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

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Preface

These explanatory notes describe proposed amendments to the *Income Tax Act*, *Excise Tax Act* 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.

Table of Contents

Clause in Legislation	Section Amended	Topic	Page
Part 1 – Amendments to the Income Tax Act and Related Regulations			
Income Tax Act			
1	12	NISA Receipts.....	5
2	14	Eligible Capital Property.....	5
3	15	Partnerships.....	6
4	18	Definitions.....	6
5	34.1	Additional Business Income.....	13
6	38	Taxable Capital Gain – Gift of Securities	13
7	39	Capital Gain – Gift of Cultural Property	14
8	40	Reserve – Property Disposed of to Child	15
9	69	Inadequate Consideration.....	16
10	70	Death of a Taxpayer	16
11	73	<i>Inter Vivos</i> Transfers by Individuals	19
12	80.03	Lifetime Capital Gains Exemption.....	20
13	80.04	Debt Obligations – Transfer of Forgiven Amounts.....	20
14	80.3	Income Deferral	21
15	94	Non-Resident Trusts.....	23
16	94.2	Investments in Non-Resident Commercial Trusts	24
17	95	Definitions.....	25
18	104	Trusts and their Beneficiaries.....	29
19	107.4	Qualifying Disposition.....	34
20	108	Definitions.....	34
21	110.1	Deduction for Gifts	35
22	110.6	Lifetime Capital Gains Exemption.....	35
23	112	Loss on Share Held by Trust	41
24	118.1	Definitions – Charitable Donations Tax Credit.....	41
25	120.4	Tax on Split Income	48
26	122	Tax Payable by Trust	48
27	127	Investment Tax Credit of Testamentary Trust.....	52
28	127.51	Minimum Amount Determined.....	53
29	127.52	Adjusted Taxable Income Determined	53
30	127.53	Basic Exemption	53
31	128.1	Change in Residence	54
32	138.1	Rules Related to Segregated Funds	54
33	143	Communal Organizations.....	55
34	143.1	Amateur Athlete Trusts	55
35	146	Registered Retirement Savings Plan	56
36	146.1	Registered Education Savings Plan	56
37	148	Life Insurance Policies	57
38	149	Exception re Investment Income of Certain Clubs.....	61
39	149.1	Definitions.....	62
40	152	Reassessment with Taxpayer’s Consent.....	62
41	156.1	Instalment Exemption	62
42	160	Joint Liability – Spousal and Similar Trusts	63
43	161	Contra Interest.....	63
44	164	Refund of Overpayment.....	64
45	165	Objections to Assessments	65

Clause in Legislation	Section Amended	Topic	Page
46	207.6	Retirement Compensation Arrangements.....	65
47	210	Part XII.2 Tax	65
48	212	Back-to-Back Loan Arrangements	66
49	212.3	Foreign Affiliate Dumping – Conditions for Application	69
50	219.1	Paid-Up Capital Reinstatement	92
51	220	Deemed Security	92
52	227	Foreign Affiliate Dumping – Late-Filing Form.....	93
53	248	Definitions.....	93
54	249	Taxation Year.....	95
55	249.1	Fiscal Period.....	96
56	256	Associated Corporations	97
Income Tax Regulations			
57	300	Annuities	98
58	304	Prescribed Annuity Contracts.....	99
59	306	Exempt Policies.....	100
60	307	Accumulating Fund.....	105
61	308	Net Cost of Pure Insurance.....	106
62	310	Interpretation.....	108
63	1104	Capital Cost Allowance – Interpretation	109
64	1401	Insurance Business Policy Reserves.....	111
65	1403	Assumptions in Applying Paragraph 1401(1)(c)	117
66	Schedule II	Capital Cost Allowance – Prescribed Classes	118
Part 2 – Amendments to the Excise Tax Act and Related Regulations			
Excise Tax Act			
67	123	Definitions.....	120
68	149	Meaning of “Investment Plan”	122
69	172.1	Definitions.....	122
70	261.01	Pension Plan Rebate	123
Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations			
71	1	Definitions.....	127

Part 1

Amendments to the Income Tax Act and Related Regulations

Income Tax Act

Clause 1

NISA Receipts

ITA
12(10.2)

Subsection 12(10.2) of the *Income Tax Act* (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 2

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 3

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 4

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 or partnership (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.

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 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 connected non-resident, and the debt or other obligation meets a condition in any of clauses 18(6)(c)(i)(A) to (D) (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 the debt or other obligation was entered into on condition that the particular debt (owed by the taxpayer to the intermediary) also be entered into. This condition is similar to the condition in the current subsection 18(6). The condition in clause 18(6)(c)(i)(C) is that the particular debt (owed by the taxpayer to the intermediary) was entered into on condition that the debt or other obligation also be entered into. Finally, the condition in clause 18(6)(c)(i)(D) is that it can reasonably be concluded that if the debt or other obligation did not exist, either all or a portion of the particular amount (owed by the taxpayer to the intermediary) would not be outstanding at that time, or the terms or conditions of the particular debt would be different than they are.

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 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 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 if the intermediary or the person or partnership that does not deal at arm's length with the intermediary, as the case may be, were not granted any specified right, then either all or a portion of the particular amount would not be outstanding at that time, or the terms or conditions of the particular debt or other obligation would be different than they are.

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, use, mortgage, hypothecate, assign, pledge or in any way encumber, invest, sell or otherwise dispose of, or in any way alienate, the property. 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.

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 or partnership 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).*

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.*
- *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 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 if the bank or any person that does not deal at arm's length with the bank were not granted any specified right, all or a portion of the \$50 million outstanding in respect of the particular loan would not be outstanding at the time, or the terms or conditions of the particular loan would be different. 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.*
- *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 apply), 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.*

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 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 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 2: 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 particular amount (\$50 million) 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 3: 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 $A \times B/C$, 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.

Clause 5

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 6

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 7

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 consequential on the repeal of the definition “settlor” in subsection 108(1). The reference to “settlor” is removed and the subparagraph now refers 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 8

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 9

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 10

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.

Clause 11

***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 12

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 13

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 14

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 15

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 16

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 17

Definitions

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.

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.

If the risk of loss or expected returns in respect of the insurance of the foreign policy pool, in combination with the risk of loss or expected returns from the agreements or arrangements, can reasonably be traced to actual returns in respect of the tracked policy pool, the affiliate can be considered to be, in substance, insuring the risks in the tracked policy pool. If 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.

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.

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) 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).

Paragraph 95(2.11)(b) requires that the Canadian taxpayer satisfy at least one of two conditions. The first is that throughout the period the taxpayer 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 a related corporation resident in Canada, for the taxation year of the taxpayer or the related 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 related Canadian corporations on a reasonable basis.

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

Clause 18

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 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) and the trust's income under subsection 12(10.2) (*i.e.*, NISA Fund No. 2 receipts) – 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 the 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 be 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. Subsections 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 19

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 subsection 107.4(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 20

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.

“settlor”

The definition “settlor” in subsection 108(1) of the Act applies for the purposes of subparagraph 39(1)(c)(vii), subsections 104(27) and (27.1) and the definition “preferred beneficiary” in subsection 108(1). Under the definition, the settlor of a testamentary trust is the individual in consequence of whose death the trust arose. The settlor of an *inter vivos* trust is the individual who created the trust (and if the trust was created jointly with the individual’s spouse or common law-partner, also the individual who is that spouse or common-law partner), provided that the fair market value of the trust’s property contributed by the individual exceeds that of property contributed by other persons.

The definition “settlor” is repealed. Subparagraph 39(1)(c)(vii) and subsections 104(27) and (27.1) no longer use the expression. For purposes of the definition “preferred beneficiary”, a reference to a settlor has its ordinary meaning.

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 21

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 22

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 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 23

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 24

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 25

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 26

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:*

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

- *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 out 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 created by a deceased individual’s will 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 27

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 28

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 29

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 30

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 31**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 32**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 33

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 34

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 35

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 36

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 37

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 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 to deem certain life insurance policies issued before 2017, and not otherwise subject to the new rules for policies issued after 2016, to be issued at a particular time after 2016 for 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 into another type of life insurance under the policy or is added to the policy. In this event, the policy is deemed to be issued at that time and not at any other 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 38

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)(I) 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 39**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 40**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 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 41**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 42

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). 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 43

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 44**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 45**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 46**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 47**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 48

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, four conditions, set out in paragraphs 212(3.1)(a) to (d), 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 intermediary can be either a resident of Canada or a non-resident. 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(3.1)(b)) may be satisfied in one of two ways. The first, under subparagraph 212(3.1)(b)(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 any of clauses 212(3.1)(b)(i)(A) to (D) (an “intermediary debt”). The condition in clause 212(3.1)(b)(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)(b)(i)(B) is that the debt or other obligation was entered into on condition that the particular debt (owed by the taxpayer to the intermediary) also be entered into. The condition in clause 212(3.1)(b)(i)(C) is that the particular debt (owed by the taxpayer to the intermediary) was entered into on condition that the debt or other obligation also be entered into. Finally, the condition in clause 212(3.1)(b)(i)(D) is that it can reasonably be concluded that if the debt or other obligation did not exist, either all or a portion of the particular amount (owed by the taxpayer to the intermediary) would not be outstanding at that time, or the terms or conditions of the particular debt would be different than they are.

The second way in which paragraph 212(3.1)(b) may be satisfied (as set out in subparagraph 212(3.1)(b)(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 if the intermediary or the person or partnership that does not deal at arm's length with the intermediary, as the case may be, were not granted any specified right, then either all or a portion of the particular amount would not be outstanding at that time, or the terms or conditions of the particular debt or other obligation would be different than they are.

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, use, mortgage, hypothecate, assign, pledge or in any way encumber, invest, sell or otherwise dispose of, or in any way alienate, the property. The 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.

The conditions listed in paragraph 212(3.1)(b) 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 third condition (set out in paragraph 212(3.1)(c)) 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)(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 212(3.1)(b)(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)(b)(ii)) – 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 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 particular amount) 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)(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 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)(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.

Paragraph 212(3.1)(d) 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)(b)(i) or (ii). The amount of the interest is determined by the formula $((A \times B/C) - D) \times (E - F)/E$.

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)(b)(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)(b)(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 49

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 ($\$60 \text{ million} / \$80 \text{ million} = \$90 \text{ million} / \120 million), and the PUC of the class A shares of Canco2 is reduced by \$30 million ($\$30 \text{ million} / \$40 \text{ million} = \$90 \text{ 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 15th day of the month following the month 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, at the dividend time, 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 and penalties under the Act apply 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).

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 $A \times B/C$ 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 subsection 51(1) applies to 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 50

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 51

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 52

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.

Clause 53

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. Consistent with the intention 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.

This amendment comes into force on December 31, 2015.

“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.

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 (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(28) applies in respect of property disposed of, or transferred, in the 2014 and subsequent taxation years.

Clause 54

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 55

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 56

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.

Income Tax Regulations

Clause 57

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 58

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 to this rule to the case where the holder is a qualified disability trust.

These amendments apply to the 2016 and subsequent taxation years.

Clause 59

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. 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 issued before 2017 an interest in which was last acquired before December 2, 1982.	<p>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 <i>Income Tax Act</i>, R.S.C. 1952, c.148.</p> <p>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.</p>

<p>Policies issued before 2017 an interest in which was last acquired after December 1, 1982 and before 1990.</p>	<p>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 <i>Income Tax Act</i>, R.S.C. 1952, c.148.</p> <p>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.</p>
<p>Policies issued before 2017 an interest in which was last acquired after 1989.</p>	<p>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.</p> <p>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.</p>

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.

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 60

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.

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 deductibility 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 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 61

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).

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 62

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.

“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 63

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 64**Insurance Business Policy Reserves****Part XIV**

Part XIV of the Regulations provides rules in respect of insurance business policy reserves.

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 life insurance policy”

The fund value of a life insurance policy is relevant for a life insurance policy (other than an annuity contract) issued after 2016. The fund value of a life insurance policy at any time is the total at that time of all investment accounts in respect of the policy. The fund value of a life insurance policy is calculated by adding the amount of each investment account in respect of the policy. For greater certainty, the fund value of a life insurance 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 life insurance 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.

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 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 65

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 66**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.

Part 2**Amendments to the Excise Tax Act and Related Regulations****Excise Tax Act****Clause 67****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). Amendments to subsection 123(1) amend the definitions “participating employer” and “pension plan” and add new definitions “pooled registered pension plan”, “PRPP administrator” and “registered pension plan”.

The amendments to subsection 123(1) are deemed to have come into force on December 14, 2012.

Subclause 67(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.

Subclause 67(2)**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).

Subclause 67(3)

Definitions

ETA

123(1)

Subsection 123(1) of the Act is amended to add three new definitions.

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 “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 “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.

Clause 68

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 69

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 70**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 70(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 70(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 70(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 70(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 70(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 70(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 70(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.

Selected Listed Financial Institutions Attribution Method (GST/HST) Regulations

Clause 71

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) of the Act), 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.