

Preface

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

The Honourable Joe Oliver, P.C., M.P.
Minister of Finance

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

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Legislative Proposals Relating to the Income Tax Act and Regulations

Repeated Failure to Report Income Penalty

Clause 1

Repeated failure

ITA
163(1)

Subsection 163(1) provides for a penalty for repeated failure by a person to report any amount required to be included in computing that person's income for a taxation year.

Subsection 163(1) is amended to specify that a person is liable to the penalty under this subsection only if the person fails to report at least \$500 of income in a taxation year, fails to report at least \$500 in any of the three preceding taxation years and is not liable to a penalty under subsection 163(2). The amount of the penalty is determined under new subsection 163(1.1).

This amendment applies to taxation years that begin after 2014.

Amount of penalty

ITA
163(1.1)

New subsection 163(1.1) provides for the calculation of the amount of the penalty under subsection 163(1). The amount of the penalty is the lesser of:

- 10 per cent of the amount of unreported income; and
- an amount equal to 50 per cent of the difference between the understatement of tax (or the overstatement of tax credits) related to the unreported amount and the amount of any tax paid in respect of the unreported amount (e.g., by an employer as employee withholdings).

This amendment applies to taxation years that begin after 2014.

Donations Involving Private Corporation Shares or Real Estate

To increase support for charities, Budget 2015 proposed to provide an exemption from capital gains tax in respect of certain arm's length dispositions of real estate or private corporation shares. The types of property that are eligible for a capital gains exemption under this measure are often illiquid and difficult to value. They are generally closely-held by families or small groups of individuals. The tax attributes associated with transactions involving these types of property are complex. These circumstances may present a heightened risk of self-dealing, unreasonable valuations, or tax planning being used to access the tax benefits of this proposal and other tax benefits in ways that are not intended. The core set of amendments to implement this Budget 2015 proposal are being released for consultation and are described in these notes. While these amendments include a number of provisions to address several potential issues that

could otherwise result in unintended and undesirable effects from a tax policy perspective, concerns remain in relation to the potential use of this measure to obtain unintended tax benefits, beyond the scope of the targeted incentive. The government will continue to monitor the effectiveness of the measure and take appropriate action to address such tax planning, as required.

Overview

The basic capital gains exemption is created in new paragraph 38(*a.4*). New section 38.3 provides the formulas for the calculation of the portion of a capital gain that is exempt under new paragraph 38(*a.4*). New section 38.4 provides rules for the application of new paragraph 38(*a.4*), as well as providing a number of anti-avoidance rules.

Clause 2

Taxable capital gain and allowable capital loss

ITA
38

Section 38 of the Act defines a taxpayer's taxable capital gain, allowable capital loss and business investment loss from the disposition of property as one-half of the taxpayer's capital gain, capital loss or business investment loss from the disposition, subject to certain exceptions.

Taxable capital gain – general

ITA
38(*a*)

Paragraph 38(*a*) is amended to include a reference to new paragraph (*a.4*), which reduces a taxpayer's taxable capital gain from the disposition of a property to zero if certain conditions are met. For further information, refer to the commentary on new paragraph 38(*a.4*).

This amendment applies to the 2017 and subsequent taxation years.

Taxable capital gain – private shares and real estate

ITA
38(*a.4*)

New paragraph 38(*a.4*) of the Act provides for a proportional exemption from capital gains tax on the donation of all or a portion of the monetary proceeds of disposition from the sale of shares of a private corporation or real estate under certain circumstances. More specifically, it provides that a taxpayer's taxable capital gain from the disposition of a property to which subsection 38.4(1) applies is zero if certain conditions are met.

New paragraph 38(*a.4*) applies to reduce the applicable portion (see new section 38.3) of a taxable capital gain from the disposition of property to zero if the conditions in new subparagraph 38(*a.4*)(i) or (ii) are met.

Pursuant to subparagraph 38(*a.4*)(i),

- subsection 38.4(1) must apply to the disposition,

- the gift must be made in money by the taxpayer to a qualified donee not more than 30 days after the disposition, and
- the taxpayer must be resident in Canada at the end of the taxation year of the disposition.

New subparagraph 38(a.4)(ii) applies in the context of the death of a taxpayer. In those circumstances, the conditions that must be met for paragraph 38(a.4) to apply are as follows:

- the taxpayer must have been resident in Canada immediately before the taxpayer's death,
- the disposition of property must have been deemed by section 70 to have occurred,
- new subsection 38.4(1) must apply to the subsequent disposition of the property by the taxpayer's graduated rate estate, and
- a gift to which subsection 118.1(5.1) applies must be made in money by the estate to a qualified donee not more than 30 days after the subsequent disposition.

For further information, refer to the commentary on new section 38.3 and new subsection 38.4(1).

This amendment applies to the 2017 and subsequent taxation years.

Clause 3

Allocation of gain – paragraph 38(a.4)

ITA
38.3

New section 38.3 of the Act is relevant for the purposes of new paragraph 38(a.4) of the Act, which provides for a proportional exemption from capital gains tax on the donation of all or a portion of the monetary proceeds of disposition from the sale of shares of a private corporation or real estate under certain circumstances, as described above. Section 38.3 provides formulas to determine that portion of a taxpayer's capital gain on the disposition that benefits from the exemption under new paragraph 38(a.4). New section 38.3 applies if the conditions in new subsection 38.4(1) are met.

New paragraph 38.3(a) applies where the conditions in new subparagraph 38(a.4)(i) are met in respect of the disposition of property by the taxpayer (*i.e.*, in the context of an inter vivos gift). New subparagraph 38.3(a)(i) provides that the portion of the taxpayer's capital gain on the disposition that benefits from the exemption under new paragraph 38(a.4) is determined under the formula $A \times (B - C)/D$, which prorates the capital gains exemption to reflect the portion of the proceeds of disposition that are donated, as described in more detail below.

Paragraph 38.3(b) applies where the taxpayer is the estate of an individual and the conditions in clauses 38(a.4)(ii)(C) and (D) are met in respect of the disposition of property by the estate (referred to as the "subsequent disposition"), *i.e.*, the estate disposes of the property and donates an amount of money to a qualified donee within 30 days after the disposition. Similar to subparagraph 38.3(a)(i), subparagraph 38.3(b)(i) provides, in the context of the death of a taxpayer, that the portion of the taxpayer's capital gain on the disposition that benefits from the exemption under new paragraph 38(a.4) is prorated under the formula $A \times (B - C)/D$.

Specifically,

- Variable A is the taxpayer's capital gain from the disposition of the property and, in the context of the death of an individual, the individual's capital gain from the disposition, under section 70, of the property.
- Variable B is, in general terms, the lesser of
 - the total amount of money donated to a qualified donee by the taxpayer within 30 days after the disposition and designated as a gift in respect of which new paragraph 38(a.4) applies by the taxpayer in their return of income for the taxation year; and,
 - in normal circumstances, the amount of money received by the taxpayer as proceeds from the disposition prior to the making of the gift or, in the context of the death of an individual, the amount of money received by the individual's estate as proceeds from the disposition prior to the making of the gift. In effect, Variable B ensures that the preferential capital gains tax treatment provided under new paragraph 38(a.4) applies only to the cash portion of the proceeds received from the disposition of the property that are donated to a qualified donee.
- Variable C is the amount of the advantage, if any, in respect of the gift. An advantage is defined in subsection 248(32) and is, generally, the total value of any property, services, compensation, use or other benefits to which the donor of a property is entitled. In effect, by subtracting Variable C from Variable B, the formula requires the taxpayer to calculate the "eligible amount" of the gift (as defined in subsection 248(31)) for the purposes of determining the portion of the taxpayer's capital gain to which new paragraph 38(a.4) applies.
- Variable D is the taxpayer's proceeds of disposition of the property or, in the context of the death of an individual, the estate's proceeds of the subsequent disposition.

New subparagraphs 38.3(a)(ii) and (b)(ii) ensure that the regular taxable capital gains inclusion rate in paragraph 38(a) is applied to the extent that the taxpayer's capital gain from the disposition of the property, or in the context of the death of the individual, the individual's capital gain from the disposition of the property under section 70, exceeds the amount determined by the formula in new subparagraph 38.3(a)(i) or (b)(i), as the case may be.

This amendment applies to the 2017 and subsequent taxation years.

ITA
38.4

New section 38.4 provides rules for the application of new paragraph 38(a.4), as well as providing a number of anti-avoidance rules.

Application of paragraph 38(a.4)

ITA
38.4(1)

New subsection 38.4(1) of the Act is relevant for the purposes of new paragraph 38(a.4), which provides for a proportional exemption from capital gains tax on the donation of all or a portion of the monetary proceeds of disposition from the sale of shares of a private corporation or real

estate under certain circumstances. New subsection 38.4(1) provides a list of conditions that describe the circumstances of a donation that qualifies for the capital gains exemption. If all three conditions are satisfied, then a capital gains tax exemption is available under new paragraph 38(a.4). The conditions are set out in new paragraphs 38.4(1)(a) to (c).

New paragraph 38.4(1)(a) requires that the property be either a share of the capital stock of a private corporation, or real or immovable property situated in Canada.

New paragraph 38.4(1)(b) sets out the conditions that apply in respect of the disposition of the property. New subparagraph 38.4(1)(b)(i) requires that the disposition occur after 2016. New subparagraph 38.4(1)(b)(ii) requires that the disposition be a sale to a person or partnership. New subparagraph 38.4(1)(b)(iii) specifies that the sale cannot be a transaction, or part of a series of transactions or events, that involves the circumvention of certain arm's length or non-affiliation requirements for the sale of the property. New subparagraph 38.4(1)(b)(iii) is intended to prevent any direct or indirect disposition to a non-arm's length or affiliated person from qualifying for the tax incentive treatment. Any situation where a non-arm's length or affiliated person acquires or obtains the property is intended to be ineligible for the tax incentive provided under new paragraph 38(a.4). More specifically, under new clause 38.4(1)(b)(iii)(A), the disposition cannot be a transaction, or part of a series of transactions, under which the purchaser of the property is affiliated, or not dealing at arm's length, with either the taxpayer or the qualified donee to which a gift is made in connection with the disposition. As well, new clause 38.4(1)(b)(iii)(B) provides that the disposition cannot be a transaction, or part of a series of transactions or events that include one or more agreements or other arrangements that:

- are entered into by the taxpayer or by a person or partnership that is affiliated, or does not deal at arm's length, with the taxpayer,
- have the effect, or would have the effect if entered into by the taxpayer instead of the person or partnership, of providing to the taxpayer all or any portion of the risk of loss or opportunity for gain or profit in respect of the property for a definite or indefinite period of time, and
- can reasonably be considered to have been entered into, in whole or in part, with the purpose of avoiding the application of clause 38.4(1)(b)(iii)(A).

New paragraph 38.4(1)(c) contains an anti-avoidance rule that will deny the application of new paragraph 38(a.4) if any one of certain events arise in the taxation year that the disposition of property occurs. These events are:

- Pursuant to new subparagraph 38.4(1)(c)(i), the acquisition by the taxpayer (or a person or partnership with which the taxpayer is not dealing at arm's length or is affiliated) or the qualified donee (or a person or partnership with which the qualified donee is not dealing at arm's length or is affiliated) in the taxation year, directly or indirectly, all or any portion of the property, property substituted for the property or property that derives its value from the property.
- Pursuant to new subparagraph 38.4(1)(c)(ii), where the property is a share of the capital stock of a corporation, the redemption, acquisition or cancellation of that share, or a share substituted for it, in the taxation year at a time when the taxpayer, a person or partnership

not dealing at arm's length with the taxpayer or the taxpayer's estate (if applicable) does not deal at arm's length or is affiliated with the corporation.

- Pursuant to new subparagraph 38.4(1)(c)(iii), the loanback rule in subsection 118.1(16) applying in the taxation year to determine the fair market value of a gift made in the particular taxation year or a previous taxation year, where the gift was an amount of money donated to a qualified donee within 30 days after a disposition of shares or real estate that was exempted from capital gains tax under new paragraph 38(a.4). (New subparagraph 38.4(1)(c)(iii) will also apply to a loan back event involving a corporate donor as subsection 110.1(6) provides that subsection 118.1(16), among others, applies to a corporation as if the references in subsection 118.1(16) to an individual were read as references to a corporation.)

This amendment applies to the 2017 and subsequent taxation years.

Reversal of capital gains exemption

ITA

38.4(2)

New subsection 38.4(2) of the Act applies if any of the events described in new subsection 38.4(3) occurs. Its effect is to tax a capital gain that was previously exempted from tax in a prior year under new paragraph 38(a.4) (*i.e.*, for having made a gift to a qualified donee of all or a portion of the monetary proceeds of disposition from the sale of shares of a private corporation or real estate within the relevant time required).

New subsection 38.4(2) deems a particular taxpayer to have a capital gain for a particular taxation year from the disposition of a property, being property that qualified for the capital gains exemption under new subsection 38.4(1) in any preceding taxation year, equal to the portion of the taxpayer's capital gain on the disposition to which new paragraph 38(a.4) previously applied in the preceding year. In essence, if new subsection 38.4(3) applies, a taxpayer will be deemed to have a capital gain in the taxation year pursuant to new subsection 38.4(2), and the amount of the capital gain will be equal to the amount that was previously determined to be eligible for the preferential capital gains treatment under new paragraph 38(a.4).

For further information, refer to the commentary below on new subsection 38.4(3).

This amendment applies to the 2017 and subsequent taxation years.

ITA

38.4(3)

New subsection 38.4(3) of the Act sets out three conditions. The existence of any of the three conditions will trigger the application of new subsection 38.4(2), the capital gains exemption reversal.

New paragraph 38.4(3)(a) applies if any of a listed group of persons acquires the shares or real estate, or property substituted for the shares or real estate. More specifically, it addresses the situation in which the particular taxpayer, the qualified donee, or a person or partnership with which the particular taxpayer or qualified donee is not dealing at arm's length or is affiliated, acquires in the particular taxation year, directly or indirectly, all or any portion of the property,

property substituted for the property, or property that derives its value from the property to which new subsection 38.4(1) applied in a preceding taxation year.

New paragraph 38.4(3)(b) applies in certain circumstances if the property is a share of a private corporation. The condition in new paragraph 38.4(3)(b) is met if that share, or a share substituted for it, is redeemed, acquired or cancelled in the particular taxation year at a time when the taxpayer, a person or partnership not dealing at arm's length with the taxpayer or the taxpayer's estate, if applicable, does not deal at arm's length or is affiliated with the corporation.

New paragraph 38.4(3)(c) applies if the loanback rule in subsection 118.1(16) applies in the particular taxation year to determine the fair market value of a gift made in the particular taxation year or a previous taxation year, where the gift was an amount of money donated to a qualified donee within 30 days after a disposition of shares or real estate that was exempted from capital gains tax under new paragraph 38(a.4). (New paragraph 38.4(3)(c) will also apply to a corporate donor as subsection 110.1(6) provides that subsection 118.1(16), among others, applies to a corporation as if the references in subsection 118.1(16) to an individual were read as references to a corporation.)

This amendment applies to the 2017 and subsequent taxation years.

Taxpayer ceasing to exist

ITA

38.4(4)

New subsection 38.4(4) of the Act contains further anti-avoidance rules that are relevant to the new capital gains exemption in paragraph 38(a.4). Subsection 38.4(4) addresses situations where the taxpayer who benefitted from the preferential capital gains tax treatment under paragraph 38(a.4) has ceased to exist. Where the conditions in new subsection 38.4(4) are met, new subsection 38.4(2) will effectively reverse a previous capital gains exemption by triggering a taxable capital gain at a particular time in a later year.

The conditions in subsection 38.4(4) are as follows:

- a taxpayer, referred to as the “other taxpayer”, who benefitted from the capital gains exemption under new paragraph 38(a.4) on a particular disposition of shares or real estate in a prior taxation year, ceased to exist;
- a second taxpayer, referred to as the “particular taxpayer”
 - was either not dealing at arm's length or was affiliated with the other taxpayer immediately before the other taxpayer ceased to exist, or
 - is not dealing at arm's length with or is affiliated with a person or partnership at the particular time that was not dealing at arm's length or was affiliated with the other taxpayer immediately before the other taxpayer ceased to exist; and
- sometime after the taxation year in which the other taxpayer benefitted from the capital gains exemption under 38(a.4) on the particular disposition of shares or real estate, and during the period that is 60 months after the particular disposition, any of the following events occur at a particular time:
 - the particular taxpayer directly or indirectly acquires all or any portion of
 - the shares or real estate,

- property substituted for the shares or real estate, or
- property that derives its value from the shares or real estate,

where the shares or real estate were previously sold by the other taxpayer under the particular disposition in the prior taxation year;

- if a share of a private corporation was the subject of the particular disposition by the other taxpayer in the prior taxation year, where that share, or a share substituted for it, is redeemed, acquired or cancelled in the particular taxation year at a time when the particular taxpayer, or the particular taxpayer's estate, if applicable, directly or indirectly holds an interest in the corporation and does not deal at arm's length or is affiliated with the corporation; or
- the loanback rule in subsection 118.1(16) applies to determine the fair market value of a gift made in the current or prior taxation year, where
 - the gift was an amount of money to a qualified donee that was made by the other taxpayer within 30 days after a disposition of shares or real estate and exempted from capital gains tax under new paragraph 38(a.4), and
 - the particular taxpayer uses property of the qualified donee under an agreement made no earlier than five years before the gift was made, provided that the use of the property is not in the course of the donee's charitable activities.

(This rule will also apply where the particular taxpayer is a corporation as subsection 110.1(6) provides that subsection 118.1(16), among others, applies to a corporation as if the references in subsection 118.1(16) to an individual were read as references to a corporation.)

This amendment applies to the 2017 and subsequent taxation years.

Deemed excess

ITA
38.4(5)

New subsection 38.4(5) of the Act is introduced to charge interest in respect of the taxable portion of an amount deemed to be a capital gain for a particular taxation year under new subsection 38.4(2).

While new subsection 38.4(2) deems a particular taxpayer to have a capital gain in the taxation year in which any of the events in new subsection (3) occur or, where the particular taxpayer no longer exists, another taxpayer to have a capital gain in the taxation year in which any of the events in new subsection (4) occur, in either case, the taxpayer who is deemed to have a capital gain for the particular year is considered to have benefitted from the exemption under new paragraph 38(a.4). Accordingly, for the purposes of subsection 161(1), new subsection (5) deems this taxpayer to have an excess (*i.e.*, tax owing) immediately after its balance-due day for the year computed as if:

- the taxpayer were resident in Canada throughout the year;
- the taxpayer's tax payable for the year were equal to the tax payable by the taxpayer on its taxable income for the year;

- the amount included in the taxpayer's income as a result of the application subsection (2) was the taxpayer's only taxable income for the year;
- the taxpayer claimed no deductions under Division E for the year;
- the taxpayer had not paid any amounts on account of its tax payable for the year; and
- the tax payable had been outstanding throughout the period that begins immediately after the end of the preceding taxation year that included the disposition of property to which subsection 38.4(1) had previously applied, and that ends on the taxpayer's balance-due day for the particular year.

For further information, refer to the commentary to new subsections 38.4(2) to (4).

This amendment applies to the 2017 and subsequent taxation years.

Clause 4

Donated flow-through shares

ITA

40(12)

Subsection 40(12) of the Act is generally intended to allow the exemption from capital gains tax on donations of shares of a class in which a taxpayer acquired shares issued pursuant to a flow-through share agreement only to the extent that cumulative capital gains in respect of dispositions of shares of that class exceed the original cost of the flow-through shares.

Subsection 40(12) is amended to add a reference to new paragraph 38(*a.4*) which provides for a proportional exemption from capital gains tax, in certain circumstances, on the donation of all or a portion of the monetary proceeds of disposition from the sale of shares of a private corporation or real estate under certain circumstances. This amendment ensures that subsection 40(12) applies to a disposition of flow-through shares that are issued by a private corporation, where the proceeds of disposition of the shares are the subject of a gift such that new paragraph 38(*a.4*) applies to their disposition.

Subsection 40(12) is also amended to ensure that paragraph 38(*a.1*) applies for the purposes of the donation of flow-through shares, including where the disposition of flow-through shares is deemed by section 70 to have occurred and the shares are the subject of a gift to which subsection 118.1(5.1) applies and that is made by a taxpayer's graduated rate estate to a qualified donee.

This amendment applies to the 2017 and subsequent taxation years.

Investments by Registered Charities in Limited Partnerships

Clause 5

Deemed ownership of partnership property

ITA

149.1(11)

Private foundations are subject to certain restrictions on their corporate shareholdings pursuant to sections 149.1, 149.2 and 188.1 of the Act. In general, a private foundation is required to divest itself of excessive shareholdings in corporations and to disclose material corporate shareholdings in its annual prescribed information form. Section 149.1 provides the rules that must be met for charities to obtain and keep registered status. Section 149.2 provides rules relating to the calculation of the divestment obligation percentages of a private foundation in respect of its excess holdings of the shares of the capital stock of a corporation. Section 188.1 of the Act provides for the application of penalties to charities and the suspension of the privilege of issuing charitable donation tax receipts.

New subsection 149.1(11) of the Act is introduced consequential to the introduction of new subsection 253.1(2), which provides that where a registered charity or registered Canadian amateur athletic association holds an interest as a limited partner in a limited partnership, it will not be considered, solely because of its acquisition or holding of the limited partnership interest, to carry on any business or other activity of the partnership.

New subsection 149.1(11) provides that, for the purposes of sections 149.1, 149.2 and 188.1, each member of a partnership is deemed to own the portion of each property of the partnership equal to the proportion that the fair market value of the member's interest in the partnership is of the fair market value of all interests in the partnership. The effect of new subsection 149.1(11) is that the calculation of a private foundation's excess corporate holdings for the purposes of sections 149.1, 149.2 and 188.1 is determined by effectively looking through partnerships of which it is member.

This amendment is deemed to have come into force on April 21, 2015.

Clause 6

Investments in limited partnerships

ITA

253.1

Section 253.1 of the Act applies for specified provisions of the Act and *Income Tax Regulations* where a trust or corporation holds an interest as a limited partner in a limited partnership. It provides that the trust or corporation will not, solely because of its acquisition and holding of the limited partnership interest, be considered to carry on any business or other activity of the partnership.

Section 253.1 is amended in two respects. First, the existing rules are renumbered and included in new subsection 253.1(1). Second, new subsection 253.1(2) is introduced.

New subsection 253.1(2) provides that where a registered charity or registered Canadian amateur athletic association (RCAAA) holds an interest as a limited partner in a limited partnership, it will not be considered, solely because of its acquisition or holding of the limited partnership interest, to carry on any business or other activity of the partnership if certain conditions are met. New subsection 253.1(2) applies for the purposes of section 149.1 (which provides the rules that must be met for charities to obtain and keep registered status) and subsections 188.1(1) and (2) (which, in general terms, determine the tax liability of a registered charity in respect of the revocation of the charity's registration). The specific conditions that must be met for the provision to apply are:

- by operation of any law governing the arrangement in respect of the partnership, the liability of the registered charity or RCAAA as a member of the partnership must be limited;
- the registered charity or RCAAA must deal at arm's length with each general partner of the partnership; and
- the registered charity or RCAAA, or the registered charity or RCAAA together with persons and partnerships with which it does not deal at arm's length, cannot hold interests in the partnership that have a fair market value of more than 20% of the fair market value of the interests of all members of the partnership.

This amendment applies in respect of investments in limited partnerships that are made or acquired after April 20, 2015.

Synthetic Equity Arrangements

Clause 7

Where No Deduction Permitted

ITA

112(2.3)

Subsection 112(2.3) of the Act denies an inter-corporate dividend deduction in respect of dividends received by a corporation as part of a "dividend rental arrangement" of the particular corporation. The term "dividend rental arrangement" is defined in subsection 248(1) of the Act.

This subsection is amended for purposes of clarification to add a reference to a dividend rental arrangement of a partnership of which the particular corporation is directly or indirectly a member and of a trust under which the particular corporation is a beneficiary. This amendment ensures that the wording of this subsection is consistent with the definition "dividend rental arrangement", which provides that the "person" who enters into the arrangement may be a partnership or a person as otherwise defined under the Act, which includes a trust.

Subsection 112(2.3) and the definitions "dividend rental arrangement" and "synthetic equity arrangement" apply on a dividend-per-dividend basis. In other words, for each dividend received on a share, the share must be tested to determine whether the definitions "synthetic equity arrangement" and "dividend rental arrangement" are met in respect of the share. Even if a share

is part of a dividend rental arrangement for a given dividend, it may not be for a subsequent dividend.

For further information, see the commentary on new paragraphs (c) and (d) of the definition “dividend rental arrangement” in subsection 248(1) and on the new definition “synthetic equity arrangement” in that subsection.

This amendment applies to

- dividends that are paid or become payable after April 2017; and
- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

Dividend Rental Arrangements – Exception

ITA

112(2.31)

New subsection 112(2.31) of the Act provides an exception to the application of subsection 112(2.3) to a dividend received in a particular period if:

- the dividend rental arrangement is a dividend rental arrangement because of new paragraph (c) of the definition “dividend rental arrangement” in subsection 248(1) of the Act (*i.e.*, it involves a synthetic equity arrangement); and
- the taxpayer establishes that, throughout the particular period, no tax-indifferent investor or group of tax-indifferent investors, each member of which is affiliated with every other member, has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share because of the synthetic equity arrangement or a specified synthetic equity arrangement.

There is no exception to the application of subsection 112(2.3) if the dividend rental arrangement is a dividend rental arrangement because of paragraph (d) of the definition “dividend rental arrangement” in subsection 248(1).

A taxpayer is considered to have satisfied the condition described in new paragraph 112(2.31)(b) if it meets the requirements of paragraph (a), (b), (c) or (d) of new subsection 112(2.32) of the Act. Each of these paragraphs allows the taxpayer to satisfy this condition by obtaining certain specified representations from its counterparty or counterparties.

These representation rules apply only to shorter chains of derivatives as the veracity of representations made by parties in longer chains would not be practicably verifiable by the Minister of National Revenue.

For further information, see the commentary on new subsection 112(2.32), on new paragraphs (c) and (d) of the definition “dividend rental arrangement” in subsection 248(1) and on the new definition “synthetic equity arrangement” in that subsection.

This amendment applies to

- dividends that are paid or become payable after April 2017; and

- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

Representations

ITA

112(2.32)

New subsection 112(2.32) of the Act sets out rules under which a taxpayer is able to satisfy the condition in new paragraph 112(2.31)(b) by obtaining certain specified representations from its synthetic equity arrangement counterparty or counterparties. In its simplest form, these rules require the taxpayer to obtain two types of representations from its counterparty to the synthetic equity arrangement: (1) the counterparty is not a tax-indifferent investor, and (2) the counterparty does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share. The second type of representation is used as a substitute for a back-to-back anti-avoidance rule, and is intended to prevent a taxpayer from avoiding the application of the synthetic equity arrangement rules by interposing a counterparty between itself and a tax-indifferent investor. It is intended that the representations provide taxpayers and the Minister of National Revenue with additional certainty as to whether an intermediate counterparty has, in fact, entered into a specified synthetic equity arrangement with a tax-indifferent investor.

New subsection 112(2.32) requires that the representations obtained by the taxpayer be accurate. If a taxpayer relies on specified representations to claim an inter-corporate dividend deduction on a share throughout a particular period but these representations are later determined to be inaccurate by the Minister of National Revenue, then the exception under subsection 112(2.31) will not be considered to have applied to the arrangement. As such, the arrangement will be considered to be a dividend rental arrangement throughout that particular period.

New subsection 112(2.32) also requires that the representations be in writing. For example, these representations could be included in a confirmation under an ISDA Master Agreement between the parties, if one exists.

Paragraph (a) applies to a single synthetic equity arrangement. In such a situation, a taxpayer will be considered to have satisfied the condition described in new paragraph 112(2.31)(b) if it obtains accurate representations in writing from its counterparty, or from each member of a group comprised of all its counterparties each of which is affiliated with every other member (referred to in the subsection as an “affiliated counterparty”) that:

- it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period; and
- it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period.

For these purposes, and elsewhere in new subsection 112(2.32), reasonable expectations are those of a reasonable person, based on all of the facts and circumstances at the time the synthetic

equity arrangement is entered into in respect of the particular period. However, new subsection 112(2.33) of the Act provides that if, during the particular period, the reasonable expectations of the counterparty or affiliated counterparty change, then the particular period for which it has provided a representation is deemed to end at that time.

Paragraph (b) applies to back-to-back chains of agreements or arrangements where the final counterparty in the chain is either a single counterparty or an affiliated group of counterparties. In general terms, a taxpayer will obtain representations that its counterparty (or each of its affiliated counterparties) is not a tax-indifferent investor and has obtained representations similar to those provided by a single counterparty (or each affiliated counterparty) under paragraph (a). More specifically, a taxpayer will be considered to have satisfied the condition described in paragraph 112(2.31)(b) if it obtains accurate representations in writing from its counterparty, or from each affiliated counterparty, that:

- it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period;
- it has entered into one or more specified synthetic equity arrangements that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit in certain specified circumstances; and
- it has obtained accurate representations in writing from each of its specified counterparties, or from each member of the group of affiliated specified counterparties (as these terms are defined in this subsection) that:
 - it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period; and
 - it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period.

Paragraph (c) applies to back-to-back chains of arrangements where the final counterparties in the chain deal at arm's length with each other, and generally allows a taxpayer to indirectly obtain representations in respect of certain arrangements that would not have constituted synthetic equity arrangements had they been entered into directly by the taxpayer with the final counterparties. In such a situation, a taxpayer will be considered to have satisfied the condition described in new paragraph 112(2.31)(b) if it obtains accurate representations in writing from its counterparty, or from each affiliated counterparty, that:

- it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period,
- it has entered into specified synthetic equity arrangements:
 - that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share;
 - where no single specified counterparty or single group of affiliated specified counterparties has been provided with all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share; and
 - where each specified counterparty or affiliated specified counterparty deals at arm's length with each other; and

- it has obtained accurate representations in writing from each of its specified counterparties, or from each of its affiliated specified counterparties, that:
 - it is a person resident in Canada and it does not reasonably expect to cease to be resident in Canada during the particular period; and
 - it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period.

Paragraph (*d*) allows two or more related Canadian resident parties in a chain of derivatives, that includes the taxpayer, to be effectively counted as one party for the purposes of new subsection 112(2.32). This objective is realized by allowing the last party in the synthetic equity arrangement chain to obtain the representations required by paragraphs (*a*), (*b*) or (*c*). In order for the taxpayer to rely on paragraph (*d*), the last party in the synthetic equity arrangement chain that has entered into one or more specified synthetic equity arrangements that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit in respect of a share must have entered into those specified synthetic equity arrangements only with a counterparty or counterparties that deal at arm's length with it. The term "synthetic equity arrangement chain" is defined separately in subsection 248(1) of the Act.

For further information, see the commentary on new subsection 112(2.31), new paragraphs (*c*) and (*d*) of the definition "dividend rental arrangement" in subsection 248(1) and the new definition "synthetic equity arrangement" in that subsection.

This amendment applies to

- dividends that are paid or become payable after April 2017; and
- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

End of Particular Period

ITA
112(2.33)

New subsection 112(2.33) of the Act provides that if, at a time during a particular period, a counterparty, specified counterparty, affiliated counterparty or affiliated specified counterparty reasonably expects to become a tax-indifferent investor or, if it has provided a representation described by subparagraph 112(2.32)(*a*)(ii) or clause 112(2.32)(*b*)(iii)(B) or (*c*)(iii)(B) in respect of a share, to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share, the particular period for which it has provided a representation in respect of the share is deemed to end at that time. New subsection 112(2.33) is intended to ensure that the exception in subsection 112(2.31) is only available for the period during which the representations that have been provided remain accurate.

For further information, see the commentary on new subsection 112(2.32).

This amendment applies to

- dividends that are paid or become payable after April 2017; and
- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

Interpretation

ITA

112(2.34)

New subsection 112(2.34) of the Act provides that, for greater certainty, each reference in new subsection 112(2.32) of the Act to a “counterparty”, a “specified counterparty”, an “affiliated counterparty” or an “affiliated specified counterparty” is to be read as referring only to a person or partnership that obtains all or any portion of the risk of loss or opportunity for gain or profit in respect of a share. New subsection 112(2.34) effectively clarifies that the representations described in subsection 112(2.32) do not have to be obtained from certain contractual parties that may be involved in an equity derivative transaction, such as third-party calculation agents, if they do not obtain any economic exposure in respect of the share.

This amendment applies to

- dividends that are paid or become payable after April 2017; and
- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

Synthetic Equity Arrangements – Ordering

ITA

112(10)

New subsection 112(10) of the Act is intended to ensure that a person or partnership cannot circumvent the application of new paragraph (c) of the definition “dividend rental arrangement” in subsection 248(1) of the Act and the dividend stop-loss rules in section 112 of the Act by systematically matching synthetic equity arrangements with more recently acquired shares in a way that leaves earlier acquired shares avoiding the dividend rental arrangement rules and, where the 365-day ownership requirement is met, the dividend stop-loss rules on a subsequent disposition of the shares.

Subsection 112(10) provides that, for the purposes of the listed provisions in the stop-loss rules, if a synthetic equity arrangement is in respect of a number of shares that are identical properties (referred to in the subsection as “identical shares”) that is less than the total number of such identical shares owned by a person or partnership at that time and in respect of which there is no

other synthetic equity arrangement, then the synthetic equity arrangement is deemed to be in respect of those identical shares in the order in which the person or partnership acquired them.

Example

A taxable Canadian corporation (the “Taxpayer”) owns 500 shares of ABC Co. These shares were acquired at the following dates:

- *100 of the shares were acquired on September 1, 2015;*
- *300 of the shares were acquired on December 1, 2015; and*
- *100 of the shares were acquired on March 1, 2016.*

On July 1, 2016, the Taxpayer enters into a six-month cash-settled total return swap that references 100 shares of ABC Co. On January 1, 2017, on termination of the swap, the Taxpayer actually disposes of the 500 shares of ABC Co.

During the term of the swap, the Taxpayer will have a synthetic equity arrangement in respect of 100 shares of ABC Co. Since the Taxpayer owns a total of 500 shares of ABC Co., subsection 112(10) will apply to provide that the synthetic equity arrangement will be matched with the shares of ABC Co. in the order in which the Taxpayer acquired those shares (i.e., on a first-in-first-out (“FIFO”) basis). As such, the shares of ABC Co. referenced under the swap will be matched, on a FIFO basis, with the 100 shares of ABC Co. that were acquired on September 1, 2015.

For further information, see the commentary on new paragraphs (c) and (d) of the definition “dividend rental arrangement” in subsection 248(1) and on the new definition “synthetic equity arrangement” in that subsection.

This amendment is deemed to have come into force on April 22, 2015.

Clause 8

Definitions

ITA
248(1)

“dividend rental arrangement”

The definition “dividend rental arrangement” is amended to add new paragraphs (c) and (d). Its language is also updated in certain respects.

New paragraph (c) of the definition provides that a dividend rental arrangement of a person includes any synthetic equity arrangement in respect of a DRA share of the person. The term “synthetic equity arrangement” is defined in subsection 248(1) of the Act. A synthetic equity arrangement that is a dividend rental arrangement under new paragraph (c) of the definition may, depending on the circumstances, also constitute a dividend rental arrangement under existing paragraph (a) of the definition.

New paragraph (*d*) of the definition is an anti-avoidance rule intended to prevent parties that otherwise deal at arm's length with each other from colluding with one-another to circumvent the definition "synthetic equity arrangement". Paragraph (*d*) reflects the broader assumption underlying the synthetic equity arrangement rules that market participants that otherwise deal at arm's length with each other will not collude with one-another to enter into transactions that do not fall within the rules but have the effect of providing the same benefits to each participant.

Paragraph (*d*) provides that a dividend rental arrangement will include one or more agreements or arrangements (other than agreements or arrangements described in new paragraph (*c*) of the definition) that are entered into by the person or the connected person referred to in paragraph (*a*) of the new definition "synthetic equity arrangement" including for greater certainty, by any combination of the person and connected persons if:

- the agreements or arrangements have the effect, or would have the effect if each agreement entered into by a connected person were entered into by the person, of eliminating all or substantially all of the person's risk of loss and opportunity for gain or profit in respect of a DRA share of the person;
- as part of a series of transactions that includes these agreements or arrangements, a tax-indifferent investor (as defined in subsection 248(1)), or a group of tax-indifferent investors each member of which is affiliated with every other member, obtains all or substantially all of the risk of loss and opportunity for gain or profit in respect of the DRA share or an identical share (as defined in new subsection 112(10) of the Act); and
- it is reasonable to conclude that one of the purposes of the series of transactions is to obtain the result described above.

For further information, see the commentary on the new definitions "synthetic equity arrangement", "DRA share" and "tax-indifferent investor" in subsection 248(1).

This amendment applies to

- dividends that are paid or become payable after April 2017; and
- dividends that are paid or become payable at any time after October 2015 and before May 2017 on a share if, in general terms, all or any part of an agreement or arrangement, in respect of the share, is entered into, acquired, extended or renewed, or if the notional amount under an agreement is increased, after April 21, 2015 and before that time.

"DRA share"

The definition "DRA share" is added to subsection 248(1) of the Act. A "DRA share" of a person or partnership is intended to include any share on which dividends could be received (or deemed to be received) by the person or partnership and in respect of which there could be a synthetic equity arrangement.

In most cases, a person or partnership will receive a dividend on a share if the person or partnership owns the share for tax purposes. This will be the case, for example, if the person or partnership owns the share under the governing private law or is deemed to own the share under

a securities lending arrangement. Such a share will be a DRA share of that person or partnership under paragraph (a) of the definition.

It is also possible for a person or partnership to be deemed to receive a dividend on a share without the person or partnership being considered to own the share for tax purposes. Paragraphs (b), (c), and (d) of the definition are intended to deal with these situations. A share that is described in any of these paragraphs will be a DRA share of that person or partnership.

This amendment is deemed to have come into force on April 22, 2015.

“recognized derivatives exchange”

The definition “recognized derivatives exchange” is added to subsection 248(1) of the Act. A “recognized derivatives exchange” is a person or partnership recognized or registered under the securities laws of a province to carry on the business of providing the facilities necessary for the trading of options, swaps, futures contracts or other financial contracts or instruments whose market price, value, delivery obligations, payment obligations or settlement obligations are derived from, referenced to or based on an underlying interest.

For the purposes of the definition, an exchange will be considered to be recognized or registered under the securities laws of a province if a provincial securities commission has, for example, published a public statement or notice to this effect. Both Canadian and foreign derivatives exchanges may potentially meet the requirements of the definition.

The definition is relevant for the purposes of subparagraph (b)(i) of the new definition “synthetic equity arrangement” in subsection 248(1), which provides an exception for certain agreements traded on a recognized derivatives exchange from being characterized as a synthetic equity arrangement.

For further information, see the commentary on the new definition “synthetic equity arrangement” in subsection 248(1).

This amendment is deemed to have come into force on April 22, 2015.

“specified mutual fund trust”

The definition “specified mutual fund trust” is added to subsection 248(1) of the Act. A “specified mutual fund trust”, at any time, means a mutual fund trust other than one for which it can reasonably be considered, having regard to all the circumstances, including the terms and conditions of the units of the trust, that the total of all amounts each of which is the fair market value, at that time, of a unit issued by the trust and held by a person exempt from tax under section 149 of the Act is all or substantially all of the total of all amounts each of which is the fair market value, at that time, of a unit issued by the trust.

The definition is relevant for the purposes of paragraphs (c) and (e) of the new definition “tax-indifferent investor” in subsection 248(1), which exclude a specified mutual fund trust from being characterized as a tax-indifferent investor.

For further information, see the commentary on the new definitions “tax-indifferent investor” and “synthetic equity arrangement” in subsection 248(1).

This amendment is deemed to have come into force on April 22, 2015.

“specified synthetic equity arrangement”

The definition “specified synthetic equity arrangement” is added to subsection 248(1) of the Act. A “specified synthetic equity arrangement”, in respect of a DRA share of a person or partnership, means one or more agreements or other arrangements that:

- have the effect of providing to a person or partnership all or any portion of the risk of loss or opportunity for gain or profit in respect of the DRA share; and
- can reasonably be considered to have been entered into in connection with a synthetic equity arrangement, in respect of the DRA share, or in connection with another specified synthetic equity arrangement, in respect of the DRA share.

Paragraph (a) of the definition provides that, for greater certainty, opportunity for gain or profit includes rights to, benefits from and distributions on a share.

The definition is relevant for the purposes of new subsections 112(2.31) and (2.32) of the Act. In general terms, a “specified synthetic equity arrangement” represents the second or any subsequent leg in a back-to-back chain of agreements or arrangements.

For further information, see the commentary on new subsections 112(2.31) and (2.32) and on the definition “synthetic equity arrangement” in subsection 248(1).

This amendment is deemed to have come into force on April 22, 2015.

“synthetic equity arrangement”

The definition “synthetic equity arrangement” is added to subsection 248(1) of the Act. A “synthetic equity arrangement” in respect of a DRA share of a person or partnership (referred to in the definition as the “particular person”) means one or more agreements or other arrangements that satisfy the criteria in paragraph (a) of the definition, but does not include any agreements or arrangements described in any of subparagraphs (b)(i), (ii) or (iii) of the definition.

Subparagraph (a)(i) of the definition provides that a synthetic equity arrangement must be entered into by the particular person or by a person or partnership that does not deal at arm’s length with, or is affiliated with, the particular person (referred to in the definition as a “connected person”) including, for greater certainty, by any combination of the particular person and connected persons, with one or more persons or partnerships (referred to in the definition as a “counterparty” and in new subsection 112(2.32) of the Act as a “counterparty” or an “affiliated counterparty”, as appropriate).

Subparagraph (a)(ii) of the definition provides that a synthetic equity arrangement must have the effect, or would have the effect if each agreement entered into by a connected person were entered into by the particular person, of providing all or substantially all of both the risk of loss and opportunity for gain or profit in respect of the DRA share of the particular person to a counterparty or a group of counterparties (each member of which is affiliated with every other member).

Two or more agreements or other arrangements entered into in connection with each other by the same two parties must be considered together to determine if the overall effect is to provide all or substantially all of the risk of loss and opportunity for gain or profit in respect of a DRA share to the counterparty. Otherwise, parties could replicate a total return exposure arrangement by

entering into two or more separate agreements, each of which would not provide all or substantially all of the risk of loss and opportunity for gain or profit in respect of the DRA share, but together would do so. To that end, subparagraph (a)(ii) of the definition considers each agreement entered into by a connected person (within the meaning assigned by subparagraph (a)(i) of the definition) to have been entered into by the particular person for the purpose of determining whether all or substantially all of the risk of loss and opportunity for gain or profit in respect of a DRA share of that particular person has been provided to a counterparty.

The determination of whether all or substantially all of the risk of loss and opportunity for gain or profit in respect of a share has been provided to a counterparty is highly factual. In particular, the term “substantially all” does not always lend itself to a bright-line, numerical threshold. For instance, a relevant consideration is the factual threshold under which a counterparty that enters into an arrangement as an alternative to investing directly in shares would not find it economically viable to do so.

An element of probability must generally be taken into account in determining the risk of loss and opportunity for gain or profit in respect of a share that is provided under an arrangement. For example, a particular person may enter into a cash-settled total return swap that references a particular share when the share is trading at \$100 and under which the counterparty agrees to pay the particular person an amount equal to any decrease in the fair market value of the share but only where the share drops to a price between \$100 and \$60 at the end of the term. The total return swap may still be considered to provide substantially all of the risk of loss to the counterparty if, for example, it is virtually certain, as determined when the swap is entered into, that the share will trade within that range.

A synthetic equity arrangement may have the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of a share to a counterparty where the arrangement references the share of the corporation in respect of which the particular person receives a dividend but also where it references a different share of the same corporation, a share of another corporation or any other underlying interest, provided that it is reasonably expected to provide the same or substantially the same risk of loss and opportunity for gain or profit as the relevant share.

A synthetic equity arrangement may have the effect of providing to a counterparty all or substantially all of the risk of loss and opportunity for gain or profit in respect of a number of shares of a corporation that is different than the number of shares of that corporation referenced under the arrangement. When a synthetic equity arrangement provides to a counterparty a fraction or a multiple of all or substantially all of the risk of loss and opportunity for gain or profit of a number of referenced shares, the number of shares in respect of which the arrangement is in respect of must be adjusted to take into account the fraction or multiple. For example, if a cash-settled total return swap provides 50% of the risk of loss and opportunity for gain or profit on 200 shares of ABC Co., the total return swap will be considered to be an arrangement that provides 100% of the same exposure on 100 shares of ABC Co. (and will therefore be a synthetic equity arrangement in respect of 100 shares of ABC Co.).

Subparagraph (a)(ii) of the definition also provides that, for greater certainty, opportunity for gain or profit includes rights to, benefits from and distributions on a share. Under a typical synthetic equity arrangement, the particular person will be under an obligation to pay or credit an

amount that is contingent upon or determined by reference to dividends paid on the underlying shares, whether the reference is explicit or implicit (referred to in these notes as “dividend-equivalent amounts”). Certain synthetic equity arrangements, such as total return swaps, will provide for dividend-equivalent amounts equal to the actual dividend payments on the underlying shares. Other types of synthetic equity arrangements, such as forward contracts and same strike price put-call arrangements, may provide for dividend-equivalent amounts based on expected dividend payments on the underlying shares.

Given that subparagraph (a)(ii) of the definition is based on the effects of an arrangement, for the purposes of determining whether an arrangement has the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit to a counterparty:

- there is no requirement that the counterparty have some legal right with respect to the underlying share referenced under the synthetic equity arrangement; and
- an arrangement entered into where each counterparty is substituted for a central clearing counterparty, through novation or otherwise, is generally considered to have been entered into by the initial counterparties.

Subparagraph (a)(iii) of the definition provides that where an arrangement is entered into by a connected person, it must be reasonable to consider that the arrangement was entered into with the knowledge, or where there ought to have been the knowledge, that the effect described in subparagraph (a)(ii) of the definition would result. This ensures that the synthetic equity arrangement rules will not apply to a particular person when a connected person enters into a transaction that inadvertently economically offsets the economic exposure of a DRA share of the particular person.

Paragraph (b) of the definition excludes certain agreements and arrangements from being a synthetic equity arrangement.

Subparagraph (b)(i) of the definition excludes an agreement that is traded on a recognized derivatives exchange unless it can reasonably be considered that, at the time the agreement is entered into:

- the particular person or the connected person, as the case may be, knows or ought to know that its counterparty is a tax-indifferent investor; or
- one of the main reasons for entering into the agreement is to obtain the benefit of a deduction in respect of a payment, or a reduction of an amount that would otherwise have been included in income, under the agreement, that corresponds to an expected or actual dividend in respect of a DRA share.

The first anti-avoidance rule contained in subparagraph (b)(i) of the definition is intended to prevent, for example, counterparties from agreeing to the terms of an equity derivative outside of an exchange and then executing the trade through the exchange when it is thinly-traded.

The second anti-avoidance rule is intended to prevent a particular person from entering into an exchange-traded derivative for one of the main reasons of obtaining, for example, the benefit of a deduction in respect of a payment under the agreement that corresponds to expected dividends in respect of a DRA share. A particular person could realize a similar tax benefit if it entered into an exchange-traded equity derivative as if it entered into an over-the-counter equity derivative,

such as a total return swap, in respect of the same DRA share. If a particular person enters into an exchange-traded derivative for essentially commercial reasons, such as temporarily hedging itself against broad market risks, and if obtaining the deduction in respect of a payment that corresponds to expected dividends is merely incidental to those commercial reasons, then the particular person would generally not be considered to be subject to this anti-avoidance rule. Circumstances relevant in determining the reasons for entering into the agreement may include the particular person's historical usage of similar exchange-traded derivatives.

Subparagraph (b)(ii) provides that the definition does not include one or more agreements or other arrangements that would otherwise be a synthetic equity arrangement, in respect of a share owned by the particular person (such agreements or other arrangements are referred to in this subparagraph of the definition as the "synthetic short position"), if:

- the particular person has entered into one or more other agreements or other arrangements (other than, for greater certainty, an agreement under which the share is acquired or an agreement or arrangement under which the particular person receives a deemed dividend and is provided with all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share) that have the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share to the particular person (such other agreements or other arrangements are referred to in subparagraph (b)(ii) of the definition as the "synthetic long position");
- the synthetic short position has the effect of offsetting all amounts included or deducted in computing the income of the particular person with respect to the synthetic long position; and
- the synthetic short position was entered into for the purpose of obtaining the effect described above.

Subparagraph (b)(iii) of the definition excludes certain ordinary course share purchase transactions from being characterized as a synthetic equity arrangement. More specifically, this subparagraph provides that the definition does not include an agreement to purchase the shares of a corporation, or a purchase agreement that is part of a series of agreements to purchase the shares of a corporation, under which a counterparty or a group of counterparties each member of which is affiliated with every other member acquires control of the corporation that has issued the shares being purchased.

However, this exception will not be available where the main reason for establishing, incorporating or operating the corporation is to have subparagraph (b)(iii) of the definition apply. This anti-avoidance rule and the requirement that the acquisition of control must be with respect to the corporation that has issued the shares being purchased are intended to ensure that only ordinary corporate acquisitions qualify for the exception.

Example – Total Return Swap

A taxable Canadian corporation (the "Taxpayer") owns 200 shares of ABC Co. On June 15, 2016, the Taxpayer enters into a one-year cash-settled total return swap that references 200 shares of ABC Co. with an entity that is exempt from tax under Part I of the Act (the "Tax-Exempt").

Under the total return swap:

- *the Taxpayer agrees to pay the Tax-Exempt an amount equivalent to the dividends received on the 200 shares of ABC Co. plus an amount equal to any increase in the fair market value of these shares during the term of the total return swap; and*
- *the Tax-Exempt agrees to pay the Taxpayer an amount determined by applying an interest rate to the notional amount of the total return swap plus an amount equal to any decrease in the fair market value of the 200 shares during the term of the total return swap.*

The total return swap entered into between the Taxpayer and the Tax-Exempt is a synthetic equity arrangement in respect of the 200 shares of ABC Co., as it has the effect of providing all of the risk of loss and opportunity for gain or profit in respect of the 200 shares of ABC Co. to the Tax-Exempt.

Example – Forward Contract

A taxable Canadian corporation (the “Taxpayer”) owns 400 shares of ABC Co. On September 15, 2016, the Taxpayer enters into a one-year cash-settled forward contract with an entity that is exempt from tax under Part I of the Act (the “Tax-Exempt”) where the Taxpayer agrees to sell and the Tax-Exempt agrees to purchase 400 shares of ABC Co. in one year.

The settlement amount under the forward contract is based on the difference between the fair market value of the 400 shares of ABC Co. measured at maturity and the agreed-upon forward price of the 400 shares of ABC Co. This forward price is the spot price of the shares on the date the contract is entered into plus a market interest rate applied to the spot price over the term of the contract minus the amount of the expected dividends on the shares over the term of the contract.

The forward contract entered into between the Taxpayer and the Tax-Exempt is a synthetic equity arrangement in respect of the 400 shares of ABC Co., as it has the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of the 400 shares of ABC Co. to the Tax-Exempt.

Example – Put-Call Arrangement

A taxable Canadian corporation (the “Taxpayer”) owns 600 shares of ABC Co. On November 1, 2016, the Taxpayer purchases a put option from an entity that is exempt from tax under Part I of the Act (the “Tax-Exempt”) allowing it to sell 600 shares of ABC Co. to the Tax-Exempt at a strike price equal to the spot price of the shares on the date the option is entered into plus a market interest rate applied to the spot price over the term of the option minus the amount of the expected dividends on the shares over the term of the option. Simultaneously, another taxable Canadian corporation which does not deal at arm’s length with the Taxpayer (the “Subsidiary”) sells a call option to the Tax-Exempt allowing it to purchase 600 shares of ABC Co. from the Subsidiary at the same strike price as the put option. Both options are European style, that is, they are exercisable on the same date in the future. The Subsidiary has full knowledge of the put option purchased by the Taxpayer.

If the value of the 600 shares is above the strike price on the exercise date, the Tax-Exempt will exercise the call option and receive the difference between the fair market value of the shares

and the strike price. Conversely, if the value of the shares is below the strike price on the exercise date, the Taxpayer will exercise the put option and receive the difference between the fair market value of the shares and the strike price.

The put-call arrangement entered into by the Taxpayer and the Subsidiary with the Tax-Exempt is a synthetic equity arrangement in respect of the 600 shares of ABC Co. as it has the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of the 600 shares of ABC Co. to the Tax-Exempt.

Example – Offsetting Synthetic Position

A taxable Canadian corporation (the “Taxpayer”) owns 200 shares of ABC Co. On November 1, 2016, the Taxpayer enters into a two-year cash-settled total return swap that references 200 shares of ABC Co. with another taxable Canadian corporation in which the Taxpayer takes a long position (i.e., it acquires economic exposure to an additional 200 ABC Co. shares).

On the same day, the Taxpayer then enters into a two-year cash-settled total return swap that references 200 shares of ABC Co. with an entity that is exempt from tax under Part I of the Act (the “Tax-Exempt”) in which the Taxpayer takes a short position.

The short position that the Taxpayer has taken under the two-year cash-settled total return swap with the Tax-Exempt would normally be a synthetic equity arrangement in respect of the 200 shares of ABC Co. owned by it. However, it would be excluded under subparagraph (b)(ii) of the definition “synthetic equity arrangement”. In effect, the short swap position would be considered to offset the long swap position rather than the directly owned shares.

For further information, see the commentary on new paragraph (c) of the definition “dividend rental arrangement” in subsection 248(1) of the Act.

This amendment is deemed to have come into force on April 22, 2015.

“synthetic equity arrangement chain”

The definition “synthetic equity arrangement chain” is added to subsection 248(1) of the Act. A “synthetic equity arrangement chain”, in respect of a share owned by a person or partnership, means a synthetic equity arrangement – or a synthetic equity arrangement in combination with one or more specified synthetic equity arrangements – where:

- no party to the synthetic equity arrangement or a specified synthetic equity arrangement, if any, is a non-resident person or a partnership other than a Canadian partnership; and
- each other party to these agreements or arrangements is affiliated with the person or partnership.

The definition is relevant for the purposes of paragraph 112(2.32)(d) of the Act, which allows the last party in a synthetic equity arrangement chain to obtain the representations required to satisfy the condition in paragraph 112(2.31)(b).

For further information, see the commentary on the definitions “synthetic equity arrangement” and “specified synthetic equity arrangement” in subsection 248(1), and on subsections 112(2.31) and (2.32).

This amendment is deemed to have come into force on April 22, 2015.

“tax-indifferent investor”

The definition “tax-indifferent investor” is added to subsection 248(1) of the Act. Paragraph 112(2.31)(b) provides an exception to the inter-corporate dividend deduction denial rule in subsection 112(2.3) where a taxpayer can establish that no tax-indifferent investor or group of tax-indifferent investors, each member of which is affiliated with every other member, has all or substantially all of the risk of loss and opportunity for gain or profit in respect of a share because of a synthetic equity arrangement or a specified synthetic equity arrangement. The notion of “tax-indifferent investor” therefore essentially limits the application of subsection 112(2.3) to dividends received on DRA shares for which there is a synthetic equity arrangement or a specified synthetic equity arrangement entered into with certain counterparties that do not pay any Canadian income tax on the dividend-equivalent amounts received under the arrangement, namely, persons exempt from tax under section 149 of the Act, certain non-resident persons and trusts or partnerships of which such persons are, directly or indirectly, beneficiaries or members.

Paragraphs (a) and (b) of the definition refer respectively to a person exempt from tax under section 149 and a non-resident person, other than a person to which all amounts paid or credited under a synthetic equity arrangement or a specified synthetic equity arrangement may reasonably be attributed to the business carried on by the person in Canada through a permanent establishment.

Paragraph (c) of the definition refers to a trust resident in Canada (other than a specified mutual fund trust) if any of the interests as a beneficiary under the trust is not a fixed interest in the trust (such a trust is referred to in the definition as a “discretionary trust”).

Paragraphs (d) and (e) of the definition provide look-through rules where the counterparty to the synthetic equity arrangement or the specified synthetic equity arrangement is a partnership or a trust resident in Canada (other than a specified mutual fund trust or a discretionary trust described in paragraph (c)).

For further information, see the commentary on subsections 112(2.3), (2.31) and (2.32).

This amendment is deemed to have come into force on April 22, 2015.

Synthetic Equity Arrangements – Disaggregation

ITA

248(42)

New subsection 248(42) of the Act disaggregates an arrangement that references a portfolio of shares or an index of shares into separate arrangements for each type of identical share (as defined in new subsection 112(10) of the Act) referenced under the initial arrangement.

Subsection 248(42) provides that, for the purposes of the new definition “synthetic equity arrangement” in subsection 248(1) of the Act, new paragraphs (c) and (d) of the definition “dividend rental arrangement” in that subsection and new subsections 112(2.31), (2.32) and (10) of the Act, an arrangement that reflects the fair market value of more than one type of identical share is considered to be a separate arrangement in respect of each type of identical share the value of which the arrangement reflects.

Example

A taxable Canadian corporation (the “Taxpayer”) owns 100 shares of ABC Co., 200 shares of DEF Co. and 150 shares of GHI Co. On August 15, 2016, the Taxpayer enters into a one-year cash-settled total return swap that references 100 shares of ABC Co., 100 shares of DEF Co. and 100 shares of GHI Co. with an entity that is exempt from tax under Part I of the Act (the “Tax-Exempt”).

On August 31, 2016, ABC Co. declares a dividend of \$1 per share, DEF Co. declares a dividend of \$2 per share and GHI Co. declares a dividend of \$2 per share, all with a record date of September 2, 2016 and a payment date of September 5, 2016.

Under the total return swap, the Taxpayer is obligated to pay a dividend-equivalent amount of \$500 to the Tax-Exempt. Given that there will be a separate synthetic equity arrangement in respect of each of the three kinds of identical shares referenced under the total return swap, the Taxpayer will have a “dividend rental arrangement” in respect of the shares of each of these corporations.

The Taxpayer will be denied an inter-corporate dividend deduction on all of the \$100 dividends (100/100 x \$100) received from ABC Co., on \$200 (100/200 x \$400) of the \$400 dividends received from DEF Co. and on \$200 (100/150 x \$300) of the \$300 dividends received from GHI Co.

For further information, see the commentary on new subsections 112(2.31), (2.32) and (10), and on new paragraph (c) of the definition “dividend rental arrangement” in subsection 248(1) and the new definition “synthetic equity arrangement” in that subsection.

This amendment is deemed to have come into force on April 22, 2015.

Clause 9

ITR
8201

Section 8201 of the *Income Tax Regulations* provides a definition of the term “permanent establishment” for the purposes of various provisions in the Act.

This section is amended to add a reference to the new definition “tax-indifferent investor” in subsection 248(1) of the Act.

This amendment is deemed to have come into force on April 22, 2015.

Tax Avoidance of Corporate Capital Gains (Section 55)

Clause 10

Stock dividends

ITA

52(3)(a)

Subsection 52(3) of the Act establishes the cost of a share received as a stock dividend by a shareholder of a corporation.

Paragraph 52(3)(a) provides that, where a shareholder receives a stock dividend that is a dividend, the cost to the shareholder of the share received is generally the amount of the stock dividend. In the case of such a stock dividend paid to a corporate shareholder, the cost of the share does not include the amount, if any, of the dividend that the corporation may deduct under subsection 112(1) in computing its taxable income, except the portion of the dividend that would not be a capital gain under subsection 55(2) because it could reasonably be considered to be attributable to the income earned or realized by any corporation (commonly known as “safe income”).

Paragraph 52(3)(a) is amended consequential to amendments made to section 55.

Amended subparagraph 52(3)(a)(i) provides that, where the stock dividend is received by an individual, the cost of the share to the individual is the amount of the stock dividend. This amount is, in general, the related corporate paid-up capital in respect of the stock dividend.

In any other case, amended subparagraph 52(3)(a)(ii) provides that the cost of the stock dividend is the total of two amounts which are determined under clauses (A) and (B) respectively.

In general terms, clause (A) provides that the cost of a stock dividend received by a corporation is the safe income that could reasonably be considered to contribute to the unrealized capital gain on the share on which the stock dividend is paid. More specifically, the amount under clause (A) is the amount, if any, by which

- the amount that is the lesser of the amount of the stock dividend (see the definition “amount” in subsection 248(1)) and its fair market value, exceeds
- the amount of the dividend that a shareholder that is a corporation may deduct under subsection 112(1), except any portion of the dividend that, if paid as a separate dividend, would not exceed the amount of income earned or realized by any corporation that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value of the share on which the dividend is received. As is the case under the current rule, the reduction for amounts deductible under subsection 112(1) is to be applied regardless of whether subsection 55(2) actually applies to the dividend (subject to the exception for safe income).

In general terms, clause (B) applies if the anti-avoidance rule in subsection 55(2) applies in respect of the stock dividend (or would have applied if there were no safe income in respect of the stock dividend). The description of B in the formula concerns cases where the fair market

value of a stock dividend exceeds the amount of the stock dividend for the purpose of clause (A) above. This could be the case if the fair market value of a share that is issued as a stock dividend is greater than the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the stock dividend (commonly called “high-low” shares), which fair market value is deemed to be the amount of the dividend for the purpose of subsection 55(2) under subsection 55(2.2).

Clause (B) provides an amount that is determined by the formula $A + B$:

- Variable A is the amount of the stock dividend deemed to be a capital gain by amended paragraph 55(2)(c). For this purpose, and unlike in clause (A) discussed above, the “amount” of the stock dividend is determined under new subsection 55(2.2) – in general, that amount corresponds to the fair market value of the share issued as a stock dividend and not its paid-up capital.
- Variable B is the amount, if any, by which the amount of the stock dividend that is deemed by paragraph 55(2.3)(b) to reduce the safe income of any corporation that could reasonably be considered to contribute to the capital gain on the share (which gain was reduced by the dividend) exceeds the amount determined for clause (A).

Example

- *Holdco owns all of the shares (Class A) of Subco, which have a fair market value (FMV) of \$100 and an adjusted cost base of \$0.*
- *Subco pays Holdco a stock dividend by issuing a preferred share (Class B) having a FMV of \$100 and a paid-up capital of \$50. The amount of the stock dividend is \$50, equal to its paid-up capital (see the definition “amount” in subsection 248(1)).*
- *Subco has \$70 of safe income that can reasonably be considered to contribute to the capital gain that could be realized by Holdco on a disposition at FMV, immediately before the dividend, of the Class A shares of Subco.*
- *Paragraph 55(2)(a) applies to deem \$30 of the fair market value of the stock dividend not to be a dividend (that is, the excess of the FMV of the Class B share issued as a stock dividend (\$100) over safe income (\$70)).*

Under subparagraph 52(3)(a)(ii), the cost of the Class B share to Holdco is \$100. The following illustrates the calculation of the cost of the Class B share to Holdco, which is equal to the total of the amounts determined under Clauses (A) and (B).

The amount determined under Clause (A) is \$50, which is the excess of the amount determined under subclause (A)(I) over the amount determined under subclause (A)(II).

- *\$50 is the amount determined under subclause (A)(I), which is the lesser of the FMV of the Class B share (\$100) and the amount of the stock dividend (\$50) under the definition “amount” in subsection 248(1).*
- *\$0 is the amount under subclause (A)(II), which is the amount of the stock dividend that is deductible under subsection 112(1) reduced by the amount of safe income in respect of the Class A shares (\$50).*

The amount under Clause (B) is \$50, which is the amount determined by the formula $A + B$.

- *\$30 is the amount determined for variable A, which is the portion of the stock dividend that is deemed not to be a dividend under paragraph 55(2)(a).*
- *\$20 is the amount determined for variable B, which is the excess of the safe income (\$70) that could reasonably be considered to contribute to the gain on the Class A shares over the amount determined under clause (A) (\$50).*

In general, this amendment applies to dividends received after April 20, 2015.

Clause 11

Adjusted cost base – deemed dividend

ITA

53(1)(b)(ii)

Subparagraph 53(1)(b)(i) of the Act provides an addition to the adjusted cost base (ACB) to a taxpayer of property that is a share of the capital stock of a corporation resident in Canada. This increase is equal to the amount that is deemed to be a dividend received by the taxpayer before that time under the anti-avoidance rule in subsection 84(1). In the case of a corporate shareholder, however, subparagraph 53(1)(b)(ii) reduces the addition referred to in subparagraph (i) by the portion, if any, of the deemed dividend that the shareholder is permitted to deduct under subsection 112(1) in computing its taxable income, except the portion of the dividend that would not be a capital gain under subsection 55(2) because the gain could reasonably be considered to be attributable to income earned or realized by any corporation before the safe-income determination time (“safe income”). Essentially, the amount that is added to the cost of the share because of the deemed dividend is limited to the related safe income.

The wording of subparagraph 53(1)(b)(ii) is amended consequential to amendments made to section 55 (that is, to be consistent with the wording of new paragraph 55(2.1)(c)). Subsection 55(2.1)(c) applies where a taxable dividend exceeds the amount of safe income that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received. Accordingly, the amount of the dividend that is added to the cost of the share under subparagraph 53(1)(b) is limited to the safe income that could reasonably be considered to contribute to the capital gain of the share on which the dividend is received.

This amendment applies to dividends received after April 20, 2015.

Clause 12

Definitions

ITA

54

Section 54 of the Act contains various definitions that apply for the purposes of subdivision C – Taxable Capital Gains and Allowable Capital Losses.

“proceeds of disposition”

ITA
54(j)

Paragraph 54(j) of the definition “proceeds of disposition” provides that the proceeds of disposition of a share do not include any amount that is deemed by subsection 84(2) or (3) to be a dividend received in respect of the share and that is not deemed by paragraph 55(2)(a) or subparagraph 88(2)(b)(ii) not to be a dividend.

Paragraph (j) is amended consequential to amendments to subsection 55(2). Amended paragraph (j) excludes from the definition “proceeds of disposition” any amount that would otherwise be proceeds of disposition of a share to the extent that the amount is either an amount described in new subparagraph (i) or (ii).

New subparagraph (j)(i) excludes from the definition “proceeds of disposition” the amount that is deemed by subsection 84(2) or (3) to be a dividend received except to the extent the dividend is deemed to be proceeds of disposition by paragraph 55(2)(b), or is deemed not to be a dividend by subparagraph 88(2)(b)(ii).

This amendment applies to dividends received after April 20, 2015.

Clause 13

Taxable dividends received by corporations resident in Canada

ITA
55

Section 55 of the Act applies to certain transactions under which a corporation resident in Canada receives a taxable dividend that is deductible under subsections 112(1), 112(2) or 138(6).

Deemed proceeds or gain

ITA
55(2)

Subsection 55(2) of the Act is an anti-avoidance provision directed against dividends designed to use the intercorporate dividend deduction to unduly reduce the capital gain on any share. When the subsection applies, the amount of the dividend is deemed to be either proceeds of disposition of the share on which the dividend is paid or a capital gain of the corporation that received the dividend, and not to be a dividend received by the corporation. Section 55 is intended to counter the reduction of corporate capital gains on any share through the payment of tax-deductible dividends that reduce the share’s fair market value or that increase the cost of property.

Subsection 55(2) does not apply where the gain that has been reduced is attributable to the share’s portion of the income (“safe income”) earned or realized by any corporation after 1971 and before the safe-income determination time for the transaction, the event or the series of transactions or events in which a corporation resident in Canada has received a dividend deductible under subsections 112(1), 112(2) or 138(6). Safe income is protected from the application of subsection 55(2) because this income has been subject to corporate income tax and should therefore be allowed to be paid as a tax-free dividend to other Canadian corporations.

Subsection 55(2) currently applies where one of the purposes of (or, in the case of a dividend under subsection 84(3), one of the results of) a dividend is to significantly reduce the capital gain on any share.

A recent decision of the Tax Court of Canada held that the current anti-avoidance rule did not apply in a case where the effect of a dividend in kind (consisting of shares of another corporation) was to create an unrealized capital loss on shares (that is, the shares had a cost that exceeded fair market value after the dividend is paid). The unrealized loss was then used to avoid corporate capital gains tax otherwise payable on the sale of another property. These transactions can have an effect identical to transactions that directly reduce a corporate capital gain. Such transactions may be challenged by the Government under the existing general anti-avoidance rule. However, as any such challenge could be both time-consuming and costly, section 55 is being amended to ensure that the appropriate tax consequences apply.

Subsection 55(2) is amended to address the same tax policy concern that can arise where dividends are paid on a share not to reduce a capital gain on the share but instead to cause a significant decrease to the fair market value of the share or to cause a significant increase in the total cost amounts of properties of the corporate dividend recipient. Such dividends can result in an undue reduction of corporate capital gains.

Example

Corporation A wholly owns Corporation B, which has one class of shares (Class B). These shares have a fair market value (FMV) of \$1 million and an adjusted cost base (ACB) of \$1 million.

Corporation A sets up Corporation C which has one class of shares (Class C). These Class C shares have a FMV/ACB= \$0.

Corporation A transfers its Class B shares (FMV/ACB=\$1 million) to Corporation C in return for additional Class C shares (FMV/ACB=\$1 million).

Corporation C pays a \$1 million dividend in kind to Corporation A – the in kind property is Corporation C's Class B shares of Corporation B (FMV/ACB=\$1 million).

Result:

- 1. Corporation C has a \$0 capital gain from disposing of its Class B shares of Corporation B (FMV/ACB=\$1 million).*
- 2. The FMV of Corporation C is reduced by \$1 million because of the payment of the \$1 million dividend in kind.*
- 3. The FMV of Corporation A's Class C shares of Corporation C is reduced to \$0 from \$1 million. Their ACB remains \$1 million.*

4. *The total cost amount of all of Corporation A's properties is*
- a. *\$1 million immediately before the dividend (Class C ACB=\$1 million), and*
 - b. *\$2 million immediately after the dividend (Class C ACB=\$1 million + Class B ACB=\$1 million).*

Subsection 55(2) is replaced by subsections 55(2) to (2.5).

Amended subsection 55(2) provides that if it applies to a taxable dividend received by a corporation resident in Canada (referred to in subsections (2) to (2.2) and subsection (2.4) as the "dividend recipient"), the amount of the dividend (other than the portion of it, if any, subject to tax under Part IV that is not refunded as a consequence of the payment of a dividend by a corporation where the payment is part of the series referred to in subsection (2.1)) is deemed not to be a dividend received by the dividend recipient (paragraph 55(2)(a)). Instead, the amount of the dividend is deemed to be either:

- proceeds of disposition of the share by paragraph 55(2)(b), if the dividend is received on a redemption, acquisition or cancellation of a share, by the corporation that issued it, to which subsection 84(2) or (3) applies, except to the extent that it is otherwise included in computing such proceeds; and
- a gain of the dividend recipient, for the year in which the dividend was received, from the disposition of capital property by paragraph 55(2)(c), in the case of any dividend that is not subject to the application of paragraph (b).

In the case of the exception from subsection 55(2) accorded the portion of a dividend to which Part IV tax applies, this exception does not apply if a refund of Part IV tax is received as part of a series as a consequence of the payment of a taxable dividend by a corporation to any shareholder, including an individual.

This amendment applies to dividends received after April 20, 2015.

Application of subsection 55(2)

ITA
55(2.1)

New subsection 55(2.1) of the Act determines if subsection 55(2) applies to a taxable dividend received by a corporation resident in Canada (referred to in subsections (2) to (2.2) and subsection (2.4) as the "dividend recipient") as part of a transaction or event or a series of transactions or events. Subsection 55(2) applies to a dividend recipient's taxable dividend if the three conditions in paragraphs 55(2.1)(a) to (c) are met.

First, the condition in paragraph (2.1)(a) is met where the dividend recipient is entitled to a deduction in respect of the taxable dividend under subsection 112(1) or (2) or 138(6).

Second, the condition in paragraph (2.1)(b) is met where

- (i) one of the purposes of the payment or receipt of the dividend (or, in the case of a dividend under subsection 84(3), one of the results of which) is to effect a significant reduction in the portion of the capital gain that, but for the dividend,

would have been realized on a disposition at fair market value of any share of capital stock immediately before the dividend, or

- (ii) the dividend (other than a dividend received in respect of a redemption, acquisition or cancellation of a share, by the corporation that issued it, to which subsection 84(2) or (3) applies) is received on a share that is held as capital property by the dividend recipient and one of the purposes of the payment or receipt of the dividend is to effect
- a significant reduction in the fair market value of any share, or
 - a significant increase in the amount that is the total of the cost amounts of all properties of the dividend recipient.

The “one of the purpose” tests in subparagraphs (b)(i) and (ii) are to be applied separately to each dividend. For example, subparagraph (b)(ii) could apply to a dividend one of the purposes of which is to increase significantly the cost of any property even if subparagraph (i) applies (or does not apply because one of the purposes was not to reduce significantly a gain on any share). Subparagraph (b)(ii) does not apply, however, to a dividend received on the redemption, acquisition or cancellation of a share by the corporation that issued it, to which subsection 84(2) or (3) applies. In such cases, the shares are disposed of to the issuing corporation.

Third, the condition in paragraph (2.1)(c) is met where the amount of the dividend exceeds the amount of safe income that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received. Former subsection 55(2) referred to the safe income exception by referring to the portion of the capital gain “attributable” to safe income. Paragraph (2.1)(c) instead refers to the portion of the safe income that could reasonably be considered to “contribute” to the capital gain that could be realized. This change of wording is intended to accommodate the new purposes described in subparagraph (b)(ii).

This amendment applies to dividends received after April 20, 2015.

Special rule – amount of the stock dividend

ITA
55(2.2)

New subsection 55(2.2) of the Act sets out the amount of a stock dividend for the purpose of applying subsections (2), (2.1), (2.3) and (2.4). For this purpose, the amount of a stock dividend and the dividend recipient’s entitlement to a deduction under subsection 112(1) or (2) or 138(6) in respect of that dividend is the greater of (1) the increase in the paid-up capital of the corporation that paid the dividend because of the dividend, and (2) the fair market value of the share received as a stock dividend.

Example

Assume that Corporation A pays a stock dividend to Corporation B and that the share that is issued as a stock dividend has a fair market value (FMV) of \$1 million and a paid-up capital (PUC) of \$1.

The amount of the stock dividend to Corporation B is \$1 million for the purpose of applying subsections 55(2), (2.1), (2.3) and (2.4). Under subsection 55(2.2), the amount of the stock dividend is the greater of

- *\$1 (PUC of \$1, which would otherwise be the amount of the stock dividend under the definition “amount” in subsection 248(1)), and*
- *\$1 million (the FMV of the share issued as a stock dividend).*

As a result, the “one of the purposes” tests in subparagraph 55(2.1)(b)(i) and (ii) are to be applied to a \$1 million dividend instead of the \$1 dividend determined under the definition of “amount” in subsection 248(1).

For further information, see commentary on subsection 52(3).

This amendment applies to dividends received after April 20, 2015.

Stock dividends and safe income

ITA

55(2.3)

New subsection 55(2.3) of the Act applies if the conditions in new subsection 55(2.4) are met. In general terms, new subsection 55(2.3) applies to a stock dividend if the fair market value of the share that is issued as a stock dividend exceeds the amount of the related increase in the paid-up capital of the corporation that paid the dividend, to the extent that the dividend would have been subject to subsection 55(2) if the exception regarding income earned or realized by any corporation after 1971 and before the safe-income determination time (“safe income”) did not exist.

Subsection 55(2.3) provides two rules regarding the amount of a stock dividend and safe income.

First, paragraph 55(2.3)(a) provides in general that the amount of a stock dividend is deemed to be a separate taxable dividend for the purpose of applying subsection 55(2) to the extent of the portion of the amount that does not exceed the safe income that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received. The effect of this provision is analogous to that provided to dividends that are designated out of safe income under paragraph 55(5)(f). The portion of the stock dividend that exceeds the amount of safe income, if any, can be subject to subsection 55(2).

Second, paragraph 55(2.3)(b) provides in general that the separate dividend out of safe income to which paragraph 55(2.3)(a) applies is deemed to reduce the safe income of any corporation that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received.

This amendment applies to dividends received after April 20, 2015.

Application of subsection 55(2.3)

ITA
55(2.4)

New subsection 55(2.4) of the Act provides that new subsection (2.3) applies if the conditions indicated in paragraphs (a) to (c) are met.

First, the condition in paragraph 55(2.4)(a) is met where a corporation resident in Canada (referred to in subsections (2) to (2.2) and subsection (2.4) as the “dividend recipient”) holds a share upon which it receives a stock dividend.

Second, the condition in paragraph 55(2.4)(b) is met where the fair market value of the share or shares issued as a stock dividend exceeds the amount by which the paid-up capital of the corporation that paid the stock dividend is increased because of the dividend.

Third, the condition in paragraph 55(2.4)(c) is met where subsection 55(2) would apply to the dividend if subsection (2.1) were read without reference to its paragraph (c). In general, paragraph 55(2)(c) applies where the amount of a dividend exceeds the safe income that could reasonably be considered to contribute to the capital gain of the share on which the dividend is received.

As result, if one of the purposes of the payment or receipt of a stock dividend is to significantly reduce a capital gain on any share, to significantly reduce the fair market value of any share or to significantly increase the total of all cost amounts of all properties of the dividend recipient, the amount of the dividend (which is the greater of its fair market value and its paid up capital for the purpose of section 55) can be either

- a taxable dividend paid out of safe income (to the extent that subsection (2.3) applies), or
- a taxable dividend to which subsection (2) applies (except to the extent that the Part IV exception applies to the dividend, or if the exemptions in subsection 55(3) apply).

This amendment applies to dividends received after April 20, 2015.

Determination of reduction in fair market value

ITA
55(2.5)

New subsection 55(2.5) of the Act provides that, for the purpose of applying the fair market value (FMV) reduction rule in clause 55(2.1)(b)(ii)(A), whether any dividend causes a significant reduction in the fair market value of any share is to be determined as if the fair market value of the share, immediately before the dividend, was increased by an amount equal to the amount, if any, by which the fair market value of the dividend received on the share exceeds the fair market value of the share.

Example

Corporation A owns all of the shares of Corporation B, which have a total fair market value (FMV) of \$0.

Corporation B borrows \$2 million to pay a \$2 million dividend to Corporation A. The FMV of

the shares of Corporation B remains at \$0 after the payment of the \$2 million dividend. Therefore, the dividend has not reduced the FMV of the shares of Corporation B.

The FMV of the dividend (\$2 million) exceeds the FMV of the shares (\$0) by \$2 million.

Subsection 55(2.2) requires that the FMV of the shares of Corporation B be increased by \$2 million before the dividend (the amount by which the FMV of the dividend exceeds the FMV of the share on which the dividend was paid). Consequently, the reduction in the FMV of the shares caused by the dividend is considered to be \$2 million (as opposed to no FMV reduction without the rule).

This amendment applies to dividends received after April 20, 2015.

Exemption from subsection 55(2)

ITA

55(3)(a)

Paragraph 55(3)(a) of the Act provides an exemption from the application of subsection 55(2) for dividends received in the course of certain related-party transactions. More specifically, paragraph 55(3)(a) exempts a dividend received by a corporation if, as part of a transaction or event or a series of transactions or events that includes the receipt of the dividend, there was not, at any particular time, a disposition of property or a significant increase in the total direct interest in a corporation in the circumstances described in subparagraphs 55(3)(a)(i) to (v).

The exemption for dividends in paragraph 55(3)(a) is amended to apply only to dividends received on a redemption, acquisition or cancellation of a share, by the corporation that issued it, to which subsection 84(2) or (3) applies. In both cases, the dividend arises on a cancellation of the share. This change is made consequential to amendments to subsection 55(2) and new subsections 55(2.1) to (2.5). It is meant to ensure that subsections 55(2) to (2.5) are not circumvented by related persons using other types of dividends to significantly reduce a capital gain in respect of any share, to significantly reduce the fair market value of any share or to significantly increase the total of the cost amounts of all of the properties of the dividend recipient.

The amended exception in paragraph 55(3)(a) for related-person dividends is intended to facilitate *bona fide* corporate reorganizations by related persons. It is not intended to be used to accommodate the payment or receipt of dividends or transactions or events that seek to increase, manipulate, manufacture or stream cost base.

This amendment applies to dividends received after April 20, 2015.

Interpretation of paragraph 55(3)(a)

ITA

55(3.01)(d)(i)

Subsection 55(3.01) contains various interpretative rules for the purpose of paragraph 55(3)(a). Paragraph 55(3.01)(d) provides that proceeds of disposition are to be determined without reference to

- the expression “paragraph 55(2)(a) or” in paragraph (j) of the definition “proceeds of disposition” in section 54, and
- section 93.

Subparagraph 55(3.01)(d)(i) is amended to provide that proceeds of disposition are to be determined without reference to subparagraph (j)(i) of the definition “proceeds of disposition” in section 54. In general, that subparagraph refers to dividends that are deemed to be proceeds of disposition by paragraph 55(2)(b). By ignoring those proceeds, subparagraph 55(3.01)(d)(i) ensures that, for the purpose of applying the exemption for certain related-person dividends in paragraph 55(3)(a), proceeds of disposition do not include subsections 84(2) and (3) dividends that are recharacterized as proceeds of disposition under paragraph 55(2)(b).

This amendment applies to dividends received after April 20, 2015.

Applicable rules

ITA

55(5)(f)

Subsection 55(5)(f) of the Act allows a corporation to designate any portion of a taxable dividend received to be a separate taxable dividend for the purpose of section 55. The amount of the taxable dividend that is in excess of the designated dividend is also deemed to be a separate dividend.

A designation under paragraph 55(5)(f) must be filed by the corporation receiving the taxable dividend in its return of income under Part I of the Act for the taxation year in which the dividend was received. Such a designation would be advantageous where the taxable dividend could otherwise exceed the corporate recipient’s share of safe income of the payer corporation. By designating a separate dividend that is from safe income, the designation ensures that that portion of the whole dividend that is received is not recharacterized under section 55.

Paragraph 55(5)(f) is amended consequential to new subsection 55(2.3), which also may apply to deem all or a portion of the amount of certain stock dividends to be a separate dividend.

This amendment applies to dividends received after April 20, 2015.

Clause 14

Definitions

ITA

89(1)

Subsection 89(1) of the Act defines certain terms that apply to corporations and their shareholders.

“capital dividend account”

The definition “capital dividend account” is part of a mechanism for allowing capital gains to flow through a private corporation without attracting an extra level of tax. The non-taxable amount of a capital gain realized by a private corporation is added to its capital dividend account from which capital dividends may be received tax-free by its shareholders.

Clauses (a)(i)(A) and (a)(ii)(A) of the definition “capital dividend account” provide that a corporation’s capital gain or loss from the disposition of a property is computed for capital dividend purposes without reference to subparagraphs 52(3)(a)(ii) and 53(1)(b)(ii). Clauses (a)(i)(A) and (a)(ii)(A) are amended consequential to amendments made to subparagraphs 52(3)(a)(ii) and 53(1)(b)(ii). In general, no capital dividend election may be made in respect of a corporation’s capital gain from disposing of shares to the extent that the gain arises because the cost of the shares does not include amounts described in new subclause 52(3)(a)(ii)(A)(II) and amended subparagraph 53(1)(b)(ii).

This amendment applies to dispositions made after April 20, 2015.

Withholding for Non-Resident Employers

Clause 15

Withholding

ITA

153(1)(a)

Section 153 requires the withholding of tax from certain payments described in paragraphs 153(1)(a) to (t). The person making such a payment is required to remit the amount withheld to the Receiver General on behalf of the payee. Paragraph 153(1)(a) requires withholdings with respect to salary, wages and other remuneration paid to an employee, including a non-resident employee working in Canada for a non-resident employer, other than amounts described in subsection 115(2.3) (relating to the 2010 Vancouver Olympics) or 212(5.1) (relating to certain acting services).

Paragraph 153(1)(a) is amended to exclude from the withholding obligations, in addition to amounts described in 212(5.1), amounts paid at any time by a qualifying non-resident employer to a qualifying non-resident employee if, at the time of the payment, the employee is a “qualifying non-resident employee” and the employer is a “qualifying non-resident employer”, both as defined in subsection 153(6). The reference to subsection 115(2.3) is no longer necessary and so, it is not included in the revised paragraph (a).

This amended paragraph applies in respect of payments made after 2015.

Definitions

ITA

153(6)

Existing subsection 153(6) defines the term “designated financial institution”, which is used in subsection 153(1). Subsection 153(6) is amended to add two new definitions: “qualifying non-resident employee” and “qualifying non-resident employer”, which are used in the new withholding exception in subparagraph 153(1)(a)(ii).

“qualifying non-resident employee”

In order to be a qualifying non-resident employee at any time in respect of a payment of salary, wages or other remuneration (*i.e.*, a payment referred to in paragraph 153(1)(a)), three conditions

must be met by the employee in new paragraphs 153(1)(a), (b) and (c) of the definition “qualifying non-resident employee”. The condition in paragraph (a) of the definition is that the employee is resident in a country with which Canada has a tax treaty at the time of the payment. The condition in paragraph (b) of the definition is that the employee is not liable to tax under Part I of the Act in respect of such payment because of that treaty. The condition in paragraph (c) of the definition may be satisfied in two ways. First, if the employee works in Canada for less than 45 days in the calendar year that includes the time of payment, alternatively, if the employee is present in Canada for less than 90 days in any 12-month period that includes the time of that payment.

Days worked in Canada include only days during which the employee is physically present in Canada and paid by his or her employer for the time spent in Canada which generally exclude weekends, days off and holidays.

Note that the maximum number of days specified in paragraph (c) of the definition “qualifying non-resident employee” may be higher than what is authorized by the tax treaty referred to in paragraph (b) of the definition. Since all three conditions (new paragraphs (a), (b) and (c)) in the definition “qualifying non-resident employee” must be satisfied to be a qualifying non-resident employee, an employee who is not treaty-exempt (for example, due to an employee’s extended presence in Canada, totalling over 183 days during a 12-month period that overlaps two consecutive calendar years) cannot qualify.

The computation of the number of days present in Canada follows the OECD commentary “days of physical presence” method and includes any day during which the employee is present in Canada, even if the employee is only present for a portion of the day.

“qualifying non-resident employer”

A qualifying non-resident employer means an employer who, at any time in respect of a payment of salary, wages or other remuneration, is resident in a country with which Canada has a tax treaty (if the employer is not a partnership) at the time of the payment and is certified by the Minister under subsection 153(7) at the time of the payment. If the employer is a partnership, there is a requirement that at least 90% of the partnership’s income or loss for the fiscal period that includes the time of the payment is allocated to members that are resident in a country with which Canada has a tax treaty. If the income of the partnership is nil for the fiscal period, the income for that period is deemed to be \$1,000,000 for the purpose of determining a member’s share of the partnership income.

This amendment applies in respect of payments made after 2015.

Certification by Minister

ITA
153(7)

New subsection 153(7) gives the Minister the authority to certify an employer, or revoke an employer’s certification, for the purpose of the definition “qualifying non-resident employer” in subsection (6), which is relevant for the exclusion from the withholding requirements in subparagraph 153(1)(a)(ii).

The Minister may certify an employer for a specific period of time if the employer has applied in prescribed form containing prescribed information and the Minister is satisfied that the employer meets the conditions in paragraph (a) of the definition “qualifying non-resident employer” in subsection (6) and meets the conditions established by the Minister.

The Minister may revoke an employer’s certification if the Minister is no longer satisfied that the employer meets the previously mentioned conditions.

This amendment applies in respect of payments made after 2015.

Clause 16

No penalty – qualifying non-resident employers

ITA
227(8.6)

New subsection 227(8.6) provides an exception to qualifying non-resident employers (defined in subsection 153(6)) from the penalty to withhold tax in subsection 227(8) in respect of a payment made to an employee if, after reasonable inquiry, the employer had no reason to believe at the time of the payment that the employee was not a qualifying non-resident employee (defined in subsection 153(6)).

This amendment applies in respect of payments made after 2015.

Clause 17

Remuneration and benefits

ITR
200(1)

Under subsection 200(1) of the *Income Tax Regulations*, a taxpayer who makes a payment described in subsection 153(1) of the *Income Tax Act* is generally required to make an information return in prescribed form.

Consequential to amendments to paragraph 153(1)(a) of the Act, subsection 200(1) is amended to ensure that payments made in respect of salary, wages or other remuneration by a non-resident employer to a non-resident employee that are exempt from withholding because of new subparagraph 153(1)(a)(ii) continue to be subject to the requirement in subsection 200(1) to make an information return unless new subsection 200(1.1) applies.

New subsection 200(1.1) excludes from subsection 200(1) the requirement for a taxpayer to make an information return in two specific situations. The first situation is when an annuity payment in respect of an interest in an annuity contract to which subsection 201(5) applies is paid. This exception was previously part of subsection 200(1). The second situation is when an amount is paid by a qualifying non-resident employer to a qualifying non-resident employee exempted from the withholding requirement under subparagraph 153(1)(a)(ii) of the Act if, after reasonable inquiry, the qualifying non-resident employer has no reason to believe that the employee’s total taxable income earned in Canada under Part I of the Act (including amounts described in paragraph 110(1)(f) of the Act such as amounts that are exempted from income tax in Canada because of a provision contained in a tax treaty that has the force of law in Canada) in

the calendar year during which the payment is made is more than \$10,000 in Canadian dollars or its equivalent in foreign currency.

This amended subsection applies in respect to payments made after 2015.

Clause 18

Tax deduction information

ITR
210

Consequential to amendments to paragraph 153(1)(a) of the Act, section 210 of the *Income Tax Regulations* is amended to ensure that a qualifying non-resident employer (as defined in subsection 153(6) of the Act) is subject to section 210 in respect of its payments in respect of salary, wages or other remuneration to a qualifying non-resident employee (as defined in subsection 153(6) of the Act).

This amended section applies in respect of payments made after 2015.

Captive Insurance

Clause 19

Determination of certain components of foreign accrual property income

ITA
95(2)(a.2) to (a.23)

Paragraph 95(2)(a.2) of the Act includes in the income from a business other than an active business and thus the foreign accrual property income (“FAPI”) of a foreign affiliate of a taxpayer resident in Canada, the income of the affiliate from the insurance of risks (including income from the reinsurance of risk) where the risks insured were in respect of

- a person resident in Canada
- property situated in Canada, or
- a business carried on in Canada.

The rule does not apply, however, where more than 90% of the gross premium income of the affiliate from the insurance (net of reinsurance ceded) of risks was derived from the insurance of other risks of persons with whom the affiliate deals at arm’s length. Where the rule applies to the foreign affiliate of the taxpayer, the insurance of those risks is deemed to be a separate business other than an active business of the affiliate.

Paragraph 95(2)(a.2) is amended in two ways. First, it is modernized and restructured, by replacing its former subparagraphs 95(2)(a.2)(i) to (iii) with references to the new defined term “specified Canadian risks”, which are defined in new paragraph 95(2)(a.23) as the same risks that were previously described in those subparagraphs. It is further restructured by moving the existing rule into new subparagraphs 95(2)(a.2)(i) and (ii), to accommodate the addition of the new rules in new subparagraphs 95(2)(a.2)(iii) and (iv). The changes described above are merely structural and not substantive changes.

Second, paragraph 95(2)(a.2) is amended by adding new rules in subparagraphs 95(2)(a.2)(iii) and (iv). Subparagraph 95(2)(a.2)(iii) provides that, to the extent income in respect of the ceding of Canadian risks is not already included in a foreign affiliate's income from a business other than an active business because of subparagraph 95(2)(a.2)(i) or (ii), it is to be so included. For these purposes, an affiliate's income in respect of the ceding of Canadian risks includes (but is not limited to):

- income of the affiliate from services in respect of the ceding of specified Canadian risks, and
- the amount, if any, by which the fair market value of the consideration provided in respect of the ceding of the specified Canadian risks exceeds the affiliate's cost in respect of those specified Canadian risks.

Subparagraph 95(2)(a.2)(iv) is analogous to subparagraph 95(2)(a.2)(ii) and, where subparagraph 95(2)(a.2)(iii) applies in respect of the ceding of specified Canadian risks, deems

- the ceding of those risks to be a separate business, other than an active business, carried on by the affiliate, and
- any income of the affiliate that pertains to or is incident to that business to be from a business other than an active business.

Paragraph 95(2)(a.21) is amended by adding references to the new defined term "specified Canadian risks". No substantive changes are made to this paragraph.

New paragraph 95(2)(a.23) defines the new term "specified Canadian risks", for purposes of paragraphs 95(2)(a.2) and (a.21). These risks are the same ones that were previously described in subparagraphs 95(2)(a.2)(i) to (iii), and the new definition replaces the description previously in those subparagraphs. Specifically, specified Canadian risks are defined as risks in respect of a person resident in Canada, a property situated in Canada or a business carried on in Canada.

These amendments apply to taxation years of a taxpayer that begin after April 20, 2015.

Example: Paragraph 95(2)(a.2)(iii) and (iv)

Assumptions

- FA1 is a non-resident corporation, all of the shares of which are owned by a corporation resident in Canada ("Canco").
- FA1 reinsures risks of an arm's length Canadian insurance company, which constitute "specified Canadian risks" (as defined in paragraph 95(2)(a.23)), and pays a cash "ceding commission" to the Canadian insurance company.
- Subsequently, FA1 retrocedes these risks to an arm's length, non-resident reinsurer. As part of the same arrangement, the non-resident reinsurer also retrocedes foreign risks to FA1.
- Paragraph 95(2)(a.21) does not apply to deem the foreign risks to be specified Canadian risks because, based on certain other facts concerning the arrangement, the condition in subparagraph 95(2)(a.21)(ii) is not satisfied.

Analysis

To the extent income in respect of the ceding of the Canadian risks by FA1 to the non-resident reinsurer is not already included in FA1's income from a business other than an active business because of subparagraph 95(2)(a.2)(i) or (ii), subparagraphs 95(2)(a.2)(iii) and (iv) will apply in this case. In this regard, subparagraph 95(2)(a.2)(iii) provides that, for these purposes, a foreign affiliate's income from the ceding of Canadian risks includes an amount equal to the difference between the fair market value of the consideration provided in respect of the ceding of the specified Canadian risks and the affiliate's cost in respect of those specified Canadian risks. Since, as part of the same arrangement under which the non-resident reinsurer reinsures the specified Canadian risks, FA1 also reinsures the foreign risks of the non-resident reinsurer, the portfolio of foreign risks constitute consideration provided by the non-resident reinsurer in respect of the ceding of the specified Canadian risks by FA1. Accordingly, FA1's income from the ceding of the specified Canadian risks is equal to the difference between the fair market value of the foreign risks and FA1's cost in respect of those specified Canadian risks (which costs may include the ceding commission paid by FA1 to the Canadian insurance company).

Canadian Exploration Expense

Clause 20

Definitions

ITA

66.1(6)

Subsection 66.1(6) of the Act provides several definitions for the purposes of section 66.1, such as Canadian exploration expense, cumulative Canadian exploration expense, and Canadian renewable and conservation expense.

“Canadian exploration expense”

The definition “Canadian exploration expense” (CEE) in subsection 66.1(6) defines oil, gas, mining, and Canadian renewable and conservation expenses that qualify for treatment as CEE, which expenses are fully deductible in the taxation year incurred or in a future taxation year.

Paragraph (a) of the definition of CEE describes expenses incurred in the oil and gas sector and paragraph (f) of the definition describes similar expenses incurred in the mining sector. The definition of CEE is amended to provide that costs associated with undertaking environmental studies and community consultations that are required in order to obtain an exploration permit are eligible for CEE treatment.

In this regard, the definition of CEE is amended in two respects.

First, paragraph (a) of the definition of CEE is reorganized and amended by adding two new subparagraphs. Subparagraph (i) refers to geological, geophysical and geochemical expenses, which are currently described in paragraph (a). Subparagraph (ii) adds a reference to an expense

for environmental studies or community consultations including such an expense that is undertaken to obtain a right, license or privilege for the purpose of determining the existence, location, extent or quality of an accumulation of petroleum or natural gas in Canada.

Second, the preamble to paragraph (f) of the definition of CEE is amended to include an expense for environmental studies or community consultations including such an expense undertaken to obtain a right, license or privilege for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada. The amendment also ensures that an expense for such studies and consultations will not be excluded from CEE because of subparagraph (f)(v) of the definition of CEE.

These amendments apply in respect of expenses incurred after February 2015.