Preface

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

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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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Income Tax Act, Income Tax Application Rules and Income Tax Regulations

Ecological Gifts Program

Clause 1

Ecological gifts

Income Tax Act (ITA)
43(2)

Subsection 43(2) of the *Income Tax Act* (the Act) applies where the part of a property donated as an ecological gift is a covenant, easement or servitude established under common law, the civil law of the province of Quebec, or the law of other provinces allowing for their establishment. Subsection 43(2) ensures that a portion of the adjusted cost base ("ACB") of the land to which the covenant, easement or servitude relates is allocated to the donated covenant, easement or servitude. For this purpose, the allocation of the ACB of the land to the gift is calculated in proportion to the percentage decrease in the value of the land as a result of the donation.

Subsection 43(2) currently applies to "real servitudes" under the *Civil Code of Quebec*. Subsection 43(2) is amended to also make it applicable to certain "personal servitudes" under the *Civil Code of Quebec* consequential on the amendments to paragraph 110.1(1)(d) and paragraph (a) of the definition "total ecological gifts" in subsection 118.1(1), which extend the applicability of these provisions to certain gifts of land that are "personal servitudes" under the *Civil Code of Quebec*.

This amendment applies in respect of gifts made after March 21, 2017.

Clause 2

Ecological gifts

ITA
110.1(1)(d)

Section 110.1 of the Act provides rules for calculating the deduction, in computing the taxable income of a corporation, in respect of gifts made by the corporation to registered charities and other qualified donees. Paragraph 110.1(1)(d) provides for the deduction, in computing a corporation's taxable income, of the eligible amount of an ecological gift made by the corporation.

An ecological gift is a gift of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude) that is certified by the Minister of the Environment, or a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is important to the preservation of Canada's environmental heritage. The gift must be made to certain specified donees.

Several amendments are being made to paragraph 110.1(1)(d) and each of the amendments applies in respect of gifts made after March 21, 2017.

Paragraph 110.1(1)(d) is amended to apply to gifts of "personal servitudes" under the *Civil Code of Quebec*, where the personal servitude applies to the ecologically sensitive land and has a term of not less than 100 years.

Clauses 110.1(1)(d)(iii)(B) and (C) of the Act provide for a deduction, in computing a corporation's taxable income, of the eligible amount of an ecological gift made by the corporation to a municipality in Canada or to a municipal or public body performing a function of government in Canada.

Clauses 110.1(1)(d)(iii)(B) and (C) are amended to stipulate that where it is proposed that an ecological gift be made by a corporation to a municipality or to a municipal or public body performing a function of government in Canada, the making of the gift to the municipality or to the municipal or public body performing a function of government in Canada must be approved by the Minister of the Environment (or her designate) in respect of each such gift.

Clause 110.1(1)(d)(iii)(D) provides for a deduction, in computing a corporation's taxable income, of the eligible amount of an ecological gift made by the corporation to a registered charity, one of the main purposes of which is, in the opinion of the Minister of Environment, the conservation and protection of Canada's environmental heritage. That registered charity must be approved by that Minister or her designate in respect of each such gift.

Clause 110.1(1)(d)(iii)(D) is amended to exclude gifts to private foundations from qualifying for the deduction.

Ecological gifts

ITA
110.1(5)

Subsection 110.1(5) of the Act provides that the fair market value of a gift of ecologically sensitive land (or a covenant, easement or servitude in respect of ecologically sensitive land) is deemed to be the amount determined by the Minister of the Environment.

Consequential on the amendments to paragraph 110.1(1)(d) and paragraph (a) of the definition "total ecological gifts" in subsection 118.1(1) paragraph 110.1(5)(b) is amended to extend the application of subsection 110.1(5) to "personal servitudes" under the *Civil Code of Quebec*. For more information, see the commentary on paragraph 110.1(1)(d) and the definition "total ecological gifts" in subsection 118.1(1).

This amendment applies in respect of gifts made after March 21, 2017.

Clause 3

Definitions - “total ecological gifts”

ITA
118.1(1)

Subsection 118.1(1) provides a definition of “total ecological gifts”. This definition applies for the purpose of the charitable donation tax credit, based on the eligible amount of a gift, which is available to individuals under subsection 118.1(3).

An ecological gift is a gift of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Quebec, a real servitude) that is certified by the Minister of the Environment, or a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is important to the preservation of Canada’s environmental heritage. The gift must be made to certain specified donees.

Paragraph (a) of the definition is amended to include gifts of “personal servitudes” under the *Civil Code of Quebec*, where the personal servitude applies to the ecologically sensitive land and has a term of not less than 100 years.

Subparagraph (b)(i) of the definition in subsection 118.1(1) is amended to stipulate that where it is proposed that an ecological gift be made by an individual to a municipality in Canada or to a municipal or public body performing a function of government in Canada, the making of the gift to the municipality or to the municipal or public body performing a function of government in Canada must be approved by the Minister of the Environment (or her designate) in respect of each such gift.

Subparagraph (b)(ii) of the definition in subsection 118.1(1) is amended to exclude donations to private foundations.

The amendments to the definition “total ecological gifts” apply in respect of gifts made after March 21, 2017.

Clause 4

Tax payable by recipient of an ecological gift

ITA
207.31

Section 207.31 imposes a tax on charities, Canadian municipalities and municipal or public bodies performing a function of government in Canada, if, without the approval of the Minister of the Environment, they dispose of or change the use of property given to them as an ecological gift. For more information, see the commentary on subsection 110.1(5) and 118.1(1).

Section 207.31 is amended to confirm that the tax applies regardless of how the entity acquired the property and to clarify that the Minister of the Environment (or a person designated by that Minister) is responsible for determining whether a change in the use of a property has occurred.

Anti-avoidance Rules for Registered Plans

Clause 5

Share deemed listed

ITA
87(10)

Subsection 87(10) of the Act provides a rule dealing with an amalgamation of two or more taxable Canadian corporations where shares of a predecessor corporation that are listed on a "designated stock exchange" are temporarily replaced by unlisted shares of the new corporation. Subsection 87(10) deems those temporary shares to have been listed on a designated stock exchange for certain purposes under the Act, such as for qualified investment rules for registered savings arrangements.

Subsection 87(10) is amended to replace the reference to subsection 205(1) with a reference to subsection 146.4(1), consequential on the repeal of section 205 and moving the definition "qualified investment" that previously appeared in that section for RDSP purposes to subsection 146.4(1).

This amendment comes into force on March 23, 2017.

Clause 6

Qualifying exchange of mutual funds

ITA
132.2(3)(h)

Paragraph 132.2(3)(h) of the Act ensures that the merger of two mutual fund trusts, or a mutual fund trust and a mutual fund corporation, will not cause shares or units of the transferor fund to cease to be qualified investments for trusts governed by RRSPs and certain other registered plans.

Paragraph 132.2(3)(h) is amended to replace the reference to subsection 205(1) of the Act by a reference to subsection 146.4(1), consequential on the repeal of section 205 and moving the definition "qualified investment" that previously appeared in that section for RDSP purposes to subsection 146.4(1).

This amendment comes into force on March 23, 2017.

Clause 7

Registered Education Savings Plans

ITA
146.1

Budget 2017 announced that the anti-avoidance rules and special taxes of Part XI.01 of the Act are being extended to apply to RESPs. Consequential amendments are being made to the rules in section 146.1 of the Act that apply to RESPs.

For more information, see the commentary on Part XI.01.

Definitions

ITA
146.1(1)

Subsection 146.1(1) defines a number of terms that apply for the purposes of the rules in section 146.1 that apply to registered education savings plans (RESPs).

These amendments come into force on March 23, 2017.

education savings plan

An "education savings plan" is defined as a contract between an individual who is the subscriber and a person or organization who is the promoter. This definition is amended to remove the reference to an “organization”.

promoter

Subsection 146.1(1) is amended to introduce a new definition "promoter", which refers to a person described as a promoter in the definition “education savings plan”. As a consequence of the extension of the rules in Part XI.01 of the Act to RESPs, the term “promoter” is important for several purposes under those rules.

RESP revocable

ITA
146.1(2.1)

Subsection 146.1(2.1) of the Act contains rules that prevent an RESP trust from acquiring or holding a non-qualified investment, carrying on a business or borrowing money. If any of these events occur, the RESP is revocable and, under subsections 146.1(12.1) to (13), its registration may be revoked by the Minister of National Revenue.

Paragraphs 146.1(2.1)(a) and (b) are repealed as a consequence of the rules under Part XI.01 of the Act being extended to apply to RESPs. The consequences of holding a non-qualified investment under an RESP are now set out under Part XI.01.

The repeal applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Trust not taxable

ITA
146.1(5)

Subsection 146.1(5) of the Act generally provides that no income tax is payable by a trust governed by an RESP.

Consequential on the repeal of paragraphs 146.1(2.1)(a) and (b), and on the rules of Part XI.01 of the Act being extended to apply to RESPs, subsection 146.1(5) is amended to add an exception to the general rule of no income tax being payable by an RESP trust. Specifically, subsection (5) is amended such that Part I tax applies to any income or gain earned by the trust that is attributable to holding any property that is not a “qualified investment" (as defined in subsection 146.1(1)).

Part I tax is payable by the trust on the amount that would be its income for the relevant taxation year if it had no income or losses other than from the non-qualified investments that it held in the year, and no capital gains or capital losses other than from the disposition of its non-qualified investments. For this purpose:

- "income" includes dividends described by section 83 of the Act;
- the trust's taxable capital gain or allowable capital loss from the disposition of a property is equal to the full amount of the capital gain or capital loss from the disposition; and
- the trust's income in respect of a non-qualified investment is to be calculated without reference to subsection 104(6) of the Act.

The amendment applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Educational assistance payments

ITA
146.1(7)

Subsection 146.1(7) of the Act generally requires that educational assistance payments made from an RESP to an individual in a taxation year are included in the individual's income for the taxation year.

Subsection 146.1(7) is amended such that an "excluded amount" may be taken into account in computing the amount of educational assistance payments that must be included in the individual's taxable income for a taxation year. For more information, see the commentary on subsection 146.1(7.2).

This amendment comes into force on March 23, 2017.

Other income inclusions

ITA
146.1(7.1)

Paragraph 146.1(7.1)(a) of the Act provides that accumulated income payments (other than amounts transferred to an RDSP under the conditions set out in subsection 146.1(1.2)) received under an RESP by a taxpayer in a taxation year must be included in computing the taxpayer's income for the year.

Paragraph 146.1(7.1)(a) is amended such that an "excluded amount" may also be taken into account in computing the amount of accumulated income payments included in the recipient's taxable income for a taxation year. For more information, see the commentary on subsection 146.1(7.2).

This amendment comes into force on March 23, 2017.

Excluded amount

ITA
146.1(7.2)

Subsection 146.1(7.2) of the Act is amended to expand what constitutes an excluded amount for the purposes of determining the taxable portion of educational assistance payments (EAP) and accumulated income payments (AIP) under an RESP. To prevent double taxation, where an advantage tax had been paid in respect of an amount of RESP income (*e.g.*, an advantage attributable to a prohibited investment) and where the amount is subsequently part of an EAP or AIP, the amount will be an "excluded amount" under subsection (7.2) for the purposes of subsections (7) and (7.1).

This amendment is consequential on Part XI.01 of the Act being extended to apply to RESPs. For further information, see the commentary on Part XI.01.

This amendment comes into force on March 23, 2017.

Example

Alexandre is the subscriber of an RESP where Frédéric and Jérémie are beneficiaries. In 2018, the RESP acquires a prohibited investment that has a fair market value of $30,000. The RESP disposes of the prohibited investment in 2021. The income earned on the prohibited investment is an "advantage" as defined in subsection 207.01(1) for which the subscriber is liable to pay a 100% tax under section 207.05.

The income and the tax payable for the years that the RESP held the investment are $1,200 for 2018, $1,400 for 2019, $1,600 for 2020 and $1,800 for 2021, for a total of $6,000.

Frédéric receives EAPs of $2,000 in 2022, $2,000 in 2023 and $1,500 in 2024. Jérémie receives EAPs of $2,000 in 2024 and $2,000 in 2025.

The "excluded amount" will reduce the taxable portion of EAPs as follows:

Year	*Beneficiary*	*Taxable EAP (net of excluded amount):*	*Balance of excluded amount*
Before 2022			*$6,000*
2022	*Frédéric*	*$2,000-$2000= $0*	*$6,000-$2,000 = $4,000*
2023	*Frédéric*	*$2,000-$2000= $0*	*$4,000-$2,000 = $2,000*
2024	*Frédéric*	*$1,500-$1,500= $0*	*$2,000-$1,500 = $500*
2024	*Jérémie*	*$2,000-$500= $1,500*	*$500-$500 = 0$*
2025	*Jérémie*	*$2,000- $0= $2,000*	*$0*

In this example, the excluded amount had a declining balance (to nil) over three years. Assuming no other tax is paid under section 207.05 for the plan (beyond the $6,000 described above), the EAPs paid to the beneficiaries after 2024, and AIPs (if any) to Alexandre, will be fully included in taxable income and not be reduced by an excluded amount.

Clause 8

Registered Disability Savings Plans

ITA
146.4

Budget 2017 announced that the anti-avoidance rules and special taxes of Part XI.01 of the Act are being extended to apply to RDSPs. Consequential amendments are being made to the rules in section 146.4 of the Act that apply to RDSPs.

Paragraph 146.4(4)(i) generally prohibits payments from an RDSP that are not disability assistance payments to a beneficiary and so, Part XI.01 cannot be paid using funds in the RDSP.

For more information, see the commentary on Part XI.01.

Definitions

ITA
146.4(1)

Subsection 146.4(1) of the Act defines a number of terms that apply for the purposes of the rules in section 146.4 that apply to registered disability savings plans (RDSPs).

These amendments come into force on March 23, 2017.

contribution

The definition "contribution" is relevant for the purposes of several provisions in section 146.4 and Part XI of the Act. Consequential on the repeal of Part XI of the Act and the Part XI.01 anti-avoidance rules being extended to apply to RDSPs, paragraph (d) of the definition "contribution" is amended to remove the reference to subsection 205(1).

disability savings plan

A "disability savings plan" of a beneficiary is an arrangement between a trust company (referred to as the issuer of the disability savings plan) and one or more entities listed in subparagraph (a)(ii). Subparagraph (a)(i) of the definition is amended to reflect the new definition “issuer” in subsection 146.4(1).

issuer

A new definition “issuer” is added to subsection 146.4(1). The definition refers to a person described as an issuer in the definition “disability savings plan”. As a consequence of the extension of the rules in Part XI.01 of the Act to RDSPs, the term “issuer” is important for several purposes under those rules.

qualified investment

A new definition “qualified investment” is added to subsection 146.4(1). Consequential on the repeal of Part XI of the Act, the definition “qualified investment” that previously appeared in subsection 205(1) of the Act is moved to subsection 146.4(1) of the Act. The definition is relevant for several provisions in section 146.4 and Part XI.01 of the Act.

specified maximum amount

This definition is relevant for the purposes of subparagraph 146.4(4)(n)(i), which imposes the maximum annual limit on the amount of disability assistance payments that can be made from an RDSP when the plan is a primarily government-assisted plan.

Consequential on the repeal of Part XI of the Act, the descriptions of A and B in the definition “specified maximum amount” are amended to refer to the new definition “qualified investment” in subsection 146.4(1) that replaced the definition that previously appeared in subsection 205(1) of the Act.

Plan conditions

ITA
146.4(4)(l)

Paragraph 146.4(4)(l) of the Act limits the amount of disability assistance payments that can be paid from an RDSP.

Consequential on the repeal of Part XI of the Act, the descriptions of A and D in the formula in paragraph 146.4(4)(l) are amended to refer to the new definition “qualified investment” in subsection 146.4(l) that replaced the definition that previously appeared in subsection 205(1) of the Act.

These amendments come into force on March 23, 2017.

Trust not taxable

ITA
146.4(5)

Paragraph 146.4(5)(b) of the Act provides that an RDSP trust is taxable on income from carrying on a business or income earned on non-qualified investments.

Consequential on the repeal of Part XI of the Act, paragraph 146.4(5)(b) is amended to remove the reference to subsection 205(1) of the Act and to add a reference to the definition “qualified investment” that has been added to subsection 146.4(1).

This amendment comes into force on March 23, 2017.

Non-taxable portion of disability assistance payments

ITA
146.4(7)

Subsection 146.4(7) of the Act sets out a formula to determine the non-taxable portion of a disability assistance payment (DAP) for the purpose of subsection 146.4(6). In general terms, the proportion of a DAP that is non-taxable is the same as the proportion that the total contributions made to the RDSP (other than transfers made to plan in accordance with subsection 146.4(8)) is to the total value of the plan's assets.

A new variable D is added to the formula, to add to the non-taxable portion of the DAP an amount in respect of which an advantage tax has been paid under subsection 207.05 of the Act, unless (i) the advantage tax is waived, cancelled or refunded, or (ii) the amount has been included in the non-taxable portion of a DAP.

This amendment comes into force on March 23, 2017.

Example

Laurianne is the holder of an RDSP where William is the beneficiary. In 2018, the RDSP acquires a prohibited investment that has a fair market value of $30,000. The RDSP disposes of the prohibited investment in 2021. The income earned on the prohibited investment is an "advantage" as defined in subsection 207.01(1) for which the holder is liable to pay a 100% tax under section 207.05.

The income and the tax payable for the years that the RDSP held the investment are $1,200 for 2018, $1,400 for 2019, $1,600 for 2020 and $1,800 for 2021, for a total of $6,000.

William receives disability assistance payments (DAP) of $10,000 each year from 2022 to 2024.

Assume that, after applying the formula A x B/C, the taxable portion of the DAPs before applying formula D is $5,000, then:

- *For the DAP in 2022, the non-taxable portion will include a variable D equal to $5,000;*
- *For the DAP in 2023, the non-taxable portion will include a variable D equal to $1,000; and*
- *For the DAP in 2024 and subsequent years, the non-taxable portion will include a variable D equal to nil.*

Obligations of issuer

ITA
146.4(13)

Subsection 146.4(13) of the Act imposes obligations on the issuer of an RDSP to minimize the possibility that a plan holder may become liable to pay tax under Part XI of the Act in connection with the Plan. Paragraph 146.4(13)(d) is repealed, consequential on the repeal of Part XI of the

Act and on Part XI.01 being extended to apply to RDSPs. For more information, see the commentary on subsection 207.01(5).

This amendment comes into force on March 23, 2017.

Clause 9

Taxes in respect of registered disability savings plans

ITA
Part XI

Part XI of the Act generally imposes taxes on the holder of an RDSP in connection with various transactions (*e.g.*, acquisition of non-qualified investments) within the RDSP. Part XI is being repealed consequential on amendments to include RDSPs among the registered plans that are subject to taxes under Part XI.01 of the Act for holding non-qualified investments or prohibited investments.

The repeal applies to transactions and events occurring, income earned, capital gains accruing and investments acquired, after March 22, 2017.

Clause 10

Taxes in respect of registered plans

ITA
Part XI.01

Consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to Part XI.01 of the Act, the heading for Part XI.01 is being amended to generally refer to "Taxes in respect of registered plans". The heading previously referred only to RRIFs, RRSPs and TFSAs.

Clause 11

Taxes in respect of registered plans

ITA
Part XI.01

Part XI.01 of the Act contains anti-avoidance rules applicable to Tax-Free Savings Accounts, Registered Retirement Savings Plans and Registered Retirement Income Funds to help ensure that such registered plans do not provide excessive tax advantages unrelated to their respective basic objectives. To improve the consistency of the tax rules that apply to investments held by registered plans, Budget 2017 announced that the anti-avoidance rules of Part XI.01 would be extended to apply to Registered Education Savings Plans and Registered Disability Savings Plans.

Definitions

ITA
207.01(1)

Subsection 207.01(1) of the Act provides definitions for the purposes of Part XI.01. It incorporates by reference the definitions in subsection 146(1) (other than the definition "benefit"), 146.2(1) and 146.3(1).

The opening words in subsection 207.01(1) are amended to also incorporate by reference the definitions in subsections 146.1(1) and 146.4(1). This amendment is consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to taxes under this Part for holding non-qualified investments or prohibited investments.

This amendment applies to transactions and events occurring, income earned, capital gains accruing and investments acquired after March 22, 2017.

advantage

Amounts described in the definition of advantage in subsection 207.01(1) are subject to a special tax under section 207.05. The definition of advantage is amended in three respects to reflect the inclusion of RDSPs and RESPs under the Part XI.0I rules.

Paragraph (a) of the definition “advantage” is amended by:

- adding a reference to a beneficiary in subparagraph (a)(iii), to allow a beneficiary of an RDSP or of an RESP to receive an interest in the registered plan without triggering the section 207.05 tax;
- adding a reference to “promoter” (alongside issuer and carrier) in subparagraph (a)(iv), to exempt payments or allocations from an RESP promoter from being an advantage; and
- by adding a new exception under subparagraph (iv.1) in relation to an amount paid under or because of the *Canada Disability Savings Act*, the *Canada Education Savings Act* or paid under a designated provincial program.

Second, consequential on the addition of RDSP and RESP to the definition “registered plan”, subparagraph (c)(ii) is amended to replace the reference to “RRIF or RRSP” with a reference to “registered plan that is not a TFSA”.

Finally, paragraph (d) is amended to refer to the new definition “registered plan strip” in subsection 207.01(1). For more information, see the commentary on the definition “registered plan strip” in subsection 207.01(1).

These amendments apply to transactions and events occurring, income earned, capital gains accruing and investments acquired after March 22, 2017.

controlling individual

The definition “controlling individual” provides a common term for the holder of a TFSA or the annuitant of a RRIF and an RRSP for the purpose of the application of Part XI.01 of the Act. This definition is amended so that the common term also includes or the holder of an RDSP and the subscriber of an RESP, consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to Part XI.01.

This amendment applies to transactions and events occurring, income earned, capital gains accruing and investments acquired after March 22, 2017.

registered plan

This definition provides a common term for the plans that are subject to Part XI.01 of the Act, namely RRIFs, RRSPs and TFSAs. This definition is amended to add RDSPs and RESPs.

This amendment applies to transactions and events occurring, income earned, capital gains accruing and investments acquired after March 22, 2017.

registered plan strip

Consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to Part XI.01 of the Act, a new definition “registered plan strip” replaces the definition “RRSP strip” and will apply to RDSPs, RESPs, RRIFs and RRSPs (and not to TFSAs).

A “registered plan strip” is generally a transaction or event that, contrary to the intent of the rules in the Act pertaining to registered plans, seeks to remove or devalue registered plan assets without an income inclusion for the annuitant. The new definition contains a longer list of transactions or events that are not considered to be a strip, to reflect certain events or transactions that are specific to RESPs and RDSPs. A registered plan strip is included as paragraph (d) of the definition “advantage” under subsection 207.01(1) and is subject to tax on advantages under section 207.05.

This amendment applies to transactions and events occurring, income earned, capital gains accruing and investments acquired, after March 22, 2017.

RRSP strip

An “RRSP strip” is generally a transaction that, contrary to the intent of the RRSP and RRIF rules, seeks to remove or devalue RRSP or RRIF assets without an income inclusion for the annuitant. Consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to Part XI.01 and the introduction of the new definition “registered plan strip”, the definition “RRSP strip” is repealed.

This repeal applies to transactions and events occurring, income earned, capital gains accruing and investments acquired, after March 22, 2017.

swap transaction

A “swap transaction” is generally a transfer of property between a controlling individual of a registered plan (or a person with whom the controlling individual does not deal at arm’s length) and a registered plan of the individual, with certain exceptions.

Consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to taxes under Part XI.01, the exceptions in paragraphs (b) and (d) are expanded. Paragraph (b) is amended to add certain amounts paid into an RDSP or RESP that are not considered to be a contribution to the plan, such as amount paid under the *Canada Education Savings Act* or *Canada Disability Savings Act*. Paragraph (d) is amended to allow swap transactions between two plans of the controlling individual that are either both RDSPs or both RESPs.

These amendments apply after 2021 in relation to a swap transaction undertaken to remove a property from an RDSP or RESP, and after 2027 in the case of a swap transaction to remove a transitional prohibited property, if it is reasonable to conclude that tax would be payable under Part XI.01 of the Act if the property were retained in the RDSP or RESP. In any other case, they apply after June 2017.

transitional prohibited property

This definition describes property held by an individual’s RRIF or RRSP at a particular time if the property was also held by a RRIF or an RRSP of the individual on March 22, 2011 and was a prohibited investment for that RRIF or RRSP on March, 23, 2011.

This definition is amended to also describe property that was held by the RDSP or RESP of an individual on March 22, 2017 and that was a prohibited investment for that RDSP or RESP on March, 23, 2017. The amendment is consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to taxes under Part XI.01.

This amendment applies to transactions and events occurring, income earned, capital gains accruing and investments acquired after March 22, 2017.

Obligations of issuer

ITA
207.01(5)

Subsection 207.01(5) of the Act requires that the issuer or carrier of a TFSA, RRIF or RRSP that governs a trust exercise the care, diligence and skill of a reasonably prudent person to minimize the possibility that the trust holds a non-qualified investment.

Consequential on Part XI.01 of the Act being extended to apply to RDSPs and RESPs, subsection 207.01(5) is amended to add a reference to a “promoter” (of an RESP). Issuers of RDSPs will be included under subsection (5) by virtue of the existing reference to “issuer” and by the amendment to the definition “registered plan” in subsection (1).

Adjusted cost base

ITA
207.01(7)

Subsection 207.01(7) of the Act deems the cost of a transitional prohibited property (as defined in subsection 207.01(1)) for a trust governed by a RRIF or RRSP to be equal to its fair market value on March 22, 2011.

Consequential on Part XI.01 of the Act being extended to apply to RDSPs and RESPs, subsection 207.01(7) is amended to deem the cost of a transitional prohibited property held by a RDSP or RESP to be equal to its fair market value on March 22, 2017. No changes are made to this subsection in respect of transitional prohibited property held by RRIFs and RRSPs.

This amendment comes into force on March 23, 2017.

Prohibited investment status

ITA
207.01(8) and (9)

Subsections 207.01(8) and (9) of the Act allow the controlling individual of an RRSP or RRIF to make an election in certain circumstances in respect of property held by the RRSP or RRIF that would, in the absence of such an election, cease to be a prohibited investment at a particular time and therefore be subject to a deemed disposition in accordance with subsection 207.01(6) and subject to a section 207.05 advantage tax on the capital gain.

Consequential on Part XI.01 being extended to apply to RDSPs and RESPs:

- Each of paragraph 207.01(8)(a) and subsection 207.01(9) is amended to replace a reference to “RRIF or RRSP” by a reference to “registered plan (other than a TFSA)”; and
- Paragraph 207.01(8)(c) is amended to specify that an election under 207.05(4) is required only in the case of a property held by a RRIF or RRSP.

Even though an election need not be filed in respect of a property held by an RDSP or RESP, such property must otherwise meet the conditions in paragraphs 207.01(8)(a), (b) and (d) in order to be afforded the transitional relief provided by subsections 207.01(8) and (9) of the Act.

This amendment comes into force on March 23, 2017.

Exchange of property

ITA
207.01(12) and (13)

Subsections 207.01(12) and (13) of the Act extend the transitional relief from the prohibited investment and advantage rules that are afforded to transitional prohibited property held by a trust governed by an individual's RRIF or RRSP to non-cash property acquired by the trust in the

course of certain permitted reorganization or exchange transactions (to which any of section 51, subsection 85(1) and sections 85.1, 86 and 87 apply).

Consequential on Part XI.01 being extended to apply to RDSPs and RESPs:

- Each of paragraphs 207.1(12)(a) and 207.01(13)(b) is amended to replace a reference to "RRIF or RRSP" with a reference to "registered plan (other than a TFSA)";
- Paragraph 207.01(12)(d) is amended to specify that an election under 207.05(4) is required only in the case of a property held by a RRIF or RRSP; and
- Paragraph 207.01(13)(a) is amended such that, apart from presumptive dates that apply to a property held by a RRIF or RRSP, subsection (13) applies to a property held by an RDSP or RESP on March 22, 2017 that became a prohibited investment on March 23, 2017.

Whereas an election need not be filed in respect of a property held by an RDSP or RESP, such property must otherwise all meet all of the conditions in subsection 207.01(12) in order to be afforded the transitional relief provided by subsections 207.01(12) and (13) of the Act.

This amendment comes into force on March 23, 2017.

Clause 12

Both prohibited and non-qualified investment

ITA
207.04(3)

Subsection 207.04(3) of the Act applies if a property would otherwise be, at the same time, both a non-qualified investment and a prohibited investment. In those circumstances, the property is deemed not to be a non-qualified investment such that the property is a prohibited investment for purposes of the taxing provision in Part XI.01.

Subsection 207.04(3) is amended to expand its application to properties held by RDSPs and RESPs, by adding references to subsections 146.1(5) and 146.4(5). As a result of this amendment, Part XI.01 tax (*i.e.*, a 100 per cent tax on advantages) will apply to income earned on non-qualified investments held in RDSPs and RESPs rather than the Part I tax that would otherwise apply.

This amendment comes into force on March 23, 2017.

Apportionment of refund

ITA
207.04(5)

New subsection 207.04(5) of the Act provides that, where two or more persons are entitled to a refund under subsection 207.04(4) in respect of a particular property, the refund must be shared and may not exceed the amount that would be refundable if only one person were entitled to the

refund. If the persons cannot agree on portions to be claimed by each, the Minister of National Revenue may fix the portions.

This amendment comes into force on March 23, 2017.

Liability for tax

ITA
207.04(6)

Subsection 207.04(6) of the Act provides that at the time that a tax is imposed under subsection 207.04(1) in respect of an RDSP or RESP, each holder of the RDSP or each subscriber of the RESP is jointly and severally, or solidarily, liable to pay the tax. This new subsection is consequential on amendments to include RDSPs and RESPs among the registered plans that are subject to taxes under Part XI.01 of the Act for holding non-qualified investments or prohibited investments.

This amendment comes into force on March 23, 2017.

Clause 13

Amount of tax payable

ITA
207.05(2)

Subsection 207.05(2) of the Act determines the amount of tax payable in respect of different types of advantages. Subsection 207.05(2) requires that the amount of tax payable in relation to an "RRSP strip" is the amount of the strip.

Consequential on Part XI.01 of the Act being extended to apply to RDSPs and RESPs, subsection 207.05(2) is amended to replace its reference to “RRSP strip” (a repealed definition) with a reference to the new definition “registered plan strip”.

This amendment comes into force on March 23, 2017.

Liability for tax

ITA
207.05(3)

Subsection 207.05(3) of the Act generally imposes the liability for the advantage tax under section 207.05 on the controlling individual of a registered plan. However, if the advantage is extended by the issuer or a carrier of a registered plan, or by a person not dealing at arm's length with the issuer or the carrier, then the issuer or the carrier is liable to pay the tax.

Consequential on Part XI.01 of the Act being extended to apply to RDSPs and RESPs, and because those plans could have multiple holders or subscribers, subsection 207.05(3) of the Act is amended to:

- require that each controlling individual (each holder of an RDSP and each subscriber of an RESP) is joint and severally, or solidarily, liable to pay the tax; and
- to add “promoter” (of an RESP) alongside carrier and issuer, to require that the promoter is liable to pay the tax when the advantage is extended by the promoter or a person not operating at arm’s length from the promoter.

This amendment comes into force on March 23, 2017.

Clause 14

Multiple holders or subscribers

ITA
207.07(1.1)

New subsection 207.07(1.1) of the Act provides two rules that apply where two or more holders of a RDSP or two or more subscribers of an RESP are jointly liable with each other to pay a tax under Part X1.01. Paragraph (a) provides that a payment by any of the holders or subscribers on account of the joint liability reduces the joint liability to the extent of the payment. Paragraph (b) provides that if the required return is filed by one of the RDSP holders, or one of the RESP subscribers, only that return need be filed in respect of the joint liability.

This amendment comes into force on March 23, 2017.

Clause 15

Tax payable by trust under RESP

ITA
207.1(3)

Under subsection 207.1(3) of the Act, a trust governed by an RESP is required to pay a 1% penalty tax on the fair market value of all property held by the trust at the end of each month that is not a qualified investment.

Part XI is repealed consequential on amendments to include RESPs among the registered plans that are subject to taxes under Part XI.01 of the Act for holding non-qualified investments or prohibited investments.

The repeal applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Clause 16

Definitions

ITA
259(5)

Section 259 of the Act provides, for specified provisions of the Act, a look-through rule that applies where a registered plan trust acquires units of a qualified trust. Subsection 259(5) of the Act provides various definition for the purposes of section 259.

Consequential on the repeal of Part XI of the Act and the extension of Part XI.01 of the Act to apply to RDSPs, the definition “designated provisions” in subsection 259(5) of the Act is amended to remove a reference to “Part XI” and to add a reference to “Part XI.01”.

This amendment comes into force on March 23, 2017.

Clause 17

Qualified investment

Income Tax Regulations (ITR)
221(2)

Subsection 221(2) of the *Income Tax Regulations* (the Regulations) requires certain types of corporations and trusts to file an information return whenever the corporation or trust claims that its shares or units are a qualified investment for certain registered plans. Subsection 221(2) is amended to replace the reference to section 205 of the Act with a reference to section 146.4, consequential on the repeal of section 205 and moving the definition “qualified investment” that previously appeared in that section for RDSP purposes to section 146.4.

This amendment comes into force on March 23, 2017.

Clause 18

RDSP or RESP information return

ITR
222

New section 222 of the Regulations applies if, at any time, an RDSP trust or an RESP trust acquires or disposes of a property that is not a qualified investment, or if a property held by the trust becomes or ceases to be a qualified investment. The issuer of the RDSP or the promoter of the RESP must so notify the holder of the RDSP or subscriber of the RESP in prescribed form and manner on or before the last day of February of the following year. This notification requirement is intended to ensure that the holder or subscriber is provided with sufficient information to comply with their tax obligations under Part XI.01 of the Act in connection with the non-qualified investment.

This amendment comes into force on March 23, 2017.

Clause 19

Qualified investment

ITR
4900(1)

Subsection 4900(1) of the Regulations lists the types of property that are qualified investments for a trust governed by an RRSP, RRIF or DPSP.

The opening words of subsection 4900(1) are amended by replacing the reference to the definition "qualified investment" in subsection 205(1) of the Act with a reference to the definition "qualified investment" in subsection 146.4(1). This amendment is consequential on the repeal of section 205 and moving the definition "qualified investment" that previously appeared in that section for RDSP purposes to subsection 146.4(1).

This amendment comes into on March 23, 2017.

ITR
4900(1)(g)

Paragraph 4900(1)(g) of the Regulations prescribes, as a qualified investment, a bond, debenture, note or similar obligation issued by, or a deposit with, a credit union that has not at any time in the year granted a benefit, resulting from the investment, to the RRSP or RRIF annuitant or any beneficiary or employer under the DPSP.

The opening words of paragraph 4900(1)(g) are amended to remove an exception that previously applied for RESPs, consequential on the repeal of paragraphs 146.1(2.1)(a) and (b) of the Act and the extension of the anti-avoidance rules of Part XI.01 of the Act to RESPs.

This amendment applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Qualified investment

ITR
4900(5)

Subsection 4900(5) of the Regulations prescribes, as a qualified investment for an RESP, an interest in a trust or a share of a corporation that was a registered investment (as defined in subsection 204.4(1) of the Act) for an RESP during the calendar year or the immediately preceding year.

Subsection 4900(5) is amended to replace the reference to subsection 205(1) of the Act with a reference to subsection 146.4(1), consequential on the repeal of section 205 and moving the definition "qualified investment" that previously appeared in that section for RDSP purposes to subsection 146.4(1).

This amendment comes into force on March 23, 2017.

Small business investment

ITR
4900(6)

Subsection 4900(6) of the Regulations prescribes certain investments in small businesses to be a qualified investment for RRSPs, RRIFs, and RESPs. Consequential on the repeal of section subsection 4900(8) of the Regulation, the preamble of subsection 4900(6) is amended to remove the reference to subsection 4900(8).

This amendment applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Small business investment

ITR
4900(8)

Subsection 4900(8) of the Regulations disqualifies certain small business investments from being qualified investments for a trust governed by an RESP if a subscriber provides services to the small business, and it is reasonable to consider that part of the return on the small business investment held in the RESP is payment for those services.

Consequential on Part XI.01 of the Act being extended to apply to RESPs, subsection 4900(8) is repealed. A similar rule relating to the provision of services by the controlling individual of an RESP is included in the definition "advantage" in amended subsection 207.01(1) of the Act. Consequently, it is no longer necessary to apply subsection 4900(8) in the context of RESPs.

The repeal applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Small business corporation

ITR
4900(12) and (13)

Subsection 4900(12) of the Regulations allows certain shares of small business corporations, venture capital corporations and cooperative corporations to be qualified investments for RESPs under certain conditions.

Subsection 4900(13) is an anti-avoidance rule intended to ensure that amounts received in respect of shares described in subsection 4900(12) by an RESP trust are in the nature of a return on investment, and not a diverted payment for goods or services.

Subsection 4900(12) and (13) are repealed consequential on amendments to include RESPs among the registered plans that are subject to taxes under Part XI.01 of the Act for holding non-qualified investments or prohibited investments.

The repeal applies in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

ITR
4900(14) and (15)

Subsection 4900(14) of the Regulations allows certain shares of small business corporations, venture capital corporations and cooperative corporations to be qualified investments for RRSPs, RRIFs and TFSAs under certain conditions.

Subsection 4900(15) provides that certain investments are prescribed to be prohibited investments for RRSPs, RRIFs and TFSAs. In general terms, the investments that are prescribed as prohibited investments are investments that are qualified investments solely because of subsection 4900(14), but which are no longer described in any of subparagraphs 4900(14)(a)(i) to (iii).

Consequential on the anti-avoidance rules of Part XI.01 of the Act being extended to apply to RESPs, subsections 4900(14) and (15) of the Regulations are amended to apply also to RESPs.

These amendments apply in respect of any investment acquired after March 22, 2017 and any investment acquired before March 23, 2017 that ceases to be a qualified investment on or after that day.

Investment Fund Mergers

Clause 20

When subsec. (15) applies to adventurers in trade

ITA
18(14)(c)

Subsection 18(14) of the Act sets out the circumstances in which the loss-deferral rule in subsection 18(15) applies to dispositions of property that are described in an inventory of a business that is an adventure or concern in the nature of trade. Paragraph 18(14)(c) of the Act excludes from the application of this rule dispositions under specified provisions of the Act. As a consequence of the introduction of section 138.2 (a new rule that allows insurers to effect tax-deferred mergers of segregated funds), a reference to subsection 138.2(4) in paragraph 18(14)(c) is introduced so that "dispositions" that are qualifying transfers are also excluded from the application of subsection 18(15).

This amendment applies to taxation years that begin after 2017.

Clause 21

Definitions

ITA
54 "superficial loss" (c)

The definition "superficial loss" in section 54 of the Act excludes losses on dispositions listed in paragraphs (c) to (h) of the definition. As a consequence of the introduction of section 138.2 (a new rule that allows insurers to effect tax-deferred mergers of segregated funds), a reference to subsection 138.2(4) is introduced so that "dispositions" that are qualifying transfers are also excluded under paragraph (c) of the definition "superficial loss" in section 54.

This amendment applies to taxation years that begin after 2017.

Clause 22

Dispositions ignored

ITA
126(4.4)(a)

Subsection 126(4.4) of the Act directs that certain dispositions and acquisitions of property be ignored for the purposes of the foreign tax credit limitation in subsections 126(4.1) and (4.2) and the definition of "economic profit" in subsection 126(7). As a consequence of the introduction of section 138.2 (a new rule that allows insurers to effect tax-deferred mergers of segregated funds), a reference to subsection 138.2(4) in paragraph 126(4.4)(a) is introduced so that "dispositions"

that are qualifying transfers are also excluded from the application of subsection 126(4.1) and (4.2) and the definition of "economic profit" in subsection 126(7) of the Act.

This amendment applies to taxation years that begin after 2017.

Clause 23

Section 132.2 of the Act provides rules to facilitate the merger of two mutual fund trusts, or a mutual fund trust and a mutual fund corporation, on a tax-deferred basis. Unitholders or shareholders in turn are permitted a tax-deferred exchange of their shares or units of the terminating fund (*i.e.*, the transferor) for units of the continuing fund (*i.e.*, the transferee). Such a merger is referred to as a "qualifying exchange". A qualifying exchange provides for the funds to be tax-efficiently reorganized so as to achieve economies of scale and avoid the duplication of expenses. However, these rules do not provide for the reorganization of a mutual fund corporation into multiple mutual fund trusts. This is problematic for a mutual fund corporation that is organized as a multi-class "switch" corporation. A switch corporation typically offers different types of asset exposure in different investment funds, and generally each fund is structured as a separate class of shares within the same mutual fund corporation.

Several changes to section 132.2 are introduced to allow the reorganization of a mutual fund corporation into multiple mutual fund trusts. This will allow a switch corporation to merge on a tax-deferred basis with multiple mutual fund trusts under certain conditions. In general terms, the definition of "qualifying exchange" in section 132.2 is amended to include the reorganization of a mutual fund corporation into multiple mutual fund trusts and references to "the transferee" in the section are replaced by references to "a transferee" to reflect the intention that a mutual fund corporation could merge on a tax-deferred basis into more than one mutual fund trusts.

Technical changes are also introduced to clarify and to facilitate the use of these merger rules.

The definition of qualifying exchange is amended to clarify that a mutual fund corporation that holds units of mutual fund trusts that will be the transferees will be able to meet the definition of, and to undertake, a tax-deferred qualifying exchange.

Subparagraph 132.2(3)(l)(iii) is introduced so that capital gains dividends can be made payable by a transferor corporation up to 60 days after the qualifying exchange, provided the dividend is made payable and paid to taxpayers that held shares of a class of shares that is recognized as an investment fund before the end of that period. This will permit fund managers to take additional time to determine the amount of any capital gains dividends to be paid, and to whom such dividends may be paid.

Another amendment is introduced that, for the purpose of computing the "capital gain redemptions" amount for the transferor or transferee, only share or unit redemptions occurring before the "transfer time" – in other words, occurring prior to the merger and not undertaken in the course of effecting the merger – may be taken into account. As the purpose of this computation, in connection with the capital gains refund, is to recognize the extent of redemptions that may be subject to capital gains tax at the shareholder or unitholder level, it is appropriate that redemptions that could not be subject to capital gains tax, as shareholders and unitholders receive a rollover, are not taken into account.

These amendments generally apply in respect of qualifying exchanges that occur on or after March 22, 2017.

Definitions re qualifying exchange of mutual funds

ITA
132.2 (1)

The definition of "qualifying exchange" contains a series of conditions required to be satisfied for a transfer of property to be considered as a qualifying exchange. The preamble and paragraphs (a) and (b) of the definition of "qualifying exchange" are amended to allow the reorganization of a mutual fund corporation into multiple mutual fund trusts, and the current structure of the definition is restructured into new paragraphs (a), (b) and (c).

In addition, conditions are introduced in new paragraph (d) and need to be satisfied only when properties are transferred from a transferor to more than one transferee (*i.e.,* from a switch corporation to mutual fund trusts). When this is the case, these conditions need to be satisfied in order for the exchange to be considered as a qualifying exchange. These conditions are:

- All shares of each class of shares that is recognized under securities legislation as or as part of an investment fund of the transferor (*i.e.,* the switch corporation) are disposed of to the transferor within 60 days after the transfer time; and
- The units received in consideration for a particular share of a class of shares, that is recognized under securities legislation as or as part of an investment fund, of the transferor (*i.e.,* the switch corporation) are units of the transferee (*i.e.* a mutual fund trust) to which was transferred all of substantially all of the properties that were allocated to that investment fund immediately before the transfer time.

New paragraph (a) of the definition also clarifies that a mutual fund corporation that holds units of mutual fund trusts that will be the "transferees" may qualify as a tax-deferred qualifying exchange.

Existing paragraph (c) of the definition, which required the transferor and the transferee or transferees, as the case may be, to jointly elect by filing a prescribed form with the Minister of National Revenue on or before the election's due date, has been moved to paragraph (e).

General

ITA
132.2 (3)

In order to allow a mutual fund corporation to merge on a tax-deferred basis into multiple mutual trusts, the following changes are introduced:

- references to "the transferee" in subsection 132.2(3) are replaced by references to "a transferee";
- the reference to "one or both of the funds" in subparagraph 132.2(3)(g)(vi) is replaced by "the transferor or the transferee";

- the reference to “either of the funds” in paragraph 132.2(3)(j) is replaced by “any of the funds”; and
- paragraph 132.2(3)(i), which provides the amount that should be added to the amount determined under the description of A in the definition of refundable capital gains tax on hand in subsection 132(4) in respect of the transferee, is amended to prorate the amount that should be attributed to each transferee.

ITA
132.2(3)(a.1)

New paragraph 132.2(3)(a.1) of the Act is added to address situations involving a transferor that transfers to a transferee a unit of that transferee in exchange for a new unit of that transferee. In such case, the transferor is deemed to have disposed of the unit and to have received a new unit of the transferee at the transfer time.

ITA
132.2(3)(l)(iii)

A mutual fund corporation that is a transferor undergoing a qualifying exchange is deemed to have a taxation year end at the acquisition time, defined in subsection 132.2(2) of the Act as a time following the time following the transfer time. Paragraph 132.2(3)(n) provides that the transferor is not a mutual fund corporation in taxation years beginning after the transfer time.

New subparagraph 132.2(3)(l)(iii) is added to address situations where the transferor wishes to declare and pay a capital gains dividend following the acquisition time but within sixty days of the transfer time. Generally, mutual fund corporations may pay a capital gains dividend up to sixty days following the end of the corporation’s taxation year, provided the corporation continues to qualify as a mutual fund corporation throughout that following year. A capital gains dividend paid in that sixty day period is taken into account in computing the mutual fund corporation’s capital gains refund in respect of that year. This new rule permits a capital gains dividend to be made payable and paid within a period ending 60 days after the transfer time by deeming the dividend in certain circumstances to have become payable immediately before the year-end triggered by the qualifying exchange, at a time when the transferor is still a mutual fund corporation. It is anticipated that in the case of a switch corporation with multiple investment funds merging into multiple mutual fund trusts, this rule will permit the corporation additional time to determine the amount of capital gains dividends to be paid to shareholders of the investment funds that are becoming unitholders of the transferee mutual fund trusts.

ITA
132.2(3)(m)(iii)

Subparagraph 132.2(3)(m)(iii) is added to apply if the shares of the transferor fund are redeemed prior to the year end triggered following a qualifying exchange, throughout which the transferor and transferee funds are a mutual fund trust or mutual fund corporation. The new rule provides

that, for the purpose of computing the “capital gain redemptions” amount for that year for the transferor or transferee, only share or unit redemptions occurring before the “transfer time may be taken into account. As the purpose of this computation, in connection with the capital gains refund, is to recognize the extent of redemptions that may be subject to capital gains tax at the shareholder or unitholder level this amendment ensures that redemptions that could not be subject to capital gains tax, as shareholders and unitholders receive a rollover on redemptions arising in the course of the qualifying exchange, are not taken into account.

Qualifying exchange – non-depreciable property

ITA
132.2 (4)

In order to allow a mutual fund corporation to merge on a tax-deferred basis into multiple mutual trusts, the reference to “the funds” in subsection 132.2(4) of the Act is replaced by “the transferor and transferee”.

In addition, new paragraph 132.2(4)(c) is introduced to clarify that when a transferor transfers to a transferee a unit of that transferee, paragraphs 132.2(4)(a) and (b) do not apply to the transferee to determine the cost of the unit transferred.

Depreciable property

ITA
132.2 (5)

In order to allow a mutual fund corporation to merge on a tax-deferred basis into multiple mutual fund trusts, the reference to “the funds” in subsection 132.2(5) of the Act is replaced by “the transferor and transferee”.

Amendment or Revocation of Election

ITA
132.2 (7)

The reference to the election described in paragraph (c) of the definition “qualifying exchange” in subsection 132.2(1) of the Act is now in paragraph (e) of the same definition. Consequently, the reference is updated to paragraph (e).

Clause 24

Section 138.1 of the Act provides rules for the taxation of segregated funds established by insurance companies.

Rules relating to segregated funds

ITA
138.1(1)(a)

Paragraph 138.1(1)(a) deems a trust to exist and is referred in this section as the “related segregated fund trust”.

As a consequence of the introduction of the merger rules for segregated funds, paragraph 138.1(1)(a) is amended so that this trust is also deemed to exist for the purpose of new section 138.2 of the Act. For more information, see the commentary under section 138.2.

This amendment applies to taxation years that begin after 2017.

Rules relating to segregated funds

ITA
138.1(1)(f)

Paragraph 138.1(1)(f) deems the income of a related segregated fund trust to be an amount that has become payable in the year to the beneficiaries of the related segregated fund trust for the purposes of subsections 104(6), (13) and (24). This ensures that the income of the related segregated fund trust may be deducted in computing its income each year. The beneficiaries are required to include in their income, as became payable to them in the year, such portion of the amount that but for the deduction would have been income to the related segregated fund trust.

Generally, trusts may deduct in computing taxable income non-capital losses available for carry forward or carry back from previous or subsequent years. However, as the related segregated fund trust’s income becomes payable each year, there is no opportunity for such trust to utilize these losses.

Paragraph 138.1(1)(f) is amended to deem the taxable income of a related segregated fund trust to be an amount that has become payable in the year, so that available non-capital loss carryforwards of the deemed related segregated fund trust may be deducted by the trust against the remaining amount of its income in excess of its taxable income.

This amendment applies to taxation years that begin after 2017.

Clause 25

Transition – non capital loss

ITA
138.1(2.1)

New subsection 138(2.1) of the Act provides that for the purpose of determining the taxable income of a segregated fund in a taxation year that begins after 2017, the non-capital losses of the related segregated fund trust that arise in taxation years that begin before 2018 are deemed to be nil. As a result, a segregated fund will not be able to deduct non-capital losses that arose for taxation years that begin before 2018 in computing its income (and determining the amount that

becomes payable to beneficiaries) for taxation years that begin after 2017. For more information, see the commentary under paragraph 138.1(1)(f).

Clause 26

Segregated funds – merger rules

ITA
138.2

Segregated funds are life insurance policies that have many of the characteristics of mutual fund trusts. However, unlike mutual fund trusts, the Act does not permit segregated funds to merge on a tax-deferred basis. New section 138.2 is introduced to allow insurers to effect tax-deferred mergers of segregated funds in a manner generally similar to that permitted for mutual funds under section 132.2.

New section 138.2 defines a “qualifying transfer”. On a qualifying transfer, the property held in respect of one segregated fund is transferred to another segregated fund on a rollover basis and the policyholders of the first segregated fund exchange their interests in the first fund for interests in the other fund also on a rollover basis. As a result, the funds may be tax-efficiently reorganized so as to achieve economies of scale and avoid the duplication of expenses. New section 138.2 applies to qualifying transfers that are carried out after 2017.

In general terms the section is organized as follow:

- subsection 138.2(1) sets out the necessary conditions for a merger of segregated funds to be considered a qualifying transfer;
- subsection 138.2(2) sets out rules that will apply if a qualifying transfer has occurred;
- subsections 138.2(3) and (4) set out the tax treatment of gains and losses in respect of properties held by the funds (*i.e.,* the transferor and the transferee) at the time of the transfer;
- subsection 138.2(5) provides that, notwithstanding subsections 138.1(3) or (4), the amount of capital losses resulting from the disposition of property by a merging related segregated fund trust, to the extent they exceed the fund’s capital gains (including those deemed to be realized under subsections 138.2(3) or (4)) are attributable to the fund and not to the beneficiaries; and
- subsection 138.2(6) establishes the due date for the election required to treat a segregated fund merger as a qualifying exchange.

Qualifying transfer of funds

ITA
138.2(1)

New subsection 138.2(1) of the Act sets out the conditions under which a qualifying transfer could occur. The conditions are:

- All property of the segregated fund trust (the "first fund" or the transferor) becomes property of another segregated fund trust (the "second fund" or the transferee) at the transfer time;
- Every beneficiary (*i.e.,* person that had an interest) in the first fund has:
    - received an interest in the second fund,
    - ceased to be a beneficiary in the first fund, and
    - received no other consideration for their interest;
- The trustee of both funds is a resident of Canada; and
- The funds' trustee has filed an election in prescribed form with the Minister of National Revenue on or before the due date set out in subsection 138.2(6).

General

ITA
138.2(2)

New subsection 138.2(2) provides rules that will apply to a related segregated fund trust (the "first fund" or the transferor) and another related segregated fund trust (the "second fund" or the transferee) if a qualifying transfer has occurred.

The last taxation year of both funds that began before the transfer time is deemed to have ended at the transfer time and the next taxation year of the second fund is deemed to have begun immediately after the transfer time.

Non capital losses, net capital losses, restricted farm losses, farm losses or limited partnership losses of both funds for taxation years that begin before the transfer time can not be deducted in computing the taxable income of either fund for taxation years that begin after the transfer time.

Each beneficiary of the first fund is deemed to have disposed of his or her interest in that fund at the time of the transfer for proceeds of disposition, and to have acquired an interest in the second fund at a cost, equal to his or her cost of the interest in the first fund immediately before the transfer time.

Acquisition fees in respect of the policyholder's interest in the first fund are deemed to be in respect of the second fund.

Specific rules that adjust the cost of related segregated fund trust property in the event of a withdrawal or disposition of a policyholder's interest in the related segregated fund trust (subsections 138.1 (4) and (5)) do not apply in respect any disposition of an interest in the first fund arising on the qualifying transfer. Subsections 138.1(4) and (5) are intended to avoid double tax when a policyholder withdraws or otherwise disposes of an interest in the related segregated fund trust and property is sold by the segregated fund trust to fund proceeds paid to the policyholder as consideration. If the segregated fund merger is carried out as a qualifying transfer, capital gains would not be realized at the fund or the policyholder level, with the result that there is no risk of double tax in these circumstances. Accordingly, the rules in subsections 138.1(4) and (5) are not required.

Transferor – capital gains and losses

ITA
138.2(3)

New subsection 138.2(3) of the Act sets out the tax treatment of gains and losses on properties held by the transferor related segregated fund trust immediately before the transfer time, as well as the cost of such property to the transferee related segregated fund trust.

Properties of the transferor are deemed to have been disposed immediately before the transfer time and to have been acquired by the transferee at the transfer time for an amount equal to the lesser of (i) the fair market value immediately before the transfer time and (ii) the greater of the cost of the property to the transferor immediately before the transfer time and the amount that is designated in the election filed in respect of the qualifying transfer.

This provision permits the transferor to realize capital gains on property, if available, to the extent of any capital losses arising on the deemed disposition of other property of the transferor.

Transferee – capital gains and losses

ITA
138.2(4)

New subsection 138.2(4) of the Act sets out the tax treatment of gains and losses of properties held by the transferee related segregated fund trust at the time of the transfer.

Properties of the transferee are deemed to have been disposed of immediately before the transfer time and to have been reacquired by the transferee for an amount equal to the lesser of (i) the fair market value immediately before the transfer time and (ii) the greater of the cost of the property to the transferee immediately before the transfer time and the amount that is designated in the election filed in respect of the qualifying transfer.

This provision permits the transferee to realize capital gains on its property, if available, to the extent of any capital losses arising on the deemed disposition of other property of the transferee.

Loss limitation

ITA
138.2(5)

New subsection 138.2(5) of the Act sets out that, notwithstanding subsections 138.1(3) and (4), the amount of capital losses resulting from the disposition of fund properties that exceed the fund’s capital gains (including those realized pursuant to subsections 138.2(3) or (4)) are attributable to the fund and not to the beneficiaries. This provision will limit the ability of a transferor or transferee related segregated fund trust to provide to policyholders accrued but previously unrealized capital losses on property held by the related segregated fund trust.

Due date

ITA
138.2(6)

New subsection 138.2(6) of the Act establishes the due date for the election to treat a transfer as a qualifying transfer, as required under paragraph 138.2(1)(d). The due date is the later of the day that is six months after the day that includes the transfer time and a day that the Minister of National Revenue may specify.

Clean Energy Generation Equipment: Geothermal Energy

Clause 27

Capital cost allowance – interpretation

ITR
1104

Section 1104 of the Regulations sets out various definitions and interpretation rules that apply for the purpose of determining the capital cost allowance (CCA) rate for a taxation year in respect of a depreciable property of a taxpayer.

Section 1104 is amended consequential on the amendments made to subparagraph (d)(vii) of Class 43.1 to expand eligibility for classes 43.1 (30% rate) and 43.2 (50% rate) to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity.

Classes 43.1 and 43.2 – energy conservation property

ITR
1104(17)(a)

Subsection 1104(17) of the Regulations requires environmental compliance in respect of certain properties before those properties can be included in class 43.1 or 43.2 in Schedule II to the Regulations.

Subsection 1104(17) prevents the inclusion of the capital cost of certain property in Class 43.1 or 43.2 if the property is not in compliance with environmental laws, by-laws and regulations at the time the property becomes available for use. The subsection applies to property that would otherwise be included in Class 43.1 or 43.2. Property is not in compliance if, at the time the property becomes available for use by the taxpayer, the taxpayer has not satisfied the requirements of all environmental laws, by-laws and regulations of Canada, a province or a municipality in Canada, or of a municipal or public body performing a function of government in Canada, applicable in respect of the property.

If a property is not included in Class 43.1 or 43.2 because of subsection 1104(17), the property may remain included in the CCA class that would otherwise apply to that property.

Paragraph 1104(17)(a) is amended to add a reference to subparagraph (d)(vii) of Class 43.1 to Schedule II, which ensures that the requirement for environmental compliance also applies to property described in that subparagraph. This amendment is consequential on amendments to subparagraph (d)(vii) of Class 43.1 to expand eligibility for classes 43.1 (30% rate) and 43.2 (50% rate) to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity.

This amendment applies to property acquired after March 21, 2017 that has not been used or acquired for use before March 22, 2017.

Clause 28

Canadian renewable and conservation expense

ITR
1219

Section 1219 of the Regulations defines “Canadian renewable and conservation expense” (CRCE) for the purposes of subsection 66.1(6) of the Act. CRCE is included in calculating a taxpayer's “Canadian exploration expense” pool, as defined by subsection 66.1(6), and is eligible to be renounced under a flow-through share agreement. If the majority of the tangible property in a project is eligible for inclusion in Classes 43.1 or 43.2, certain intangible project start-up expenses (for example, engineering and design work and feasibility studies) are treated as CRCE. These expenses may be deducted in full in the year incurred, carried forward indefinitely for use in future years, or transferred to investors using flow-through shares.

In general terms, subsection 1219(1) provides that CRCE is an expense incurred (for certain listed purposes) by a taxpayer in respect of a project for which it is reasonable to expect that at least 50% of the capital cost of the depreciable property to be used in the project would be included in Class 43.1 or 43.2 or would be so included but for subsection 1219(1). Subsection 1219(2) excludes certain listed amounts from being CRCE under subsection 1219(1).

ITR
1219(1)(f)

Paragraph 1219(1)(f) of the Regulations provides that CRCE may include an expense incurred for the drilling or completion of certain wells. However, paragraph 1219(1)(f) ensures that CRCE does not include an expense in respect of a well that is, or can reasonably be expected to be, used for the installation of underground piping that is included in paragraph (d) of Class 43.1 or paragraph (b) of Class 43.2.

Paragraph 1219(1)(f) is reorganized by introducing two new subparagraphs (i) and (ii). Subparagraph 1219(1)(f)(i) continues to exclude expenses in respect of a well that is, or can reasonably be expected to be, used for the installation of underground piping that is included in paragraph (d) of Class 43.1 or paragraph (b) of Class 43.2.

New subparagraph 1219(1)(f)(ii) is introduced to ensure that CRCE may not include an expense that is in respect of a well that is referred to in new paragraph (h). New paragraph (h) generally includes a geothermal well that is described in subparagraph (d)(vii) of Class 43.1.

These amendments are consequential on changes to subparagraph (d)(vii) of Class 43.1. For more information, see the commentary on that provision.

This amendment applies in respect of expenses incurred after March 21, 2017.

ITR
1219(1)(h)

The costs of drilling and completing exploratory wells are fully deductible in the year they are incurred as CRCE when it is reasonable to expect that at least 50 per cent of the capital cost of the depreciable property will be used in an electricity generation project included in Class 43.1 or 43.2 in Schedule II of the Regulations. The costs of drilling and completing geothermal production wells for an electricity generation project that qualifies for Class 43.2 are included in Class 43.2. However, the costs of drilling and completing geothermal wells for supplying heat energy do not qualify for either CRCE nor for inclusion in Classes 43.1 or 43.2.

Consequential on amendments to subparagraph (d)(vii) of Class 43.1 that ensure that cost of completing a geothermal well for supplying heat is eligible for inclusion in Classes 43.1 and 43.2, new paragraph (h) is introduced to allow for certain expenses in respect of geothermal wells to be eligible for inclusion in CRCE. The new paragraph (h) applies to certain expenses in respect of a geothermal project, only if at least 50% of the depreciable property to be used in the project, determined by reference to its capital cost, is described in subparagraph (d)(vii) of Class 43.1.

In particular, new subparagraph (h)(i) ensures that cost of all geothermal drilling (*e.g.*, including geothermal production wells), for both electricity and heating projects, qualifies as CRCE. Similarly, subparagraph (h)(ii) ensured that an expense incurred solely for the purpose of determining the extent and quality of a geothermal resource qualifies as CRCE.

These amendments are consequential on changes to paragraph (d)(vii) of Class 43.1 which are discussed in more detail in the related explanatory note.

This amendment applies in respect of expenses incurred after March 21, 2017.

ITR
1219(4)

New subsection 1219(4) of the Regulations requires that expenses under new paragraph (1)(h) are only eligible as CRCE if the geothermal project described in that paragraph is in compliance with all environmental laws, by-laws and regulations of Canada, a province or a municipality in Canada, or of a municipal or public body performing a function of government in Canada.

This amendment is analogous to the requirements under subsection 1104(17) that apply to certain property and equipment described in Classes 43.1 and 43.2.

This amendment is consequential on the introduction of new paragraph 1219(1)(h) and to changes to paragraph (d)(vii) of Class 43.1. For more information, see the commentary on those provisions.

This amendment applies in respect of expenses incurred after March 21, 2017.

Clause 29

Capital cost allowance – prescribed classes

ITR
Schedule II

Schedule II to the Regulations lists the properties that can be included in each capital cost allowance (CCA) class. A portion of the capital cost of depreciable property is deductible as CCA each year. CCA rates for each type of property, identified by their CCA classes, are set out in section 1100 of the Regulations.

Class 43.1 (30% CCA rate)

Class 43.1 in Schedule II to the Regulations currently provides an accelerated CCA rate of 30% per year (on a declining-balance basis) for clean energy generation and energy conservation equipment. Class 43.1 (and indirectly Class 43.2) is amended to expand eligibility for inclusion in Classes 43.1 and 43.2 to geothermal equipment that is used primarily for the purpose of generating heat, or a combination of heat and electricity, and to make geothermal heating an eligible thermal energy source for use in a district energy system.

ITR
Class 43.1 (d)(vii)

Subparagraph (d)(vii) of Class 43.1 in Schedule II to the Regulations describes equipment that is used primarily for the purpose of generating electrical energy solely from geothermal energy (geothermal energy equipment). Under the present wording of the subparagraph, geothermal energy equipment does not include equipment that is used primarily for the purpose of generating heat.

The subparagraph is amended to expand eligibility for classes 43.1 (30% rate) and 43.2 (50% rate) to include geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity. In this regard, the eligible costs include the cost of completing a geothermal well (*e.g.*, installing the wellhead and production string) and, for systems that produce electricity, the cost of related electricity transmission equipment. However, equipment used for the purpose of heating a swimming pool using geothermal heat is not eligible.

This amendment applies in respect of property acquired after March 21, 2017 that has not been used or acquired for use before March 22, 2017.

ITR
Class 43.1 (d)(xv)

District energy systems transfer thermal energy between a central generation plant and a group or district of buildings by circulating steam, hot water or cold water through a system of underground pipes. Thermal energy distributed by a district energy system can be used for heating, cooling or in an industrial process. District energy equipment that is part of a district energy system is currently included in subparagraph (d)(xv) of Class 43.1 only if the system distributes thermal energy primarily generated by one or more of an eligible cogeneration system, a ground source heat pump, active solar heating equipment, waste-fuelled thermal energy equipment and heat recovery equipment.

Clause (d)(xv)(B) of Class 43.1 is amended to add a reference to property described in subparagraph (d)(vii) of Class 43.1. This amendment adds geothermal equipment as one of the eligible thermal energy sources for use in a district energy system.

This amendment is consequential on changes to paragraph (d)(vii) of Class 43.1, which are discussed in more detail in the related explanatory note, and applies in respect of property acquired after March 21, 2017 that has not been used or acquired for use before March 22, 2017.

ITR
Class 43.2 (50% CCA rate)

Class 43.2 in Schedule II to the Regulations provides for a temporary accelerated CCA rate of 50% for certain Class 43.1 properties. Class 43.2 includes some of the properties described in Class 43.1 if acquired after February 22, 2005 and before 2020.

Consequential on amendments to subparagraphs (d)(vii) of Class 43.1, eligibility for inclusion in 43.2 (50% rate) is expanded to geothermal equipment that is used primarily for the purpose of generating heat or a combination of heat and electricity. Similarly, consequential on amendments to subparagraphs (d)(xv) of Class 43.1, eligibility for inclusion in 43.2 is expanded to make geothermal heating as an eligible thermal energy source for use in a district energy system that is otherwise eligible for inclusion in Class 43.2.

These amendments apply in respect of property acquired after March 21, 2017 that has not been used or acquired for use before March 22, 2017.

Canadian Exploration Expense: Oil and Gas Discovery Wells

Clause 30

ITA
66.1

Section 66.1 of the Act provides the rules relating to the deduction of "Canadian exploration expense" (CEE) (as defined in subsection 66.1(6)). Specifically, the deduction of CEE is provided for through the concept of "cumulative Canadian exploration expense" (as defined in subsection 66.1(6)) and deductions under subsections 66.1(2) and (3) with respect to cumulative Canadian exploration expense. Subsections 66.1(2) and (3) allow a taxpayer a deduction for a taxation year of up to 100% of its cumulative Canadian exploration expense (cumulative CEE) at the end of the year.

ITA
66.1(6)

"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.

Under subparagraph (d)(i) of the CEE definition, CEE includes a taxpayer's expenses incurred in a taxation year for drilling or completing an oil or gas well in Canada, only in the event that the drilling or completing of the well resulted in the initial discovery that a natural underground reservoir contains petroleum or natural gas, and the discovery occurred within six months after the end of the year.

Subparagraph (d)(i) of the CEE definition is amended by introducing new clause (i)(C). New subclause (i)(C)(I) provides for a grandfathering provision whereas new subclause (i)(C)(II) is the main provision which applies in all other cases.

Subclause (C)(II) ensures that expenditures related to drilling or completing a discovery well (or in building a temporary access road to, or in preparing a site in respect of, any such well) incurred after 2018 (including expenses incurred in 2019 that are deemed to have been incurred in 2018 because of the "look-back" rule) no longer qualify as CEE. By default, such expenses will be included in the definition "Canadian development expense" (CDE) in subsection 66.2(5).

Subclause (C)(I) is a grandfathering rule that ensures that expenses actually incurred before 2021 continue to qualify as CEE if the expenses are related to drilling or Ccompleting a discovery well, where the taxpayer has, before March 22, 2017, entered into a written commitment (including a commitment to a government under the terms of a license or permit) to incur those expenses.

Reclassification of Expenses Renounced to Flow-Through Share Investors

Clause 31

ITA
66

Section 66 of the Act provides for the deduction of certain resource related expenses.

ITA
66(12.601)

Subsections 66(12.601) and (12.602) allow eligible small oil and gas corporations (including any associated corporations) with total taxable capital employed in Canada of less than $15 million to collectively renounce up to $1 million of Canadian development expenses (CDE) per calendar year and have those expenses reclassified as Canadian exploration expenses (CEE) in the hands of flow-through shareholders. This allows flow-through shareholders to deduct 100% of the amount of renounced Expenses as CEE. CDE is deductible at a rate of 30% per year.

The CDE eligible for reclassification must generally be incurred within the 24-month period that begins on the day on which the relevant flow-through share agreement is entered into, and must be incurred on or before the effective date of the renunciation. In addition, under the "look-back" rule, expenses incurred and renounced in the first 60 days of a calendar year can be treated as having been incurred at the end of the preceding calendar year.

Paragraph 66(12.601)(b) is amended to no longer permit eligible small oil and gas corporations to reclassify the first $1 million of CDE as CEE. This amendment applies in respect of expenses incurred after 2018 (including expenses incurred in 2019 that are deemed to be incurred in 2018 because of the look-back rule). However, CDE expenses incurred after 2018 and before April 2019 that are renounced under a flow-through share agreement entered into after 2016 and before March 22, 2017 remain eligible for reclassification as CEE.

Meaning of Factual Control

Clause 32

Factual control - interpretation

ITA
256(5.11)

New subsection 256(5.11) reverses the effect of a 2016 decision of the Federal Court of Appeal (*McGillivray Restaurant Ltd. v. The Queen*), in which the court held that the factors that may be used to determine if a person has factual (*de facto*) control are limited to a legally enforceable right and ability to effect a change in the board of directors, or its powers, or to exercise influence over the shareholder or shareholders who have that right and ability.

Subsection 256(5.11) provides that, for the purposes of the Act, the determination as to whether a taxpayer has *de facto* control of a corporation shall:

- Take into consideration all factors that are relevant in the circumstances; and
- Not be limited to, and the relevant factors to be considered in making the determination need not include, whether the taxpayer has a legally enforceable right or ability to effect a change in the board of directors of the corporation, or the board's powers, or to exercise influence over the shareholder or shareholders who have that right or ability.

This measure will apply in respect of taxation years that begin after March 21, 2017.

Timing of Recognition of Gains and Losses on Derivatives

Clause 33

Elective use of the mark-to-market method

ITA
10.1

New section 10.1 of the Act sets out rules for the timing of recognition of a taxpayer's profit or loss in respect of derivatives held on income account. These rules have two basic components.

The first component of these rules introduces a new elective regime that allows a taxpayer to mark-to-market its eligible derivatives (as defined in new subsection 10.1(5)) on an annual basis.

- New subsection 10.1(1) describes the process for electing into this mark-to-market regime.
- New subsection 10.1(2) provides taxpayers with the possibility of revoking an election.
- New subsection 10.1(3) ensures that any re-election into the mark-to-market regime will apply only on a prospective basis.
- New subsection 10.1(4) directs electing taxpayers to two separate mark-to-market valuation rules whose respective application depends on whether the taxpayer qualifies as a financial institution (as defined in subsection 142.2(1)).
- In general terms, new subsection 10.1(5) defines an eligible derivative as any financial derivative instrument held on income account that has a practically verifiable fair market value.
- New subsection 10.1(6) provides the mark-to-market valuation rule for eligible derivatives held by electing taxpayers that are not financial institutions.
- New subsection 10.1(7) defers the recognition of unrealized profits or losses that accrued on eligible derivatives held by a taxpayer at the beginning of an election year until the taxation year in which these derivatives are actually disposed of.
- New subsection 10.1(9) contains interpretative rules that apply for the purposes of new subsections 10.1(4) to (7).
- Consequential amendments to other provisions of the Act are also introduced to protect the integrity of the elective mark-to-market regime and to ensure that this choice does not lead to avoidance opportunities.

The second component of these rules, contained in new subsection 10.1(8), imposes the realization method as the default method of profit computation for any derivative held on income account (including eligible derivatives) by a taxpayer that is not a financial institution and that has not elected into the mark-to-market regime.

These amendments, including the consequential amendments in clauses 34 and 36 to 40, apply to taxation years that begin after March 21, 2017.

Mark-to-market election

ITA
10.1(1)

New subsection 10.1(1) of the Act allows a taxpayer to recognize its profit or loss in respect of its eligible derivatives (as defined in new subsection 10.1(5)) on a mark-to-market basis by electing to have new subsection 10.1(4) apply to the taxpayer. New subsection 10.1(4) directs electing taxpayers to two separate mark-to-market valuation rules whose respective application depends on whether the taxpayer is a financial institution for the purposes of the mark-to-market property rules in sections 142.2 to 142.6.

An election to have new subsection 10.1(4) apply in a particular taxation year must be filed with the Minister of National Revenue on or before the taxpayer's filing due date for that taxation year. Once made, the election is valid for that taxation year and for all subsequent taxation years unless revoked with the concurrence of the Minister under new subsection 10.1(2).

For more information, see the commentary on new subsections 10.1(2) and (4) and the definition "eligible derivative" in new subsection 10.1(5).

Revocation

ITA
10.1(2)

New subsection 10.1(2) of the Act provides that the Minister of National Revenue may, on application by the taxpayer in prescribed form, grant permission to the taxpayer to revoke an election made under new subsection 10.1(1).

A revocation applies to each taxation year of the taxpayer that begins after the day on which the taxpayer is notified in writing that the Minister concurs with the revocation and is subject to such terms and conditions as are specified by the Minister. Where such notice is received in the same taxation year in which request to revoke the election is made, new subsection 10.1(4) will continue to apply – and an electing taxpayer will be required to stay in the mark-to-market regime – until the end of that taxation year.

For more information, see the commentary on new subsections 10.1(1) and (4).

Subsequent election

ITA
10.1(3)

New subsection 10.1(3) of the Act provides that, notwithstanding new subsection 10.1(1), a subsequent election under subsection 10.1(1) will result in new subsection 10.1(4) applying in respect of each taxation year of the taxpayer that begins after the day on which a prescribed form is filed by the taxpayer to make that subsequent election. As a result of this rule, the ability to make an election into the mark-to-market regime, with hindsight, will be limited to a taxpayer's first election under subsection 10.1(1). Any subsequent election will apply only on a prospective basis. This rule is intended to protect the integrity of the elective mark-to-market regime from transfers in and out of the regime with the benefit of hindsight regarding the performance of the eligible derivatives.

For more information, see the commentary on new subsections 10.1(1), (2) and (4).

Application

ITA
10.1(4)

New subsection 10.1(4) of the Act sets out the consequences of an election made under new subsection 10.1(1). It is divided into two paragraphs. Which paragraph applies depends on whether the electing taxpayer is a financial institution (as defined in subsection 142.2(1)).

If the electing taxpayer is a financial institution (as defined in subsection 142.2(1)), paragraph 10.1(4)(a) provides that each eligible derivative (as defined in new subsection 10.1(5)) held by the taxpayer at any time in a taxation year in respect of which subsection 10.1(4) applies to the taxpayer is, for the purpose of applying the provisions of the Act and with such modifications as the circumstances require, deemed to be mark-to-market property (as defined in subsection 142.2(1)) of the taxpayer for the taxation year. Section 142.5 requires a financial institution to recognize annually the change in value of its mark-to-market property. Certain derivatives held by financial institutions already qualify as mark-to-market property where they meet the definition "tracking property" and are "fair value property" of the financial institution for the year (as those terms are defined in subsection 142.2(1)). Where the electing taxpayer is a financial institution, the principal effect of paragraph 10.1(4)(a) is to broaden the category of derivatives that are marked to market under section 142.5 to include eligible derivatives of the financial institution.

If the electing taxpayer is not a financial institution (as defined in subsection 142.2(1)), paragraph 10.1(4)(b) provides that new subsection 10.1(6) applies to the taxpayer in respect of each eligible derivative held by the taxpayer at the end of a taxation year in respect of which subsection 10.1(4) applies to the taxpayer. Where the electing taxpayer is not a financial institution, the combined effect of paragraph 10.1(4)(b) and subsection 10.1(6) is that each eligible derivative of the taxpayer is marked to market in each taxation year to which the election applies.

For more information, see the commentary on new subsections 10.1(1) and (6) and the definition “eligible derivative” in new subsection 10.1(5).

Eligible derivative

ITA
10.1(5)

New subsection 10.1(5) of the Act defines an “eligible derivative” of a taxpayer for a taxation year for the purposes of section 10.1. An eligible derivative of a taxpayer for a taxation year is intended to include any agreement that is a derivative financial instrument, held at any time in the taxation year by the taxpayer, and that meets the conditions set out in paragraphs 10.1(5)(a) to (c).

The first condition, in paragraph 10.1(5)(a), is that the agreement is not a capital property, a Canadian resource property, a foreign resource property or an obligation on account of capital of the taxpayer. By excluding capital properties and obligations that are on account of capital of the taxpayer, the effect of this condition is that a derivative must be held on income account in order to qualify as an eligible derivative. A Canadian resource property or a foreign resource property of a taxpayer (as those terms are defined for the purposes of the Act) do not qualify as an eligible derivative irrespective of whether they are held on income account.

The second condition, in paragraph 10.1(5)(b), is intended to ensure that the mark-to-market treatment of an electing taxpayer’s eligible derivatives is based on fair market values that are practicably verifiable by the Minister of National Revenue. This second condition can be met in one of two ways.

The first way (set out in subparagraph 10.1(5)(b)(i)) to satisfy the second condition is that the taxpayer has produced audited financial statements prepared in accordance with generally accepted accounting principles in respect of the taxation year. This condition assumes that a derivative is generally required to be valued at its fair value under generally accepted accounting principles and is so valued in a taxpayer’s audited financial statements.

The second way (set out in subparagraph 10.1(5)(b)(ii)) to satisfy the second condition is that the derivative has a readily ascertainable fair market value. This will be relevant only in cases where subparagraph 10.1(5)(b)(i) does not apply to an electing taxpayer, such as an individual, on the basis that the taxpayer has not produced audited financial statements. The fair market value of a derivative can be considered readily ascertainable where, for example, the derivative is actively traded on a public market, such as a derivatives exchange. A derivative would also generally be considered to have a readily ascertainable fair market value where

- a determination of its fair market value is accessible to the Minister, either directly or indirectly, from an independent third party such as a central counterparty or a third-party pricing source (*e.g.*, Bloomberg Valuation Service, registered securities dealers or brokers) or
- its fair market value is principally derived from, or corroborated by, values that are observable to the Minister of National Revenue (*e.g.*, a commodity price, currency exchange rate, index level, interest rate or stock price).

The third condition, in paragraph 10.1(5)(c), is relevant only where the derivative is held by a financial institution (as defined in subsection 142.2(1)). This condition requires that the agreement is not a tracking property (as defined in subsection 142.2(1)), other than an excluded property (as defined in subsection 142.2(1)). This condition ensures that the definition of an eligible derivative excludes derivatives that would otherwise be subject to the mark-to-market property rules in sections 142.2 to 142.6 of the Act. For more information, see the commentary on subsection 10.1(4).

Deemed disposition

ITA
10.1(6)

New subsection 10.1(6) of the Act sets out the mark-to-market rules for eligible derivatives held by an electing taxpayer that is not a financial institution (as defined in subsection 142.2(1)). Specifically, it requires each eligible derivative held by such a taxpayer at the end of a taxation year to be marked to market if subsection 10.1(4) applies to the taxpayer in respect of the taxation year. Subsection 10.1(6) does this by the combined effect of its paragraphs (a) and (b).

Paragraph 10.1(6)(a) deems the taxpayer to have disposed of each such eligible derivative immediately before the end of the year and to have received proceeds or paid an amount, as the case may be, equal to its fair market value at the time of disposition. In accordance with new subsection 10.1(9), where the eligible derivative is not a property of the taxpayer, the deemed disposition under paragraph 10.1(6)(a) will result in the eligible derivative being deemed to have been settled or extinguished in respect of the taxpayer.

Depending on whether the taxpayer is deemed to have received proceeds or paid an amount as a result of this deemed disposition, paragraph 10.1(6)(a) may result in the recognition of a profit or a loss in respect of the eligible derivative. Whether the taxpayer is deemed to have received proceeds or paid an amount as a result of the deemed disposition will depend on whether the derivative had a positive or a negative fair market value at the time of disposition.

Paragraph 10.1(6)(b) deems the taxpayer to have reacquired, or reissued or renewed, the eligible derivative at the end of the year at an amount equal to the proceeds or the amount, as the case may be, determined under paragraph 10.1(6)(a). A taxpayer would be deemed to have reissued or renewed the eligible derivative where it is not a property of the taxpayer at the end of the year (as is the case, for example, of an option written by the taxpayer where the taxpayer is not entitled to receive any payments from the holder).

For more information, see the commentary on new subsections 10.1(4) and (9).

Election year – gains and losses

ITA
10.1(7)

To mitigate any short-term advantage or disadvantage to a taxpayer of electing into the mark-to-market regime, new subsection 10.1(7) of the Act defers the recognition of unrealized profits or losses that accrued on eligible derivatives held by a taxpayer at the beginning of an election year until the taxation year in which these eligible derivatives are actually disposed of. Subsection 10.1(7) is also intended to ensure that the fair market value of an electing taxpayer's eligible derivatives at the beginning of an election year provides the starting point for their mark-to-market treatment over the duration of the election.

The preamble to subsection 10.1(7) sets out two conditions for the rules to apply. The first condition is that a taxpayer must hold the eligible derivative at the beginning of an election year of the taxpayer. For the purpose of subsection 10.1(7), an "election year" refers to the first taxation year in respect of which a taxpayer's first election, or any subsequent election made under subsection 10.1(1), applies. The second condition is that, in the taxation year immediately preceding that election year, the taxpayer did not compute its profit or loss in respect of that eligible derivative in accordance with a method of profit computation that produces a substantially similar effect to subsection 10.1(6). This second condition limits the application of new subsection 10.1(7) to electing taxpayers that did not compute their profit or loss in respect of eligible derivatives on a mark-to-market basis in the taxation year immediately preceding an election year.

Where these conditions are met, the taxpayer is deemed by subparagraph 10.1(7)(a)(i) to have disposed of the eligible derivative immediately before the beginning of the election year and received proceeds or paid an amount, as the case may be, equal to the fair market value of the eligible derivative at that time. In accordance with new subsection 10.1(9), the deemed disposition of a taxpayer's eligible derivative under subparagraph 10.1(7)(a)(i) includes its settlement or extinguishment in respect of the taxpayer where the eligible derivative is not a property of the taxpayer.

Under subparagraph 10.1(7)(a)(ii), the taxpayer is deemed to have reacquired, or reissued or renewed, the eligible derivative at the beginning of the election year at an amount equal to the proceeds or the amount, as the case may be, determined under subparagraph 10.1(7)(a)(i).

Paragraph 10.1(7)(b) defers the timing of recognition of the profit or loss that would arise (determined without reference to that paragraph) on the deemed disposition of a taxpayer's eligible derivative immediately before the beginning of an election year under new subparagraph 10.1(7)(a)(i). Under subparagraph 10.1(7)(b)(i), that profit or loss is deemed not to arise in the taxation year immediately preceding the election year. Rather, under subparagraph 10.1(7)(b)(ii), the profit or loss is deemed to arise in the taxation year in which the taxpayer disposes of the eligible derivative (otherwise than because of paragraph 10.1(6)(a) or 142.5(2)(a)).

New paragraph 10.1(7)(c) clarifies the application of the loss suspension rule in subsection 18(15) to the disposition referred to in subparagraph 10.1(7)(b)(ii). It provides that, for the purpose of applying subsection 18(15) to that disposition, the profit or loss that is deemed to

arise under subparagraph 10.1(7)(b)(ii) is included in determining the amount of the transferor's loss, if any, from the disposition.

For more information, see the commentary on new subsections 10.1(6) and (8).

Example 1 – Application of new paragraphs 10.1(7)(a) and (b)

At the beginning of taxation year 1, A enters into a futures agreement to buy a particular commodity in 5 years. At that time, the fair market value of the agreement is nil. In taxation year 1, A computes its profit or loss in respect of the derivative on a realization basis and, therefore, does not use a method of profit computation that produces a substantially similar effect to subsection 10.1(6).

The agreement continues to be held by A at the beginning of taxation year 2, at which time A makes an election under subsection 10.1(1).

The conditions for the application of subsection 10.1(7) having been met, subparagraph 10.1(7)(a)(i) deems A to have disposed of the derivative immediately before the beginning of taxation year 2. At that time, the derivative has a fair market value to A of -$10. Accordingly, subparagraph 10.1(7)(a)(i) deems A to have paid an amount equal to $10 at that time. Under subparagraph 10.1(7)(a)(ii), A is deemed to have reacquired the derivative at the beginning of taxation year 2 for an amount equal to the deemed amount paid (i.e.,-$10).

Immediately before the end of taxation year 2, the fair market value of the derivative has increased to $20. At that time, under paragraph 10.1(6)(a), A is deemed to have disposed of the derivative and to have received proceeds of $20. Accordingly, A recognizes a profit of $30 in respect of the derivative at that time (i.e., $20 – (-$10)). Under paragraph 10.1(6)(b), A is deemed to have reacquired the derivative at the end of taxation year 2 for an amount equal to the deemed proceeds received (i.e., $20).

Immediately before the end of taxation year 3, the fair market value of the derivative has increased to $30. At that time, under paragraph 10.1(6)(a), A is deemed to have disposed of the derivative and to have received proceeds of $30. Accordingly, A recognizes a profit of $10 ($30 - $20) at that time. Under paragraph 10.1(6)(b), A is deemed to have reacquired the derivative at the end of taxation year 3 for an amount equal to the deemed proceeds received (i.e., $30). In taxation year 4, A settles the derivative for proceeds of $40.

Determined without reference to paragraph 10.1(7)(b), a loss of $10 ($0 - $10) would arise in taxation year 1 on the deemed disposition in subparagraph 10.1(7)(a)(i), representing the amount of A's unrealized loss in respect of the derivative immediately before the beginning of taxation year 2 (i.e., the election year). However, the combined effect of subparagraphs 10.1(7)(b)(i) and (ii) is to deem this loss not to have arisen in taxation year 1 but, rather, in the taxation year in which A disposes of the derivative otherwise than because of paragraph 10.1(6)(a) (i.e., in taxation year 4). Accordingly, on the disposition of the derivative in taxation year 4, A would recognize no profit or loss (i.e., (($40 - $30) - $10)).

Example 2 – Application of new paragraph 10.1(7)(c)

Assume the facts are the same as in example 1, except that A disposes of the derivative in taxation year 4 for proceeds of $25. Assume further that the disposition is made to B, an affiliated person.

Under paragraph 10.1(7)(c), for the purpose of applying subsection 18(15) in respect of the disposition of the derivative, the loss of $10 that is deemed to arise in year 4 under subparagraph 10.1(7)(b)(ii) is included in determining the amount of A's loss, if any, from the disposition. Therefore, for the purpose of applying subsection 18(15), the amount of A's loss from the disposition (determined without reference to that subsection) would be $15.

Default realization method

ITA
10.1(8)

New subsection 10.1(8) of the Act provides the default method of profit computation that must be used in respect of any financial derivative instrument held on income account (including but not limited to eligible derivatives) by a taxpayer that is not a financial institution (as defined in subsection 142.2(1)) and that has not elected into the mark-to-market regime for eligible derivatives under subsection 10.1(1). The immediate effect of subsection 10.1(8) is to prevent such a taxpayer from using the mark-to-market method to compute its income from a business or property in respect of any financial derivative instrument held on income account where no election has been made.

It should be noted that subsection 10(15) and paragraph 18(1)(x) restrict a taxpayer's ability to use the lower of cost and market method to compute its income from a business or property in respect of a financial derivative instrument. Taken together, the combined effect of these provisions and subsection 10.1(8) is to impose the realization method as the default method of profit computation for financial derivative instruments that are held on income account by a taxpayer that is not a financial institution (as defined in subsection 142.2(1)), to the extent that subsection 10.1(4) does not apply in respect of eligible derivatives held by such a taxpayer.

For more information, see the commentary on subsections 10.1(1), (4) and (6).

Interpretation

ITA
10.1(9)

New subsection 10.1(9) of the Act provides two rules that apply for the purposes of new subsections 10.1(4) to (7). These rules are intended to ensure that the terminology used in these provisions is applicable to derivatives that are not property of a taxpayer.

The first rule, in paragraph 10.1(9)(a), provides that if an agreement that is an eligible derivative of a taxpayer is not property (as is the case, for example, of an option written by the taxpayer where the taxpayer is not entitled to receive any payments from the holder), the taxpayer is

deemed to hold the agreement at any time while the taxpayer is a party to the agreement. The second rule, in paragraph 10.1(9)(b), deems a taxpayer to have disposed of such an agreement when it is settled or extinguished in respect of the taxpayer.

Subsection 10.1(9) parallels the introduction of similar rules in new subsection 18(21). For more information, see the commentary on that provision.

For more information, see the commentary on new subsections 10.1(6) and (7).

Clause 34

When subsec. (15) applies to adventurers in the nature of trade

ITA
18(14)(c)

Subsection 18(14) of the Act describes the conditions in which the loss-deferral rule in subsection 18(15) applies to dispositions of property that are described in an inventory of a business that is an adventure or concern in the nature of trade. Paragraph 18(14)(c) excludes from the application of the rule dispositions deemed to have occurred under specified provisions of the Act.

Paragraph 18(14)(c) is amended to add to the list of deemed dispositions those referred to in new subsections 10.1(6) and (7). Where they apply, these subsections deem dispositions of a taxpayer's eligible derivatives (as defined in new subsection 10.1(5)) to have occurred for the purposes of the elective mark-to-market regime for eligible derivatives in new section 10.1. To the extent that an eligible derivative qualifies as inventory of a business that is an adventure or concern in the nature of trade, the loss-deferral rule in subsection 18(15) will not apply in determining the amount of a taxpayer's profit or loss in respect of such eligible derivatives as a result of these deemed dispositions.

For more information, see the commentary on new subsections 10.1(6) and (7) and the definition "eligible derivative" in new subsection 10.1(5).

Clause 35

New subsections 18(17) to (23) of the Act introduce rules that are intended to prevent the deferral or avoidance of tax that is associated with tax-motivated straddle transactions. In such a transaction, a taxpayer typically enters into offsetting short and long positions and then selectively realizes the loss on the losing position in a taxation year and defers the recognition of the offsetting profit on the winning position until the following taxation year.

Subsection 18(18) provides the conditions for the application of subsection 18(19), which is the operative rule. In general terms, subsection 18(19) is a stop-loss rule that provides that a loss realized on the disposition of a particular position (as defined in subsection 18(17)) is recognized only to the extent that it exceeds the "net" amount of unrecognized profit on open positions, including the offsetting position (as defined in subsection 18(17)), in the straddle transaction at

the end of the particular taxation year. The amount of the disallowed loss is carried forward to the next taxation year and its recognition is subject to the same limitation in that taxation year.

Subsection 18(20) provides for three exceptions to the application of this operative rule. Subsection 18(21) contain interpretative rules that apply for the purposes of subsections 18(17) to (23). Finally, subsections 18(22) and 18(23) are anti-avoidance rules that are intended to prevent a deferral of income in situations where connected persons (as defined in subsection 18(17)), together hold offsetting positions but have different taxation year-ends.

These amendments apply in respect of a particular position of a person or partnership if

- the position is acquired, entered into, renewed or extended, or becomes owing by, the person or partnership after March 21, 2017; or
- an offsetting position in respect of the position is acquired, entered into, renewed or extended, or becomes owing, by the person or partnership or a connected person, after March 21, 2017.

Definitions
ITA
18(17)

New subsection 18(17) of the Act sets out relevant definitions that apply for the purposes of subsections 18(17) to (23).

“offsetting position”

An “offsetting position” in respect of a particular position of a person or partnership (referred to as the “holder”) means one or more positions that satisfy the following conditions:

- they are held by the holder or by a person or partnership that does not deal at arm’s length with, or is affiliated with, the holder (referred to as a “connected person”) including, for greater certainty, by any combination of the holder and one or more connected persons;
- they have the effect, or would have the effect if each of the positions held by a connected person were held by the holder, of eliminating all or substantially all of the holder’s risk of loss and opportunity for gain or profit in respect of the particular position, and
- if held by a connected person, they can reasonably be considered to have been held with the purpose of obtaining the effect described above.

The design of the definition is similar to that of the definition “synthetic disposition arrangement” in subsection 248(1). Therefore, for more information regarding the operation of this definition including the determination of whether all or substantially all of a holder’s risk of loss and opportunity for gain or profit in respect of a position has been eliminated, see the commentary on the definition “synthetic disposition arrangement”.

Offsetting positions are sometimes of the same kind. For example, a short derivative position could be an offsetting position to a long derivative position. Offsetting positions may also be of

different kinds. For example, a short derivative position could be an offsetting position to a security or to a commodity; or a foreign currency debt owing could be an offsetting position to foreign currency.

For more information, see the commentary on the new definition “position”.

“position”

A position of a person or partnership means one or more properties, obligations or liabilities of the person or partnership that satisfy two conditions.

The first condition (in paragraph (a)) is that each property, obligation or liability is:

- a share in the capital stock of a corporation;
- an interest in a partnership;
- an interest in a trust;
- a commodity;
- foreign currency;
- a financial derivative instrument;
- a debt owed to or owing by the person or partnership that, at any time, is
    - a foreign currency debt,
    - a debt with contingent interest, or
    - a debt that that is convertible into or exchangeable for an interest in, or right in, a share, a partnership interest, a trust interest or a commodity;
- an obligation to transfer or return to another person or partnership a property identical to any particular property described in any of subparagraphs (i) to (vii) of the definition that was previously transferred or lent to the person or partnership by that person or partnership; or
- an interest, or for civil law a right, in any property that is described in any of subparagraphs (i) to (vii) of the definition.

The second condition (in paragraph (b)), which is applicable when there is more than one property, obligation or liability, is that it must be reasonable to conclude that each is held in connection with the other.

“successor position”

A successor position in respect of a position (referred to as the “initial position”) means a particular position that satisfies the following conditions:

- the particular position is an offsetting position in respect of a second position,
- the second position was an offsetting position in respect of the initial position that was disposed of at a particular time; and
- the particular position was entered into during the period that begins 30 days before, and ends 30 days after, the particular time.

The definition “successor position” is an anti-avoidance rule that is intended to apply when a person or partnership disposes of a particular position in a straddle transaction and then replaces it in circumstances when the existing stop-loss rules of the Act do not suspend the loss realized on that particular position. Under these circumstances, any unrecognized profit or loss on the successor position at the end of the particular taxation year will be included in the amount determined by variable C under subsection 18(19).

For more information, see the commentary on new subsection 18(19) and the new definitions “offsetting position” and “position”.

“unrecognized loss”

An unrecognized loss in respect of a position of a person or partnership at a particular time in a taxation year means the loss, if any, that would be deductible in computing the income of the person or partnership for the year with respect to the position if it were disposed of immediately before the particular time at its fair market value at the time of disposition.

The terms “unrecognized loss” and “unrecognized profit” are used in the description of variables D and E under subsection 18(19). For more information, see the commentary on new subsection 18(19) and the new definitions “position” and “unrecognized profit”.

“unrecognized profit”

An unrecognized profit in respect of a position of a person or partnership at a particular time in a taxation year, means the profit, if any, that would be included in computing the income of the person or partnership for the year with respect to the position if it were disposed of immediately before the particular time at its fair market value at the time of disposition.

For more information, see the commentary on new subsection 18(19) and the new definitions “position” and “unrecognized loss”.

Example 1 – Definitions of Offsetting Position and Successor Position

On September 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset decreases in value. On November 1, 2017, the taxpayer disposes of the long position at a $75,000 loss, at which time there is $75,000 of unrecognized profit on the offsetting short position. At the same time, the taxpayer enters into a new long position that is offsetting with respect to the retained short position. The referenced asset increases in value from that time to the end of 2017. On December 1, 2017, the taxpayer disposes of the short position at a profit of $40,000, at which time there is $35,000 of unrecognized profit in the new long position. At the same time, the taxpayer enters into a new short position that is offsetting to the new long position. On January 2, 2018, the taxpayer disposes of the new long position at a profit of $45,000 and the new short position at a loss of $10,000.

Under these circumstances, the new long position is a successor position to the original long position at the end of 2017. Also, the new short position is an offsetting position to this successor

long position at the end of 2017. Therefore, the unrecognized profit on the new long position and the unrecognized loss on the new short position at the end of 2017 will be included in the amount determined by variable C under subsection 18(19).

Example 2 – Definitions of Offsetting Position and Successor Position

On August 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset decreases in value. On October 1, 2017, the taxpayer disposes of the long position at a $300,000 loss and the short position at a $300,000 profit. On October 1, 2017, the taxpayer enters into a new short position that is identical to the original short position. The referenced asset continues to decrease in value. At the end of 2017, there is $250,000 of unrecognized profit in respect of the new short position.

Under these circumstances, the new short position is not an offsetting position or a successor position to the long position at the end of 2017. Therefore, the unrecognized profit on the new short position will not be included in the amount determined by variable C under subsection 18(19).

When subsection 18(19) applies

ITA
18(18)

New subsection 18(18) of the Act sets out the conditions for the application of the stop-loss rule in subsection 18(19). Subsection 18(18) provides that subsection 18(19) applies in respect of a disposition of a particular position by a person or partnership (the “transferor”) if

- the disposition is not a disposition that is deemed to have occurred by section 70, subsection 104(4), section 128.1 or subsections 138(11.3) or 149(10);
- the transferor is not a financial institution (as defined in subsection 142.2(1)), a mutual fund corporation or a mutual fund trust, and
- the particular position was, immediately before the disposition, not a capital property, or an obligation or liability on account of capital, of the transferor.

For more information, see the commentary on new subsection 18(19) and the new definition “position” in new subsection 18(17).

Straddle losses

ITA
18(19)

In general terms, new subsection 18(19) of the Act contains a stop-loss rule that provides that a loss realized on the disposition of a particular position is recognized in a particular taxation year only to the extent that it exceeds the “net” amount of unrecognized profit on open positions of the straddle transaction at the end of that taxation year.

This stop-loss rule will typically apply to a loss realized on a particular position that is determined on a realization basis but it may also apply to a position that is subject to mark-to-market taxation when the conditions of application of the stop-loss rule are otherwise met.

This stop-loss rule is intended to prevent the deferral or avoidance of tax that is associated with a straddle transaction by deferring the recognition of any loss realized on the disposition of a particular position to the same taxation year in which the profits in respect of the relevant open positions of the straddle transaction are realized.

In particular, this stop-loss rule provides that the portion of the loss, if any, from the disposition of a particular position that is deductible in computing the transferor's income for a particular taxation year is the amount determined by the formula A + B – C.

Variable A is

- if the particular taxation year is the taxation year in which the disposition occurs, the amount of the loss otherwise determined which, for greater certainty, is subject to subsection 18(15), and
- in any other taxation year, nil.

Thus, in general terms, variable A is relevant only for the taxation year in which the disposition of the particular position occurs. For all other taxation years, variable A will be nil.

Variable B is

- if the disposition occurred in a preceding taxation year, the amount determined for C in respect of the immediately preceding taxation year, and
- in any other taxation year, nil.

Thus, variable B is, in effect, the amount of the loss (if any) disallowed in the immediately preceding taxation year that is carried forward to the particular taxation year to be retested under the stop-loss rule.

Variable C is the lesser of

- the amount determined for A for the taxation year in which the disposition occurs, and
- the amount determined by the formula D – (E + F).

Thus, variable C is, in effect, the amount of the loss that is disallowed in the particular taxation year.

Variable D is the total of all amounts of unrecognized profit at the end of the particular taxation year in respect of

- the particular position,
- offsetting positions in respect of the particular position,
- successor positions in respect of the particular position, and
- offsetting positions in respect of any successor position in respect of the particular position.

Variable E is the total of all amounts of unrecognized loss at the end of the particular taxation year in respect of the same positions referred to in the description of variable D (except for the particular position).

In the most basic straddle transaction, the transferor will dispose of the particular position shortly before its taxation year-end and then dispose of the offsetting position shortly after the beginning of the following taxation year. In such a transaction, variable C will equal the amount of unrecognized profit at the end of the particular taxation year in respect of the offsetting position to the particular position. In other words, variable C will simply equal the amount referred to in subparagraph (ii) of the description of variable D.

In more complex straddle transactions, shortly after disposing of the particular position, the transferor will enter into a successor position that is offsetting with respect to the retained position. By entering into such successor position, the transferor remains economically hedged until the end of the straddle transaction. Typically, the transferor will hold on to both these positions past its taxation year-end and then dispose of them shortly afterwards. In these cases, variable C will generally equal the “net” amount of unrecognized profit in respect of these open positions. In other words, variable C will equal D – E, that is the amount of unrecognized profit at the end of the particular taxation year in respect of these open positions minus the amount of unrecognized loss at the end of the particular taxation year in respect of these same open positions.

Finally, over the course of certain straddle transactions, the transferor will dispose of more than one loss position. In these cases, the amount determined by D – E will be reduced by any loss that is still suspended at the end of the particular taxation year for any position that was disposed of prior to the disposition of the particular position. Variable F, which represents the total of all amounts of suspended losses for prior dispositions of positions in the straddle transaction, is determined by the formula G – H. In this context, for each prior disposition, variable G is, in effect, the amount of the loss otherwise determined whereas variable H is, in effect, the amount of the loss allowed under subsection 18(19) for the particular taxation year or a preceding taxation year.

The application of the stop-loss rule contained in subsection 18(19) may be illustrated by the following examples. It is assumed in each example that a transferor with a calendar year-end enters into perfectly offsetting long and short derivative positions that reference the same asset.

For more information, see the commentary on new subsection 18(18) and the new definitions “offsetting position”, “position”, “successor position”, “unrecognized loss”, and “unrecognized profit” in new subsection 18(17).

Example 1 – Basic Straddle

On August 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset increases in value from that time to the end of 2017. On December 29, 2017, the taxpayer disposes of the short position at a $50,000 loss, at which time there is $50,000 of unrecognized profit in respect of the offsetting long position. On January 1, 2018, the taxpayer disposes of the long position at a profit of $50,500.

For the 2017 taxation year, the amount of the taxpayer’s loss from the disposition of the short position will be nil (i.e., A + B – C = $50,000 + 0 - $50,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $50,000), and*
- *D – (E + F) = $50,500 – (0 + 0)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the short position will be $50,000 (i.e., A + B – C = 0 + $50,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $50,000), and*
- *D – (E + F) = 0 – (0 + 0)*

In sum, the entire $50,000 loss on the disposition of the short position will be disallowed for the 2017 taxation year because there is $50,500 of unrecognized profit on the offsetting long position at year-end. This entire $50,000 loss will be allowed for the 2018 taxation year because the long position is disposed of in that year and, as a result, there is no unrecognized profit on the long position at year-end.

Example 2 – Successor Position

On September 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset decreases in value. On November 1, 2017, the taxpayer disposes of the long position at a $75,000 loss, at which time there is $75,000 of unrecognized profit in respect of the offsetting short position. At the same time, the taxpayer enters into a new long position (successor long position) that is offsetting with respect to the retained short position. The referenced asset then increases in value from November 1, 2017 to the end of 2017 and returns back to its September 1, 2017 level. On January 2, 2018, the taxpayer disposes of the successor long position at a profit of $75,000 and the offsetting short position at no profit or loss.

For the 2017 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be nil (i.e., A + B – C = $75,000 + 0 - $75,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = $75,000 – (0 + 0)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be $75,000 (i.e., A + B – C = 0 + $75,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = 0 – (0 + 0)*

In sum, the entire $75,000 loss on the disposition of the long position will be disallowed for the 2017 taxation year because there is an aggregate $75,000 of unrecognized profit on the successor position at year-end. This entire $75,000 loss will be allowed for the 2018 taxation year because both the successor long position and the offsetting short position are disposed of in that year and, as a result, there is no unrecognized profit on these positions at year-end.

In this example, the offsetting short position – the position that is held throughout the straddle transaction – has no unrecognized profit at the end of the 2017 taxation year. This unrecognized

profit has completely shifted to the successor long position. Absent taking into account the unrecognized profit on the successor long position, the entire $75,000 loss on the disposition of the original long position would have been recognized in the 2017 taxation year.

Example 3 – Successor Position

Assume the facts are the same as in example 2, except that after decreasing in value from September 1, 2017, to November 1, 2017, the referenced asset increases in value from November 1, 2017, to the end of 2017 and partially returns to its September 1, 2017 level. On January 2, 2018, the taxpayer disposes of the successor long position at a profit of $40,000 and the offsetting short position at a profit of $35,000.

For the 2017 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be nil (i.e., A + B – C = $75,000 + 0 - $75,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = $75,000 (i.e., $40,000 + $35,000) – (0 + 0)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be $75,000 (i.e., A + B – C = 0 + $75,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = 0 – (0 + 0)*

In sum, the entire $75,000 loss on the disposition of the long position will be disallowed for the 2017 taxation year because there is $75,000 of unrecognized profit on both the successor long position and the offsetting short position at year-end. This entire $75,000 loss will be allowed for the 2018 taxation year because both the successor long position and the offsetting short position are disposed of in that year and, as a result, there is no unrecognized profit on these positions at year-end.

Example 4 – Successor Position

Assume the facts are the same as in example 2, except that after decreasing in value from September 1, 2017 to November 1, 2017, the referenced asset continues to decrease in value from November 1, 2017 to the end of 2017. On January 2, 2018, the taxpayer disposes of the successor long position at a loss of $75,000 and the offsetting short position at a profit of $150,000.

For the 2017 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be nil (i.e., A + B – C = $75,000 + 0 - $75,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = $150,000 – ($75,000 + 0)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the long position will be $75,000 (i.e., A + B – C = 0 + $75,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $75,000), and*
- *D – (E + F) = 0 – (0 + 0)*

In sum, the entire $75,000 loss on the disposition of the long position will be disallowed for the 2017 taxation year because there is $75,000 of "net" unrecognized profit on both the successor long position and the offsetting short position at year-end. This entire $75,000 loss will be allowed for the 2018 taxation year because both the successor long position and the offsetting short position are disposed of in that year and, as a result, there is no unrecognized profit on these positions at year-end.

Example 5 – Multiple Loss Positions

On August 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset decreases in value. On November 1, 2017, the taxpayer disposes of the long position at a $200,000 loss, at which time there is an unrecognized profit of $200,000 on the short position. At the same time, the taxpayer enters into a new long position (successor long position) that is offsetting with respect to the retained short position. The referenced asset then increases in value. On December 1, 2017, the taxpayer disposes of the successor long position at a profit of $200,000, at which time there is no unrecognized profit or loss on the retained short position. At the same time, the taxpayer enters into a new long position (successor to successor long position) that is offsetting with respect to the retained short position. On December 28, 2017, the taxpayer disposes of the short position at a loss of $300,000. On January 2, 2018, the taxpayer disposes of the successor to the successor long position at a profit of $300,000.

For the 2017 taxation year, the amount of the taxpayer's loss from the disposition of the original long position will be nil (i.e., A + B – C = $200,000 + 0 - $200,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $200,000), and*
- *D – (E + F) = $300,000 – (0 + 0)*

For the 2017 taxation year, the amount of the taxpayer's loss from the disposition of the short position will be $200,000 (i.e., A + B – C = $300,000 + 0 - $100,000). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $300,000), and*
- *D – (E + F) = $300,000 – (0 + $200,000)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the original long position will be $200,000 (i.e., A + B – C = 0 + $200,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $200,000), and*
- *D – (E + F) = 0 – (0 + 0)*

For the 2018 taxation year, the amount of the taxpayer's loss from the disposition of the short position will be $100,000 (i.e., A + B – C = 0 + $100,000 - 0). Under these circumstances, variable C will be equal to the lesser of:

- *A for the 2017 taxation year (i.e., $300,000), and*
- *D – (E + F) = 0 – (0 + 0)*

In sum, the entire $200,000 loss on the disposition of the long position and a $100,000 loss on the disposition of the short position will be disallowed for the 2017 taxation year because there is $300,000 of unrecognized profit on the successor to the successor long position at year-end. These losses will be allowed for the 2018 taxation year because the successor to the successor long position is disposed of in that year and, as a result, there is no unrecognized profit on that position at year-end.

Absent the adjustment under variable F when determining the loss from the disposition of the short position for the 2017 taxation year, the entire $300,000 loss would have been disallowed which would have effectively represented an over-counting of the $300,000 of unrecognized profit on the successor to the successor long position at year-end.

Example 6 – Coordination With Existing Stop-Loss Rules

On September 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset increases in value from that time to the end of 2017. On December 30, 2017, the taxpayer disposes of the short position to an affiliated person at an $80,000 loss, at which time there is $80,000 of unrecognized profit in respect of the offsetting long position. On January 1, 2018, the taxpayer disposes of the long position at a profit of $80,500. On January 1, 2019, the affiliated person disposes of the short position to a non-affiliated person.

Assuming that subsection 18(15) suspends the $80,000 loss realized on the disposition of the short position, then subsection 18(19) would not apply to this loss because it only suspends a loss if it is otherwise available. Therefore, the $80,000 loss realized on the disposition of the short position would only be unsuspended on January 1, 2019 pursuant to subsection 18(15).

Exceptions

ITA
18(20)

New subsection 18(20) of the Act provides for three exceptions to the application of the stop-loss rule under subsection 18(19).

The first exception (in paragraph (a)) applies to a particular position when either the particular position, or the offsetting position in respect of the particular position, consists of:

- commodities that the holder of the position manufactures, produces, grows, extracts or processes, or
- debt that the holder of the position incurs in the course of a business that consists of one or any combination of the activities described above.

This first exception is intended to exclude certain business hedging arrangements. For example, this exception would generally apply to the disposition of a short futures contract that was entered into by a farmer to protect against a potential decline in the price of his or her crop.

The second exception (in paragraph (b)) applies to a particular position if the transferor continues to hold the position – that would be an offsetting position in respect of the particular position if the particular position continued to be held by the transferor – throughout a 30-day period beginning on the date of disposition of the particular position and at no point during the period

- is the transferor's risk of loss with respect to the position reduced in any material respect by another position entered into or disposed by the transferor, or
- would the transferor's risk of loss with respect to the position be reduced in any material respect by another position entered into or disposed by a connected person, if the other position were entered into or disposed by the transferor.

The use of a 30-day period of full economic exposure to the remaining position as a proxy for the *bona fide* purpose of the straddle transaction is consistent with the definition "successor position" in subsection 18(17).

For more information, see the commentary on new subsection 18(19).

Example – 30-day Exception

On August 1, 2017, a taxpayer enters into offsetting long and short positions. The referenced asset increases in value. On December 29, 2017, the taxpayer disposes of the short position at a $225,000 loss, at which time there is $225,000 of unrecognized profit in respect of the offsetting long position. On February 9, 2018, the taxpayer disposes of the long position at a $250,000 profit.

In these circumstances, the second exception will apply to the short position as the taxpayer continues to hold the long position throughout a 30-day period beginning on the date of disposition of the particular position (i.e., the 30-day period beginning on December 29, 2017 and ending on January 28, 2018).

The third exception (in paragraph (c)) applies to a particular position if it can reasonably be considered that none of the main purposes of the series of transactions or events, or any of the transactions or events in the series, of which the holding of both the particular position and offsetting position are part, is to avoid, reduce or defer tax that would otherwise be payable under the Act.

This third exception is intended to exclude non-tax motivated transactions that merely happen to involve offsetting positions and that may not fall within the scope of the first two exceptions. For example, this third exception would generally apply to transactions undertaken primarily with the intention of generating profits on the spread between two offsetting positions. However, this third exception would not apply if the tax benefit resulting from such a transaction is disproportionate to the profit earned on it. This third exception may also apply to *bona fide*

business hedging arrangements that do not fall within the scope of the first exception in paragraph (a). Finally, this third exception may apply to other types of non-tax motivated arrangements where the unrecognized profit with respect to an open position arises primarily in a different period from when the realized loss with respect to the particular position arose.

Example – Commercial Exception

On April 1, 2017, a taxpayer enters into a long position. The referenced asset decreases in value. On December 2, 2017, the taxpayer enters into a short position referencing the same asset. At that time, the short position is an offsetting position to the long position. On December 3, 2017, the taxpayer disposes of the long position at a $50,000 loss. The taxpayer holds on to the short position past its taxation year-end and disposes of it on January 1, 2018 at a $35,000 profit.

In these circumstances, the third exception will generally apply to the long position as the realized loss on the position arose primarily in a different period from when the unrecognized profit on the short position arose.

Application

ITA
18(21)

New subsection 18(21) of the Act provides for four supporting rules that apply for the purposes of subsections 18(17) to 18(23).

The first rule (in paragraph (a)) provides that, if a particular position is not property, as is the case, for example, a written option or a debt that is owed by a person or partnership, the person or partnership is deemed:

- to hold the position while it is a position of the person or partnership, and
- to have disposed of the position when the position is settled or extinguished in respect of the person or partnership.

The second rule (in paragraph (b)) provides that a disposition of a position is deemed to include a disposition of a portion of the position. After the disposition of a portion of a position, the holder of the original position will be, when appropriate, considered to hold the remaining portion as a position for the purposes of subsection 18(19).

Example – Disposition of a Portion of a Position

On September 1, 2017, a taxpayer enters into offsetting long (forward contract to buy 100,000 barrels of crude oil) and short (forward contract to sell 100,000 barrels of crude oil) positions. The price of crude oil increases. On December 28, 2017, the taxpayer partially closes out its short position by closing out on the sale of 40,000 barrels of crude oil. On January 3, 2018, the taxpayer partially closes out its long position by closing out on the purchase of 40,000 barrels of crude oil.

Under these circumstances, the second rule clarifies that the partial close out of the short position is a disposition of a position for the purposes of subsections 18(17) to (23).

The third rule (in paragraph (c)) is an anti-avoidance rule that supplements the definition "offsetting position" in subsection 18(17). In particular, this rule deems a position to be an offsetting position in respect of a particular position of a person or partnership if:

- there is a high degree of negative correlation between changes in value of the position and the particular position, and
- it can reasonably be considered that the principal purpose of the series of transactions or events, or any of the transactions in the series, of which the holding of both the particular position and offsetting position are part, is to avoid, reduce or defer tax that would otherwise be payable under this Act.

This anti-avoidance rule may apply, for example, to straddle transactions constructed with options that may eliminate the opportunity for gain or profit or the risk of loss, but not both as is required by the definition "offsetting position" in subsection 18(17).

The fourth rule (in paragraph (d)) is an anti-avoidance rule that supplements the definition "successor position" in subsection 18(17). In particular, this rule deems one or more positions to be a successor position in respect of a particular position of a person or partnership if:

- a portion of the particular position was disposed of at a particular time;
- the position is, or the positions include, a position that consists of the portion of the particular position that was not disposed of (referred to as the "remaining portion of the particular position");
- if there is more than one position, the position or positions that do not consist of the remaining portion of the particular position were entered into during the period that begins 30 days before, and ends 30 days after, the particular time;
- the position is, or the positions taken together would be, an offsetting position in respect of a second position (within the meaning of the definition "successor position");
- the second position was an offsetting position in respect of the particular position; and
- it can reasonably be considered that the principal purpose of the transactions or events, or any of the transactions in the series, of which the disposition of a portion of the particular position and the holding of one or more positions are part, is to avoid, reduce or defer tax that would otherwise be payable under the Act.

This anti-avoidance rule is intended to prevent the use of partial dispositions of positions in order to avoid the application of these rules.

For more information, see the commentary on new subsections 18(18) to (23) and the new definitions "offsetting position" and "position" in new subsection 18(17).

Different Taxation Years

ITA

18(22)

New subsections 18(22) and 18(23) of the Act are anti-avoidance rules that are intended to prevent a deferral or avoidance of tax in situations where connected persons, as defined in subsection 18(17), together hold offsetting positions but have different taxation year-ends.

Subsection 18(22) provides that the deeming rule in subsection 18(23) applies if:

- at any time in a particular taxation year of a transferor, a gain position (as defined) is held by a connected person;
- the connected person disposes of the gain position in the particular taxation year; and
- the taxation year of the connected person in which the disposition of the gain position occurs ends after the end of the particular taxation year.

For more information, see the commentary on new subsection 18(23) and the new definition "offsetting position" in new subsection 18(17).

Different Taxation Years

ITA
18(23)

Subsection 18(23) of the Act deems a portion of the profit, if any, realized from the disposition of a gain position referred to in subsection 18(22) to be unrecognized profit in respect of the gain position until the end of the taxation year of the connected person in which the disposition occurs. That portion of the profit is determined by the formula A x B/C.

Variable A is the amount of the profit otherwise determined.

Variable B is the number of days in the taxation year of the connected person in which the disposition of the gain position occurs that are after the end of the particular taxation year.

Variable C is the total number of days in the taxation year of the connected person in which the disposition of the gain position occurs.

For more information, see the commentary on new subsection 18(22).

Example – Different Taxation Year-Ends

K and L are connected persons as defined in subsection 18(17). K has a December 31 taxation year-end whereas L has a December 29 taxation year-end. On November 1, 2017, they enter into offsetting long and short positions. The referenced asset increases in value. On December 31, 2017, K disposes of the short position at a $100,000 loss. On the same day, L disposes of the long position at a $100,000 profit.

Even though the two positions are disposed of on the same day, the overall transaction will result in a deferral benefit on the basis that the $100,000 loss will be recognized in K's December 31, 2017 taxation year whereas the $100,000 profit will be recognized in L's December 29, 2018 taxation year.

Absent the anti-avoidance rules in subsections 18(22) and 18(23), subsection 18(19) would not prevent the deferral of income associated with the transaction. Subsection 18(19) would only suspend K's loss on the disposition of the short position to the extent that L has an unrecognized profit on the long position at the end of K's taxation year in which the disposition of the short position occurs. On December 31, 2017, L would have no unrecognized profit on the long position since that position is disposed of on that day.

In this context, subsections 18(22) and 18(23) will apply to deem $99,452 (i.e., A x B/C = $100,000 x 363/365) of the $100,000 profit realized on the disposition of the long position to be unrecognized profit in respect of the long position until December 29, 2018.

Clause 36

Eligible derivatives

ITA
85(1.12)

Subsection 85(1.1) of the Act describes the type of property (referred to as "eligible property") that may be transferred to a corporation on a rollover basis under subsection 85(1).

New subsection 85(1.12) provides that, notwithstanding subsection 85(1.1), an eligible derivative (as defined in new subsection 10.1(5)) of a taxpayer to which new subsection 10.1(6) applies is not an "eligible property" of the taxpayer in respect of a disposition by the taxpayer to a corporation. Similar amendments are being made to the preambles to subsections 85(2) and 97(2), which provide for the rollover of certain properties by, or to, partnerships. These amendments ensure that a non-financial institution that has elected under new subsection 10.1(1) to mark to market its eligible derivatives cannot rely on the rollover mechanisms in subsections 85(1) and (2) and 97(2) to defer the recognition of any unrealized profit that accrued in the year of transfer in respect of such property, which are intended to be revalued to fair market value on an annual basis. The potential for such property to be rolled over to a transferee that has not made an election under subsection 10.1(1) could frustrate that policy objective. These amendments parallel the exclusion, under subparagraph 85(1.1)(g)(iii), of property that is a mark-to-market property of a financial institution.

For more information, see the commentary on new subsection 10.1(6) and the definition "eligible derivative" in new subsection 10.1(5).

Transfer of property to corporation from partnership

ITA
85(2)

Subsection 85(2) of the Act provides that the rules in subsection 85(1) will apply and allow a transfer on a tax-deferred basis of certain properties by a partnership to a taxable Canadian corporation in exchange for shares.

The preamble to subsection 85(2) is amended to provide that, if new subsection 10.1(6) applies to the partnership, property that is an eligible derivative (as defined in new subsection 10.1(5)) of the partnership is excluded from subsection 85(2). This amendment parallels the introduction of new subsection 85(1.12) and the amendment to the preamble to subsection 97(2).

For more information, see the commentary on new subsections 10.1(6), 85(1.12) and the definition "eligible derivative" in new subsection 10.1(5).

Clause 37

ITA
87(2)(e.41)

New paragraph 87(2)(e.41) of the Act applies with respect to each eligible derivative (as defined in new subsection 10.1(5)) of a predecessor corporation immediately before the end of its last taxation year where new subsection 10.1(6) applied to the predecessor corporation in its last taxation year. It provides that each such eligible derivative is deemed to have been reacquired or reissued or renewed, as the case may be, by the new corporation at its fair market value immediately before the amalgamation. As a result of new paragraph 87(2)(e.41), the cost to the new corporation of each such eligible derivative is equal to its fair market value immediately before the amalgamation.

It should be noted that the predecessor corporation is deemed to have disposed of each such eligible derivative immediately before the amalgamation and received proceeds or paid an amount, as the case may be, equal to its fair market value at the time of disposition. This deemed disposition occurs by the combined effect of paragraph 87(2)(a) and new subsection 10.1(6).

For more information, see the commentary on new subsection 10.1(6) and the definition "eligible derivative" in new subsection 10.1(5).

ITA
87(2)(e.42)

New paragraph 87(2)(e.42) of the Act is introduced consequential on the introduction of new subsection 10.1(6). In general terms, new subsection 10.1(7) defers the recognition of a taxpayer's unrealized profit or loss in respect of eligible derivatives held by the taxpayer at the beginning of the first taxation year in respect of which an election made under new subsection 10.1(1) applies to the taxpayer until the taxation year in which they are actually disposed of by the taxpayer.

New paragraph 87(2)(e.42) provides that, for the purposes of new subsection 10.1(7), the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation.

For more information, see the commentary on new subsection 10.1(7) and the definition "eligible derivative" in new subsection 10.1(5).

Clause 38

ITA
88(1)(e.2)

Paragraph 88(1)(e.2) of the Act provides that a number of rules that apply to amalgamations under subsection 87(2) also apply, with certain modifications, to windings-up under subsection 88(1). This paragraph is amended to add a reference to new paragraph 87(2)(e.42). Accordingly, for the purposes of new subsection 10.1(7), the parent is deemed to be the same corporation as, and a continuation of, the subsidiary.

For more information, see the commentary on new subsection 10.1(7) and new paragraph 87(2)(e.42).

ITA
88(1)(i)

New paragraph 88(1)(i) of the Act provides that, for the purposes of new subsection 10.1(6), the taxation year of a subsidiary in which an eligible derivative (as defined in new subsection 10.1(5)) was distributed to, or assumed by, the parent on a winding-up is deemed to have ended immediately before the time when the eligible derivative was distributed or assumed. Consequently, if subsection 10.1(6) applies to the subsidiary, it will deem the subsidiary to have disposed of the eligible derivative immediately before the distribution to, or assumption by, the parent and to have received proceeds or paid an amount, as the case may be, equal to its fair market value at the time of disposition.

For more information, see the commentary on new subsection 10.1(6) and the definition "eligible derivative" in new subsection 10.1(5).

Clause 39

Agreement or election of partnership members

ITA
96(3)

Subsection 96(3) of the Act provides rules that apply if a member of a partnership makes an election under certain provisions of the Act for a purpose that is relevant to the computation of the member's income from the partnership. In such a case, the election will be valid only if it is made on behalf of all the members of the partnership and the member has authority to act for the partnership.

Subsection 96(3) is amended to apply for the purposes of an election made under new subsection 10.1(1). For more information, see the commentary on new subsection 10.1(1).

Clause 40

Rules if election by partners

ITA
97(2)

Subsection 97(2) of the Act sets out rules which allow a taxpayer to dispose of certain types of property on a tax-deferred basis to a Canadian partnership of which the taxpayer is a member immediately after the time of disposition. This subsection is amended to provide that, if new subsection 10.1(6) applies to the taxpayer, property that is an eligible derivative (as defined in new subsection 10.1(5)) of the taxpayer is excluded from subsection 97(2).

This amendment parallels the introduction of new subsection 85(1.12) and the amendment to the preamble to subsection 85(2). For more information, see the commentary on new subsections 10.1(6) and 85(1.12) and the definition “eligible derivative” in new subsection 10.1(4).

Billed-basis Accounting

Clause 41

Work in progress

ITA
10(14)

Section 34 of the Act provides an exception to full accrual accounting in computing the income of a business that is a professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor by allowing the income to be determined without taking into account any work in progress at year end.

Subsection 10(14) of the Act provides, for the purposes of 10(12) and 10(13), that a property included in the inventory of a business includes professional work in progress that would be included if paragraph 34(a) (the basic rule described above) did not apply.

Consequential on the repeal of section 34, subsection 10(14) is repealed.

This amendment comes into force on January 1, 2024.

Work in progress – transitional rule

ITA
10(14.1)

Section 34 of the Act provides an exception to full accrual accounting in computing the income of a business that is a professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor by allowing the income from that business to be determined without taking into account any work in progress at year end.

Consequential on the repeal of section 34, new subsection 10(14.1) of the Act provides a five-year transitional rule for the purpose of valuing work in progress from a business that is a professional practice of one of the designated professions listed above. Subsection 10(14.1) provides that for the purposes of computing the income of a taxpayer from a business the cost and the fair market value of the taxpayer's work in progress from the business is deemed to be:

- 20 per cent of the cost and fair market value of the taxpayer's work in progress at the end of the first taxation year that begins after March 21, 2017;
- 40 per cent of the cost and fair market value of the taxpayer's work in progress at the end of the second taxation year that begins after March 21, 2017;
- 60 per cent of the cost and fair market value of the taxpayer's work in progress at the end of the third taxation year that begins after March 21, 2017; and
- 80 per cent of the cost and fair market value of the taxpayer's work in progress at the end of the fourth taxation year that begins after March 21, 2017.

For the fifth taxation year that begins after March 21, 2017 the full amount in respect of work in progress must be included in computing income from a professional business.

This transitional relief is only available to a taxpayer who elected to exclude work in progress in computing income in respect of the last taxation year that begins before March 22, 2017.

New subsection 10(14.1) applies to taxation years ending after March 21, 2017.

Clause 42

Professional business

ITA
34

Section 34 of the Act provides an exception to full accrual accounting in computing the income of a business that is the professional practice of an accountant, dentist, lawyer, medical doctor, veterinarian or chiropractor by allowing the income from that business to be determined without taking into account any professional work in progress at year end.

Paragraph 34(a) of the Act is amended to limit the ability of a professional to elect to exclude work in progress at the end of the year to taxation years that begin before March 22, 2017.

The amendment to paragraph 34(a) applies to taxation years ending after March 21, 2017.

Section 34 is repealed. For more information, see the commentary on the transitional rules in subsection 10(14.1).

The repeal of section 34 comes into force on January 1, 2024.

Extending the Base Erosion Rules to Foreign Branches of Life Insurers

Clause 43

Specified Canadian risks

ITA
95(2)(a.23)

Paragraph 95(2)(a.23) defines the term "specified Canadian risks", for the purposes of paragraphs 95(2)(a.2) and (a.21).

Consequential on the addition of new paragraph 95(2)(a.24), which uses this term, paragraph 95(2)(a.23) is amended to add a reference to paragraph 95(2)(a.24).

This amendment applies to taxation years that begin after March 21, 2017.

Deemed specified Canadian risks

ITA
95(2)(a.24)

Paragraph 95(2)(a.2) includes in the income from a business other than an active business, and therefore the foreign accrual property income, of a foreign affiliate of a taxpayer resident in Canada, the income of the affiliate from the insurance of "specified Canadian risks" (defined in paragraph 95(2)(a.23)), including from the reinsurance of such risks.

New paragraph 95(2)(a.24) deems risks that would not otherwise be specified Canadian risks to be specified Canadian risks for the purposes of paragraph 95(2)(a.2) in certain circumstances. Such a risk is deemed by subparagraph 95(2)(a.24)(i) to be a specified Canadian risk of a particular foreign affiliate if

- as a part of a transaction or series of transactions, the particular affiliate insured or reinsured the risk, and
- it can reasonably be concluded that one of the purposes of the transaction or series of transactions was to avoid the application of any of paragraphs 95(2)(a.2) to (a.22).

Subparagraph 95(2)(a.24)(ii) is analogous to paragraph 95(2)(a.22) and applies where one or more agreements or arrangements, in respect of a risk that is deemed by subparagraph 95(2)(a.24)(i) to be a specified Canadian risk, is entered into by the particular affiliate, or by a foreign affiliate of another taxpayer if any of the following does not deal at arm's length with the particular affiliate:

- the other taxpayer;
- the affiliate of the other taxpayer; or
- a partnership of which that other taxpayer or its affiliate is a member.

If these conditions are satisfied, then

- activities performed in connection with those agreements or arrangements are deemed to be a separate business, other than an active business, carried on by the particular affiliate or other affiliate, as the case may be, and
- any income of the particular affiliate or other affiliate, as the case may be, from the business (including income that pertains to or is incident to the business) is deemed to be income from a business other than an active business.

This amendment applies to taxation years that begin after March 21, 2017.

Clause 44

Income — designated foreign insurance business

ITA
138(2.1)

Section 138 of the Act sets out detailed rules relating to the taxation of insurance corporations.

Paragraph 138(2)(a), in particular, provides that, if a life insurer resident in Canada carries on business in Canada and in a country other than Canada in a taxation year, its income or loss for the year from carrying on an insurance business is the amount of its income or loss for the taxation year from carrying on the insurance business in Canada. As such, the income from a Canadian-resident life insurer's business carried on outside Canada is generally not taxable in Canada.

New subsection 138(2.1) is intended to ensure that income from the insurance of specified Canadian risks (which, as provided in subsection 138(12), has the same meaning as in paragraph 95(2)(a.23)) does not escape taxation in Canada in cases where the specified Canadian risks are insured (or reinsured) as part of a life insurer's business carried on outside Canada. It applies in respect of a life insurer resident in Canada if the life insurer has a "designated foreign insurance business" in a taxation year – which is, in general terms, a foreign insurance business where the insurance of specified Canadian risks comprises more than a *de minimis* proportion of the business. For more information, see the new definition "designated foreign insurance business" in subsection 138(12).

If new subsection 138(2.1) applies in respect of a life insurer for a taxation year, paragraph 138(2.1)(a) provides that, for the purposes of computing the life insurer's income or loss from carrying on an insurance business in Canada for that taxation year, the life insurer's insurance business carried on in Canada is deemed to include the insurance of the specified Canadian risks that are insured as part of the life insurer's designated foreign insurance business. The intention is that the life insurer's income from the specified Canadian risks be included in computing its income from carrying on an insurance business in Canada, and that the insurance or reinsurance of the specified Canadian risks is in all other respects treated as though it had occurred as part of the life insurer's Canadian insurance business.

Paragraph 138(2.1)(b) applies in respect of a taxation year of a life insurer resident in Canada in which the life insurer has a designated foreign insurance business, if that business was not a designated foreign insurance business of the life insurer in the immediately preceding taxation

year. It is similar to paragraph 138(11.91)(d) (a rule that applies for the purposes of computing a non-resident insurer’s income where the insurer commences to carry on an insurance business in Canada or ceases to be exempt from tax under Part I). If paragraph 138(2.1)(b) applies, it treats the life insurer as having claimed, under a number of enumerated provisions, the maximum reserves in respect of the specified Canadian risks insured or reinsured by it as part of its designated foreign insurance business, for the immediately preceding taxation year. Such reserves are included in determining the life insurer’s income and Canadian investment fund for the taxation year in respect of which paragraph 138(2.1)(b) applies.

Paragraph 138(2.1)(c) deems the life insurer to have

- carried on the designated foreign insurance business in Canada in the taxation year immediately preceding a taxation year in respect of which subsection 138(2.1) applies, and
- to have included in income the amount of negative policy reserves that would have been prescribed in respect of the life insurer for the purposes of paragraphs 12(1)(e.1) and 138(4)(b) (and the regulations thereunder), for the immediately preceding taxation year, in respect of the insurance policies in respect of the specified Canadian risks.

This amendment applies to taxation years that begin after March 21, 2017.

Insurance swaps

ITA
138(2.2)

New subsection 138(2.2) of the Act effectively subjects a Canadian-resident life insurer’s foreign insurance businesses to an anti-avoidance rule (in paragraph 95(2)(a.21)) that was previously limited to foreign affiliates of Canadian taxpayers. The rule is intended to ensure that a life insurer cannot avoid Canadian taxation of its income from the insurance of specified Canadian risks through certain arrangements whereby the specified Canadian risks are, in general terms, “swapped” for foreign risks.

For the purposes of section 138, new subsection 138(2.2) deems risks that would otherwise not be specified Canadian risks to be specified Canadian risks if

- the risks are insured by a life insurer resident in Canada as part of an insurance business carried on in a country other than Canada, and
- the risks would be deemed to be specified Canadian risks because of paragraph 95(2)(a.21) if the life insurer were a foreign affiliate of a taxpayer.

If a risk is deemed, under subsection 138(2.2), to be a specified Canadian risk, this result is relevant in determining whether the life insurer has a designated foreign insurance business in a taxation year; if so, then the deeming rules in subsection 138(2.1) would apply in respect of the risk. Notably, for the purposes of computing the life insurer’s income or loss from carrying on an insurance business in Canada, the life insurer’s insurance business carried on in Canada would be deemed to include the insurance of the specified Canadian risk. For more information, see the commentary under subsection 138(2.1).

This amendment applies to taxation years that begin after March 21, 2017.

Insurance swaps

ITA
138(2.3) and (2.4)

New subsection 138(2.3) of the Act provides the conditions of application for new subsection 138(2.4), which is a complementary rule to the anti-avoidance rule in subsection 138(2.2). Subsections 138(2.3) and (2.4) are analogous to paragraph 95(2)(a.22), a rule that applies in respect of certain "insurance swap" arrangements of foreign affiliates of Canadian taxpayers. Subsection 138(2.4) is intended to ensure that any income derived from agreements or arrangements, in respect of risks of a Canadian-resident life insurer that are deemed by the anti-avoidance rule in subsection 138(2.2) to be specified Canadian risks, does not escape Canadian taxation.

Subsection 138(2.3) provides that subsection 138(2.4) applies only in cases where

- subsection 138(2.2) applies to deem one or more risks insured by a life insurer resident in Canada to be specified Canadian risks; and
- one or more agreements or arrangements in respect of those risks have been entered into by the life insurer, or by one of the other persons or partnerships enumerated in subparagraphs 138(2.3)(b)(ii) to (v) (referred to in subsection 138(2.4) as an "agreeing party").

If subsection 138(2.4) applies in respect of one or more agreements or arrangements in respect of a risk that is deemed by subsection 138(2.2) to be a specified Canadian risk, then the following two consequences are provided:

- To the extent that activities performed in connection with the agreements or arrangements can reasonably be considered to be performed for the purpose of obtaining the result described in subparagraph 95(2)(a.21)(ii), those activities are deemed to be either part of a Canadian-resident life insurer's insurance business carried on in Canada, or a separate business, other than an active business, carried on by a foreign affiliate of a taxpayer (depending on the identity of the agreeing party).
- Any income from those activities (including income that pertains to or is incident to those activities) is deemed to be either income from the life insurer's insurance business carried on in Canada, or income from the business, other than an active business, carried on by the foreign affiliate of a taxpayer (depending on the identify of the agreeing party).

The reference in paragraph 138(2.4)(a) to the result described in subparagraph 95(2)(a.21)(ii) is to be interpreted as referring to a state of affairs in which a life insurer's risk of loss or opportunity for gain or profit in respect of the risks that subsection 138(2.2) deems to be specified Canadian risks, in combination with the agreeing party's risk of loss or opportunity for gain in respect of the relevant agreements or arrangements, can reasonably be considered to be determined, in whole or in part, by reference to one or more criteria (described in clauses 95(2)(a.21)(ii)(A) to (C)) in respect of risks insured by another person or partnership.

This amendment applies to taxation years that begin after March 21, 2017.

Ceding of Canadian risks

ITA
138(2.5)

New subsection 138(2.5) of the Act provides that a Canadian-resident life insurer's income in respect of the ceding of specified Canadian risks in its insurance business carried on in a country other than Canada is, in certain circumstances, included in computing the life insurer's income or loss from its insurance business carried on in Canada. Subsection 138(2.5) applies in circumstances where, if the life insurer were a foreign affiliate of a taxpayer, its income in respect of the ceding of the specified Canadian risks would be included in computing its income from a business, other than an active business, because of subparagraph 95(2)(a.2)(iii) (unless that income has already been included in computing the life insurer's income or loss from its Canadian insurance business because of subsection 138(2.1), (2.2) or (2.4)). For more information, see the commentary under subparagraph 95(2)(a.2)(iii).

This amendment applies to taxation years that begin after March 21, 2017.

Anti-avoidance

ITA
138(2.6)

New subsection 138(2.6) of the Act is an anti-avoidance rule that is analogous to the anti-avoidance rule in paragraph 95(2)(a.24), which applies in respect of foreign affiliates of Canadian taxpayers.

For the purposes of section 138, paragraph 138(2.6)(a) deems a risk that would not otherwise be a specified Canadian risk to be a specified Canadian risk that was insured as part of an insurance business carried on in Canada by a particular Canadian-resident life insurer, if it can reasonably be concluded that one of the purposes of the transaction or series of transactions as part of which the life insurer insured the risk was to avoid

- having a designated foreign insurance business, or
- the application, in respect of the risk, of any of subsections 138(2.1) to (2.5), which are intended to ensure that a Canadian-resident life insurer's income from the insurance or reinsurance of specified Canadian risks is subject to Canadian tax.

Paragraph 138(2.6)(b) applies if a risk is deemed by paragraph 138(2.6)(a) to be a specified Canadian risk, and one or more agreements or arrangements in respect of the risk have been entered into by any of the persons or partnerships described in subparagraphs 138(2.3)(b)(i) to (v). Where these conditions are met, paragraph 138(2.6)(b) provides the following consequences:

- Activities performed in connection with the agreements or arrangements are deemed to be either part of a Canadian-resident life insurer's insurance business carried on in Canada, or a separate business, other than an active business, carried on by a foreign affiliate of a taxpayer (depending on the identity of the agreeing party).
- Any income from those activities (including income that pertains to or is incident to those activities) is deemed to be either income from the life insurer's insurance business carried

on in Canada, or income from the business, other than an active business, carried on by the foreign affiliate (depending on the identify of the agreeing party).

Paragraph 138(2.6)(b) is analogous to subsection 138(2.4), except that the application of the former, unlike that of the latter, is not conditioned on the activities performed in connection with the relevant agreements or arrangements being performed for the purpose of obtaining the result described in subparagraph 95(2)(a.21)(ii).

This amendment applies to taxation years that begin after March 21, 2017.

Computation of income of a non-resident insurer

ITA
138(11.91)

Subsection 138(11.91) provides rules for the computation of a non-resident insurer's income where the insurer commences to carry on an insurance business in Canada or ceases to be exempt from tax under Part I.

Paragraph 138(11.91)(d) is amended to provide that it applies for the purposes of determining amounts to be included pursuant to paragraph 12(1)(d.1).

This amendment applies to taxation years that begin after March 21, 2017.

Definitions

ITA
138(12)

Subsection 138(12) contains definitions that are relevant for the purpose of computing an insurer's income from carrying on an insurance business in Canada.

"designated foreign insurance business"

The new definition "designated foreign insurance business" is relevant for determining whether new subsection 138(2.1) applies to a life insurer resident in Canada.

A designated foreign insurance business, of a Canadian-resident life insurer in a taxation year, means an insurance business that is carried on by the life insurer in a country other than Canada in the year, unless a "safe harbour" test is met. The safe harbour applies, and the specified Canadian risks are considered to constitute a *de minimis* proportion of the insured risks within the business carried on in a country other than Canada, if more than 90% of the gross premium revenue from the business for the year from the insurance of risks (net of reinsurance ceded) is in respect of the insurance of risks (other than specified Canadian risks) of persons with whom the life insurer deals at arm's length.

This definition, including the safe harbour test, is to be applied separately for each business carried on by a life insurer in a country other than Canada. If a life insurer has multiple businesses in a given country, then the definition is to be applied separately in respect of each

such business. However, in applying the definition, a life insurer's operations in a given country are to be treated as a separate business from its operations in any other country.

This amendment applies to taxation years that begin after March 21, 2017.

"insurance"

The definition "insurance" is added to provide, for greater certainty, that the insurance of a risk includes the reinsurance of the risk.

This amendment applies to taxation years that begin after March 21, 2017.

"specified Canadian risk"

The new definition "specified Canadian risk" is added and has the same meaning as in the definition in paragraph 95(2)(a.23). This term is used in new subsections 138(2.1) to (2.3), (2.5) and (2.6), and in the new definition "designated foreign insurance business" in subsection 138(12).

This amendment applies to taxation years that begin after March 21, 2017.

Stub Period Foreign Accrual Property Income

Clause 45

ITA
91

New subsections 91(1.1) to (1.4) of the Act are introduced to ensure that the appropriate amount of foreign accrual property income (FAPI) is included in a taxpayer's income under subsection 91(1) where:

- the taxpayer is subject to an acquisition of control and the FAPI earned by a foreign affiliate of the taxpayer prior to the acquisition of control is not included in another taxpayer's income because of the application of paragraph 95(2)(f.1); or
- the taxpayer's interest in a foreign affiliate is reduced in certain circumstances.

Absent the application of subsection 91(1.2) in such circumstances, the taxpayer would generally not be required to include in its income the "stub-period FAPI" – i.e., the FAPI earned by the foreign affiliate in the portion of the affiliate's taxation year prior to either the acquisition of control or the reduction of the taxpayer's interest, as the case may be.

Related amendments are also made in subsections 5907(8) and (8.1) of the Regulations.

Subsection 91(1.1) provides that the operative rule in subsection 91(1.2) applies at a particular time in respect of a particular foreign affiliate of a taxpayer if the conditions in paragraphs 91(1.1)(a) to (d) are satisfied.

Paragraph 91(1.1)(a) requires that an amount would be included in the taxpayer's income under subsection 91(1) – in respect of a share of the particular affiliate or another foreign affiliate of the taxpayer that has an equity percentage in the particular affiliate – for the taxation year of the particular affiliate (determined without reference to the deeming rule in subsection 91(1.2)) that includes the particular time (referred to as the particular affiliate's "ordinary taxation year"), if the taxation year ended at the particular time. Thus, subsection 91(1.2) applies only if the particular affiliate earns FAPI during the stub period ending at the particular time.
Paragraph 91(1.1)(b) requires that, immediately after the particular time, there is either

- an acquisition of control of the taxpayer (subparagraph 91(1.1)(b)(i)), or
- a triggering event that can reasonably be considered to result in a change to the aggregate participating percentage of the taxpayer in respect of the particular affiliate for the ordinary taxation year of the particular affiliate (subparagraph 91(1.1)(b)(ii)).

For these purposes, subsection 91(1.3) defines the terms "triggering event" and "aggregate participating percentage". For more information, see the commentary under those definitions in subsection 91(1.3).

In general terms, the situation targeted by subparagraph 91(1.1)(b)(ii) is where a triggering event would, but for the application of subsection 91(1.2), result in all or a portion of the particular

affiliate's stub-period FAPI not being included in the taxpayer's income under subsection 91(1). Because subparagraph 91(1.1)(b)(ii) does not set out a hypothetical test – in that it does not test whether the taxpayer's aggregate participating percentage in respect of the particular affiliate for the particular affiliate's ordinary taxation year would have been different had the triggering event never occurred – any alternative transactions, which might have taken place (and affected the taxpayer's aggregate participating percentage) had the triggering event not occurred, are not relevant in applying the test in subparagraph 91(1.1)(b)(ii). In determining whether a triggering event meets the test in subparagraph 91(1.1)(b)(ii), notwithstanding that the taxpayer's aggregate participating percentage is measured at the end of the particular affiliate's ordinary taxation year, it is also not intended that intervening events – between the time of the triggering event and the end of the particular affiliate's ordinary taxation year – be taken into consideration. Rather, the intention is that a triggering event can reasonably be considered to result in a change in the taxpayer's aggregate participating percentage in respect of the particular affiliate if it would give rise to that result in itself without regard to any intervening or hypothetical alternative events would also have resulted in that change.

Example

Assumptions

- Canco, a corporation resident in Canada, owns all of the shares of FA, a non-resident corporation.
- Canco and FA each have calendar taxation years.
- FA's only income in a particular taxation year is $10 million of FAPI, earned evenly throughout the year.
- Canco transfers 20 per cent of the shares of FA to Forco1 (a non-resident corporation that deals at arm's length with Canco) on June 30 of the particular taxation year. There were multiple alternative purchasers for the FA shares.
- On October 1 of the particular taxation year, Forco2 (another non-resident corporation that deals at arm's length with Canco) subscribes for preferred shares of FA with a fixed cumulative dividend entitlement of $10 million that is payable every December 31.

Analysis

*The sale by Canco of shares of FA to Forco1 on June 30 is a triggering event under paragraph (a) of the definition in subsection 91(1.3). The June 30 sale meets the condition in subparagraph 91(1.1)(b)(ii), as it can reasonably be considered to result in a change in Canco's aggregate participating percentage in respect of FA for FA's ordinary taxation year, specifically a reduction from 100 per cent to 80 per cent. In applying the test in that subparagraph in respect of the June 30 sale, it is irrelevant that an alternative transaction (*e.g.*, a disposition of the FA shares by Canco to another purchaser instead of to Forco1) could have equally reduced Canco's aggregate participating percentage in respect of FA for FA's ordinary taxation year. Nor is it relevant that a subsequent event (*i.e.*, Forco2's subscription for preferred shares in FA, with a*

cumulative dividend entitlement equal to FA's income for the particular taxation year) reduces Canco's aggregate participating percentage in respect of FA to nil.

The issuance of preferred shares by FA to Forco2 on October 1 also satisfies paragraph (a) of the "triggering event" definition. In addition, the issuance satisfies subparagraph 91(1.1)(b)(ii), since it can reasonably be considered to reduce Canco's aggregate participating percentage in respect FA for FA's ordinary taxation year to nil.

As a result of these transactions, in respect of Canco,

- *Paragraph 91(1.2)(a) deems FA's particular taxation year to end immediately before the June 30 sale of FA shares, with the result that the $5 million of FAPI earned by FA before that time in the particular taxation year is included in computing Canco's income under subsection 91(1);*
- *Paragraph 91(1.2)(b) deems FA's next taxation year to begin immediately after the June 30 sale; and*
- *Paragraph 91(1.2)(a) deems that next taxation year of FA to end immediately before the issuance by FA of preferred shares to Forco2 on October 1, with the result that $2 million of the $2.5 million of FAPI earned by FA between June 30 and October 1 is included in Canco's income under subsection 91(1).*

Paragraph 91(1.1)(c) provides that, if subparagraph 91(1.1)(b)(i) applies (*i.e.*, there has been an acquisition of control of the taxpayer immediately after the particular time), subsection 91(1.2) applies only if

- all or a portion of an amount of income earned by the particular affiliate during the portion of its ordinary taxation year before the particular time is excluded in computing the income of another taxpayer because of paragraph 95(2)(f.1); and
- the reason paragraph 95(2)(f.1) applies is that the taxpayer is a "designated acquired corporation" (as defined in subsection 95(1)) of the other taxpayer.

In other words, paragraph 91(1.1)(c) is intended to ensure that the operative rule in subsection 91(1.2) applies only in respect of acquisitions of control that give rise to the application of the FAPI "carve-out" rule in paragraph 95(2)(f.1). The latter paragraph applies where, for example, a taxpayer is subject to an acquisition of control and, subsequently, is amalgamated with or wound up into the acquiring corporation such that the taxpayer is a "designated acquired corporation" (as defined in subsection 95(1)) of the amalgamated or acquiring corporation. Absent the application of subsection 91(1.2) in these circumstances, the income accruing to the particular affiliate prior to the acquisition of control (*i.e.*, during the "stub period") would generally not be included in the taxpayer's income under subsection 91(1), and paragraph 95(2)(f.1) effectively carves out that stub-period income in computing the particular affiliate's FAPI, for its ordinary taxation year, in respect of the amalgamated or acquiring corporation (*i.e.*, the "other taxpayer" referred to in paragraph 91(1.1)(c)). By applying subsection 91(1.2) in these circumstances, which deems the particular affiliate's taxation year to end at the particular time, the particular affiliate's stub-period FAPI is included in the income of the taxpayer for its taxation year that ends immediately before the acquisition of control.

Paragraph 91(1.1)(d) sets out four exceptions. If any of these exceptions applies, a triggering event that otherwise satisfies the condition in paragraph 91(1.1)(b)(ii) will not lead to the application of subsection 91(1.2).

The first exception, in subparagraph 91(1.1)(d)(i), applies if the change referred to in subparagraph 91(1.1)(b)(i) (*i.e.*, the change, in the taxpayer's aggregate participating percentage in respect of the particular affiliate for the affiliate's ordinary taxation year, that can reasonably be considered to result from the triggering event)

- is a decrease; and
- is equal to the total increase – that can reasonably be considered to result from the triggering event – in the aggregate participating percentage of one or more other taxpayers in respect of the particular affiliate for its ordinary taxation year. For these purposes, the other taxpayers must be persons that are resident in Canada (other than a person that is – or a trust, any of the beneficiaries under which is – exempt from tax under Part I of the Act by reason of a statutory provision) and do not deal at arm's length with the taxpayer at the time of the triggering event.

In general terms, this exception ensures that subsection 91(1.2) does not apply to, among other things, certain intra-group transactions where a disposition or acquisition by one group member does not result in a decrease in the overall aggregate participating percentage of the group in respect of a foreign affiliate. Subparagraph 91(1.1)(d)(i) is premised on all of the stub-period FAPI of the particular affiliate that would, but for the triggering event, have been taxable to the taxpayer instead being taxable to one or more non-arm's length taxpayers. For this reason, the exception is only available if the other taxpayers (or, if a taxpayer is a trust, all of its beneficiaries) are taxable under Part I of the Act.

The second exception, in subparagraph 91(1.1)(d)(ii), applies if the triggering event is on an amalgamation described in subsection 87(1). The reason for this exception is that such an amalgamation does not result in a decrease in the overall aggregate participating percentage of the group.

The third exception, in subparagraph 91(1.1)(d)(iii), is one of two *de minimis* exceptions. It applies if the triggering event is an "excluded acquisition or disposition" (defined in subsection 91(1.3)). In general terms, an excluded acquisition or disposition is one of an equity interest in a corporation, partnership or trust that meets the condition in subparagraph 91(1.1)(b)(i), but where the resulting change in the taxpayer's aggregate participating percentage in respect of the particular affiliate for its ordinary taxation year is less than one per cent (subject to an anti-avoidance rule in paragraph (b) of the definition "excluded acquisition or disposition"). For more information, see the commentary under the definition "excluded acquisition or disposition" in subsection 91(1.3).

The final exception from subsection 91(1.2) is in subparagraph 91(1.1)(d)(iv), which sets out a second *de minimis* exception. In general terms, this exception is available where the net decrease in the taxpayer's aggregate participating percentage in respect of the particular affiliate for the

affiliate's ordinary taxation year, that can reasonably be considered to result from one or more triggering events in the year, is five per cent or less. For purposes of determining this net decrease, increases and decreases in the taxpayer's aggregate participating percentage resulting from triggering events that meet the conditions in subparagraph 91(1.1)(d)(i) or (ii) are not taken into consideration. However, increases or decreases from triggering events that meet the condition in subparagraph 91(1.1)(d)(iii) (*i.e.*, excluded acquisitions or dispositions) are taken into consideration for these purposes.

The combined effect of subparagraphs 91(1.1)(d)(iii) and (iv) is that, as long as all of the triggering events in respect of a taxpayer that occur in a taxation year are excluded acquisitions or dispositions (or a combination of excluded acquisitions or dispositions and triggering events meeting the conditions in subparagraph 91(1.1)(d)(i) or (ii)), then the condition in paragraph 91(1.1)(d) will not be satisfied. If, however, there is a triggering event in respect of the taxpayer in a taxation year that does not meet any of the exceptions in subparagraphs 91(1.1)(d)(i) to (iii), then, in determining whether the five per cent *de minimis* threshold is exceeded (*i.e.*, whether the exception in subparagraph 91(1.1)(d)(iv) applies), changes in the taxpayer's aggregate participating percentage in respect of the particular foreign affiliate that result from excluded acquisitions or dispositions are taken into account.

If the five per cent *de minimis* threshold in subparagraph 91(1.1)(d)(iv) is exceeded in a taxation year, subsection 91(1.2) applies at the time immediately before each triggering event in that year, other than a triggering event that is an excluded acquisition or disposition or meets the conditions in subparagraph 91(1.1)(c)(i) or (ii).

Where the conditions in subsection 91(1.1) are satisfied, subsection 91(1.2) applies at the particular time, and provides the following deeming rules for the purposes of sections 91 and 92.

- The affiliate's taxation year that would otherwise have included the particular time is deemed to have ended at the time (referred to in section 91 as the "stub-period end time") that is immediately before the particular time. This deemed taxation year-end applies in respect of only the particular taxpayer and all connected corporations and connected partnerships, in respect of the particular taxpayer.
- If the affiliate is, immediately after the particular time, a foreign affiliate of the particular taxpayer or of a connected corporation or connected partnership, in respect of the particular taxpayer, the affiliate's next taxation year after the stub-period end time is deemed, in respect of the particular taxpayer or the connected corporation or connected partnership, to begin immediately after the particular time.
- For the purposes of determining the affiliate's FAPI for its taxation year that is deemed to end at the stub-period end time, in respect of the particular taxpayer or a connected corporation or connected partnership, in respect of the particular taxpayer, all transactions or events that occur at the particular time are deemed to occur at the stub-period end time. This is to ensure that FAPI resulting from such transactions or events is attributed to the particular taxpayer, and relevant connected corporations, for their taxation years that include the stub-period end time.

Subsection 91(1.3) contains a number of definitions that apply in that subsection, as well as subsections (1.1) and (1.2).

"**aggregate participating percentage**"

The "aggregate participating percentage", of a taxpayer in respect of a foreign affiliate of the taxpayer for a taxation year of the affiliate, is the total of all amounts, each of which is the participating percentage, in respect of the affiliate, of a share of a corporation that is owned by the taxpayer at the end of the affiliate's taxation year.

The amount of FAPI of a controlled foreign affiliate of a taxpayer that is included in the income of the taxpayer under subsection 91(1) at the end of a taxation year of the affiliate is based on the "participating percentage" (defined in subsection 95(1)), in respect of the affiliate, of each share owned by the taxpayer at the end of the taxation year.

The definition "aggregate participating percentage" aggregates the participating percentages, in respect of a foreign affiliate, of all shares owned by a taxpayer at the end of a taxation year of the affiliate. This makes it possible to determine, for the purposes of subparagraph 91(1.1)(b)(ii), whether, as a result of a triggering event, there has been a change in the taxpayer's interest in the affiliate that would be expected to affect the amount of the affiliate's FAPI that is included in the taxpayer's income under subsection 91(1).

"**connected corporation**"

A "connected corporation', in respect of a particular taxpayer, is a corporation that – at or immediately after the particular time at which subsection 91(1.2) applies in respect of a foreign affiliate of the particular taxpayer – is resident in Canada and meets the condition in paragraph (a) or paragraph (b) of this definition.

Paragraph (a) is met if, at or immediately after the particular time, the corporation does not deal at arm's length with the particular taxpayer.

Paragraph (b) is met if, at or immediately after the particular time,

- the corporation deals at arm's length with the particular taxpayer;
- the foreign affiliate is a foreign affiliate of the corporation at the particular time; and
- the aggregate participating percentage of the corporation in respect of the foreign affiliate for the affiliate's ordinary taxation year may reasonably be considered to have increased as a result of the triggering event that gave rise to the application of subsection 91(1.2).

If subsection 91(1.2) applies at a particular time in respect of a foreign affiliate of a particular taxpayer, then, for the purposes of sections 91 and 92, paragraph 91(1.2)(a) deems the affiliate's taxation year to have ended immediately before the particular time in respect of each connected

corporation in respect of the particular taxpayer (as well as the particular taxpayer and each connected partnership).

Example

Assumptions

- Canco1 and Canco2, two corporations resident in Canada that deal at arm's length with each other, each own 50 per cent of the shares of a non-resident corporation that is a controlled foreign affiliate (CFA) of both Canco1 and Canco2.
- Halfway through a taxation year, Canco1 sells all of the shares of CFA owned by Canco1 to Canco2.
- CFA earns $100 of FAPI, which accrues evenly over the taxation year.

Analysis

The sale by Canco1 of shares of CFA to Canco2 is a triggering event that meets the conditions in subparagraph 91(1.1)(b)(i), causing subsection 91(1.2) to apply in respect of CFA at the "particular time" referred to in subsections 91(1.1) and (1.2), which is the time immediately before the disposition by Canco1 of the shares of CFA. As a result, paragraph 91(1.2)(a) deems CFA's taxation year that includes the particular time to have ended at the time immediately before the particular time (the "stub-period end time"), in respect of Canco1 and each connected corporation or connected partnership in respect of Canco1.

Canco2 deals at arm's length with Canco1 and Canco2's aggregate participating percentage in respect of CFA for its ordinary taxation year may reasonably be considered to have increased as a result of the sale of the shares. Canco2 is therefore a connected corporation in respect of Canco1, and thus the deemed year-end applies in respect of Canco2.

The result of this deemed year-end is that, under subsection 91(1), $25 of CFA's FAPI is included in computing Canco1's income for its taxation year that includes the stub-period end time ($100 x ½ year x 50% participating percentage). With regard to Canco2, $25 of CFA's FAPI is included in computing Canco2's income for its taxation year that includes the stub-period end time ($100 x ½ year x 50% participating percentage), and $50 of CFA's FAPI is included in computing Canco2's income for its taxation year that includes CFA's regular taxation year end ($50 x 100% participating percentage in respect of CFA at that time). Thus, a total of $100 is included, in respect of CFA's FAPI, in computing the income of Canco1 and Canco2, which matches the amount of CFA's FAPI.

In the absence of paragraph (b) of the "connected corporation" definition, there would be no deemed year end under subsection 91(1.2) in respect of Canco2 – and paragraph 95(2)(f.1) does not apply to limit the amount of CFA's FAPI in respect of Canco2 because CFA was already a foreign affiliate of Canco2 prior to its acquisition of the remaining CFA shares from Canco1 – with the result that CFA's full $100 of FAPI would be included under subsection 91(1) in

computing Canco2's income for its taxation year that includes CFA's regular taxation year end (based on Canco2's 100% participating percentage in respect of CFA at that time). Thus, a total of $125 would have been included, in respect of CFA's FAPI, in computing the income of Canco1 and Canco2, even though CFA only earned $100 of FAPI.

"**connected partnership**"

A "connected partnership", in respect of a particular taxpayer, is a partnership of which – at or immediately after the particular time at which subsection 91(1.2) applies in respect of a foreign affiliate of the particular taxpayer – the particular taxpayer or a connected corporation in respect of the particular taxpayer is a member. For these purposes, membership in a particular partnership is to be determined by looking through any partnerships through which the particular taxpayer or a connected corporation holds an interest in the particular partnership.

For more information, see the commentary under the definition "connected corporation".

"**excluded acquisition or disposition**"

An "excluded acquisition or disposition", in respect of a taxation year of a foreign affiliate of a taxpayer, is an acquisition or disposition of an equity interest in a corporation, partnership or trust that

- can reasonably be considered to result in a change in the aggregate participating percentage of the taxpayer in respect of the affiliate for the taxation year of the affiliate, and
- satisfies the conditions in paragraphs (a) and (b) of the definition.

Paragraph (a) requires that the change in aggregate participating percentage that can reasonably be considered to result from the acquisition or disposition must be less than one per cent. (For greater certainty, the required change is a one per cent increase or decrease in the aggregate participating percentage, as opposed to a change of one percentage point.)

Paragraph (b) requires that it cannot reasonably be considered that one of the main reasons the acquisition or disposition occurs as a separate acquisition or disposition from one or more other acquisitions or dispositions is to avoid the application of subsection 91(1.2). This condition is intended to ensure that subsection 91(1.2) cannot be avoided by undertaking a "small" acquisition or disposition separately, rather than as part of a another acquisition or disposition that occurs.

“triggering event”

A “triggering event” is

- an acquisition or disposition of an equity interest in a corporation, partnership or trust, or
- a change in the terms or conditions of shares of a corporation or the rights as a member of a partnership or as a beneficiary under a trust.

Absent either an acquisition of control (which satisfies the condition in subparagraph 91(1.1)(b)(i)) or a triggering event, the operative rule in subsection 91(1.2) does not apply. More particularly, a change in a taxpayer’s interest in a foreign affiliate can only give rise to the application of subsection 91(1.2) if the change results from a triggering event (as provided in subparagraph 91(1.1)(b)(ii)).

The definition “triggering event” is broad, to ensure that a wide range of transactions are potentially within the scope of subparagraph 91(1.1)(b)(ii) and subsection 91(1.2). Very generally, an equity interest in a corporation, trust or partnership is intended to describe any right (other than a right as a typical creditor), whether absolute or contingent, to receive, either immediately or in the future, an amount that can reasonably be regarded as all or any part of the capital, revenue or income of one of these entities. In addition, a triggering event includes not only acquisitions and dispositions of equity interests by the taxpayer, but also by other persons or partnerships (including on an issuance of shares, or trust or partnership units).

New subsections 91(1.4) and (1.5) provide elections that taxpayers can make to have subsection 91(1.2) apply in circumstances where it would otherwise not apply because the conditions in subsection 91(1.1) are not satisfied.

Subsection 91(1.4) provides that subsection 91(1.2) applies in respect of a particular affiliate at a particular time if the following conditions are met:

- The conditions in paragraph 91(1.1)(a) are met in respect of the particular affiliate at the particular time;
- Immediately after the particular time, there is a disposition of shares of the particular affiliate or another foreign affiliate of the taxpayer that had an equity percentage (as defined in subsection 95(4)) in the particular affiliate by
  - the taxpayer, or
  - a controlled foreign affiliate of the taxpayer; and
- The taxpayer and all specified corporations jointly elect by the relevant deadline. “Specified corporation” is defined for these purposes in subparagraphs 91(1.4)(c)(i) to (iii).

Example

Assumptions

- Canco, a corporation resident in Canada, owns all of the shares of FA1 and FA3, each of which are non-resident corporations. FA1 owns all of the shares of FA2.
- The adjusted cost base of Canco in the shares of FA1, and of FA1 in the shares of FA2, is nominal.
- FA1, FA2 and FA3 all have calendar taxation years.
- FA2's only income for a particular taxation year is $100 of FAPI, earned in the first half of the year.
- Halfway through the particular taxation year, FA1 sells the shares of FA2 to FA3 for $100. Canco subsequently sells the shares of FA1 to an arm's length party prior to the end of the particular taxation year.

Analysis

FA1 earns $50 of FAPI from its sale of the shares of FA2 to FA3 (representing the taxable portion of the $100 capital gain). Unless an election is filed under subsection 91(1.4), subsection 91(1.2) does not apply to deem FA1 to have a taxation year-end as a result of the sale because Canco's aggregate participating percentage in respect of FA2 for the particular taxation year of FA2 did not decrease as a result of the sale. In that case, when Canco subsequently sells the shares of FA1 to an arm's length party, subsection 91(1.2) then applies to deem FA1's taxation year to end at the "stub-period end time", which is the time immediately before the "particular time" referred to in subsections 91(1.1) and (1.2) (the "particular time" is immediately before the disposition by Canco of the shares of FA1). As a result, under subsection 91(1), FA1's $50 of FAPI is included in computing Canco's income for its taxation year that includes the stub-period end time. In addition, all of FA2's $100 of FAPI is included in computing Canco's income for its taxation year that includes FA2's taxation year end. Thus, a total of $150, in respect of FA2's FAPI, is included in computing Canco's income, even though FA2's underlying income is only $100.

*If Canco instead elects (jointly with all "specified corporations", as defined in subparagraphs 91(1.4)(c)(i) to (iii)) under subsection 91(1.4) to have subsection 91(1.2) apply in respect of FA1's sale of the shares of FA2 to FA3, then paragraph 91(1.2)(a) deems FA2's taxation year to end at the stub-period end time in respect of that sale (*i.e.*, the time immediately before the time immediately before the sale). This election allows all $100 of FA2's FAPI to be included in computing Canco's income for its taxation year that includes FA2's stub-period end time. For the purposes of computing FA2's taxable surplus, subsections 5907(8) and (8.1) of the Regulations deem FA2's taxation year to end, and the sale of FA2 shares by FA1 to occur, at the stub-period end time. Therefore, $100 is also included in FA2's taxable surplus which, by virtue of the application of subsections 93(1.1) and 93(1.11), eliminates the gain that FA1 would otherwise realize on the disposition of the shares of FA2. In addition, paragraph 92(1)(a) applies*

to add $100 to Canco's adjusted cost base of the shares of FA1, with the result that Canco does not realize a gain on its subsequent sale of the shares of FA1.

New subsection 91(1.5) provides that a particular taxpayer resident in Canada can elect to have subsection 91(1.2) apply at a particular time in respect of a particular foreign affiliate of the particular taxpayer if the following conditions are satisfied:

- Immediately after the particular time, there is an acquisition or disposition of shares of a foreign affiliate of another taxpayer (this could be either the particular affiliate or another affiliate) that results in a decrease to the surplus entitlement percentage of the other taxpayer in respect of the particular affiliate.
- As a result of this acquisition or disposition, subsection 91(1.2) applies to the other taxpayer resident in Canada in respect of the particular affiliate.
- The surplus entitlement percentage of the particular taxpayer in respect of the particular affiliate increases as a result of the acquisition or disposition.
- Subsection 91(1.2) does not apply, in the absence of subsection 91(1.5), to the particular taxpayer in respect of the acquisition or disposition.
- The particular affiliate is a foreign affiliate of the particular taxpayer at the particular time.

New subsection 91(1.5) is repealed for taxation years that begin on or after Announcement Date. For those taxation years, subsection 91(1.2) applies automatically in the circumstances described in subsection 91(1.5) because paragraph (b) of the definition "connected corporation" in new subsection 91(1.3) incorporates such circumstances. As such, the election in subsection 91(1.5) is no longer needed.

If the particular time referred to in subsection 91(1.1) is before Announcement Date (the "pre-Announcement Date period"), the version of subsections 91(1.1) to (1.4) that was released in draft form on September 16, 2016 is to be used for the purpose of applying new subsections 91(1.1) to (1.4) unless:

- the taxpayer and all connected corporations and connected partnerships in respect of the taxpayer jointly elect in writing; and
- the election is filed with the Minister by the later of the taxpayer's filing due date for its taxation year that includes Announcement Date and six months after Royal Assent.

If a taxpayer (and each connected corporation and connected partnership) files an election meeting these requirements, the version of new subsections 91(1.1) to (1.4) released on Announcement Date will apply in respect of the taxpayer for the pre-Announcement Date period but those subsections are to be read without reference to subparagraph 91(1.1)(b)(i) and paragraph 91(1.1)(c) in respect of any acquisition of control of the taxpayer that occurs before Announcement Date.

Clause 46

ITR
600

Section 600 of the Regulations prescribes provisions of the Act for the purposes of obtaining permission to amend, revoke or extend the time to file an election, for which ministerial discretion may be exercised under paragraphs 220(3.2)(a) and (b) of the Act.

Paragraph 600(b) is amended to add a reference to subsection 91(1.4). For further information, see the commentary on subsections 91(1.1) to (1.4).

This amendment comes into force on July 12, 2013.

Clause 47

Stub Period FAPI

ITR
5907(8)

New paragraph 5907(8)(b) and new subsection 5907(8.1) of the Regulations ensure appropriate surplus consequences in circumstances where new subsections 91(1.1) to (1.5) of the Act apply. The latter provisions are intended to ensure that “stub period” foreign accrual property income (FAPI) is included in the income of a taxpayer for the taxation year in which the taxpayer disposes of, or reduces in certain circumstances, its interest in a foreign affiliate. For more information, see the commentary under subsections 91(1.1) to (1.5).

Subsection 5907(8) provides rules for the purposes of computing the various amounts in section 5907 (generally, surplus balances of foreign affiliates and amounts relating to them). New paragraph 5907(8)(b) provides that, for these purposes, if subsection 91(1.2) of the Act applies at a particular time in respect of a foreign affiliate of a corporation, the various amounts are to be computed, in respect of “attributed amounts” for the stub period in respect of the particular time, as if

- the affiliate’s taxation year that would have included the particular time ended at the stub-period end time in respect of the particular time; and
- all transactions or events, giving rise to attributed amounts, that occurred at the particular time, occurred at the stub-period end time in respect of the particular time.

These rules are intended to ensure that, where subsection 91(1.2) of the Act applies to cause FAPI of a particular foreign affiliate to be included in computing a taxpayer’s income, the FAPI is also reflected in the affiliate’s surplus balances at the appropriate time. In particular, this ensures that the resulting surplus is available for the purposes of an election under subsection 93(1), to reduce the gain that the taxpayer or another foreign affiliate of the taxpayer would otherwise realize on a disposition of the particular affiliate’s shares prior to the particular affiliate’s “normal” taxation year end.

The deeming rules in paragraph 5907(8)(b) apply only for purposes of computing the various amounts in respect of attributed amounts for the stub period in respect of the particular time. Thus, in general terms, the deemed year end is intended to allow only a foreign affiliate's "stub-period FAPI" to be reflected in its surplus balances. The rules do not deem a foreign affiliate's taxation year to end for all surplus computation purposes.

New subsection 5907(8.1) defines the terms "attributed amounts", "stub period" and "stub-period end time", for the purposes of new paragraph 5907(8)(b).

These amendments are deemed to have come into force on July 12, 2013, subject to an election that allows taxpayers to have the amendments apply prospectively.

Nurse Practitioners

Clause 48

Income exceeding income of supporting person

ITA
63(2)(b)

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing an individual's income. When more than one taxpayer contributes to the support of an eligible child, the child care expense deduction must generally be claimed by the taxpayer with the lower income for the year. One of the exceptions to this rule is where a medical doctor certifies that the lower-income supporting individual is incapable of caring for children because of that individual's mental or physical infirmity.

Clause (i)(B) in the description of variable C in paragraph 63(2)(b) is amended to also authorize nurse practitioners to make such certifications.

This amendment applies to certifications made on or after Announcement Date.

Clause 49

Medical expense credit

ITA
118.2(2)

Subsection 118.2(2) sets out the expenses that may be included in the computation of an individual's medical expense credit.

Therapy

ITA
118.2(2)(l.9)

Paragraph 118.2(2)(l.9) of the Act provides that an expense is eligible for the medical expense credit if it is for remuneration paid for therapy administered to an individual with a severe mental or physical impairment who is eligible for the disability tax credit. The therapy must be prescribed by, and administered under the general supervision of listed medical practitioners.

Paragraph 118.2(2)(l.9) is amended to add nurse practitioners to the list of medical practitioners who are able to prescribe and supervise therapy for the purposes of this paragraph.

This amendment applies to expenses incurred on or after Announcement Date.

Design of therapy plan

ITA
118.2(2)(l.92)

Paragraph 118.2(2)(l.92) of the Act provides that an expense is eligible for the medical expense credit if it is for remuneration paid for the design of an individualized therapy plan. Paragraph 118.2(2)(l.92) is amended to add nurse practitioners to the list of medical practitioners who can prescribe a therapy plan and under whose general supervision such a plan can be administered.

This amendment applies to expenses incurred on or after Announcement Date.

Clause 50

Students eligible for the disability tax credit

ITA
118.6(3)(b)

Subsection 118.6(3) of the Act applies for the purpose of calculating amounts deductible under subsections 118.6(2) and (2.1). Subsection 118.6(3) extends full-time student eligibility for the education tax credit to certain part-time students, where the student is eligible for the disability tax credit or cannot be enrolled on a full-time basis because of the student's mental or physical impairment.

Paragraph 118.6(3)(b) is amended to permit nurse practitioners to certify that an individual has in the year a mental or physical impairment the effects of which on the individual are such that the individual cannot reasonably be expected to be enrolled as a full-time student while so impaired

This amendment applies to certifications made on or after Announcement Date.

Clause 51

Registered disability savings plan

ITA
146.4(1) “specified year”

Paragraph 146.4(4)(l) and subparagraph 146.4(4)(n)(i) of the Act limit the amount of disability assistance payments that can be paid from a registered disability savings plan (RDSP), unless the year in which the payments are made is a “specified year”.

The definition “specified year” in subsection 146.4(1) is amended to permit nurse practitioners to certify that the beneficiary's state of health is such that, in the professional opinion of the nurse practitioner, the beneficiary is not likely to survive more than five years.

This amendment applies to certifications made on or after Announcement Date.

Specified disability savings plan

ITA
146.4(1.1)

Where certain conditions are met, subsection 146.4(1.1) of the Act permits an RDSP beneficiary with a shortened life expectancy to make withdrawals without requiring the repayment of the assistance holdback amount.

Subsection 146.4(1.1) is amended to permit nurse practitioners to certify in writing that the RDSP beneficiary is, in the nurse practitioner's professional opinion, unlikely to survive more than five years.

This amendment applies to certifications made on or after Announcement Date.

Election on cessation of DTC eligibility

ITA
146.4(4.1)

Subsection 146.4(4.1) of the Act sets out the conditions that a holder of an RDSP must meet in order to make an election to keep the RDSP open in respect of a beneficiary who is DTC-ineligible for a particular taxation year.

Paragraph 146(4.1)(a) is amended to permit nurse practitioners to certify in writing that the nature of the beneficiary's condition is such that, in the nurse practitioner's professional opinion, the beneficiary is likely to become DTC-eligible again.

This amendment applies to certifications made on or after Announcement Date.

Clause 52

Optional forms

ITR
8302(4)(b)

Paragraph 8302(4)(b) of the Regulations contains an exception to the normalized pension rule under paragraph 8302(3)(o), if a medical doctor certifies that the plan member's spouse or common-law partner has a life expectancy significantly shorter than normal.

Subparagraph 8302(4)(b)(i) is amended to permit nurse practitioners to certify in writing that the life expectancy of an individual is significantly shorter than normal.

This amendment applies to certifications made on or after Announcement Date.

Clause 53

Additional conditions

ITR
8503(4)(e) and (f)

Paragraphs 8503(4)(e) and (f) of the Regulations are amended to provide that all medical information taken into account by the plan administrator in determining that a member is totally and permanently disabled, or that a period is a period of disability, may be obtained from a written report of a nurse practitioner.

This amendment applies to reports made on or after Announcement Date.

Clause 54

Optional forms

ITR
8517(6)(b)

Paragraph 8517(6)(b) of the Regulations contains an exception to the normalized pension rule under paragraph 8517(5)(g), if a medical doctor certifies that the plan member's spouse or common-law partner has a life expectancy significantly shorter than normal.

Clause 8517(6)(b)(ii)(A) is amended to permit nurse practitioners to certify in writing that the life expectancy of an individual is significantly shorter than normal.

This amendment applies to certifications made on or after Announcement Date.

Armed Forces Deduction

Clause 55

Deductions for payments

ITA
110(1)(f)(v)

Subparagraph 110(1)(f)(v) provides a deduction in the computation of taxable income for employment income earned by members of the Canadian Forces or a police force serving on a deployed operational mission based on a particular risk score as determined by the Department of National Defence. The maximum amount that an individual may deduct in a taxation year cannot exceed the highest level of pay earned by a non-commissioned member of the Canadian Forces.

Clause 110(1)(f)(v)(A) is amended to extend this tax deduction to all Canadian Forces members and police officers participating in deployed international operational missions (as determined by the Department of National Defence), without the requirement that a particular risk score be associated with the missions.

Clause 110(1)(f)(v)(B) is also amended to increase the maximum amount that an individual may deduct in a taxation year to the highest level of pay earned by a Lieutenant-Colonel (General Services Officer) of the Canadian Forces.

These amendments apply to the 2017 and subsequent taxation years.

Designated mission

ITA
110(1.3)

Subsection 110(1.3) provides the Minister of Finance the authority to, upon the recommendation of the Minister of National Defence (for Canadian Forces members) or the Minister of Public Safety (for police officers), designate a mission for the purposes of subclause 110(1)(f)(v)(A)(II).

Consequential on the amendment to clause 110(1)(f)(v)(A), subsection 110(1.3) is repealed. For more information, see the notes to subparagraph 110(1)(f)(v).

This amendment applies to the 2017 and subsequent taxation years.