2).

Paragraph 212.3(2)(*a*) is amended to replace the reference to "investment time" with "dividend time", which is defined in subsection 212.3(4). This change ensures an appropriate result where a CRIC makes an investment in a foreign affiliate at a time when the CRIC is not yet controlled by a non-resident corporation and the CRIC subsequently becomes so controlled as part of the series of transactions or events that includes the making of the investment.

The dividend withholding tax rate to be applied may be reduced under an applicable tax treaty. By providing that the deemed dividend occurs at the dividend time – generally defined by subsection 212.3(4) as the time when the parent acquires control of the CRIC (as long as control is acquired within one year after the investment time) – rather than at the investment time, the amendment generally ensures that the parent may benefit from the most favourable withholding rate reduction under the applicable treaty. If the parent does not acquire control within one year of the investment time, subsection 212.3(4) provides that the dividend time occurs one year after the investment time, which may result in a higher withholding tax rate (depending on the terms of the applicable tax treaty).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Dividend Substitution Election

ITA
212.3(3)

Subsection 212.3(3) of the Act provides an elective rule that allows for all or a portion of a dividend that would otherwise be deemed, under paragraph 212.3(2)(*a*), to be paid by the CRIC to the parent to instead be deemed to be paid by certain other Canadian-resident corporations in the corporate group (that are "qualifying substitute corporations", as defined in subsection 212.3(4)), to either the parent or another non-resident corporation in the group. The amounts of the dividends deemed to be paid by the qualifying substitute corporations and the CRIC are agreed to in the election, which, in order to be valid, must allocate the entire amount of the deemed dividend otherwise arising under paragraph 212.3(2)(*a*) to classes of shares of qualifying substitute corporations and of the CRIC. Where an election is made under subsection 212.3(3), subsection 212.3 (7) provides rules that, in certain circumstances, allow the deemed dividends to be offset against, and therefore reduce, the paid-up capital (PUC) of the classes of shares of the qualifying substitute corporations and the CRIC in respect of which the dividends are deemed to be paid.

Substantial modifications are made to subsection 212.3(3). The most significant change is that the scope of the election under the subsection is more limited: it no longer has any impact on the PUC offset under subsection 212.3(7), which now applies without the need for an election (*i.e.*, it applies automatically). For further information, please see the commentary on subsection 212.3(7).

As a result of this amendment, the election under subsection 212.3(3) is limited to determining the payer and the payee of the deemed dividend under paragraph 212.3(2)(*a*). The subsection allows an election to be made to have the dividend deemed:

- to have been paid by the CRIC or a qualifying substitute corporation, as agreed on in the election; and
- to have been paid to, and received by, the parent or a non-resident corporation that does not deal at arm's length with the parent, as agreed on in the election. By allowing taxpayers to elect as payee any non-resident corporation that does not deal at arm's length with the parent, the amendment provides greater flexibility than the current rules, which allow only non-resident corporations controlled by the parent to be payees.

Subsection 212.3(3) is also amended to ease the filing requirements for the election by:

- removing the requirement that all qualifying substitute corporations in respect of the CRIC be parties to the election. The only qualifying substitute corporation that is required to be a party to the election is a qualifying substitute corporation that the CRIC elects to be the payer of the deemed dividend; and
- providing that the election must be filed on or before the filing-due date of the CRIC for its taxation year that includes the dividend time, rather than, under the current rules, by the earliest of the filing-due dates of the CRIC and the qualifying substitute corporations for their taxation years that include the time the investment is made.

These amendments apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012.

Definitions

ITA
212.3(4)

Subsection 212.3(4) of the Act defines "qualifying substitute corporation" for the purposes of section 212.3. Subsection 212.3(4) is amended to add new definitions of the terms "cross-border class" and "dividend time".

"cross-border class"

A cross-border class, in respect of an investment described in subsection 212.3(10), is a class of shares of a CRIC or qualifying substitute corporation if, immediately after the dividend time in respect of the investment,

- the parent, or a non-resident corporation that does not deal at arm's length with the parent, owns at least one share of the class, and
- no more than 30% of the shares of the class are owned by persons resident in Canada that do not deal at arm's length with the parent.

This definition is relevant to subsections 212.3(6) and (7).

This amendment applies to transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012. In respect of transactions and events that occur before Announcement Date, subsection 212.3(4) of the Act is to be read without reference to paragraph (*b*) of the definition "cross-border class".

"dividend time"

The dividend time in respect of an investment is

- if the CRIC is controlled by the parent at the investment time (within the meaning assigned by subsection 212.3(1)), the investment time, or
- in any other case, the earlier of (i) the first time, after the investment time, at which the CRIC is controlled by the parent, and (ii) one year after the day that includes the investment time.

If the CRIC is not controlled by the parent at the investment time, and the parent does not acquire control within one year of the investment time, the dividend time will be one year after the investment time, which could have implications for the parent, as described in the commentary on paragraph 212.3(2)(*a*) and subsection 212.3(7).

Dividend time is relevant for determining the time at which a dividend is deemed to be paid under paragraph 212.3(2)(*a*). It is also relevant in determining – for the purposes of the paid-up capital offset rule in subsection 212.3(7), which may reduce the amount of the deemed dividend under paragraph 212.3(2)(*a*) – the time at which the relevant paid-up capital adjustment is made. Corresponding amendments are made to paragraph 212.3(2)(*a*) and subsection 212.3(7), in each case replacing references to "investment time" with "dividend time". For further information, see the commentary on those provisions.

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

"qualifying substitute corporation"

A qualifying substitute corporation, in respect of a CRIC, is defined as a Canadian-resident corporation that is controlled by the parent of the CRIC and that has an equity percentage (as defined in subsection 95(4)) in the CRIC, where at least one share of the capital stock of the corporation is owned by the parent or a non-resident corporation with which the parent does not deal at arm's length. This definition is relevant for the purposes of the paid-up capital set-off rule in subsection 212.3(7).

The definition is amended to provide that a Canadian-resident corporation will satisfy the control requirement if it is controlled by either the parent or a non-resident corporation that does not deal at arm's length with the parent. This amendment addresses, in particular, the situation where a qualifying substitute corporation is not controlled by the parent because the corporation that controls the related group is deemed by paragraph 212.3(15)(*a*) to not control the CRIC and thus is not the parent for purposes of section 212.3.

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Sequential Investments – Paragraph (10)(*f*)

ITA
212.3(5.1)

New subsection 212.3(5.1) of the Act ensures that, in certain circumstances where an indirect investment in a subject corporation is made after and as part of the same series of transactions or events as a direct investment in the subject corporation, paragraph 212.3(2)(*a*) does not cause a deemed dividend (or, in combination with subsection 212.3(7), a paid-up capital reduction) in respect of the indirect investment to the extent of the amount of the earlier direct investment. This is achieved, where the conditions in paragraphs 212.3(5.1)(*a*) to (*c*) are satisfied, by reducing the total referred to in paragraph 212.3(2)(*a*) (*i.e.*, essentially the value of the consideration provided by the CRIC for the investment) in respect of an indirect investment by a CRIC in a subject corporation described in paragraph 212.3(10)(*f*) by the total referred to in paragraph 212.3(2)(*a*) in respect of an earlier direct investment in the subject corporation by another corporation resident in Canada. The effect of subsection 212.3(5.1) is to reduce the amount of the deemed dividend under paragraph 212.3(2)(*a*) (or, where applicable, the paid-up capital reduction under subsection 212.3(7)) in respect of the indirect investment, since the total referred to in paragraph 212.3(2)(*a*) determines this amount.

All the following conditions must be satisfied for subsection 212.3(5.1) to apply:

- The first direct investment in the subject corporation by the other corporation must be described in paragraph 212.3(10)(*a*) or (*b*), and paragraph 212.3(2)(*a*) must apply to the investment. This would not be the case where, for example, the exception in subsection 212.3(16) or (18) applied to the investment.

- Immediately after the investment time in respect of the first investment, the other corporation (which made the first investment) is not controlled by the parent of the CRIC that makes the second indirect investment.
- The other corporation becomes, after the time that is immediately after the investment time in respect of the first investment and as part of a transaction or event or series of transactions or events that includes the making of the first investment, controlled by the parent of the CRIC that makes the second investment because of the second investment.

Subsection 212.3(5.1) may apply, for example, where a Canadian company makes an investment in a foreign affiliate as a pre-acquisition step in a foreign takeover of the Canadian company.

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Anti-Avoidance Rule – Cross-Border Class

ITA
212.3(6)

Subsections 212.3(6) and (7) of the Act provide rules that allow for dividends that are otherwise deemed to arise under paragraph 212.3(2)(*a*) or (3)(*b*), to be offset against the paid-up capital (PUC) of the shares of the CRIC, or qualifying substitute corporations in respect of the CRIC, in certain circumstances. Subsection 212.3(6) provides the conditions for subsection 212.3(7) (the operative rules) to apply.

Existing subsection 212.3(6) is repealed consequential on amendments to subsection 212.3(7). This repeal applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

A new subsection 212.3(6) is then introduced. New subsection 212.3(6) is an anti-avoidance rule that deems, in certain circumstances, a particular class of shares of a CRIC or a qualifying substitute corporation to not be a cross-border class in respect of an investment (defined in subsection 212.3(4)) if the ownership of the class, or the funding of the investment, has been structured so as to inappropriately reduce the effect of a reduction of PUC under subsection 212.3(7). Subsection 212.3(6) applies when the conditions in paragraphs 212.3(6)(*a*) and (*b*) are satisfied.

There are two general types of transactions to which subsection 212.3(6) may apply. The first, described in subparagraph 212.3(6)(*a*)(i), is where a particular corporation resident in Canada that does not deal at arm's length with the parent acquires shares of the particular class (or shares that are substituted for those shares) as part of a transaction or event or series of transactions or events that includes the investment. Subsection 212.3(6) applies to such an acquisition if it can reasonably be considered that one of the main reasons for the acquisition was to increase the amount of a deduction required under paragraph 212.3(7)(*b*) or (*c*) in computing the PUC in respect of shares of the particular class held by the particular corporation. In the absence of this rule, the parent could cause one of its Canadian subsidiaries to acquire shares of a cross-border class, in respect of the investment, of either the CRIC or another Canadian subsidiary of the parent, with a view to increasing the amount of the PUC reduction under paragraph 212.3(7)(*b*) or (*c*) with respect to shares owned by a Canadian corporation and thus reduce the impact of the PUC reduction on shares held by the parent or non-resident corporations that do not deal at arm's length with the parent.

The second type of transaction to which subsection 212.3(6) may apply, described in subparagraph 212.3(6)(*a*)(ii), is where a particular corporation resident in Canada that does not deal at arm's length with the parent owns shares of the particular class (or shares that are substituted for those shares) and, as part of a transaction or event or series of transactions or events that includes the investment,

- the PUC in respect of the particular class is increased other than as a result of an acquisition of shares of the particular class by the particular corporation, and

- the increase in PUC can reasonably be considered to be connected to funding provided to the particular corporation or another corporation resident in Canada by the parent or a non-resident person that does not deal at arm's length with the parent. The increase is connected to the funding where, for example, the funding provided by the parent or the other non-resident person funds, directly or indirectly, both the investment and a contribution of capital to the particular class.

However, even if the two conditions described immediately above are met, paragraph 212.3(6)(*a*) is not satisfied if

- the funding results in an increase, equal to the amount funded, in the PUC of a class of the particular corporation, or the other corporation, that is a cross-border class in respect of the investment, and
- this increase occurred at or before the time of the increase to the PUC in respect of the particular class.

The concern is that, if the parent, either directly or indirectly through other non-resident corporations that do not deal at arm's length with the parent, provides funding to a particular corporation in the Canadian group that does not increase the PUC of any class of shares of the particular corporation, and the PUC of the particular class is increased in connection with such funding, then the funding could be structured in a manner that inappropriately reduces the effect of a reduction of PUC under subsection 212.3(7). In particular, the funding could have been made to have the PUC deduction under paragraph 212.3(7)(*b*) or (*c*), resulting from the investment, occur in respect of the particular class rather than another cross-border class whose non-resident ownership is proportionately greater than that of the particular class.

As a consequence of the condition in paragraph 212.3(6)(*b*), subsection 212.3(6) will apply only where it is reasonable to consider that one of the main reasons for the funding, which does not increase the PUC of any class of shares of the particular corporation, is to increase the amount of a deduction required under paragraph 212.3(7)(*b*) or (*c*) in computing the PUC in respect of shares of the particular class held by the particular corporation.

New subsection 212.3(6) applies to transactions or events that occur on or after Announcement Date.

Reduction of Deemed Dividend

ITA
212.3(7)

In addition to the changes to subsection 212.3(6), amendments are made to subsection 212.3(7), which will now contain both the operative paid-up capital (PUC) offset rules and the conditions for their application. The provision is amended so that, in all cases where the conditions for their application are satisfied, the PUC offset rules now apply automatically to offset the PUC in respect of relevant shares against the dividend otherwise deemed under paragraph 212.3(2)(*a*). Corresponding amendments are made to subsection 212.3(3) to reflect the fact that an election is no longer required in order to have a PUC offset. For further information, please see the commentary on subsection 212.3(3).

The elimination of the election does not constitute a substantive change. The election only allowed the CRIC to choose whether to have the PUC offset apply. It did not generally permit the CRIC to choose the specific classes of shares whose PUC is used to offset the deemed dividend or the amount of PUC from each such class of shares used for the offset. Rather, the classes of shares and amounts of PUC were determined by the rule that the PUC offset must result in the greatest possible reduction of PUC in respect of shares owned by the parent or another non-resident corporation that does not deal at arm's length with the parent.

Amended subsection 212.3(7) contemplates three types of situations. The first, set out in paragraph 212.3(7)(*a*), is where the CRIC demonstrates – in respect of one or classes of shares of the CRIC, or of a qualifying substitute corporation, all the shares of which are owned, immediately after the dividend time in respect of the investment, by persons that deal at arm's length with the CRIC – that

- the amount of PUC in respect of each of the classes arose as a consequence of one or more transfers of property, directly or indirectly, to the CRIC, and
- all of the property transferred was used by the CRIC to make, in whole or in part, the investment (or, in the case of an investment described in paragraph 212.3(10)(*f*), the direct acquisition referred to in that paragraph).

In other words, where the creation of an amount of PUC in respect of the relevant classes of shares of the CRIC or qualifying substitute corporations can be traced to a direct or indirect (through related corporations) transfer of property to the CRIC and the property is subsequently used by the CRIC to make an investment in a subject corporation, then that amount of PUC can be reduced as an offset against the deemed dividend under paragraph 212.3(2)(*a*).

The second situation to which subsection 212.3(7) applies, set out in paragraph 212.3(7)(*b*), is where the amount, determined without reference to paragraph 212.3(7)(*b*) (*i.e.*, reflecting any reduction under subparagraph 212.3(7)(*a*)(ii)), of the dividend deemed under paragraph 212.3(2)(*a*) to have been paid and received is equal to or greater than the total of all amounts comprising the PUC in respect of a cross-border class (defined in subsection 212.3(4)) of shares in respect of the investment, immediately after the dividend time. Where this is the case

- the amount of the deemed dividend is reduced by the total PUC of the cross-border classes immediately after the dividend time, and
- the PUC of each of the cross-border classes – having reduced, and been offset against, the deemed dividend – is reduced to nil. More particularly, in computing, at any time after the dividend time, the PUC in respect of each cross-border class in respect of the investment, there is to be deducted an amount equal to the PUC in respect of that class immediately after the dividend time, determined without reference to paragraph 212.3(7)(*b*).

The third situation to which subsection 212.3(7) applies, set out in paragraph 212.3(7)(*c*), is where paragraph 212.3(7)(*b*) does not apply (*i.e.*, the amount, determined without reference to paragraph 212.3(7)(*b*), of the deemed dividend under paragraph 212.3(2)(*a*) is less than the total PUC of cross-border classes in respect of the investment immediately after the dividend time) and there is at least one cross-border class in respect of the investment. Where this is the case

- the amount of the deemed dividend is reduced to nil, as it is fully offset by the PUC in respect of the cross-border classes, and
- in computing, at any time after the dividend time, the PUC of the cross-border classes of shares of the CRIC or of a qualifying substitute corporation, in respect of the investment, there is to be deducted the amount by which the deemed dividend is reduced under subparagraph 212.3(7)(*c*)(ii). In determining the amount to be deducted in respect of any particular cross-border class, there is to be allocated to that class the amount that will result in the greatest total reduction of the PUC in respect of shares of cross-border classes that are owned by the parent or another non-arm's length non-resident corporation.

Under subparagraph 212.3(7)(*c*)(ii), the deemed dividend must be allocated first to the class of shares of the CRIC or qualifying substitute corporation of which the parent or non-arm's length non-resident owns the greatest proportionate share immediately after the dividend time; then, any remainder, to the class of which the parent or non-arm's length non-resident owns the second greatest proportionate share; and so on.

Subparagraph 212.3(7)(*c*)(iii) addresses the circumstance where the proportion of the shares of the particular class owned, in aggregate, by the parent and non-resident corporations that do not deal at arm's length with the parent is equal to the proportion so owned of one or more other cross-border classes (all those classes, together with the particular class, being referred to as the "relevant classes"). In that circumstance, there would, in the absence of subparagraph 212.3(7)(*c*)(iii), be more than one possible amount by which the PUC of each of the relevant classes could be reduced and still satisfy the requirement of subparagraph 212.3(7)(*c*)(ii).

In that case, subparagraph 212.3(7)(*c*)(iii) requires that the proportion that the reduction under subparagraph 212.3(7)(*c*)(ii) of the PUC of a particular relevant class is to the PUC, determined immediately after the dividend time and without reference to paragraph 212.3(7)(*c*), of the particular class be equal to the proportion that the total reduction under subparagraph 212.3(7)(*c*)(ii) to the PUC in respect of all the relevant classes is of the total PUC of all the relevant classes, determined immediately after the dividend time and without reference to paragraph 212.3(7)(*c*). Where applicable, this rule requires that the PUC of all the relevant classes be reduced by the same proportion.

Example: Subparagraph 212.3(7)(c)(iii)

Assumptions

- *NR Co1, a non-resident corporation, owns all the class A common shares of Canco1, a corporation resident in Canada, with PUC of $80 million. Canco1 has no shares of any other class issued or outstanding.*
- *NR Co2 owns all of the shares of NR Co1, and all of the class A shares of Canco2, a corporation resident in Canada, with PUC of $40 million. Canco 2 has no shares of any other class issued or outstanding.*
- *The class A common shares of Canco1 and the class A common shares of Canco2 are both cross-border classes, as defined in subsection 212.3(4) and taking into consideration the anti-avoidance rule in subsection 212.3(6).*
- *Canco 1 and Canco 2 each own 50% of the issued and outstanding shares of Cansub, a corporation resident in Canada.*
- *Cansub acquires all the shares of Forco from an arm's length vendor for $90 million (i.e., in an investment described in paragraph 212.3(10)(a)). The exception in subsection 212.3(16) does not apply to the acquisition.*

Analysis

In respect of Cansub's acquisition of the shares of Forco, subparagraph 212.3(7)(c)(i) reduces the deemed dividend otherwise arising under paragraph 212.3(2)(a) to nil. Subparagraph 212.3(7)(c)(ii), combined with subparagraph 212.3(7)(c)(iv), reduces the PUC of the class A common shares of Canco1 and Canco2 by a total of $90 million (i.e., the amount by which the deemed dividend is reduced under subparagraph 212.3(7)(c)(i)).

Because every class A share of Canco1 and Canco2 is owned by either NR Co1 or NR Co2, there is more than one amount by which the PUC of each of those classes could be reduced in order to obtain the result required under subparagraph 212.3(7)(c)(ii), i.e., the greatest total reduction of the PUC in respect of shares of cross-border classes that are owned by the parent or another non-resident corporation that does not deal at arm's length with the parent. However, subparagraph 212.3(7)(c)(iii) requires that the proportion that the reduction under subparagraph 212.3(7)(c)(ii) of the PUC of a particular relevant class is to the PUC, determined immediately after the dividend time and without reference to paragraph 212.3(7)(c), of the particular class be equal to the proportion that the total reduction under subparagraph 212.3(7)(c)(ii) to the PUC in respect of all the relevant classes is of the total PUC of all the relevant classes, determined immediately after the dividend time and without reference to paragraph 212.3(7)(c). In this example, the latter proportion is $90 million/$120 million. Thus, the PUC of the class A shares of Canco1 is reduced by $60 million ($60 million/$80 million = $90 million/$120 million), and the PUC of the class A shares of Canco2 is reduced by $30 million ($30 million/$40 million = $90 million/$120 million).

Paragraph 212.3(7)(*d*) has a filing requirement that applies where the amount of the deemed dividend otherwise arising under paragraph 212.3(2)(*a*) is reduced because of any of subparagraphs 212.3(7)(*a*)(i), (*b*)(i) and (*c*)(i). In that case, the CRIC must file with the Minister of National Revenue, on or before the CRIC's filing-due date for its taxation year that includes the dividend time, a form containing prescribed information and setting out:

- the amount of the PUC, determined immediately after the dividend time and without reference to subsection 212.3(7), of each class of shares that is described in paragraph 212.3(7)(*a*) or that is a cross-border class in respect of the investment;
- the PUC of the shares of each of those classes that are owned by the parent or another non-resident corporation that does not, at the dividend time, deal at arm's length with the parent; and
- the reduction under subparagraph 212.3(7)(*a*)(ii), (*b*)(ii) or (*c*)(ii), as the case may be, in respect of each class.

If the form is not filed on time, subparagraph 212.3(7)(*d*)(ii) deems the CRIC to have paid to the parent, and the parent to have received from the CRIC, on the filing-due date, a dividend equal to the total of the PUC reductions in respect of the investment under any of subparagraphs 212.3(7)(*a*)(i), (*b*)(i) and (*c*)(i). Interest applies in respect of any unpaid or late-paid withholding tax on the deemed dividend. The CRIC is thus treated as though there is no PUC available to be offset, under subsection 212.3(7), against the deemed dividend otherwise arising under paragraph 212.3(2)(*a*). However, a consequential amendment to paragraph 227(8.5)(*b*) provides that penalties under subsection 227(8), for failure to withhold an amount as required under section 215, do not apply in respect of a failure to pay withholding tax on the deemed dividend under subparagraph 212.3(7)(*d*)(ii). For further information, please see the commentary on that subparagraph.

New subsection 227(6.2) provides, in certain circumstances, for a refund of withholding tax paid in respect of the deemed dividend under subparagraph 212.3(7)(*d*)(ii), if the CRIC late-files the form and makes a written application for a refund. For further information, please see the commentary on subsection 227(6.2).

These amendments to subsection 212.3(7) apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012.

Paid-up Capital Adjustment

ITA
212.3(8)

Subsection 212.3(8) of the Act ensures that the reductions to paid-up capital made under paragraphs 212.3(2)(*b*) and (7)(*b*) do not produce an inappropriate result where because of a share redemption, acquisition or cancellation, or a reduction of paid-up capital, subsection 84(3), (4) or (4.1) subsequently treats the corporation as having paid a dividend on the shares to which the paid-up capital reduction relates. Similar rules exist in various other provisions of the Act that adjust paid-up capital – see for example paragraph 85(2.1)(*b*) and subsections 128.1(3) and 212.1(2).

Subsection 212.3(8) is amended, consequential on the amendments to subsection 212.3(7), to replace the existing references to paragraph 212.3(7)(*b*) with references to subsection 212.3(7). For further information, please see the commentary on subsection 212.3(7).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012.

Paid-up Capital Reinstatement

ITA
212.3(9)

Existing subsection 212.3(9) of the Act allows a reinstatement of paid-up capital (PUC) in respect of a class of shares of a CRIC or a qualifying substitute corporation immediately before a reduction of capital in certain circumstances where the PUC was initially reduced by the operation of paragraph 212.3(2)(*b*) or (7)(*b*). The amount by which the PUC may be reinstated is the least of three amounts. The first is the amount of the distribution or reduction of PUC by the particular corporation. The second is the amount by which the PUC of the particular corporation was reduced by the operation of paragraph 212.3(2)(*b*) or (7)(*b*).

The third amount is based on the extent to which the distribution is traceable to property acquired as an investment (referred to in this commentary as the "original property") in a subject corporation. For this purpose, two situations are contemplated: either i) the original property consists of foreign affiliate shares and those shares or substituted shares are distributed by the particular corporation, in which case the amount is based on the fair market value of the distributed shares; or ii) proceeds from a disposition of subject corporation shares or of a debt owing by a subject corporation, or dividends or reductions of capital in respect of such shares, are distributed, in which case the amount is based on the amount of the proceeds, dividends or reductions of capital. In the latter case, the particular corporation is required to trace the proceeds, dividends or reductions of capital to the distribution and to establish that they occurred within 180 days of the distribution.

Subsection 212.3(9) is amended in a number of respects, which generally expand the circumstances in which a PUC reinstatement is available. In conjunction with these amendments, continuity rules are added in new subsections 212.3(9.1) and 212.3(9.2) to ensure a corporation retains its ability to reinstate PUC in certain circumstances involving internal reorganizations. For more information, please see the commentary on subsections 212.3(9.1) and (9.2).

As a result of the amendments, the amount of PUC to be reinstated is the lesser of two amounts, set out in paragraphs 212.3(9)(*a*) and (*b*).

Existing paragraph 212.3(9)(*a*) is repealed and existing paragraph 212.3(9)(*b*) is moved to paragraph 212.3(9)(*a*). The amount computed under amended paragraph 212.3(9)(*a*) is essentially the same as under existing paragraph 212.3(9)(*b*): the total amount by which the PUC in respect of the given class of shares of the particular corporation has previously been reduced in respect of the investment under paragraph 212.3(2)(*b*) or subsection 212.3(7) less any previous reinstatements of PUC under subsection 212.3(9). In addition, amendments are made to the timing references in paragraph 212.3(9)(*a*). Subparagraph 212.3(9)(*a*)(i) is amended to refer to PUC reductions that occurred before the subsequent time and subparagraph 212.3(9)(*a*)(ii) is amended to refer to previous PUC reinstatements that occurred "before the time that is immediately before the subsequent time" in order to avoid circularity in the operation of the provision.

The amount for paragraph 212.3(9)(*b*) will vary depending on whether it is computed under subparagraph 212.3(9)(*b*)(i) or (ii). The two subparagraphs correspond to the two different situations that qualify for the PUC reinstatement. The computation under subparagraph 212.3(9)(*b*)(i) applies if all the following conditions are satisfied:

- The investment is described in paragraph 212.3(10)(*a*), (*b*) or (*f*).
- The PUC in respect of the class is reduced at the subsequent time (*i.e.*, a time subsequent to the investment time) as part of or because of a distribution of property by the particular corporation whose PUC is being reinstated.
- The property (the "distributed shares") is shares of the subject corporation or shares of a foreign affiliate that were substituted for those shares.

If those conditions are satisfied, the amount determined under subparagraph 212.3(9)(*b*)(i) is given by the formula A/B. Variable A is the amount determined under clause (A) or (B) of variable A, depending on the circumstances. Clause (A) applies if the investment that gave rise to the PUC reduction is described in paragraph 212.3(10)(*b*) (*i.e.*, a contribution of capital to the subject corporation by the CRIC). The amount determined under clause (A) is the portion of the fair market value, immediately before the subsequent time, of the distributed shares that can reasonably be considered to relate to the capital contribution.

Clause (B) of variable A applies if the investment is described in paragraph 212.3(10)(*a*) (*i.e.*, a direct acquisition of shares of the subject corporation by the CRIC) or 212.3(10)(*f*) (*i.e.*, an indirect acquisition of shares of the subject corporation that results from a direct acquisition by the CRIC of shares of another corporation resident in Canada). The amount determined under clause (B) is the lesser of two amounts:

- The portion of the fair market value, immediately before the subsequent time, of the distributed shares that can reasonably be considered to relate to the shares (the "acquired shares") of the subject corporation that were acquired on the investment (subclause (B)(I) of variable A).
- The proportion of the amount determined for subparagraph 212.3(9)(*a*)(i) that the amount determined under subclause (B)(I) is of the fair market value, immediately before the subsequent time, of the acquired shares, or the portion of the fair market value of shares that were substituted for the acquired shares, that can reasonably be considered to relate to the acquired shares (subclause (B)(II) of variable A).

Variable B is, if the particular corporation that had a reduction of PUC in respect of a class of its shares is, immediately after the dividend time in respect of the investment, a qualifying substitute corporation in respect of the CRIC, the particular corporation's equity percentage (as defined in subsection 95(4)) in the CRIC immediately after the dividend time in respect of the investment. Otherwise, the amount determined for variable B is one.

Example: Subparagraph 212.3(9)(b)(i)

Assumptions

- *NR Co, a non-resident corporation, owns all the class A common shares of Canco, a corporation resident in Canada. Canco has no shares of any other class issued or outstanding.*
- *Canco owns 80% of the common shares of Cansub, a corporation resident in Canada. The other 20% of the Cansub common shares are held by arm's length persons. Cansub has no shares of any other class issued or outstanding.*
- *At time X, Cansub acquired 100 shares, representing all the shares of the capital stock of Forco, a non-resident corporation, for $100 million (i.e., in an investment described in paragraph 212.3(10)(a)). Subsection 212.3(7) required the PUC of the class A common shares of Canco to be reduced by $100 million as a result of this investment by Cansub.*
- *At a time that is subsequent to time X, when the 100 Forco shares have a fair market value of $120 million, Cansub distributes 60 Forco shares to its shareholders as a return of capital. As a result, Canco receives 48 Forco shares (i.e., 80% of the 60 shares distributed).*
- *Canco distributes the 48 Forco shares (with a fair market value of $57.6 million) to NR Co as a return of capital on its class A common shares. The PUC of Canco's class A shares is reduced by $57.6 million because of the distribution.*
- *Canco has had no prior PUC reinstatements in respect of the investment. As such, the amount determined for paragraph 212.3(9)(a) is $100 million (i.e., the prior PUC reduction of $100 million less prior PUC reinstatements of nil).*

Analysis

All the conditions in subparagraph 212.3(9)(b)(i) are satisfied in respect of the investment and the return of capital at the subsequent time. Specifically, the investment is described in paragraph 212.3(10)(a), the PUC of the class A Canco shares is reduced at the subsequent time because of a distribution of property by Canco as a return of capital, and the property is shares of the capital stock of the subject corporation (i.e., Forco).

The amount determined under subparagraph 212.3(9)(b)(i) is given by the formula A/B. Variable A is the lesser of the amounts determined under subclauses (B)(I) and (II) of the variable. Subclause (B)(I) is the portion of the fair market value of the distributed shares that can reasonably be considered to relate to the acquired shares. The value of the distributed shares is $57.6 million (being 48% of the value of the Forco shares), all of which relates to the acquired shares. In this instance, the distributed shares are the acquired shares.

The amount determined under subclause (B)(II) is the proportion of the amount determined under subparagraph 212.3(9)(a)(i) ($100 million) that the amount determined for subclause (B)(I) ($57.6 million) is of the fair market value of all of the acquired shares ($120 million). The amount determined under subclause (B)(II) is, therefore, $48 million (48% of the $100 million). The amount determined for variable A is $48 million, being the lesser of the amounts determined under subclause (B)(I) ($57.6 million) and subclause (B)(II) ($48 million).

Immediately after the dividend time in respect of the investment, Canco is a qualifying substitute corporation in respect of Cansub (i.e., the CRIC). The amount determined for variable B is equal to Canco's equity percentage (as defined in subsection 95(4)) in Cansub. In this instance, Canco's equity percentage is 80%. The amount determined for A/B in subparagraph 212.3(9)(b)(i) is $48 million divided by 80%, or $60 million. Therefore, the amount of the PUC reinstatement is $60 million, being the lesser of the amounts determined under paragraph 212.3(9)(a) ($100 million) and paragraph 212.3(9)(b) ($60 million).

If subparagraph 212.3(9)(*b*)(i) does not apply, subparagraph 212.3(9)(*b*)(ii) determines the amount for the purposes of paragraph 212.3(9)(*b*). Subparagraph 212.3(9)(*b*)(ii) is amended to no longer require a return of, or reduction to, the PUC of a class of shares of the particular corporation to which subsection 212.3(9) applies in order to obtain the PUC reinstatement. In addition, the preamble to subsection 212.3(9) is amended to refer to investments described in any of paragraphs 212.3(10)(*a*) to (*f*), to extend the PUC reinstatement to investments in a debt or other amount owing by a subject corporation, as described in paragraph 212.3(10)(*c*) or (*d*) or subparagraph 212.3(10)(*e*)(i). This amendment permits the PUC reduced under paragraph 212.3(2)(*b*) or subsection 212.3(7) to be reinstated when the particular corporation has received a repayment of, or proceeds from the disposition of, the debt of the subject corporation that arose on the investment, or has received interest on the debt.

As a result of these amendments, the amount determined under subparagraph 212.3(9)(*b*)(ii) is generally the amount received by a corporation resident in Canada on shares of, or debts owing by, a subject corporation that can be traced to the investment that resulted in the prior reduction of PUC of shares of the CRIC or the qualifying substitute corporation. The concept is that, if property is received in Canada from a disposition of a share, or debt, of a subject corporation or from dividends, interest or returns of capital from the subject corporation, the value of that property represents a return of invested amounts and can no longer be considered an amount invested in the subject corporation. Reinstating PUC therefore puts the particular corporation in the same position as if the amount had not been invested in the first instance.

However, this general rule does not apply if the shares of, or debt owing by, a subject corporation are merely replaced with shares or debt of another foreign affiliate and subsection 212.3(18) provides an exception for the resulting acquisition of the replacement shares or debt, or if the shares of, or debt owing by, the subject corporation are sold within a related Canadian corporate group and subsection 212.3(18) provided an exception for the related acquisition. Although PUC may be reinstated under subparagraph 212.3(9)(*b*)(ii) upon the receipt of property, if the corporation applies the proceeds received in a manner that results in a new investment described in subsection 212.3(10), this may in turn result in a reduction to PUC under paragraph 212.3(2)(*b*) or subsection 212.3(7) in respect of the new investment.

The amount determined under subparagraph 212.3(9)(*b*)(ii) is given by the formula A x B/C where:

- Variable A is the amount that is the fair market value of property that is demonstrated to have been received at the subsequent time by the particular corporation or by a corporation resident in Canada that was not dealing at arm's length with the particular corporation (the "recipient corporation") as any of:

  (A) proceeds from the disposition of the acquired shares, or other shares to the extent that proceeds from the disposition of those other shares relate to the acquired shares or to shares of a subject corporation to which the CRIC made a contribution of capital (*i.e.*, an investment described in paragraph 212.3(10)(*b*)), other than

- the fair market value of shares of another foreign affiliate of the taxpayer that were acquired by the recipient corporation as consideration for the disposition and as an investment to which subsection 212.3(16) or (18) applies to provide an exception to subsection 212.3(2), or
- proceeds from a disposition to a corporation resident in Canada for which the acquisition is an investment to which subsection 212.3(16) or (18) applies;

(B) a reduction of PUC or a dividend in respect of a class of shares of the subject corporation or the portion of a reduction of PUC or a dividend in respect of substituted shares that can reasonably be considered to relate to the subject shares; or

(C) in respect of certain debt obligations or other amounts owing by a subject corporation, either (i) a repayment of or proceeds from the disposition of that debt obligation or other amount owing, other than where it is replaced with a new debt obligation or other amount owing to a foreign affiliate or a share of the particular corporation, and as an investment to which subsection 212.3(16) or (18) applies, or as proceeds from a disposition to an affiliated corporation resident in Canada where subsection 212.3(16) or (18) applies to the other corporation in respect of its acquisition, or (ii) as interest on the debt obligation or other amount owing.

- Variable B is the amount determined under paragraph 212.3(9)(*a*) in respect of the class of shares.
- Variable C is the total of all amounts determined under paragraph 212.3(9)(*a*) in respect of all classes of shares of the particular corporation or any corporation that does not deal at arm’s length with the particular corporation. Variables B and C effectively take into account the possibility that a particular investment may result in PUC reductions in respect of more than one class of shares or in respect of one or more Canadian corporations, and are intended to prorate any PUC reinstatement across all the classes that were impacted by the investment.

These amendments apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012. In respect of transactions and events that occur before August 16, 2013, subparagraph 212.3(9)(*b*)(ii) is to be read without reference to subclause (A)(I) of the description of A.

Exchange of Debt Obligation for Shares

ITA
212.3(9.1)

Subsection 212.3(9.1) of the Act is introduced to ensure that the ability to reinstate paid-up capital is not lost when a debt obligation that relates to a particular investment described in paragraph 212.3(10)(*c*) or (*d*) or subparagraph 212.3(10)(*e*)(i) is exchanged for shares of a subject corporation and subparagraph (18)(*b*)(i) or paragraph (18)(*d*) applies to the acquisition of the shares occurring on the exchange. If subsection 212.3(9.1) applies, then for the purposes of subsection 212.3(9), all amounts in respect of the particular investment that were either deducted under paragraph 212.3(2)(*b*) or subsection 212.3(7) from, or added under subsection 212.3(9) to, the paid-up capital in respect of a class of shares before the time of the exchange are deemed to have been deducted or added, as the case may be, in respect of the acquisition of the shares received in the exchange and not the particular investment.

New subsection 212.3(9.1) applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Continuity for Paid-Up Capital Reinstatement

ITA
212.3(9.2)

Subsection 212.3(9.2) of the Act is introduced to ensure that the ability to reinstate paid-up capital is not lost in respect of a class of shares of a corporation resident in Canada when those shares are replaced as a result of a reorganization to which any of sections 51, 85, 85.1, 86 and 87 apply. Specifically, if shares (the "new shares") of a class of a corporation resident in Canada are acquired, in a transaction to which any of those provisions apply, in exchange for a share (the "old share") of a particular corporation that is either the corporation or another corporation resident in Canada, then for the purposes of subsections 212.3(8) and (9), the following rules apply:

- If the corporation that issues the new shares is not the particular corporation, it is deemed to be the same corporation as, and a continuation of, the particular corporation.
- The new shares are deemed to be the same share, and of the same class of the particular corporation, as the old share.
- If the old share remains outstanding after the exchange, it is deemed to be a share of a different class of the particular corporation.

New subsection 212.3(9.2) applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Investment in Subject Corporation

ITA
212.3(10)

Subsection 212.3(10) of the Act defines an "investment", in a subject corporation made by a CRIC, for the purposes of section 212.3. Paragraph 212.3(10)(*c*) provides that an investment includes a transaction as part of which an amount becomes owing by the subject corporation to the CRIC, unless the amount owing satisfies either of two exceptions set out in subparagraphs 212.3(10)(*c*)(i) and (ii). The first exception is for certain amounts that become owing to the CRIC in the ordinary course of the CRIC's business. The second exception is for an amount in respect of which a pertinent loan or indebtedness (PLOI) election is made under paragraph 212.3(11)(*c*).

Paragraph 212.3(10)(*c*) is amended to add a third exception for an amount that is owing by a subject corporation to a CRIC because a dividend has been declared, but not yet paid, by the subject corporation (within the meaning of subsection 212.3(1)).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Control

ITA
212.3(15)

Subsection 212.3(15) of the Act provides special rules for determining control for the purposes of section 212.3 and the corporate immigration rule in paragraph 128.1(1)(*c.3*).

This subsection is amended in three respects. First, it is restructured by converting paragraphs 212.3(15)(*a*) and (*b*) into subparagraphs 212.3(15)(*a*)(i) and (ii), respectively.

Second, subparagraph 212.3(15)(*a*)(i), which generally provides that a CRIC that is controlled by more than one non-resident corporation is deemed not to be controlled by any non-resident corporation that controls another non-resident corporation that controls the CRIC, is amended to add a reference to "a taxpayer to which paragraph 128.1(1)(*c.3*) applies", and the new term "specific corporation", which refers to a CRIC or a taxpayer to which paragraph 128.1(1)(*c.3*) applies. These changes clarify that the rule in subparagraph 212.3(15)(*a*)(i) applies for the purpose of determining the parent corporation in respect of an immigrating corporate taxpayer referred to in paragraph 128.1(1)(*c.3*).

The third amendment to subsection 212.3(15) introduces a deeming rule. New paragraph 212.3(15)(*b*) ensures that subsection 212.3(2) cannot be avoided where a corporation is held through a related group of non-resident holding companies, no one member of which owns shares having more than 50% of the votes in respect of the corporation. The rule applies if at any time

- a corporation is not, in the absence of subsection 212.3(15), controlled by any non-resident corporation, and
- a related group (as defined in subsection 251(4) and determined without reference to paragraph 251(5)(*b*)), each member of which is a non-resident corporation, is in a position to control the corporation.

Where these conditions are met, the rule deems the corporation to be controlled at that time by

- the member of the group that has the greatest direct equity percentage (within the meaning of subsection 95(4)) in the corporation at that time, or
- if no member of the group has a direct equity percentage in the corporation that is greater than that of every other member, the member determined by the corporation or, if the corporation does not make a determination, by the Minister of National Revenue.

The amendments to paragraph 212.3(15)(*a*) apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012. New paragraph 212.3(15)(*b*) applies in respect of transactions and events that occur after August 15, 2013.

Exception – More Closely Connected Business Activities

ITA
212.3(16)

Subsection 212.3(16) of the Act provides an exception from the operative foreign affiliate dumping rule in subsection 212.3(2). The exception is intended to allow a Canadian subsidiary of a foreign multinational corporation to invest in foreign affiliates in certain circumstances where the Canadian subsidiary is making a strategic acquisition of a business that is more closely connected to its business than to that of any non-resident member of the multinational group. The exception applies where the conditions set out in paragraphs 212.3(16)(*a*) to (*c*) are satisfied.

Amendments are made to the conditions in paragraphs 212.3(16)(*b*) and (*c*). The condition in paragraph 212.3(16)(*b*) is that officers of the CRIC must have and exercise the principal decision-making authority in respect of the making of an investment and a majority of those officers must be persons that are resident, and work principally, in Canada or the country of residence of a connected affiliate (within the meaning of subparagraph 212.3(16)(*b*)(ii)) at the time the investment is made.

Paragraph 212.3(16)(*b*) is amended to provide that the condition in that paragraph can also be satisfied where officers of a corporation resident in Canada that does not deal at arm's length with the CRIC at the investment time satisfy the requirements in that paragraph with respect to principal decision-making authority and residence. This amendment makes paragraph 212.3(16)(*b*) more consistent with the existing paragraph 212.3(16)(*a*), which allows business activities of Canadian-resident corporations that do not deal at arm's length with the CRIC to be taken into account in determining whether the "closer connection" condition in that paragraph is met.

Consistent with the amendment to paragraph 212.3(16)(*b*), paragraph 212.3(16)(*c*) is also amended to allow officers of a corporation resident in Canada with which the CRIC does not deal at arm's length to be taken into account in determining whether the conditions in subparagraphs 212.3(16)(*c*)(i) and (ii) are satisfied.

These amendments apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have them come into force on August 14, 2012.

Dual Officers

ITA
212.3(17)

Subsection 212.3(17) of the Act provides a deeming rule that precludes officers of the CRIC who are also officers of certain non-resident corporate group members from "counting" towards the majority required, under paragraphs 212.3(16)(*b*) and (*c*), to be resident and working principally either in Canada or in the country of residence of a connected affiliate (within the meaning of subparagraph 212.3(16)(*b*)(ii)). More specifically, subsection 212.3(17) excludes any officer of a non-resident corporation with which the CRIC, at the investment time, does not deal at arm's length (other than the subject corporation, a subject subsidiary corporation or a connected affiliate), by deeming the officer to not be resident, and to not work principally, in a country in which a connected affiliate is resident.

This deeming rule applies, for example, where officers of the parent, who are also officers of the CRIC, are resident and work principally in the residence country of a connected affiliate. This situation might arise where the parent and the connected affiliate are resident in the same country. In the absence of the rule in subsection 212.3(17), those officers would count towards the majority required to satisfy the conditions in paragraphs 212.3(16)(*b*) and (*c*) because both those paragraphs allow officers of the CRIC who are resident in the residence country of a connected affiliate to count towards the required majority. The rule in subsection 212.3(17) recognizes that in such cases the relevant officers generally have a greater nexus to the parent or other non-resident corporation, and the other residence country, than to the CRIC and Canada.

Subsection 212.3(17) is amended consequential on the amendments to paragraphs 212.3(16)(*b*) and (*c*), to extend the deeming rule in the subsection to officers of a corporation resident in Canada that does not deal at arm's length with the CRIC at the investment time. For further information, please see the commentary on paragraphs 212.3(16)(*b*) and (*c*).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Exception – Corporate Reorganizations

ITA
212.3(18)

Subsection 212.3(18) of the Act provides a number of exceptions to the foreign affiliate dumping rules for various forms of corporate reorganizations and distributions that result in the direct or indirect acquisition of shares of a subject corporation by a CRIC. The underlying premise for these exceptions is that if no incremental value is being transferred from a CRIC to a subject corporation, subsection 212.3(2) should not apply. However, subsection 212.3(19) provides that a subset of these exceptions (found in paragraphs 212.3(18)(*b*) and (*d*)) will not apply to transactions involving what are commonly referred to as "preferred shares", notwithstanding that no incremental value is transferred.

Subsection 212.3(18) is amended in several respects which generally broaden its application. A reference to new subsection 212.3(18.1) is added to the preamble, making subsection 212.3(18) subject to subsection 212.3(18.1). For further information, please see the commentary on subsection 212.3(18.1).

A reference to paragraph 212.3(10)(*d*) is added to paragraph 212.3(18)(*a*) so that, where the relevant conditions are met, paragraph 212.3(18)(*a*) now provides an exception in respect of intercompany transfers of debt obligations issued by a subject corporation (*i.e.*, investments described in paragraph 212.3(10)(*d*)). Subparagraph 212.3(18)(*a*)(i) is modified by moving existing clause 212.3(18)(*a*)(i)(A) into the opening words of subparagraph 212.3(18)(*a*)(i), adding new clause 212.3(18)(*a*)(i)(A) and modifying existing clause 212.3(18)(*a*)(i)(B).

The addition of clause 212.3(18)(*a*)(i)(A) is intended to accommodate post-acquisition restructuring transactions that occur after the acquisition of a Canadian corporation that owns foreign affiliates by a CRIC from an unrelated vendor. For example, if a CRIC (in this commentary referred to as the "original acquirer") acquires from a third party the shares of another Canadian corporation (in this commentary referred to as the "target") that owns foreign affiliates, the acquisition may or may not be an investment described in paragraph 212.3(10)(*f*). Following the acquisition, subsequent transfers of the shares of, or debt owing by, a foreign affiliate of the target between Canadian corporate group members generally should not result in the application of subsection 212.3(2) because the subsequent transfers do not result in an incremental new investment in a foreign affiliate.

Clause 212.3(18)(*a*)(i)(A) is satisfied in this example, and the exception in paragraph 212.3(18)(*a*) applies, provided that

- each share of the disposing corporation (in this example, the target) is owned, immediately before the transfer, by either the Canadian transferee corporation or another corporation resident in Canada that is related to the parent, and
- none of these shareholders of the disposing corporation is, at any time in the period during which the series that includes the transfer occurs and that is before the transfer, dealing at arm's length with the parent or a non-resident corporation that participates in the series and is related to the parent.

Existing clause 212.3(18)(*a*)(i)(B) requires the disposing corporation to be, at no time in the period during which the series occurs, dealing at arm's length with the CRIC. The clause is modified to replace the reference to the CRIC with a reference to the parent or a non-resident corporation that participates in the series and is, at any time that is in the period and before the investment time, related to the parent.

Subparagraph 212.3(18)(*a*)(ii) is almost identical to subparagraph 212.3(18)(*a*)(i) but it applies to acquisitions of foreign affiliate shares (and, as a result of amendments discussed above to paragraph 212.3(18)(*a*), debt obligations issued by a foreign affiliate) by a CRIC that is formed on the amalgamation of two or more Canadian resident corporations. Subparagraph 212.3(18)(*a*)(ii) is amended to conform clause 212.3(18)(*a*)(ii)(B) with the changes to subparagraph 212.3(18)(*a*)(i), described above.

Paragraph 212.3(18)(*b*) lists a number of exceptions relating to share-for-share transactions at the foreign affiliate level and certain distributions made by a foreign affiliate. Paragraph 212.3(18)(*b*) is amended to add a new exception in subparagraph 212.3(18)(*b*)(viii) for acquisitions of shares of a subject corporation by a CRIC as a result of a disposition of shares by the CRIC to a partnership to which subsection 97(2) applies.

Paragraph 212.3(18)(*c*) provides exceptions for internal reorganizations that involve an indirect acquisition of shares of a subject corporation by a CRIC, described in paragraph 212.3(10)(*f*), resulting from the direct acquisition by the CRIC of shares of another corporation resident in Canada. Subparagraphs 212.3(18)(*c*)(i) and (ii) are almost identical to subparagraphs 212.3(18)(*a*)(i) and (ii), respectively, which deal with direct acquisitions by the CRIC of shares of a subject corporation.

Paragraph 212.3(18)(*c*) is amended in three respects. First, subparagraph 212.3(18)(*c*)(i) is amended consequential on the changes to subparagraph 212.3(18)(*a*)(i), described above.

The other two changes are to subparagraph 212.3(18)(*c*)(ii). That subparagraph currently provides an exception for an amalgamation described in subsection 87(1) of two or more predecessor corporations to form a CRIC. An amalgamation of this type could result in the CRIC making an investment described in paragraph 212.3(10)(*f*) where, as a result of the amalgamation, the CRIC indirectly acquires shares of a subject corporation by directly acquiring, from one of its predecessor corporations, shares of another corporation resident in Canada that in turn owns shares of the subject corporation.

Subparagraph 212.3(18)(*c*)(ii) is amended consequential on the changes to subparagraph 212.3(18)(*a*)(ii), described above. In addition, subparagraph 212.3(18)(*c*)(ii) is amended to extend the exception in that subparagraph to situations where the corporation formed on the amalgamation is not the CRIC but is instead a corporation resident in Canada of which the CRIC is a shareholder. This situation could arise, for example, where a Canadian-resident corporation that is a shareholder of a predecessor corporation acquires shares of the corporation formed on the amalgamation, which in turn owns shares of the subject corporation. It is also possible that, in respect of an amalgamation, both the corporation formed on the amalgamation and one or more shareholders of that corporation could be CRICs in respect of different indirect investments, which are described in paragraph 212.3(10)(*f*) and occur on the amalgamation.

A similar amendment is made to subparagraph 212.3(22)(*a*)(iii). For further information, please see the commentary on that subparagraph.

Paragraph 212.3(18)(*d*) prevents subsection 212.3(2) from applying where debt is exchanged for equity. The paragraph supplements the rules in subparagraphs 212.3(18)(*b*)(i) and (*c*)(iii) that deal with subsection 51(1) conversions of debt into equity. Paragraph 212.3(18)(*d*) is amended to clarify that the exception applies only where a bond, debenture or note issued by a subject corporation is exchanged for shares of the subject corporation and subsection 51(1) would apply to the exchange if the terms of the debt conferred on the holder of the debt the right to make the exchange.

The amendments to paragraphs 212.3(18)(*a*), (*b*) and (*c*) apply in respect of transactions and events that occur after March 28, 2012 (but with a modified reading for paragraphs 212.3(18)(*a*) and (*c*) in respect of transactions and events that occur before Announcement Date), subject to an election to have them come into force on August 14, 2012. The addition of the reference to subsection 212.3(18.1) in the preamble of subsection 212.3(18) and the amendment to paragraph 212.3(18)(*d*) apply in respect of transactions and events that occur after August 15, 2013.

Exchange – Pertinent Loan or Indebtedness

ITA
212.3(18.1)

New subsection 212.3(18.1) of the Act provides that the exceptions in subsection 212.3(18), which generally prevent subsection 212.3(2) from applying to various forms of corporate reorganizations and distributions, do not apply to certain investments by a CRIC in a subject corporation. In particular, subsection 212.3(18.1) provides that subsection 212.3(18) does not apply to an investment that is an acquisition of property, if the property can reasonably be considered to have been received by the CRIC as repayment in whole or in part, or in settlement, of a pertinent loan or indebtedness (PLOI) (as defined in subsection 212.3(11)). As a consequence, subsection 212.3 could potentially apply to the investment.

When a loan made by a CRIC to a subject corporation is treated as a PLOI, subsection 212.3(2) does not apply in respect of the PLOI. Subsection 212.3(18.1) clarifies that a CRIC cannot replace a PLOI with a second investment in a subject corporation described in subsection 212.3(18.1) without subsection 212.3(2) applying to the second investment. Without the new subsection, the intended consequences under the foreign affiliate dumping rules in section 212.3, and the related PLOI regime under section 17.1, could potentially be avoided (subject to the Act’s general anti-avoidance rule).

Subsection 212.3(18.1) applies in respect of transactions and events that occur after August 15, 2013.

Example

Assumptions

- *A CRIC makes a loan to its foreign affiliate and an election is made under paragraph 212.3(11)(c) to have the loan treated as a PLOI.*
- *One year later, the loan is exchanged for shares issued by the foreign affiliate to the CRIC in an exchange to which subsection 51(1) applies.*

Analysis

As a result of the PLOI election, the CRIC is required, under paragraph 17.1(1)(b), to include in its income interest at the prescribed rate for the year during which the PLOI remains outstanding. Subsection 212.3(2) does not apply to this investment because of the PLOI election.

The subsequent acquisition by the CRIC of shares is an investment described in paragraph 212.3(10)(a). Subject to the exceptions in subsections 212.3(16) or (18), subsection 212.3(2) would apply to this investment. The investment is described in subparagraph 212.3(18)(b)(i); but pursuant to subsection 212.3(18.1), the exception in subparagraph 212.3(18)(b)(i) does not apply in this case because the investment is an acquisition by the CRIC of shares of the subject corporation that are received by the CRIC in settlement of a PLOI. Therefore, subsection 212.3(2) applies to the investment.

Preferred Shares

ITA
212.3(19)

Subsection 212.3(19) of the Act provides that the exceptions in subsection 212.3(16) and paragraphs 212.3(18)(*b*) and (*d*) are not available in respect of a CRIC's acquisition of shares of a subject corporation if the CRIC does not have a fully participating equity interest in the subject corporation. In other words, the exceptions are not available where the CRIC acquires what are commonly referred to as "preferred shares", unless the subject corporation is a subsidiary wholly-owned corporation of the CRIC.

Subsection 212.3(19) is amended to provide that subparagraph 212.3(1)(*b*)(ii) applies to an acquisition of preferred shares described in subsection 212.3(19). For further information, please see the commentary on paragraph 212.3(1)(*b*).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Mergers

ITA
212.3(22)

For the purposes of section 212.3 and subsections 219.1(3) and (4) of the Act, subsection 212.3(22) provides "continuity" rules – similar to the rules in subsections 87(1.2) and 88(1.5) – that apply to amalgamations under subsection 87(11) and windings-up under subsection 88(1). It also contains complementary deeming rules that exclude from the application of the rule in subsection 212.3(2) an investment by a CRIC in a foreign affiliate that results from a merger to which subsection 87(11) or 88(1) applies.

In the case of a vertical amalgamation to which subsection 87(11) applies, subparagraph 212.3(22)(*a*)(ii) ensures that subsection 212.3(2) does not apply, as a result of the amalgamation, to a CRIC that is formed by the amalgamation. The new corporation formed by the amalgamation is deemed not to acquire any property of the parent or of any subsidiary as a result of the amalgamation, and thus it does not make an investment described in subsection 212.3(10).

New subparagraph 212.3(22)(*a*)(iii) is added to ensure that subsection 212.3(2) does not apply, as a result of the amalgamation, to a CRIC that is a shareholder of the parent and that acquires, on the amalgamation, shares of the new corporation. Each shareholder of the new corporation formed by the amalgamation is deemed not to acquire indirectly any shares as a result of the amalgamation. This ensures that where the parent or a subsidiary owns, directly or indirectly, shares of a foreign affiliate, the amalgamation does not result in a CRIC that is a shareholder of the new corporation making an indirect acquisition of shares of a subject corporation (*i.e.*, an investment described in paragraph 212.3(10)(*f*)) by virtue of directly acquiring shares of the new corporation on the amalgamation.

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Indirect Investment

ITA
212.3(23)

Subsection 212.3(23) of the Act is an anti-avoidance rule targeted at situations where a CRIC uses a “good” foreign affiliate as a conduit to make an investment in a “bad” foreign affiliate. A “good” foreign affiliate is a subject corporation an investment in which, by the CRIC, would satisfy the exception in subsection 212.3(16); an investment by the CRIC in a “bad” foreign affiliate would not satisfy that exception. Thus, subsection 212.3(23) can apply to effectively override subsection 212.3(16).

A reference to subsection 212.3(24) is added to subsection 212.3(23). As a result, subsection 212.3(23) may also override the exception from subsection 212.3(2) in subsection 212.3(24). This change is made as a consequence of the amendments to subsection 212.3(24) that expand the scope of the exception in that subsection. This amendment ensures that subsection 212.3(2) cannot be avoided by a CRIC, for example, investing in a subject corporation that, in turn, makes a loan to a “good” foreign affiliate, where the latter then uses the loan proceeds to acquire shares of a “bad” foreign affiliate. For further information, please see the commentary on subsection 212.3(24).

This amendment applies in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Indirect Funding

ITA
212.3(24)

Subsection 212.3(24) of the Act generally provides an exception from subsection 212.3(2) that applies, in certain circumstances, where a CRIC funds one foreign affiliate indirectly through another foreign affiliate and the exception in subsection 212.3(16) would have applied had the CRIC instead funded the first foreign affiliate directly.

Subsection 212.3(24) is amended to expand the scope of the exception it provides. The condition in existing paragraph 212.3(24)(*a*) that the subject corporation must make a loan to a particular corporation is removed, as is the condition in existing paragraph 212.3(24)(*c*) that requires the CRIC to demonstrate that, throughout the period during which the loan made by the subject corporation to the particular corporation is outstanding, the particular corporation uses the loan proceeds in an active business that it carries on in its country of residence. In their place, amended paragraph 212.3(24)(*a*) requires the CRIC to demonstrate that all of the property received by the subject corporation from the CRIC as a result of the investment was used by the subject corporation at a particular time that is within 30 days after the investment time and at all times after the particular time, either:

- to derive income from activities that can reasonably be considered to be directly related to active business activities carried on by a particular corporation and all of the income, which would otherwise be income from property, is deemed to be income from an active business to the subject corporation by subparagraph 95(2)(*a*)(i); or

- to acquire a property, all or substantially all of the income from which is, or would be, if there were income from the property, derived from amounts paid or payable, directly or indirectly, to the subject corporation by a particular corporation and the income is, or would be, income from an active business because of subparagraph 95(2)(*a*)(ii).

For example, subsection 212.3(24) may apply where a subject corporation makes a loan to a particular corporation, which uses the loan proceeds for the purpose described in clause 95(2)(*a*)(ii)(D) – generally, to earn income from property that is shares of another qualifying interest foreign affiliate of the CRIC and that are excluded property of the particular corporation.

All other conditions in existing subsection 212.3(24) remain. The particular corporation must be, at the particular time, a controlled foreign affiliate of the CRIC, as defined in section 17 (amended paragraph 212.3(24)(*b*)), and the particular corporation must be a corporation in which a direct investment by the CRIC would qualify for the exception in subsection 212.3(16) (amended paragraph 212.3(24)(*c*)).

Consequential on the amendments to subsection 212.3(24), a reference to that subsection is added to subsection 212.3(23). For further information, please see the commentary on subsection 212.3(23).

These amendments apply in respect of transactions and events that occur after March 28, 2012, subject to an election to have it come into force on August 14, 2012.

Clause 66

Paid-Up Capital Reinstatement

ITA
219.1(3) and (4)

Subsections 219.1(3) to (5) of the Act are part of the Act's foreign affiliate dumping rules, which are primarily contained in section 212.3. Subsections 219.1(3) and (4) contain rules, similar to subsection 212.3(9), that allow a corporation's paid-up capital (PUC) to be "reinstated" immediately before the corporation emigrates, where it has had a prior reduction of its PUC under paragraph 212.3(2)(*b*) or (7)(*b*). This PUC reinstatement will reduce the departure tax otherwise payable by an emigrating corporation under subsection 219.1(1).

Paragraph 219.1(3)(*b*) is amended in two respects. First, the reference to paragraph 212.3(7)(*b*) is replaced with a reference to subsection 212.3(7) in order to account for the restructuring of that subsection. Second, the reference to an investment described in paragraph 212.3(10)(*a*), (*b*) or (*f*) is replaced with a reference to an investment described in any of paragraphs 212.3(1)(*a*) to (*f*). This amendment is consequential on modifications to subsection 212.3(9) to extend the PUC reinstatement rules to allow, in certain circumstances, for PUC reinstatements in respect of dispositions of debt obligations owed by a subject corporation.

Similarly, subsection 219.1(4) is amended in three respects. The first two amendments correspond to those described above. The third amendment is to introduce new subparagraph 219.1(4)(*b*)(iii), which refers to the fair market value of all debt obligations owed to the CRIC by a subject corporation, other than a debt obligation that is a pertinent loan or indebtedness. The third amendment is consequential on modifications to subsection 212.3(9) to extend the PUC reinstatement rules to apply in respect of debt obligations owed by a subject corporation.

These amendments apply to corporate emigrations that occur after March 28, 2012.

Clause 67

Deemed Security

ITA
220(4.51)(*a*)

Subsections 220(4.5) to (4.54) of the Act permit an individual to elect, on giving security acceptable to the Minister of National Revenue, to defer payment of an amount of tax that is owing as a result of the deemed disposition of certain property upon the individual ceasing to be resident in Canada. Subsection 220(4.51) excuses an individual (other than a trust) from the requirement to provide security for an amount at least equal to the taxes payable on the first $100,000 of capital gains ($50,000 of taxable capital gains) resulting from the deemed disposition. The amount determined under subsection 220(4.51) is, for administrative simplicity, the amount of tax that an *inter vivos* trust (other than one described in subsection 122(2)) would pay for the relevant taxation year if the trust's taxable income for the year were $50,000. This represents a proxy for describing an amount that would be determined if a flat rate of tax of 29% applied.

Subsection 220(4.51) is amended, consequential on the amendment of subsection 122(2), to refer to a trust (other than a graduated rate estate or qualified disability trust). This continues to represent a proxy for a flat 29% rate.

This amendment applies to the 2016 and subsequent taxation years.

Clause 68

Foreign Affiliate Dumping – Late-Filed Form

ITA
227(6.2)

New subsection 227(6.2) of the Act is introduced to provide a refund, in certain circumstances, of withholding tax paid on a deemed dividend under subparagraph 212.3(7)(*d*)(ii) in respect of an investment to which the foreign affiliate dumping rule in paragraph 212.3(2)(*a*) applies. Where a corporation resident in Canada, or CRIC (as defined in subsection 212.3(1)), does not file the form required under subparagraph 212.3(7)(*d*)(i) on time, subparagraph 212.3(7)(*d*)(ii) deems a dividend to be paid by the CRIC to its parent (as defined in subsection 212.3(1)) equal to the amount of the paid-up capital offset otherwise available under subsection 212.3(7) to reduce the amount of a deemed dividend under paragraph 212.3(2)(*a*). For further information, please see the commentary on paragraph 212.3(7)(*d*).

The withholding tax refund under subsection 227(6.2) is available if:

- the CRIC complies with the requirements of subparagraph 212.3(7)(*d*)(i) after the deadline provided in subparagraph 212.3(7)(*d*)(ii) (*i.e.*, the CRIC late-files the required form);
- a written application for the refund is made on, or no more than two years after, the day on which the form is filed; and
- neither the CRIC, nor the person on whose behalf the withholding tax was paid to the Receiver General, is (or is about to become) liable to make a payment to the Government. In this instance, the Minister of National Revenue may apply the refund otherwise payable to the liability.

The amount refundable under paragraph 227(6.2)(*a*) is the lesser of the total amount of withholding tax paid, on or prior to the day on which the application for refund is filed, in respect of a person's withholding tax liability on the deemed dividend under subparagraph 212.3(7)(*d*)(ii) and the amount of withholding tax the person was liable to pay in respect of the deemed dividend.

Paragraph 227(6.2)(*c*) provides that, if the amount of withholding tax a person was liable to pay in respect of the deemed dividend under subparagraph 212.3(7)(*d*)(ii) exceeds the total amount of withholding tax paid, on or prior to the day on which the application for refund is filed, then the CRIC is deemed to pay that excess to the Receiver General on the day on which the form described in subparagraph 212.3(7)(*d*)(i) is filed.

Subsection 227(6.2) applies to transactions or events that occur on or after March 28, 2012.

ITA
227(8.5)

Subsection 227(8.5) of the Act provides two exemptions to corporations from the penalty for failing to withhold tax in subsection 227(8). Paragraph 227(8.5)(*b*) is amended to add a third exemption for failing to withhold tax in respect of an amount deemed by subparagraph 212.3(7)(*d*)(ii) to have been paid as a dividend by a corporation. Subparagraph 212.3(7)(*d*)(ii) deems, for the purposes of Part XIII, a dividend to have been paid by the corporation to the non-resident parent (within the meaning assigned by subsection 212.3(1)) to the extent that (i) the amount of the deemed dividend otherwise arising under paragraph 212.3(2)(*a*) (pertaining to the "foreign affiliate dumping" rules) is reduced because of a paid-up capital offset provided for in any of subparagraphs 212.3(7)(*a*)(i), (*b*)(i) and (*c*)(i), and (ii) the taxpayer does not satisfy the filing requirement set out in subparagraph 212.3(7)(*d*)(i) on time.

This amendment applies to transactions and events that occur after March 28, 2012.

Clause 69

Reporting Foreign Affiliates

ITA
233.4

Section 233.4 of the Act provides reporting requirements in respect of foreign affiliates. In general terms, it provides that taxpayers resident in Canada (or certain partnerships) of which a non-resident corporation or non-resident trust is a foreign affiliate must file an information return in respect of the affiliate. Section 233.4 is amended in two respects.

Subsection 233.4(1) defines the expression "reporting entity" for the purpose of section 233.4. A reporting entity for a taxation year or fiscal period means

- a taxpayer resident in Canada (other than a taxpayer all of whose taxable income for the year is exempt from tax under Part I of the Act) of which a non-resident corporation or trust is a foreign affiliate at any time in the year, or
- a partnership where the share of the income or loss of the partnership for the period of members not resident in Canada is less than 90% of the total income or loss of the partnership for the period, and a non-resident corporation or trust is a foreign affiliate of the partnership at any time in the period.

Subparagraph 233.4(1)(*c*)(i) is amended to further limit the circumstances in which a partnership is a reporting entity, by providing that a partnership is not a reporting entity for a fiscal period unless the share of its income or loss for the period of members that are either non-residents or taxpayers all of whose taxable income is exempt from tax under Part I of the Act is less than 90% of the total income or loss of the partnership for the period. This amendment renders the criteria for a partnership being a reporting entity more consistent with the criteria for other taxpayers.

Subsection 233.4(2) provides rules for the purpose of determining the foreign affiliate status of a non-resident corporation or trust in relation to a taxpayer resident in Canada or a partnership for the purpose of section 233.4. Subsection 233.4(2) is amended by adding a new paragraph (*d*), which deems a non-resident corporation or trust to not be a foreign affiliate of the taxpayer if

- the taxpayer is a member of one or more partnerships described in subparagraph 233.4(1)(*c*)(i) of which the non-resident corporation or trust is a foreign affiliate, and

- the taxpayer does not have any direct or indirect interest (determined without reference to the partnership look-through rule in subsection 93.1(1)) in the non-resident corporation or trust, other than through its interest in the partnerships.

This amendment limits the circumstances in which the same information is required to be reported by both a partnership and its members in respect of the same foreign affiliate. The amendment is consequential to the addition of section 233.4 to the list of provisions in subsection 93.1(1.1) for purposes of which the partnership look-through rule in subsection 93.1(1) applies.

The amendments apply in respect of taxation years that end after July 11, 2013.

Clause 70

Information That May Be Communicated

ITA
241(3.3)

New subsection 241(3.3) of the Act, which applies on Royal Assent, is added to provide authority to the Minister of Canadian Heritage to publish certain information relevant to the Canadian film or video production tax credit program. The information includes the title of a film or video production in respect of which a certificate has been issued or revoked by that Minister, as well as the names of producers and artists in respect of which that Minister has allotted "points" in determining whether the production is a "Canadian film or video production" under proposed section 1106 of the Regulations.

Disclosure of Taxpayer Information

ITA
241(4)

Subsection 241(4) of the Act authorizes the limited communication of information to government officials outside of the Canada Revenue Agency.

New subparagraph 241(4)(*d*)(xvi) allows information in respect of film or video productions to be communicated to officials of an office or agency of the government of Canada or of a province that provides a program of assistance for such productions. The information may be communicated only for the purpose of administration or enforcement under the program. New subparagraph 241(4)(*d*)(xvii) extends this authority to communicate information to an official of the Canadian Radio-television and Telecommunications Commission, solely for the purpose of the administration or enforcement of a regulatory function of that Commission.

New subparagraphs 241(4)(*d*)(xvi) and (xvii) apply on Royal Assent.

Clause 71

Definitions

ITA
248(1)

Subsection 248(1) of the Act defines various terms for the purposes of the Act.

"disposition"

Paragraph (*f*) of the definition "disposition" provides that a transfer of property between trusts is not a disposition for purposes of the Act if certain conditions are met. Subparagraph (*f*)(vi) requires that if the transferor is a certain type of trust, that the transferee must be the same type of trust. One type of trust referred to in that paragraph is a trust that is deemed by subsection 143(1) to be an *inter vivos* trust in existence in respect of a congregation that is a constituent part of a religious organization.

Subparagraph (*f*)(vi) of the definition "disposition" is amended, consequential on a similar amendment to section 143, to replace the reference to an *inter vivos* trust with a reference to a trust.

This amendment applies to the 2016 and subsequent taxation years.

"graduated rate estate"

Subsection 248(1) is amended to add the definition "graduated rate estate". The graduated rate estate of an individual at any time is the estate that arose on and as a consequence of the individual's death, if that time is no more than 36 months after the death and the estate is at that time a testamentary trust.

The income tax rules are predicated on the understanding that an individual has only one estate that arises on the individual's death. Consistent with this and the intention that that there be only one graduated rate estate in respect of a deceased individual, for an estate to be an individual's graduated rate estate at any time, a number of other conditions must also be satisfied:

- the estate must designate itself, in its T3 return of income for its first taxation year (or if the estate arose before 2016, for its first taxation year after 2015), as the individual's graduated rate estate;
- no other estate can have designated itself as a graduated rate estate of the individual; and
- the estate must include the individual's Social Insurance Number (or if the individual has not been assigned a Social Insurance Number before the death, such other information as is acceptable to the Minister of National Revenue) in its return of income for each taxation year of the estate that ends after 2015 and before that time.

In the case where an individual's will provides for the creation of a trust from all or a part of the property of the individual's estate, the property may be considered property of the estate until the estate transfers or distributes the property to the trust or the duties of the personal representative in administering the estate are complete. In some cases, however, property in separate trusts created under the terms of an instrument, such as a will, will not form part of an individual's estate for income tax purposes. For example, a particular individual's estate does not include a trust created under the terms of another individual's will, such as, for example, a spouse or common-law partner trust described in paragraph 70(6)(*b*) of the Act for the benefit of the particular individual.

This amendment comes into force on December 31, 2015.

"international shipping"

A definition of international shipping is introduced in order to clarify the application of paragraph 81(1)(*c*) and subsection 250(6). The definition is based on the language previously found in subparagraph 250(6)(*a*)(i) and provides that international shipping:

- includes the operation of ships owned or leased by a person or partnership (called the "operator") that are used, either directly or as part of a pooling arrangement, primarily in transporting passengers or goods in international traffic. This includes the chartering of ships provided that one or more persons related to the operator (in the case of corporations) or persons or partnerships affiliated with the operator (in any other case) has complete possession, control and command of the ships;
- includes activities, such as accounting or marketing activities, that are incident to or pertaining to the operation of the ships used in the shipping business; and
- specifically excludes offshore storing or processing of goods, fishing, laying cable, salvaging, towing, tug-boating, offshore oil and gas activities (such as exploration and drilling activities, but excluding the transportation of oil and gas), dredging and leasing of ship by a lessor to a lessee that has complete possession, control and command of the ship (unless the lessor or a corporation, trust or partnership affiliated with the lessor has an eligible interest, which is defined in subsection 250(6.04), in the lessee).

In addition to the activities that are specifically excluded, the definition precludes activities that do not involve the operation of ships, such as bareboat chartering, from qualifying as international shipping.

This amendment applies to taxation years that begin after July 12, 2013.

“international traffic”

The definition “international traffic” applies in respect of a non-resident person carrying on a business of transporting passengers or goods. This definition is modified to apply in respect of partnerships, as well as persons, and to remove the unnecessary “non-resident” qualifier.

This amendment applies to taxation years that begin after July 12, 2013.

“personal trust”

A “personal trust” is defined in subsection 248(1) of the Act as a testamentary trust, or an *inter vivos* trust (other than a unit trust) no beneficial interest in which was acquired for consideration (as determined under subsection 108(7)) payable to the trust or to a contributor to the trust.

Paragraph (*a*) of the definition “personal trust” is amended to replace the reference to a testamentary trust with a reference to a graduated rate estate. Paragraph (*b*) of the definition is amended to replace the reference to an *inter vivos* trust in that paragraph with a reference to a trust.

These amendments apply to the 2016 and subsequent taxation years.

“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 and migrants. Taxable Canadian property includes real or immovable property (including Canadian resource property and timber resource property) situated in Canada, as well as certain shares and other interests that derive their value principally from such property.

Paragraph (*e*) of the definition generally provides that taxable Canadian property of a taxpayer includes shares of the capital stock of a corporation that is listed on a designated stock exchange, a share of the capital stock of a mutual fund corporation or a unit of a mutual fund trust if, at any time during the previous 60 months,

- the taxpayer and persons that deal at non-arm’s length with the taxpayer own 25% or more of the shares of the corporation or units of the trust, as the case may be, and
- the shares or units derive more than 50% of their fair market value from real or immovable property situated in Canada.

Generally speaking, when a partnership disposes of property that is taxable Canadian property of the partnership, the gain is calculated at the partnership level and a portion of the gain is allocated to each partner.

Paragraph (*e*) is amended to ensure that a disposition by a partnership of taxable Canadian property constitutes a disposition of taxable Canadian property by a non-resident partner of the partnership for the purposes of subsection 2(3), which provides that an income tax is payable by certain non-residents that have disposed of taxable Canadian property. Specifically, the paragraph is amended to provide that the 25% ownership test applies to shares or units held by the taxpayer, persons that deal at non-arm’s length with the taxpayer and partnerships whose members include, either directly or indirectly, the taxpayer or persons that deal at non-arm’s length with the taxpayer.

This amendment applies in determining whether a property is taxable Canadian property of a taxpayer after July 11, 2013.

Trust-to-Trust Transfers

ITA
248(25.1)

Subsection 248(25.1) of the Act provides that a trust, to which property is transferred from another trust in circumstances to which paragraph paragraph (*f*) of the definition "disposition" in subsection 248(1), is treated as a continuation of the other trust. The subsection does not apply for purposes of paragraph 122(2)(*f*).

Consequential on amendments to subsection 122(2), subsection 248(25.1) is amended to remove the reference to subsection 122(2). For further information, see the commentary on subsection 122(2).

This amendment applies to the 2016 and subsequent taxation years.

Farming and Fishing Business

ITA
248(29)

New subsection 248(29) of the Act provides that, for the purposes of subsection 40(1.1) and sections 70, 73 and 110.6, where at any time property is used principally in a combination of the activities of a farming business and a fishing business it will be deemed to have been used at that time principally in the course of carrying on a farming or fishing business. This rule is introduced to accommodate taxpayers involved in a combination of farming and fishing to ensure that property that is principally used in a combination of both activities is treated the same as property that is used principally in either one of those activities.

New subsection 248(29) applies in respect of property disposed of, or transferred, in the 2014 and subsequent taxation years.

Clause 72

Taxation Year

ITA
249(1)(*b*) and (*c*)

Subsection 249(1) of the Act defines a taxation year for purposes of the Act. The definition applies except as otherwise provided (for example, as under subsections 149(10) and 249(4)). Paragraph 249(1)(*b*) provides that the taxation year of an individual, other than a testamentary trust, is the calendar year. Paragraph 249(1)(*c*) provides that the taxation year of a testamentary trust is the period for which the accounts of the trust are made up for purposes of assessment under the Act.

Paragraph 249(1)(*b*) is amended to provide that the taxation of a graduated rate estate is the period for which the accounts of the estate are made up for purposes of assessment under the Act. Paragraph 249(1)(*c*) is amended to provide that in any case where paragraphs 249(1)(*a*) and (*b*) do not apply, a taxation year is the calendar year. The definition continues to apply except as otherwise provided under the Act.

These amendments apply to the 2016 and subsequent taxation years.

Trust Transition from Graduated Rates
ITA
249(4.1)

Subsection 249(4.1) of the Act sets out the consequences to a particular trust (other than a mutual fund trust) of the particular trust ceasing to qualify for a non-calendar year taxation year. Under the definition "taxation year" in subsection 249(1), for the 2016 and subsequent taxation years, only a particular trust that is a graduated rate estate may have a non-calendar taxation year. For earlier taxation years, any testamentary trust may have a non-calendar taxation year.

In the case where the particular trust exists at the end of 2015, paragraph 249(1)(*a*) deems a taxation year to end at that time. An exception is provided if the particular trust is an estate that exists at the end of 2015 and that is an individual's graduated rate estate for the estate's first 2016 taxation year. In this case – and in the case where the particular trust is an estate that arose on a death after 2015 and that is a graduated rate estate for its first taxation year – the deemed taxation year-end is deferred until the last time at which the estate is a graduated rate estate. For further information, see the commentary on the definition “graduated rate estate” in subsection 248(1).

When paragraph 249(1)(*a*) deems a taxation year to end immediately before a particular time and the particular trust continues to exist at the particular time, paragraph 249(1)(*b*) provides that a new taxation year is deemed to begin at the particular time and paragraph 249(1)(*c*) provides that the particular trust has not established its fiscal period.

This amendment comes into force on December 31, 2015.

Graduated Rate Estate

ITA
249(5)

Subsection 249(5) of the Act provides that the period for which the accounts of a testamentary trust are made up for purposes of assessment under the Act may not exceed 12 months and that no change in the time when such a period ends may be made without the concurrence of the Minister of National Revenue.

Subsection 249(5) is amended to replace the reference to a testamentary trust with a reference to a graduated rate estate.

This amendment applies to the 2016 and subsequent taxation years.

Loss of Testamentary Trust Status

ITA
249(6)

Subsection 249(6) of the Act deems a taxation year to end when a trust loses its status under the Act as a testamentary trust. As a result, among other things, the trust ceases to qualify for a non-calendar taxation year. Subsection 248(4.1) now sets out the consequences of a trust ceasing to qualify for a non-calendar taxation year. Subsection 249(6) is, therefore, repealed.

This amendment applies to transactions and events that occur after 2015.

Clause 73

Fiscal Period

ITA
249.1(1)

Subsection 249.1(1) of the Act defines the term “fiscal period” for the purposes of the Act. Paragraph 249.1(1)(*b*) provides restrictions on the timing of fiscal periods of certain individuals, trusts, partnerships and professional corporations. Paragraph 249.1(1)(*b*) ensures that certain businesses will have a fiscal period end at the end of the calendar year. An exception is provided for testamentary trusts, which qualify for non-calendar fiscal periods.

Paragraph 249.1(1)(*b*) is amended so that the exception for testamentary trusts is replaced by an exception for graduated rate estates. A clarifying amendment adds a reference to a mutual fund trust in the description of a fiscal period to which paragraph 132.11(1)(*c*) applies.

These amendments apply to the 2016 and subsequent taxation years.

Alternative Method

ITA
249.1(4)

Subsection 249.1(4) of the Act allows an individual who carries on a business (including in partnership with other individuals) to elect out of the calendar year-end fiscal period requirement for the business otherwise imposed under paragraph 249.1(1)(*b*). To qualify, the election must be filed before the individual's filing-due date for the relevant taxation year. If the business is carried on in partnership with individuals that include a testamentary trust, the election must be filed before the earliest of the individuals' filing-due dates for the relevant taxation year.

Subsection 249.1(4) is amended to replace the references in that subsection to a testamentary trust with references to a graduated rate estate. These amendments are consequential on an amendment to subsection 249(1) to provide that graduated rate estates are the only individuals that can generally have an off-calendar taxation year-end.

These amendments apply to the 2016 and subsequent taxation years.

Revocation of Election

ITA
249.1(6)

Subsection 249.1(6) of the Act provides that, where an individual has elected under subsection 249.1(4) to have an off-calendar fiscal period in respect of a business, the individual may subsequently revoke that election for future fiscal periods. To qualify, the revocation must be filed before the individual's filing-due date for the relevant taxation year. If the business is carried on in partnership with individuals that include a testamentary trust, the revocation must be filed before the earliest of the individuals' filing-due dates for the relevant taxation year.

Subsection 249.1(6) is amended to replace the references in that subsection to a testamentary trust with references to a graduated rate estate. These amendments are consequential on an amendment to subsection 249(1) to provide that graduated rate estates are the only individuals that can generally have an off-calendar taxation year-end.

These amendments apply to the 2016 and subsequent taxation years.

Clause 74

Residence of International Shipping Corporation

ITA
250(6)

Canada's basic policy regarding the taxation of international shipping income has been in place for over 85 years. That policy is to not tax the international shipping income of non-resident companies, provided their home countries provide Canadian companies a comparable exemption.

In 1991, the government introduced a rule that clarifies whether a foreign-incorporated shipping company is a non-resident of Canada. This rule does not have any relevance for companies that are incorporated in Canada or for their foreign affiliates managed abroad.

Subsection 250(6) of the Act was introduced in 1991 to establish rules for determining the residence of a corporation that is incorporated outside Canada where its principal business in a taxation year consists of the operation of ships used primarily in transporting passengers or goods in international traffic and all or substantially all of its gross revenue for the year is from the operation of ships in transporting such passengers and goods. Where a corporation meets these conditions (and has not been granted articles of continuance in Canada), subsection 250(6) deems the corporation to be resident throughout the year in the country in which it was incorporated and to not be resident in Canada.

Subsequent amendments improved the 1991 residence rule by applying the same test to all foreign shipping companies whether their ships are held directly or in a wholly-owned foreign subsidiary and they confirmed that the exemption applies to capital gains, as well as to other income.

Subsection 250(6) is amended to introduce more flexible rules for international shipping corporations in order to reflect the structures of modern shipping organizations. In particular, the amendments implement the following changes:

- They provide for the use of trusts and partnerships, both as holding entities and as operating entities in a shipping group.
- They lower the ownership threshold that is required for certain purposes to 25% in order to accommodate a broader range of shipping group structures.
- They allow “back-office” services to be provided by an entity in a shipping group to another entity that is part of the group and that engages directly in international shipping if, among other conditions, those services would have qualified as part of the recipient entity’s shipping business if they were undertaken by it.

Amended subsection 250(6) applies to a corporation that meets certain conditions. It must have international shipping as its principal business in a taxation year or else it must hold eligible interests (generally, at least a 25% interest is held, together with holdings of related persons and affiliated partnerships) in one or more eligible entities (generally, a shipping corporation that qualifies for the subsection 250(6) deeming rule or a partnership or trust that would so qualify if it were a corporation). If eligible interests in eligible entities are held by the corporation, the cost of those interests and of debts owing to the corporation by those entities must be at least 50% of the cost of all property held by the corporation throughout the year. As well, all or substantially all the corporation’s gross revenue for the year must consist of a combination of gross revenue from international shipping, gross revenue from eligible interests held by the corporation in an eligible entity and interest on debt owing by an eligible entity in which an eligible interest is held by the corporation.

Therefore, in order to qualify for the subsection 250(6) deeming rule, a corporation must either have international shipping as its principal business or it must have a significant investment in one or more corporations, partnerships or trusts that are eligible entities. To qualify as an eligible entity, a corporation, partnership or trust must either have international shipping as its principal business for the year or it must hold eligible interests in one or more eligible entities. If eligible interests in eligible entities are held by the corporation, partnership or trust, the cost of those interests and of debts owing to the corporation, partnership or trust by those eligible entities must be at least 50% of the cost of all property held by the corporation, partnership or trust throughout the year. This approach allows for the use of holding entities and tiers of ownership (whether corporations, trusts or partnerships) within a shipping group. The test set out in subsection 250(6) is performed at each level and applies through tiers of entities until there is a partnership, corporation or trust that has international shipping as its principal business.

The definitions “eligible entity” and “eligible interest” are in new subsection 250(6.04). A deeming rule for determining whether a person or partnership holds an eligible interest in an eligible entity is in new subsection 250(6.05). For further information, please see the commentaries on subsections 250(6.04) and 250(6.05). The new definition “international shipping” is introduced in subsection 248(1). For further information, please see the commentary on the definition “international shipping” in subsection 248(1).

This amendment applies to taxation years that begin after July 12, 2013.

Partner’s Gross Revenue

ITA
250(6.01)

Since a partner may not have gross revenue from the partner’s interest in a partnership based on the definition “gross revenue” in subsection 248(1), this provision clarifies that, for the purposes of paragraph 250(6)(*b*), the gross revenue from a partner’s partnership interest is considered to be the amount of profit allocated from the partnership to the partner. The term “profit” is not defined for this purpose and is intended to have its ordinary commercial meaning.

This amendment applies to taxation years that begin after July 12, 2013.

Service Providers

ITA
250(6.02) and (6.03)

New subsections 250(6.02) and (6.03) of the Act are introduced to facilitate the use of single-purpose entities that provide services within the shipping group. The provisions deem certain ancillary services provided by a member of an international shipping group in support of core shipping activities carried on by members of the group to qualify as international shipping activities, provided certain conditions are met. These conditions are found in new subsection (6.02). If they are met, subsection (6.03) will apply so that such a service provider will be considered to have international shipping as its principal business, allowing it to potentially qualify for the deeming rule in subsection 250(6). Subsection 250(6.02) sets out the conditions that must be met for a service provider within a shipping group to qualify for the deeming rule in subsection 250(6.03). More specifically, subsection 250(6.02) provides that subsection (6.03) applies to a service provider (defined as the "relevant entity") if all the following conditions are met:

- The relevant entity does not have international shipping as its principal business in the year (determined without reference to the deeming rule in subsection 250(6.03) in order to avoid circularity in the operation of subsections 250(6.02) and 250(6.03)).
- All or substantially all the gross revenue of the relevant entity is derived from the provision of services to one or more eligible entities (as defined in subsection 250(6.04)) other than services described in paragraphs (*a*) to (*h*) of the definition "international shipping" in subsection 248(1) (those paragraphs list activities that are specifically excluded from qualifying as international shipping), international shipping activities, an eligible interest held by the relevant entity in an eligible entity or debt owing by an eligible entity in which an eligible interest is held by the relevant entity or a person related to it.
- The relevant entity is a subsidiary wholly-owned corporation (as defined in subsection 87(1.4)) of the eligible entity referred to in paragraph (*b*) or the relevant entity or one or more persons related to the relevant entity (if the relevant entity and each such person is a corporation) or persons or partnerships affiliated with the relevant entity (in any other case), or a combination thereof, holds an eligible interest in each eligible entity to which it provides services (i.e., those referred to in paragraph (6.02)(*b*)).
- All or substantially all the shares of the capital stock of the relevant entity (or other interests in the relevant entity if the relevant entity is a trust or partnership) are held, directly or indirectly through one or more subsidiary wholly-owned corporation (as defined in subsection 87(1.4)) by one or more corporations, trusts or partnerships that would qualify as eligible entities if they did not own shares of, or interests in, the relevant entity (in order to avoid circularity in applying the definition "eligible entity").

New subsection 250(6.03) applies for the purposes of subsection 250(6) and paragraph 81(1)(*c*). If it applies, a corporation, trust or partnership (defined as the "relevant entity" in subsection 250(6.02)) that does not have international shipping as its principal business in a taxation year but that provides services (other than services described in paragraphs (*a*) to (*h*) of the definition "international shipping" in subsection 248(1)) to one or more eligible entities will be deemed:

- to have international shipping as its principal business in a taxation year; and
- to have earned as gross revenue from international shipping activities the gross revenue that it derived from providing those services.

This amendment applies to taxation years that begin after July 12, 2013.

Definitions

ITA
250(6.04)

New subsection 250(6.04) of the Act defines certain terms for the purposes of subsections 250(6) to (6.03).

"eligible entity"

An eligible entity, for a taxation year, is a corporation that is deemed by subsection 250(6) to be a resident in a foreign country for the year, or a trust or partnership that, in general terms, would qualify for the deeming rule in subsection 250(6) for the year if it were a corporation. More particularly, in order for a trust or partnership to be an eligible entity for the year, it must satisfy the conditions in subparagraph 250(6)(*a*)(i) or (ii) and all or substantially all its gross revenue must consist of amounts described in subparagraphs 250(6)(*b*)(i) to (iii).

In order to meet the tests in subparagraph 250(6)(*a*)(i) or (ii), the partnership or trust must

- have international shipping as its principal business in the year, or
- hold eligible interests in one or more eligible entities throughout the year and at no time in the year can the total of the cost amounts of all those eligible interests and of all debts owing to the partnership or trust by those entities be less than 50% of the total of the cost amounts of all its property.

The gross revenue described in subparagraphs 250(6)(*b*)(i) to (iii) is

- gross revenue from international shipping,
- gross revenue from an eligible interest held by the trust or partnership in an eligible entity, and
- gross revenue from interest on a debt owing by an eligible entity in which an eligible interest is held by the trust or partnership.

This amendment applies to taxation years that begin after July 12, 2013.

"eligible interest"

"Eligible interest" is defined to mean an interest of at least 25% in a corporation, trust or partnership. For corporations, the interest is based on the votes and fair market value associated with shares of its capital stock. For trusts and partnerships, the interest is based on the relative fair market value of the interest in the trust or partnership.

This amendment applies to taxation years that begin after July 12, 2013.

Holdings in Eligible Entities

ITA
250(6.05)

New subsection 250(6.05) of the Act contains an aggregation rule, for the purpose of determining whether a person or partnership (called the "holder" in this subsection) holds an eligible interest in an eligible entity. This rule applies to subsections 250(6) to (6.04).

If the holder is a corporation, in addition to the shares or interests in the eligible entity held by it, the corporation is deemed to hold all the shares held by each corporation related to it and each person (other than a corporation) or each partnership that is affiliated with it.

If the holder is not a corporation, in addition to the shares or interests in the eligible entity held by it, the holder is deemed to hold all shares held by each person or partnership affiliated with it.

This amendment applies to taxation years that begin after July 12, 2013.

Clause 75

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 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.

Definitions

ITA
251.2(1)

Subsection 251.2(1) of the Act contains definitions that apply for purposes of section 251.2. Subsection 251.2(1) is amended to add several definitions that are relevant for the purposes of a rule in subsection 251.2(3) that provides that the acquisition of equity in certain types of investment trusts will not be treated as a loss restriction event of the trusts.

These amendments are deemed to have come into force on March 21, 2013. However, if a trust 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 taxation year that ends before January 1, 2015, then these amendments are deemed to have come into force in respect of that trust on January 1, 2014.

"fixed interest"

The expression "fixed interest" is relevant in applying the definition "investment fund".

A fixed interest at any time of a person in a trust means an interest of the person as a beneficiary under the trust (determined without reference to subsection 248(25) of the Act) if none of the income or capital of the trust to be distributed in respect of any interest in the trust depends on the exercise, or the failure to exercise, by any person of any discretionary power. For this purpose, a discretionary power excludes a power that

- conforms to normal commercial practices in respect of a trust,
- is consistent with terms that would be acceptable to the beneficiaries under the trust if the beneficiaries were dealing with each other at arm's length, and
- does not materially affect the value of an interest as a beneficiary under the trust relative to the value of other such interests under the trust.

"investment fund"

The expression "investment fund" is relevant in determining whether a particular trust will qualify for the rule in paragraph 251.2(3)(*f*) that provides that the acquisition of equity in certain types of investment trusts will not be treated as a loss restriction event of the trust.

An investment fund at any particular time means a trust that is at the particular time a portfolio investment fund and that is from the time of its creation until the particular time either a mutual fund trust (as defined under subsection 132(6) of the Act) or a quasi-mutual fund trust. For this purpose, a quasi-mutual fund trust means a non-discretionary trust that would be a mutual fund trust if it satisfied the prescribed conditions in paragraph 4801(*b*) of the *Income Tax Regulations* (including the requirement that the trust have at least one class of prescribed interests with 150 investors). Trusts that existed at the time the trust loss restriction event rules were first announced on March 21, 2013 are required to meet the mutual fund trust or quasi-mutual fund trust requirements only as of that date.

For further information, see the commentary on the definition “portfolio investment fund”, paragraph 251.2(3)(*f*) and subsection 251.2(7).

“portfolio investment fund”

The expression “portfolio investment fund” is relevant in applying the definition “investment fund”. Paragraph 251.2(3)(*f*) provides that the acquisition of equity in a trust is not a loss restriction event of the trust if certain conditions are met, including that the trust is immediately before the acquisition an investment fund. To qualify as an investment fund immediately before the acquisition, the trust must in turn be a portfolio investment fund at that time. A portfolio investment fund does not include a trust that directly or indirectly carries on a business or that holds significant real estate or resource properties.

The definition “portfolio investment fund” has the same meaning as the definition “portfolio investment entity” in subsection 122.1(1) of the Act with certain modifications. These modifications apply the definition “non-portfolio property” in subsection 122.1(1) without reference to the location in Canada of property or residence in Canada of an entity. Specifically,

- Paragraph (*a*) of the definition replaces the references to “subject entity” in paragraph (*a*) of the definition “non-portfolio property” in subsection 122.1(1) with references to “entity”, which is also defined in subsection 122.1(1);
- Paragraph (*b*) of the definition requires that the definition “Canadian real, immoveable or resource property” in subsection 248(1) of the Act be read as though
    - its paragraph (*a*) were read without reference to “situated in Canada”,
    - its paragraph (*b*) were read as “a Canadian resource property or a foreign resource property”, and
    - “timber resource property” in paragraph (*c*) were defined as extending to rights in respect of property outside Canada; and
- Paragraph (*c*) of the definition requires that paragraph (*c*) of the definition “non-portfolio property” in subsection 122.1(1) be read without reference to “in Canada”.

For further information, see the commentary on paragraph 251.2(3)(*f*).

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.

New paragraph 251.2(3)(*f*) of the Act applies to provide that the acquisition 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. Namely, paragraph 251.2(3)(*f*) provides that the acquisition of equity in a trust that is immediately before the acquisition an investment fund as defined under subsection 251.2(1) will not result in a person (or group of persons) being considered to have become a majority-interest beneficiary (or group of majority-interest beneficiaries) in the trust. This result is subject to the requirement that the acquisition not be part of a series of transactions or events under which the trust becomes a portfolio investment fund or ceases to qualify as an investment fund.

This amendment is deemed to have come into force on March 21, 2013. However, if a trust 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 taxation year that ends before January 1, 2015, then this amendment is deemed to have come into force in respect of that trust on January 1, 2014.

For further information, see the commentary on subsection 251.2(7).

ITA
251.2(7)

New subsection 251.2(7) applies to various deadlines for a trust that is subject to a loss restriction event and, as a result of which, subsection 249(4) of the Act applies to deem the trust's taxation year (the "stub year") to end before the loss restriction event.

The effect of subsection 251.2(7) is that the filing-due date by which the trust must file with the Minister of National Revenue the trust's return of income for the stub year and issue its T3 information slips in respect of the stub year is the day that would have been determined had the trust not been subject to the loss restriction event (i.e., 90 days after what would have been the trust's taxation year-end if subsection 249(4) did not apply). The trust's balance-due day (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) for the stub year is also extended to that day.

Subsection 251.2(7) also ensures that a trust is not prevented from making an election, under subsection 132(6.1) of the Act, to be treated as a mutual fund trust from the beginning of its first taxation year to the time at which such an election is made, because of a loss restriction event that occurs (or that would have occurred in the absence of the election applying retroactively to provide relief under paragraph 251.2(3)(*f*) of the Act) in the period of eligibility for the election. That period expires on the 90th day following the end of the trust's first taxation year. Under subsection 251.2(7), the trust's first taxation year is to be determined without reference to any intervening taxation years that have arisen (or that would have otherwise arisen) because of subsection 249(4) and so, the time period for a trust to qualify as a mutual fund trust is not shortened by a loss restriction event.

This amendment is deemed to have come into force on March 21, 2013. However, if a trust 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 taxation year that ends before January 1, 2015, then this amendment is deemed to have come into force in respect of that trust on January 1, 2014.

Clause 76

Associated Corporations

ITA
256(1.2)(*f*)

Section 256 of the Act contains rules for determining whether one corporation is associated with another corporation in a taxation year. Subsection 256(1.2) contains rules that apply in determining whether, and if so by whom, a corporation is controlled for purposes of determining whether the corporation is associated with another corporation. Paragraph 256(1.2)(*f*) provides a "look-through" rule where shares of the capital stock of a corporation are held by a trust. Subparagraphs 256(1.2)(*f*)(i) to (iii) treat shares owned by a trust to be also owned by the trust's beneficiaries. The extent of any beneficiary's deemed ownership depends upon whether the beneficiary's rights to certain amounts under the trust depend on the exercise by any person of, or the failure by any person to exercise, any discretionary power.

Subparagraph 256(1.2)(*f*)(i) applies in the special case of a testamentary trust under which one or more of the trust's beneficiaries is entitled to all of the income of the trust before the death of the beneficiary (or the last of them) and no other person could, before the relevant death, receive or otherwise obtain the use of any of the income or capital of the trust. In this case, the subparagraph deems shares owned by the trust also to be owned before the relevant death by those beneficiaries, ignoring other beneficiaries.

Subparagraph 256(1.2)(*f*)(i) is repealed. As a consequence, subparagraphs 256(1.2)(*f*)(ii) and (iii) are amended to remove references in those subparagraphs to subparagraph 256(1.2)(*f*)(i).

These amendments apply to the 2016 and subsequent taxation years.

Clause 77

Functional Currency Tax Reporting

ITA
261

Overview

Section 261 of the Act confirms that as a general rule all amounts required to be determined under the provisions of the Act are to be determined in Canadian currency. It also provides an exception to this requirement where certain conditions are met. If the conditions are met, certain Canadian resident corporations will be permitted to determine their Canadian tax results in their elected functional currency.

Application of Subsection 261(5)

ITA
261(3)(*b*)

Subsection 261(3) of the Act provides the conditions that must be met for a taxpayer to determine its Canadian tax results for a particular taxation year using a currency other than the Canadian dollar. The condition in paragraph 261(3)(*b*) currently requires that the taxpayer file an election with the Minister of National Revenue on or before the day that is six months before the end of the particular taxation year.

Paragraph 261(3)(*b*) is amended to require the election to be filed with the Minister of National Revenue on or before the day that is 60 days after the first day of the first taxation year for which the taxpayer wishes to compute its Canadian tax results using its elected functional currency. This amendment permits a taxpayer with a short taxation year to more easily make the election.

This amendment applies to taxation years that begin after July 12, 2013.

Partnerships and Foreign Affiliates

ITA
261(6)(*a*)(iii) and (6.1)(*a*)(i)(C)

Subsection 261(6) of the Act deals with situations where a taxpayer that has made a functional currency election (an electing taxpayer) is or becomes a member of a partnership. Subsection 261(6.1) provides similar rules that deal with the foreign accrual property income (FAPI) of a non-resident corporation that is, or becomes, a foreign affiliate of an electing taxpayer. Generally, both of these subsections attribute to the partnership or foreign affiliate, as the case may be, the same tax reporting currency – and the same history of changes in tax reporting currency – as the electing taxpayer.

Subparagraph 261(6)(*a*)(iii) is amended, as a consequence of the amendment to paragraph 261(3)(*b*), to cause section 261 to apply as if the partnership were a taxpayer that had as its first functional currency year its first fiscal period that begins on or after the first day of the electing taxpayer's first functional currency year.

Clause 261(6.1)(*a*)(i)(C) is similarly amended to cause section 261 to apply as if the foreign affiliate were a taxpayer that had as its first functional currency year its first taxation year that begins on or after the first day of the electing taxpayer's first functional currency year.

These amendments apply to taxation years that begin after July 12, 2013.

Determination of Amounts Payable

ITA
261(11)

Subsection 261(11) of the Act contains rules for determining amounts payable under the Act by taxpayers that determine their Canadian tax results using an elected functional currency. Clause 261(11)(*b*)(i)(A) and paragraphs 261(11)(*c*) and (*d*) are each amended to replace the erroneous reference in those provisions to "this Part" (i.e., Part XVII) with a reference to Part I.

These amendments apply to taxation years that begin after December 13, 2007.

Amalgamations – Deemed Application of Subsection (5)

ITA
261(17.1)

New subsection 261(17.1) of the Act is added to deal with situations where each predecessor corporation, in respect an amalgamation within the meaning of subsection 87(1), has the same elected functional currency and has not filed a notice of revocation under subsection 261(4) on or before the day that is six months before the end of its last taxation year. Where this is the case, the new corporation formed on the amalgamation is deemed to have made an election under paragraph 261(3)(*b*) to have subsection 261(5) apply to it, and to have filed the election with the Minister of National Revenue on the first day of its first taxation year. The common elected functional currency of the predecessor corporations is deemed to be the new corporation's functional currency for its first taxation year, and therefore its elected functional currency.

This amendment is intended to ensure that an amalgamated corporation can continue to determine its Canadian tax results using the same elected functional currency of its predecessor corporations without having to file an election.

This amendment applies to amalgamations that occur after July 12, 2013.

Income Tax Regulations

Clause 78

Periodic Payments

ITR
102(6)

Part I of the *Income Tax Regulations* (the Regulations) provides rules concerning deductions at source that an employer must withhold from amounts paid to employees. Section 102 of the Regulations requires employers to withhold an amount on account of the employee's income tax liabilities from an employee's earnings.

Subsection 102(6) provides that no amount is to be withheld by an employer in respect of amounts that are deductible in computing income under subparagraph 110(1)(*f*)(v) of the Act, which applies to certain employment income earned by Canadian Forces members and police officers on high-risk missions.

Subsection 102(6) is amended to also provide that no amount is to be withheld by an employer in respect of an amount that is deductible in computing income under subparagraph 110(1)(*f*)(iii) or (iv) of the Act, which apply to employment income earned by certain employees of prescribed international organizations and prescribed international non-governmental organizations.

This amendment applies to amounts paid after July 11, 2013.

Clause 79

Annuities

Part III

Part III of the *Income Tax Regulations* (the "Regulations") contains prescribed rules for annuities and other life insurance policies.

Capital Element of Annuity Payments

ITR
300(2)

The income tax rules require, with some exceptions, that the non-capital portion of annuity payments received by a taxpayer in a taxation year be included in the taxpayer's income for the year. Section 300 of the Regulations contains rules that apply for determining the part of a payment made under an annuity contract that is to be treated as a capital payment. The determination is made under subsection 300(1) by reference to

- if the annuity contract is for a term certain, the amount of payments to be made under the contract, and
- if the contract is one under which payments continue to be made having regard to the survival of an individual, the amount of payments expected to be made under the contract.

In the second case – where the annuity payments continue for a period that depends upon the survival of an individual – subsection 300(2) contains rules for determining the payments expected to be made under the contract.

Paragraph 300(2)(*a*) is amended to update the mortality tables used in determining the payments expected to be made under an annuity contract. The new table is the *Annuity 2000 Basic Mortality Table* published in the *Transactions of Society of Actuaries, 1995-96 Reports*. The use of this table applies to annuities issued after 2016. The table does not apply to an annuity issued before 2017, except where

- the annuity rates under the contract were not fixed and determined before 2017, or
- the annuity rates under the contract were fixed and determined before 2017 but
    - annuity payments under the contract did not start before 2017, and
    - on December 31, 2016, the contract would not be a prescribed annuity contract (under section 304 of the Regulations) even if section 304 were read without regard to subparagraph 304(1)(*c*)(i) or the contract could be terminated other than on the death of an individual whose life is a measuring life under the contract.

Subsection 300(2) is also amended by moving the definition "adjusted purchase price" from its current location in paragraph 300(2)(*b*) to section 310, which contains a number of definitions relevant to Part III of the Regulations. Consequential on this change, existing paragraphs 300(2)(*c*) and (*d*) are renumbered as paragraphs 300(2)(*b*) and (*c*), respectively. Renumbered paragraphs 300(2)(*b*) and (*c*) are also amended to conform to current drafting standards.

Finally, renumbered paragraph 300(2)(*b*) is amended to add a rule for determining the age of an individual to be used on the date as of which a calculation is being made if the insurer that issued the relevant annuity contract determined the individual's life to be a substandard life at the time the contract was issued and the annuity table used to compute the total of the payments expected to be made under the contract is the *Annuity 2000 Basic Mortality Table* published in the *Transactions of Society of Actuaries, 1995-96 Reports*. In this case, subparagraph 300(2)(*b*)(i) provides that the age to be used is the age in years obtained by adding two amounts. The first amount is the age used at the time the contract was issued for the purposes of determining the annuity rate under the policy. The second is the number obtained by subtracting the calendar year in which the contract was issued from the calendar year of the date on which the calculation under the subparagraph is being made.

Subparagraph 300(2)(*b*)(ii) contains the rule found in existing paragraph 300(2)(*c*). This rule continues to apply in all cases other than a case where subparagraph 300(2)(*b*)(i) applies.

These amendments come into force on Royal Assent.

Clause 80

Prescribed Annuity Contracts

ITR
304(1)(*c*)

Section 304 of the Regulations prescribes certain annuity contracts for exclusion from the rules in section 12.2 of the *Income Tax Act* that require income from insurance policies to be reported on an accrual basis. Paragraph 304(1)(*c*) provides an exclusion for an annuity under which payments have commenced if the annuity is one for which a number of other conditions are also satisfied.

Clause 304(1)(*c*)(iii)(A) requires that the holder of the annuity be an individual (other than a trust), a specified trust (*i.e.*, an *alter ego* trust, joint spousal or common-law partner trust or post-1971 spousal or common-law partner trust) or a testamentary trust. Clause 304(1)(*c*)(iii)(A) is amended so that an annuity issued after 2015 does not qualify as a prescribed annuity contract (PAC) under paragraph 304(1)(*c*) if the holder is a trust, unless the holder is a qualified disability trust for the year in which the annuity was issued or a specified trust. An annuity issued before 2016 can continue to qualify as a PAC if it is held by a trust that was a testamentary trust at the time the annuity was issued.

Clause 304(1)(*c*)(iv)(B) requires that the term of the annuity not extend beyond a fixed term or a period defined by reference to the life of a specified individual. Clause 304(1)(*c*)(iv)(C) requires that, where the term of the annuity is guaranteed or fixed, the term cannot exceed a period of time determined by reference to the age, when the contract was first held, of a specified individual.

Clauses 304(1)(*c*)(iv)(B) and (C) are amended to require that the specified individual be, in the case of a qualified disability trust, an individual who is an electing beneficiary (as defined in subsection 122(3) of the *Income Tax Act*) of the trust for the taxation year in which the annuity is issued.

Clauses 304(1)(*c*)(iv)(B) and (C) are further amended, as they apply in the case of an annuity the holder of which is a trust that was a testamentary trust at the time the annuity was issued, to reflect that such a trust qualifies as a holder of a PAC only if the annuity was issued before 2016. The requirement under clause 304(1)(*c*)(iii)(B) is also modified where the annuity is issued to such a trust after October 23, 2012 and before 2016. For these annuities, an individual qualifies as a specified individual if the individual was entitled, when the contract was first held, to receive all of the trust's income from the annuity (*i.e.*, the specified individual's rights to the trust income can be limited to the part of the income that is from the annuity payments that are received by the trust on or before the individual's death and that are not treated as capital payments for income tax purposes).

Clause 304(1)(*c*)(iv)(E) requires that the annuity not allow the holder's rights under the contract to be disposed of before certain events. If the holder is a testamentary trust, other than a specified trust, these events are the earlier of the death of the specified individual and the time at which the trust ceases to be a testamentary trust. Clause 304(1)(*c*)(iv)(E) is amended to apply this rule to the case where the holder is a qualified disability trust.

These amendments apply to the 2016 and subsequent taxation years.

Clause 81

Exempt Policies

ITR
306

The Act contains rules regarding the taxation of the income earned on the savings in a life insurance policy. In the case of a policy other than an annuity contract, the tax treatment differs depending on whether a policy is classified as an "exempt policy". A test (the exemption test) is applied each year to determine whether a policy is an exempt policy. The exemption test measures the extent to which a life insurance policy is protection-oriented (*i.e.*, an exempt policy) or savings-oriented (*i.e.*, a non-exempt policy).

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

These rules, including the exemption test, were introduced in the early 1980s. These proposals would amend a number of aspects of the rules relating to the tax treatment of life insurance policies other than annuity contracts, including:

1. the determination of whether a policy is an exempt policy;
2. the determination of what types of transactions give rise to a disposition of an interest in a policy;
3. the determination of the tax treatment of a disposition of an interest in a policy (having regard to both the adjusted cost basis of the interest and its proceeds of the disposition); and
4. amendments to the Investment Income Tax consequential on some of the other amendments.

The proposals would also amend the rules applying to the determination of the capital element of annuity payments for life contingent annuity contracts.

Amendments to the rules regarding the tax treatment of life insurance policies have typically been accompanied by grandfathering for existing policies. As a result, the manner in which the rules apply also depends upon the date on which an interest in the policy was last acquired and, in some cases, the date of issuance of the policy. Grandfathering is also proposed in respect of the principal legislative amendments described in this commentary. Unless otherwise indicated in this commentary, a reference in the commentary to a policy issued after 2016 includes a policy issued before 2017 for which an issuance time after 2016 has been determined under subsection 148(11) of the *Income Tax Act*, and a reference to a policy issued before 2017 does not include a policy to which that subsection so applies. The following table summarizes grandfathering in respect of the accrual taxation rules and exempt testing for life insurance policies other than annuity contracts:

Policy Acquisition/Issuance Date	**Income Tax Treatment**
Policies originally issued before 2017 an interest in which was last acquired before December 2, 1982.	Exempt from accrual taxation unless grandfathering is lost because a prescribed premium is paid and certain other conditions met. If grandfathering is lost, annual or triennial accrual applies unless the policy is an exempt policy. See subsections 12.2(1), (3) and (9) of the *Income Tax Act*, R.S.C. 1952, c.148. For a policy that was originally issued before 2017, in determining whether the policy is an exempt policy at a time after 2016, the rules that apply to policies issued after 2016 will apply only if subsection 148(11) of the Act applies to deem the policy to be issued at a particular time after 2016 that is on or before the time.

Policies originally issued before 2017 an interest in which was last acquired after December 1, 1982 and before 1990.	Annual or triennial accrual taxation depending upon taxpayer, unless the policy is an exempt policy, as determined under rules applicable to a policy interest last acquired after December 1, 1982 and before 1990. See subsections 12.2(1) and (3) of the *Income Tax Act*, R.S.C. 1952, c.148. For a policy that was originally issued before 2017, in determining whether the policy is an exempt policy at a time after 2016, the rules that apply to policies issued after 2016 will apply only if subsection 148(11) of the Act applies to deem the policy to be issued at a particular time after 2016 that is on or before the time.
Policies originally issued before 2017 an interest in which was last acquired after 1989.	Annual accrual taxation, unless policy is an exempt policy, as determined under rules applicable to policies an interest in which was last acquired after 1989. See subsection 12.2(1) of the Act. For a policy that was originally issued before 2017, in determining whether the policy is an exempt policy at a time after 2016, the rules that apply to policies issued after 2016 will apply only if subsection 148(11) of the Act applies to deem the policy to be issued at a particular time after 2016 that is on or before the time.

ITR
306(1)

Subsection 306(1) of Regulations provides that a life insurance policy (other than an annuity contract or a deposit administration fund policy) is an exempt policy if the savings accumulating in the policy do not exceed the savings in its associated benchmark policies (the exemption test policies or ETPs). This determination is generally made on each policy anniversary of the policy, having regard both to current savings (paragraph 306(1)(*a*)) and future anticipated savings in the policy and its ETPs (the pre-testing rule in paragraph 306(1)(*b*)). A policy that is not an exempt policy on a policy anniversary cannot subsequently become an exempt policy. Section 307 contains rules for determining the savings (the accumulating fund) in a policy and its ETPs. The rules in section 307 in turn rely upon a number of determinations made under section 1401. For information on related amendments, see the commentary on sections 307 and 1401.

A number of amendments are made to section 306. These amendments generally apply to policies issued after 2016. Subsection 148(11) of the Act may apply in certain circumstances to a policy otherwise issued before 2017 to determine the time at which the policy is issued for purposes of section 306 (other than subsection 306(9)).

Paragraph 306(1)(*b*) contains a pre-testing rule that applies in determining whether a policy is an exempt policy on a given policy anniversary of the policy. The rule requires that, on the policy anniversary, it must be reasonable to expect, having regard to a number of assumptions, that the policy and ETP savings requirement set out in paragraph 306(1)(*a*) will be met on future policy anniversaries. Paragraph 306(1)(*b*) is amended for policies issued after 2016 to shorten the pre-testing period to the policy's first subsequent policy anniversary. Under the new pre-testing rule, it must be reasonable to expect that the requirement in paragraph 306(1)(*a*) will be met on the policy's next policy anniversary.

This determination is to be made without regard to any automatic adjustments (such as withdrawals or increases in the benefit on death) that could be made after the policy anniversary to ensure that the policy is an exempt policy. Where variables that enter into the calculation of the accumulating fund of a policy or of the ETPs issued in respect of a coverage under the policy are not fixed and determined on the policy anniversary, this determination is to be made by making projections using the most recent values for these variables.

These amendments come into force on Royal Assent.

ITR
306(3) to (9)

ETP: date of issuance, benefit on death and time of payment of the benefit on death

Under existing paragraph 306(3)(*a*) of the Regulations, the first ETP of a policy is deemed to be issued on the date of issuance of the policy. An additional ETP is deemed to be issued, under existing paragraph 306(3)(*b*), in respect of the policy if the benefit on death under the policy increases by more than 8% from the time of the immediately preceding policy anniversary (or the policy's date of issuance if the rule is being applied on the policy's first policy anniversary). Existing paragraph 306(3)(*c*) defines the ETP's benefit on death on a policy anniversary. The ETP's benefit on death is presumed to be the same as that of the policy on the policy anniversary, with special rules for allocating the death benefit across ETPs in circumstances where a policy has more than one ETP issued in respect of it. Existing paragraph 306(3)(*d*) determines the time at which the benefit on death is presumed to be payable under an ETP (*i.e.*, the earlier of the death of the life insured under the policy and the endowment date of the ETP). Under existing subparagraph 306(3)(*d*)(ii), the ETPs in respect of a policy are generally presumed to endow at age 85 of the individual whose life is insured under the policy. For policies under which the individual whose life is insured is older than 75 years on their date of issuance, the ETP endowment date is instead presumed to be ten years after the date of issuance of the policy.

Paragraphs 306(3)(*a*) to (*d*) are renumbered and paragraph 306(3)(*e*) is repealed. Paragraphs 306(3)(*a*) and (*b*) become subparagraphs 306(3)(*a*)(i) and (ii), paragraph 306(3)(*c*) becomes subparagraphs 306(4)(*a*)(i) and (ii), and paragraph 306(3)(*d*) becomes paragraph 306(4)(*b*). The renumbered provisions continue to apply to policies issued before 2017.

Rules for ETPs for life insurance policies issued after 2016 are found in new paragraph 306(3)(*b*), subparagraphs 306(4)(*a*)(iii) to (v) and paragraph 306(4)(*b*). In defining ETPs, these rules account for the possibility of more than one life being insured under a policy (*i.e.*, there being separate coverages under a policy), as well as accounting for policies that provide joint insurance coverage in respect of two or more lives. For further information on the meaning of coverage, see the commentary on the definition "coverage" in section 310.

An ETP issued in respect of coverages under a policy issued after 2016 will have the following characteristics:

- Under subparagraph 306(3)(*b*)(i), the first ETP in respect of each coverage under the policy is generally deemed to be issued on the policy anniversary that is on, or that immediately precedes, the date of issue of the coverage (if the coverage is issued before the first policy anniversary, then the ETP is deemed to be issued when the policy was issued). That first ETP's benefit on death, which is determined under the formula in subparagraph 306(4)(*a*)(iii), is equal to the coverage's benefit on death (variable A of the formula) grossed up by the portion of the policy's fund value benefit, if any, that is allocated to the coverage (variable B of the formula) less the total benefits on death allocated as of that date to other ETPs issued in respect of the coverage (variable C of the formula).

  A fund value benefit corresponds to the portion of the fund value of a life insurance policy that increases the benefit on death but does not reduce the net amount at risk under any coverage. The fund value benefit is not associated with any specific coverage. Therefore, if the coverage is in respect of a policy with a fund value benefit, the coverage's share is calculated (*i.e.*, under variable B of the formula in subparagraph 306(4)(*a*)(iii)) based on the maximum amount of fund value benefit that would be payable under the policy if no other coverage were offered. For further information on the meaning of "benefit on death", "fund value of a life insurance policy" and "fund value benefit", see the commentary on section 310 and subsection 1401(3).

- An additional ETP is deemed to be issued on a policy anniversary, under new subparagraph 306(3)(*b*)(ii), in respect of the coverage if the benefit on death under the coverage increases by more than 8% between the time of the policy's immediately preceding policy anniversary or the coverage's date of issuance, whichever is later, and the policy anniversary. Subparagraph 306(4)(*a*)(iv) provides that the benefit on death of the additional ETPs issued under this rule is the amount of the excess under subparagraph 306(3)(*b*)(ii) (*i.e.*, the amount by which the increase in the benefit on death of the coverage exceeded the 8% annual growth permitted by the subparagraph).

- An additional ETP is deemed to be issued on a policy anniversary, under new subparagraph 306(3)(*b*)(iii), in respect of the coverage if the policy's fund value benefit increases by more than a particular amount between the time of the policy's immediately preceding policy anniversary or the policy's date of issuance, whichever is later, and the policy anniversary. The particular amount is equal to the amount by which 8% of the policy's benefit on death on the immediately preceding policy anniversary or the policy's date of issuance, whichever is later, exceeds the total of all amounts each of which is, in respect of a coverage under the policy, equal to the lesser of: (1) the increase in the benefit on death of each coverage from the time of the policy's immediately preceding policy anniversary or the coverage's date of issuance, whichever is later; and (2) 8% of the benefit on death of the coverage on the immediately preceding policy anniversary or the coverage's date of issuance, whichever is later.

  If an ETP in respect of a coverage under a policy is issued on a policy anniversary because of subparagraph 306(3)(*b*)(iii), no other ETP in respect of a coverage under the policy is issued on that policy anniversary because of that subparagraph (in effect allowing the life insurer to choose, in this case, in respect of which coverage the ETP will be issued on that policy anniversary). Subparagraph 306(4)(*a*)(v) provides that the benefit on death of an ETP issued under this rule is the lesser of the amount of the excess under subparagraph 306(3)(*b*)(iii) and the maximum amount of the fund value benefit, determined on the date of issue of the ETP, that would be payable under the policy if no other coverage were offered.

- Under paragraph 306(4)(*b*), each ETP's benefit on death is presumed to be paid at the earlier of the ETP's endowment date (generally, age 90) and the date of death of the individual whose life is insured under the coverage; an exception applies in the case of a coverage under which two or more lives are jointly insured – in that case, the ETP's benefit on death is presumed to be paid at the earlier of its endowment date and the date at which the benefit on death under the coverage would be payable as a result of, in the case of joint first-to-die coverage, the death of the first of the lives jointly insured, and, in the case of a joint-last-to-die coverage, the death of the last of the lives jointly insured. For further information on an ETP's endowment date, see the commentary on section 310.

In cases where a life insurance policy is issued before 2017, but for which a deemed issuance date at a particular time after 2016 is determined by subsection 148(11) of the Act, the issue dates of ETPs in respect of the life insurance policy are preserved for ETPs issued before the particular time (i.e., the ETP issue dates for ETPs issued in respect of the policy before the particular time are as originally determined under subparagraphs 306(3)(*a*)(i) and (ii)). Subparagraphs 306(3)(*b*)(ii) and (iii) apply to determine whether, and if so at what time, at or after the particular time ETPs are issued in respect of a coverage under the life insurance policy. However, in determining at or after the particular time the death benefit of ETPs issued in respect of the policy, subsection 306(4) applies as though all ETPs issued in respect of the policy were issued after 2016.

Existing subsection 306(4) of the Regulations provides a number of exceptions to the general rules that apply in determining whether a policy is an exempt policy. The rules in existing subsection 306(4) are moved to subsections 306(5) to (9) and new rules are added to those subsections for policies issued after 2016.

Reduction in ETP death benefit

Under existing paragraph 306(4)(*a*), where the benefit on death under a life insurance policy is reduced, the benefit on death of ETPs that have been issued in respect of the policy under existing paragraph 306(3)(*b*) (*i.e.*, ETPs issued after the date of issuance of the policy because the 8% growth limit test was failed) is reduced. The reduction is allocated to those ETPs under existing subparagraphs 306(4)(*a*)(i) and (ii) based on the proximity of their date of issuance to the time at which the benefit on death is reduced (*i.e.*, the reduction is allocated first to the most recent ETPs). Paragraph 306(4)(*a*) is renumbered as subsection 306(5). Paragraph 306(5)(*a*) preserves existing 306(4)(*a*) for purposes of policies issued before 2017.

Paragraph 306(5)(*b*) contains a new rule for policies issued after 2016. For post-2016 policies, if the benefit on death under a coverage under the policy, or the coverage's share of a fund value benefit, is reduced, the benefit on death of an ETP issued in respect of the coverage because of having failed the 8% growth limit test in new subparagraph 306(3)(*b*)(ii) or because of subparagraph 306(3)(*b*)(iii) is reduced by the least of three amounts: (i) the actual reduction in the benefit on death; (ii) the relevant ETP's benefit on death as otherwise determined ignoring the actual reduction in the benefit on death; and (iii) the portion if any of the actual reduction not applied to other ETPs issued, on or after the date of issue of the ETP, in respect of the coverage. This reduction is generally consistent with the approach taken to policies issued before 2017, except that, for post-2016 policies, the rule applies on a coverage basis.

ETP re-dating rule

Existing paragraph 306(4)(*b*) is an anti-avoidance rule that limits the ability to increase the savings in a policy several years after its issuance in circumstances in which savings were not contributed in earlier years of the policy. The rule applies if the accumulating fund of (*i.e.*, the savings in) a life insurance policy on its 10th or any subsequent policy anniversary exceed 250% of its savings on its third preceding policy anniversary. Where the rule applies, the policy is in effect treated as being re-issued, by having the issuance dates of each ETP associated with the policy re-dated to the later of that third preceding policy anniversary and the date on which the relevant ETPs were issued.

Paragraph 306(4)(*b*) is renumbered as subsections 306(6) and (7). The substance of the existing rule is generally maintained for all policies (*i.e.*, whether issued before 2017 or not), except for two new rules that relax the test for all policies. Specifically, the anti-avoidance rule will not apply at a time after 2016, even if the policy savings increase exceeds the 150% savings growth limit in the measurement period, unless the policy's accumulating fund at that time exceeds

- for policies issued before 2017, 3/20 of the total of the accumulating fund at that time in respect of each ETP issued in respect of the policy, and
- for policies issued after 2016, 3/8 of the total of the accumulating fund at that time in respect of each ETP issued in respect of a coverage under the policy.

The rule is also relaxed, after 2016, by providing that once the rule applies, it cannot apply again on the next six policy anniversaries.

New subsection 306(7) generally preserves the existing ETP issuance re-dating rule and clarifies that ETP issuance re-dating under the subsection does not apply for purposes of paragraph 306(4)(*a*) and subsection 306(5).

Saving provisions

Existing paragraph 306(4)(*c*) applies in respect of certain older policies issued before December 2, 1982. If, because of a transaction undertaken after December 1, 1982, the policy is required to be tested for exempt policy status, paragraph 306(4)(*c*) deems the policy to have been an exempt policy at all times prior to the first of those transactions undertaken after December 1, 1982. The rule ensures that the conditions in subsection 306(1) are satisfied in respect of that period. Paragraph 306(4)(*c*) is renumbered as subsection 306(9). For further information on a related amendment, see the commentary on subsection 306(10).

Existing paragraph 306(4)(*d*) provides for a 60-day grace period under which a policy, that fails the exemption test requirements under subsection 306(1) on a policy anniversary of the policy, can be "untainted" so as to restore its exempt policy status. Typically, during the grace period, cash would be withdrawn from the policy, or the policy's death benefit increased, to restore its status as an exempt policy. Paragraph 306(4)(*d*) is renumbered as subsection 306(8). Note that a policy that does not satisfy the exemption test requirements at the end of the grace period would be subject to a deemed disposition, under paragraph 148(2)(*d*) of the Act, at the time the policy ceased to be an exempt policy.

These amendments come into force on Royal Assent.

Clause 82

Accumulating Fund

ITR
307

Section 307 of the Regulations prescribes the meaning of "accumulating fund" for the purposes of Part III of the Regulations and sections 12.2 and 148 of the Act. The accumulating fund of a life insurance policy is used in measuring whether the policy is protection-oriented (*i.e.*, an exempt policy, as determined under section 306 of the Regulations) or savings-oriented (*i.e.*, a non-exempt policy). It is intended that life insurance policies that are savings-oriented be taxed on an annual basis at the policyholder level so that excessive savings in such a policy do not accumulate on a tax-free basis at the policyholder level.

Unless otherwise indicated in this commentary, a reference in the commentary to a policy issued after 2016, includes a policy issued before 2017 for which an issuance time after 2016 has been determined under subsection 148(11) of the *Income Tax Act*, and a reference to a policy issued before 2017 does not include a policy to which that subsection so applies.

ITR
307(1)

Paragraph 307(1)(*a*) of the Regulations defines the accumulating fund of a taxpayer's interest in an annuity contract not issued by a life insurer. Paragraph 307(1)(*a*) is amended to modernize its language.

Paragraph 307(1)(*b*) defines the accumulating fund of a taxpayer's interest in a life insurance policy, including an annuity contract issued by a life insurer. The computation of an accumulating fund under paragraph 307(1)(*b*) is made having regard to amounts determined under subsection 1401(1). The post-amble to paragraph 307(1)(*b*) is repealed because the assumptions contained in the post-amble are no longer required to compute the necessary amounts under section 1401 – those assumptions, which related to the application of section 1401 in an earlier context, are no longer applicable under the current law relating to the deducibility by life insurers of certain reserves under subsection 138(3) of the Act.

Paragraph 307(1)(*c*) defines the accumulating fund of an exemption test policy (ETP) issued in respect of a life insurance policy. The computation of an accumulating fund under paragraph 307(1)(*c*) is made having regard to amounts determined under paragraph 1401(1)(*c*) of the Regulations. Paragraph 307(1)(*c*) is amended to account for the new definitions "endowment date" and "pay period" in section 310 and to add a new rule for computing the accumulating fund of an ETP issued in respect of a coverage under a life insurance policy issued after 2016. For further information on the definitions "endowment date" and "pay period", see the commentary on section 310 of the Regulations.

For ETPs issued in respect of life insurance policies issued before 2017, subparagraph 307(1)(*c*)(i) and (ii), together with paragraph (*a*) of the definition "pay period", preserve the existing components of paragraph 307(1)(*c*) and subsection 307(4). These amendments render subsection 307(4) redundant and the subsection is repealed.

For life insurance policies issued after 2016, subparagraphs 307(1)(*c*)(i) and (ii), together with paragraph (*b*) of the definition "pay period", apply in determining the relevant ETP's accumulating fund. In addition, new subparagraph 307(1)(*c*)(iii) applies to assign to the relevant ETP at a particular time that is after the ETP's endowment date an accumulating fund equal to its benefit on death at the particular time. In cases where a life insurance policy is issued before 2017, but for which a deemed issuance date at a particular time after 2016 is determined by subsection 148(11) of the Act, the issue dates of ETPs in respect of the life insurance policy are preserved for ETPs issued before the particular time (i.e., the ETP issue dates for ETPs issued in respect of the policy before the particular time are as originally determined under subparagraphs 306(3)(*a*)(i) and (ii)) in determining at and after the particular time the accumulating funds of those ETPs.

In more general terms, the accumulating fund of an ETP at a particular time depends on whether the particular time at which the determination is made is during or after the ETP's pay period (*i.e.*, the period, as defined in section 310, over which premiums are assumed to be paid under the ETP). Existing subparagraph 307(1)(*c*)(i) provides that, if the particular time is after the ETP's pay period, its accumulating fund is equal to the present value of the future benefits provided by the ETP. New subparagraph 307(1)(*c*)(i) provides that, if the particular time is during the ETP's pay period, its accumulating fund will be equal to the product of the present value, calculated at the end of the pay period, of the future benefit on death of the ETP and the ratio of the number of years since its issuance and the number of years in its pay period.

Existing subparagraph 307(1)(*c*)(ii) provides that, if the particular time is during the ETP's pay period, its accumulating fund is equal to the product of the present value, calculated at the end of the pay period, of the future benefits provided by the ETP multiplied by the ratio of the number of years since its issuance to the number of years in its pay period. An ETP's pay period is calculated based on the age of the individual whose life is insured under the exemption test policy at its date of issue. New subparagraph 307(1)(*c*)(ii) provides that, if the particular time is after the ETP's pay period, its accumulating fund is to equal the present value at the particular time of the future benefit on death under the ETP.

These amendments come into force on Royal Assent.

Computing Accumulating Fund

ITR
307(2)

Subsection 307(2) of the Regulations contains rules that apply in computing the accumulating fund in respect of an interest in a policy and in respect of an ETP. The opening words of subsection 307(2) and paragraph 307(2)(*a*) are amended to modernize their structure.

Paragraphs 307(2)(*b*) and (*c*) contain rules that apply in computing an accumulating fund under paragraphs 307(1)(*b*) and (*c*), respectively. Paragraphs 307(2)(*b*) and (*c*) are amended to limit their application to amounts being determined in respect of life insurance policies issued before 2017. Paragraph 307(2)(*c*) is also amended to account for amendments to subsection 1401(1) and the introduction of the definition "endowment date" in section 310. It is also amended to clarify that the benefit on death of an ETP is calculated net of any portion related to a segregated fund. Finally, the rules in existing subsection 307(3) are moved to new subparagraph 307(2)(*c*)(iii) and the subsection is repealed.

New paragraph 307(2)(*d*) is added to provide rules of application for the purpose of calculating the accumulating fund of an ETP issued in respect of a coverage under a life insurance policy issued after 2016. The paragraph provides that the present value of the future benefit of death under an ETP issued in respect of a coverage is to be calculated using the mortality rates for the life (based on the age of the life at the issuance of the coverage) or lives jointly insured under the coverage and the interest rate determined under new subsection 1401(4) (*i.e.*, the mortality and interest rates used in respect of a coverage for the purpose of calculating the net premium reserve in respect of the relevant life insurance policy). New subparagraph 307(2)(*d*)(ii) clarifies that the benefit on death of an ETP is calculated net of any portion related to a segregated fund.

These amendments come into force on Royal Assent.

References to 1401

ITR
307(5)

Subsection 307(5) of the Regulations modifies certain provisions under section 1401 as they apply in determining an amount under section 307. Paragraph 307(5)(*c*) is repealed as a modified reading of the policy loan reference in paragraph 1401(1)(*c*) is no longer needed in determining an amount under section 307. This amendment is consequential on amendments to subsection 1401(1).

This amendment comes into force on Royal Assent.

Clause 83

Net Cost of Pure Insurance

ITR
308

Section 308 of the Regulations contains rules for computing the net cost of pure insurance (NCPI) for a year in respect of a taxpayer's interest in a life insurance policy. NCPI for a year generally measures the annual cost associated with the insurance component under a policy or the net premium that would be payable for a one-year insurance with a benefit on death equal to the net amount at risk under the policy (*i.e.*, the difference between the benefit on death and the savings of the policy).

Unless otherwise indicated in this commentary, a reference in the commentary to a policy issued after 2016, includes a policy issued before 2017 for which an issuance time after 2016 has been determined under subsection 148(11) of the *Income Tax Act*, and a reference to a policy issued before 2017 does not include a policy to which that subsection so applies.

Net Cost of Pure Insurance and Mortality Gains and Losses

ITR
308(1) to (1.2)

Subsection 308(1) of the Regulations provides that the NCPI for a year in respect of a taxpayer's interest in a policy is calculated as the product of the probability of death in the year of a life insured under the policy multiplied by the net amount at risk in respect of the taxpayer's interest in the policy at the end of the year. The probability of death in a year is calculated based on the 1969-75 mortality tables of the Canadian Institute of Actuaries published in Volume XVI of the *Proceedings of the Canadian Institute of Actuaries* and the relevant characteristics of the life insured under the policy. The net amount at risk in respect of a taxpayer's interest in a policy at the end of a year is calculated as the difference between the benefit on death in respect of the interest at the end of the year and the accumulating fund (as defined in section 307 and calculated ignoring policy loans) or the cash surrender value in respect of the interest at the end of the year depending on the method regularly followed by the life insurer in computing the net cost of insurance.

Subsection 308(1.1) provides that for a particular class of life insurance policy where pricing does not depend on smoking or sex status, the probability of death in a year may be determined using mortality rates other than the rates in subsection 308(1) to the extent these rates would result in a net cost of pure insurance that is equal to the expected value of the net cost of pure insurance using the aggregated mortality tables described in subsection 308(1).

Subsection 308(1) is amended to introduce new rules for policies issued after 2016. For policies issued before 2017, the current rules are preserved in paragraph 308(1)(*a*) and subsection 308(1.1). Subsection 308(1.1) is amended to refer to paragraph 308(1)(*a*).

For policies issued after 2016, paragraph 308(1)(*b*) provides that the NCPI of an interest in a policy is equal to the sum of the interest's net cost of pure insurance in respect of each coverage under the policy. A coverage's

NCPI in respect of an interest for a year is equal to the product of the probability of death of the life or lives jointly insured in a year under the coverage multiplied by the coverage's net amount at risk in respect of the interest at the end of the year. The probability of death is calculated based on the mortality rates used for the purpose of calculating present values in respect of the coverage for calculating the net premium reserve in respect of the life insurance policy for the purposes of paragraph 1401(1)(*c*) or based on the rule in new subsection 308(1.2).

The net amount at risk of a coverage in respect of an interest at the end of a year is calculated as the difference between the benefit on death of the coverage in respect of the interest at the end of the year and the coverage's net premium reserve that would have been calculated in respect of an interest on the last policy anniversary that is on or before the last day of the year if the benefit on death under the coverage and the fund value of the coverage were equal to the benefit on death under the coverage and the fund value of the coverage at the end of the year. The coverage's net premium reserve on that policy anniversary is equal to the total of variables A and C of the definition "net premium reserve" calculated for the purposes of the exemption test in subsection 1401(3).

Subsection 308(1.2) provides that for a life insurance policy issued after 2016 where pricing does not depend on smoking or sex status, the probability of death in a year may be determined using mortality rates other than the rates in paragraph 308(1)(*b*) to the extent these rates would result in a net cost of pure insurance that is equal to the expected value of the net cost of pure insurance using the aggregated mortality tables described in subsection 1401(4).

These amendments come into force on Royal Assent.

Clause 84

Interpretation

ITR
310

Section 310 of the Regulations defines a number of terms for the purposes of sections 300, 301 and 304 to 310. Section 310 is amended to add a number of new definitions and to amend the definition "benefit on death". These amendments come into force on Royal Assent.

Unless otherwise indicated in this commentary, a reference in the commentary to a policy issued after 2016, includes a policy issued before 2017 for which an issuance time after 2016 has been determined under subsection 148(11) of the *Income Tax Act*, and a reference to a policy issued before 2017 does not include a policy to which that subsection so applies.

"adjusted purchase price"

The definition "adjusted purchase price" replaces the same definition found in current paragraph 300(2)(*b*). That paragraph is repealed and its contents moved to this definition in section 310.

"benefit on death"

The definition "benefit on death" excludes both policy dividends (including related interest) held on deposit by an insurer and amounts payable as a result of accidental death. The definition is amended to instead incorporate by reference the new definition "benefit on death" in subsection 1401(3). For further information, see the commentary on subsection 1401(3).

"coverage"

The new definition "coverage" is relevant in applying sections 306, 307 and 308 to life insurance policies issued after 2016. In respect of these policies, certain determinations under those sections are made in respect of the coverages under a policy, and not in respect of the policy as a whole. For the purposes of section 306, coverage under a life insurance policy means all life insurance, other than a fund value benefit, under the policy in respect of a specific life, or two or more specific lives jointly insured.

For the purposes of section 307 and 308, coverage under a life insurance policy has the meaning assigned by subsection 1401(3) of the Regulations. Under that subsection, coverage means each life insurance, other than a fund value benefit, that is

- in respect of a specific life, or two or more specific lives jointly insured under a policy, and
- subject to a particular schedule of premium or cost of insurance rates

“endowment date”

Each exemption test policy (ETP) issued in respect of a life insurance policy has an endowment date. The ETP’s endowment date represents a presumption of the latest time at which the ETP’s benefit on death will become payable. This time is factored into the calculation of the ETP’s accumulating fund, as determined under paragraph 307(1)(*c*).

Paragraph (*a*) of the new definition “endowment date” incorporates, for life insurance policies issued before 2017, the rules found in existing subparagraph 306(3)(*d*)(ii) with some adjustments. Under that paragraph, the endowment date of an ETP issued in respect of an actual policy issued before 2017 is the later of two dates: (i) the date that is ten years after date of issue of the actual policy; and (ii) the first policy anniversary that is on or after the day on which the individual whose life is insured under the policy would, if the individual survived, attain the age of 85 years.

Paragraph (*b*) of the definition sets out the endowment date of an ETP in respect of a coverage under a life insurance policy issued after 2016. For these policies, the endowment date of ETPs issued in respect of the coverage is generally the later of two dates: (i) the date that is 15 years after date of issue of the ETP; and (ii) the first policy anniversary that is on or after the day on which the individual whose life is insured under the coverage would, if the individual survived, attain the age of 90 years. A special rule is in place for an insured life of an individual who is over 90 years of age at the time the ETP is issued – in this case, the relevant ETP’s endowment date is the first policy anniversary that is on or after the day on which the individual would, if the individual survived, attain the age of 105 years. Another special rule applies if the coverage under the policy is for two or more lives jointly insured – in this case, the relevant ETP’s endowment date is the day that would be determined under the general rule described above, but using the equivalent single age that reasonably approximates under actuarial principles the mortality rates of the lives jointly insured.

For further information on related amendments, see the commentary on paragraphs 306(1)(*b*) and 307(1)(*c*) and subsection 307(2).

“fund value benefit”

The new definition “fund value benefit” incorporates by reference the new definition “fund value benefit” in subsection 1401(3). For further information, see the commentary on subsection 1401(3).

“fund value of a coverage”

The new definition “fund value of a coverage” incorporates by reference the new definition “fund value of a coverage” in subsection 1401(3). For further information, see the commentary on subsection 1401(3).

“pay period”

Each exemption test policy (ETP) issued in respect of a life insurance policy has a pay period. The pay period is relevant to determining the ETP’s accumulating fund (*i.e.*, savings). For further information on a policy’s accumulating fund, see the commentary on section 307.

Paragraph (*a*) of the new definition “pay period” incorporates, for life insurance policies issued before 2017, the rules found in existing paragraph 307(1)(*c*) and subsection 307(4). For these policies, the pay period of the relevant ETPs is, subject to two exceptions, the 20-year period that begins on the ETP's date of issue (as determined under new paragraph 306(3)(*a*)). The first exception applies if, on that date, the individual whose life is insured has attained the age of 75 years – in this case, the pay period is instead the 10-year period that starts on that date. The second exception applies if, on that date, the individual whose life is insured has attained the age of 66 years but not 75 years – in this case, the pay period is the period that starts on that date and lasts for the numbers of years obtained when the numbers of years by which the individual's age on that date exceeds 65 is subtracted from 20.

Paragraph (*b*) of the definition sets out the pay period of an ETP issued in respect of a coverage under a life insurance policy issued after 2016. The general rule for these policies is that the pay period is the eight-year period that starts on the date of issue of the relevant ETP. Two exceptions apply. The first applies if the coverage is for a single insured life and the individual whose life is insured under the coverage would, if the individual survived, attain the age of 105 years within the eight-year period that starts on the date of issue of the relevant ETP – in this case, the ETP's pay period is the period that starts on that date and that ends on the first policy anniversary that is on or after the day on which the individual would, if the individual survived, attain the age of 105 years. The second exception applies if two or more lives are jointly insured under the coverage in respect of which the relevant ETP is issued and an individual of an age equal to the equivalent single age on the date of the issue of the coverage would, if the individual survived, attain the age of 105 years within the eight-year period that starts on the date of issue of the ETP – in this case, the ETP's pay period is the period that starts on that date and that ends on the first policy anniversary that is on or after the day on which the individual of an equivalent single age would, if the individual survived, attain the age of 105 years.

Clause 85

Capital Cost Allowance – Interpretation

ITR
1104

Section 1104 of the Regulations sets out various definitions that apply for the purpose of determining the capital cost allowance (CCA) for a taxation year in respect of a depreciable property of a taxpayer.

Section 1104 is amended consequential on the amendments made to classes 43.1 and 43.2 to expand eligibility to include water-current energy equipment and equipment used to gasify eligible waste fuel for use in a broader range of applications.

Classes 43.1 and 43.2 – Energy Conservation Property

ITR
1104(13)

Subsection 1104(13) of the Regulations sets out various definitions that apply for the purposes of Class 43.1 (30% CCA rate per year on a declining-balance basis) and Class 43.2 (50% CCA rate on a declining-balance basis) of Schedule II to the Regulations.

Subsection 1104(13) is amended to add the new definition "producer gas". Producer gas means fuel the composition of which, excluding its water content, is all or substantially all non-condensable gases that is generated primarily from eligible waste fuel using a thermo-chemical conversion process and that is not generated using any fuels other than eligible waste fuel or fossil fuel. The new definition is relevant for the purposes of determining whether the equipment is eligible for inclusion in Class 43.2 because it is described in clause (*c*)(i)(A), subparagraph (*d*)(ix) or new subparagraph (*d*)(xvi) of Class 43.1 of Schedule II to the Regulations.

The new definition "producer gas" comes into force on February 11, 2014.

ITR
1104(17)(*a*)

Subsection 1104(17) of the Regulations requires environmental compliance in respect of certain properties before those properties can be included in Class 43.1 or Class 43.2 in Schedule II. Class 43.1 provides for an accelerated capital cost allowance (CCA) rate of 30% and Class 43.2 provides for a temporary accelerated CCA rate of 50% for certain Class 43.1 properties acquired before 2020.

Subsection 1104(17) prevents the inclusion of the capital cost of certain property in Class 43.1 or Class 43.2 of Schedule II if the property is not in compliance with environmental laws, by-laws and regulations at the time when the property becomes available for use. The subsection applies to property that would otherwise be included in subparagraph (*c*)(i) of Class 43.1 or is described in any of subparagraphs (*d*)(viii), (ix), (xi) and (xiii) of Class 43.1 and paragraph (*a*) of Class 43.2. Property is not in compliance if at the time the property becomes available for use by the taxpayer, the taxpayer has not satisfied the requirements of all environmental laws, by-laws and regulations of Canada, a province or a municipality in Canada, or of a municipal or public body performing a function of government in Canada, applicable in respect of the property.

If a property is excluded from Class 43.1 or Class 43.2 because of new subsection 1104(17), the property may be included in the CCA class that would otherwise apply to that property.

Paragraph 1104(17)(*a*) is amended to add references to subparagraphs (*d*)(xiv) and (xvi) of Class 43.1 to Schedule II to ensure that the requirement for environmental compliance also applies to property described in those paragraphs. This amendment is consequential on amendments to subparagraph (*d*)(xiv) of Class 43.1 to Schedule II to include water-current energy equipment (*i.e.*, equipment used to generate electricity using kinetic energy of flowing water, otherwise than by diverting or impeding the natural flow of the water or by using physical barriers or dam-like structures) and the introduction of new subparagraph (*d*)(xvi) of Class 43.1 of Schedule II to include equipment used primarily for the purpose of generating producer gas by gasifying eligible waste fuels.

This amendment applies to property acquired after February 10, 2014.

Clause 86

Insurance Business Policy Reserves

Part XIV

Part XIV of the Regulations provides rules in respect of insurance business policy reserves.

Unless otherwise indicated in this commentary, a reference in the commentary to a policy issued after 2016, includes a policy issued before 2017 for which an issuance time after 2016 has been determined under subsection 148(11) of the *Income Tax Act*, and a reference to a policy issued before 2017 does not include a policy to which that subsection so applies.

Policy Reserves

ITR
1401(1)

Section 1401 of the Regulations applies in determining certain amounts for the purpose of calculating a life insurer's Canadian life investment income for the purposes of Part XII.3 of the Act. Section 1401 also applies for the purpose of calculating a life insurance policy's accumulating fund in section 307. For further information, see the commentary on section 307 and subsections 1401(3), (4) and (5) of the Regulations and the definition "adjusted cost basis" in subsection 148(9) of the Act.

Paragraphs 1401(1)(*a*), (*b*), (*c.1*) and (*d*) are amended to clarify the time of the making of determinations under those paragraphs and to update those provisions. Paragraph 1401(1)(*c*) and subsection 1403(1) are amended, and subsections 1401(3), (4) and (5) are added, to provide new rules for policies issued after 2016. Paragraph

1401(5)(*b*) and subsection 148(11) of the Act may apply in certain circumstances to a policy otherwise issued before 2017 to determine the time at which the policy is issued or whether life insurance issued under the policy is deemed to be separate policy for purposes of the new rules.

For life insurance policies issued before 2017 and annuity contracts, the amount determined under paragraph 1401(1)(*c*) in respect of a life insurance policy remains, in general terms, the greater of the policy's cash surrender value (as defined in subsection 1408(1)) and the reserve component in respect of the policy. The cash surrender value component measures the savings accessible upon the surrender of the policy. The reserve component measures the savings accumulating in respect of future benefits under the policy. The reserve component is equal to the difference between the present value of future benefits and the present value of future modified net premiums (the modified net premium reserve). Modified net premiums, as defined in subsection 1408(1), generally refers to the portion of premiums corresponding to the benefits (*i.e.*, premiums net of expenses and loading or net premiums) adjusted to take into account policy acquisition costs in the early policy years.

For life insurance policies (other than annuity contracts) issued after 2016, paragraph 1401(1)(*c*) is amended to provide that the cash surrender value component will be calculated without taking into account charges (*i.e.*, surrender charges) that are applicable on the surrender of a policy. In addition, the reserve component of the paragraph as it applies to these policies is computed by reference to the net premium reserve in respect of the policy. The net premium reserve component is, in general terms, equal to the difference between the present value of future benefits and the present value of future net premiums with relevant adjustments to account for policies where premiums are not fixed and determined. The net premium reserve component is to be calculated using the assumptions and other rules found in subsection 1401(4). Subsection 1401(5) provides specific rules and assumptions for the calculation of both the cash surrender value and net premium reserve components for the purposes of Part XII.3 of the Act. In addition, subsection 1401(5) provides transitional rules for Part XII.3 purposes in respect of policies issued before 2017. The commentary on those subsections and subsection 1401(3) contains more information on the net premium reserve component of paragraph 1401(1)(*c*).

These amendments come into force on Royal Assent.

Definitions

ITR
1401(3)

New subsection 1401(3) of the Regulations contains definitions that apply for the purpose of calculating the amount determined under paragraph 1401(1)(*c*) for a life insurance policy (other than an annuity contract) issued after 2016. Some of these definitions also apply for the purposes of the exemption test in section 306 of the Regulations, the calculation of the net cost of pure insurance under section 308 of the Regulations and the determination under section 148 of the Act of the tax treatment of a disposition of an interest in a life insurance policy. Paragraph 1401(5)(*b*) and subsection 148(11) of the Act may apply to determine in certain circumstances to a policy otherwise issued before 2017 to determine the time at which the policy is issued or whether life insurance issued under the policy is deemed to be separate policy for purposes of those provisions.

New subsection 1401(3) comes into force on Royal Assent.

"benefit on death"

A benefit on death ordinarily includes an amount payable on the death of a life insured. The definition "benefit on death" excludes from this meaning any additional amount payable as a result of an accidental death. The definition also extends the meaning to include an endowment benefit (*i.e.*, a benefit payable upon the survival of the life insured at a specified age). A benefit on death does not include an amount held on deposit by an insurer and associated interest income (including policy dividends left on deposit with an insurer) if the interest income is included in the income of a policyholder under Part I of the Act.

For the purposes of paragraph 1401(1)(*c*), the definition “benefit on death” is relevant to defining the vector of benefits on death in respect of a coverage under a life insurance policy (see the definition “future benefits to be provided”, and a number of other definitions, in subsection 1401(3)). The definition “benefit on death” also applies, because of section 310, for a number of purposes in Part III of the Regulations.

“coverage”

For a life insurance policy (other than an annuity contract) issued after 2016, the reserve component of the amount determined under paragraph 1401(1)(*c*) (*i.e.*, the net premium reserve) includes three separate elements, two of which are calculated based on amounts determined for each coverage under the policy.

A coverage means each life insurance, other than a fund value benefit, that is

- in respect of a specific life, or two or more specific lives jointly insured under a policy, and
- subject to a particular schedule of premium or cost of insurance rates.

A coverage includes the benefits on death that are payable under the coverage, the premium or cost of insurance rates payable or chargeable under the coverage, the fund value that is used to determine the net amount at risk under the coverage and the net amount at risk, if any, during the period over which the coverage will be in effect.

“fund value benefit”

The fund value benefit under a life insurance policy at any time is the difference, if any, between the policy’s fund value (as defined in subsection 1401(3)) and the total of all amounts each of which is the fund value of a coverage (as defined in subsection 1401(3)) under the policy. The fund value benefit corresponds to the portion of the fund value of a life insurance policy that increases the benefit on death and does not reduce the net amount at risk in respect of any coverage under the policy.

Fund value benefit is relevant for life insurance policies (other than an annuity contract) issued after 2016. For the purposes of paragraph 1401(1)(*c*), the fund value benefit is relevant to computing the net premium reserve in respect of a policy. The net premium reserve in respect of policy includes three elements, one of which (the amount for variable B of the formula in the definition “net premium reserve”) is calculated by reference to the fund value benefit. The definition “fund value benefit” also applies, because of section 310 of the Regulations, for the purposes of subsections 306(4) and (5) of the Regulations and for the purposes of paragraph 148(2)(*e*) and the definition “adjusted cost basis” in subsection 148(9) of the Act. For further information, see the commentary on those provisions.

“fund value of a coverage”

The fund value of a coverage is relevant for a life insurance policy (other than an annuity contract) issued after 2016. The fund value of a coverage under a life insurance policy is calculated by adding the portion of each investment account, in respect of the policy, that reduces the net amount at risk under the coverage for the purpose of calculating the cost of insurance charges of the coverage that will be deducted from one or more investment accounts under the policy during the period over which those costs are chargeable or would be chargeable if cost of insurance charges were to apply until the termination of the coverage. The fund value of a coverage corresponds to the portion of the fund value of a life insurance policy that does not increase the benefit on death but instead reduces the net amount at risk under any coverage (*i.e.*, the difference between a coverage’s benefit on death and the coverage’s fund value) under the policy. Fund value of a coverage under a life insurance policy is relevant to applying the definitions “fund value benefit”, “future benefits to be provided”, “future premiums or cost of insurance charges” and “net premium reserve” in subsection 1401(3).

“fund value of a policy”

The fund value of a policy is relevant for a life insurance policy (other than an annuity contract) issued after 2016. The fund value of a policy at any time is the total at that time of all investment accounts in respect of the policy. The fund value of a policy is calculated by adding the amount of each investment account in respect of the policy. For greater certainty, the fund value of a policy includes an amount held on deposit by an insurer and associated interest income if the interest income is not included in the income of a policyholder under Part I of the Act and excludes an amount held on deposit by an insurer and associated interest income if the interest income is included in the income of a policyholder under Part I of the Act. The definition “fund value of a policy” applies for the purposes of the definition “fund value benefit”.

“future benefits to be provided”

Future benefits to be provided in respect of a coverage is relevant for a life insurance policy (other than an annuity contract) issued after 2016. Future benefits to be provided in respect of a coverage at any time means the vector comprised of each of the benefits on death that would become payable at a particular time that is after that time under the coverage depending on the time of death of the life or lives jointly insured under the coverage.

If a coverage has a fund value at the time at which the future benefits to be provided are determined, the benefit on death payable at a particular time that is after that time is equal to the net amount at risk in respect of a coverage at that time (*i.e.*, the difference between the coverage’s benefit on death at that time and the coverage’s fund value at that time). If a coverage does not have a fund value at the time at which the future benefits to be provided are determined, the benefit on death payable at a particular time after that time is determined based on the terms of the policy at that time.

“future net premiums or cost of insurance charges”

Future net premiums or cost of insurance charges in respect of a coverage is relevant for a life insurance policy (other than an annuity contract) issued after 2016. The definition “future net premiums or cost of insurance charges” in respect of a coverage applies in determining the amount for variable C of the formula in the definition “net premium reserve” in subsection 1401(3). A coverage’s future net premiums or cost of insurance charges at any time corresponds to the vector comprised of each future net premium or cost of insurance that would become payable or chargeable at a particular time after that time if the life or lives jointly insured under the coverage survived until the particular time.

Specifically, under paragraph (*a*) of the definition, for the purpose of determining an amount under paragraph 1401(1)(*c*) in calculating the accumulating fund of a life insurance policy, a coverage’s vector of future net premiums or cost of insurance charges at any time is calculated by prorating its vector of future premiums or cost of insurance at that time (*i.e.*, each future net premium or cost of insurance payable or chargeable at a particular time after that time). Prorating applies based on the ratio of the present value of the coverage’s future benefits to be provided on its date of issue to the present value of the coverage’s future premiums or cost of insurance charges on the coverage’s date of issue.

Under paragraph (*b*) of the definition, for the purpose of determining an amount under paragraph 1401(1)(*c*) in calculating Canadian life investment income under Part XII.3 of the Act, a coverage’s vector of future net premiums or cost of insurance charges is calculated by prorating its vector of future premiums or cost of insurance charges based on the prorating used for determining the “modified net premium” relevant to policies issued before 2017. For Part XII.3 purposes, for policies other than annuities issued after 2016, the modified net premium approach will continue to be used in determining the reserve component under paragraph 1401(1)(*c*).

“future premiums or cost of insurance charges”

Future net premiums or cost of insurance charges in respect of a coverage is relevant for a life insurance policy (other than an annuity contract) issued after 2016. The definition “future premiums or cost of insurance charges” in respect of a coverage applies for the purposes of the definition “future net premiums or cost of insurance charges” in respect of a coverage.

Future premiums or cost of insurance charges in respect of a coverage at any time means the vector comprised of each future premium or cost of insurance in respect of the coverage that would be payable or chargeable against an investment account under the policy, as the case may be, at a particular time after that time if the life or lives jointly insured under the coverage survive until the particular time. The vector of future premiums or cost of insurance charges includes the amount of each future premium or cost of insurance charge and the time at which the premium or cost of insurance would become payable or chargeable, as the case may be.

If a coverage has a fund value at the time future premiums or cost of insurance charges are determined, its vector of future premiums or cost of insurance charges at that time is determined assuming that the net amount at risk at a particular time after that time is equal to the coverage's net amount at risk at that time (*i.e.*, the difference between its benefit on death at that time and its fund value at that time). If a coverage does not have a fund value at the time future premiums or cost of insurance charges are determined, its vector of future premiums or cost of insurance charges will be determined based on the terms of the policy at that time.

"interpolation time"

The interpolation time of a coverage is relevant for a life insurance policy (other than an annuity contract) issued after 2016.The interpolation time of a coverage is the earlier of the time that is eight years after the date of issue of the coverage, and the first time after which no premiums are payable or costs of insurance chargeable in respect of the coverage. The interpolation time of a coverage applies in determining at any time the amount for variable C of the formula in the definition "net premium reserve" in subsection 1401(3) as it applies for the purpose of calculating the accumulating fund of a life insurance policy. The determination at any time of variable C of that formula depends upon whether that time is before the interpolation time of the coverage or not.

"net premium reserve"

The net premium reserve of a policy is the reserve component determined under paragraph 1401(1)(*c*) in respect of the policy if the policy is issued after 2016 and is not an annuity contract. Policies issued before 2017 and annuity contracts continue to use the modified net premium reserve, as determined in existing paragraph 1401(1)(*c*), in determining the reserve component determined under that paragraph. In cases where a life insurance policy is issued before 2017, but for which a deemed issuance date at a particular time after 2016 is determined by subsection 148(11) of the Act, the net premium reserve of the policy is to be used as the reserve component in determining at and after the particular time the policy's accumulating fund, and for this purpose the policy's original issuance date is to be used.

The net premium reserve in respect of a life insurance policy at any time equals the total of three elements calculated at that time, being variables A, B and C of the formula in the definition.

For a life insurance policy with a fund value, at the time the net premium reserve is calculated, variables A and B capture the reserve associated with the fund value of the policy at that time. Variable A represents the reserve associated with the fund value of all coverages under the policy. The present value of the fund value of a coverage is calculated as if the fund value were a benefit on death issued on the life, or lives jointly, insured under the coverage. Variable B represents the reserve associated with the portion of the fund value of a policy that is not a fund value of a coverage (*i.e.*, the reserve associated with the fund value benefit). Variable B equals the fund value benefit at that time.

Variable C calculates the reserve associated with the portion of a policy's benefit on death that is not paid from the fund value of the policy. It is equal to the total of the reserve in respect of the portion of a coverage's benefit on death that is not paid from the fund value of the coverage. The reserve in respect of the portion of a coverage's benefit on death that is not paid from the fund value of the coverage is calculated using two set of rules that apply depending on whether the amount is calculated for the purposes of calculating the accumulating fund in respect of a policy or Canadian life investment income under Part XII.3 of the Act.

For the purpose of calculating the accumulating fund in respect of a policy, if the time at which variable C is calculated is at or after the interpolation time, variable C is equal to the difference between the present value of the coverage's future benefits to be provided at that time and the present value of the coverage's future net premiums or cost of insurance charges at that time. If the time at which variable C is calculated is before the interpolation time, variable C is calculated by prorating the amount that would be determined at the interpolation time for variable C. In addition, if the coverage has a fund value at the time variable C is calculated, the amount for variable C that would be determined at the interpolation time is calculated as if the benefit on death at the interpolation time were equal to the net amount at risk at the time variable C is calculated. Prorating is applied based on the ratio of the number of years that the coverage has been in effect at the time variable C is calculated and the number of years that the coverage would have been in effect at the interpolation time.

For the purpose of calculating Canadian life investment income under Part XII.3 of the Act, variable C at any time equals the difference between the present value of the coverage's future benefits to be provided at that time and the present value of the coverage's future net premiums or cost of insurance charges at that time. The coverage's future net premiums or cost of insurance charges are generally calculated based on the existing definition "modified net premium" in subsection 1408(1) and existing mortality, lapse and interest rates in section 1403.

"policy anniversary"

The definition "policy anniversary" incorporates by reference the existing definition "policy anniversary" in subsection 310(1). Under that definition, the ordinary meaning of policy anniversary is extended to assign, to certain policies that do not otherwise have a policy anniversary in the relevant calendar year, a policy anniversary that is the end of that calendar year. The expression policy anniversary is used in new paragraph 1401(4)(*c*). For further information, see the commentary on subsection 1401(4).

Accumulating Fund

ITR
1401(4)

New subsection 1401(4) of the Regulations provides rules for the purpose of determining an amount under paragraph 1401(1)(*c*) in respect of the calculation of the accumulating fund, as determined under section 307, in respect of a life insurance policy (other than an annuity contract) issued after 2016. Subsection 148(11) of the Act may apply to determine the time at which a particular policy is issued for purposes of subsection 1401(4).

Paragraph 1401(4)(*a*) provides that present values are to be calculated using an annual interest rate of 3.5% and mortality rates in respect of the life or lives jointly insured under a coverage are to be factored into the calculation of the present value. Paragraph 1401(4)(*b*) sets out a number of rules for determining mortality rates in respect of a life or lives jointly insured under a coverage. Under subparagraph 1401(4)(*b*)(i), for a life that is not jointly insured with other lives and is not a substandard life, the mortality rates in respect of the life are calculated based on the age of the life that is nearest or last to the date of issue of the coverage, depending on the pricing methodology used by the issuer of the policy, and on the *Proposed CIA Mortality Tables, 1986-1992* included in the *May 17, 1995 Canadian Institute of Actuaries Memorandum*, extended to include select mortality rates from age 81 to age 90 developed using the methodology used by the Canadian Institute of Actuaries to derive select mortality rates from age 71 to age 80.

The mortality tables used for a particular life insured should be those corresponding to the characteristics of the life insured. For example, if the life is insured is a female and smoker, the mortality table corresponding to a smoking female is to be used. If a life is not jointly insured with other lives and is a substandard life, the mortality rates would, depending on the method used by the insurer for the purpose of determining the premium or cost of insurance rates in respect of the coverage, be determined by: (i) multiplying the mortality rates that would be otherwise determined if the life were a standard life by the rating attributed to the life insured (but the grossed up mortality rates can never exceed one); or (ii) using the mortality rates that would have been determined had the life insured been a standard life and the age of the life insured been the age used by the insurer for the purpose of determining the premium or cost of insurance rates in respect of the coverage.

When the coverage is underwritten, select and ultimate mortality rates associated with the age of the life insured at issuance from the relevant mortality table are to be used. Under subparagraph 1401(4)(*b*)(ii), for lives that are jointly insured under a coverage, the joint mortality rates are calculated based on the *Proposed CIA Mortality Tables, 1986-1992* included in *the May 17, 1995 Canadian Institute of Actuaries Memorandum*, extended to include select mortality rates from age 81 to age 90 developed using the methodology used by the Canadian Institute of Actuaries to derive select mortality rates from age 71 to age 80 and using the pricing methodology of the issuer of the policy.

Paragraph 1401(4)(*c*) provides a rule for calculating the present value of future net premiums or cost of insurance charges. Future net premiums or cost of insurance charges means the vector of future net premiums or cost of insurance charges, including the time of payment or charge, as the case may be, of each future net premium or cost of insurance charge, which (ignoring the paragraph) corresponds to the time of payment or charge of each future premium or cost of insurance charge. If the time of payment or charge of a future premium or cost of insurance charge is a policy anniversary, paragraph 1401(4)(*c*) deems the time to be one day after the policy anniversary.

New subsection 1401(4) comes into force on Royal Assent.

Canadian Life Investment Income

ITR
1401(5)

New subsection 1401(5) of the Regulations provides rules for determining an amount under paragraph 1401(1)(*c*) for the purpose of calculating an insurer's Canadian life investment income under Part XII.3 of the Act in respect of a life insurance policy other than an annuity contract.

Paragraph 1401(5)(*a*) applies to policies issued after 2016. Subsection 148(11) of the Act does not apply to determine the time at which a policy is issued for this purpose. However, paragraph 1401(5)(*b*) applies to policies issued before 2017 in circumstances similar to those to which subsection 148(11) of the Act applies.

Subparagraph 1401(5)(*a*)(i) requires that present value calculations required for determining an amount under paragraph 1401(1)(*c*) in respect of a coverage under a life insurance policy are to be made using the rates of interest, mortality and lapse defined under section 1403. For this purpose, section 1403 is to be read without regard to the adjustments provided under subsections 1403(2) to (8); in addition, the rates referred to under paragraph 1403(1)(*e*) are to be the rates used by the insurer in determining the premiums or cost of insurance charges in respect of the coverage. Specifically, if there are no fixed and determined premiums in respect of a coverage, the rates to be used are those used for determining the cost of insurance rates of the coverage. If the coverage is one where premiums are fixed and determined, the rates to be used are those used for determining the premium rates of the coverage.

Subparagraph 1401(5)(*a*)(iii) provides a rule for calculating the present value of future net premiums or cost of insurance charges. Future net premiums or cost of insurance charges means the vector of future net premiums or cost of insurance charges, including the time of payment or charge, as the case may be, of each future net premium or cost of insurance charge which (ignoring the subparagraph) will correspond to the time of payment or charge of each future premium or cost of insurance charge. If the time of payment or charge of a future premium or cost of insurance charge is a policy anniversary, subparagraph 1401(5)(*a*)(iii) deems the time to be one day after the policy anniversary.

Paragraph 1401(5)(*b*) deems certain life insurance under a policy issued before 2017, and not otherwise subject to the new rules for policies issued after 2016, to be a separate life insurance policy issued at a particular time. The paragraph applies if the particular time is after 2016 and life insurance – in respect of a life or two or more lives jointly insured and in respect of which a particular schedule or premiums or cost of insurance rates applies – is converted (other than only because of a change in premium or cost of insurance rates) into another type of life insurance or is added to the policy. The rule does not apply if the insurance is part of a rider that is deemed by subsection 211(2) of the Act to be a separate life insurance policy. The rule also does not apply, in the case of insurance added to the policy, if the added insurance is:

- medically underwritten before 2017;
- medically underwritten to obtain a reduction in the premium or cost of insurance rates under the policy;
- paid for with policy dividends; or
- reinstated.

For further information, see the commentary on paragraph 1401(1)(*c*) and on subsection 148(11) of the Act.

New subsection 1401(5) comes into force on Royal Assent.

Clause 87

Assumptions in Applying Paragraph 1401(1)(*c*)

ITR
1403(1)

Subsection 1403(1) of the Regulations contains rules that apply for purposes of paragraph 1401(1)(*c*) in determining the amount of a modified net premium or an amount determined by an insurer under that paragraph.

Subsection 1403(1) is amended so that it generally does not apply to life insurance policies issued after 2016, unless the policy is an annuity contract. Subsection 148(11) of the Act may apply in certain circumstances, except as noted below, to determine the time at which a policy is issued for purposes of subsection 1403(1).

Under a special rule contained in subsection 1401(5), the rules in subsection 1403(1) remain relevant in applying paragraph 1401(1)(*c*) for the purposes of subsection 211.1(3) of the Act in respect of policies issued after 2016. For this purpose, subsection 148(11) of the Act does not apply. Instead, paragraph 1401(5)(*b*) may apply to treat a new insurance under a policy issued before 2017 to be a separate policy issued at a particular time after 2016. For further information, see the commentary on paragraph 1401(1)(*c*) and subsection 1401(5), and on subsection 148(11) of the Act.

This amendment comes into force on Royal Assent.

Clause 88

Interpretation

ITR
5907

Subsection 5907 of the Regulations provides definitions and rules of interpretation for the purposes of Part LIX of the Regulations and also prescribes certain rules for particular foreign affiliate provisions of the Act.

ITR
5907(1)

Subsection 5907(1) of the Regulations provides definitions for the purposes of Part LIX of the Regulations. A number of these definitions are amended.

"earnings"

The definition "earnings" is relevant for the purpose of computing the surpluses and deficits of a foreign affiliate. Subparagraph (*a*)(iii) of the definition "earnings" provides that earnings of a foreign affiliate of a taxpayer resident in Canada for a taxation year from an active business means the amount that would be the affiliate's income from the active business for the year under Part I of the Act if the business were carried on in Canada, the foreign affiliate were resident in Canada and the Act were read without reference to certain provisions of the Act. The subparagraph applies only where the affiliate is not required by the income tax law of the country in which it is resident, or carries on the business, to compute the income or profits from the active business.

Subparagraph (*a*)(iii) is amended to add a reference to subsection 18(4) so that in determining the amount that would be the foreign affiliate's income from an active business, the Act is to be read without reference to the thin capitalization rules in subsection 18(4).

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013. A taxpayer may also elect to have this amendment apply in respect of earlier taxation years.

"exempt earnings"

The definition "exempt earnings" is relevant for the purpose of computing the exempt surplus and exempt deficit of a foreign affiliate.

This definition is amended in three respects. First, the portion of paragraph (*a*) of the definition "exempt earnings" after subparagraph (iii) is repealed because it is no longer relevant following the introduction of the "hybrid surplus" and "hybrid deficit" concepts, which are defined in this subsection and generally include capital gains (other than the taxable portion of a gain that is included in computing the affiliate's foreign accrual property income) from the disposition of shares of another foreign affiliate. Gains that are included in computing an affiliate's hybrid surplus and hybrid deficit are excluded from its exempt earnings under the preamble of paragraph (*a*). Second, clause (*d*)(ii)(A) of the definition is amended to add a reference to new subclause 95(2)(*a*)(i)(A)(IV) of the Act to ensure that amounts recharacterized as active business income under that subclause are included in exempt earnings. Third, subclause (*d*)(ii)(E)(I) of the definition is amended to reflect the amendments to clause 95(2)(*a*)(ii)(D) of the Act, which remove the requirement that the second and third affiliates referred to in that clause be resident in the same country. For further information, please see the commentary on subparagraphs 95(2)(*a*)(i) and (ii).

The first amendment noted above applies in respect of dispositions made after 2012.

The amendment to clause (*d*)(ii)(A) applies in respect of taxation years of a foreign affiliate of a taxpayer that begin after July 12, 2013. A taxpayer may elect to have the amendment apply in respect of taxation years of all foreign affiliates of the taxpayer that end after 2007.

The amendment to subsection (*d*)(ii)(E)(I) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after July 12, 2013.

"exempt surplus"

The definition "exempt surplus" is primarily relevant for the purpose of determining the deductibility of dividends received from a foreign affiliate, pursuant to subsection 5900(1) of the Regulations and subsection 113(1) of the Act.

Subparagraph (vi) of the description of A and subparagraph (vi) of the description of B of the definition are both amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

These amendments apply in respect of taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

"hybrid surplus"

The definition "hybrid surplus" is primarily relevant for determining the surplus treatment of capital gains and losses realized in respect of dispositions of certain shares of a foreign affiliate, certain partnership interests, and certain financial instruments relating to such shares and partnership interests.

Subparagraph (v) of the description of A and subparagraph (vii) of the description of B of the definition are both amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

These amendments come into force on August 20, 2011, unless an election is made to have these amendments come into force, in respect of the taxpayer, on July 12, 2013.

“hybrid underlying tax”

The definition “hybrid underlying tax” is relevant in accounting for income or profits taxes paid in respect of hybrid surplus. It is similar to the concept of underlying foreign tax, which applies in the context of taxable surplus.

Subparagraph (iv) of the description of A and subparagraph (iv) of the description of B of the definition are both amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

These amendments come into force on August 20, 2011, unless an election is made to have these amendments come into force, in respect of the taxpayer, on July 12, 2013.

“taxable surplus”

The definition “taxable surplus” is primarily relevant for the purpose of determining the deductibility of dividends received from a foreign affiliate, pursuant to subsection 5900(1) of the Regulations and subsection 113(1) of the Act.

Subparagraph (iv) of the description of A and subparagraph (vi) of the description of B of the definition are both amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

“underlying foreign tax”

The definition “underlying foreign tax” is primarily relevant for the purposes of determining the deductibility of dividends received from a foreign affiliate of a corporation, pursuant to subsection 5900(1) of the Regulations and subsection 113(1) of the Act.

Subparagraph (v) of the description of A and subparagraph (iv) of the description of B of the definition are both amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.03)

Subsection 5907(1.03) of the Regulations is a rule analogous to subsection 91(4.1) of the Act, which denies foreign tax credits and similar deductions with respect to foreign income or profits tax if the burden of that tax is not, in fact, borne by the taxpayer.

Subsection 5907(1.03) is amended to add a reference to new subsection 5907(1.092) of the Regulations. For further information, please see the commentary on subsection 5907(1.092).

This amendment applies to income or profits tax paid in respect of the income of a foreign affiliate of a corporation for taxation years of the foreign affiliate that end in taxation years of the corporation that end after

March 4, 2010, unless an election is made to have it apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.091) and (1.092)

New subsections 5907(1.091) and (1.092) of the Regulations ensure that appropriate surplus adjustments are made where, under foreign tax laws, the shareholder of a fiscally transparent entity (FTE) that is a foreign affiliate of a taxpayer, and not the FTE itself, is liable for and pays foreign tax in respect of income of the FTE. This situation is also addressed by the amendments to the definition "foreign accrual tax" (FAT) in subsection 95(1) of the Act. For further information, please see the commentary on the definition "foreign accrual tax" in subsection 95(1).

Subsection 5907(1.091) sets out the conditions for the application of subsection 5907(1.092). It generally provides that subsection 5907(1.092) applies, in respect of income or profits tax paid by, or refunded to, a foreign affiliate (the shareholder affiliate) of a taxpayer – in respect of the income, profits or loss of another foreign affiliate (the transparent affiliate) of the taxpayer – if all the following conditions are satisfied:

- The shareholder affiliate has an equity percentage (as defined in subsection 95(4) of the Act) in the transparent affiliate.
- The income or profits tax is paid to, or refunded by, a foreign country.
- The shareholder affiliate, and not the transparent affiliate, is liable for that tax, or is entitled to that refund, under the income tax laws of the foreign country (other than solely because the shareholder affiliate is part of a group of corporations that determine their liabilities for income or profits tax payable to the government of that country on a consolidated or combined basis).

When these conditions are satisfied, subsection 5907(1.092) ensures that the foreign income or profits tax paid by, or refunded to, the shareholder affiliate has appropriate consequences for the shareholder affiliate's surplus accounts. In the absence of subsection 5907(1.092), the surplus regulations in Part LIX of the Regulations would not apply appropriately because the entity paying the tax (i.e., the shareholder affiliate) is not the entity (i.e., the transparent affiliate) that earned the income to which the tax relates.

Appropriate surplus adjustments are achieved by rules that parallel the rules in subsection 5907(1.1), which deal with surplus adjustments to reflect tax payments and refunds in respect of a group of foreign affiliates that determine their income tax liability on a consolidated or combined basis.

New paragraph 5907(1.092)(*a*) determines the surplus results to the shareholder affiliate in respect of income or profits taxes paid or refunded. Subparagraph 5907(1.092)(*a*)(i) deems the tax that is paid by, or refunded to, the shareholder affiliate not to have been so paid or refunded. Subparagraph 5907(1.092)(*a*)(ii) deems any such income or profits tax that would have been payable by the shareholder affiliate for the year if the shareholder affiliate had no other taxation year and had not been liable for income or profits tax in respect of income or profits of the transparent affiliate to have been paid by the shareholder affiliate for the year.

Subparagraph 5907(1.092)(*a*)(iii) applies if the shareholder affiliate has a loss for the year, and because of that loss, the tax otherwise payable by it on behalf of itself and the transparent affiliate is reduced, or the shareholder affiliate receives a refund of income or profits tax. In either case, to the extent that the tax is reduced or the refund is received because of the loss, the amount of such reduction or refund received is deemed to have been received by the shareholder affiliate as a refund for the year of the loss of income or profits tax in respect of the loss.

Subparagraphs 5907(1.092)(*a*)(iv) and (v) provide adjustments to the surplus accounts of the shareholder affiliate, which are generally the same adjustments as would have occurred in respect of the transparent affiliate's surplus accounts had the tax been paid by, or refunded to, the transparent affiliate.

Subparagraph 5907(1.092)(*a*)(iv) makes surplus adjustments in the case where income or profits tax is paid by the shareholder affiliate in respect of the transparent affiliate's income. It provides that any income or profits tax that would have been payable by the transparent affiliate for the year, if the transparent affiliate had no other taxation year, had no income or profits other than those that are included in computing the income or profits of the shareholder affiliate under the relevant foreign law and had been liable (and no other person had been liable) for the tax, reduces specific surplus accounts, or increases specific deficit accounts, of the shareholder affiliate, to the extent that it would have resulted in such reductions to the corresponding surplus accounts, or increases to corresponding deficit accounts, of the transparent affiliate had it been payable by the transparent affiliate. Subparagraph 5907(1.092)(a)(iv) also provides for an increase to the shareholder affiliate's hybrid underlying tax, to the extent of any adjustment under that subparagraph to hybrid surplus or deficit, and an increase to the shareholder affiliate's underlying foreign tax, to the extent of any adjustment under that subparagraph to taxable surplus or deficit.

Subparagraph 5907(1.092)(*a*)(v) makes surplus adjustments where, because of a loss of the transparent affiliate for the year, income or profits tax otherwise payable by the shareholder affiliate is reduced or is refunded to the shareholder affiliate. These adjustments are the converse of the adjustments under subparagraph 5907(1.092)(*a*)(iv).

New paragraph 5907(1.092)(*b*) determines the surplus results in respect of the shareholder affiliate and the transparent affiliate in respect of amounts paid and received as compensatory payments for tax paid or refunds received by the shareholder affiliate. Subparagraph 5907(1.092)(*b*)(i) applies in respect of amounts paid to the shareholder affiliate by the transparent affiliate in respect of the income or profits tax that would have been payable by the transparent affiliate for the year had it been liable, and no other person had been liable, for income or profits tax in respect of income or profits of the transparent affiliate. Subparagraph 5907(1.092)(*b*)(ii) conversely applies in respect of amounts paid by the shareholder affiliate to the transparent affiliate in respect of a reduction or refund, because of a loss or tax credit of the transparent affiliate for a taxation year, of the income or profits tax that would otherwise have been payable by the shareholder affiliate for the year. In respect of the transparent affiliate, a compensatory amount it pays to the shareholder affiliate in respect of tax paid by the shareholder affiliate, and a compensatory amount it receives from the shareholder affiliate in respect of the reduction or refund, are deemed to be a payment and refund, respectively, of such income or profits tax. In respect of the shareholder affiliate, an adjustment is made to the appropriate surplus accounts and, as applicable, to the balance of either hybrid underlying tax or underlying foreign tax, of the shareholder affiliate, depending on the effect that the deemed payment or refund of tax would have on the surplus balances of the transparent affiliate.

Finally, under new paragraph 5907(1.092)(*c*), any amount – in respect of any income or profits tax that would have been payable by a transparent affiliate for the year had it been liable, and no other person had been liable, for income or profits tax in respect of its income or profits – paid by the transparent affiliate, in respect of a shareholder affiliate, to another transparent affiliate in respect of the shareholder affiliate, is deemed, for the purposes of paragraph 5907(1.092)(*b*), to have been paid to the shareholder affiliate by the first transparent affiliate, and paid by the shareholder affiliate to the second transparent affiliate.

Consequential amendments are also made to the definitions "exempt surplus", "hybrid surplus", "hybrid underlying tax", "taxable surplus" and "underlying foreign tax" in subsection 5907(1) of the Regulations to add references to additions or reductions under subsection 5907(1.092). For further information, please see the commentaries on those definitions.

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.1)

Subsection 5907(1.1) of the Regulations contains rules for the calculation of surpluses and deficits of a foreign affiliate where the affiliate is a member of a group of foreign affiliates that files a consolidated or combined return in a foreign country (e.g., the United States) and one of the affiliates (the primary affiliate) in the group is responsible, on behalf of the group, for paying, or claiming a refund of, the tax of the primary affiliate and the other members (the secondary members) of the group.

Subsection 5907(1.1) is amended to remove the requirement that the primary and secondary affiliates all be resident in the same foreign country under whose laws they are treated as a consolidated or combined group.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 2003.

ITR
5907(1.11)

New subsection 5907(1.11) of the Regulations deems a non-resident corporation to be a foreign affiliate of a corporation resident in Canada, in certain circumstances, for the purposes of subsection 5907(1.1). Foreign affiliate status is relevant in the context of subsection 5907(1.1) because that subsection applies only in respect of two or more foreign affiliates of a Canadian-resident corporation that determine their foreign income tax liabilities on a consolidated or combined basis. For further information, please see the commentary on subsection 5907(1.1).

Subsection 5907(1.11) generally deems, for the purposes of subsection 5907(1.1), a non-resident corporation to be a foreign affiliate of a particular corporation resident in Canada if the non-resident corporation is a foreign affiliate of another corporation that is

- resident in Canada, and
- related to the particular corporation resident in Canada, otherwise than because of a right referred to in paragraph 251(5)(*b*) of the Act.

This rule ensures, among other things, that where a Canadian-resident corporation does not have an equity percentage (as defined in subsection 95(4) of the Act) in a non-resident corporation that is a member of the same foreign consolidated group as one or more foreign affiliates of the Canadian-resident corporation, subsection 5907(1.1) can still apply in respect of that non-resident corporation.

Subsection 5907(1.11) applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 2003.

ITR
5907(1.12), (1.13)

New subsection 5907(1.12) of the Regulations sets out the conditions for the application of new subsection 5907(1.13). Subsection (1.13) may apply where a particular foreign affiliate of a corporation resident in Canada that is a "secondary affiliate" within the meaning assigned by subsection 5907(1.1) (rules for the calculation of surplus and deficit balances of a foreign affiliate where the affiliate is a member of a group of foreign affiliates that files a consolidated or combined return in a foreign country) is also a "shareholder affiliate" in respect of a "transparent affiliate", within the context of new subsections 5907(1.091) and (1.092).

Subsection 5907(1.12) sets out that subsection 5907(1.13) applies where a secondary affiliate has an equity percentage in a transparent affiliate and, under the relevant foreign law, if the secondary affiliate were not a member of the consolidated group, it would be liable for income tax and responsible for paying any such income tax in respect of its interest in the transparent affiliate.

If subsection 5907(1.13) applies, paragraph 5907(1.13)(*a*) applies for the purposes of applying subparagraphs 5907(1.1)(*a*)(iv) and (*b*)(i), and paragraph 5907(1.13)(*b*) applies for the purposes of applying subparagraphs 5907(1.1)(*a*)(v) and (*b*)(ii). These provisions ensure that regulation 5907(1.1) results in adjustments to the surplus balances of the primary affiliate, to the extent that income or profits tax of the group is determined in respect of the earnings or loss of a transparent affiliate (that is not a member of the consolidated group) in respect of the secondary affiliate, that are the same as the adjustments to the surplus balances that would be required if the earnings or loss were derived directly by the secondary affiliate.

For example, subparagraph 5907(1.1)(*a*)(iv) has the effect of increasing or decreasing surplus or deficit balances of the primary affiliate to the extent that income or profits tax that would otherwise be payable by the secondary affiliate for the year, if the secondary affiliate were not a member of the consolidated group and had no other taxation year, would otherwise have decreased the net earnings of the secondary affiliate included in its exempt or taxable earnings, or reduced the hybrid surplus of the secondary affiliate. New subparagraph 5907(1.13) clarifies that, for the purposes of subparagraph 5907(1.1)(*a*)(iv), to the extent that such tax that would otherwise be payable by the particular affiliate is increased because of net earnings for the year of a transparent affiliate, and not of the particular affiliate, the amount is deemed to have been income or profits tax that would otherwise have reduced the net earnings included in the exempt or taxable earnings of the particular affiliate. As such, subparagraph 5907(1.1)(*a*)(iv) will require the same adjustment to the surplus or deficit balances of the primary affiliate as if the net earnings were earned directly by the particular affiliate (rather than indirectly through a transparent affiliate that is not recognized as a member of the consolidated group under foreign law).

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of a taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.21), (1.22)

New subsection 5907(1.21) of the Regulations sets out the conditions for the application of subsection 5907(1.22) of the Regulations. Subsection 5907(1.22) may apply for the purposes of subsection 5907(1.2) (rules for the computation of the surplus and deficit balances of a foreign affiliate of a taxpayer where the affiliate is entitled under foreign tax law to deduct losses of another foreign affiliate (the “loss affiliate”). To the extent that the loss that is deducted by a foreign affiliate is not a direct loss of the loss affiliate (as otherwise required under subsection 5907(1.2)), but instead is a result of a loss of a transparent affiliate (within the context of new subsections 5907(1.091) and (1.092)) in respect of the loss affiliate, new subsections 5907(1.21) and (1.22) should generally deem the loss of the transparent affiliate to be a loss of the loss affiliate for those purposes.

These amendments apply to taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have these amendments apply in respect of a taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.3)

In computing a taxpayer’s income, subsection 91(4) of the Act allows a deduction in respect of the foreign accrual tax that is attributable to foreign accrual property income included in the taxpayer’s income. Subsection 95(1) of the Act defines foreign accrual tax to include amounts prescribed to be foreign accrual tax.

In circumstances where a loss incurred by a foreign corporation in a particular group of foreign affiliates is relevant in the computation of the income tax liability of the group, paragraphs 5907(1.3)(*a*) and (*b*) of the Regulations provide that an amount will be considered foreign accrual tax if the amount is paid by a particular foreign corporation to another foreign corporation for the use of a loss in computing the group’s foreign tax liability. These provisions apply where the loss of the other corporation is an active business loss or a capital loss resulting from the disposition of excluded property as well as where the loss is one that is determined under the current version of paragraph 5903(1)(*a*).

Subsection 5907(1.3) is amended to modernize its language and to accommodate the use in certain foreign jurisdictions of fiscally transparent entities (FTEs) that are considered to be corporations under Canadian tax principles. A common example of an FTE is a limited liability company (LLC) formed under various U.S. state statutes. In recognition of the fact that, under certain foreign income tax laws, the shareholder of an FTE, and not the FTE itself, is liable for and pays the foreign tax in respect of income of the FTE, paragraphs 5907(1.3)(*a*) and (*b*) are amended to

- refer to consolidated group taxation under the tax laws of the country in which the foreign affiliate that is a shareholder of the FTE (the shareholder affiliate) is resident, and
- allow an amount paid by the shareholder affiliate for the use of another group member's loss to qualify as FAT in certain circumstances.

This amendment applies in respect of taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have it apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

ITR
5907(1.5) and (1.6)

Subsections 5907(1.5) and (1.6) of the Regulations contain rules that allow for the reinstatement in certain circumstances of foreign accrual tax denied under subsection 5907(1.4). Subsection 5907(1.4) ensures that an amount paid by a particular affiliate to another corporation, as contemplated by subsection 5907(1.3), that is in respect of a loss of another corporation will only be foreign accrual tax to the extent that the amount paid can reasonably be considered to be in respect of a foreign accrual property loss of a controlled foreign affiliate of a person or partnership that is, at the end of the relevant taxation year, a relevant person or partnership (within the meaning of new subsection 5903(6)) in respect of the taxpayer.

Subsection 5907(1.5) and (1.6) allow foreign accrual tax that is initially denied under subsection 5907(1.4) to be reinstated in the year in which the loss that caused the denial, and all other losses of group members for that same taxation year, would otherwise have been used against non-foreign accrual property income of the consolidated group, provided those losses are used up within five years of the year in which the foreign accrual property income is realized.

Subsections 5907(1.5) and (1.6) are amended in two respects. First, consistent with amendments to subsection 5907(1.3), subsections 5907(1.5) and (1.6) are amended to accommodate the use of fiscally transparent entities (FTEs) in certain foreign jurisdictions. This is accomplished by adding references to a "shareholder affiliate", i.e., a foreign affiliate that is the shareholder of a foreign FTE and that makes the compensatory payment to another group member for the use of a loss in respect of which subsection 5907(1.4) applies. For further information, please see the commentary on subsection 5907(1.3).

Second, subsections 5907(1.5) and (1.6) are amended to expand the circumstances in which they can apply. Those subsections currently apply only in respect of foreign affiliates that are resident in foreign jurisdictions with consolidated tax reporting systems. They are amended to also apply in respect of foreign affiliates that are resident in foreign jurisdictions with tax loss transfer systems (sometimes called "group relief" systems).

These amendments apply in respect of taxation years of a foreign affiliate of a taxpayer that end after 2010, unless an election is made to have them apply in respect of taxation years of all foreign affiliates of a taxpayer that end on or after July 12, 2013.

Clause 89

Prescribed Children's Programs

ITR
9400

Section 9400 of the Regulations prescribes programs of activity for the purposes of the Child Fitness Tax Credit and the Children's Arts Tax Credit. Subsections 9400(1), (2) and (3) are amended to change the references to subsection 118.03(1) of the Act to references to subsection 122.8(1), consequential to amendments to the Act that make the Child Fitness Tax Credit refundable.

These amendments apply to the 2015 and subsequent taxation years.

Clause 90

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.

Class 43.1 (30% CCA rate) and Class 43.2 (50% CCA rate)

Class 43.1 in Schedule II to the Regulations currently provides an accelerated CCA rate of 30% per year (on a declining-balance basis) for clean energy generation and energy conservation equipment. Class 43.2 provides an accelerated CCA rate of 50% per year (on a declining-balance basis) for property included in that class. In general, Class 43.2 includes property described in Class 43.1 that is acquired on or after February 23, 2005 and before 2020. Unlike Class 43.1, however, Class 43.2 applies to cogeneration and waste-fuelled electricity generation equipment described in paragraphs (*a*) to (*c*) of Class 43.1 only if the energy efficiency of the system does not exceed a 4,750 BTU per kilowatt-hour requirement (instead of a 6,000 BTU per kilowatt-hour requirement for Class 43.1).

Class 43.1 (and indirectly Class 43.2) is amended to expand Class 43.2 eligibility to include water-current energy equipment and equipment used to gasify eligible waste fuel for use in a broader range of applications.

ITR
Class 43.1 (*c*)(i)(A)

Clause (*c*)(i)(A) of Class 43.1 in Schedule II to the Regulations currently describes property that is used to generate electrical energy, or both electrical and heat energy, using only fuel that is fossil fuel, eligible waste fuel, spent pulping liquor or any combination of those fuels.

Clause (*c*)(i)(A) is amended to include property that is used to generate electrical energy, or both electrical and heat energy, using producer gas. This amendment is consequential on introduction of the definition "producer gas" in subsection 1104(13) and new subparagraph (*d*)(xvi) of Class 43.1 to Schedule II, which expands Class 43.2 to include property used to gasify eligible waste fuel to generate producer gas.

This amendment applies in respect of property acquired after February 10, 2014 that has not been used or acquired for use before February 11, 2014.

ITR
Class 43.1 (*d*)(ix)

Subparagraph (*d*)(ix) of Class 43.1 to Schedule II describes equipment used for the sole purpose of generating heat energy, primarily from the consumption of eligible waste fuel and not using any fuel other than eligible waste fuel or fossil fuel. Consequential on introduction of subparagraph (*d*)(xvi) of Class 43.1 to Schedule II, which expands Class 43.2 to include property used to gasify eligible waste fuel to generate producer gas, subparagraph (*d*)(ix) is amended to include equipment that is used for the sole purpose of generating heat energy, primarily from the consumption of eligible waste fuel, producer gas or a combination of eligible waste fuel and producer gas. Eligible equipment may not use any fuel other than eligible waste fuel, fossil fuel or producer gas.

Such equipment continues to include fuel handling equipment used to upgrade the combustible portion of the fuel and control, feedwater and condensate systems, and other ancillary equipment. However, eligible equipment does not include equipment used for the purpose of producing heat energy to operate electrical generating equipment, buildings or other structures, heat rejection equipment (such as condensers and cooling water systems), fuel storage facilities, other fuel handling equipment and property otherwise included in Class 10 or 17.

This amendment applies in respect of equipment acquired after February 10, 2014 that has not been used or acquired for use before February 11, 2014.

ITR
Class 43.1 (*d*)(xiv)

Subparagraph (*d*)(xiv) of Class 43.1 in Schedule II to the Regulations currently describes equipment that generates electricity using wave or tidal energy without using physical barriers or other dam-like structures.

Subparagraph (*d*)(xiv) is amended to include property that is primarily used for the purpose of generating electricity using kinetic energy of flowing water or wave or tidal energy (otherwise than by diverting or impeding the natural flow of the water or by using physical barriers or dam-like structures). Current rules regarding the inclusion or exclusion of specific equipment will continue to apply.

Eligible equipment includes support structures, control, conditioning and battery storage equipment, submerged cables and transmission equipment. Eligible equipment does not include buildings, distribution equipment, auxiliary electrical generating equipment, property otherwise included in Class 10 and property that would be included in Class 17 if that class were read without reference to its subparagraph (*a.1*)(i).

This amendment applies in respect of property acquired after February 10, 2014 that has not been used or acquired for use before February 11, 2014.

ITR
Class 43.1 (*d*)(xvi)

New subparagraph (*d*)(xvi) of Class 43.1 is introduced to expand Class 43.2 eligibility to include property used to gasify eligible waste fuel for use in a broader range of applications.

Subparagraph (*d*)(xvi) describes equipment used by the taxpayer, or by a lessee of the taxpayer, primarily for the purpose of generating producer gas by gasifying eligible waste fuels. Such equipment includes piping (including fans and compressors), air separation equipment, storage equipment, equipment used for drying or shredding eligible waste fuel, ash-handling equipment, equipment used to upgrade the producer gas into biomethane and equipment used to remove non-combustibles and contaminants from the producer gas.

However, eligible equipment to generate producer gas does not include equipment (either on a stand alone basis or as part of system that is used to generate producer gas) used to generate producer gas if the gas is to be converted into liquid biofuels or chemicals. In addition, eligible equipment does not include buildings or other structures, heat rejection equipment (such as condensers and cooling water systems), and property otherwise included in Class 10 or 17.

This amendment applies in respect of equipment acquired after February 10, 2014 that has not been used or acquired for use before February 11, 2014.

Clause 91

Assessments

Clause 14 provides for the automatic override of the normal statute-barring rules of subsection 152(4) of the Act for clauses 5, 20 and 21, subsections 24(1), (3), (5), (12), (14) to (16), (22), (23), (26) to (28), (30) to (32), (34), (37) to (42), sections 71 and 72 and subsections 82(1), (3) to (5), (7) to (25) and (27) to (33).

Part 2

Amendments to the Excise Tax Act (GST/HST Measures) and a Related Text

Excise Tax Act

Clause 92

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).

Subclause 92(1)

Definition "participating employer"

ETA
123(1)

Existing definition "participating employer" of a pension plan means an "employer" (as defined in subsection 123(1) of the Act) that has made, or is required to make, contributions to the pension plan or payments under the pension plan in respect of the employer's employees or former employees. A participating employer also includes an employer prescribed under subsection 8308(7) of the *Income Tax Regulations*, which generally describes certain cases where an employee of one employer renders services to, and receives remuneration from, another employer. The existing definition "participating employer" applies only in respect of a pension plan that is a "registered pension plan" (as defined in subsection 248(1) of the *Income Tax Act*).

The definition "participating employer" of a pension plan is amended so that it also applies in respect of a pension plan that is a "pooled registered pension plan" (as newly defined in subsection 123(1)). An employer is a participating employer of a pooled registered pension plan if it has made, or is required to make, contributions to the pooled registered pension plan in respect of all or a class of its employees or former employees. An employer is also a participating employer of a pooled registered pension plan if it has remitted, or is required to remit, to the "PRPP administrator" (as newly defined in subsection 123(1)) of the pooled registered pension plan contributions made by "members" (as defined in subsection 147.5(1) of the *Income Tax Act*) of the pooled registered pension plan under a contract with the PRPP administrator in respect of all or a class of the employees of the employer.

An employer that has made or remitted contributions to a registered pension plan or a pooled registered pension plan in the past will remain a participating employer in respect of that registered pension plan or pooled registered pension plan, as the case may be, even if it does not currently make or remit contributions.

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

Subclauses 92(2) and (3)

Definitions "substantial renovation" and "builder"

ETA
123(1)

"substantial renovation"

Residential housing that is substantially renovated is generally treated the same as newly constructed housing for GST/HST purposes and is therefore subject to GST/HST under the same rules and conditions as newly constructed housing. In addition, an owner who is an individual and who substantially renovates their home may qualify for the GST/HST new housing rebate in respect of GST/HST costs incurred during the renovation.

Under the current definition "substantial renovation" in subsection 123(1) of the Act, for residential housing to be considered substantially renovated, "all or substantially all" of the building must be removed or replaced other than certain core structural components of the building.

The current definition "substantial renovation" refers to the entire building in applying the "all or substantially all" test, which could encompass any non-residential parts of a building (e.g., commercial space) and residential condominium units owned by other persons. As a result, certain renovations of residential housing units that would otherwise be considered a "substantial renovation" may fall outside of the current definition.

Accordingly, the definition "substantial renovation" is amended to apply the "all or substantially all" test with respect to the whole or part of a residential complex in which one or more residential units are located.

"builder"

The definition "builder" in subsection 123(1) is integral to the GST/HST treatment of residential housing. Generally, residential housing that is newly constructed or substantially renovated by a builder is subject to GST/HST when it is sold by the builder prior to having been occupied as a place of residence or lodging or when it is first rented out or occupied by the builder as a place of residence. Residential housing that is sold by a person other than a builder or that is sold by a builder after it has been rented out or occupied by the builder as a place of residence is generally exempt from GST/HST.

The current definition "builder" includes persons that substantially renovate various types of housing but not persons that substantially renovate residential condominium units. This current definition could result in residential condominium units that are substantially renovated for resale or rental not being subject to GST/HST, with other types of housing (e.g., single homes and traditional apartment buildings) that are substantially renovated being subject to GST/HST.

To correct this disparity, paragraph (*a*) of the definition "builder" is amended so that a person who substantially renovates a residential condominium unit is a "builder" for GST/HST purposes where the other conditions in the definition "builder" are met.

The amendments to the definitions "builder" and "substantial renovation" in subsection 123(1) apply to a person's sales of substantially renovated housing made after April 8, 2014 and to such sales (other than sales that are deemed to have been made under section 191 of the Act) made on or before April 8, 2014 that would have been taxable sales had the amended definitions applied and for which an amount as or on account of tax was charged, collected or remitted under Part IX of the Act. The amendments also apply to a person's sales of substantially renovated housing that would be deemed to have been made under section 191 on or before April 8, 2014 if the definitions "builder" and "substantial renovation" were read as amended by this amending clause and the person reported an amount as or on account of GST/HST as a result of the person applying section 191 in respect of the substantially renovated housing, in the person's GST/HST return:

- that is filed or required to be filed on or before April 8, 2014; or
- that is for a reporting period that begins on or before April 8, 2014, that is required to be filed after April 8, 2014 and that is filed on or before the due date for the return.

In addition, under a transitional rule, a person that makes or is deemed to make a taxable sale of residential housing after April 8, 2014 may be allowed to claim input tax credits relating to the taxable sale that would normally be disallowed as of April 8, 2014 due to the limitation periods in which to claim the input tax credits. The transitional rule recognizes that a person that makes or is deemed to make taxable sales as a result of the amendments to the definitions "builder" and "substantial renovation" may not be able to claim the input tax credits in respect of those taxable sales within the statutory time limit. This transitional rule applies where a person makes or is deemed to make a taxable sale of a residential complex after April 8, 2014 that would not be a taxable sale if the definitions "builder" and "substantial renovation" applied as they read before this amending clause is assented to. The person must be entitled to claim an input tax credit, or amount that would be an input tax credit if the definitions "builder" or "substantial renovation" were read as amended by this amending clause, in respect of property or services acquired, imported or brought into a participating province by the person during a reporting period that ends on or before April 8, 2014 for consumption or use in making the taxable sale of the complex. However, input tax credits allowed under this transitional rule (referred to as "unclaimed credits") must not have been previously claimed or deducted in determining the person's net tax for any reporting period the return for which is filed or is required to be filed on or before April 8, 2014. If these conditions are met, unclaimed credits in relation to the complex are deemed to be input tax credits for a reporting period of the person that includes April 8, 2014 and not to be input tax credits of the person for any other period. As a result, the person will be entitled to claim the unclaimed credits within the applicable limitation period that begins after the end of the reporting period that includes April 8, 2014, in accordance with subsection 225(4) of the Act.

Subclause 92(4)

Definition "pension plan"

ETA
123(1)

Existing definition "pension plan" means a "registered pension plan" (as defined in subsection 248(1) of the *Income Tax Act*) that governs a person that is a trust or that is deemed to be a trust for the purposes of the *Income Tax Act*. It also means a registered pension plan in respect of which a corporation meets the following two conditions:

- the corporation is incorporated and operated either solely for the administration of the registered pension plan or for the administration of the registered pension plan and for no other purpose other than acting as trustee of, or administering, a trust governed by a retirement compensation arrangement, where the terms of the arrangement provide for benefits only in respect of individuals who are provided with benefits under the registered pension plan; and
- the corporation is accepted by the Minister of National Revenue as a funding medium for the purpose of the registration of the registered pension plan under the *Income Tax Act*.

Finally, existing definition "pension plan" also means a registered pension plan in respect of which a person is prescribed for the purposes of the definition "pension entity" in subsection 123(1) of the Act.

The definition "pension plan" is amended so that it also refers to pooled registered pension plans. Specifically, it is amended to include a pooled registered pension plan that governs a person that is a trust or that is deemed to be a trust for the purposes of the *Income Tax Act*. It is also amended to include a pooled registered pension plan in respect of which a corporation meets the following two conditions:

- the corporation is incorporated and operated either solely for the administration of the pooled registered pension plan or for the administration of the pooled registered pension plan and for no other purpose other than acting as trustee of, or administering, a trust governed by a retirement compensation arrangement, where the terms of the arrangement provide for benefits only in respect of individuals who are provided with benefits under the pooled registered pension plan; and
- the corporation is described in paragraph 149(1)(*o.2*) of the *Income Tax Act* and all of the shares, and rights to acquire shares, of the capital stock of the corporation are owned, at all times since the date on which it was incorporated, by the pooled registered pension plan.

Also, the amended definition "pension plan" includes a pooled registered pension plan in respect of which a person is prescribed for the purposes of the definition "pension entity" in subsection 123(1).

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

Subclause 92(5)

Definitions

ETA
123(1)

Subsection 123(1) of the Act is amended to add three new definitions.

New definition "pooled registered pension plan" has the same meaning as in paragraph 149(5)(*a*) of the Act, which means a pooled registered pension plan as defined for the purposes of the *Income Tax Act*. A pooled registered pension plan under the *Income Tax Act* is a "pooled pension plan" (defined in subsection 147.5(1) of the *Income Tax Act* as a plan that is registered under the *Pooled Registered Pension Plans Act* or a similar law of a province) that has been accepted for registration by the Minister of National Revenue for the purposes of the *Income Tax Act*, which registration has not been revoked.

New definition "PRPP administrator" of a pooled registered pension plan means the "administrator" (as defined in subsection 147.5(1) of the Income Tax Act) of the pooled registered pension plan.

New definition "registered pension plan" has the same meaning as in paragraph 149(5)(*a*), which means a registered pension plan as defined for the purposes of the *Income Tax Act*. A registered pension plan under the *Income Tax Act* is a pension plan (other than a pooled pension plan) that has been registered by the Minister for the purposes of that Act and whose registration has not been revoked.

These amendments are deemed to have come into force on December 14, 2012.

Clause 93

Meaning of "Investment Plan"

ETA
149(5)

Subsection 149(5) of the Act defines the term "investment plan" for the purposes of section 149. Entities that meet the definition "investment plan" are "listed financial institutions" for the purposes of the Act, by virtue of subparagraph 149(1)(*a*)(ix).

Existing paragraph 149(5)(*a*) lists trusts that are included in the definition "investment plan" and includes trusts governed by various plans, trusts and arrangements as defined for the purposes of the *Income Tax Act*.

Paragraph 149(5)(*a*) is amended to provide that a trust governed by a "pooled registered pension plan" (as defined for the purposes of the *Income Tax Act*) is included in this definition. This amendment applies in respect of any taxation year of a person that ends on or after December 14, 2012.

It should be noted that a "pension entity" (as defined in subsection 123(1) of the Act) of a pooled registered pension plan that is a corporation is an investment plan for the purposes of section 149 by virtue of existing paragraph 149(5)(*f*). Paragraph 149(5)(*f*) provides that a corporation exempt from tax by reason of paragraph 149(1)(*o.1*) or (*o.2*) of the *Income Tax Act* is included in the definition "investment plan".

Clause 94

Definitions

ETA
172.1(1)

Subsection 172.1(1) of the Act defines terms used in section 172.1. Amendments to this subsection amend the definition "excluded activity".

For the purposes of section 172.1, an "excluded activity" is generally an activity in respect of a pension plan that is undertaken by a "participating employer" of the "pension plan" (as those terms are defined in subsection

123(1) of the Act) and that is of a type normally carried on by an employer for purposes other than administering a pension plan, such as for securities regulation or financial reporting purposes. Excluded activities are carved out from the definition “pension activities” in subsection 172.1(1) and, as a result, the acquisition of property or a service, or the consumption or use of “employer resources” (as defined in subsection 172.1(1)), exclusively in the course of excluded activities is not subject to the deemed supply rules contained in subsections 172.1(5) to (7).

Existing definition “excluded activity” in subsection 172.1(1) is amended to add new paragraph (*d.1*), which applies only if the pension plan is a “pooled registered pension plan” (as defined in subsection 123(1)). Paragraph (*d.1*) provides that an excluded activity includes an activity undertaken exclusively for compliance by a participating employer of the pooled registered pension plan as a “PRPP administrator” (as defined in subsection 123(1)) of the pooled registered pension plan with requirements under the *Pooled Registered Pension Plans Act* or a similar law of a province. However, this compliance activity is an excluded activity under paragraph (*d.1*) only if it is undertaken exclusively for the purpose of making a taxable supply of a service to a pension entity of the pooled registered pension plan that is to be made

- for consideration that is not less than the fair market value of the service; and
- at a time when no election under subsection 157(2) of the Act made jointly by the participating employer and the pension entity is in effect.

This amendment applies in respect of any fiscal year of a person ending on or after December 14, 2012.

Clause 95

Subsidized Residential Complexes

ETA
191.1(2)

Under the self-supply rules in section 191 of the Act, when a builder constructs or substantially renovates residential housing and subsequently rents it out or occupies it as a place of residence before being sold, the builder is required to pay GST/HST as if the housing was sold and re-purchased by the builder (referred to as “self-supply”). The builder is deemed to have paid and collected GST/HST calculated based on the fair market value of the housing at the time of the self-supply and the GST/HST rate that is in effect at the time of the self-supply in the province in which the housing is situated.

Section 191.1 of the Act provides for a special rule that is used to determine the amount of GST/HST the builder is deemed to have paid and collected on the self-supply where the housing in question is government-funded housing (referred to as “subsidized housing”) intended for certain target groups, such as seniors or individuals with a disability. This rule ensures that the builder’s GST/HST liability on the self-supply of subsidized housing is at least equal to the input tax credits or rebates the builder would be entitled to claim in respect of the GST/HST paid in respect of the construction of the housing.

This is accomplished through the use of a special rule requiring the builder to pay, on the self-supply, the GST/HST payable in respect of the housing inputs (e.g., the land forming part of the subsidized housing and the building materials and services used to construct or substantially renovate the subsidized housing) where the GST/HST calculated on the fair market value of the subsidized housing at the time of self-supply is less than the total of the GST/HST payable in respect of the housing inputs.

Where the GST/HST payable in respect of the housing inputs is at a different tax rate than would otherwise be the case if the housing inputs were acquired at the time of self-supply and in the province where the subsidized housing is situated, this special rule can lead to anomalous results. For example, under the special rule, a builder that acquired land when the rate of GST was 7% would pay tax based on that higher rate even if a 5% GST rate was in effect at the time of self-supply (on the other hand, if the purchase of the land was subject to the 5% GST rate, then the builder would pay tax based on that 5% GST rate). Also, due to varying rates of tax, similar anomalies can occur where housing inputs are acquired outside the province where the housing is located.

In addition, if a Canadian builder purchases housing inputs outside Canada and imports them exclusively for use in commercial activities (e.g., the construction of subsidized housing), the provincial component of the HST generally does not apply. Similarly, if the imported housing inputs are services (e.g., architectural services) imported for use exclusively in commercial activities, neither the GST nor the provincial component of the HST is payable. As a result, a builder that imported housing inputs may be required to pay a lower amount of GST/HST on self-supply of the housing than another builder of subsidized housing that pays tax on self-supply but purchased all of the housing inputs in the province where the housing is situated.

Similarly, anomalous results can occur if housing inputs are sourced from a province other than the province in which the housing is situated and the provincial component of the HST, if any, is different in the source province than in the province in which the subsidized housing is situated. For example, if a builder in Manitoba purchases housing inputs in Ontario to construct subsidized housing in Manitoba, the GST/HST payable upon self-supply of the subsidized housing would be higher (13%) than if the builder had purchased the same inputs in Manitoba (5%).

To address these anomalies this clause amends the special rule for subsidized housing in subsection 191.1(2) so that the GST/HST payable in respect of housing inputs for the purposes of this rule is equal to the total GST/HST that would have been payable on the acquisition of those housing inputs if:

- the GST/HST rate applicable for the housing inputs was the GST/HST rate applicable at the time of self-supply; and
- the housing inputs had been acquired in the province in which the housing is situated.

The amendment does not change any relief currently available for the acquisition of housing inputs that do not attract GST/HST where those inputs are relieved from GST/HST for reasons other than their importation, or bringing into a participating province, for use exclusively in the course of commercial activities.

For example, relief from GST/HST would still be available for:

- housing inputs (such as land) that were purchased before the GST came into effect (i.e., before 1991);
- housing inputs that are purchased GST/HST exempt (such as land that was previously used in exempt activities); or
- with respect to the provincial component of the HST, housing inputs that were purchased prior to the province joining the HST (such as land purchased in Ontario prior to July 1, 2010).

This amendment applies in respect of any self-supply of subsidized housing that occurs on or after April 1, 2013.

However, an exception would apply to self-supplies of subsidized housing where construction of the housing commenced on or before April 8, 2014. For these transitional self-supplies, for the purpose of applying the special rule in subsection 191.1(2), the builder is permitted to determine the tax payable in respect of housing inputs using either the current rule or the proposed rule, whichever results in a lower amount of tax payable.

A further transitional measure applies if an amount has been taken into account in assessing the net tax of a builder of subsidized housing under section 296 of the Act and the amount, or part of the amount, is deemed not to have been collected under the applicable self-supply rule as result of the application of the amended special rule for subsidized housing discussed above. The transitional measure allows the builder to request in writing, within one year after the day on which this amending clause is assented to, that the Minister of National Revenue assess, reassess, or make an additional assessment of, the net tax to take into account the effect of the amended special rule and, if a request is made, provides for an assessment, reassessment or additional assessment to be made.

Clause 96

Public Service Body Rebates

ETA
259

Existing section 259 of the Act provides for rebates of GST/HST to selected public service bodies, charities and substantially government-funded non-profit organizations.

Rebate for Health Care Facility

ETA
259(4.11)

Under subsection 259(1), “charity” is defined, for the purposes of section 259, to include non-profit organizations that operate non-profit facilities described in paragraph (*c*) of the definition “health care facility” in Part II of Schedule V to the Act so that these organizations are eligible for the same public service body rebates in respect of the operation of these facilities that are available to organisations that qualify as registered charities under the *Income Tax Act*.

New subsection 259(4.11) is added to clarify that a non-profit organization that qualifies as a charity for the purposes of section 259 only because it operates such a health care facility is entitled to claim a public service body rebate as a charity only to the extent that the GST/HST it incurs relates to its intended consumption, use or supply of property or services in the course of activities engaged in by the non-profit organization in the course of operating the health care facility.

Extent of Consumption, Use or Supply – Relevant Time

ETA
259(4.12)

New subsection 259(4.12) is added consequential to the addition of new subsection 259(4.11), which clarifies that a non-profit organization that qualifies as a charity for purposes of section 259 only because it operates a health care facility described in paragraph (*c*) of the definition “health care facility” in Part II of Schedule V to the Act is entitled to claim a public service body rebate as a charity only to the extent that the GST/HST it incurs relates to its intended consumption, use or supply of property or services in the course of activities engaged in by the non-profit organization in the course of operating the health care facility.

New subsection 259(4.12) describes the relevant times for determining the extent to which a property or a service is intended for consumption, use or supply in the course of activities engaged in by the non-profit organization in the course of operating the health care facility. The relevant times for making this determination are consistent with the relevant times (e.g., the time of importation in relation to tax attributable to the importation of a good) for determining the extent of intended consumption, use or supply in the course of other activities for which a public service body rebate can be claimed.

New subsections 259(4.11) and (4.12) apply for the purposes of determining a rebate under section 259 for which an application is filed on or after April 8, 2004.

Clause 97

Pension Plan Rebate

ETA
261.01

Existing section 261.01 of the Act provides for a GST/HST rebate for “pension entities” of a “pension plan” (as those terms are defined in subsection 123(1) of the Act) and allows a pension entity of a pension plan and “qualifying employers” (as defined in subsection 261.01(1)) of the pension plan to make a joint election to transfer some or all of the pension entity's rebate entitlement to some or all of the qualifying employers. Existing section 261.01 applies only in respect of pension plans that are "registered pension plans" (as defined in subsection 248(1) of the *Income Tax Act*).

Section 261.01 is amended to extend these rebate and election rules to "pooled registered pension plans" (as defined in subsection 123(1)).

Subclause 97(1)

Definition "pension contribution"

ETA
261.01(1)

Subsection 261.01(1) of the Act defines terms used in section 261.01.

Existing definition "pension contribution" in subsection 261.01(1) means a contribution by a person to a pension plan that may be deducted by the person under paragraph 20(1)(*q*) of the *Income Tax Act* in computing its income.

The definition "pension contribution" is repealed as it is replaced by the new definition "employer contribution" in this subsection.

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

Subclause 97(2)

Definition "pension rebate amount"

ETA
261.01(1)

A "pension rebate amount" of a pension entity of a pension plan for a "claim period" (as defined in subsection 259(1) of the Act) of the pension entity represents the amount of a rebate for the claim period that either the pension entity, if it is a "qualifying pension entity" (as defined in this subsection), may be entitled to claim under subsection 261.01(2) of the Act or in respect of which a deduction from net tax may be claimed by participating employers of the pension plan under any of subsections 261.01(5), (6) or (9).

The definition "pension rebate amount" is amended so that it applies in respect of pension entities of pooled registered pension plans. It is not amended in respect of pension entities of registered pension plans.

The pension rebate amount of a pension entity of a pension plan for a claim period is the amount determined by multiplying the total of all "eligible amounts" (as defined in this subsection) of the pension entity for the claim period by a particular percentage that is determined in respect of the pension plan.

For a pension entity of a registered pension plan, the particular percentage continues to be 33%. For a pension entity of a pooled registered pension plan, the method for determining the particular percentage depends on whether "employer contributions" or "employee PRPP contributions" (as defined in this subsection) were made to the pension plan in the particular calendar year that is the last calendar year ending on or before the last day of the claim period.

- Where employer contributions or employee PRPP contributions were made to the pooled registered pension plan in the particular calendar year, the particular percentage is the amount determined by multiplying 33% by a ratio determined by the formula C divided by D for the particular calendar year. Element C is the total of all amounts, each of which is determined for an employer that made employer contributions to the pooled registered pension plan in the particular calendar year and is the sum of: (1) all employer contributions made by the employer to the pooled registered pension plan in the particular calendar year; and (2) all "employee PRPP contributions" (as defined in this subsection) made by employees of the employer to the pooled registered pension plan in the particular calendar year.

Element D is the total of all amounts contributed to the pooled registered pension plan in the particular calendar year.

- Where neither employer contributions nor employee PRPP contributions were made to the pooled registered pension plan in the particular calendar year but it is reasonable to expect that employer contributions will be made in a following calendar year, the particular percentage is the amount determined by multiplying 33% by a ratio determined by the formula E divided by F for the first calendar year in which employer contributions are reasonably expected to be made to the pooled registered pension plan that ends after the last day of the claim period. Element E is the total of all amounts, each of which is determined for an employer reasonably expected to make employer contributions to the pooled registered pension plan in that first calendar year and is the sum of: (1) all employer contributions reasonably expected to be made by the employer to the pooled registered pension plan in that first calendar year; and (2) all employee PRPP contributions reasonably expected to be made by employees of the employer to the pooled registered pension plan in that first calendar year. Element F is the total of all amounts reasonably expected to be contributed to the pooled registered pension plan in that first calendar year.
- Where neither employer contributions nor employee PRPP contributions were made to the pooled registered pension plan in the particular calendar year and it is not reasonable to expect that employer contributions will be made in a following calendar year, the particular percentage is 0%.

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

Subclause 97(3)

Definition "qualifying employer"

ETA
261.01(1)

Existing definition "qualifying employer" of a pension plan for a calendar year means a participating employer of the pension plan that is a registrant and that has made pension contributions to the pension plan in the immediately preceding calendar year. Where no pension contributions were made to the pension plan in the immediately preceding calendar year by any participating employer of the pension plan, existing definition "qualifying employer" of the pension plan for the calendar year means a participating employer of the pension plan that is a registrant and that was the employer of one or more "active members" (as that term is defined in this subsection) of the pension plan in the immediately preceding calendar year.

Consequential amendments are made to paragraph (*a*) of the definition "qualifying employer" to reflect the repeal of the definition "pension contribution" and the enactment of the new definition "employer contribution" in this subsection.

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

Subclause 97(4)

Definition "qualifying pension entity"

ETA
261.01(1)

Existing definition "qualifying pension entity" means a pension entity of a pension plan, other than a pension plan in respect of which (a) "listed financial institutions" (as defined in subsection 123(1) of the Act) made 10% or more of the total "pension contributions" (as defined in this subsection) to the pension plan in the last preceding calendar year in which pension contributions were made; or (b) it can reasonably be expected that listed financial institutions will make 10% or more of the total pension contributions to the pension plan in the next calendar year in which pension contributions will be required to be made to the pension plan.

Consequential amendments are made to the definition “qualifying pension entity” to reflect the repeal of the definition “pension contribution” and the enactment of the new definition “employer contribution” in this subsection.

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

Subclause 97(5)

Definitions

ETA
261.01(1)

Subsection 261.01(1) of the Act is amended to add two new definitions.

New definition “employee PRPP contribution” made by an employee of an employer to a pooled registered pension plan means a contribution by the employee to the pooled registered pension plan where that contribution both may be deducted by the employee under paragraph 60(*i*) of the *Income Tax Act* in computing the employee's income for purposes of that Act and is remitted by the employer to the “PRPP administrator” (as defined in subsection 123(1) of the Act) of the pooled registered pension plan under a contract between the employer and the PRPP administrator in respect of all or a class of the employees of the employer.

New definition “employer contribution” means a contribution by an employer to a pension plan that may be deducted by the employer under paragraph 20(1)(*q*) of the *Income Tax Act* in computing its income for the purposes of that Act. This definition has the same meaning as the existing definition “pension contribution” in this subsection, which is repealed.

These amendments are deemed to have come into force on December 14, 2012.

Subclause 97(6)

Election to Share Rebate — Not Engaged Exclusively in Commercial Activities

ETA
261.01(6)

Existing subsection 261.01(6) of the Act provides for a joint election to permit a qualifying pension entity of a pension plan to transfer all or part of its “pension rebate amount” for a claim period of the qualifying pension entity, and all or part of its “provincial pension rebate amount” (as these terms are defined in subsection 261.01(1)) for the claim period, to all or some of the qualifying employers of the pension plan, provided that at least one of the qualifying employers of the pension plan is not engaged exclusively in commercial activities throughout the claim period.

If the election is made for a claim period of a qualifying pension entity, paragraph 261.01(6)(*a*) requires that an amount, referred to as the “shared portion”, be determined in respect of each qualifying employer. This shared portion in respect of a qualifying employer for a claim period of the qualifying pension entity is determined by multiplying three amounts in a formula. One of those three amounts is element C, which represents the qualifying employer’s degree of participation in the pension plan expressed as a percentage. Where pension contributions were made to the pension plan in the particular calendar year that immediately precedes the calendar year that includes the last day of the claim period, element C is in turn determined by dividing element D by element E. Existing element D is the total pension contributions made by the qualifying employer to the pension plan in the particular calendar year. Existing element E is the total pension contributions that were made to the pension plan in the particular calendar year.

Subsection 261.01(6) is amended to permit the joint election under this subsection to be made between a qualifying pension entity of a pooled registered pension plan and the qualifying employers of the pooled registered pension plan. More specifically, to effect this expansion of subsection 261.01(6), the following amendments are made:

- Consequential amendments are made to element C to reflect the repeal of the definition “pension contribution” and the enactment of the new definition “employer contribution” in subsection 261.01(1).
- Elements D and E are amended in respect of pension plans that are pooled registered pension plans. The amendments are applicable where employer contributions were made by a qualifying employer to the pooled registered pension plan in the particular calendar year that immediately precedes the calendar year that includes the last day of the claim period. In this case,
  - element D includes not only the total of all employer contributions made by the qualifying employer to the pooled registered pension plan in the particular calendar year, but also the total of all employee PRPP contributions made by employees of the qualifying employer to the pooled registered pension plan in the particular calendar year; and
  - element E is the total of all amounts contributed to the pooled registered pension plan in the particular calendar year.

For pooled registered pension plans in all other cases, the determination of elements D and E remains unchanged.

The amendments to subsection 261.01(6) do not affect a joint election made under this subsection between a qualifying pension entity of a registered pension plan and the qualifying employers of the registered pension plan.

These amendments apply in respect of any claim period of a pension entity ending on or after December 14, 2012.

Subclause 97(7)

Non-Qualifying Pension Entities

ETA
261.01(9)

Existing subsection 261.01(9) of the Act generally allows a “non-qualifying pension entity” (as defined in subsection 261.01(1)) of a pension plan and all of the qualifying employers of the pension plan to make a joint election so that some or all of those qualifying employers may, in determining their net tax, claim a deduction in respect of a pension rebate amount and a provincial pension rebate amount of the non-qualifying pension entity of the pension plan.

If the election is made for a claim period of a non-qualifying pension entity, each qualifying employer may deduct, in determining its net tax for its reporting period that includes the day on which the election is filed, the amount determined by multiplying three amounts in a formula. One of those three amounts is element C, which represents the qualifying employer's degree of participation in the pension plan expressed as a percentage. Where pension contributions were made to the pension plan in the particular calendar year that immediately precedes the calendar year that includes the last day of the claim period, element C is in turn determined by dividing element E by element F. Existing element E is the total pension contributions made by the qualifying employer to the pension plan in the particular calendar year. Existing element F is the total pension contributions that were made to the pension plan in the particular calendar year.

Subsection 261.01(9) is amended to permit the joint election under this subsection to be made between a non-qualifying pension entity of a pooled registered pension plan and the qualifying employers of the pooled registered pension plan. More specifically, to effect this expansion of subsection 261.01(9), the following amendments are made:

- Consequential amendments are made to element C to reflect the repeal of the definition “pension contribution” and enactment of new definition “employer contribution” in subsection 261.01(1).

- Elements E and F are amended in respect of pension plans that are pooled registered pension plans. The amendments are applicable where employer contributions were made by a qualifying employer to the pooled registered pension plan in the calendar year (referred to as the “preceding calendar year”) that immediately precedes the calendar year that includes the last day of the claim period. In this case,
  - element E includes not only the total of all employer contribution made by the qualifying employer to the pooled registered pension plan in the preceding calendar year, but also the total of all employee PRPP contributions made by employees of the qualifying employer to the pooled registered pension plan in the preceding calendar year; and
  - element F is the total of all amounts contributed to the pension plan in the preceding calendar year.

For pooled registered pension plans in all other cases, the determination of elements E and F remains unchanged.

The amendments to subsection 261.01(9) do not affect a joint election made under this subsection between a qualifying pension entity of a registered pension plan and the qualifying employers of the registered pension plan.

These amendments apply in respect of any claim period of a pension entity ending on or after December 14, 2012.

Clause 98

Refining Services

ETA
Sch. VI, Pt. V, section 6.3

New section 6.3 of Part V of Schedule VI to the Act has the effect of zero-rating services of refining a metal, including a precious metal, to produce a precious metal where the services are supplied to an unregistered non-resident person. An assaying, gem removal, or similar service supplied in conjunction with such refining services is also zero-rated.

New section 6.3 applies to any supply made after April 8, 2014 and to any supply made on or before that day if the supplier did not, on or before that day, charge or collect any amount as or on account of GST/HST.

A special rule applies to any supplier who has not charged or collected GST/HST in respect of a supply of a service that is zero-rated under new section 6.3 but who has accounted for tax in respect of the supply in determining the supplier’s net tax in a return filed on or before April 8, 2014 for a reporting period that ended after 2010. Such a supplier can apply for a rebate under section 261 of the Act in respect of that tax, even if the normal time limit for the rebate has expired or the amount has been assessed, before the later of the day that is one year after the day that this Act receives royal assent and the day that is two years after the day on which the supplier’s return for the reporting period was filed.

Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations

Clause 99

Definitions

Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations
1

Section 1 of the *Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations* defines terms used in these regulations.

Existing definition “manager” of an investment plan (as defined in this section) means

- in the case of a "pension entity" (as defined in subsection 123(1) of the Act) of a "registered pension plan" (as defined in subsection 248(1) of the *Income Tax Act*), the "administrator" (as defined in subsection 147.1(1) of that Act) of the registered pension plan; and
- in any other case, the person that has ultimate responsibility for the management and administration of the assets and liabilities of the investment plan.

The definition "manager" is amended to provide that, in the case of a pension entity of a "pooled registered pension plan" (as defined in subsection 123(1)), the manager is the "PRPP administrator" (as defined in that subsection) of the pooled registered pension plan.

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

Part 3

Excise Act, 2001

Clause 100

Refund of Duty – Destroyed Tobacco Products

EA, 2001
181(1)

Section 181 of the *Excise Act, 2001* (the Act) currently allows a tobacco licensee to apply for a refund of the duty paid on tobacco products re-worked or destroyed by the tobacco licensee in accordance with section 41, provided the licensee applies for the refund within two years of the day the tobacco was re-worked or destroyed. Current section 181 is renumbered as subsection 181(1) and new subsections 181(2) and (3) are introduced to provide refund of the cigarette inventory tax introduced in the Economic Action Plan 2014.

This amendment is deemed to have come into force on February 12, 2014.

Refund of Inventory Tax – Destroyed Domestic Cigarettes

EA, 2001
181(2)

New subsection 181(2) of the Act provides a refund of the cigarette inventory tax to tobacco licensees on taxed cigarettes, as defined in section 58.1, that are destroyed or re-worked, in line with the refund of the excise duty that exists for tobacco products that are destroyed or re-worked.

New paragraph 181(2)(*a*) stipulates that a refund of the inventory tax will only be provided to a tobacco licensee if the licensee provides evidence satisfactory to the Minister of National Revenue that the cigarettes were manufactured in Canada, that they were re-worked or destroyed by the licensee in accordance with section 41 and that either:

- the cigarettes were taxed cigarettes of the licensee and the inventory tax was paid by the licensee, or
- the cigarettes were taxed cigarettes of a particular person that is not the licensee, the tax was paid by that particular person and an amount equal to the tax was paid by the licensee to that particular person on account of that tax.

New paragraph 181(2)(*b*) provides that a licensee must apply for the refund within two years after the taxed cigarettes are re-worked or destroyed.

This amendment is deemed to have come into force on February 12, 2014.

Refund of Inventory Tax – Destroyed Imported Cigarettes

EA, 2001
181(3)

Similar to new subsection 181(2), new subsection 181(3) of the Act provides a refund of the cigarette inventory tax to importers on taxed cigarettes, as defined in section 58.1, that are destroyed, in line with the refund of the excise duty that exists for tobacco products that are destroyed or re-worked.

New paragraph 181(3)(*a*) stipulates that a refund of the inventory tax will only be provided to a particular person if that person provides evidence satisfactory to the Minister of National Revenue that the cigarettes were imported by that particular person, that they were destroyed by the particular person in accordance with the *Customs Act* or the *Customs Tariff* and that either:

- the cigarettes were taxed cigarettes of the particular person and the inventory tax was paid by the particular person, or

- the cigarettes were taxed cigarettes of another person that is not the particular person, the tax was paid by the other person and an amount equal to the tax was paid by the particular person to the other person on account of that tax.

New paragraph 181(3)(*b*) provides that the particular person must apply for the refund within two years after the taxed cigarettes are destroyed.

This amendment is deemed to have come into force on February 12, 2014.

Effective December 1, 2019, the portion of new subsection 181(3) before paragraph (*a*) is amended to exclude refunds of inventory tax under this subsection for cigarettes in respect of which duty has been imposed under section 53. For cigarettes in respect of which duty has been imposed under section 53, a refund of inventory tax may be provided under new subsection 181.1(2) if the conditions under that subsection are met.

Clause 101

Refund of Duty – Destroyed Imported Tobacco

EA, 2001
181.1(1)

Currently section 181.1 permits a duty free shop licensee to apply for a refund in respect of the duty imposed on imported manufactured tobacco under section 53 and paid by the licensee, provided the licensee destroyed the tobacco in accordance with the *Customs Act* and an application for the refund is made within two years of the tobacco being destroyed. Section 181.1 is renumbered as subsection 181.1(1) and new subsection 181.1(2) is introduced to provide refund of the cigarette inventory tax introduced in the Economic Action Plan 2014.

This amendment comes into force on December 1, 2019.

Refund of Inventory Tax – Destroyed Imported Cigarettes

EA, 2001
181.1(2)

New subsection 181.1(2) of the Act provides a refund of the cigarette inventory tax to duty free shop licensees on taxed cigarettes, as defined in section 58.1, that are destroyed, in line with the refund of the duty under section 53 that exists for imported manufactured tobacco that are destroyed.

New paragraph 181.1(2)(*a*) stipulates that a refund of the inventory tax will only be provided to a duty free shop licensee if the licensee provides evidence satisfactory to the Minister of National Revenue that:

- the cigarettes were taxed cigarettes of the licensee and the inventory tax was paid by the licensee, and
- the cigarettes were destroyed by the licensee in accordance with the *Customs Act*.

New paragraph 181.1(2)(*b*) provides that the licensee must apply for the refund within two years after the cigarettes are destroyed.

This amendment comes into force on December 1, 2019.