Explanatory Notes to Legislative Proposals Relating to the Income Tax Act and Regulations

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Preface

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

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Deputy Prime Minister and 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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Employee Ownership Trusts

Clause 1

When s. 15(2) not to apply – employee ownership trusts

Income Tax Act ("ITA")
15(2.51)

As a general rule, subsection 15(2) requires that certain indebtedness owed to a corporation by a shareholder, a person connected with a shareholder, or a member of a partnership or a beneficiary of a trust that is a shareholder of that corporation be included in the debtor's income in the year in which the indebtedness arose.

New subsection 15(2.51) provides an exception to the income inclusion rule in subsection 15(2) to facilitate qualifying business transfers to employee ownership trusts (as defined in subsection 248(1)). More specifically, this new provision allows a corporation that is a qualifying business (as defined in subsection 248(1)) to make a loan to the employee ownership trust (EOT) to facilitate the sale of the qualifying business to the EOT. Bona fide arrangements must be made to repay the balance of the shareholder loan within 15 years.

For more information on the definitions "employee ownership trust", "qualifying business" and "qualifying business transfer", see the commentary to these definitions in subsection 248(1).

This amendment comes into force on January 1, 2024.

Clause 2

Reserve – dispositions to employee ownership trusts

ITA
40(1.3)

Where a taxpayer disposes of capital property in a taxation year, the gain otherwise determined may be reduced under subparagraph 40(1)(a)(iii) by a reasonable reserve in respect of proceeds of disposition that are not due to the taxpayer until after the end of the year. However, the gain from the disposition is fully recognized over the first five (or, in some cases, ten) taxation years of the taxpayer ending after the time of disposition.

New subsection (1.3) provides an extension of the application of subparagraph 40(1)(a)(iii) for dispositions of shares of a qualifying business to an employee ownership trust (EOT) pursuant to a qualifying business transfer. In computing the taxpayer's gain from the disposition of qualifying business shares to the EOT, the taxpayer may claim a reserve over up to ten years whereby a minimum of ten per cent of the gain is included in the taxpayer's income each year.

The extension of the ten-year capital gains reserve to qualifying business transfers to EOTs is intended to facilitate the sale of businesses to EOTs.

For more information on the definitions "employee ownership trust", "qualifying business" and "qualifying business transfer", see the commentary to these definitions in subsection 248(1).

These amendments apply in respect of transactions that occur on or after January 1, 2024.

Clause 3

ITA
80.4(3)(c)

New paragraph 80.4(3)(c) provides an exception to the deemed interest benefit that an indebted shareholder would otherwise be deemed to realize under subsection 80.4(2). Specifically, this exception will apply for up to 15 years where an employee ownership trusts (EOT) borrows funds from a qualifying business for the purpose of purchasing the qualifying business pursuant to a qualifying business transfer. The loan must meet the conditions provided in new subsection 15(2.51) to be eligible for the new paragraph 80.4(3)(c) exception. (See the commentary to subsection 15(2.51) for more information.)

This amendment comes into force on January 1, 2024.

Clause 4

ITA
108(1)

"**trust**"

The definition "trust" excludes certain trusts from being treated as trusts for a number of specified purposes, including the application of the 21-year deemed disposition rule.

New paragraph (h) of the definition "trust" under subsection 108(1) is added to extend the above-described exclusions to employee ownership trusts (EOTs). Paragraph (a.1) of the definition "trust", which includes certain employment-related trusts, is also amended to exclude EOTs.

For more information on the definition "employee ownership trust", see the commentary to this definition in subsection 248(1).

This amendment comes into force on January 1, 2024.

Clause 5

Definitions

ITA
248(1)

“employee benefit plan”

The definition “employee benefit plan” is amended to exclude employee ownership trusts (as defined in subsection 248(1)) from the ambit of the definition. A trust that is an employee ownership trust will therefore not be an employee benefit plan.

“employee ownership trust”

Subsection 248(1) provides the new definition “employee ownership trust” (EOT). An EOT is an irrevocable trust, which at all relevant times, satisfies all of the conditions provided under paragraphs (a) through (j) of the definition.

Residence

Paragraph (a) requires that the trust is resident in Canada. This determination is made without reference to subsection 94(3).

Employee Beneficiary Conditions

Paragraph (b) provides employee beneficiary conditions. The EOT must be exclusively for the benefit of all individuals that meet the requirements provided in subparagraphs (i) to (iv).

Clause (b)(i)(A) requires that each of the beneficiaries of the EOT are individuals who are employed by one or more qualifying businesses controlled by the EOT. (For more information on the definition “qualifying business”, see the commentary to this definition in subsection 248(1).) Though not required, an EOT may exclude employees that have not yet completed an applicable probationary period of employment from being a beneficiary, but such exclusionary period may not exceed a maximum duration of 12 months.

Clause (b)(i)(B) permits the trust to include individuals (including estates of individuals) who are former employees of one or more qualifying businesses controlled by the trust, and who were employees of the qualifying business after the trust first acquired control of the qualifying business. If the trust includes former employees as beneficiaries of the trust, the former employees must meet the same conditions applicable to current employees provided in subparagraphs (b)(ii) to (iv) to qualify as beneficiaries. If an individual described in clause (b)(i)(A) ceases to be employed by a qualifying business or dies, depending on the terms of the

EOT's trust deed and other relevant facts, the individual or their estate may retain any right to receive amounts payable by the EOT to the former employee.

Subparagraph (b)(ii) excludes as beneficiaries individuals that own, directly or indirectly in any manner whatever (other than through an interest in the EOT), 10% or more of the fair market value of any class of shares of the capital stock of a qualifying business controlled by the EOT.

Subparagraph (b)(iii) provides an additional limitation on a beneficiary's share ownership in the qualifying business(es). This rule requires that each beneficiary does not own, directly or indirectly, together with any person or partnership that is related to or affiliated with the individual, 50% or more of the fair market value of any class of shares of the capital stock of a qualifying business controlled by the EOT.

Subparagraph (b)(iv) excludes as beneficiaries individuals who immediately before the time of a qualifying business transfer to the EOT, owned, directly or indirectly in any manner whatever, together with any person or partnership that is related to or affiliated with the individual, 50% or more of the fair market value of the shares of the capital stock and indebtedness of the qualifying business.

Distribution Criteria

Paragraph (c) provides the conditions governing the determination of beneficiaries' income and capital interests in the EOT and corresponding distributions from the EOT. Specifically, the interest of each beneficiary must be determined in the same manner as other current employee beneficiaries, or (if applicable) in the same manner as other former employee beneficiaries of a qualifying business controlled by the trust, based solely on a reasonable and equitable application of any combination of the following criteria:

- the total hours of employment service provided by the beneficiary to the qualifying business,
- the total salary, wages and other remuneration paid or payable to the beneficiary by the qualifying business, and
- the total period of employment service the beneficiary has provided to the qualifying business.

Other criteria external to the above-listed criteria must not be taken into account in determining the beneficiaries' income and capital interests in the EOT. Developing a distribution formula using any combination of the above-listed criteria requires that the formula includes at least one factor.

An EOT could apply a different combination of the above-listed criteria for income distributions versus capital distributions. For example, where the formula is applied reasonably and equitably in the relevant circumstances, an EOT could distribute income amounts to beneficiaries based on a formula incorporating all three criteria but distribute capital based on only 2 of the 3 criteria listed.

Similarly, an EOT could apply different formulas for current employees (described under clause (b)(i)(A)) and (if applicable) former employees (described under clause (b)(i)(B)). Where an EOT is set up for the benefit of both current and former employees, it could administer four different distribution formulas:

- a formula for current employees in respect of distributions of income;
- a formula for current employees in respect of distributions of capital;
- a formula for former employees in respect of distributions of income; and
- a formula for former employees in respect of distributions of capital.

Example – Application of Distribution Criteria

An EOT is distributing the $2 million dividend it received from its wholly-owned qualifying business based on an equal weighting of current seniority (total period of employment service) and employment income (total salary, wages and other remuneration paid) over the last five years using the following formula:

$$(A \div B \times 50\%) + (C \div D \times 50\%)$$

where

A is the beneficiary's years of employment service to the qualifying business,
B is the total years of employment service of all beneficiaries to the qualifying business,
C is the beneficiary's employment income in the last five years (including overtime pay) from the qualifying business, and
D is the total employment income of all beneficiaries in the last five years from the qualifying business.

Kristina has worked for the EOT-owned qualifying business for nine years and earned $300,000 of employment income from the qualifying business in the last five years. Together, the EOT beneficiaries have accumulated 5,000 years of employment service and $120 million in employment income over the last five years. At this time, Kristina would be eligible to receive 0.215% of the distributed amount.

$$(9 \div 5{,}000 \times 50\%) + (\$300{,}000 \div \$120{,}000{,}000 \times 50\%) = 0.215\%$$

This equates to a distribution of $4,300 to Kristina.

Example – Reasonable or Equitable Distribution Formula

An EOT is distributing the $1 million dividend it received from its wholly-owned qualifying business based on a distribution formula that solely relies on the employees' employment income (total salary, wages and other remuneration paid) over the last five years. Current seniority (i.e., total period of employment service) and hours worked are not accounted for in the formula. The distribution formula is as follows:

$$(A \div B)$$

where

A is the beneficiary's employment income in the last five years (including overtime pay) from the qualifying business, and

B is the total employment income of all beneficiaries in the last five years from the qualifying business.

Blair is a customer service representative that has worked for the EOT-owned qualifying business for twenty years, and has earned $250,000 of employment income from the qualifying business in the last five years. Together, the EOT beneficiaries have accumulated $200 million in employment income over the last five years. At this time, Blair would be eligible to receive 0.125% of the distributed amount.

$$(\$250{,}000 \div \$200{,}000{,}000) = 0.125\%$$

This equates to a distribution of $1,250 to Blair.

Sam is the chief executive officer of the EOT-owned qualifying business and has worked for the business for five years and earned $25,000,000 of employment income from the qualifying business in the last five years. Together, the EOT beneficiaries have accumulated $200 million in employment income over the last five years. At this time, Sam would be eligible to receive 12.5% of the distributed amount.

$$(\$25{,}000{,}000 \div \$200{,}000{,}000) = 12.5\%$$

This equates to a distribution of $125,000 to Sam, which is 100 times more than the amount distributed to Blair.

The above-described formula considers salary alone and does not limit the amount of the salary considered. Consequently, administering distributions in accordance with this formula may produce results that are not reasonable or equitable in accordance with paragraph (c) of the EOT definition. Reasonableness is a question of fact and requires a measure of judgment and common sense. Equity is a question of fairness. While it may be argued that higher salaried employees create more value for the underlying business and therefore greater distributions from the EOT to such employees are reasonable and equitable, a formula that results in significantly disproportionate distributions between lower salaried employees and higher salaried employees would (subject to other material facts) likely not be considered reasonable and equitable under paragraph (c) of the EOT definition.

Even-Hand Rule

Paragraph (d) prohibits the trustees of the EOT from acting in the interest of one beneficiary (or group of beneficiaries) to the prejudice of another beneficiary (or group of beneficiaries). For example, if the trustees of the EOT resolved to amend the distribution criteria listed in paragraph (c) so that they were determined solely based on an employee’s total salary for the year this change alone would not necessarily violate this even-hand rule. However, any additional weighting of salaries in favour of employees earning higher salaries (such as salary to the power of two) could prejudice lower-income employee beneficiaries.

Similarly, a distribution formula based on salary or wages alone which does not apply a limit to the amount of the salary or wages considered in determining the distributions may also violate this rule. In particular, if salaries differ significantly between the employee beneficiaries, a formula that does not apply a limit to the salary amount taken into account for determining distributions could create unreasonably high distributions in favour of employees earning higher salaries to the detriment of lower-salary employee beneficiaries.

Eligible Trustees

Paragraph (e) provides the eligibility conditions for each trustee to the EOT. Specifically, each trustee must be either an individual (other than a trust) or a corporation resident in Canada that is licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada the business of offering to the public its services as a trustee.

Governance and Trustee Representation

Paragraphs (f) to (h) provide conditions for the governance of the EOT, including the composition of the trustees of the EOT. These conditions are intended to balance the interests of the selling shareholders of a qualifying business with the interests of the purchasing employees of the qualifying business to ensure that a qualifying business transfer occurs on arm’s length terms and to ensure that the EOT acquires control of the qualifying business upon the qualifying business transfer.

Paragraph (f) provides that each trustee has an equal vote in the conduct of the affairs of the trust.

Paragraph (g) provides that at least one-third of the trustees must be beneficiaries of the EOT as current employees of a qualifying business controlled by the trust. Such employee trustees may be appointed, or otherwise elected to the position of trustee within the last five years by the beneficiaries described in clause (b)(i)(A).

Paragraph (h) provides that if any trustee is appointed (other than by an election within the last five years by the beneficiaries of the trust described in clause (b)(i)(A)), at least 60% of all trustees must be persons that deal at arm’s length with any person who has, directly or indirectly in any manner whatever, as part of a series of transactions or events, sold shares of a qualifying business to the EOT (or to any person controlled by the trust) prior to the trust acquiring control of the qualifying business. Provided that the requirements in paragraphs (g) and (h) are met, all of the trustees of the EOT could be appointed rather than elected.

Fundamental Changes to Trust Property

Paragraph (i) requires that beneficiaries of the EOT who are current employees of one or more of the qualifying businesses of the EOT must approve certain fundamental changes to the qualifying business. More than 50% of the beneficiaries of the trust described in clause (b)(i)(A) must approve the following transactions or events:

i. any transaction or event or series of transactions or events that causes the trust to cease to control a qualifying business;
ii. a disposition of all or substantially all of the assets of a qualifying business; and
iii. a winding-up or amalgamation of a qualifying business.

Trust Property

Paragraph (j) requires that all or substantially all the fair market value of the property of the trust is attributable to shares of the capital stock of one or more qualifying businesses that the trust controls.

“employee trust”

The new definition “employee trust” is amended to exclude employee ownership trusts (as defined in subsection 248(1)) from the ambit of the definition. A trust that is an employee ownership trust will therefore not be an employee trust.

“qualifying business”

The new definition “qualifying business” is relevant for the rules applicable to employee ownership trusts (EOTs). A qualifying business is defined as a corporation controlled by a trust that satisfies the conditions in paragraphs (a) to (c).

Canadian-controlled Private Corporation

Paragraph (a) requires that the corporation be a Canadian-controlled private corporation.

Governance and Board Representation

Paragraph (b) provides a restriction on the governance of the qualifying business. Specifically, not more than 40% of the directors of the qualifying business can be individuals that, immediately before the time that the EOT acquired control of the corporation, owned, directly or indirectly in any manner whatever, together with any person or partnership that is related to or affiliated with the director, 50% or more of the fair market value of the shares of the capital stock or indebtedness of the corporation.

Paragraph (c) requires that the qualifying business deals at arm’s length and is not affiliated with any person or partnership that owned 50% or more of the fair market value of the shares of the capital stock or indebtedness of the corporation immediately before the time the EOT acquired control of the corporation.

“qualifying business transfer”

The new definition “qualifying business transfer” means a disposition by a taxpayer of shares of the capital stock of a corporation (“subject corporation”) to a trust or to a Canadian-controlled private corporation (“purchaser corporation”) that is controlled and wholly-owned by a trust, provided that certain conditions are met. These conditions are provided in paragraphs (a) through (c).

Paragraph (a) provides requirements for the subject corporation being disposed of. Specifically, immediately before the disposition, all or substantially all the fair market value of the assets of the subject corporation must be attributable to assets (other than an interest in a partnership) that are used principally in an active business carried on by the subject corporation or by a corporation that is controlled and wholly-owned by the subject corporation.

Paragraph (b) provides requirements applicable to the time of the disposition of the shares of the subject corporation described in paragraph (a). Specifically, at the time of the disposition, the taxpayer must deal at arm’s length with the trust (and any purchaser corporation), the trust must acquire control of the subject corporation, and the trust must be an employee ownership trust (EOT), the beneficiaries of which are employed in the business described in paragraph (a).

Paragraph (c) provides requirements following the disposition described in paragraph (b). First, at all times after the disposition, the taxpayer must deal at arm’s length with the subject corporation, the trust and any purchaser corporation. Second, at all times after the disposition, the taxpayer must not retain any right or influence that, if exercised, would allow the taxpayer (whether alone or together with any person or partnership that is related to or affiliated with the taxpayer) to control, directly or indirectly in any manner whatever, the subject corporation, the trust, or any purchaser corporation.

This definition is intended to ensure that only genuine business transfers to EOTs on arm’s length terms can benefit from the new 10-year capital gain reserve, the new 15-year exception to the shareholder loan rule and the new 15-year exception to the deemed interest benefit rule.

These amendments to subsection 248(1) come into force on January 1, 2024.

Retirement Compensation Arrangements

Clause 1

Income inclusions

ITA

12(1)

Section 12 provides for the inclusion of various amounts in computing the income of a taxpayer for a taxation year from a business or property.

Paragraph 12(1)(n.3) requires amounts received by an employer from certain retirement compensation arrangements to be included in the employer's income.

Paragraph 12(1)(n.3) is amended consequential on the introduction of section 207.71, which if certain conditions are met, provides for a refund of refundable tax paid in respect of a retirement compensation arrangement that is secured by a letter of credit or surety bond. Accordingly, where an amount is refunded to an employer pursuant to subsection 207.71(3), the amount is to be included in computing the employer's income for the taxation year in which the amount was received.

This amendment applies to the 2024 and subsequent taxation years.

Clause 2

Definitions

ITA
207.5(1)

"refundable tax"

The "refundable tax" of a retirement compensation arrangement at the end of a taxation year is defined as:

- 50% of all contributions made under the arrangement before that time (paragraph a), plus
- 50% of the amount by which the total income or capital gains of the arrangement exceeds its losses for the year or any preceding taxation year (paragraph (b)), minus
- 50% of all benefits paid under the arrangement (other than those benefits paid as part of a series of contributions and refunds) for the year or any preceding taxation year (paragraph (c)).

Paragraph (a) of the definition "refundable tax" is amended to include a reference to the new definition "excluded contribution". Any amount that is determined to be an "excluded contribution" shall not be included in the amount of contributions in paragraph (a) and is therefore excluded for the purposes of determining the arrangement's "refundable tax".

"excluded contribution"

The new definition "excluded contribution" in subsection 207.5(1) refers to an amount paid under a "specified arrangement", also defined in this subsection, to obtain or renew a letter of credit or surety bond issued by a financial institution for the purposes of securing retirement benefits under the arrangement.

The “excluded contribution” definition is only relevant for the purposes of the “refundable tax” definition. An “excluded contribution” is still considered to be a contribution to a “retirement compensation arrangement” for the purposes of that definition in subsection 248(1).

“specified arrangement”

The new definition “specified arrangement” in subsection 207.5(1) refers to a retirement compensation arrangement that has a primary purpose of providing annual or more frequent retirement benefit payments and that meets one of the following conditions:

- it provides benefits that are supplemental to the benefits provided under a registered pension plan, a registered retirement savings plan, a deferred profit sharing plan, a pooled registered pension plan, or any combination of these plans, or
- it meets all, or substantially all, of the criteria to be registered as a registered pension plan (except for, most notably, the maximum benefit limits prescribed in the Regulations).

These amendments are deemed to have come into force on March 28, 2023.

Clause 3

ITA
207.71

As of March 28, 2023, amounts defined as an “excluded contribution” (in subsection 207.5(1)) are no longer subject to the refundable tax in section 207.7.

New section 207.71 provides for a refund mechanism of a retirement compensation arrangement’s refundable tax that was paid with respect to excluded contributions made prior to March 28, 2023, provided certain conditions are met. Amounts would generally be refunded at a rate of 50% of the retirement benefits paid after 2023 directly by an eligible employer to beneficiaries whose retirement benefits were secured under a specified arrangement with a letter of credit or surety bond issued by a financial institution.

New section 207.71 applies to the 2024 and subsequent taxation years.

Definitions

ITA
207.71(1)

New subsection 207.71(1) sets out definitions that apply for the purposes of the new refund mechanism in cases where a “specified arrangement” was secured (before March 28, 2023) by a letter of credit or surety bond.

“eligible employer”

The definition “eligible employer” refers to an employer that paid an “excluded contribution” under a “specified arrangement” before March 28, 2023. See the additional commentary for the definitions added to subsection 207.5(1).

Only eligible employers will be allowed to file an election under subsection (2) for the purposes of obtaining a refund for refundable tax that was paid in respect of excluded contributions.

“specified refundable tax”

The definition of “specified refundable tax” is the maximum total amount of refundable tax that can be refunded with respect to a “specified arrangement” (as defined in subsection 207.5(1)) for any given year, determined by the formula A – B.

Variable A is the total amount of refundable tax that was paid solely with respect to fees incurred prior to March 28, 2023 for obtaining or renewing a letter of credit or surety bond for the purposes of securing future retirement benefit payments under a retirement compensation arrangement. The amount for variable A is the amount that was elected under subsection (2) and should remain fixed for each year that the specified refundable tax is determined.

Variable B is the total amount of all refunds determined under subsection (3) for each preceding taxation year. The amount for variable B increases each year as the eligible employer claims refunds.

The amount of specified refundable tax is determined at the end of the taxation year and is relevant for the purposes of determining the amount of the refund that can be claimed under subsection (3) for any given year.

Election

ITA
207.71(2)

New subsection 207.71(2) contains three conditions that, when satisfied, allow the eligible employer to claim a refund of refundable tax under subsection 207.71(3).

The first condition (paragraph 207.71(2)(a)) is met if an eligible employer, or the custodian of a specified arrangement, paid a refundable tax with respect to an “excluded contribution” made before March 28, 2023.

The second condition (paragraph 207.71(2)(b)) requires that the eligible employer file an election with the Minister of National Revenue, in prescribed form and manner, identifying the retirement compensation arrangement as a “specified arrangement”.

Lastly, paragraph 207.71(2)(c) requires that, as part of the election, the employer must identify the total amount of refundable tax that was paid solely with respect to excluded contributions. This amount corresponds to variable A in the definition of “specified refundable tax”.

For additional information, see the commentary on the new definitions “excluded contribution” and “specified arrangement” in subsection 207.5(1) and the definition “specified refundable tax” in subsection 207.71(1).

Amount of refund

ITA
207.71(3)

New subsection 207.71(3) applies where an “eligible employer” (as defined in subsection (1)) has filed an election with the Minister of National Revenue under subsection (2).

Under this subsection, an eligible employer can claim a refund, upon filing a return for a taxation year, equal to 50% of all retirement benefits paid in the year directly by the eligible employer for the benefit of beneficiaries whose retirement benefits were secured under a “specified arrangement” (as defined in subsection 207.5(1)) with a letter of credit or surety bond. The amount claimed in a taxation year cannot exceed the arrangement’s “specified refundable tax” balance (as defined in subsection 207.71(1)) at the end of the taxation year.

Unless it is requested that the refund be paid to the custodian of the arrangement, the Minister shall pay the refund directly to the eligible employer.

Refundable tax definition

ITA
207.71(4)

New subsection 207.71(4) provides that where an eligible employer claims a refund of refundable tax under subsection (3) with respect to a specified arrangement, the arrangement’s “refundable tax” balance (as defined in subsection 207.5(1)) must be reduced by the amount of the refund claimed for the year.

Alternative Minimum Tax for High-Income Individuals

Clause 1

ITA
127.51

Section 127.51 provides for the calculation of an individual's minimum tax, if any, for the year. An individual's minimum tax for a taxation year is determined in accordance with the formula: $A \times (B - C) - D$.

A is the appropriate percentage (currently 15%); B is the individual's adjusted taxable income determined in accordance with the rules providing for the minimum tax; C is the individual's basic minimum tax exemption for the year; and, D is the individual's basic tax credit for the year.

The description of A is amended to provide that the minimum tax percentage will be 20.5%.

The description of C in the formula in section 127.51 reduces the minimum tax amount by an individual's basic exemption for the year, which is currently $40,000.

The description of C is amended to provide that the basic exemption will be the first dollar amount referred to in paragraph 117(2)(d). This is the lower bound for the fourth income tax bracket. The existing income tax bracket inflation indexing will apply to this basic exemption amount.

Currently the basic exemption is only available to individuals (other than trusts) and graduated rate estates. Paragraph C is also amended to provide that the basic exemption is available to qualified disability trusts (as defined in subsection 122(3)). The reference to graduated rate estates is also removed because graduated rate estates are exempt from the minimum tax under new clause 127.55(f)(i)(A).

The description of D in section 127.51 is an individual's basic tax credit for the year for the purposes of the minimum tax. This credit is determined under section 127.531.

The description of D is amended to provide that, for the purposes of computing an individual's minimum tax, an individual's basic tax credit is one half of the amount otherwise determined under section 127.531.

These amendments will apply for taxation years that begin after 2023.

Clause 2

Section 127.52 includes rules for calculating an individual's adjusted taxable income for the purposes of the minimum tax payable under section 127.5. This is the base on which minimum tax is calculated. An individual's adjusted taxable income is generally their income for the year calculated based on regular rules except with fewer deductions, exemptions and tax credits.

Section 127.52 is amended in several ways. These amendments apply to taxation years that begin after 2023.

ITA
127.52(1)(d)(i)

Subparagraph 127.52(1)(d)(i) provides that in computing an individual's adjusted taxable income for minimum tax purposes, taxable capital gains (paragraph 38(a)), allowable capital losses (paragraph 38(b)), allowable business investment losses (paragraph 38(c)) and gains from listed personal property (section 41) are included at a rate of 4/5, or 80%. These amounts would otherwise be included at a rate of 50%.

This amendment will set the minimum tax inclusion rate for capital gains, allowable capital losses and gains from listed personal property at 100%, or 1/1. Allowable business investment losses will now be included at a rate of 50% (like under regular rules), since the inclusion rate applicable to allowable business investment losses under paragraph 38(c) is no longer modified by subsection 127.52(1).

The exception for gifts to qualified donees is also removed, such that capital gains on gifts to qualified donees would be included at the 100% rate. An exception is provided in new paragraph 127.52(1)(d.1) to address gifts of publicly listed securities, which would be included at a 30% rate.

ITA
127.52(1)(d)(ii)

Subparagraph 127.52(1)(d)(ii) provides that in computing an individual's adjusted taxable income for minimum tax purposes, there is an inclusion in the individual's income of a taxable capital gain where a trust designates a taxable capital gain to be a taxable capital gain of a beneficiary. This inclusion is currently computed as 80% of the capital gain.

This amendment will change the taxable capital gain inclusion rate for a taxable capital gain allocated by a trust to a beneficiary to be 100% of the capital gain. This will now match the 100% taxable capital gain inclusion rate provided for in newly amended subparagraph 127.52(d)(i).

The amendment will apply for taxation years that begin after 2023.

ITA
127.52(1)(d.1)

This amendment adds new paragraph 127.52(1)(d.1). Paragraph 38(a.1) provides that the taxable capital gains inclusion rate is 0% on the donation of publicly listed securities to qualified donees. This amendment provides that the taxable capital gains inclusion rate on the donation of publicly listed securities will be 3/10 (or 30%) for the purposes of computing an individual's minimum tax.

ITA

127.52(1)(g)

Paragraph 127.52(1)(g) is relevant to calculating the minimum tax of a trust. It deals with taxable capital gains of a trust that are generally deductible by the trust and included in the income of a beneficiary (including, if applicable, for minimum tax purposes). More specifically, paragraph 127.52(1)(g) provides that, for the purpose of computing the adjusted taxable income of a trust for a year, the non-taxable portion of certain net taxable capital gains of the trust is to be deducted. These net taxable capital gains are those designated by the trust under subsection 104(21), those included by virtue of subsection 104(13) or section 105 in computing the income of a non-resident beneficiary and those paid to a beneficiary by a trust governed by an employee benefit plan.

Under subparagraph (g)(i) the trust can deduct the amount otherwise deductible under 127.52, which is generally 1/2 of relevant capital gains (i.e., the taxable capital gain amount). Under existing subparagraph (g)(ii), the trust can deduct an extra 3/5 of those amounts. This provides an additional deduction of 30% of the capital gain (i.e., 3/5 × 1/2 = 3/10). As such, the total trust deduction for relevant taxable capital gain amounts for the purposes of the minimum tax is currently 80% of the capital gain (i.e., 3/10 + 1/2 = 8/10). This matches the current 80% minimum tax inclusion of the trust beneficiary.

This amendment removes the reference to 3/5 in the formula. As such, the trust's deduction for minimum tax purposes is now 100% (i.e., 1/2 + 1/2 = 100%) of relevant capital gains that are allocated to beneficiaries. This matches the new 100% minimum tax inclusion by the recipient of the allocated amount.

ITA
127.52(1)(h)

Paragraph 127.52(1)(h) limits, for the purposes of computing an individual's minimum tax, the amounts deductible under sections 110 to 110.7. Only those amounts specifically listed in paragraph 127.52(1)(h) may be deducted. This amendment replaces subparagraphs 127.52(1)(h)(i) to (v) with new subparagraphs (i) to (iv). Existing subparagraph 127.52(1)(h)(vi) (amounts deductible under paragraph 110(1)(g), tuition assistance for basic adult education) is not changed by these amendments.

New subparagraph 127.52(1)(h)(i) retains the deduction available under subsection 110(2) (the deduction for those taking vows of perpetual poverty).

New subparagraph 127.52(h)(ii) provides for the deduction under subsections 110.6(2) and (2.1) (the lifetime capital gains exemption) and paragraph 110(1)(d.01) (the deduction for donated stock options of publicly listed shares). For the purposes of computing an individual's minimum tax, these deductions are being increased by a factor of 7/5. The amendment to paragraph 127.52(h) removes the 50% deduction under paragraph 110(1)(d), the regular stock option deduction which would otherwise decrease the stock option inclusion rate to 50%. It is now 100%. As such, with the capital gains inclusion rate and stock option rate being increased to 100%, an increased 7/5 deduction for the lifetime capital gains exemption and donated stock options, provides that the minimum tax net inclusion rate for capital gains that are subject to the lifetime capital gains exemption and income from donated stock options will be 30%. Other deductions for stock options provided under paragraphs 110(1)(d.1) – (d.3) will no longer be available.

Example

Daniel realizes a capital gain of $3,000,000 in 2024 on the disposition of shares that qualify for the lifetime capital gains exemption. For regular income tax purposes, he claims a lifetime capital gains deduction of $500,000 under subsection 110.6(2.1). Pursuant to amended paragraph 127.52(1)(d), 100% of the $3,000,000 capital gain must be included in Daniel's income for alternative minimum tax purposes. Amended subparagraph 127.52(h)(ii) will allow Daniel to claim a deduction, for minimum tax purposes, equal to 7/5 of $500,000 (i.e., a deduction of $700,000). Accordingly, for minimum tax purposes, Daniel will have a net inclusion of $2.3 million dollars in respect of the capital gain. This is equal to a 30% inclusion rate for the portion of the capital gain that benefited from the lifetime capital gains inclusion rate (i.e., $1,000,000 of the capital gain) and a 100% inclusion rate for the balance (i.e., $2,000,000).

Example

In 2024, Caroline exercises an employee stock option with a nominal price strike price, pursuant to which she acquires publicly listed shares worth $1,000,000. Immediately thereafter she disposes of the underlying shares to a qualified donee. For regular income tax purposes, Caroline includes $1,000,000 in her income under subsection 7(1), but is entitled to deduct $500,000 under paragraph 110(1)(d) (the stock option deduction) and an additional $500,000 under paragraph 110(1)(d.01) (the deduction for donated securities). For minimum tax purposes, she must include $1,000,000 in her income and cannot claim a deduction under paragraph 110(1)(d). However, she can claim a deduction equal to 7/5 of her deduction under 110(1)(d.01) (i.e., $700,000). Accordingly, her net inclusion for minimum tax purposes is $300,000 (or 30% of her employment benefit). If Caroline had not qualified for a deduction under paragraph 110(1)(d.01), for minimum tax purposes she would have been required to include in income the full $1,000,000 employment benefit with no deduction.

New subparagraph 127.52(h)(iii) provides for deductions available under paragraph 110(1)(f). New clauses 127.52(h)(iii)(A) and (B) limit to 50% the amount otherwise deductible for the old age pension supplement (included in income under clause 56(1)(a)(i)(A)) and social assistance (included in income under paragraph 56(1)(u)), workers compensation (deductible under subparagraph 110(1)(f)(ii)) and the deduction for Canadian Forces and police for designated international missions (deductible under subparagraph 110(1)(f)(v)).

New subparagraph 127.52(h)(iv) reduces to 50% the Northern Residents deduction (available under subsection 110.7(1)).

ITA
127.52(1)(i)(i)

For the purpose of calculating an individual's adjusted taxable income for the minimum tax, paragraph 127.52(i) restricts the application of an individual's losses arising in other taxation years that are deductible in computing the individual's taxable income under Part I of the Act. The carried losses from other years that may be deducted for the purposes of the minimum tax under paragraphs 111(a), (c), (d) and (e) are the lesser of those that were otherwise deducted in the year (clause 127.52(1)(i)(i)(A)) and the calculation of those losses for the other years by reference to how the relevant portions of subsection 127.52(1) applied in those other taxation years (clause 127.52(l)(i)(i)(B)). In general, if, for minimum tax purposes, such losses would have been reduced in calculating adjusted taxable income for the taxation years in which the losses arose, they will not be available in calculating adjusted taxable income for the current taxation year.

The amendment to clause 127.52(1)(i)(i)(A) limits the use of other years' non-capital loss (paragraph 111(1)(a)) and limited partnership loss (paragraph 111(1)(e)) carried amounts. For the purposes of determining an individual's minimum tax, the amounts that may be deducted under paragraphs 111(1)(a) and (e) are half of the amounts that the individual otherwise deducted for the year under those paragraphs.

ITA
127.52(1)(i)(i)

Clause 127.52(l)(i)(i)(B) provides that the calculation of losses available under paragraphs 111(a), (c), (d) and (e) for other years is by reference to how the relevant portions of subsection 127.52(1) applied in those other taxation years.

The amendment to clause 127.52(1)(i)(i)(B) limits the use of other years' non-capital loss (paragraph 111(1)(a)) and limited partnership loss (paragraph 111(1)(e)) carried amounts under the alternative calculation of the losses that are available. For the purposes of determining an individual's minimum tax, the amounts that may be deducted under paragraphs 111(1)(a) and (e) are half of the amounts that would otherwise be deductible by the individual for the respective year under those paragraphs.

The amendment will apply for taxation years that begin after 2023.

ITA
127.52(1)(i)(ii)

Subparagraph 127.52(1)(i)(ii) allows the use of other year's capital loss carried amounts (provided under paragraph 111(1)(b)). The maximum amount that may be deducted is the amount that the taxpayer would have deducted under paragraph 111(1)(b) if paragraph 127.52(1)(d) had been applicable in computing the amount deductible under paragraph 111(1)(b). This allows the taxpayer to calculate and deduct their loss carry amount using the higher inclusion rate provided in 127.52(1)(d) (currently 80%).

Similar to subparagraph 127.52(1)(i)(i), the carried losses from other years that may be deducted for the purposes of the minimum tax under paragraph 111(1)(b) are the lesser of those amounts that would have been deducted in the year (determined based on the inclusion rate in 127.52(1)(d), as described above) and the calculation of those losses for the other years by reference to how the relevant portions of subsection 127.52(1) applied in those other taxation years (clause 127.52(l)(i)(ii)(B)).

The amendment to clause 127.52(1)(i)(ii)(A) removes the application of paragraph 127.51(1)(d) in determining the amount of other year capital losses that may be deducted. As such, for the purposes of determining an individual's minimum tax, the amount that may be deducted under paragraph 111(1)(b) is the amount that the individual actually deducted for the year under that paragraph. Accordingly, the inclusion rate for capital loss carryforwards is reduced to 50%, instead of the current 80%.

ITA
127.52(1)(i)(ii)

Clause 127.52(l)(i)(ii)(B) provides that the calculation of capital losses available under paragraph 111(b) for other years is by reference to how the relevant portions of subsection 127.52(1) applied in those other taxation years.

The amendment to clause 127.52(1)(i)(ii)(B) removes, for taxation years beginning after 2023, the application of paragraph 127.52(1)(d) in determining the computation of capital losses that are available to be carried forward or backward for a year.

ITA
127.52(1)(k)

New paragraph 127.52(1)(k) limits certain deductions to a rate of 50% for the purposes of computing an individual's minimum tax. As such, for the purposes of computing an individual's minimum tax, the individual may only deduct one half of the amounts otherwise deducted in the year:

- For certain office and employment expenses.
- For interest and financing expenses in respect of an amount borrowed to earn income from property. This limitation does not apply for the purposes of other provisions of the minimum tax rules that apply to limit the deduction of interest and financing expenses for specific purposes. The limitation also does not apply to money borrowed by an employee ownership trust (or a Canadian-controlled private corporation that is controlled and wholly-owned by the trust) to acquire a qualifying business pursuant to a qualifying business transfer.
- For Canada Pension Plan/Quebec Pension Plan contributions on self-employed earnings, enhanced CPP contributions and Quebec parental insurance plan self-employed premiums.
- For moving expenses.
- For child care expenses.
- For the disability supports deduction.

Clause 3

ITA
127.531(a)

An individual's basic minimum tax credit, half of which is deductible under 127.51 in computing minimum tax, is determined under section 127.531. Paragraph 127.531(a) is amended so that the tax credit provided under subsections 118.3(2) (which provides criteria for determining the entitlement of a supporting individual of a disabled person to claim the disabled person's unused disability tax credit) and (3) (the allocation of the disability tax credit where more than one individual is entitled to the credit in respect of the same dependant) and sections 118.8 to 118.9 (the transfer of unused tuition credits), are included in computing the basic minimum tax credit.

The amendment will apply for taxation years that begin after 2023.

Clause 4

ITA
127.55(f)

Section 127.55 limits the application of the minimum tax set out in section 127.5. Paragraph 127.55(f) is amended to provide that certain trusts will not be subject to the minimum tax. These exempted trusts are trusts which throughout the taxation year are:

- A mutual fund trust.
- A related segregated fund trust.
- A trust, all of the units of which are traded on a designated stock exchange.
- A master trust.
- A graduated rate estate.
- An employee life and health trust.
- A trust governed under:
  - a deferred profit sharing plan,
  - a pooled registered pension plan,
  - a registered education savings plan,
  - a registered pension plan,
  - a registered retirement income fund,
  - a registered retirement savings plan,
  - a tax-free savings account,
  - an employee profit sharing plan,
  - a registered supplementary unemployment benefit plan, or
  - a first home savings account.
- A trust, some of the classes of the units of which are traded on a designated stock exchange.

- An investment fund as defined under subsection 251.2(1), unless the trust is an investment fund throughout the taxation year as part of a transaction or event or series of transactions or events one of the main purposes of which is to avoid the minimum tax.
- A trust that meets the following conditions:
    - all of the beneficiaries of the trust are exempt from minimum tax or are trusts, all of the beneficiaries of which are exempt from minimum tax,
    - no beneficiary, other than one described above, can be added,
    - all of the interests are fixed interests (as defined in subsection 94(1)), and
    - it is irrevocable.
- A trust that is otherwise exempt from tax under Part I.
- A trust deemed to have been created under paragraph 143(1)(a) (a communal organization).

The amendment will apply for taxation years that begin after 2023.

Intergenerational Business Transfers

Clause 1

ITA
40(1)(a)(iii)

Subparagraph 40(1)(a)(iii) is amended to add a reference to new subsection (1.2) which extends the five-year period to 10 years for dispositions of shares that satisfy the conditions of subsections 84.1(2.31) or (2.32). For more information, see the commentary to new subsection (1.2) of the Act.

Reserve - intergenerational business transfers

ITA
40(1.2)

As a general rule, where a taxpayer disposes of capital property in a taxation year, subparagraph 40(1)(a)(iii) provides that the gain otherwise determined may be reduced by a reasonable reserve in respect of proceeds of disposition that are not due to the taxpayer until after the end of the year. The taxpayer must include at least 1/5 of the gain in income each year over a maximum reserve period of five-years.

New subsection 40(1.2) provides an exception to the general rule provided under subparagraph 40(1)(a)(iii) to enable a taxpayer to claim a reserve over up to a ten-year period if the conditions in subsections 84.1(2.31) or (2.32) are satisfied in respect of the disposition.

These amendments come into force on January 1, 2024.

Clause 2

ITA
84.1(2)(e)

Section 84.1 is an anti-avoidance rule that prevents an individual from avoiding tax that would ordinarily arise on a taxable dividend by removing corporate surplus through a non-arm’s length transfer of shares.

In general terms, section 84.1 applies when a taxpayer resident in Canada that is not a corporation (i.e., an individual, trust or partnership) transfers shares (the “subject shares”) of a Canadian corporation (a “subject corporation”) to another corporation (the “purchaser corporation”) on a non-arm’s length basis for consideration that can be either a share of the capital stock of the purchaser corporation or non-share consideration (e.g., cash or a promissory note).

Paragraph 84.1(2)(e) is intended to accommodate certain intergenerational business transfers by deeming them to occur at arm’s length for purposes of section 84.1. Paragraph (e) requires that the subject shares (i.e., the shares being transferred by the individual taxpayer to the purchaser corporation) be either shares of the capital stock of a family farm or fishing corporation (FFFC shares) or qualified small business corporation (QSBC) shares. In general terms, these are the types of shares that may qualify for the lifetime capital gains exemption (LCGE) and each represents an interest in an underlying active business carried on in Canada. Paragraph 84.1(2)(e) also requires that the purchaser corporation retain the subject shares for a period of 60 months. Additional rules regarding the application of paragraph (e) are provided in subsection 84.1(2.3).

While intended to accommodate intergenerational business transfers from parents to children or grandchildren who wish to continue to carry on the family business, the exception in paragraph (e) may unintentionally permit the distribution of corporate surplus in the form of capital gains without requiring that the transfer of a business takes place.

Consequently, paragraph 84.1(2)(e) is amended to:

- ensure that only genuine intergenerational business transfers from an owner-manager parent to an adult owner-manager child may benefit from the exception by adding conditions for paragraph (e) to apply in new subsections (2.31) and (2.32) (either of which a taxpayer may satisfy, and each of which include the current conditions that the subject shares be QSBC or FFFC shares, and that the purchaser corporation be controlled by one or more children or grandchildren of the taxpayer),
- repeal the 60-month holding period condition for the subject shares, and
- clarify that the deemed arm’s length relationship between the taxpayer and the purchaser corporation applies at the time of the disposition of the subject shares notwithstanding any other paragraph in subsection 84.1(2); consequently, the application of paragraph (e) will override the deemed adjusted cost base and the other deemed non-arm’s length relationship rules provided in subsection (2).

In support of paragraph (e), consequential amendments are made to replace subsection (2.3) with new rules applicable to the conditions in new subsections (2.31) and (2.32). Additionally, new subsection 40(1.2) provides up to a 10-year capital gains reserve for intergenerational business transfers that satisfy the conditions of subsection (2.31) or (2.32).

Paragraph (e) and subsections (2.3), (2.31), and (2.32) serve the dual purpose of:

- accommodating the genuine intergenerational transfer of an active business from an individual owner-manager to their adult owner-manager child or grandchild (including a niece or nephew and grandniece or nephew), and
- protecting the integrity of section 84.1 as an anti-avoidance rule that governs the taxation of corporate distributions.

For more information, see the commentary to new subsections (2.3), (2.31), and (2.32).

This amendment applies to dispositions of shares that occur on or after January 1, 2024.

Rules for subsections 84.1(2.31) and 84.1(2.32)

ITA
84.1(2.3)

Subsection 84.1(2.3) provides three additional conditions for the application of paragraph 84.1(2)(e). First, paragraph (a) provides certain consequences of the purchaser corporation disposing of the subject shares within 60 months. Second, paragraph (b) provides certain rules relating to the lifetime capital gains exemption in subsections 110.6(2) or (2.1) where the subject corporation has taxable capital employed in Canada of between $10 and $15 million. Third, paragraph (c) requires the taxpayer to provide the Minister of National Revenue with an independent assessment of the fair market value of the subject shares and an affidavit attesting to the disposal of the shares.

Consequential upon the introduction of new subsections (2.31) or (2.32) for the application of paragraph (2)(e), subsection (2.3) is replaced with new rules applicable for purposes of new subsections (2.31) and (2.32).

Extended Definition of Child

New paragraph 84.1(2.3)(a) provides an extended definition of “child” for the purposes of subsections 84.1(2.31) and (2.32).

For the purposes of the Act, subsection 252(1) provides an extended meaning of persons who are considered to be children of a taxpayer. Under subsection 252(1), a reference to a child of a taxpayer includes the spouse or common-law partner of a child of the taxpayer. However, if the taxpayer’s child dies, the spouse or common-law partner of the child is no longer considered a child of the taxpayer.

Subsection 70(10) provides an extended meaning of the definition "child" for the purposes of the intergenerational rollover rules in section 70 and 73 (as well as other rules). The definition "child" of a taxpayer in subsection 70(10) also includes a person who was a child of the taxpayer immediately before the death of the spouse or common-law partner of the person. As a result of this extended definition, the death of a person's spouse or common-law partner will not cause the person to cease to be the child of the parent of their deceased spouse or common-law partner.

New paragraph 84.1(2.3)(a) adopts the meaning of "child" under subsection 70(10) for the purposes of the intergenerational business transfer rules under subsections 84.1(2.31) and (2.32) and extends it to also include a niece or nephew of the taxpayer or taxpayer's spouse or common-law partner, a spouse or common-law partner of the niece or nephew and children of the niece or nephew.

Control by a taxpayer together with a spouse or common-law partner

New paragraph 84.1(2.3)(b) applies for purposes of subparagraphs 84.1(2.31)(a)(i) and (2.32)(a)(i) to ensure that if a subject corporation is controlled by the spouse or common-law partner of a taxpayer, it shall also be considered to be controlled by the taxpayer together with the spouse or common-law partner of the taxpayer for the purposes of these subparagraphs.

Control of Partnerships

New paragraph 84.1(2.3)(c) is an interpretation rule that applies to determine whether a taxpayer controls a partnership (that is a relevant group entity) for the purposes of subparagraphs 84.1(2.31)(c)(iii) and (2.32)(c)(iii).

Paragraph (c) provides that, for the purposes described above, a partnership is deemed to be a corporation (the "deemed corporation") with a capital stock of a single class of shares and with a total of 100 issued and outstanding shares. Each member of the partnership is deemed to be a shareholder of the deemed corporation and to own a number of shares based on the partner's proportionate interest in the partnership. More specifically, the number of shares deemed to be owned by each partner at any time is determined by reference to its "specified proportion" (as defined in subsection 248(1) of the Act) in respect of the partnership for the last fiscal period of the partnership ending before that time. Where this is not determinable (e.g., because no fiscal period of the partnership has ended since the partner became a member of the partnership), the number of shares deemed to be held by the partner is determined by reference to the relative fair market value of its interest in the partnership.

The deeming rules contained in paragraph (c) do not replace, but rather apply in addition to, all other rules of the Act that are relevant in determining control.

Direct or Indirect Ownership of Shares and Equity Interests

New paragraph 84.1(2.3)(d) is an interpretation rule that applies to determine whether a taxpayer owns, directly or indirectly, equity (including shares) or debt of a subject corporation, purchaser corporation or relevant group entity for the purpose of subsections (2.31) and (2.32).

Paragraph (d) facilitates the determination of a taxpayer's indirect ownership interest by "looking-through" multi-tiered organizational structures. More specifically, paragraph (c) provides that the term "own, directly or indirectly" in respect of a property means (i) direct ownership of the property, and (ii) an ownership interest in the shares of a corporation, an interest in a partnership or an interest in a trust that has a direct or indirect interest, or for civil law a right, in the property.

However, for the purposes of paragraphs (2.31)(d) and (e) and (2.32)(d) and (e) (which require a taxpayer to transfer their equity interests in an underlying business), paragraph (d) provides that property does not include debt and debt-like non-voting preferred shares of (A) the purchaser corporation, (B) the subject corporation, or (C) a relevant group entity (all as defined in subsections (2.31) and (2.32)).

For purposes of paragraph (2.32)(f), paragraph (d) facilitates the "look-through" of multi-tiered structures to determine the fair market value of a taxpayer's (direct or indirect) economic interest (including both debt and equity interests) in a purchaser corporation, subject corporation, and relevant group entity. However, for the purposes of paragraph (2.32)(f), there is no exception for debt or debt-like non-voting preferred shares.

Discretionary Trusts

New paragraph 84.1(2.3)(e) is an anti-avoidance rule predicated on the general policy against the use of discretionary or similar interests to avoid certain tax consequences. More particularly, new paragraph (e) is intended to prevent taxpayers from using discretionary interests in trusts to avoid the conditions provided in new subsections (2.31) and (2.32) (e.g., by taking the position that, due to the discretionary nature of the trust, a beneficiary does not own any property of the trust).

New paragraph (e) applies if the share of the accumulating income or capital of a beneficiary of the trust depends on the exercise by any person of, or the failure by any person to exercise, any discretionary power. New paragraph (e) effectively deems a beneficiary under a discretionary trust to hold or acquire, as the case may be, all of the property held or acquired by the trust. This result is achieved by deeming the beneficiary to have a 100% interest in the trust for the purposes of subsections (2.31) and (2.32).

Relief for Arm's Length Share Transfers

New paragraph 84.1(2.3)(f) provides relief, in certain circumstances, where a parent and child or children undertake an intergenerational business transfer pursuant to the conditions in new subsections (2.31) or (2.32) and the child or children subsequently disposes of, or causes the disposition of, all the shares in the capital stock of the purchaser corporation, the subject corporation, or all relevant group entities (as defined in subparagraphs (2.31)(c)(iii) and (2.32)(c)(iii), as applicable) to an arm's length person or group. In such a situation, the conditions under new paragraphs (2.31)(f) and (g) or (2.32)(g) and (h), as applicable, that the child or children would otherwise have had to satisfy are deemed to be met as of the time of the disposition provided that all equity interests in all relevant businesses (as defined in subparagraph (2.32)(c)(iii)) held, directly or indirectly, by the child or children are included in the disposition.

A child could cause a disposition of subject shares by directing a purchaser corporation (which the child controls) to dispose of all of its shares of the subject corporation, for example.

Relief for Share Transfers Between Children

New paragraph 84.1(2.3)(g) provides relief, in certain circumstances, where a parent and child (or children) undertake an intergenerational business transfer pursuant to the conditions in new subsections (2.31) or (2.32) and the child (or any one or more of the children) subsequently dispose of, or cause the disposition of shares of a purchaser corporation, subject corporation or relevant group entity to another child or group of children of the taxpayer (referred to as the "new child" or "new children"). In such scenario, the conditions in paragraphs (2.31)(f) and (g) or (2.32)(g) and (h) (applicable in respect of the child(ren)'s control of the subject corporation and carrying on and management of the underlying active business) are deemed (A) to be met as of the time of the disposition, and (B) to continue to apply to the new child (or new group of children) and any other member of the group of children that controls the subject corporation and the purchaser corporation at the time of the disposition.

Relief for death or disability

New paragraph 84.1(2.3)(h) provides relief, in certain circumstances, where a parent and child or grandchild undertake an intergenerational business transfer pursuant to the conditions in new subsections (2.31) or (2.32) and the child is unable to satisfy the control, service, management or continuing active business conditions listed in new paragraphs 84.1(2.31)(f) and (g) or (2.32)(g) and (h), as applicable, because the child has died, or has, after the disposition of the subject shares, suffered a severe and prolonged physical or mental impairment. In such a situation, such conditions are deemed to be met from the time of the death or disability of the child or grandchild.

Relief for Distribution of Business Assets to Satisfy Creditors

New paragraph 84.1(2.3)(i) provides relief, in certain circumstances, from the conditions in subparagraphs (2.31)(f)(iii) and (2.32)(g)(iii) (requiring each relevant business of a subject corporation and relevant group entity to continue to be carried on for a minimum time period) if the business of the subject corporation or relevant group entity has ceased to be carried on due to the disposition of all of the assets that were used to carry on the business in order to satisfy debts owed to creditors of the corporation or of the entity.

Meaning of Management

New paragraph 84.1(2.3)(j) provides an interpretation rule for the meaning of the word "management" in paragraphs (2.31)(g) and (2.32)(h) as referring to the direction or supervision of business activities but not including the provision of advice.

This amendment applies to dispositions of shares that occur on or after January 1, 2024.

Immediate Intergenerational Business Transfer

ITA
84.1(2.31)

New subsection 84.1(2.31) is intended to accommodate the intergenerational transfer of an active business from an individual owner-manager to their adult owner-manager child (within the meaning provided in paragraph 84.1(2.3)(a)) in a manner that protects the integrity of the anti-avoidance rule in subsection 84.1(1). It provides conditions for paragraph 84.1(2)(e) to apply to a disposition of subject shares by an individual taxpayer to a purchaser corporation controlled by the individual's child that would otherwise be subject to subsection (1). An individual taxpayer and their child may elect to satisfy the conditions of either subsection (2.31) or subsection (2.32) in order for the exception in paragraph (2)(e) to apply.

The conditions in subsection (2.31) are summarized and discussed in further detail below.

Parent must control subject corporation immediately before disposition of subject shares

New paragraph 84.1(2.31)(a) is intended to ensure that the taxpayer (together with a spouse or common-law partner) has control of the interest in the underlying business being transferred to their child's purchaser corporation, and thus is not acting as an accommodating person to facilitate the avoidance of subsection 84.1(1). New paragraph (a) requires that, immediately before the time the subject shares are disposed of by the taxpayer, the taxpayer (whether alone or together with a spouse or common-law partner) controlled the subject corporation, and no other person or group of persons controlled, in law or in fact, the subject corporation.

Parent must not have previously sought 84.1(2)(e) exception in respect of a relevant business

New subparagraph 84.1(2.31)(a)(ii) is intended to ensure that a business is effectively transferred only once from a taxpayer to their child pursuant to the exception in paragraph 84.1(2)(e). This condition precludes a taxpayer from undertaking successive transfers of shares of a subject corporation that derive their value from the same active business that was relevant to the determination of whether a prior disposition of subject shares satisfied paragraph 84.1(2)(e).

Transferor cannot be a trust

New subparagraph 84.1(2.31)(b)(i) is intended to prevent abuse of paragraph (2)(e) and subsection (2.31) through the use of trusts. This provision requires that the taxpayer who transfers the subject shares be an individual (other than a trust). Trusts are excluded for greater certainty, and to prevent their use by individuals seeking to effectively multiply their lifetime capital gains exemption limit using accommodating beneficiaries.

Child or children must control purchaser corporation

New subparagraph 84.1(2.31)(b)(ii) is intended to ensure that the taxpayer’s adult child or children control the purchaser corporation. This provision requires that, at the time the subject shares are disposed of by the taxpayer, the purchaser corporation is controlled by one or more children of the taxpayer, each of whom is 18 years of age or older. For this purpose and throughout subsection (2.31), the extended meaning of “child” in paragraph 84.1(2.3)(a) applies.

Subject shares must be qualified small business corporations shares or *shares of the capital stock of a family farm or fishing corporation*

New subparagraph 84.1(2.31)(b)(iii) is intended to ensure that the underlying business being transferred by the owner-manager parent is an active business carried on in Canada. This provision requires that the subject shares (i.e., the shares being transferred to the purchaser corporation) be either “qualified small business corporations shares” (QSBC shares) or “shares of the capital stock of a family farm or fishing corporation” (FFFC shares) (as defined in subsection 110.6(1) of the Act). In general terms, QSBC shares and FFFC shares represent shares of a corporation that, directly or indirectly, carries on an active business in Canada.

Parent must relinquish control

New paragraph 84.1(2.31)(c) is intended to ensure that the taxpayer (together with a spouse or common-law partner) relinquishes control of the interest in the underlying business being transferred to their child’s purchaser corporation. This subparagraph requires that, at all times after the disposition of the subject shares, the taxpayer (together with a spouse or common-law partner) does not control, either in law or in fact, any of the subject corporation, the purchaser corporation, or any other person or partnership (referred to as a “relevant group entity”) that carries on, at the disposition time, an active business (referred to as a “relevant business”) that is relevant to the determination of whether subject shares are QSBC shares or FFFC shares.

Parent must transfer ownership of the business

New paragraphs 84.1(2.31)(d) and (e) are intended to ensure that the taxpayer (together with a spouse or common-law partner) transfers ownership of the underlying active business held through the subject shares to their child’s purchaser corporation. Under these provisions, the parents must immediately transfer at least a majority of the common shares of the subject corporation and any relevant group entity, and transfer the balance of common shares and equity interests within 36 months.

New subparagraphs (d)(i) and (ii) require that, at all times after the disposition time, the taxpayer (and a spouse of common-law partner of the taxpayer) must not own, directly or indirectly, 50% or more of any class of shares and equity interest, other than non-voting fixed value preferred shares (i.e., shares of a “specified class”, as defined in subsection 256(1.1) of the Act) of the subject corporation and any relevant group entity.

New subparagraphs (e)(i) and (ii) require the taxpayer (together with a spouse or common-law partner) to dispose of the remaining balance of their shares (other than non-voting preferred shares) in the subject corporation and equity interests (other than non-voting preferred shares) in any relevant group entity within 36 months following the disposition time.

The taxpayer (and a spouse or common-law partner of the taxpayer) may continue to hold debt and debt-like preferred shares (i.e., non-voting fixed value preferred shares) in the subject corporation, the purchaser corporation and any relevant group entity for an indefinite period.

Child or children must acquire control and carry on the business

New paragraph 84.1(2.31)(f) is intended to ensure that the taxpayer's child (or group of children) acquires control of the subject corporation and carries on the underlying active business. New paragraph (f) requires that, for a minimum period of 36 months after the disposition of the subject shares by the parent to the purchaser corporation:

- the child (or group of children) retains legal control of the subject corporation and the purchaser corporation (and thus retains legal control of the acquired interest in the underlying active business),
- the child (or at least one member of such group of children) is actively engaged on a regular and continuous basis in the underlying active business (a child working at least an average of 20 hours per week during the portion of the year the active business operates is deemed to satisfy this condition per the reference to paragraph 120.4(1.1)(a)), and
- each underlying active business of the subject corporation and any relevant group entity continues to be carried on as an active business.

Relieving rules to the application of paragraph (f) are provided by new subparagraphs (2.3)(f)(i) where one or more of the children referred to in subparagraph (f)(i) disposes of, or causes the disposition of, all of the shares in the capital stock of the purchaser corporation, the subject corporation, or all relevant group entities, to an arm's length person or group of persons.

Similarly, where one or more children referred to in subparagraph (f)(i) disposes of, or causes the disposition of, shares of the purchaser corporation, subject corporation or a relevant group entity to another child or group of children of the taxpayer, subparagraph (2.3)(g)(i) deems the conditions of paragraphs (2.31)(f) and (g) to be met as of the time of the disposition and to continue to apply to the new child or new group of children.

Lastly, where a child, or each child referred to in subparagraph (f)(ii), has (after the disposition of the subject shares) died or suffered one or more prolonged impairments in physical or mental functions relieving rules to the application of paragraph (f) are provided by new subparagraph (2.3)(h)(i).

With respect to the requirement that the active business of the subject corporation and any relevant group entity continues to be carried on as an active business, paragraph 84.1(2.3)(i) provides a relieving rule where the business ceases to be carried on due to the disposition of all of the assets of the business to satisfy debts owed to creditors of the corporation or entity.

Management of the business must be transferred to the child

New paragraph 84.1(2.31)(g) is intended to ensure that management of the underlying active business is transferred to the taxpayer's child (or at least one member of the group of children). Paragraph (g) requires that, within 36 months after the disposition time or such greater period of time as is reasonable in the circumstances, the taxpayer (and a spouse or common-law partner of the taxpayer):

- transfer to their child (or at least one member of the group of children) the management of each active business of the subject corporation and any relevant group entity, and
- permanently cease to manage such business.

New paragraph 84.1(2.3)(j) provides interpretive rules for the meaning of the word "management".

Joint election

New paragraph 84.1(2.31)(h) recognizes that the actions of the taxpayer's child could potentially cause the taxpayer to fail to satisfy the above conditions and to thus be reassessed under subsection (1). This paragraph requires that the taxpayer and the child (or each member of the group of children) jointly elect, in prescribed form, for subsection (2.31) to apply in respect of the disposition of the subject shares. The election must be filed with the Minister of National Revenue (i.e., the Canada Revenue Agency) on or before the taxpayer's filing-due date for the taxation year that includes the disposition time.

Pursuant to new subsection 160(1.5), any child who makes this joint election is, jointly and severally, or solidarily, liable for any amount payable by the taxpayer that is greater than it would have otherwise been had the share disposition satisfied the conditions in subsection 84.1(2.31). In recognition of the minimum 36 month period required to satisfy the above conditions, new subparagraph 152(4)(b.5)(i) provides the Minister with an additional three years after the normal reassessment period to assess the taxpayer where the conditions of subsection 84.1(2.31) are not met.

For more information, see the commentary on paragraph 84.1(2)(e), subsections 84.1(2.3) and (2.32), paragraphs 87(2)(j.6) and 152(4)(b.5) and subsection 160(1.5).

This amendment applies to dispositions of shares that occur on or after January 1, 2024.

Gradual Intergenerational Business Transfer

ITA
84.1(2.32)

New subsection 84.1(2.32) is intended to accommodate the gradual intergenerational transfer of an active business from an individual owner-manager to their adult owner-manager child (within the meaning provided in paragraph 84.1(2.3)(a)) in a manner that protects the integrity of subsection 84.1(1). New subsection (2.32) provides conditions for paragraph 84.1(2)(e) to apply to a disposition of subject shares by an individual taxpayer to a purchaser corporation controlled by the individual's child that would otherwise be subject to subsection (1). An individual taxpayer and their child may elect to satisfy the conditions of either new subsection (2.32) or new subsection (2.31) in order for the exception in paragraph (2)(e) to apply.

The conditions in new subsection (2.32) are summarized and discussed in further detail below.

Parent must control subject corporation immediately before disposition of subject shares

New paragraph 84.1(2.32)(a) is intended to ensure that the taxpayer (together with a spouse or common-law partner) has control of the interest in the underlying business being transferred to their child's purchaser corporation, and thus is not acting as an accommodating person to facilitate the avoidance of subsection 84.1(1). New paragraph 84.1(2.32)(a) requires the parent to control the subject corporation before the disposition. This condition is identical to the one in paragraph 84.1(2.31)(a) for the immediate business transfer. See the commentary on that paragraph for more discussion.

Parent must not have previously sought 84.1(2)(e) exception in respect of a relevant business

New subparagraph 84.1(2.32)(a)(ii) is intended to ensure that a business is effectively transferred only once from a taxpayer to their child pursuant to the exception in paragraph 84.1(2)(e). This condition precludes a taxpayer from undertaking successive transfers of shares of a subject corporation that derive their value from the same active business that was relevant to the determination of whether a prior disposition of subject shares satisfied paragraph 84.1(2)(e).

Transferor cannot be a trust

New subparagraph 84.1(2.32)(b)(i) is intended to prevent abuse of paragraph (2)(e) and subsection (2.32) through the use of trusts. This provision requires that the taxpayer who transfers the subject shares be an individual (other than a trust). Trusts are excluded for greater certainty, and to prevent their use by individuals seeking to effectively multiply their lifetime capital gains exemption limit with accommodating beneficiaries.

Child or children must control purchaser corporation

New subparagraph 84.1(2.32)(b)(ii) is intended to ensure that the taxpayer's adult child or children control the purchaser corporation. This provision requires that, at the time the subject shares are disposed of by the taxpayer, the purchaser corporation is controlled by one or more children of the taxpayer, each of whom is 18 years of age or older. For this purpose and throughout subsection (2.32), the extended meaning of "child" in paragraph 84.1(2.3)(a) applies.

Subject shares must be qualified small business corporations shares or *shares of the capital stock of a family farm or fishing corporation*

New subparagraph 84.1(2.32)(b)(iii) is intended to ensure that the underlying business being transferred by the owner-manager parent is an active business carried on in Canada. This provision requires that the subject shares (i.e., the shares being transferred to the purchaser corporation) be either “qualified small business corporations shares” (QSBC shares) or “shares of the capital stock of a family farm or fishing corporation” (FFFC shares) (as defined in subsection 110.6(1) of the Act). In general terms, QSBC shares and FFFC shares represent shares of a corporation that, directly or indirectly, carries on an active business in Canada.

Parent must relinquish control

New paragraph 84.1(2.32)(c) is intended to ensure that the taxpayer (together with a spouse or common-law partner) relinquishes control of the interest in the underlying business being transferred to their child’s purchaser corporation. This subparagraph requires that, at all times after the disposition of the subject shares, the taxpayer (together with a spouse or common-law partner) does not control, at law, any of the subject corporation, the purchaser corporation, or any other person or partnership (referred to as a “relevant group entity”) that carries on, at the disposition time, an active business (referred to as a “relevant business”) that is relevant to the determination of whether subject shares are QSBC shares or FFFC shares.

To provide greater certainty and administrative convenience, paragraph (c) does not expressly require that a parent relinquish factual control of the subject corporation, purchaser corporation or any relevant group entity. However, paragraph (c) is not intended to be relied upon by a parent as justification for retaining effective or factual control over the subject corporation, purchaser corporation or any relevant group entity.

Parent must transfer ownership of the business

New paragraphs 84.1(2.32)(d), (e) and (f) are intended to ensure that the taxpayer (together with a spouse or common-law partner) commences, at the time of disposition of the subject shares, to transfer ownership of the underlying active business held through the subject shares to their child’s purchaser corporation and relinquishes any majority ownership interest in the underlying active business within 10 years (referred to as the “final sale time”). These requirements are intended to ensure that both ownership and factual control of the entities that hold interests in the underlying active business are transferred from the taxpayer (and a spouse or common-law partner) to their child or children within 10 years of the disposition time.

New subparagraphs (d)(i) and (ii) require that, at all times after the disposition time, the taxpayer (and a spouse of common law partner of the taxpayer) must not own, directly or indirectly, 50% or more of any class of shares and equity interest, other than non-voting fixed value preferred shares (i.e., shares of a “specified class”, as defined in subsection 256(1.1) of the Act) of the subject corporation and any relevant group entity.

New subparagraphs (e)(i) and (ii) require the taxpayer (together with a spouse or common-law partner) to dispose of the remaining balance of their shares (other than non-voting preferred shares) in the subject corporation and equity interests (other than non-voting preferred shares) in any relevant group entity within 36 months following the disposition time.

The taxpayer (and a spouse or common law partner of the taxpayer) may continue to hold debt and debt-like preferred shares in the subject corporation, the purchaser corporation, and any relevant group entity for an indefinite period (subject to the restrictions on the fair market value of such economic interests provided in new subparagraphs (f)(i) and (ii)).

Where the subject shares are, at the disposition time, FFFC shares, subparagraph (f)(i) provides that, within 10 years after the disposition time, the taxpayer (and a spouse of common law partner of the taxpayer) must not own, directly or indirectly, more than 50% of the fair market value of all interests (including any debt or equity interest) that they held, directly or indirectly, in any of the subject corporation, the purchaser corporation and any relevant group entity immediately before the disposition time.

Where the subject shares are, at the disposition time, QSBC shares (other than shares also described in subparagraph (f)(i), i.e., other than shares that are also FFFC shares), subparagraph (f)(ii) provides that, within 10 years after the disposition time, the taxpayer (and a spouse of common law partner of the taxpayer) must not own, directly or indirectly, more than 30% of the fair market value of all interests (including any debt or equity interest) that they held, directly or indirectly, in any of the subject corporation, the purchaser corporation and any relevant group entity immediately before the disposition time.

Economic interests in a subject corporation, purchaser corporation, or a relevant group entity owned indirectly through a multi-tiered structure or a discretionary trust are subject to the indirect ownership interpretation rule provided in new paragraph (2.3)(d) and the deeming rule provided in new paragraph (2.3)(e). For more information, see the commentary to paragraphs (2.3)(d) and (e).

Child or children must acquire control and carry on the business

New paragraph 84.1(2.32)(g) is intended to ensure that the taxpayer’s child (or group of children) acquires control of the subject corporation and carries on the underlying active business. New paragraph (g) requires that, from the time of disposition of the subject shares until the later of 60 months after the disposition time and the final sale time:

- the child (or group of children) retains legal control of the subject corporation and the purchaser corporation (and thus retains legal control of the acquired interest in the underlying active business),
- the child (or at least one member of such group of children) is actively engaged on a regular and continuous basis in the underlying active business (a child working at least an average of 20 hours per week during the portion of the year the active business operates is deemed to satisfy this condition per the reference to paragraph 120.4(1.1)(a)), and
- each underlying active business of the subject corporation and any relevant group entity continues to be carried on as an active business.

Relieving rules to the application of paragraph (g) are provided by subparagraph (2.3)(f)(ii) where one or more of the children referred to in subparagraph (g)(i) disposes of, or causes the disposition of, all of the shares in the capital stock of the purchaser corporation, the subject corporation, or all relevant group entities, to an arm's length person or group of persons.

Similarly, where one or more children referred to in subparagraph (g)(i) disposes of, or causes the disposition of, shares of the purchaser corporation, subject corporation or a relevant group entity to another child or group of children of the taxpayer, subparagraph (2.3)(g)(ii) deems the conditions of paragraphs (2.32)(g) and (h) to be met as of the time of the disposition and to continue to apply to the new child or new group of children.

Lastly, where a child, or each child referred to in subparagraph (g)(ii), has (after the disposition of the subject shares) died or suffered one or more prolonged impairments in physical or mental functions relieving rules to the application of paragraph (g) are provided by new subparagraph (2.3)(h)(ii).

With respect to the requirement that the active business of the subject corporation and any relevant group entity continues to be carried on as an active business, paragraph 84.1(2.3)(i) provides a relieving rule where the business ceases to be carried on due to the disposition of all of the assets of the business to satisfy debts owed to creditors of the corporation or entity.

Management of the business must be transferred to the child

New paragraph 84.1(2.32)(h) is intended to ensure that management of the underlying active business is transferred to the taxpayer's child (or at least one member of the group of children). Paragraph (h) requires that, within 60 months after the disposition time or such greater period of time as is reasonable in the circumstances, the taxpayer (and a spouse or common-law partner of the taxpayer):

- transfer to their child (or at least one member of the group of children) the management of each active business of the subject corporation and any relevant group entity, and
- permanently cease to manage such business.

New paragraph 84.1(2.3)(j) provides interpretive rules for the meaning of the word "management".

Joint election

New paragraph 84.1(2.32)(i) recognizes that the actions of the taxpayer's child could potentially cause the taxpayer to fail to satisfy the above conditions and to thus be reassessed under subsection (1). This new subparagraph requires that the taxpayer and the child (or each member of the group of children) jointly elect, in prescribed form, for subsection (2.32) to apply in respect of the disposition of the subject shares. The election must be filed with the Minister of National Revenue (i.e., the Canada Revenue Agency) on or before the taxpayer's filing-due date for the taxation year that includes the disposition time.

Pursuant to new subsection 160(1.5), any child who makes this joint election is, jointly and severally, or solidarily, liable for any amount payable by the taxpayer that is greater than it would have otherwise been had the share disposition satisfied the conditions in subsection (2.32). In recognition of the minimum five to ten-year period required to satisfy the above conditions, new subparagraph 152(4)(b.5)(ii) provides the Minister with an additional ten years after the normal reassessment period to assess the taxpayer where the conditions of subsection 84.1(2.32) are not met.

For more information, see the commentary on paragraph 84.1(2)(e), subsections 84.1(2.3) and (2.31), paragraphs 87(2)(j.6) and 152(4)(b.5) and subsection 160(1.5).

This amendment applies to dispositions of shares that occur on or after January 1, 2024.

Clause 3

Continuing corporation

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) provides continuity rules for the purposes of a number of provisions of the Act. Specifically, it provides, for certain enumerated purposes, the corporation formed as the result of an amalgamation is considered to be the same corporation as, and a continuation of, each predecessor corporation. Because of paragraph 88(1)(e.2), these continuity rules also apply in the context of a winding-up to which subsection 88(1) applies.

Paragraph 87(2)(j.6) is amended to add a reference to new subsections 84.1(2.31) and (2.32), which provide the intergenerational business transfer conditions for the application of the paragraph 84.1(2)(e) exception to the anti-avoidance rule in subsection 84.1(1).

This amendment is consequential on the amendments to paragraph 84.1(2)(e) and subsection 84.1(2.3) and upon the introduction of new subsections 84.1(2.31) and (2.32). This amendment ensures that an amalgamation (as defined in subsection 87(1)) of a subject corporation and a purchaser corporation (as defined in subsection 84.1(1)) and a winding-up under subsection 88(1) of a subject corporation into a purchaser corporation, are permitted under new subsections 84.1(2.31) and (2.32) which will continue to apply to the reorganized corporate group. For more information, see the commentary on subsections 84.1(2.31) and (2.32).

This amendment comes into force on January 1, 2024.

Clause 4

Assessment and reassessment

ITA
152(4)(b.8)

Subsection 152(4) generally provides that the Minister of National Revenue may at any time assess tax and other amounts payable by a taxpayer for a taxation year, but may not assess after the normal reassessment period for the year. An individual taxpayer’s normal reassessment period for a year is generally three years from the date of the initial notice of assessment.

New paragraph 152(4)(b.8) is introduced to allow the Minister of National Revenue to reassess a taxpayer who does not satisfy the intergenerational business transfer conditions listed in new subsections 84.1(2.31) or (2.32), as applicable, for the exception in paragraph 84.1(2)(e) to apply to the anti-avoidance rule in subsection 84.1(1).

Specifically, new subparagraph 152(4)(b.8)(i) provides an additional three year reassessment period after the end of the normal reassessment period for the taxpayer in respect of the taxation year in which an election was filed under paragraph 84.1(2.31)(h). Because the conditions in subsection 84.1(2.31) cannot be satisfied until a minimum period of 36 months has passed, an extended reassessment period is required to afford the Minister of National Revenue the ability to verify compliance.

Similarly, new subparagraph 152(4)(b.8)(ii) provides an additional ten year reassessment period after the end of the normal reassessment period for the taxpayer in respect of the taxation year in which an election was filed under paragraph 84.1(2.32)(i). Because the conditions in subsection 84.1(2.32) cannot be satisfied until a minimum period of up to ten years has passed, an extended reassessment period is required to afford the Minister of National Revenue the ability to verify compliance.

For more information, see the commentary on subsections 84.1(2.31) and (2.32).

This amendment comes into force on January 1, 2024.

Clause 5

Joint liability – intergenerational business transfer

ITA
160(1.5)

New subsection 160(1.5) is added consequential on the introduction of the joint elections provided by new paragraphs 84.1(2.31)(h) and 84.1(2.32)(i), as applicable, to satisfy the intergenerational business transfer conditions listed in new subsections 84.1(2.31) or (2.32) for the exception in paragraph 84.1(2)(e) to apply to the anti-avoidance rule in subsection 84.1(1).

New paragraphs 84.1(2.31)(h) and 84.1(2.32)(i) require an individual taxpayer who wishes to undertake a share sale to a purchaser corporation controlled by their adult child or children (as defined in paragraph 84.1(2.3)(a)) that will be excluded from the anti-avoidance rule in subsection 84.1(1), to jointly elect, in prescribed form, with the taxpayer’s child (or each member of a group of children) for subsection 84.1(2.31) or (2.32) to apply in respect of the share disposition.

The joint election, and the joint and several liability imposed by this new subsection, recognize that the actions of the taxpayer's child or children could potentially cause the parent to fail the conditions listed in subsection 84.1(2.31) or (2.32), as applicable. For example, where the child ceases to work in the business within the time required by subparagraph 84.1(2.31)(f)(ii) or paragraph 84.1(2.32)(g)(ii), as applicable (and without the exceptions in paragraphs 84.1(2.3)(b) or (c) applying), the conditions of subsections 84.1(2.31) or (2.32) would not be satisfied for paragraph 84.1(2)(e) to apply, and the parent would be subject to assessment or reassessment pursuant to subsection 84.1(1).

Consequently, any child who jointly elects under paragraph 84.1(2.31)(h) or (2.32)(i) for subsection 84.1(2.31) or (2.32) to apply to a share disposition is, jointly and severally, or solidarily, liable for tax payable by the parent under Part I of the Act, to the extent that the tax payable by the parent is greater than it would have been had the share disposition satisfied the conditions in subsection 84.1(2.31) or (2.32), as applicable.

For more information, see the commentary on paragraph 84.1(2)(e) and subsections 84.1(2.31) and (2.32).

This amendment comes into force on January 1, 2024.

Investment Tax Credit for Carbon Capture, Utilization, and Storage

Clause 1

Investment Tax Credit for Carbon Capture, Utilization and Storage Carbon Capture, Utilization and Storage Tax Credit

ITA
127.44

New section 127.44 provides an investment tax credit for certain expenditures incurred in respect of carbon capture, utilization and storage (CCUS) projects. It is deemed to have come into force on January 1, 2022, and will generally apply to qualifying expenditures incurred on or after that date and before 2041.

Draft legislative proposals in relation to CCUS were released for consultation on August 9, 2022. Budget 2023 provided more detail regarding certain aspects of CCUS design, as well as draft legislative proposals. These were included in the budget plan as part of the Notice of Ways and Means Motion, related to climate risk disclosure and knowledge sharing requirements. The overview below is not comprehensive but highlights the more significant changes in the new draft legislative proposals.

<u>Overview of Changes to the Legislative Proposals</u>

Since the August 9, 2022 legislative proposals (the "2022 proposals") were released, a number of aspects of the proposed CCUS rules have been modified. In particular, the proposals contained in Budget 2023 have been incorporated, including:

- rules to accommodate eligibility of dual use equipment;
- rules for eligibility of refurbishment costs;
- clarification of the interaction of CCUS credits with other government assistance, including other tax credits; and
- changes to the approach to validation of storage in concrete.

The knowledge sharing and climate risk disclosure requirements have been somewhat re-organized, but the substance of the rules is the same as proposed in Budget 2023. British Columbia is now also included as an eligible jurisdiction (along with Alberta and Saskatchewan) and new rules are included to facilitate the designation of additional jurisdictions (see commentary below on the definition "designated jurisdiction" in new subsection 127.44(1) and on new subsections 127.44(12) and (13)).

Another important change since the proposals were last released is the inclusion of new Part XII.7, which introduces a recovery tax mechanism as outlined in the August 9, 2022 Backgrounder. Recovery tax may also apply in respect of refurbishment cost investment tax credits, as described in Budget 2023. A recapture mechanism in certain circumstances of export or sale of CCUS property has also been included.

The type of taxpayers that will be eligible to claim a CCUS tax credit is proposed to be limited to taxable Canadian corporations. In the case of partnerships, a look through rule similar to the existing rule in subsection 127(8) (and similar to the approach taken in the 2022 proposals) allows access to the tax credit for members of partnerships, to the extent that they are taxable Canadian corporations.

The purpose of these new eligibility restrictions is to accommodate the most common forms of business structure in the resource and renewable sector, without introducing multiple complex new rules to accommodate individuals (including trusts) that could create unintended planning opportunities.

New subsection 13(7.6) is similar to proposed subsection 20(1.11) from the 2022 proposals. It deems certain expenditures to result in an acquisition of property. New Classes 59 and 60 are now more traditional CCA classes, and the new subsection 13(7.6) deemed property is incorporated as a property in the applicable class. For more information, see the commentary on the consequential amendments for CCUS and the clean technology investment tax credit.

The proposed definition "ineligible use", which is important in determining the overall level of tax credit support for a CCUS project expenditure, has been expanded to include the emission of captured carbon dioxide into the atmosphere (subject to a *de minimis* tolerance).

Two new rules are also proposed with a view to preventing abusive tax planning and aiding in interpretation, respectively. A new rule, similar to a rule that applies for the Canadian film tax credit (subsection 125.4(4)) is proposed to prevent the use of tax shelters in respect of CCUS projects. In addition, a provision explaining the purpose of the CCUS tax credit regime is included in the legislative proposals.

Definitions

ITA
127.44(1)

New subsection 127.44(1) provides various definitions relevant for the purpose of determining the CCUS investment tax credit (the CCUS tax credit) of a taxpayer. The definitions also apply for the purposes of new Part XII.7.

The definitions in this subsection are deemed to have come into force on January 1, 2022.

“CCUS process”

“CCUS process” provides a definition of what is meant by the process of carbon capture, utilization and storage for the purposes of CCUS tax credits. To be a CCUS process, the process must include capturing carbon, as described in paragraph (a) of the definition, and storing or using the captured carbon. Note that captured carbon is itself a defined term.

“CCUS project”

A CCUS project is defined as a project that supports a CCUS process by capturing (as described in paragraph (a) of the definition), transporting, storing or using captured carbon.

“CCUS tax credit”

The definition “CCUS tax credit” creates a cross-reference to subsection 127.44(2), which in turn refers to a portion of the cumulative CCUS development tax credit (described in subsection 127.44(4)) and CCUS refurbishment tax credit (described in subsection 127.44(5)).

“captured carbon”

“Captured carbon” means captured carbon dioxide that would otherwise be released into the atmosphere, or that is captured directly from the ambient air.

“dedicated geological storage”

In general terms, “dedicated geological storage” means a geological formation capable of permanently storing captured carbon in a “designated jurisdiction”. However, dedicated geological storage does not include a geological formation where captured carbon is used for enhanced oil recovery.

“designated jurisdiction”

“Designated jurisdiction” means each of Alberta, British Columbia and Saskatchewan, as well as any other jurisdiction in Canada or the United States that the Minister of the Environment designates as described in new subsection (13). For more information, see the commentary on new subsections (13) and (14).

“dual use equipment”

A portion of expenditures for “dual use equipment” may qualify for CCUS tax credits under certain circumstances. To be included as dual use equipment, equipment must be described in paragraph (a), (b) or (c) of the definition. Equipment described in paragraphs (a) or (b) must be verified by the Minister of Natural Resources. Equipment described in paragraph (c) does not have this requirement.

The definition “dual use equipment” describes, in paragraph (a), equipment that meets the conditions in both subparagraphs (a)(i) and (ii) (as verified by the Minister of Natural Resources). The condition in subparagraph (a)(i) is that the equipment is property that would be described in paragraph (a) or (f) of Class 57 in Schedule II to the Regulations if paragraph (a) were read without reference to the words “hydrogen production” and “solely”.

The second condition in subparagraph (a)(ii) contains two alternatives. The Minister of Natural Resources must also verify that the equipment satisfies either the requirements of clause (a)(ii)(A) or (a)(ii)(B) of the definition. Accordingly, the Minister of Natural Resources must verify that the equipment either

- collects, recovers, treats or recirculates water in support of a qualified CCUS project or
- produces electrical power or heat (or any combination of those two forms of energy) and more than 50% of either the power or the heat is expected to support
    - a qualified CCUS project, or
    - the production of hydrogen that qualifies for the clean hydrogen investment tax credit described in Budget 2023.

Under paragraph (b) of the definition, dual use equipment also includes equipment that is verified by the Minister of Natural Resources as being, in relation to property described in paragraph (a), property described in

- Class 57 paragraph (d) (certain monitoring and control equipment),
- Class 57 paragraph (e) (certain buildings or other structures), or
- Class 57 subparagraph (f)(i) (in general terms, property that is used to convert other property into CCUS property described in any of Class 57 paragraphs (a) to (e)).

As noted above, paragraph (c) of the definition “dual use equipment” is the only part of the definition that does not involve a verification by the Minister of Natural Resources. It includes property described in Class 57 subparagraph (f)(ii), i.e., equipment used to refurbish certain other property.

The other property being refurbished must be equipment described in paragraph (a) of the definition “dual use equipment”.

A portion of the cost of equipment that meets the requirements of the definition “dual use equipment” is included in variable A in the formula used in the definition “qualified carbon capture expenditure”.

“eligible use”

An “eligible use” in the context of carbon capture, utilization and storage means storing captured carbon dioxide in dedicated geological storage or using the captured carbon dioxide for producing concrete using a qualified concrete storage process. For more information, see the commentary on the definitions to “dedicated geological storage” and “qualified concrete storage process” in subsection 127.44(1).

“first day of commercial operations”

The “first day of commercial operations” is the day on which captured carbon dioxide is first delivered to a carbon transportation, carbon storage or carbon use system for the purpose of storage or use. This term is relevant for establishing the beginning of the first project period, and for determining whether a CCUS development tax credit (new subsection 127.44(4)) or a CCUS refurbishment tax credit (new subsection 127.44(5)) is applicable.

“ineligible use”

An “ineligible use” in the context of carbon capture, utilization and storage means the emission of captured carbon dioxide into the atmosphere (subject to a *de minimis* tolerance), the use of captured carbon dioxide for enhanced oil recovery or the use of captured carbon dioxide for any other purpose that is not an eligible use (as defined above).

“non-government assistance”

“Non-government assistance” has the same meaning as in subsection 127(9) of the Act.

“preliminary CCUS work activity”

Expenditures in respect of a “preliminary CCUS work activity” cannot be included as a cost of property included in Class 57 or 58 in Schedule II to the Regulations.

A preliminary CCUS work activity is an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of property described in Class 57 or 58 in respect of the taxpayer’s CCUS project. Generally, a preliminary CCUS work activity includes the following activities:

- obtaining permits or regulatory approvals,

- performing design or engineering work, including front-end engineering design studies (or equivalent studies as determined by the Minister of Natural Resources),
- conducting feasibility studies or pre-feasibility studies (or equivalent studies as determined by the Minister of Natural Resources),
- conducting environmental assessments, and
- clearing or excavating land.

“project plan”

A “project plan” is a plan for a CCUS project that reflects a front-end engineering design study (or an equivalent study as determined by the Minister of Natural Resources) for the project and describes the quantity of captured carbon that the CCUS project is expected to support for storage, in each calendar year over the life of the project, in eligible use and ineligible use. In addition, the plan must contain information required as specified in guidelines published by the Minister of Natural Resources and be filed with the Minister of Natural Resources, in the form and manner determined by the Minister of Natural Resources.

An important aspect of the project plan for tax credit calculation purposes is the projected eligible use in each of four “project periods”. Eligible use, as a ratio of ineligible use plus eligible use, creates the “projected eligible use percentage” described below.

“projected eligible use percentage”

“Projected eligible use percentage” is determined for a specific length of time – usually for each project period (these are generally five calendar years each, with minor differences for the first project period due to various potential start-up dates during a calendar year). Projected eligible use percentage is determined from the project plan as the quotient obtained from the division of projected eligible use during the relevant period with, in general terms, projected total use (i.e., ineligible use + eligible use) during the same period, expressed as a percentage.

A project that plans only eligible use (for example, permanent storage in dedicated geological storage) for the entire approximately 20-year period following the first day of commercial operations (the “total CCUS project review period” – see commentary to that new definition below) would have projected eligible use of 100% for each project period. A project that plans to use 20% of its captured carbon in enhanced oil recovery (and 80% in an eligible use) for the first and second project periods, but plans to use all of the captured carbon in the third and fourth periods for producing concrete using a qualified concrete storage process, would have a projected eligible use percentage of 80% for those first two periods and 100% for the third and fourth project periods.

This new definition is used in the new definitions “qualified carbon capture expenditure” and “qualified carbon transportation expenditure” as well as in the recovery tax provisions in new Part XII.7. In new Part XII.7, there is a companion definition “actual eligible use percentage” which is important for the calculation of the recovery tax. For more information, see the commentary on that new Part.

“qualified CCUS expenditure”

A “qualified CCUS expenditure” is any expenditure that is a qualified carbon capture expenditure, qualified carbon transportation expenditure, qualified carbon storage expenditure or qualified carbon use expenditure. See the commentary to those definitions for more detail.

“qualified CCUS project”

A “qualified CCUS project” means a CCUS project of a taxpayer that meets the following four conditions.

First, the project is expected to support the capture of carbon dioxide in Canada.

Second, an initial project evaluation has been issued by the Minister of Natural Resources, in the form and manner determined by the Minister of Natural Resources, in respect of the project.

Third, based on the project’s most recently filed project plan, in each of the project’s first 20 years of operation, the proportion of the quantity of captured carbon the project is expected to support for storage or use in eligible use equals or exceeds 10% of the quantity of captured carbon the project is expected to support for storage or use in both eligible use and ineligible use during the year.

Fourth, if the project is operated to service a facility that existed on April 7, 2022, it cannot be undertaken for the purpose of complying with emission standards that apply, or will apply, under the *Reduction of Carbon Dioxide Emissions from Coal-fired Generation of Electricity Regulations.*

As noted above, in order to qualify, a CCUS project must be expected to support the capture of carbon dioxide in Canada. It may do this by incorporating one or more parts of a CCUS process. The following are examples of projects that would generally be expected to satisfy this condition if undertaken in Canada:

- capturing carbon dioxide from a single site and transporting it up to the point where it connects to a transportation hub;
- transporting carbon captured from multiple sites (i.e., a transportation hub);
- storing or using captured carbon;
- capturing carbon dioxide from a single site, transporting the captured carbon and storing or using the captured carbon; and
- transporting and storing or using carbon captured from multiple sites (i.e., a transportation and storage hub).

“qualified carbon capture expenditure”

The definition “qualified carbon capture expenditure” is relevant to determining the amount of the taxpayer’s CCUS development tax credit under new subsection (4) and CCUS refurbishment tax credit under new subsection (5). In general terms, it represents a portion of the taxpayer’s capital expenditures incurred in the year to acquire property that is used for the capture aspect of a CCUS project (in contrast to property used in other parts of a CCUS project, such as for transportation, storage or use). The portion of capture expenditures that qualifies is determined based on the proportion of captured carbon that the CCUS project is expected to support for storage or use in eligible uses compared to ineligible uses.

The formula relies on the definition “projected eligible use percentage”. The formula also accommodates the addition of some expenditures on project “refurbishment” as qualified carbon capture expenditures after the first day of commercial operations of the project.

As noted above, the portion of expenditures that qualify is based on the projected proportion of eligible use of captured carbon compared to ineligible use. More specifically, a “qualified carbon capture expenditure” is the portion of an expenditure incurred in the year by the taxpayer to acquire a property in respect of a qualified CCUS project, determined by the formula

$$A \times (B + C + D + E) \times F$$

Variable A represents the capital cost to the taxpayer of the property acquired by the taxpayer in the year that is property described in paragraph (a) of Class 57 in Schedule II to the Regulations, or paragraph (d), (e) or subparagraphs (f)(i) and (ii) of Class 57 in relation to equipment described in paragraph (a) of Class 57. Property described in these paragraphs is the type of property that is used for, or related to, the capture aspect of a CCUS project. To be included in variable A, the Minister of Natural Resources must verify that the relevant property is described in one of the paragraphs referred to in the previous two sentences, except in the case of refurbishment property described in subparagraph (f)(ii) of Class 57.

Variable A also includes a portion of the capital cost of “dual use equipment”. The included portion is the proportion of its energy production that is expected to be used in a CCUS project is of its total expected energy production over the period of the project’s “total CCUS project review period”. For more information, see the commentary on the definitions “dual use equipment” and “total CCUS project review period”.

Property located outside of Canada is excluded, such that expenditures for property outside of Canada do not qualify for the CCUS tax credit (the same restriction exists for the other categories of qualified CCUS expenditures).

For CCUS expenditures before the first day of commercial operations of the relevant CCUS project, variables B, C, D and E are the projected eligible use percentages for each of the four project periods, respectively. For expenditures after the first day of commercial operations, the projected eligible use percentage for a particular period only applies if the expenditure is before or during the period. Hence variables B, C and D can be nil depending on the timing of the expenditure.

Variable F is a factor that adjusts the result, depending on how many “projected eligible use percentages” were used in the “(B + C + D + E)” portion of the formula. In the basic situation of expenditures (for example, $10 million of such expenditures) before the first day of commercial operations for a qualified CCUS project that projects 100% eligible use for all project periods, all of the variables after A result in “1” as a multiplier:

$10 million x (100% + 100% + 100% + 100%) x 0.25 = $10 million x 100% = $10 million.

Expenditures for property used in other parts of a CCUS project may be qualified carbon transportation expenditures, qualified carbon storage expenditures or qualified carbon use expenditures. The definition “qualified carbon transportation expenditure” is very similar to the definition “qualified carbon capture expenditure”, except that the property included in variable A of each definition references different paragraphs in Class 57, thus covering different types of property.

The definitions “qualified carbon use expenditure” and “qualified carbon storage expenditure” are also similar, except that

- there is no calculation based on projected eligible use over the project periods required, and
- the property covered by each of those definitions must be used solely to support the storage or use of captured carbon to produce concrete using a qualified concrete storage process (in the case of a qualified carbon use expenditure) or to support storage in dedicated geological storage (in the case of a qualified carbon storage expenditure).

The classification of expenditures between the different categories is relevant to determining the rate of the CCUS tax credit. Pursuant to the definition “specified percentage” in subsection (1), qualified carbon capture expenditures benefit from a higher rate relative to other types of expenditures.

New subsection (8) contains additional rules for calculating the amount of a taxpayer’s qualified carbon capture expenditures. Pursuant to that subsection, certain amounts are excluded from, or may reduce, the taxpayer’s qualified CCUS expenditures. See the commentary related to subsection (8) for more discussion.

“qualified carbon storage expenditure”

The definition “qualified carbon storage expenditure” is relevant to determining the amount of the taxpayer’s CCUS development tax credit under new subsection (4) and CCUS refurbishment tax credit under new subsection (5). In general terms, it represents a portion of the taxpayer’s capital expenditures related to property used for the storage of captured carbon (being property described in paragraph (c) of Class 57 in Schedule II to the Regulations, or paragraph (d), (e) or (f) of Class 57 in relation to equipment described in paragraph (c) of Class 57). As with the other categories of qualified expenditures, expenditures must be verified by the Minister of Natural Resources as being in respect of property described in those paragraphs, except in the case of refurbishment property described in subparagraph (f)(ii) of Class 57. The property must also be situated in Canada.

In addition, expenditures will only qualify if they are expenditures to acquire property that is expected to support storage of captured carbon solely in a manner described in paragraph (a) of the definition of “eligible use” in subsection (1). That means the property must be expected to be used to support the storage of captured carbon in dedicated geological storage. Unlike with other types of qualified expenditures for capture and transportation, there is no ability to prorate the expenditure to the extent that it relates in part to an eligible use and in part to an ineligible use.

“qualified carbon transportation expenditure”

The definition “qualified carbon transportation expenditure” is relevant to determining the amount of the taxpayer’s CCUS development tax credit under new subsection (4) and CCUS refurbishment tax credit under new subsection (5). In general terms, it represents a portion of the taxpayer’s capital expenditures related to property used for the transportation of captured carbon (being property described in paragraph (b) of Class 57 in Schedule II to the Regulations, or paragraph (d), (e) or (f) of Class 57 in relation to equipment described in paragraph (b) of Class 57). The portion of transportation expenditures that qualify is determined using the “projected eligible use percentage” for each project period in the total CCUS project review period (based on the project’s most recent project plan filed with the Minister of Natural Resources before the time the expenditure is incurred).

The definition “qualified carbon transportation expenditure” is essentially the same as the definition “qualified carbon capture expenditure”, except for the type of property that falls within variable A of the formula in each definition. See the commentary on the definition of “qualified carbon capture expenditure” for more detail.

“qualified carbon use expenditure”

The definition “qualified carbon use expenditure” is relevant to determining the amount of the taxpayer’s CCUS development tax credit under new subsection (4) and CCUS refurbishment tax credit under new subsection (5). In general terms, it represents the taxpayer’s capital expenditures related to property that is part of the “use” phase of a CCUS process (being property listed in Class 58 in Schedule II to the Regulations). Qualified carbon use expenditures must be verified by the Minister of Natural Resources as being in respect of property described in Class 58 in the case of property that is acquired before the first day of commercial operations of the relevant qualified CCUS project. The property must also be situated in Canada.

Expenditures will qualify only if they are expenditures to acquire property that is expected to support storage or use of captured carbon solely in a manner described in paragraph (b) of the definition of “eligible use” in subsection (1). That means the property must be expected to be used to support the storage or use of captured carbon to produce concrete using a qualified concrete storage process. Unlike with other types of qualified expenditures for capture and transportation, there is no ability to prorate the expenditure to the extent that it relates in part to an eligible use and in part to an ineligible use.

“qualified concrete storage process”

A “qualified concrete storage process” is a process by which at least 60% of the carbon dioxide that is injected into concrete is expected to be mineralized and permanently stored in the concrete. This expected outcome must be verified by a professional or organization that meets the accreditation requirements of paragraph (a) of the definition and the third-party inspection body requirements of its paragraph (b). This definition is relevant to the definition “eligible use”. Pursuant to paragraph (b) of that definition, captured carbon is considered to have been used in an eligible use if it is used for producing concrete using a qualified concrete storage process.

“qualifying taxpayer”

A “qualifying taxpayer” is a taxable Canadian corporation. “Taxable Canadian corporation” is defined in subsection 89(1) of the Act.

“specified percentage”

The definition “specified percentage” is the tax credit rate used to determine the amount of a taxpayer’s CCUS development tax credit and the taxpayer’s CCUS refurbishment tax credit under new subsections (4) and (5).

The specified percentage is different depending on the type of qualified CCUS expenditure. For a qualified carbon capture expenditure, the rate also varies based on whether or not the carbon is captured directly from the ambient air.

For expenses incurred after 2021 and before 2031, the rate for a qualified carbon capture expenditure is 60% if incurred to capture carbon directly from ambient air or 50% in any other case. Both rates drop by half for expenditures incurred after 2030 and before 2041.

For all other types of qualified CCUS expenditures (being qualified carbon transportation expenditures, qualified carbon storage expenditures and qualified carbon use expenditures) the rate is 37 ½% (for expenditures incurred after 2021 and before 2031) or 18 ¾% (for expenditures incurred after 2030 and before 2041).

Note that, after September 30, 2023, these credit rates are available for taxpayers that meet the labour requirements in new section 127.46. For taxpayers that do not elect to meet the labour requirements, each tax credit rate is reduced by ten percentage points. For more information, see the commentary on new section 127.46.

For all expenditures made after 2040 the rate is zero.

“total CCUS project review period”

“Total CCUS project review period” is a new definition of the time from the first day of commercial operations until the last day of the “fourth project period”. This is the approximately 20-year period during which a taxpayer could be required to pay CCUS recovery tax under Part XII.7.

Deemed payment of Part I tax

ITA
127.44(2)

New subsection 127.44(2) of the Act creates a deeming rule that deems a qualifying taxpayer to have paid an amount on account of its tax payable under Part I of the Act. This is the mechanism that creates the refundable tax credit. The amount is equal the total of the amounts in paragraphs (a) and (b). The deeming rule is conditional on filing a prescribed form with the taxpayer's return of income for the relevant taxation year. This approach to the legislative creation of a refundable tax credit is similar to that taken in section 125.4 (Canadian Film or Video Production Tax Credit) section 125.5 (Film or Video Production Services Tax Credit) and section 125.6 (Labour Credit for Journalism Organizations).

Paragraph (a) describes the taxpayer's cumulative CCUS development tax credit for the year minus the taxpayer's cumulative CCUS development tax credit for the preceding year. Paragraph (b) is the taxpayer's CCUS refurbishment tax credit for the year. A taxpayer's cumulative CCUS development tax credit for the year is determined under new subsection (4) and its CCUS refurbishment tax credit for the year is determined under subsection (5). For more information, see the commentary on those provisions below.

Deemed deduction

ITA
127.44(3)

New subsection 127.44(3) of the Act deems the amount that is deemed to have been paid on account of tax payable under new subsection (2) to have been deducted from the taxpayer's tax otherwise payable under Part I. This deeming rule applies for purposes of paragraph 12(1)(t), subsection 13(7.1) and variable I of the definition "undepreciated capital cost" in subsection 13(21) of the Act. It causes these rules to operate in the same manner whether the CCUS credit is received as a refund or deducted against tax otherwise payable.

Cumulative CCUS development tax credit

ITA
127.44(4)

Under subsection 127.44(2), the amount by which a taxpayer's "cumulative CCUS development tax credit" for a taxation year exceeds its "cumulative CCUS development tax credit" for the preceding taxation year is, in effect, its refundable CCUS development tax credit for the year. New subsection (4) effectively defines the amount of a taxpayer's cumulative CCUS development tax credit. A taxpayer's cumulative CCUS development tax credit is the specified percentage of each type of qualified CCUS expenditure (being qualified carbon capture expenditures, qualified carbon transportation expenditures, qualified carbon storage expenditures, and qualified carbon use expenditures) incurred by the taxpayer in a taxation year and before the first day of commercial operations of the relevant qualified CCUS project. The cumulative aspect in respect of CCUS development tax credits is mainly relevant for the purpose of new Part XII.7. In particular, new subsection 211.92(2) can apply to trigger the application of a recovery tax in certain circumstances related to comparative “cumulative CCUS development tax credit” amounts year-over-year.

For more detail, see the commentary for the definitions “specified percentage”, “qualified carbon capture expenditure”, “qualified carbon transportation expenditure”, “qualified carbon storage expenditure”, and “qualified carbon use expenditure” in new subsection 127.44(1) as well as the commentary on new subsection 211.92(2).

CCUS refurbishment tax credit

ITA
127.44(5)

New subsection (5) effectively defines the amount of a taxpayer’s CCUS refurbishment tax credit that can be claimed under subsection (2). As with CCUS development tax credits, a taxpayer’s CCUS refurbishment tax credit is the specified percentage of each type of qualified CCUS expenditure (being qualified carbon capture expenditures, qualified carbon transportation expenditures, qualified carbon storage expenditures and qualified carbon use expenditures). The difference is that refurbishment credits relate to expenditures after the first day of commercial operations of the relevant qualified CCUS project. Expenditures on refurbishment of a qualified CCUS project are subject to a limit, under new subparagraph (8)(b)(v), of 10% of total qualified CCUS expenditures incurred before the first day of commercial operations of the qualified CCUS project.

For more detail, see the commentary for the definitions “specified percentage”, “qualified carbon capture expenditure”, “qualified carbon transportation expenditure”, “qualified carbon storage expenditure” and “qualified carbon use expenditure” in new subsection 127.44(1).

Change to project or eligible use

ITA
127.44(6)

New subsection 127.44(6) of the Act requires a taxpayer to file a new project plan for a qualified CCUS project of the taxpayer with the Minister of Natural Resources, in the form and manner determined by the Minister of Natural Resources, if there has been a change to the project, and the Minister of Natural Resources requests the taxpayer to file a new project plan for the project. The new project plan is also required to be filed if there has been a reduction (as compared to the most recent project plan for the project) of more than five percentage points in the quantity of captured carbon that the project is expected to support for storage or use in eligible use during any five-year period over the life of the project. This rule applies at any time before the first day of commercial operations of a qualified CCUS project.

Qualified CCUS project determination

ITA
127.44(7)

New subsection 127.44(7) of the Act provides that, for the purpose of the definition of “qualified CCUS project” in subsection (1), the Minister of National Revenue may, in consultation with the Minister of Natural Resources, determine whether one or more CCUS projects of a taxpayer is one project or multiple projects. This could be relevant, for example, to determining what portion of a taxpayer’s expenditures are qualified carbon capture expenditures, qualified carbon transportation expenditures, or qualified carbon use expenditures, because each of those definitions takes into account the proportion of captured carbon that a particular qualified CCUS project will support for use in eligible uses compared to ineligible uses. This proportion could change depending on what is determined to be part of a particular qualified CCUS project. New subsection (7) also stipulates, in its paragraph (d), the power of the Minister of Natural Resources to request necessary documentation and the ability of the Minister to refuse to verify expenditures or a approve project if insufficient documentation is provided to the Minister.

Special rules – adjustments

ITA
127.44(8)

New subsection 127.44(8) of the Act contains several special rules that apply for the purposes of the CCUS tax rules.

ITA
127.44(8)(a)

New paragraph 127.44(8)(a) requires two adjustments to the cost of a taxpayer’s Class 57 or 58 property. First, the cost of the taxpayer’s Class 57 or 58 property shall be determined without reference to subsections 13(7.1) and (7.4) (allowing CCUS tax credits to be disregarded in determining the cost of property in these two classes). Second, the cost of such property is required to be reduced by the amount of any non-government assistance that, at the time of the filing of the taxpayer’s return of income under this Part for the taxation year, the taxpayer has received, is entitled to receive or can reasonably be expected to receive in respect of the property.

ITA
127.44(8)(b)

Paragraph (b) causes certain expenditures to be excluded from a taxpayer’s qualified CCUS expenditures. In particular, the following amounts must be excluded when calculating a taxpayer’s qualified CCUS expenditure:

- any amount incurred by the taxpayer before 2022 or after 2040;
- any amount in respect of any expenditure incurred to acquire property that
  - was previously used by any person or partnership,

    - for which a CCUS tax credit was previously claimed, or
    - for which a clean technology credit is claimed;
- any amount in respect of an expenditure incurred for a “preliminary CCUS work activity” (defined in new subsection 127.44(1));
- an amount that has been added to the cost of property because of section 21; and
- an expenditure on “refurbishment” (i.e., incurred on or after the first day of commercial operations of a particular qualified CCUS project) to the extent that it exceeds 10% of the taxpayer’s qualified CCUS expenditures incurred before the first day of commercial operations of the project.

ITA
127.44(8)(c)

In general terms, the CCUS rules support CCUS projects in Canada. However, taxpayers may acquire property outside of Canada to include in their CCUS projects. Because the available for use rules do not apply in relation to CCUS projects, new subsection 127.44(8)(c) provides a special rule for property being imported into Canada.

This rule generally deems the related expenditure to have been incurred, and the property acquired, at the time that it is brought into Canada. Because the rule is turned off for the purposes of subparagraph (8)(b)(i), it cannot be used to move the time of acquisition of property that was factually acquired outside Canada before 2022 to after the effective date of the CCUS regime. Similarly, this rule is subject to new subsection 127.44(11), which delays the date on which unpaid expenditures are considered to have been incurred until the date they were paid.

ITA
127.44(8)(d)

New subparagraph 127.44(8)(d) incorporates certain rules from section 127 (investment tax credits) with minor modifications to adapt them for the purposes of the CCUS rules. The effect of subsections 127(11.6) to (11.8), as adapted for CCUS purposes, is to restrict amounts recognized as costs in non-arm’s length situations. For more information, see the commentary to existing subsections 127(11.6) to (11.8).

ITA
127.44(8)(e)

New paragraph 127.44(8)(e) provides the Minister of National Revenue with the authority to determine, on the recommendation of the Minister of Natural Resources, that a process does not constitute a CCUS process. It is anticipated that this provision would be used only in unusual circumstances where a process satisfied the literal definition “CCUS process” but was nevertheless outside the intended scope of the CCUS incentive program. (This provision was included in the 2022 proposals but was previously proposed to be included in proposed subsection 1104(19) of the Regulations.)

ITA

127.44(8)(f)

New paragraph 127.44(8)(f) provides that, in determining whether a process is a CCUS process (as defined in subsection 127.44(1)) or whether a property is described in Class 57 or 58 of Schedule II to the Regulations, any technical guide published by the Department of Natural Resources applies conclusively with respect to engineering and scientific matters. This rule is similar to the existing rule in subsection 13(18.1) which applies in relation to determinations related to Classes 43.1 and 43.2.

Repayment of assistance

ITA
127.44(9)

New subsection 127.44(9) of the Act applies if a taxpayer repaid (or has not received and can no longer reasonably be expected to receive) in a particular taxation year, an amount of non-government assistance that was applied to reduce the amount of a qualified CCUS expenditure (the "reduced expenditure") under one of paragraphs (a) to (d) (the "relevant paragraph") of that definition for a preceding taxation year. The amount of the reduced expenditure is added to the amount otherwise determined to be the taxpayer's qualified CCUS expenditure (under the relevant paragraph of that definition) for the particular year.

Partnerships and limited partners

ITA
127.44(10) and (11)

The CCUS rules are intended to apply to partnerships and their partners in a similar manner to other investment tax credits under section 127, while maintaining the exclusion of tax-exempt entities from eligibility for CCUS tax credits. New subsection 127.44(10) of the Act applies if a qualifying taxpayer in a particular taxation year is a member of a partnership, and a CCUS tax credit would be determined in respect of the partnership for its taxation year that ends in the particular taxation year if the partnership were a taxable Canadian corporation. New subsection (10) provides a rule, similar to existing subsection 127(8), that effectively flows the portion of a CCUS tax credit that can reasonably be considered to be a member's share of the credit to the member.

New subsection (11) states that subsections 127(8.1) to (8.5) are applicable, with such modifications as the circumstances require, to determine the portion of the CCUS tax credit that is the partner's share of the CCUS tax credit for the particular taxation year. Subsections 127(8.1) to (8.5) restrict the amount of investment tax credits that may be allocated by a partnership to limited partners. For more information, see the commentary to those existing provisions of section 127.

Unpaid amounts

ITA
127.44(12)

New subsection 127.44(12) of the Act ensures that if an expenditure that is unpaid on the day that is 180 days after the end of the taxation year of a taxpayer in which the expenditure is incurred, for the purposes of section 127.44, the expenditure is deemed to have been incurred at the time it is paid.

Designated jurisdictions

ITA
127.44(13) and (14)

In order for captured carbon (carbon dioxide) to be stored in accordance with the requirements of the CCUS rules, it must be stored in “dedicated geological storage” as defined in subsection 127.44(1). Among other things, dedicated geological storage must be in a “designated jurisdiction”, which is also defined in subsection 127.44(1). A designated jurisdiction means any of Alberta, British Columbia or Saskatchewan, plus any jurisdiction in Canada or the United States for which a designation by the Minister of the Environment is in effect. New subsection 127.44(13) provides the authority and mechanism for the Minister of the Environment (i.e., the Minister responsible for Environment and Climate Change Canada) to designate a jurisdiction for this purpose. It also deems the existing designated jurisdictions to have been designated in this same manner.

New subsection 127.44(14) provides the Minister with the authority to revoke a designation of a jurisdiction, in circumstances where the regulatory regime or the enforcement of that regime has ceased to be adequate to ensure permanent storage of captured carbon.

Purpose

ITA
127.44(15)

New subsection 127.44(15) specifies that the purpose of new section 127.44 and new Part XII.7 of the Act is to encourage and support the investment of capital in the development and operation of carbon capture, transportation, utilization and storage capacity in Canada.

Tax shelter investments

ITA
127.44(16)

New subsection 127.44(16) prevents CCUS tax credits from being available in respect of CCUS projects if a property used in the project is a tax shelter investment (for the purpose of section 143.2).

This rule is similar to existing subsection 125.4(4), which applies in relation to Canadian Film or Video Production Tax Credits.

Late filings

ITA
127.44(17)

New subsection 127.44(17) is an administrative rule for the purpose of ensuring efficient administration of the CCUS tax credits by the Minister of National Revenue.

The rule permits the Minister to accept the late-filing by a qualifying taxpayer of the prescribed form referred to in subsection (2) only until one year after the filing-due date referred to in subsection (2). No overpayment by the taxpayer is deemed to arise under that subsection until the form has been filed with the Minister.

Clause 2

ITA
PART XII.7

New Part XII.7 of the Act introduces special taxes as well as reporting rules in relation to CCUS tax credits. Section 211.92 contains rules for recovery taxes that apply, in general terms, to certain CCUS tax credits for CCUS projects that do not meet their "projected eligible use percentage" (as defined in new subsection 127.44(1)) for the project. The potential application of these recovery taxes is only in relation to CCUS tax credits for "qualified carbon capture expenditures" and "qualified carbon transportation expenditures" (as defined in subsection 127.44(1)). Section 211.92 also includes "recapture" taxes – broadly similar to the existing recapture rules under section 127 – that apply in certain circumstances where CCUS property is disposed of or exported.

New Part XII.7 also contains reporting requirements in new section 211.93: climate risk disclosure and knowledge sharing rules as well as an annual reporting rule to aid in administration of new section 211.92. As noted above, the climate risk disclosure and knowledge sharing rules are substantively very similar to what was released in Budget 2023. Finally, sections 211.94 and 211.95 adopt various provisions of the Act for the purposes of Part XII.7 and provide an extended record retention period in relation to the CCUS rules in s. 127.44 and in Part XII.7.

As with the basic CCUS tax credit provisions in new section 127.44, these rules apply as of January 1, 2022.

ITA
211.92

New section 211.92 implements the recovery tax (i.e., repayment of tax credit) requirements as outlined in the August 9, 2022 Backgrounder and in Budget 2023, as well as related provisions.

ITA
211.92(1)

Definitions

New subsection 211.92(1) provides various definitions relevant for the purpose of determining the CCUS tax credit recovery tax liability of a taxpayer and for the reporting requirements in new section 211.93. These definitions apply for the purposes of Part XII.7 as well as section 127.44, which contains the main portion of the CCUS tax credit rules.

“actual eligible use percentage”

This is the companion definition to “projected eligible use percentage” in new subsection 127.44(1). In general terms, to qualify for tax credit support, the proponents of a CCUS project must (among other things) project their eligible use percentage in their project plan before commencing operations. The recovery tax calculations in new subsections 211.92(4) and (5) compare projected eligible use percentage to actual eligible use percentage at the end of each of four “project periods”. If actual eligible use percentage is more than five percentage points lower than projected eligible use percentage in a given period, then a recovery tax is payable to recoup the excess tax credits claimed based on what has turned out to be an over-projection of eligible use. For more information, see the commentary to new subsections 211.92(4) and (5).

“exempt corporation”

Generally, subsection 211.93(1) requires a “knowledge sharing taxpayer” to make a climate risk disclosure report available to the public in a prescribed manner stipulated in subsection 211.93(2). However, an exempt corporation is not required to produce an annual climate risk disclosure report.

An “exempt corporation” is one that is not involved in a large project. More specifically, an exempt corporation is one that does not have an ownership interest, whether directly or indirectly, in a qualified CCUS project that has incurred expenditures, or is expected to incur expenditures, based on the most recent project evaluation issued by the Minister of Natural Resources for the project, of $20 million or more.

“first project period”

A taxpayer could be liable to pay a recovery tax at the end of each of four “project periods”. Each project period is five calendar years, except that the first project period has special rules to account for project start-up dates that are off-calendar. For projects that have their “first day of commercial operations” (or their expected first day of commercial operations, if they have not yet started up) before October 1st, the end of the first project period is on December 31st of the fourth calendar year after the first “stub year”.

For those projects, the first project period will be three to nine months shorter than five years, depending on their first day of commercial operations. For projects that have their "first day of commercial operations" (or their expected first day of commercial operations, if they have not yet started up) after September 30th, the stub period is added on to the following five calendar years, resulting in a first project period of up to five years and three months in length. Each of the subsequent project periods is five calendar years commencing immediately following the end of the previous project period.

"first recovery taxation year"

The "first recovery taxation year" for a CCUS project is the year that includes the last day of the first project period of a qualified CCUS project. Similarly, each of the second, third and fourth recovery taxation years is the year that includes the last day of the corresponding project period.

"fourth project period"

The "fourth project period" in respect of a CCUS project is the period of five calendar years following the end of the third project period. Refer to the commentary above on the definition of "first project period" for more details.

"fourth recovery taxation year"

The "fourth recovery taxation year" in respect of a qualified CCUS project is the year that includes the last day of the fourth project period.

"knowledge sharing CCUS project"

A "knowledge sharing CCUS project" is a qualified CCUS project that is either

- expected to incur qualified CCUS expenditures of $250 million or more over the life of the project based on the most recent initial project evaluation issued by the Minister of Natural Resources for the project, or
- has incurred $250 million or more of qualified CCUS expenditures before the first day of commercial operations of a CCUS project.

"knowledge sharing report"

A "knowledge sharing report" in respect of a CCUS project means each of an annual operations knowledge sharing report and the construction and completion knowledge sharing report.

All knowledge sharing reports must include the information described by the Minister of Natural Resources in the *CCUS-ITC Technical Guidance Document* as published by the Minister of Natural Resources and amended from time to time, in the form annexed to the CCUS-ITC Technical Guidance Document.

“knowledge sharing taxpayer”

A “knowledge sharing taxpayer” means a taxpayer that claimed a CCUS tax credit (under section 127.44 from its tax otherwise payable under Part I) for a taxation year ending before the first day of commercial operations of a knowledge sharing CCUS project.

“project period”

A “project period” is any of the first to fourth project periods of a qualified CCUS project.

“recovery taxation year”

A “recovery taxation year” is any of the first to fourth recovery taxation years of a qualified CCUS project.

“relevant project period”

A “relevant project period”, in respect of each recovery taxation year, is the related project period, e.g., in case of the first recovery taxation year, since the first project period is the related project period, it is the relevant project period for the first recovery taxation year.

“reporting-due day”

The definition “reporting-due day” establishes the reporting-due day for the construction and completion knowledge sharing report and the annual operations knowledge sharing reports.

The reporting-due day for the construction and completion knowledge sharing report, which is a one-time report, is the last day of the sixth month beginning after the first day of commercial operations of the knowledge sharing CCUS project.

In the case of annual operations knowledge sharing reports, the definition establishes the reporting-due day for each of the five annual reports.

In this regard, the definition provides for two possibilities for the reporting-due day for the first annual operations knowledge sharing report, as follows:

- if the first day of commercial operations is before October 1st in a calendar year, the reporting-due day is the June 30th of the following calendar year, or
- if the first day of commercial operations is after September 30th in a calendar year, the reporting-due day is June 30th of the second calendar year after the calendar year which includes the first day of commercial operations.

For each of the second through the fifth annual operations knowledge sharing reports, the reporting due-day is each June 30th of each of the first four calendar years immediately following the reporting-due day for the first annual operations knowledge sharing report.

“reporting period”

The definition “reporting period” is relevant for both the construction and completion knowledge sharing report and the annual operations knowledge sharing reports.

In the case of the construction and completion knowledge sharing report, the reporting period begins on the day an expenditure for the qualified CCUS project is first incurred and ends on the first day of commercial operations of the knowledge sharing CCUS project.

In the case of each annual operations knowledge sharing report, the reporting period begins on the first day of commercial operations of the knowledge sharing CCUS project and ends on the last day of the calendar year ending immediately before the reporting-due day for that report (or for each of the annual operations knowledge sharing reports).

“reporting taxation year”

Generally, a “reporting taxation year” is a taxation year in which a CCUS tax credit is first claimed as well as each subsequent taxation year until the end of the twenty-year period which begins after the year that includes the first day of commercial operations of an eligible CCUS project.

“**second project period”**

The “second project period” in respect of a CCUS project means the five calendar years following the end of the first project period. Refer to the commentary above on the definition of “first project period” for more details.

“second recovery taxation year”

The “second recovery taxation year” in respect of a qualified CCUS project is the year that includes the last day of the second project period.

“**third project period”**

The “third project period” in respect of a CCUS project means the five calendar years following the end of the second project period. Refer to the commentary above on the definition of “first project period” for more details.

“third recovery taxation year”

The “third recovery taxation year” in respect of a qualified CCUS project is the year that includes the last day of the third project period.

Recovery of development tax credit

ITA

211.92(2)

New subsection 211.92(2) requires a taxpayer to pay a tax under Part XII.7 in certain circumstances related to the period before project start-up. The tax is payable for a particular taxation year that includes the first day of commercial operations of a CCUS project, or for any preceding year. The amount of the tax is the amount, if any, by which the taxpayer's cumulative CCUS development tax credit for the immediately preceding taxation year exceeds its cumulative CCUS development tax credit for the particular taxation year. This situation could occur if the taxpayer's "projected eligible use percentage" is reduced before operations begin.

Example

During year one of a CCUS project, a taxpayer's projected eligible use percentage for all years of the CCUS project is 100% and qualified carbon capture expenditures are calculated on that basis. Over years one and two, there are $20 million of qualified expenditures based on the 100% projected eligible use percentage. In year three, the taxpayer's plans change and only 40% of the captured carbon is expected to be used in an eligible use during all project periods; consequently, the taxpayer's new projected eligible use percentage is 40%. The taxpayer has $1 million of new expenditures in year three.

Assuming the applicable specified percentage (the tax credit rate) is 50%, at the end of year two, the taxpayer's cumulative CCUS development tax credit under subsection 127.44(4) is $20 million x 100% x 50% = $10 million. However, in year three, the taxpayer's new CCUS development credit for that year will be $1 million x 40% x 50% = $200,000.

In addition, in applying subsection 127.44(5) at the end of year three, based on the revised projected eligible use percentage, the taxpayer's qualified expenditures for the earlier years are reduced retrospectively. The qualified expenditures in the first two years, instead of being $20 million, are now $20 million x 40% = $8 million for a revised cumulative CCUS development tax credit at the end of year three of $4 million plus $200,000. Since the taxpayer received tax credits reflecting a higher eligible use than is now planned, the difference between the year two cumulative CCUS development tax credit of $10 million and the year three cumulative CCUS development tax credit of $4.2 million is $5.8 million. This amount is repayable as recovery tax to recover CCUS tax credits that were based on an over-projection of eligible use.

Acceleration of recovery tax

ITA
211.92(3)

New subsection 211.92(3) applies to trigger recovery tax if the actual eligible use percentage of a CCUS project falls below 10% during any year during the project's total CCUS project review period. This could occur if a CCUS project switched to enhanced oil recovery as its use of captured carbon. Note that subsection (3) does not apply if subsections 211.92(6) and (7), or 211.92(8), apply. For more information, see the notes to those new subsections.

In the case of qualified carbon capture expenditures and qualified carbon transportation expenditures (as defined in subsection 127.44(1)), the qualifying portion of expenditures is determined by multiplying the expenditure (as described in variable A) by the projected eligible use percentage under section 127.44 for each project period (and then using variable F in those definitions to arrive at the overall qualifying portion). “Projected eligible use percentage” is determined from the project plan as, in general terms, the quotient obtained from the division of projected eligible use during the relevant period by the projected total use (i.e., ineligible use plus eligible use) during the same period, expressed as a percentage. For more information, see the commentary to its definition in new subsection 127.44(1). Under the definition “qualified CCUS project”, a qualified CCUS project in effect must plan to operate for at least 20 years to be eligible for the CCUS tax credit. The projected eligible use percentage is required to be greater than or equal to 10% in every year for the project to be eligible for the CCUS tax credit.

If the actual eligible use percentage falls below 10% during any of the periods described in subparagraph (c)(i) or (ii) of the definition “qualified CCUS project” in subsection 127.44(1), which are generally calendar years, then paragraph (a) of subsection 211.92(3) deems the actual eligible use percentage for the relevant project period to which the period relates, and for each subsequent project period, to be nil. Paragraph (b) further deems the relevant project period for the particular recovery taxation year to include all subsequent project periods, accelerating the application of the recovery tax.

As a result, any CCUS tax credits that are recoverable for that period, or any subsequent recovery period become payable by the taxpayer under Part XII.7 for the particular recovery taxation year. Essentially, unless subsection 211.92(3) is inapplicable due to subsections 211.92(6) and (7), or 211.92(8), if a taxpayer’s actual eligible use percentage is below 10% for any year (or for the slightly longer period described in subparagraph (c)(i) of the definition “qualified CCUS project” in subsection 127.44(1)), up to the total amount of the taxpayer’s CCUS tax credits may become repayable as recovery tax under this subsection. However, if the situation of actual eligible use of under 10% for a year occurs in the second, third or fourth project period, then the CCUS tax credits allocated to prior periods are preserved.

Paragraph 211.92(3)(c) ensures that the taxpayer will not be subject to any further recovery of amounts under Part XII.7 in respect of the CCUS project.

Development credits recovery amount

ITA
211.92(4)

New subsection 211.92(4) is the recovery tax rule that can apply if there is ineligible use of captured carbon in relation to a CCUS project. It applies to recover a portion of CCUS development tax credits if

- the difference between the actual eligible use percentage for a particular recovery taxation year in respect of a relevant project period is more than the permissible de minimis tolerance of five percentage points, and

- subsection (3) does not apply (subsection (3) specifies that subsections (4) and (5) do not apply if subsection (3) applies).

Where subsection 211.92(4) applies, a taxpayer is required to add an amount to the tax otherwise payable under this Part for the recovery taxation year that relates to the relevant project period. Unless subsection 211.92(9) has previously applied, the amount to be added is the difference between the amount of the taxpayer’s cumulative CCUS development tax credit (under subsection 127.44(4)) for the taxation year that included the first day of commercial operations (i.e., based on the projected eligible use from the project plan), and the amount that would have been the taxpayer’s cumulative CCUS development tax credit for that taxation year if the projected eligible use percentage for the relevant project period were equal to its actual eligible use percentage.

Subsection 211.92(4) therefore requires a re-calculation of the taxpayer’s CCUS development tax credit entitlements using the actual eligible use percentage for the relevant project period instead of the projected eligible use percentage for that period. All other aspects of the calculation stay the same.

Example

A taxpayer has $15 million of carbon capture expenditures before the first day of commercial operations of a qualified CCUS project. In its project plan, the taxpayer projected eligible use at 100% in each project period. Consequently, assuming the taxpayer’s expenditures are described in variable A of the definition “qualified carbon capture expenditure”, variables B through E of that definition are each 100%. The bracketed portion of the formula yields 400%, while variable F is 0.25, so the taxpayer’s qualified carbon capture expenditure is $15 million x 400% x 0.25 = $15 million. Assume that the applicable specified percentage is 50%, resulting in refundable CCUS development tax credits of $7.5 million and that there are no other qualified CCUS expenditures.

At the end of the first project period, the taxpayer’s actual eligible use percentage is 100%. Therefore, no recovery tax is payable. However, at the end of the second project period – reflecting the taxpayer’s new use of some of the captured carbon in enhanced oil recovery – the taxpayer’s actual eligible use percentage is only 60%. Subsection 211.92(3) does not apply, because the actual eligible use percentage is above 10%. However, subsection 211.92(4) applies, because the actual eligible use percentage for the second project period is more than five percentage points lower than the projected eligible use percentage for the second project period. In applying the formula in subsection 211.92(4) to this example, variable A is $7.5 million, the original amount of the taxpayer’s cumulative CCUS development tax credits under subsection 127.44(4). Variable B is the same as variable A, except that instead of using the projected eligible use for the second project period (which is the relevant project period for the second recovery taxation year) the taxpayer must use the actual eligible use percentage for that period, or 60%.

This re-application of the definition “qualified carbon capture expenditure”, but with the reduced use percentage for the second project period yields:

$15 million x (100% + 60% + 100% + 100%) x 0.25 = $13.5 million.

The difference between A and B is $1.5 million, which must be paid as recovery tax under subsection 211.92(4). The qualified carbon capture expenditure definition in subsection 127.44(1) effectively allocates the taxpayer's expenditures across the four project periods. Each recovery taxation year requires looking back at the previous project period to measure the difference between the projected eligible use percentage and the actual eligible use percentage for that period. Since the $3.75 million of the taxpayer's expenditures that were notionally allocated to the second project period supported 40% ineligible use, the recovery tax, as noted above, is $1.5 million, reflecting the government's intention to provide support only to eligible use. Variable C reduces the amount payable under subsection 211.92(4) by any amount previously paid by the taxpayer under subsection (9) in respect of the project. In this example, variable C is zero.

No additional recovery tax will be payable until the third recovery taxation year, unless the taxpayer's actual eligible use percentage falls below 10%, which would cause subsection 211.92(3) to apply.

Refurbishment credits recovery amount

ITA
211.92(5)

New subsection 211.92(5) provides a rule for the recovery of the CCUS refurbishment tax credit under certain circumstances. It is similar to the rule in subsection 211.92(4) described above.

As is the case for subsection (4), subsection (5) applies in respect of the recovery of CCUS refurbishment tax credits if subsection (3) does not apply and if the difference between the actual eligible use percentage for a particular recovery taxation year and the projected eligible use percentage in respect of a relevant project period is more than the permissible *de minimis* tolerance of five percentage points. If this is the case, a taxpayer is required to add an amount to the tax otherwise payable under Part XII.7 for the particular recovery taxation year in respect of the relevant project period. Unless subsection 211.92(10) has previously applied, the amount to be added is the difference between the taxpayer's CCUS refurbishment tax credit under subsection 127.44(5) for the year or a previous taxation year, and the amount that would have been the taxpayer's CCUS refurbishment tax credit for the year or a previous taxation year if the projected eligible use percentage for the relevant project period were equal to its actual eligible use percentage. This amount is reduced under variable C by any amount previously paid by the taxpayer under subsection 211.92(10). As with CCUS development tax credits, the recovery of CCUS refurbishment tax credits is only relevant in relation to tax credits for "qualified carbon capture expenditures" and "qualified carbon transportation expenditures".

Extraordinary eligible use reduction

ITA

211.92(6)

Subsection 211.92(6) sets out the conditions when new subsection (7) applies. Subsection (7) provides for a safe harbour rule under which a taxpayer is not required to pay a recovery tax under subsections (3) to (5).

Subsection (6) has three paragraphs, one for each of the three conditions for the application of subsection (7). First, the condition in paragraph (a) is that the taxpayer's actual eligible use percentage for a qualified CCUS project during a project period is significantly reduced due to extraordinary circumstances. The extraordinary circumstances must have resulted due to *bona fide* reasons outside the taxpayer's control and outside the control of each person or partnership that does not deal at arm's length with the taxpayer.

Second, paragraph (b) requires that the taxpayer request in writing, on or before the taxpayer's filing-due date for the year, that the Minister consider the potential application of subsections (6) and (7).

Third, paragraph (c) requires that the Minister of National Revenue be satisfied that the taxpayer has taken all reasonable steps to attempt to rectify the extraordinary circumstances, and that it is appropriate, having regard to all the circumstances, to apply subsections (6) and (7).

Effect of extraordinary circumstances

ITA
211.92(7)

New subsection (7) applies if the conditions set out in subsection (6) have been met. There could be one of two consequences of the application of the new subsection (7), depending on how long the extraordinary circumstances last.

First, paragraph (a) provides that no amount is payable under subsections (3) to (5) for a taxation year if subsection (6) applies and if the qualified CCUS project's operations are affected by extraordinary circumstances for all or substantially all of the project period (i.e., the project period referred to in subsection (6)).

Second, paragraph (b) provides that, if paragraph (a) does not apply, but subsection (6) applies, then the portion of the project period during which the project's operations are affected by the extraordinary circumstances is disregarded for the purpose of calculating the actual eligible use percentage for that project period.

Shutdown

ITA
211.92(8)

New subsection 211.92(8) provides for a safe harbour rule in circumstances when a taxpayer’s qualified CCUS project is shut down. It is similar to subsections (6) and (7), except that no ministerial determination is required. The new subsection has two paragraphs that set out one of two consequences that apply if the qualified CCUS project is shut down, depending on how long the period of shutdown lasts.

Paragraph (a) provides that no amount is payable by the taxpayer under subsections (3) to (5) for a recovery taxation year in respect of the CCUS project if the project is inoperative during all or substantially all of the relevant project period. In this context, “inoperative” and “shut down” are intended to mean the same thing.

Paragraph (b) applies if paragraph (a) does not apply and the qualified CCUS project of the taxpayer was shut down for a portion of the project period. If paragraph (b) applies, then for the purposes of determining a taxpayer’s liability for tax under Part XII.7 for a recovery taxation year, the portion of the relevant project period during which the project is inoperative is to be disregarded for the purpose of calculating the actual eligible use percentage for the project period.

Development property disposition

ITA
211.92(9)

New subsection 211.92(9) provides that all or a portion of a CCUS development tax credit in respect of a particular property is either denied, or recaptured through the imposition of a tax under certain circumstances. In general terms, the rule applies if a taxpayer disposes of a property or exports it from Canada during a particular taxation year and the taxpayer obtained, or would otherwise have obtained, a CCUS tax credit in respect of the property. Subsection 211.92(10) provides a similar rule in the case of disposition or export of a property that resulted in a CCUS refurbishment tax credit. Subsections (9) and (10) do not apply to disposition of a property if the election for certain asset sales in subsection (11) applies.

Paragraph (a) applies if the time of disposition or export of the property is before the total CCUS project review period. “Total CCUS project review period” is defined in subsection 127.44(1) and it begins on the first day of commercial operations of a qualified CCUS project. If that timing condition is met, paragraph (a) provides that an expenditure in respect of the disposed property is deemed not to be a qualified CCUS expenditure for the purpose of determining the taxpayer’s cumulative CCUS development tax credit for the particular year and any subsequent taxation years. This effectively disentitles the taxpayer to a CCUS tax credit and eliminates the need to perform the recapture tax calculation. If the disposition or export is in the same year as the expenditure is incurred, no CCUS tax credit is available. If the disposition or export is later, but before the first day of commercial operations, then the taxpayer’s cumulative CCUS development tax credit (under subsection 127.44(4)) will be reduced, triggering tax, or reducing credit entitlement, under subsection 211.92(2).

Paragraph (b) applies if the export or disposition is during the total CCUS project review period. If paragraph (b) is applicable, a taxpayer is required to add to the tax otherwise payable under Part XII.7 for the year the amount determined by the formula

$$A \times B \times C \div D - E$$

Variable A in the formula is the relevant qualified CCUS expenditure in respect of the property as determined for the taxation year that included the first day of commercial operations of the CCUS project. The stipulation that that taxation year be used allows any changes to the projected eligible use percentage before start-up (which can result in changes to CCUS tax credit entitlement, or in the application of subsection 211.92(2) as described above) to be taken into account.

Variable B is the appropriate specified percentage applicable to the qualified CCUS expenditure. The A x B portion of the formula is therefore generally equal to the taxpayer's CCUS tax credit in respect of the property.

Variable C is the lesser of the capital cost of the property and either

- the proceeds of disposition of the property, if the property was disposed of to an arm's length person, or
- in any other case, the fair market value of the property at the time of its disposition or export.

Variable D is the taxpayer's capital cost of the property at the time of its acquisition.

Variable E, which reduces the total amount payable under subsection (9), is the amount of any recovery tax previously paid by the taxpayer in respect of the particular property.

<u>Example – Interaction of subsections 211.92(4) and 211.92(9)</u>

<u>Step 1 - Application of subsection 211.92(4)</u>

Assume a taxpayer incurred \$25 million on qualified carbon capture expenditures before the first day of commercial operations, projecting eligible use at 100% throughout the project, generating tax credits of \$12.5 million (i.e., the specified percentage is 50%).

For the first project period, the actual eligible use percentage turns out to be 75%. Therefore, the recovery tax in subsection 211.92(4) applies. As noted in the notes to that subsection above, A is the taxpayer's CCUS tax credits obtained, or in this case, \$12.5 million. As also noted above, variable B must be determined by re-calculating "qualified carbon capture expenditure" but using the actual eligible use percentage for the first project period, keeping everything else the same:

$$\$25 \text{ million} \times (75\% + 100\% + 100\% + 100\%) \times 0.25 = \$23{,}437{,}500.$$

This is then multiplied by the applicable specified percentage, 50%, yielding $11,718,750, the amount of tax credits that the taxpayer “ought to have” received based on their actual eligible use percentage. This is variable B. The difference between what the taxpayer in fact received and the revised number based on their actual eligible use, A – B, is $12,500,000 – $11,718,750 = $781,250.

This is the amount of recovery tax payable for the first recovery taxation year. Note that this tax amount is subject to interest from the time of the balance-due day for the year the credit arose due to the application of new section 211.94.

Step 2 – Application of subsection 211.92(9)

Assume that, in year two of the second recovery period, the same taxpayer from step 1 above sells an asset that benefited from CCUS tax credits (for qualified carbon capture expenditures) to an arm’s length party for $3 million. Its cost on acquisition, before the first day of commercial operations, was $5 million. Subsection 221.92(9) will generally apply to this situation, which is described in the opening portion of paragraph 211.92(9)(b): the time of disposition is during the total project review period. Therefore, the formula in paragraph (b) must be applied to determine the amount of “recapture” tax.

Variable A is the qualified CCUS expenditure in respect of the property, as determined for the first day of commercial operations; in this case, that amount is $5 million. Variable B is the appropriate specified percentage, or 50%. Variable C is $3 million, the property’s proceeds of disposition to an arm’s length person and variable D is the capital cost of the property, $5 million. The first portion of the formula is therefore $5 million x 50% x $3 million ÷ $5 million = $1.5 million. This is the amount that would be payable as recapture tax, except that variable E applies to reduce that amount.

The taxpayer has already paid recovery tax of $781,250 in relation to their original expenditures of $25 million. The asset that was sold represented $5 million out of $25 million or 20% of those expenditures. It is reasonable to consider that $781,250 x 20% or $156,250 has already been paid as recovery tax in respect of the property. Therefore, the amount repayable under subsection 211.92(9) is

$5 million x 50% x $3 million ÷ $5 million - $156,250 = $1,343,750.

Refurbishment property disposition

ITA
211.92(10)

New subsection 211.92(10) is very similar to subsection 211.92(9), but it applies to recapture all or a portion of the CCUS refurbishment tax credit under certain circumstances. In particular, the recapture applies if the taxpayer disposes of a property, or exports it from Canada, during a particular taxation year, and the expenditure incurred for the property resulted in the determination of a CCUS refurbishment tax credit for the taxpayer for a previous taxation year.

Since refurbishment tax credits relate to expenditures that are incurred on or after the first day of commercial operations of a CCUS project, there is no need for a rule similar to paragraph 211.92(9)(a).

Election - CCUS project sale

ITA
211.92(11)

New subsection 211.92(11) provides an election to avoid the outcomes in subsections 211.92(9) and (10) if certain conditions are met. The election may be available where a qualifying taxpayer (referred to as the vendor in this subsection) disposes of all or substantially all of its properties that are part of a qualified CCUS project of the corporation (the CCUS project properties) to a taxable Canadian corporation (referred to as the purchaser in this subsection). Instead of applying subsections (9) and (10), the purchaser can assume the relevant tax history of the vendor so that Part XII.7 taxes can apply appropriately at a later time if necessary.

If the vendor and the purchaser elect to have the rules in subsection (11) apply, subsections (9) and (10) do not apply to the vendor in respect of the dispositions of any of the CCUS project properties, and instead the four rules set out in each of the paragraphs (a) to (d) of subsection (11) apply to the purchaser.

Paragraph (a) sets out that the purchaser is deemed to have made the qualifying CCUS expenditures that were incurred by the vendor at the same time as were incurred by the vendor.

Paragraph (b) provides that provisions of the ITA that applied to the vendor in respect of the CCUS project properties that are relevant to the application of the ITA in respect of the CCUS project properties are deemed to have applied to the purchaser. In particular, the purchaser is deemed to have claimed the CCUS tax credits determined under section 127.44 that were deducted by the vendor against its taxes payable in respect of the expenditures incurred for the CCUS project properties before the disposition of the CCUS project properties by the vendor.

Paragraph (c) deems any project plans that were prepared or filed by the vendor in respect of the CCUS project properties to have been filed by the purchaser.

Paragraph (d) ensures that the purchaser is or will be liable for amounts in respect of the CCUS project properties for which the vendor would be liable under Part XII.7 regarding actions, transactions or events that occur after the dispositions of the CCUS project properties, as if the vendor had undertaken them or otherwise participated in them.

Partnerships

ITA
211.92(12) to (15)

Subsections 211.92(12) to (15) provide rules that allocate tax obligations under Part XII.7 in the context of partnerships.

ITA
211.92(12)

When a member of a partnership has claimed CCUS credits in respect of a project by applying subsection 127.44(10), subsection (12) provides, in general terms, that amounts under Part XII.7 are to be determined in respect of the partnership as if it were a taxable Canadian corporation (with a taxation year rather than a fiscal period) and as if the deemed corporation had claimed all the CCUS tax credits that were claimed by any member of the partnership.

ITA
211.92(13)

Subsection 211.92(13) requires that the amount of tax determined in respect of the partnership be allocated to the partnership members and added to their tax payable. All members of the partnership, regardless of when they acquired their partnership interest, would generally be expected to be liable to pay a share of any tax payable under Part XII.7 because of this rule. Subsection 211.92(13) is subject to an elective provision in subsection 211.92(14).

ITA
211.92(14)

Subsection 211.92(14) enables any member of a partnership that is a taxable Canadian corporation to elect to pay the entire amount determined in respect of the partnership.

ITA
211.92(15)

Subsection 211.92(15) creates joint and several liability (or, for civil law, solidary liability) for partnership members for any tax determined because of subsection (12) in respect of the partnership, except to the extent that the tax has been paid by a taxable Canadian corporation that elected under subsection 211.92(14), or has been allocated to a member of the partnership and added to their tax payable under subsection (13).

CCUS Reporting Requirements

ITA
211.93

New section 211.93 of the Act contains the knowledge sharing and climate risk disclosure requirements associated with the CCUS tax credit.

CCUS projects with eligible expenses of $250 million or more over the life of the project are required to contribute to public knowledge sharing in Canada. Taxpayers are required to make available for public dissemination certain knowledge sharing reports. The reports are required following the commissioning of the CCUS facility and for each of the five following years.

Details surrounding the content requirements of the knowledge sharing report were developed in consultation with, and will be monitored by, the Department of Natural Resources Canada.

The penalty for not producing a knowledge sharing report in respect of the commissioning of the CCUS facility or the five subsequent annual reports is $2 million for each report not produced.

Similarly, certain corporations are required to produce an annual climate risk disclosure report beginning in respect of the tax year in which an ITC is first claimed through the first 20 years of operations of the eligible CCUS project. Corporations are exempt from this requirement if they are "exempt corporations" that do not have a large CCUS project. Reports are due nine months after the taxpayer's tax year-end and are required to be made public by the taxpayer by publishing them on their website.

If a taxpayer fails to meet the climate risk disclosure requirement in respect of any year, the taxpayer is required to pay a penalty equal to the lesser of 4 per cent of the cumulative amount of the CCUS tax credits that has been claimed by the taxpayer at that time or $1 million. This penalty is applied in respect of each year that this obligation is not met, up to the end of the first 20 years of operations.

Consistent with the coming into force of other CCUS tax credit provisions of the Act, section 211.93 applies as of January 1, 2022.

Reporting requirements

ITA
211.93(1)

Subsection 211.93(1) requires a knowledge sharing taxpayer to submit, by the applicable deadline, knowledge sharing reports to the Minister of Natural Resources and to make climate risk disclosure reports available to the public. A "knowledge sharing taxpayer" is defined in subsection 211.92(1).

Paragraph 211.93(1)(a) concerns "knowledge sharing reports". It requires that a knowledge sharing taxpayer submit a knowledge sharing report to the Minister of Natural Resources for each reporting period, on or before the reporting-due day.

Paragraph 211.93(1)(b) concerns "climate risk disclosures". It requires that certain knowledge sharing taxpayers (a corporation, other than an exempt corporation (as defined in subsection 211.92(1)) make available to the public for each reporting taxation year a climate risk disclosure report, on or before the reporting-due day. A climate risk disclosure report must detail the four criteria set out by the Task Force on Climate-Related Financial Disclosures: governance, strategy, risk management, and metrics and targets. The report also needs to set out how corporate governance, strategies, policies and practices contribute to achieving Canada's commitments under the Paris Agreement and goal of net-zero by 2050.

"Reporting-due day" for the reports is defined in subsection 211.92(1). The climate risk disclosure report is to be made available to the public in a prescribed manner. (Subsection 211.93(2) provides that a climate risk disclosure report is deemed to have been made public in a prescribed manner if it includes its date of publication and is published on the taxpayer's website for at least three years after the reporting-due day.)

Subparagraph 211.93(1)(b)(i) and (ii) set out the information that is required to be included in the climate risk disclosure report. Subparagraph 211.93(1)(b)(i) requires that a climate risk disclosure report should describe the climate-related risk and opportunities for the corporation based on the following thematic areas:

- the corporation's governance measures around climate-related risks and opportunities,
- the actual and potential impacts of climate-related risks and opportunities on the corporation's businesses, strategy, and financial planning where such information is material,
- the processes used by the corporation to identify, assess, and manage climate related risks, and
- the metrics and targets used by the corporation to assess and manage relevant climate-related risks and opportunities.

Subparagraph 211.93(1)(b)(ii) requires that the climate risk disclosure report explain how the corporation's governance, strategies, policies and practices that contribute to achieving Canada's commitments under the Paris Agreement made on December 12, 2015, and goal of net-zero emissions by 2050.

Publication

ITA
211.93(2)

Subsection 211.93(2) provides that, for the purpose of paragraph 211.93(1)(b), a climate risk disclosure report is deemed to have been made publicly available in a prescribed manner if the report includes the publication date and is made available on the corporation's website for a period of at least three years after the reporting-due day (as that day is defined in subsection 211.92(1)).

Shared filing

ITA
211.93(3)

Subsection 211.93(3) is a relieving rule that applies when more than one person may be required, by subsection 211.93(1), to submit a knowledge sharing report in respect of the same CCUS knowledge sharing project. Subsection 211.93(3) deems that a report filed by one person with full and accurate disclosure in respect of a CCUS knowledge sharing project is deemed to have been filed by each person to whom subsection (1) applies in respect of the report.

Penalty - non-compliance with reporting requirements

ITA
211.93(4)

A knowledge sharing taxpayer is required to submit to the Minster of Natural Resources the construction and completion knowledge sharing report and five annual operations knowledge sharing reports. The reports are required for each relevant reporting period and are due on or before reporting-due day for each report.

Subsection 211.93(4) provides for a penalty of $2 million for failure to submit the construction and completion knowledge sharing report, or an annual operations knowledge sharing report, to the Minster of Natural Resources on or before the reporting-due day for the report. The $2 million penalty, if applicable, is payable the day after the reporting-due day for the report.

Failure to disclose

ITA
211.93(5)

Subsection 211.93(5) sets out a penalty that a taxpayer must pay if it fails to make a climate risk disclosure report publicly available as required by subsection 211.93(2). The penalty is calculated as the amount which is the lesser of

- 4% of the total CCUS tax credits claimed by the taxpayer for each taxation year that ended before the reporting-due day for the reporting taxation year (for which the climate risk disclosure report is required to be made publicly available); and
- $1 million.

Report disclosure

ITA
211.93(6)

Subsection 211.93(6) requires the Department of Natural Resources to publish each knowledge sharing report that had been submitted to the Minister of Natural Resources by a knowledge sharing taxpayer. The report is required to be published on a website maintained by the Government of Canada, as soon as practicable after the knowledge sharing taxpayer has submitted the report.

Eligible use reporting

ITA
211.93(7)

Subsection 211.93(7) provides a requirement for a taxpayer to file a report in prescribed form, along with each return of income for taxation years of the taxpayer that include any part of the relevant project period (as defined in subsection 211.92(1)) of a CCUS project.

The report is required if the CCUS project was commissioned in a prior taxation year and a tax credit under section 127.44 was claimed in respect of the CCUS project by a taxpayer for a taxation year.

The annual report must include the actual amount of carbon captured, during the calendar year ending in the taxation year, for storage or use in eligible use; and the aggregate quantity of captured carbon during that calendar year that supported storage or use in both eligible use and ineligible use.

If the taxpayer fails to file the annual report, the actual eligible use percentage (as defined in subsection 211.92(1)) for the relevant project period is deemed to be nil.

Administration

ITA
211.94

New section 211.94 provides that certain provisions of Part I relating to assessments, payments, appeals and various other procedural and administrative matters are also applicable to Part XII.7.

In particular, subsection 150(2) and (3), sections 152, 158, 159 and 161 to 167, and Division J of Part I apply to Part XII.7, with such modifications as the circumstances require.

In addition, when applying subsection 161(1) of Part I to an amount of tax payable under section 211.92 in Part XII.7, the balance-due day of a taxpayer in respect of a recovery taxation year is deemed to be the balance-due day of the taxation year for the related CCUS tax credit under subsection 127.44(2). This has the effect of creating a potential liability for interest from the taxation year for which the tax credit was originally claimed.

Records and books

ITA
211.95

New section 211.95 of the Act extends, for certain taxpayers, the time period for maintaining adequate books and records for examination by the Minster of National Revenue from six years to 26 years.

Section 230 of the Act requires that taxpayers maintain adequate books and records to enable the Minister of National Revenue to determine the taxes payable under the Act or amounts that should have been deducted, withheld or collected under the Act.

Taxpayers that claim CCUS tax credits against their tax otherwise payable are subject to recovery of the tax credits for up to 20 years. Paragraph 230(4)(b) of the Act generally requires taxpayers to maintain their books and records for a period of six years. Consequential on the introduction of new refundable CCUS tax credit under section 127.44 and Part XII.7, new section 211.95 is introduced.

The new section requires a taxpayer to maintain records and books of account as are necessary to verify information regarding CCUS tax credits of the taxpayer under section 127.44 or amounts payable by the taxpayer under Part XII.7, in respect of a qualified CCUS project, until the later of the period referred to in paragraph 230(4)(b), (which is generally six years); and 26 years from the end of the taxpayer's last taxation year for which an amount was deemed to have been paid under subsection 127.44(2) by reason of its paragraph (a).

Clause 3

Collection-commencement days

ITA
225.1(1.1)

Section 225.1 generally prevents the Minister of National Revenue from commencing collection activities for amounts assessed under the Act during specified time periods. However, the Minister may commence collection activities on the day after the expiry of the specified time period, known as the collection-commencement day.

In addition to providing for a rule of general application in paragraph (c) to describe the collection-commencement day in respect of an amount assessed under the Act, paragraphs (a) and (b) of subsection 225(1.1) also describe the collection-commencement day in the case of specific amounts that become payable by charities under certain circumstances.

Consequential on the introduction of new refundable CCUS tax credit under section 127.44 and Part XII.7, subsection 225.1(1.1) is amended by introducing new paragraph (b.1). Taxpayers that claim CCUS tax credits against their otherwise tax payable under section 127.44 may be subject to recovery of the tax credits for up to twenty years under section 211.92 in Part XII.7 of the Act. New paragraph 225.1(1.1)(b) provides that taxpayers will generally have up to five years to pay any recovery amounts that become payable subsections 211.92(2) to (5).

Subparagraph (i) of the new paragraph states that the Minister may only start collection action for one-fifth of the recovery amounts one year after the day on which the notice of assessment is mailed. Subparagraphs (ii) to (v) further allow the Minster to start collection action in respect of an additional one-fifth of the recovery amount in each of the following four years.

Clause 4

Income Tax Regulations ("ITR")
1100

Section 1100 of the Income Tax Regulations (the "Regulations") is amended to introduce various Capital Cost Allowance (CCA) classes relevant for carbon capture, utilization and storage.

These amendments apply to property acquired after 2021.

ITR
1100(1)

Paragraph 1100(1)(a) of the Regulations provides various declining-balance CCA rates applicable to certain classes of depreciable property. It is amended by adding new subparagraphs 1100(1)(a)(xliii) to (xlvi), which set the general CCA rate for Classes 57 to 60. The rates are 8% (for Class 57), 20% (for Class 58), 100% (for Class 59) and 30% (for Class 60).

ITR
1100(2)

Subsection 1100(2) of the Regulations provides rules for computing the CCA deduction in respect of a property for the year in which the property first becomes available for use.

Subsection 1100(2) has two main parts. The first part, as expressed by elements A and B, relates to the enhanced first year CCA in respect of "accelerated investment incentive property" of a taxpayer, as defined in subsection 1104(4), and property included in Classes 54 and 55, relating to "zero-emission vehicles", as defined in subsection 248(1) of the Act. The second part, as expressed by element C, is the so-called "half-year rule", which applies to any other depreciable property and limits a taxpayer's CCA claim to one-half of the otherwise applicable amount, for the year in which the property first becomes available for use.

Subsection 1100(2) is amended to add a reference to Class 59 in paragraph (a) of element A of the formula in the subsection. Since the CCA rate for Class 59 is already 100%, this amendment excludes property included in Class 59 from being eligible for the enhanced first year CCA.

ITR
Schedule II

Schedule II to the Regulations lists the properties that are 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.

These amendments are deemed to have come into force on January 1, 2022.

Class 8

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 8 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 8.

Class 17

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 17 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 17.

Class 41

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 41 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 41.

Class 41.1

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 41.1 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 41.1.

Class 41.2

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 41.2 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 41.2.

Class 43

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 43 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 43.

Class 49

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 49 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 49.

Class 53

ITR
Schedule II

Consequential on the introduction of Classes 57 and 58, the preamble to Class 53 in Schedule II to the Regulations is amended to add references to the new classes. This amendment ensures that a property that is included in Classes 57 or 58 is not included in Class 53.

Class 57

ITR
Schedule II

Class 57 in Schedule II to the Regulations describes certain property that is part of a CCUS project. Generally, such property includes equipment (including monitoring or control equipment) that is to be used solely for capturing carbon dioxide (other than oxygen production equipment), for transporting captured carbon or for storage of captured carbon in a geological formation. For these purposes, captured carbon means carbon dioxide that would otherwise be released into the atmosphere, or is captured directly from the ambient air, and carbon storage does not include storage for the purpose of enhanced oil recovery.

Class 57 also includes power generation or heat production equipment that solely supports the CCUS process (as defined in subsection 127.44(1) of the Act) and equipment that is to be used for preparing or compressing captured carbon for transportation.

A building or other structure all or substantially all of which is used, or to be used, for the installation or operation of equipment that is to be used solely for capturing, transporting or storing carbon dioxide is also included in Class 57.

In addition, property that is used solely to convert another property so that the converted property could be used for capturing carbon dioxide, for transporting captured carbon or for storage of captured carbon in a geological formation is also included in Class 57. Class 57 also includes property used to refurbish other Class 57 property.

However, Class 57 does not include equipment that is required for hydrogen production, natural gas processing or acid gas injection, even if such equipment is part of a CCUS project.

Class 57 is relevant for determining whether property is eligible for CCUS tax credit under section 127.44 of the Act. Expenditures (referred to as the qualified CCUS expenditure in subsection 127.44(1) of the Act) for certain type of properties included in Class 57 could qualify for investment tax credits of up to 60%. For further details, refer to commentary accompanying the definitions of these different types of qualified CCUS expenditures in new subsection 127.44(1) of the Act.

Class 57 is eligible for an 8 per cent CCA rate and is deemed to have come into force on January 1, 2022.

Class 58

ITR
Schedule II

Class 58 in Schedule II to the Regulations describes certain property that is part of a CCUS project. Such property includes equipment that is used solely for using carbon dioxide in industrial production (including monitoring and control equipment and refurbished equipment). For the purposes of Class 58, industrial production includes carbon dioxide storage for enhanced oil recovery.

Class 58 also includes a building or other structure all or substantially all of which is used, or to be used, for the installation or operation of equipment for using carbon dioxide in industrial production.

In addition, property that is used solely to convert another property so that the converted property could be used for using carbon dioxide in industrial production is also included in Class 58.

Class 58 is relevant for determining whether property is eligible for the CCUS tax credit under section 127.44 of the Act. Expenditures for certain properties included in Class 58 (referred to as qualified carbon use expenditures in new subsection 127.44(1) of the Act) could qualify for an investment tax credit of 37 ½% (for expenditures incurred after 2021 and before 2031) or 18 ¾% (for expenditures incurred after 2030 and before 2041).

Class 58 is eligible for a 20 per cent CCA rate and is deemed to have come into force on January 1, 2022.

Class 59

ITR
Schedule II

Class 59 in Schedule II to the Regulations provides for a 100 per cent CCA rate and includes property that is acquired for the purpose of determining the existence, location, extent or quality of a geological formation to permanently store captured carbon in Canada.

Class 59 also includes property acquired as a result of undertaking environmental studies or community consultations (including studies or consultations that are undertaken to obtain a right, license or privilege for the purpose of determining the existence, location, extent or quality of a geological formation to permanently store captured carbon). Class 59 includes property deemed to have been acquired under subsection 13(7.6) of the Act that is not included in any other class. However, Class 59 does not include property acquired for the purpose of drilling or completing an oil or gas well or for building a temporary access road to, or preparing a site in respect of, any such well. Class 59 also excludes property that is acquired for the purpose of storing captured carbon in a geological formation to support enhanced oil recovery.

Class 59 is deemed to have come into force on January 1, 2022, and applies to property acquired after 2021 that is included in the class.

Class 60

ITR
Schedule II

Class 60 includes property, not included in any other class, that is acquired for the purposes of drilling or converting a well in Canada for the permanent storage of captured carbon, including property acquired for the purpose of monitoring pressure changes or other phenomena in captured carbon permanently stored in a geological formation. In addition, the class includes property acquired for building a temporary access road to the well or preparing a site in respect of the well that is to be used for carbon storage.

Class 60 also includes the cost of property that is a right, license or privilege to determine the existence, location, extent or quality of a geological formation to permanently store captured carbon in a dedicated geological storage. Class 60 includes property deemed to have been acquired under subsection 13(7.6) of the Act that is not included in any other class. However, for the purposes of Class 60, a well does not include a well that could also be used for enhanced oil recovery.

Class 60 is deemed to have come into force on January 1, 2022, and only applies to property acquired after 2021 that is included in the class.

Clean Technology Investment Tax Credit

Clause 1

ITA
127(9)

“government assistance”

The definition of “government assistance” in subsection 127(9) is amended to exclude the new clean technology investment tax credit in section 127.45. This amendment is intended to ensure that the investment tax credits under section 127 (such as the Atlantic Investment Tax Credit), and the clean technology investment tax credit itself, are not reduced where the clean technology investment tax credit is available.

This amendment comes into force on March 28, 2023.

Clause 2

Clean Technology Investment Tax Credit

ITA
127.45

New section 127.45 provides a fully-refundable investment tax credit for certain clean technology capital property. The credit will apply to clean technology property that is both acquired and becomes available for use on or after March 28, 2023.

ITA
127.45(1)

Definitions

Subsection (1) contains definitions that apply in new section 127.45.

“clean technology investment tax credit”

The definition of “clean technology investment tax credit” defines the clean technology investment tax credit as the specified percentage of the capital cost to the taxpayer of clean technology property acquired by the taxpayer in the year. This definition is relevant to computing the amount of a taxpayer’s credit that may be claimed under subsection 127.45(2).

“clean technology property”

The definition of “clean technology property” is added to define the property for which the clean technology investment tax credit may be available. The definition contains four main requirements, which are set out in paragraphs (a) to (d).

Paragraph (a) requires that the property be situated in Canada and is intended for use exclusively in Canada.

Paragraph (b) requires that the property has not previously been acquired for use or lease before it was acquired by the taxpayer. This ensures that the credit is only available for new equipment.

Paragraph (c) requires that if the property is leased by the taxpayer to another person, that person must be a qualifying taxpayer (i.e., a taxable Canadian corporation). It also requires that the property be leased in the ordinary course of carrying on a business in Canada by the taxpayer whose principal business is one of the specified activities, or any combination thereof.

Paragraph (d) requires that the property be described in one of subparagraphs (i) to (vii), which describe specific types of equipment. These subparagraphs set out certain property described in Class 43.1 and 43.2 of Schedule II to the Regulations, with certain qualifications and exceptions. They also include “concentrated solar energy equipment” and a “small modular nuclear reactor” (both defined terms in subsection 127.45(1)). In general terms, qualifying equipment includes certain zero-emission power generation technologies (including concentrated solar energy equipment and small modular nuclear reactors), storage equipment for zero-emission energy and non-road zero-emission vehicles. Geothermal energy systems are also generally included, unless they are used for geothermal energy projects that will co-produce oil, gas or other fossil fuels.

“concentrated solar energy equipment”

The definition of “concentrated solar energy equipment” captures certain equipment used all or substantially all to generate heat or electricity exclusively from concentrated sunlight. Such equipment is then incorporated into the definition of “clean technology property” in subparagraph (d)(vi) of that definition. Concentrated solar energy equipment does not include “excluded equipment”.

“excluded equipment”

The definition of “excluded equipment” carves out certain types of property that are not intended to qualify as concentrated solar energy equipment. Excluded equipment is therefore ineligible for the clean technology investment tax credit.

“government assistance” and “non-government assistance”

For the purposes of section 127.45, the terms “government assistance” and “non-government assistance” have the meanings assigned by subsection 127(9). As is the case for existing investment tax credits in section 127, the amount of the capital cost of property that is eligible for the clean technology investment tax credit is reduced by government assistance and non-government assistance pursuant to paragraph 127.45(5)(b). Those amounts could become eligible for the clean technology investment tax credit if they are subsequently repaid, pursuant to subsection 127.45(7).

“non-clean technology use”

The definition of “non-clean technology use” describes one of the circumstances where a previously-eligible clean technology property could become subject to the recapture rules in subsections 127.45(12) to (14). It does so by applying a point-in-time test: if, after its acquisition by the taxpayer, the property no longer meets the criteria for being a clean technology property (other than the requirement that a property was not previously used), it will be treated as having been converted to a non-clean technology use.

For example:

- Equipment described in subparagraph (d)(i) of the definition of “clean technology property” would be subject to recapture if it is no longer used to generate solar, wind or water energy (e.g., the equipment is disassembled).
- A property that was originally eligible under subparagraph (d)(v) of the definition of “clean technology property” as equipment used exclusively for the purpose of generating electrical energy from geothermal energy might later be used in connection with a system that produces or co-produces a fossil fuel. This would be a non-clean technology use that could trigger recapture.
- Electrical generating equipment that was originally a component of a small modular nuclear reactor could be repurposed to a non-clean technology use such as production of energy from natural gas. In that case, it would no longer be used “all or substantially all to generate electrical energy or heat energy from nuclear fission” and could trigger recapture.

“qualifying taxpayer”

The definition of “qualifying taxpayer” ensures that only taxable Canadian corporations, including taxable Canadian corporations that are members of partnerships that acquire clean technology property, are eligible for the clean technology investment tax credit.

“small modular nuclear reactor”

The definition of “small modular nuclear reactor” describes a category of equipment that qualifies as clean technology property. It describes certain equipment that is used all or substantially all to generate heat or electricity from nuclear fission. Since the clean technology investment tax credit is intended to be limited to small reactors, the definition establishes caps on gross rated generating capacity consisting of 300 megawatts electric and 1,000 megawatts thermal. In addition, the equipment must be part of a module (or system) that is factory-assembled and transported pre-built to the installation site. Certain ancillary equipment (including nuclear fission fuel and equipment for nuclear waste disposal and disposal sites) are ineligible.

“specified percentage”

The definition of “specified percentage” sets out the rates for determining the clean technology investment tax credit.

Under paragraph (a), the rate is nil for property that is acquired before March 28, 2023. Paragraph (a) applies without reference to subsection 127.45(4), which otherwise deems property not to have been acquired until it is available for use. Accordingly, property that is acquired before March 28, 2023, but becomes available for use on or after that day, is ineligible for the clean technology investment tax credit.

Under paragraph (b), the rate for property acquired on or after March 28, 2023 and before 2034 is 30 per cent.

Under paragraph (c), the rate for property acquired in 2034 is 15 per cent. Subsection 127.45(4) would deem property that was acquired in 2033 or earlier, but available for use in 2034, to be acquired in 2034 so that it would be subject to the 15 per cent rate.

Under paragraph (d), the rate for property acquired after 2034 is nil. Subsection 127.45(4) would deem property that was acquired in 2034 or earlier, but available for use in 2035, to be acquired in 2035 so that it would be subject to the nil rate.

For property that is prepared or installed on or after October 1, 2023, the above-noted rates would be reduced by ten percentage points unless the claimant elects to meet the labour requirements set out in new section 127.46. See the commentary on that section for more information.

Refundable Clean Technology Investment Tax Credit

ITA
127.45(2)

Subsection 127.45(2) deems the amount of the clean technology investment tax credit to have been paid on account of tax payable by a qualifying taxpayer for the year, where the taxpayer has filed with its return of income for the year a prescribed form containing prescribed information. The deemed payment will result in a reduction of the taxpayer’s tax payable for the year, if any, and a refund to the extent the clean technology investment tax credit exceeds its tax payable for the year.

Time limit for application

ITA
127.45(3)

Subsection 127.45(3) places a time limit on filing the form necessary to be eligible for the clean technology investment tax credit. The prescribed form claiming the clean technology investment tax credit must be filed on or before the day that is one year after the taxpayer's filing-due date for the year. A consequential change to subsection 220(2.2) removes the Minister's discretion to waive this requirement.

Time of acquisition

ITA
127.45(4)

Subsection 127.45(4) deems clean technology property not to have been acquired until it has become available for use by a taxpayer. Accordingly, the clean technology investment tax credit cannot be claimed before the year the property is available for use, even if expenditures to acquire the property occur in an earlier year. This could also impact the credit rate during the phase-out period. See commentary to the definition of "specified percentage" in subsection 127.45(1) for more information.

Special rules – adjustments

ITA
127.45(5)

Subsection (5) sets out a number of restrictions on clean technology investment tax credit claims.

Under paragraph (a), the clean technology investment tax credit is not available for any property for which a clean technology investment tax credit was previously claimed by any person, or for which a carbon capture, utilization and storage credit was deducted. In addition, amounts added to the cost of property by virtue of section 21 may not form part of the capital cost of a clean technology property for clean technology investment tax credit purposes.

Under paragraph (b), the capital cost of clean technology property is reduced by amounts of "government assistance" and "non-government assistance" (as those terms are defined in subsection 127(9)) in respect of the property. Amounts that are repaid or are no longer expected to be received may be eligible for the clean technology investment tax credit under subsection (7).

Under paragraph (c), adjustments in subsections 127(11.6) to 127(11.8) apply to the cost of property transferred between non-arm's length parties for investment tax credit purposes. Those rules are imported for the purpose of the clean technology investment tax credit, subject to certain necessary adjustments.

Deemed deduction

ITA
127.45(6)

Subsection 127.45(6) ensures that any amount deemed to have been paid on account of tax payable under subsection 127.45(2) is also deemed to have been deducted from the taxpayer's tax otherwise payable under Part I. This deeming rule applies for the purpose of various provisions of the Act. It causes these rules to operate in the same manner whether the clean technology investment tax credit is received as a refund or is actually deducted against tax otherwise payable.

Repayment of assistance

ITA
127.45(7)

The capital cost of clean technology property may be reduced under paragraph 127.45(5)(b) by the amount of "government assistance" and "non-government assistance" that is received, is receivable or is reasonably expected to be received, in respect of the property. If such assistance is subsequently repaid or can no longer reasonably be expected to be received, those amounts may once again be eligible for the clean technology investment tax credit because of subsection 127.45(7).

Partnerships

ITA
127.45(8) and (9)

The clean technology investment tax credit rules are generally intended to apply to partnerships and their partners that are taxable Canadian corporations in the same manner as the investment tax credits under section 127. Subsection 127.45(8) applies if a taxpayer in a particular taxation year is a member of a partnership, and a clean technology investment tax credit would be determined in respect of the partnership if it were a taxable Canadian corporation. Subsection 127.45(8) provides a rule similar to subsection 127(8) that effectively flows the portion of a clean technology investment tax credit that can reasonably be considered as a member's share of the credit to the member. Where the amount of the credit allocated to a particular member of the partnership is not reasonable in the circumstances, new subsection 103(3) would apply to change the allocation.

Subsection (9) provides that subsections 127(8.1) to (8.5) are applicable, with such modifications as the circumstances require, to determine the portion of the clean technology investment tax credit that is the partner's share of the clean technology investment tax credit for the particular taxation year. Subsections 127(8.1) to (8.5) restrict the amount of investment tax credits that may be allocated by a partnership to limited partners. See the commentary to those existing provisions of section 127 for more information.

Unpaid amounts

ITA
127.45(10)

Subsection 127.45(10) ensures that if any part of the capital cost of a taxpayer’s clean technology property is unpaid on the day that is 180 days after the end of the taxation year of a taxpayer in which the clean technology property was acquired, that part of the cost is added to the capital cost of the clean technology property at the time it is paid for the purpose of the section 127.45.

Tax shelter investment

ITA
127.45(11)

Subsection 127.45(11) provides that the clean technology investment tax credit is unavailable if a clean technology property (or an interest in a person or partnership with a direct or indirect interest in such property) is a tax shelter investment under section 143.2.

Recapture – conditions for application

ITA
127.45(12)

Subsection 127.45(12) sets out three conditions for when recapture of all or part of the clean technology investment tax credit applies.

Paragraph (a) requires that the taxpayer have acquired a clean technology property in the particular year or in any of the preceding 20 calendar years. This means that the recapture rules could apply based on actions that occur during the twenty calendar years after a property is acquired.

Paragraph (b) requires that the taxpayer became entitled to a clean technology investment tax credit in respect of all or a portion of the capital cost of that property.

Paragraph (c) requires that the property be converted to a non-clean technology use, be exported from Canada or be disposed of. Paragraph (c) does not apply if the property was previously converted to a non-clean technology use or exported from Canada, which ensures that recapture is not triggered twice for the same property. In cases where the property has been disposed of without having previously been converted to a non-clean technology use or exported from Canada, recapture may be deferred in some cases by virtue of subsections 127.45(15) and (16).

Recapture of credit

ITA
127.45(13)

Where recapture applies in respect of a clean technology property, it is effectively calculated based on the proportion of the value of the property that has been utilized by the taxpayer prior to its conversion to a non-clean technology use, its export or its disposition. For example, if a clean technology property is sold to an arm’s length party for 80% of the of the original capital cost of the property to the taxpayer, 80% of the clean technology investment tax credit associated with that property will be recaptured. Similarly, if a clean technology property is converted to a non-clean technology use at a time when its fair market value is 50% of its original capital cost, 50% of the clean technology investment tax credit associated with that property will be recaptured. Recapture of the clean technology investment tax credit will in no case exceed the clean technology investment tax credit associated with the particular property.

Where a clean technology property is disposed of to a person that deals at arm’s length with the taxpayer, variable B of the formula in subsection 127.45(13) will be the proceeds of disposition of the particular property. In the other cases (being the disposition to a non-arm’s length party, conversion to a non-clean technology use or export), variable B of the formula in subsection 127.45(13) will be the fair market value of the particular property.

There is an exception to the recapture rules if the property is disposed of to certain related persons, in which case recapture may be deferred pursuant to subsections 127.45(15) and (16).

Recapture of credit – partnerships

ITA
127.45(14)

Recapture of the clean technology investment tax credit received through a partnership is to be determined in a similar manner to the recapture rules for SR&ED investment tax credits. Subsection 127.45(14) makes reference to subsections 127(28) to (31) in this regard, with such modifications as the circumstances require. See the commentary to those provisions of section 127 for more information.

Certain non-arm’s length transfers - recapture deferred

ITA
127.45(15) and (16)

Subsection 127.45(15) sets out the conditions for the deferral of recapture under subsection 127.45(16).

Under subsection 127.45(15), recapture of the clean technology investment tax credit will be deferred where clean technology property is disposed of to a related party that is itself a qualifying taxpayer in circumstances where the property would be clean technology property to the purchaser (but for the requirement that the property not have been previously used under paragraph (b) of the definition of clean technology property). This relieving provision is intended to facilitate bona fide transfers of clean technology property within corporate groups. It is similar to subsection 127(33), which provides for deferral of the recapture of certain other investment tax credits where property is transferred to a non-arm’s length party.

Subsection 127.45(16) provides for the deferred recapture. It generally causes the transferee to be treated as if it had claimed credits of the transferor in respect of the property, making it so that the transferee is subject to recapture if it changes the use of the property to a non-clean technology use or disposes of or exports the property. It makes reference to subsections 127(34) and (35), with such modifications as the circumstances require, including certain specific modifications. See the commentary to those provisions of section 127 for more information.

Clean technology investment tax credit – purpose

ITA
127.45(17)

Subsection (17) is an interpretative provision that describes the intended purpose of the clean technology investment tax credit: to encourage the investment of capital in the adoption and operation of clean technology property in Canada.

This amendment comes into force on March 28, 2023.

Clause 3

Definitions

ITA
248(1)

The following definitions, which have the meaning assigned by subsection 1104(13) of the Regulations, are added to subsection 248(1) of the Act:

- distribution equipment,
- fossil fuel, and
- transmission equipment.

These definitions support the introduction of the clean technology investment tax credit in new section 127.45.

This amendment comes into force on March 28, 2023.

Consequential amendments related to the CCUS and Clean Technology Investment Tax Credits

Clause 1

Investment tax credit

ITA

12(1)(t)

Section 12 provides for the inclusion of various amounts in computing the income of a taxpayer for a taxation year from a business or property.

The amount deducted from tax in respect of an investment tax credit reduces the tax basis of the related expenditure — that is, the undepreciated capital cost of depreciable property, the adjusted cost base of certain interests in a partnership or a trust, the amount of deductible scientific research expenditures, or the amount of qualified Canadian exploration expenditures. To the extent that such reductions in tax basis do not take place, paragraph 12(1)(t) requires the amount of any credit claimed to be included in the taxpayer’s income. Because a claim of a tax credit can produce such an income inclusion thereby affecting tax otherwise payable and the amount of investment tax credit which may be claimed in a year, the calculations can very often become circular. Accordingly, an income inclusion under paragraph 12(1)(t) is only required in a taxation year following the year in which the related investment tax credit is claimed.

Paragraph 12(1)(t) is amended to reflect the introduction of the new CCUS tax credit and the clean technology investment tax credit, by adding references to new sections 127.44 and 127.45, under which the new credits are provided.

This amendment applies to taxation years ending after 2021.

Clause 2

Deemed capital cost of certain property

ITA
13(7.1)

Section 13 provides a number of special rules related to the treatment of depreciable property. Generally, these rules apply for the purposes of sections 13 and 20 and the capital cost allowance (CCA) regulations.

Subsection 13(7.1) provides for reductions in the capital cost of a depreciable property equal to the amounts of deducted investment tax credits and certain other government assistance in respect of the property.

Subsection (7.1) is amended by adding two references to new sections 127.44 and 127.45, in the preamble and in paragraph (e). These amendments are consequential to the introduction of the new CCUS tax credit and the clean technology investment tax credit under sections 127.44 and 127.45. They will result in a reduction in the capital cost of depreciable property where the CCUS tax credit is claimed, except where new subparagraph 127.44(8)(a)(i) applies, and where the clean technology investment tax credit is claimed.

These amendments apply to taxation years ending after 2021.

Capital expenditures – Classes 59 and 60

ITA
13(7.6)

New subsection 13(7.6) deems a capital expenditure to have resulted in the acquisition of Class 59 or 60 property (as the case may be) of the taxpayer under certain circumstances.

In particular, if an expenditure would have been included in the cost of a Class 59 or 60 property, except that no property was actually acquired, the amount of the expenditure can still be added to the cost of a notional property.

So, for example, the cost of an environmental study to determine the quality of a geological formation which in the end resulted in no asset being acquired, but which is nevertheless viewed as having been capital in nature, is included in the undepreciated capital cost of a Class 59 property under this rule. Such costs would otherwise have been included in Class 14.1.

This amendment applies to expenses or costs incurred or property acquired after 2021.

Definitions

ITA
13(21)

"undepreciated capital cost"

Element I of the definition of "undepreciated capital cost" (UCC) reduces the UCC of the depreciable property of a class by the amount of any investment tax credit claimed in respect of a property which was in the class in the year where that credit was claimed subsequent to the disposition of the property. Because an investment tax credit claim reduces the balance of the class and may cause it to become negative, thereby giving rise to an income inclusion for a year which, in turn, may affect the amount of the credit which can be claimed, this calculation can become circular where the credit reduces UCC in the same year as that in which the credit is claimed. Accordingly, a reduction of the UCC of the class is required only for taxation years following the year in which a related credit is claimed.

Element I of the definition is amended, by adding references to new subsections 127.44(3) and 127.45(6), consequential to the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment applies to taxation years ending after 2021.

Loss restriction event

ITA
13(24)(a)

Subsection 13(24) is a special rule that applies where a corporation or partnership of which a corporation is a majority interest partner has acquired a depreciable property within the 12-month period ending immediately before a change of control of the corporation and the property was not used, or acquired for use, in a business carried on before that period. Under this rule, the capital cost of property acquired in the 12-month period is not included in computing undepreciated capital cost until after the change of control. Also, for the purposes of the investment tax credit and refundable investment tax credit rules in sections 127 and 127.1, the property will be considered not to have been acquired until after the change of control.

Where the property was disposed of and not reacquired before the change of control, the property is treated for capital cost allowance purposes as having been acquired immediately before the disposition. The purpose of this special rule is to prevent the transfer of depreciable property in contemplation of a change of control in order to reduce taxable income where the person acquiring control would not themselves be in a position to use the capital cost allowance or investment tax credit on the property.

Paragraph 13(24)(a) is amended to add references to new sections 127.44 and 127.45, consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment applies to taxation years ending after 2021.

Clause 3

Adjustment to cost base

ITA
53(1)(e)(xiii)

Subparagraph 53(1)(e)(xiii) provides additions to the adjusted cost base of a taxpayer’s partnership interest where investment tax credits have been recaptured (added to the taxpayer’s tax otherwise payable) as required by subsection 127(30). Where an investment tax credit is recaptured, the adjusted cost base of a partnership interest is increased to reflect the amount recaptured.

Subparagraph 53(1)(e)(xiii) is amended to add a reference to new sections 127.44 and 127.45, consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Amounts to be deducted

ITA
53(2)(c)

Paragraph 53(2)(c) provides for certain amounts that must be deducted in computing the adjusted cost base to a taxpayer of a partnership interest. New subparagraph 53(2)(c)(vi.1) is added to the paragraph to require that a deduction be made for that part of a CCUS tax credit claimed by a taxpayer pursuant to subsection 127.44(2) which can reasonably be attributed to the taxpayer’s share of a partnership’s CCUS tax credit. New subparagraph 53(2)(c)(vi.2) is added to the paragraph to require that a deduction be made for that part of a clean technology investment tax credit claimed by a taxpayer pursuant to subsection 127.45(2) which can reasonably be attributed to the taxpayer’s share of a partnership’s clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Clause 4

Continuation of corporation

ITA
87(2)(qq.1)

Paragraph 87(2)(qq) treats the corporation formed on an amalgamation as the same corporation as, and a continuation of, each of its predecessors, for the purposes of computing the new corporation’s investment tax credits.

New paragraph 87(2)(qq.1) is added to provide the same treatment for the purposes of new sections 127.44, 127.45, and Part XII.7, consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Clause 5

Winding-up

ITA
88(1)(e.31)

Subsection 88(1)(e.3) allows the flow-through of existing investment tax credits to a parent corporation on a wind-up of the subsidiary. However, a parent corporation may also be subject to recapture or recovery of the new CCUS tax credit and clean technology investment tax credit.

New paragraph 88(1)(e.31) is added to ensure this result for the purposes of new sections 127.44, 127.45, and Part XII.7, consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Clause 6

Limited partnership losses

ITA
96(2.1)(b)(ii)

Subsection 96(2.1) deals with the losses of limited partnerships. This subsection generally limits the deduction by a limited partner of losses to the extent of the limited partner's "at-risk amount" in respect of a partnership at the end of the fiscal period of the partnership ending in that year.

Subparagraph 96(2.1)(b)(ii) further limits the deduction of limited partner losses, beyond the "at-risk amount" limitation, by the amount of investment tax credits required to be added by subsection 127(8).

Subparagraph 96(2.1)(b)(ii) is amended to also reduce limited partnership losses by the amount required to be added by new subsections 127.44(10) and 127.45(8), in respect of the new CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

At-risk amount

ITA
96(2.2)

Subsection 96(2.2) defines the "at-risk amount" of a limited partner for the purposes of determining deductible losses and tax credits allocated to the partner.

Subsection 96(2.2) is amended to add references to new sections 127.44 and 127.45, consequential to the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Limited partner

ITA
96(2.4)

Subsection 96(2.4) provides an extended definition of "limited partner" for the purpose of applying the limited partnership at-risk rules in subsection 96(2.2).

Subsection 96(2.4) is amended to add references to new sections 127.44 and 127.45, consequential to the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment comes into force on January 1, 2022.

Clause 7

Agreement to share tax credits in unreasonable proportions

ITA
103(3)

Section 103 ensures the reasonable allocation of income, losses, and other amounts between partners.

New subsection 103(3) is added to ensure the reasonable allocation of the new CCUS tax credit and the clean technology investment tax credit among partners, with reference to new subsections 127.44(1) and 127.45(1). Relevant factors in the determination of reasonable allocation are the capital invested and work performed by members of the partnership, notwithstanding any agreement.

This amendment comes into force on January 1, 2022.

Clause 8

Limited partnership losses

ITA
111(1)(e)(ii)(A)

Paragraph 111(1)(e) contains rules for carryforwards of limited partnership losses. In general, limited partnership losses may not exceed a limited partner's at-risk amount, and amounts required by subsection 127(8) (investment tax credits of a partnership) to be included in computing the investment tax credit of the taxpayer for the taxation year.

Clause 111(1)(e)(ii)(A) is amended to add references to new subsections 127.44(10) and 127.45(8), consequential to the introduction of the CCUS tax credit and the clean technology investment tax credit. The effect of this amendment is to reduce losses available to a limited partner by the limited partner's share of a CCUS tax credit or clean technology investment tax credit.

This amendment applies on or after January 1, 2022.

Clause 9

Assessment

ITA

152(1)(b)

Section 152 contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer. Subsection 152(1) lists certain refunds and deemed payments on account of tax that are to be determined in the course of assessment of tax.

Consequential on the introduction of new refundable CCUS tax credit under section 127.44 of the Act and the clean technology investment tax credit under section 127.45 of the Act, paragraph 152(1)(b) is amended to add references to new subsections 127.44(2) and 127.45(2). Subsection 127.44(2) deems an amount equal to the refundable CCUS tax credit to have been paid on account of tax payable by a qualifying taxpayer.

Subsection 127.45(2) deems an amount equal to the clean technology investment tax credit to have been paid on account of tax payable by a qualifying taxpayer.

Clause 10

Reduced instalments

ITA
157(3)(e)

Section 157 requires a corporation to pay instalments of its total tax payable under Parts I, VI, VI.1 and XIII.1 of the Act. Paragraph 157(3)(e) allows a corporation to reduce its monthly installments by certain refundable amounts under the Act.

Paragraph 157(3)(e) is amended to add references to new subsections 127.44(2) and 127.45(2), consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment applies on or after January 1, 2022.

Amount of payment — three-month period

ITA
157(3.1)(c)

Subsection 157(1.1) allows small Canadian-controlled private corporations that meet certain conditions to pay their annual tax liability by quarterly instalments instead of monthly.

Subsection 157(3.1) allows these corporations to reduce each quarterly instalment by 1/4 of the amount of certain tax refunds. Paragraphs 157(3.1)(b) and (c) list these tax refunds.

Paragraph 157(3.1)(c) is amended to add references to new subsections 127.44(2) and 127.45(2), consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

This amendment applies on or after January 1, 2022.

Clause 11

Exception

ITA
220(2.2)

Subsection 220(2.2) provides that the Minister's discretion to waive a requirement to file a prescribed form, receipt or other document, or to provide prescribed information, does not extend to such items filed on or after the day specified for the purposes of subsection 37(11) or paragraph (m) of the definition of "investment tax credit" in subsection 127(9).

Subsection 220(2.2) is amended to extend the restriction on Ministerial discretion to waive filing requirements by adding references to new subsections 127.44(17) and 127.45(3), consequential on the introduction of the CCUS tax credit and the clean technology investment tax credit.

New subsection 127.44(17) contains essentially the same one-year extension time limit as in subsection 220(2.2) and is included for convenience.

Labour Requirements Related to Certain Investment Tax Credits

Clause 1

ITA
127.46

New section 127.46 introduces labour requirements that are proposed to apply in relation to the new investment tax credits for carbon capture utilization and storage (CCUS), clean technology as well as clean hydrogen and clean electricity, as announced in Budget 2023. The package of legislative proposals that accompanies these notes includes CCUS and clean technology investment tax credit rules but not rules for clean hydrogen or clean electricity credits. The labour requirements apply for taxpayers that claim the higher rate for these investment tax credits. Taxpayers that do not elect to meet the labour requirements can claim investment tax credits at a rate reduced by ten percentage points.

There are two main aspects to the labour requirements: the prevailing wage requirements and the apprenticeship requirements. In general terms, among other conditions,

- the prevailing wage requirements (subsection 127.46(3)) are met by paying "covered workers" either in accordance with the terms of an "eligible collective agreement" or at a level at least equivalent to the value of compensation (including benefits) provided to similar workers under such an agreement; and

- the apprenticeship requirements (subsection (5)) are met by ensuring that at least 10% of the labour performed by workers in the Red Seal trades is performed by registered apprentices.

The basic structure of section 127.46 is as follows:

1. Subsection 127.46(1) contains the relevant definitions.
2. Subsection 127.46(2) requires a labour requirements election to be made to by a taxpayer that claims certain tax credits at the "regular tax credit rate" (as defined in subsection 127.46(1).
3. Subsection 127.46(3) sets out the prevailing wage requirements and subsection 127.46(4) provides a related indexation rule.
4. Subsection 127.46(5) sets out the apprenticeship requirements.
5. Subsections 127.46(6) to (9) specify consequences for failing to meet the labour requirements. Subsection (10) provides an exception where subsection (9) does not apply. Subsections (11) and (12) set out the corrective measures (top-up payments to covered workers) that apply, in addition to the tax under subsection 127.46(6), for circumstances where some covered workers are not paid at the prevailing wage within the time specified (unless subsection (9) applies). Subsection (14) specifies the tax treatment of top-up payments.
6. Subsection (15) provides an exception where section 127.46 does not apply.

The new rules apply in respect of specified property (as defined in subsection 127.46(1)) prepared or installed after September 30, 2023. More detail regarding these requirements is set out below.

ITA
127.46(1)

New subsection 127.46(1) provides definitions that apply for the purposes of the section itself as well as the portions of the ITA that are relevant to the new investment tax credits.

“apprenticeship requirements”

This term creates a cross-reference to new subsection (5), which contains the requirements.

“benefits”

This term is defined to mean vacation, pension, health and welfare benefits required to be provided by employers to or for employees under an eligible collective agreement.

“covered worker”

The labour requirements apply in relation to “covered workers”. Covered workers are those workers who are engaged in the preparation or installation of specified property at a “designated work site” and whose work is primarily manual or physical in nature. The term includes workers who are employees of an “incentive claimant” (a taxpayer claiming an investment tax credit) as well as employees of any other person or partnership (contractors or subcontractors) who are engaged in the preparation or installation of the investment tax credit property.

Paragraph (c) of the definition specifically excludes workers who are administrative, clerical or executive employees, or who are business visitors to Canada under section 187 of the *Immigration and Refugees Protection Regulations*.

“designated work site”

A designated work site is a site where “specified property” of an incentive claimant is located.

“eligible collective agreement”

An eligible collective agreement for Quebec means a collective agreement negotiated in accordance with applicable provincial law. For other provinces and territories, it means either

- the most recent multi-employer collective bargaining agreement that may reasonably be considered the industry standard for a given trade, in a region, province or territory between a group of employers and a trade union, who are accredited to bargain together and to be bound by the same agreement, or
- a project labour agreement that covers the work associated with the investments eligible for the specified tax credits and that is based on the multi-employer agreements described above.

“incentive claimant”

This term means a person, or a partnership at least one member of which, plans to claim or has claimed a specified tax credit for a taxation year.

“installation taxation year”

This term generally means a taxation year during which preparation or installation of specified property takes place. It is relevant because labour that is undertaken in a different year from the year in which the related tax credit is claimed must still meet the labour requirements. This situation could occur in multi-year projects (where the labour may occur in a taxation year before the credit is claimed), or in situations where the CCUS tax credit is available in an earlier year because the available for use rules do not apply to it (i.e., the credit may be claimed in a taxation year before the labour occurs).

There may be multiple installation taxation years in respect of the same credit, and the labour requirements would need to be met in respect of all those years.

“prevailing wage requirements”

This term creates a cross-reference to new subsection (5), which contains the requirements.

“Red Seal trade”

This term has essentially its ordinary meaning of a Red Seal trade for a province or territory under the Red Seal Program.

“Red Seal worker”

This term means a covered worker whose duties are, or are equivalent to, those duties normally performed by workers in a Red Seal trade.

“reduced tax credit rate”

This term means the regular tax credit rate minus ten percentage points.

“regular tax credit rate”

This term means the “specified percentage” as defined in subsections 127.44(1) and 127.45(1), as the case may be, and is the tax credit rate available for taxpayers who meet the labour requirements.

“specified property”

This term means property all or a portion of the cost of which qualifies for a specified tax credit. The labour requirements relate to the preparation or installation of specified property.

“specified tax credit”

Under these legislative proposals, this term means a CCUS tax credit under section 127.44 or a clean technology investment tax credit under section 127.45.

ITA
127.46(2)

New subsection 127.46(2) specifies that, in order qualify for the “regular tax credit rate”, an incentive claimant must elect in prescribed form and manner to meet the labour requirements. An incentive claimant that does not elect under subsection (2) is limited to claiming the CCUS tax credit and clean technology investment tax credit at the “reduced tax credit rate”, which is ten percentage points less than the rate that would otherwise be available in respect of those credits under section 127.44 or 127.45, as applicable.

Where an incentive claimant elects to meet the labour requirements but fails to do so, the incentive claimant generally maintains its entitlement to the credit at the regular tax credit rate but will be required to take corrective measures or pay related penalties. An incentive claimant loses its entitlement to a credit at the regular tax credit rate if it fails to meet the labour requirements knowingly or in circumstances amounting to gross negligence. Subsections

127.46(6) and (7) specify the ordinary consequences of failing to meet the prevailing wage and apprenticeship requirements, respectively, in the absence of intentional conduct or gross negligence. Subsection (9) sets out the consequences of intentional conduct or gross negligence.

ITA
127.46(3)

New subsection 127.46(3) sets out the prevailing wage requirements. There are three elements to the prevailing wage requirements.

First, the required level of compensation for covered workers at the designated work site, in respect of their work on the preparation or installation of specified property, is described in paragraph 127.46(3)(a). The compensation must either be paid in accordance with an eligible collective agreement, or in an amount at least equal to the amount of wages and benefits specified in the eligible agreement that most closely aligns to the worker’s experience level, tasks and location.

The second requirement in paragraph 127.46(3)(b) is that the incentive claimant must attest in prescribed form and manner that it has met the prevailing wage requirements for its own employees at the designated work site. It must also attest that it has taken reasonable steps to ensure that covered workers employed by others at the designated work site are so compensated.

The final requirement stipulates the means of informing covered workers about the prevailing wage requirements in place at the designated work site. This should help ensure that covered workers, including workers who are not employed directly by the incentive claimant, are aware that they should expect to be paid prevailing wages.

ITA
127.46(4)

New subsection 127.46(4) requires that prevailing wages be indexed for inflation in cases where the relevant eligible collective agreement has expired. For this purpose, the average Consumer Price Index should be applied as set out in section 117.1 (the rule that applies for indexation of the personal income tax brackets) for each calendar year that begins after the expiration of the eligible collective agreement.

ITA
127.46(5)

New subsection 127.46(5) sets out the apprenticeship requirements. There are two basic elements to the apprenticeship requirements. The first, in paragraph (a), is that incentive claimants must make reasonable efforts to ensure that apprentices registered in a Red Seal trade work at least 10% of the total hours that are worked during an installation taxation year by Red Seal workers at a designated work site of the incentive claimant on the preparation or installation of specified property. However, this requirement is subject to paragraph (b) which overrides paragraph (a) if the basic requirement cannot be met because of conflicting requirements of an applicable labour law or collective agreement. In that case, the incentive claimant must make reasonable efforts to come as close as possible to meeting the paragraph (a) requirement, without breaking the other applicable rules.

The second requirement is that the incentive claimant attest in prescribed form and manner that it has met the apprenticeship requirements in respect of covered workers at the designated work site.

ITA
127.46(6)

If an incentive claimant has claimed the regular rate tax credit rate but has failed to meet the prevailing wage requirements, then the incentive claimant is liable to pay a special tax equal to $20 per day for each covered worker paid at less than the prevailing wage. This tax applies except in situations of intentional conduct or gross negligence, in which case the consequences in subsection (9) apply.

ITA
127.46(7)

In general terms, if an incentive claimant has claimed the regular rate tax credit rate but has not achieved the 10% apprenticeship labour hours requirement in subsection 127.46(5), subject to the modification of that 10% rule in paragraph 127.46(5)(b)), then the incentive claimant is liable to pay a special tax equal to $100 multiplied by the difference between the number of hours that were required to have been performed by apprentices and the number of hours of labour that were actually performed by apprentices. This tax does not apply in situations of intentional conduct or gross negligence, in which case the consequences in subsection (9) apply.

ITA
127.46(8)

New subsection 127.46(8) provides an indexation rule for the dollar amounts in subsections (6) and (7), similar to the rule in new subsection 127.46(4) that applies in relation to expired eligible collective agreements.

ITA
127.46(9)

Subsection 127.46(9) applies in circumstances of intentional conduct or gross negligence in relation to the labour requirements. In these circumstances, there are two consequences. First, the incentive claimant is disentitled to the regular tax credit rate that was claimed, and is entitled only to the reduced tax credit rate. Second, the incentive claimant must pay a penalty equal to 50% of the difference between the amount of the specified tax credit that the incentive claimant claimed, and the amount that the incentive claimant would have been entitled to claim at the reduced rate credit rate. The gross negligence penalty applies across taxation years so that, if the preparation and installation labour in relation to property that qualified for an investment tax credit occurs in a different year from the year for which the credit is claimed, the tax credit rate is reduced in the year for which the credit is claimed.

ITA
127.46(10)

Subsection (10) specifies that new subsection (9) does not apply in respect of CCUS refurbishment tax credits (those credits are described in new subsection 127.44(5)).

ITA
127.46(11) to (13)

Unless subsection (9) applies, in cases where the CRA determines that an incentive claimant did not meet the prevailing wage requirements for a designated work site for a taxation year, the incentive claimant may cause each covered worker to be paid the “top-up” amount determined under new subsection (12). In general terms, the “top-up” amount is the difference between the prevailing wages that were required to have been paid to the covered worker for a taxation year and the amount that the covered worker was actually paid for the year.

The incentive claimant is liable to a penalty under subsection (13) for each covered worker that is not paid the top-up amount. The penalty is payable to the Receiver General and is equal to 120% of the top-up amount determined by the formula in subsection (12), in respect of each worker that was not paid the top-up amount.

ITA
127.46(14)

Subsection 127.46(14) specifies the tax treatment of top-up amounts paid to covered workers under subsection (11). In particular, such a payment is deemed to be salary and wages of the worker for the year in which it is received. For the payor, the amount of the payment is deductible for income tax purposes in the year it is paid, but it does not qualify for any specified tax credit.

ITA
127.46(15)

Subsection (15) specifies that the labour requirements do not apply to a specified tax credit claimed for the acquisition of off-road zero emission vehicles or to the acquisition and installation of low carbon heat equipment.

Zero-Emission Technology Manufacturers

Clause 1

Zero-emission technology manufacturing

ITA
125.2(2)

Subsection 125.2(2) of the Act provides the formula for determining the amount of a corporation’s zero-emission technology manufacturing deduction, which provides a tax rate reduction applicable to zero-emission technology manufacturing profits (as defined in subsection 125.2(1) of the Act) for taxation years that begin after 2021 and before 2032.

Subsection 125.2(2) is amended to extend the availability of the tax rate reduction so that it is applicable to zero-emission technology manufacturing profits for taxation years that begin after 2021 and before 2035.

Specifically, variables A and C are modified such that the full tax rate reduction applies for taxation years that begin after 2021 and before 2032. The amount of the rate reduction is gradually phased-out for taxation years that begin after 2031.

Clause 2

Definitions

ITR
5202

“qualified zero-emission technology manufacturing activities”

The definition “qualified zero-emission technology manufacturing activities” in section 5202 of the Regulations describes the activities that may qualify for the zero-emission technology manufacturing deduction. A qualified zero-emission technology manufacturing activity must be a qualified activity performed in connection with the manufacturing or processing of certain property described in clauses (a)(i)(A) to (K) (subject to the restriction in subparagraph (a)(ii)). Alternatively, the activity could be performed in connection with the production of certain gases or fuels described in subparagraphs (b)(i) to (iv), or it could consist of the conversion of a vehicle described in paragraph (c).

Subparagraph (a)(i) is amended to expand the list of eligible property the manufacturing or processing of which may constitute a qualified zero-emission technology manufacturing activity to include the following:

- nuclear energy equipment (clause (L)),
- heavy water (clause (M)),
- nuclear fuels (clause (N)), and
- nuclear fuel rods (clause (O)).

Consequential on the amendment to subparagraph (a)(i), clause (a)(i)(I) is amended to ensure manufacturing (or processing) of equipment that is a component of property included in new clauses (L) to (O) may be a qualified zero-emission technology manufacturing activity.

These amendments apply for taxation years that begin after 2023.

Flow-Through Shares and Critical Mineral Exploration Tax Credit – Lithium from Brines

Clause 1

Definitions

ITA
66(15)

“principal-business corporation”

Subsection 66(15) of the Act defines various terms that apply for the purposes of section 66, which includes rules applicable to the issuance of flow-through shares.

A “principal-business corporation” is defined in subsection 66(15) as a corporation whose principal business is any of, or a combination of, several activities specified in the definition.

Consequential to the expansion of eligibility for corporations involved in the exploration and development of lithium to issue flow-through shares and renounce certain Canadian exploration expenses and Canadian development expenses to investors, paragraphs (f.1) and (g) of the “principal-business corporation” definition are amended to add:

- the production and marketing of lithium to paragraph (f.1), and
- the manufacturing of products where the processing of lithium is involved to paragraph (g).

This amendment is deemed to have come into force on March 28, 2023.

Lithium brine well deemed mine

ITA
66(21)

Consequential to the expansion of eligibility for corporations involved in the exploration and development of lithium to issue flow-through shares and renounce certain Canadian exploration expenses (CEE) and Canadian development expenses (CDE), new subsection 66(21) is introduced as an interpretive rule that deems wells for the extraction of material from lithium brine deposits to be a mine for the purposes of paragraph (f) of the CEE definition in subsection 66.1(6) and paragraphs (c.2) and (d) of the CDE definition in subsection 66.2(5).

Paragraph 66(21)(a) provides that, for the purposes listed above, a mine includes a well for the extraction of materials from lithium brine deposits.

Paragraph (b) deems all lithium brine wells of a taxpayer to be one mine if the material extracted from each well is sent to the same processing facility.

Paragraph (c) deems all lithium brine wells of a taxpayer to be one mine if the Minister of National Revenue, in consultation with the Minister of Natural Resources, determines that the wells constitute one project. This paragraph allows for an evaluation of the mine based on different geological circumstances, especially where separate wells could be connected to multiple processing facilities.

New subsection 66(21) seeks to ensure that projects for the exploration and development of lithium from brines are treated similarly to traditional mines in a mineral resource (other than bituminous sands or oil shale deposits).

This amendment is deemed to have come into force on March 28, 2023.

Clause 2

Definitions

ITA
66.2(5)

"Canadian development expense"

Subsection 66.2(5) contains the definitions "accelerated Canadian development expense", "Canadian development expense" (CDE), and "cumulative Canadian development expense".

Consequential to the addition of lithium deposits (which includes lithium brine deposits) to the "mineral resource" definition in subsection 248(1), paragraph (c.2) of the CDE definition is amended to include expenses incurred in drilling a well for the extraction of lithium from brines as an example of an expense that may qualify as CDE.

Subparagraph (iii) is added to paragraph (d) of the CDE definition to include expenses incurred in drilling or completing a lithium well after the related "mine" comes into production.

For the purposes of paragraphs (c.2) and (d), a mine includes a well or a collection of wells for the extraction of material from a lithium brine deposit under new subsection 66(21).

Thus, for example, if a new well for the extraction of lithium from brines is drilled and that new well is part of a larger collection of wells that constitute a "mine" under subsection 66(21) that has already come into production, the expenses associated with drilling that new well would qualify as CDE under new subparagraph (d)(iii).

This amendment applies to expenses incurred on or after March 28, 2023.

Clause 3

Definitions

ITA
248(1)

Subsection 248(1) defines various terms that apply for the purposes of the Act.

“mineral resource”

The definition “mineral resource” in subsection 248(1) lists several types of mineral deposits as “mineral resources” for the purposes of the Act.

In particular, “mineral resource” is relevant in determining the eligibility of a taxpayer to claim Canadian exploration expenses (CEE) (defined in subsection 66.1(6)) and Canadian development expenses (CDE) (defined in subsection 66.2(5)).

A taxpayer that is a principal-business corporation (as defined in subsection 66(15)) may also renounce qualifying CEE and CDE to investors under subsections 66(12.6) and (12.62), respectively, by entering into flow-through share agreements.

In addition to claiming the flow-through deductions, individuals (other than trusts) who invest in flow-through shares of a principal-business corporation may also be eligible to claim the Critical Mineral Exploration Tax Credit (CMETC) or the Mineral Exploration Tax Credit (METC) under subsection 127(5) in respect of certain specified CEE.

Previously, lithium was not a listed mineral resource, but a lithium deposit could be certified as a “mineral resource” by the Minister of Natural Resources under subparagraph (d)(i) if it was contained in a non-bedded deposit. However, lithium originating from brines could not be certified as it is usually found in bedded deposits.

Paragraph (d) of the “mineral resource” definition is amended by adding lithium to the list of minerals in subparagraph (ii). This allows for lithium extracted from brines (generally located in bedded deposits) to qualify as a mineral resource, and it also removes the requirement for taxpayers engaged in traditional lithium mining projects to apply to the Minister of Natural Resources for mineral resource certification.

This amendment is deemed to have come into force on March 28, 2023, and for greater certainty, does not apply in respect of expenses incurred before March 28, 2023.

Tax on Repurchases of Equity

New Part II.2 of the Act imposes a tax on the net value of equity repurchases by certain publicly listed entities (covered entities). Each covered entity must add to its tax otherwise payable for a year under Part II.2 an amount equal to 2% of the covered entity's net value of equity repurchases during the year. Although not an income tax, Part II.2 tax is included in the Act for administrative convenience given the use of the Act's existing definitions and administrative provisions to determine the amount of Part II.2 tax payable.

New sections 183.3 and 183.4 apply to transactions that occur after 2023.

Clause 1

Definitions

ITA
183.3(1)

New subsection 183.3(1) contains definitions that apply for the purposes of Part II.2.

"covered entity"

The term "covered entity" specifies the entities subject to Part II.2 tax. A covered entity for a taxation year means an entity that, at any time in the taxation year, has its issued and outstanding equity listed on a designated stock exchange (as defined in subsection 248(1)) and is a

- Canadian-resident corporation (other than a mutual fund corporation),
- real estate investment trust (as defined in subsection 122.1(1)),
- specified investment flow-through trust (SIFT trust), as defined in subsection 122.1(1) (or would be a SIFT trust if its assets were situated in Canada), or
- SIFT partnership, as defined in subsection 197(1) (or would be a SIFT partnership if its assets were situated in Canada).

"equity"

"Equity" of an entity is defined to be a share of the capital stock of a corporation, an income or capital interest in a trust, or an interest of a member of a partnership, as the case may be.

Transactions with respect to the equity of a covered entity determine the amount of Part II.2 tax payable.

"reorganization or acquisition transaction"

A "reorganization or acquisition transaction" specifies both the types of issuances of equity and the types of redemptions, acquisitions or cancellations of equity by a covered entity that are excluded from the "netting rule" calculation in subsection 183.3(2). That calculation determines the amount of Part II.2 tax payable for the year.

Issuances of Equity

An issuance of equity by a covered entity is considered a reorganization or acquisition transaction and thus is excluded from variable B of the netting rule in subsection (2) (inclusion in variable B would reduce the net amount to which Part II.2 tax applies) unless

i. cash is the only consideration paid for the issuance,
ii. the issuance is made to an employee of the covered entity (or an entity related to the covered entity) in the course of the employee's employment, or
iii. the issuance is in exchange for a bond, debenture or note of the covered entity, the terms of which confer on the holder the right to make the exchange. In other words, the issuance of equity must be in the course of converting debt into equity of the issuer.

Example – Convertible debt of the issuer

A person holds a $10 million debt instrument payable by a public corporation (Pubco). Pursuant to the terms of the debt, it can be converted at the option of the holder into common shares of Pubco that have a fair market value equal to the principal amount of the note. The individual exercises the right to convert the debt to equity and disposes of the debt to Pubco for no consideration other than for issued shares of Pubco.

Since the issuance of Pubco shares is in exchange for a debt of Pubco, which provided the terms for the exchange, the issuance is not a reorganization or acquisition transaction due to the exclusion in subparagraph (a)(iii) of the reorganization or acquisition transaction definition and thus is included as an issuance of equity in variable B of subsection 183.3(2).

Redemptions, Acquisitions or Cancellations of Equity

A redemption, acquisition or cancellation of equity is considered a reorganization or acquisition transaction and thus is excluded from variable A of the netting rule in subsection (2) (inclusion in variable A would increase the net amount to which Part II.2 tax applies) by a covered entity if it occurs under subparagraphs (b)(i) to (vi) of the reorganization or acquisition transaction definition.

Subparagraph (b)(i) describes a range of reorganization transactions where there is an exchange of equity by a holder for no consideration other than equity of

(a) the covered entity,
(b) a related entity immediately before the exchange that is a covered entity immediately after the exchange, and
(c) another covered entity ("second covered entity") that controls the covered entity ("first covered entity") (or an amalgamated successor entity of the first covered entity) immediately after the exchange.

The equity issued by the covered entity, the related entity or the second covered entity cannot include any substantive debt to qualify as a reorganization or acquisition transaction.

Example – Section 86 share-for-share exchange

A public corporation (Pubco) wishes to reorganize its share capital to exchange all of its Class A shares, held by its shareholders, for new Class B shares. The shareholders of Pubco transfer, on a tax-deferred basis under section 86, their Class A shares for new Class B shares.

Clause (b)(i)(A) of the reorganization or acquisition transaction definition is met because the exchange is for no consideration other than the newly issued Class B shares. Consequently, the redemption, acquisition or cancellation of Pubco's Class A shares that occurs on the share-for-share exchange would be a reorganization or acquisition transaction that is excluded from variable A of the formula in subsection 183.3(2).

Furthermore, the issuance of Pubco's new Class B shares do not satisfy any of the exclusions in paragraph (a) of the reorganization or acquisition transaction definition and is therefore excluded from variable B of the formula in subsection 183.3(2).

Example – Section 86 spin-off

A public corporation (Pubco) wishes to divest a particular business (Target Assets) by distributing the Target Assets to its shareholders. Pubco incorporates Spinco and transfers, on a tax-deferred basis under section 85, the Target Assets to Spinco. The shareholders of Pubco exchange all of their Pubco shares, on a tax-deferred basis under section 86, for a new class of Pubco shares and all the Spinco shares owned by Pubco. Immediately after the exchange, the Spinco shares are listed on a designated stock exchange.

Subparagraph (b)(i) of the definition reorganization or acquisition transaction is met because the exchange is for no consideration other than:

> (A) the new class of Pubco shares (equity of the covered entity), and
>
> (B) the shares of Spinco, an entity that is related to Pubco immediately before the exchange that is a covered entity immediately after the exchange (and thus, the shares of Spinco satisfy the requirement of clause (b)(i)(B) of the reorganization or acquisition transaction definition).

Consequently, the redemption, acquisition or cancellation of Pubco's shares would be a reorganization or acquisition transaction that is excluded from variable A of the formula in subsection 183.3(2).

Furthermore, the issuance of Pubco's new shares do not satisfy any of the exclusions to not be considered a reorganization or acquisition transaction (in paragraph (a) of that definition) and is therefore excluded from variable B of the formula in subsection 183.3(2).

<u>Example – Triangular Amalgamation</u>

A public corporation (Acquiror) wishes to acquire a second public corporation (Target). First, Acquiror incorporates Subco. Subco and Target then amalgamate to form Amalco pursuant to a triangular amalgamation undertaken in accordance with subsection 87(9). Consequently, the shareholders of Target exchange all of their Target shares for newly issued shares of Acquiror.

Pursuant to clause (b)(i)(C) of the definition reorganization or acquisition transaction, because the only consideration for the cancellation of Target shares is equity (Acquiror shares) of another covered entity that, immediately after the exchange, controls an amalgamated successor entity of Target, the redemption, acquisition or cancellation of Target's equity that occurs on its acquisition would be excluded from variable A of the formula in subsection 183.3(2).

Subparagraph (b)(ii) describes a wind-up of the covered entity during which all or substantially all of the property owned by the covered entity is distributed to the equity holders of the covered entity.

Subparagraph (b)(iii) describes an amalgamation of the covered entity with one or more other predecessor corporations to which subsection 87(1) applies. As part of the amalgamation, there can be no consideration for the disposition of the covered entity's equity other than equity (that does not include any substantive debt) of the amalgamated corporation.

Subparagraph (b)(iv) describes a divisive reorganization to which paragraph 55(3)(a) or (b) applies.

Subparagraph (b)(v) describes a qualifying disposition (as defined in subsection 107.4(1)) that occurs when a disposition of property to a trust does not result in any change in the beneficial ownership of the property and that otherwise meets the conditions set out in that section.

Subparagraph (b)(vi) describes a qualifying exchange (as defined in subsection 132.2(1)) that occurs as part of a merger of two mutual fund trusts or a mutual fund corporation and a mutual fund trust.

"specified affiliate"

A "specified affiliate" of a covered entity is a corporation, trust or partnership that the covered entity

(a) controls, or
(b) owns, directly or indirectly, equity of the entity having a fair market value (FMV) equal to more than 50% of the FMV of the total equity of that entity.

Where a specified affiliate of a covered entity acquires equity of the covered entity, there may be a deemed acquisition of that equity by the covered entity pursuant to subsection 183.3(5). See the commentary on subsection 183.3(5) for more information.

"substantive debt"

"Substantive debt" of a covered entity is equity that possesses debt-like characteristics. As such, substantive debt may be considered, in substance, debt rather than equity for purposes of Part II.2. Substantive debt is excluded from the Part II.2 tax calculation in subsection 183.3(2). Equity must possess the following attributes to qualify as substantive debt.

Non-convertible or exchangeable

Paragraph (a) of the substantive debt definition requires that the equity cannot be convertible or exchangeable, other than for

i. other substantive debt of the covered entity,
ii. a bond, debenture or note of the covered entity where the fair market value does not exceed the fixed redemption entitlement under paragraph (d), or
iii. equity that would be issued only after the occurrence of a trigger event pursuant to a non-viability contingent capital provision to satisfy regulatory capital requirements applicable to the covered entity. Such exceptional circumstances apply to the regulation of banks and other financial institutions under the capital adequacy requirement guidelines issued by the Office of the Superintendent of Financial Institutions.

Non-voting

Paragraph (b) of the substantive debt definition requires that the equity must be non-voting.

Fixed dividend or distribution entitlement

Paragraph (c) of the substantive debt definition requires that the equity must have a periodic rate of dividend or other distribution payable on the equity, which is expressed as a percentage of an amount equal to the fair market value of the consideration for which the equity was issued if the percentage is either:

i. a fixed percentage, or
ii. a percentage determined by reference to a market interest rate plus a fixed amount (if any).

In other words, the equity must have a fixed dividend or distribution entitlement. This includes equity that has a dividend or distribution rate that fluctuates periodically based on a market interest rate plus a fixed amount (for example, floating rate preferred shares with a dividend entitlement that is determined by reference to a Government of Canada Treasury Bill yield rate plus a fixed amount), provided the dividend or distribution rate is based on the fair market value of the consideration for which the equity was issued.

Fixed redemption entitlement

Paragraph (d) of the substantive debt definition requires that the entitlement to the holder of the equity on the redemption, cancellation or acquisition of the equity cannot exceed the total of:

i. the fair market value of the consideration for which the equity was issued,
ii. any unpaid distributions or dividends on the equity, and
iii. any premium that is payable to the holder solely due to the early redemption, cancellation or acquisition of the equity.

In other words, the equity must have a fixed redemption entitlement.

Tax payable

ITA
183.3(2)

New subsection 183.3(2) provides that a person or partnership that is a covered entity for a taxation year is liable to pay an amount of tax under Part II.2. The amount of Part II.2 tax payable is determined by the formula 0.02 x (A – B) (also referred to as the "netting rule").

Variable A of the netting rule is the total fair market value (FMV) (at the time of the redemption, acquisition or cancellation) of equity that is redeemed, acquired or cancelled in the taxation year by the covered entity. Equity that has previously been deemed to be acquired under the similar transactions rule in subsection (5) and included in this variable is excluded from variable A to ensure the same equity is not included in the formula twice. In addition, pursuant to the de minimis exception in subsection 183.3(4), if the amount determined for variable A is less than $1 million, Part II.2 tax is not payable for the taxation year (regardless of any variable B amount).

Variable B of the netting rule is the total FMV (at the time of the issuance) of equity that is issued in the taxation year by the covered entity.

Issuances and redemptions, acquisitions or cancellations of equity that are substantive debt or that occur in the course of a reorganization or acquisition transaction are not included in variable A or B of the formula.

Example – Stock consolidation (reverse split)

A public corporation (Pubco) has 10 million shares outstanding with an FMV of $10 per share. Pubco undertakes a stock consolidation (reverse split). After the stock consolidation, Pubco has 5 million shares outstanding with an FMV of $20 per share.

Stock consolidations (and similarly, stock splits) are not considered to result in an issuance or a redemption, acquisition or cancellation of shares under Part II.2 and are therefore not included in either variable A or B of the "netting rule" in subsection 183.3(2).

<u>Example – The "netting rule"</u>

During the year, a public corporation (Pubco) acquires 1,000 of its shares outstanding with an FMV of $10 million and subsequently issues 100 new shares with an FMV of $1 million in consideration for cash. None of Pubco's shares acquired or issued are considered substantive debt.

Pubco's acquisition of $10 million of its shares does not satisfy any of the transactions described in paragraph (b) of the definition reorganization or acquisition transaction in subsection 183.3(1) and is therefore included in variable A of the "netting rule".

The only consideration for Pubco's issuance of shares is $1 million of cash and thus, the issuance is not a reorganization or acquisition transaction pursuant to subparagraph (a)(i) of that definition in subsection 183.3(1). The issuance of shares is included in variable B of the "netting rule".

Pubco's Part II.2 tax payable for the taxation year is $180,000 determined by the formula 0.02 x (A – B), or 0.02 x ($10 million - $1 million).

Tax payable – anti-avoidance

ITA
183.3(3)

New subsection 183.3(3) is an anti-avoidance rule. If it is reasonable to consider that the primary purpose of a transaction or series of transactions by a covered entity is to cause a decrease in the formula under subsection 183.3(2) (either by decreasing variable A or increasing variable B), the equity is deemed by new subsection 183.3(3) to be a redemption, acquisition or cancellation of equity included in variable A or an issuance of equity included in variable B of the formula (as the case may be).

***De minimis* rule**

ITA
183.3(4)

New subsection 183.3(4) provides that if the amount determined for variable A in subsection 183.3(2) for a taxation year is less than $1 million, Part II.2 tax is not payable for the covered entity's taxation year. If a covered entity's taxation year is a short year (i.e., less than 365 days), the $1 million amount is reduced to the proportion of the amount that the number of days in the short year is of 365.

Similar transactions

ITA
183.3(5)

New subsection 183.3(5) is an anti-avoidance rule that deems equity to be acquired by a covered entity if a specified affiliate (defined in new subsection 183.3(1)) of the covered entity acquires equity of the covered entity.

Example – Specified affiliate

A public corporation (Pubco) wholly owns a second corporation (Holdco). Holdco purchases $10 million of Pubco's shares on the open market. The following year, Pubco acquires its shares held by Holdco.

Since Pubco directly controls Holdco, Holdco is a "specified affiliate" based on the definition in subsection 183.3(1). Subsection 183.3(5) deems Pubco to acquire the $10 million of Pubco shares which is included in variable A of the formula in subsection 183.3(2). The following year, when Pubco acquires its shares held by Holdco, the acquisition is excluded from variable A of the formula in subsection 183.3(2) because the shares had previously been deemed to be acquired by Pubco pursuant to subsection 183.3(5) and included in variable A of the formula in subsection 183.3(2).

Exceptions to this rule are provided for registered securities dealers acquiring equity (in the capacity of an agent) and disposing of the equity within a reasonable period of time in the ordinary course of their business, trusts that are employee benefit plans, and trusts that are governed by an employees profit sharing plan or deferred profit sharing plan.

Similar transactions – anti-avoidance

ITA
183.3(6)

New subsection 183.3(6) is an anti-avoidance rule to address transactions or series of transactions entered into by a person or partnership where one of their main purposes is to acquire equity of a covered entity to avoid Part II.2 tax otherwise payable. If this subsection applies, the person or partnership is deemed to be a specified affiliate of the covered entity.

Return

ITA
183.4(1)

New subsection 183.4(1) requires a covered entity that redeems, acquires or cancels equity in a taxation year to file with the Minister of National Revenue a return for the year under Part II.2 in prescribed form. The filing deadline for a Part II.2 return is as follows:

- If the covered entity is a corporation, the return must be filed on or before the day it is required to file its return of income under Part I for the year.

- If the covered entity is a trust, the trustee of the trust must file the return within 90 days from the end of the taxation year.
- If the covered entity is a partnership, a member of the partnership that has authority to act for the partnership must file the return before the earlier of 5 months after the end of the taxation year and March 31 immediately following the calendar year in which the taxation year ended.

Payment

ITA
183.4(2)

New subsection 183.4(2) provides that a covered entity that is liable to pay tax under this Part for a taxation year shall pay to the Receiver General its tax payable under Part II.2 for the taxation year by the following date:

- if the covered entity is a corporation or trust, the tax must be paid on or before its balance-due day for the taxation year; and
- if the covered entity is a partnership, the tax must be paid on or before the day on which the partnership is required to file a return for the year under subsection 183.4(1).

Provisions applicable to Part

ITA
183.4(3)

New subsection 183.4(3) provides that certain provisions of Part I of the Act relating to assessments, payments, appeals and other procedural and administrative matters are applicable to Part II.2 with such modifications as the circumstances require.

General Anti-Avoidance Rule

Clause 1

Assessment and reassessment

ITA
152(4)(b)

Subsection 152(4) of the Act generally provides that the Minister of National Revenue may at any time assess tax and other amounts payable by a taxpayer for a taxation year, but may not assess after the normal reassessment period for the year.

Paragraph (4)(b) is amended by adding subparagraph (viii), which allows the Minister to assess within an additional three-year period, if the assessment is made as a consequence of the application of the general anti-avoidance rule in section 245.

The extended assessment period is intended to provide the Minister with additional time to detect and analyze transactions potentially subject to the general anti-avoidance rule (GAAR). As such, an exclusion to the extended period applies where the transaction had been disclosed by the taxpayer to the Minister in accordance with section 237.3 or 237.4, which contain the disclosure rules for reportable transactions and notifiable transactions respectively.

Extended period of assessment

ITA
152(4.01)(b)

Subsection 152(4.01) limits the matters in respect of which the Minister of National Revenue can reassess when a reassessment to which paragraph 152(4)(a), (b), (b.1) or (c) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year.

Consequential on the addition of subparagraph 152(4)(b)(viii), subparagraph (4.01)(b)(xi) is added with a to reference that subparagraph. As such, a reassessment for a taxation year, made by the Minister after the normal reassessment period as a result of subparagraph (4.01)(b)(xi), is limited to the assessment of the GAAR.

Clause 2

Reportable transactions

ITA
237.3

Section 237.3 of the Act provides mandatory reporting requirements in respect of reportable transactions, requiring reporting within defined time periods.

Consequential on amendments to the GAAR in section 245, subsection 237.3(12.1) and (12.2) are added to allow for voluntary filing of disclosure in respect of transactions potentially subject to the GAAR. Such a filing is not an admission that the GAAR applies in respect of a transaction. It can result in an exclusion from the new GAAR penalty in subsection 245(5.1) and from the extended reassessment period for GAAR assessments in new subparagraph 152(4)(b)(viii).

Subsection (12.1) allows a taxpayer to file reportable transaction disclosure in respect of a transaction (or series of transactions of which a transaction is a part) in circumstances where it is not otherwise required under section 237.3. This disclosure is required to be filed on or before the taxpayer’s filing-due date for the taxation year in which the transaction occurs.

Subsection (12.2) allows disclosure under subsection (12.1) to be filed up to a year late. However, this late filing results in a one-year extension of the assessment period in respect of the transaction.

Clause 3

General Anti-Avoidance Rule

ITA
245

Section 245 of the Act contains the general anti-avoidance rule, which is intended to prevent abusive tax avoidance transactions or arrangements, but at the same time is not intended to interfere with legitimate commercial and family transactions.

Several amendments are being made to section 245 to: introduce a preamble; change the avoidance transaction standard; introduce an economic substance rule; and introduce a penalty. These amendments apply to transactions that occur on or after January 1, 2024, except for the preamble which comes into force on royal assent.

Preamble

ITA
245(0.1)

Subsection 245(0.1) is added to introduce a preamble to the GAAR, which sets out some key considerations relating to its intended purpose and operation. It is intended to inform the application of the GAAR, despite not forming a part of its analytic framework.

The subsection opens by noting that section 245 “of the Act contains the general anti-avoidance rule.” The reference to “of the Act” is intended to reinforce that the GAAR is a provision in the Act. It forms part of the context of the Act and is an important part of ensuring that the Act meets its objectives. It cannot be said that a transaction complies with the provisions of the Act if it doesn’t comply with the GAAR.

Paragraph (a) of the preamble reflects that the GAAR is intended to serve as a limit on tax planning. It is appropriate for taxpayers to engage in certain forms of tax planning; indeed, incentives delivered through the tax system (such as registered retirement savings plans for retirement saving and certain accelerated capital cost allowance rates for capital investment) rely on the ability of tax benefits to incentivize and modify behaviour. However, this freedom does not extend to misusing or abusing the tax rules. As noted in the Supplementary Information Relating to Tax Reform Measures tabled in the House of Commons on December 16, 1987, the GAAR was intended “to block sophisticated strategies designed to yield tax advantages that were not intended by Parliament.”

In a sense, paragraph (b) of the preamble imports into the Act ideas expressed in the original explanatory notes accompanying the GAAR. In particular, the original explanatory notes provided that the GAAR "seeks to distinguish between legitimate tax planning and abusive tax avoidance and to establish a reasonable balance between the protection of the tax base and the need for certainty for taxpayers in planning their affairs." The notion of fairness in subparagraph (b)(i) is intended to be broad, referring to the unfair distributional effects of tax avoidance as it shifts the tax burden from those willing and able to avoid taxes to those who are not.

This fairness objective is to be balanced with the taxpayer's need for certainty in planning their affairs (subparagraph (b)(ii)). This is to say, consideration of the GAAR involves an objective, thorough and step-by-step analysis. Within this analysis, principles of certainty, predictability and fairness do not play an independent role; rather, they are reflected in the carefully calibrated GAAR test that Parliament enacted in 1988.

An earlier version of draft legislative proposals released by the Department of Finance also included a statement in the preamble clarifying that the GAAR could apply regardless of whether a tax strategy was foreseen. This is demonstrated by the fact that, when the GAAR was initially adopted by Parliament, Parliament repealed several specific anti-avoidance rules.

Notwithstanding that specific types of tax avoidance were anticipated (and previously dealt with through those targeted rules), the GAAR was intended to be available to address those situations. This language is no longer included in the preamble because the Supreme Court of Canada has since clarified and confirmed that the GAAR is not limited to unforeseen situations (see *Deans Knight* (2023 SCC 16)).

Avoidance transaction

ITA
245(3)

The GAAR applies to a transaction only if it is an "avoidance transaction" as defined in subsection 245(3). Currently, the rule looks to whether a transaction (or series) was "undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit."

Subsection (3) is amended to change the "primarily" threshold in the avoidance transaction test to a "one of the main purposes" threshold. While that is the sole intended effect of the amendments, the change in wording necessitates a reorganization of the subsection.

Economic substance

ITA
245(4.1) and (4.2)

New subsections (4.1) and (4.2) introduce an explicit economic substance test into the GAAR. While much certainty has been obtained through the jurisprudence on many aspects of the GAAR, the appropriate role of economic substance in the GAAR analysis has been unclear. The amendments are intended to provide clarity and consistency in the economic substance test under the GAAR.

Subsection (4.1) sets out how the concept of economic substance is to be integrated into the GAAR analysis. In particular, it provides that a transaction significantly lacking in economic substance is presumed to be a misuse under paragraph (4)(a) or an abuse under paragraph (4)(b), depending on which of those paragraphs applies in the particular situation.

An analytical framework has been developed by the courts for applying the “misuse or abuse” test in subsection 245(4). Integrating these amendments into the framework used by the Supreme Court in the *Deans Knight* decision, a transaction significantly lacking in economic substance is a result that is presumed to frustrate the rationale of the provision (or provisions) relied upon or circumvented. For simplicity, these notes refer to a provision or a transaction rather than provisions or a series of transactions.

The presumption in subsection (4.1) could be rebutted in appropriate circumstances. For example, where the rationale underlying a provision is to encourage particular activities, a taxpayer could rebut the presumption by demonstrating that the effect of the transaction was what Parliament intended to encourage through enacting the provision. In less abstract terms, a taxpayer moving $100 from a taxable account to a tax-free savings account could be argued to lack economic substance, based on the facts that the taxpayer’s opportunity for gain or profit (and risk of loss) hasn’t changed and the sole reason for moving the funds to the TFSA was to obtain a tax benefit. As noted in the 2008 Budget documents, the TFSA was introduced “to improve incentives for Canadians to save.” As such, while it is possible that a transaction could be implemented which does misuse or abuse the TFSA rules, the taxpayer in this example simply responded to a tax incentive and did precisely what the government intended to encourage. Another factor that would rebut a presumption of abuse in this example is that, if the GAAR were to take away the tax benefit each time a person transfers funds from a taxable account into a TFSA, that would render the TFSA rules essentially ineffective at achieving their objective and frustrate the intent of Parliament.

A more complex example is that of corporate loss trading transactions, where losses of a corporation are sought to be used by another corporation to reduce its taxable income. Assume a transaction implemented to transfer losses within a related group is found to be significantly lacking in economic substance. In such a case, the transaction would be presumed to result in a misuse under paragraph (4)(a) or an abuse under paragraph (4)(b) because of new subsection (4.1). However, this presumption could be rebutted by demonstrating that the transaction is consistent with the rationale (to use the term from *Deans Knight*) of the provision. Looking at the text of the relevant provisions and considering their context and purpose, along with the relevant legislative history and extrinsic evidence, it should be clear that Parliament intended to provide access to certain tax benefits (i.e., loss carryforwards) based upon the existence of certain relationships. This effectively allows for the utilization of losses in certain circumstances within a related group. This policy is constrained by the existence of certain relationships, as it was noted in *Deans Knight* that “Parliament sought to ensure that a lack of continuity in a corporation’s identity was accompanied by a corresponding break in its ability to carry over non-capital losses.”

The meaning of the phrase “significantly lacking in economic substance” is provided in new subsection (4.2). It provides a number of factors which may establish that a transaction is significantly lacking in economic substance. Certain factors will be more or less relevant, depending on the particular circumstances and it is not an exhaustive list. The determination of whether a transaction is significantly lacking is economic substance is binary and feeds into the rebuttable presumption in subsection (4.1). If it is lacking, then the presumption in subsection (4.1) applies when engaging in the ‘misuse or abuse’ analysis; if not, the standard ‘misuse or abuse’ analysis applies. The “significantly” qualifier ensures that transactions which merely have some tax-planning element are not included. This is reflected in the specific factors set out in paragraphs (a) to (c), each of which contains a fairly high threshold for the test to be met. Paragraph (a) looks to whether the economic position of the taxpayer has changed as a result of the transaction. The language “opportunity for gain or profit and risk of loss of the taxpayer” is used to refer to economic exposure or economic position. If there are non-arm’s length taxpayers involved in the transaction, they are to be taken into consideration in making this determination. For example, this will be relevant where a transaction results in the shifting of rights or assets from one subsidiary to another within a group in circumstances where the economic position of the group hasn’t changed.

This factor may also be important in the context of transactions between shareholders and corporations that they control. For example, assume that Jane, a Canadian resident individual, holds all the shares of a corporation (Opco) resident in Canada that has undistributed after-tax business income on hand (retained earnings). The fair market value (FMV) of the shares exceeds their nominal paid-up capital (PUC) and adjusted cost base (ACB). Rather than distribute Opco’s retained earnings as a dividend, Jane undertakes the following series of transactions to receive the distribution in the form of a capital gain.

i. Jane transfers a portion of her Opco shares in exchange for a new class of shares of Opco pursuant to an election under subsection 85(1) of the Act. The elected amount of the share exchange gives rise to a capital gain for Jane upon which no lifetime capital gains exemption amount is claimed. Jane’s new shares have an ACB equal to their FMV and a nominal legal stated capital and paid-up capital.
ii. Jane then sells the new shares to another purchaser corporation (Buyco) that she controls and wholly-owns in exchange for a promissory note payable to her.
iii. Opco distributes its retained earnings to Buyco in the form of a tax-free inter-corporate dividend.
iv. Buyco then pays the retained earnings to Jane in satisfaction of the promissory note.

At the end of this series of transactions, Jane remains the sole shareholder of Opco and Buyco, corporations with which she does not deal at arm’s length. Following these steps, there has been no change in the opportunity for profit or gain or risk of loss for Jane, Opco and Buyco, taken together. Rather, there has simply been a movement of funds within the group, without any change in economic position (other than with respect to the tax paid on the capital gain).

As noted above, certain factors will not be as relevant in all situations. The importance (or lack thereof) of a factor requires a holistic assessment of the facts and circumstances. For example, the factor in paragraph (a) may be less relevant when applied to genuine commercial transactions between family members. Notwithstanding that related persons are deemed not to deal at arm's length (and therefore there may be no change in opportunity for gain or profit or risk of loss if their positions are considered together), they may transact independently with one another and engage in transactions that involve real changes in the economic position of individuals. For example, one sibling may sell a portion of their business to another sibling in a transaction that broadly reflects arm's length terms. In that situation, notwithstanding that the siblings are non-arm's length for purposes of the Act, it would not be appropriate to apply paragraph (a) strictly to find a significant lack of economic substance.

Subparagraphs (i) to (iv) provide examples of techniques that may be used to effect transactions which leave a taxpayer's economic position effectively unchanged (more precisely, all or substantially all of the taxpayer's opportunity for gain or profit and risk of loss remains unchanged). This is an inclusive list and is intended to allow for the fact that other techniques could be used to achieve the same economic effect.

Subparagraph (i) relates to a circular flow of funds. This is drafted to be general and economic in nature, such that it could apply regardless of the legal technique by which funds are flowed (e.g., by the creation of debt, the payment of dividends or through some other sort of arrangement). It is intended to capture situations like that described in the *Canada Trustco* (2005 SCC 54) decision, including where the flow of funds is imperfect (e.g., where some funds are left with an accommodating third party as a sort of facilitation fee).

Subparagraph (ii) looks to whether or not offsetting financial positions are used. An example would be where a taxpayer has both a long and a short position in respect of the same share such that they have eliminated all or substantially all of their economic exposure to the share. For example, these sorts of techniques were used in the planning that led to the introduction of the synthetic equity arrangement rules.

Subparagraph (iii) relates to the timing of steps within a series of transactions. Year-end straddle planning is an example of a transaction that uses this technique, where the loss leg of a transaction is closed out immediately before the end of a taxation year and the income leg is closed out immediately after, with the time gap between the two transactions being sufficiently short that the taxpayer has effectively no economic exposure to the underlying investment. In general, the duration of any economic exposure during a series of transactions can be sufficiently short so that, when the series is viewed in its totality, the taxpayer has effectively eliminated all or substantially all of their economic opportunity and risk even though, for a period of time, the taxpayer is fully exposed.

Subparagraph (iv) deals with accommodating parties. In such a case, the accommodating party might take some sort of facilitation fee (whether director or indirect) for helping to obtain the tax benefit, but the taxpayer's economic position remains essentially unchanged. As such, that accommodating party participates in transaction but does not assume any (or much) economic exposure in respect of the transaction.

The factor in paragraph (b) compares the relative weight of the expected commercial and tax aspects of a transaction. It would apply where, from the outset, the tax benefits sought are expected to exceed any commercial return. The test would account for both the possibility of a modest amount of income that is eclipsed by the tax benefit sought (e.g., $1,000 of deductions leading to $150 of tax savings with a $20 non-tax return, perhaps earned as income on a bond that is incorporated into a series of transactions) and the remote possibility of significant economic returns in the context of a tax-driven deal (e.g., a $150 tax benefit with a 2% chance of earning $1,000). In making this determination, foreign (or other) tax savings are not to be included as a commercial, non-tax return. As such, a transaction that is intended to yield $60 in foreign tax savings, $50 in Canadian income tax savings and produce a $1 commercial return would be within the scope of this factor.

The factor in paragraph (c) applies where a transaction is entirely (or almost entirely) tax driven. In such a case, as commercial goals are essentially immaterial in the context of planning the transaction, it is reasonable to infer that there is likely nothing going on economically. While the factors in paragraphs (a) and (b) focus on the specific actual or anticipated economic effects, this factor looks more to the big picture. In many cases where a transaction is entirely (or almost entirely) tax driven, it is expected that the factors in paragraphs (a) or (b) would also be present. While related to the avoidance transaction "purpose" test, the test in paragraph (c) goes a step further to apply where none of the main purposes for undertaking or arranging the transaction is a bona fide non-tax purpose.

Penalty

ITA
245((5.1) and (5.2)

Subsection (5.1) introduces a penalty to the GAAR. The amount of the penalty is determined by the formula "(A – B) x 25% - C". The penalty applies in respect of a transaction or series of transactions only if the transaction or series was not disclosed to the Minister of National Revenue in accordance with section 237.3 (reportable transactions) or 237.4 (notifiable transactions). For more information, see the commentary on section 237.3.

The penalty is computed as 25% of the amount by which a person's tax payable for a taxation year is increased as a result of the application of the GAAR. Element C reduces the amount of the penalty by the amount of any penalty payable under subsection 163(2) in respect of the transaction or series. This is intended to prevent duplication where the gross negligence penalty in subsection 163(2) applies in respect of the same transaction or series as the GAAR penalty. Where the tax benefit obtained is the creation of a tax attribute (i.e., it is described in paragraph (c) of the definition "tax benefit" in subsection 245(1)) that has not been used to reduce tax payable, no penalty would apply until the year in which the tax attribute is used to reduce tax payable (absent the application of the GAAR). In circumstances where an unutilized tax attribute is successfully challenged under the GAAR, the penalty formula would produce a nil result.

Subsection (5.2) provides an exclusion to the GAAR penalty. It is intended to be available in circumstances where a taxpayer demonstrates that it would have been reasonable to conclude that a transaction or series would not be subject to the GAAR at the time it was entered into.

The exclusion in subsection (5.2) assures the GAAR penalty will not apply to a taxpayer that entered into a transaction (or series of transactions) reasonably relying upon the current state of the case law and administrative guidance from the Minister of National Revenue. In order for this exclusion to apply, the taxpayer must demonstrate that their transaction or series was identical or almost identical to a transaction or series that was the subject of published administrative guidance or a court decision, such that it was reasonable to have concluded that the GAAR would not apply. The “identical or almost identical” threshold is quite high and, as a result, using the same tax strategy or entering into a transaction that is merely similar would not be enough to qualify for the exclusion. As the test is applied as at the time the transaction was entered into, it could be relied upon even where there are subsequent changes in administrative position or jurisprudence.

Income Tax and GST/HST Treatment of Credit Unions

Clause 1

Definitions

ITA
137(6)

“**credit union**”

The definition “credit union” in subsection 137(6) is used for purposes of the Act, as well as other federal legislation, including the definition of “credit union” in subsection 123(1) of the *Excise Tax Act*.

The definition “credit union” in subsection 137(6) includes three alternative requirements for a corporation, association or federation incorporated or organized as a credit union or cooperative credit society to qualify as a credit union. Paragraph (a), the first of the alternatives, currently requires a revenue test to be satisfied.

Paragraph (a) is amended to replace the revenue test with a requirement that the corporation, association or federation must be a “federal credit union” or a “local cooperative credit society”, each within the meaning assigned by section 2 of the *Bank Act* (except that the definition “local cooperative credit society” shall be read without reference to paragraph (b) thereof).

These changes are intended to generally align the definition of a credit union with the relevant provincial or federal requirements.

A federal credit union is defined in subsection 248(1) by reference to the meaning assigned by section 2 of the *Bank Act*. A federal credit union must be a bank that is organized and carries on business on a cooperative basis (within the meaning assigned by section 12.1 of the *Bank Act*).

A local cooperative credit society is also defined by reference to the meaning assigned by section 2 of the *Bank Act*. A local cooperative credit society must be organized on cooperative principles incorporated by or under provincial legislation and substantially all of the members must consist of natural persons. However, in order to satisfy amended paragraph (a) of the definition "credit union", the corporation, association or federation will not have to meet the financial service requirement in paragraph (b) of the definition "local cooperative credit society" in the *Bank Act*.

Subparagraph (b)(i) of the definition "credit union" in subsection 137(6) is also amended to correspondingly replace a reference to the revenue test with the requirement described above.

These amendments are deemed to have come into force on January 1, 2016.

Excessive Interest and Financing Expenses Limitation

Overview

New sections 18.2 and 18.21 of the Act, together with new paragraph 12(1)(l.2), are the core rules of the new excessive interest and financing expenses limitation ("EIFEL") regime. This regime comprises rules consistent with the recommendations in the report under Action 4 of the Group of 20 and Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Project (the "BEPS Action 4 report"). The BEPS Action 4 report recommends certain limitations on the deductibility of interest and other financing costs to address BEPS.

Consistent with the BEPS Action 4 report, the objective of the EIFEL regime is to address BEPS issues arising from taxpayers deducting for income tax purposes excessive interest and other financing costs, principally in the context of multinational enterprises and cross-border investments. To this end, as recommended in the Action 4 report, the rules adopt an "earnings stripping" approach, which restricts a taxpayer's (or group's) deductions for interest expense and other financing costs to an amount that is commensurate with the taxable income generated by its activities in Canada. In general terms, the EIFEL rules limit the amount of net interest and financing expenses (being the taxpayer's interest and financing expenses net of its interest and financing revenues) that may be deducted in computing a taxpayer's income to no more than a fixed ratio of earnings before interest, taxes, depreciation and amortisation ("EBITDA"). For this purpose, the main elements are:

- *Fixed ratio*: Pursuant to the definition "ratio of permissible expenses" in new subsection 18.2(1), the applicable fixed ratio is 30%. In order to facilitate transition to the new regime, a fixed ratio of 40% applies only for taxation years beginning on or after October 1, 2023 and before January 1, 2024 (subject to an anti-avoidance rule that denies a taxpayer the benefit of the 40% ratio, generally where the taxpayer undertakes a transaction to extend the period for which that ratio otherwise applies).

- *Interest and financing expenses and revenues*: The interest and other financing expenses of the taxpayer that are within scope of the new rules are set out in the definition "interest and financing expenses" in subsection 18.2(1) (which is the main definitions subsection for the new regime). Notably, they include, among other things, interest and financing expenses that are "capitalized" and deducted as capital cost allowance or as amounts in respect of resource expenditure pools; an imputed amount of interest in respect of certain finance leases; certain amounts that are economically equivalent to interest or that can reasonably be considered part of the cost of funding; and various expenses incurred in obtaining financing. The definition "interest and financing revenues" captures the taxpayer's interest income, as well as other income from the provision of financing. An anti-avoidance rule is included to ensure that certain amounts are included in interest and financing expenses, or excluded from interest and financing revenues.
- *EBITDA*: The taxpayer's EBITDA is referred to in the rules as "adjusted taxable income" (defined in subsection 18.2(1)), and is determined based on amounts taken into account in computing its tax liability under Part I of the Act, rather than amounts reported in its financial statements. A taxpayer's adjusted taxable income is its taxable income (or, in the case of a non-resident taxpayer, taxable income earned in Canada), determined under Part I of the Act, as adjusted for certain items. In general terms, the adjustments add amounts to taxable income to effectively reverse deductions for the taxpayer's interest and financing expenses, certain tax expenses and capital cost allowance, as well as certain other amounts; and subtract amounts to effectively reverse inclusions in taxable income for interest and financing revenues and untaxed income, as well as certain other amounts.

Notably, because it is based on taxable income, the taxpayer's adjusted taxable income reflects deductions for dividends received under section 112 (for inter-corporate dividends) and 113 (for dividends received from foreign affiliates). Thus, the new rules can limit the deductibility of interest expense incurred to invest in shares that produce such dividends. Adjusted taxable income is also reduced by losses deducted under section 111, except to the extent they are attributable to the taxpayer's net interest and financing expenses for a prior taxation year. The main operative rule of the EIFEL regime, which denies deductibility of net interest and financing expenses that exceed the permissible level, is in new subsection 18.2(2). That subsection applies to taxpayers that are corporations or trusts (the definition "taxpayer" in subsection 18.2(1) excludes natural persons and partnerships). It also applies in computing a non-resident taxpayer's taxable income earned in Canada.

Similar to the approach under the thin capitalization rules in the Act, the EIFEL rules also apply indirectly in respect of partnerships, as interest and financing expenses and revenues of a partnership are attributed to members that are corporations or trusts, in proportion to their interests in the partnership. Where a taxpayer has excessive interest and financing expenses, as determined under the rules, new paragraph 12(1)(l.2) – which is analogous to paragraph 12(1)(l.1) of the thin capitalization rules – includes an amount in the taxpayer's income in respect of the taxpayer's share of partnership interest and financing expenses.

The EIFEL rules generally apply mechanically; there is no avoidance or purpose condition for the operative rules to apply. They also apply after existing limitations on the deductibility of interest and financing expenses in the Act, including the thin capitalization rules (subsection 18(4) is amended to clarify this ordering). Any expenses whose deductibility is denied under such existing limitations are excluded from a taxpayer's interest and financing expenses for purposes of the new rules.

Exceptions

To ensure the new rules are appropriately targeted at significant BEPS risks, exceptions from the rules are provided for "excluded entities" (defined in subsection 18.2(1)), which generally comprise:

- Canadian-controlled private corporations that, together with any associated corporations, have taxable capital employed in Canada of less than $50 million (i.e., the top end of the phase-out range for the small business deduction);
- groups of corporations and trusts whose aggregate net interest expense among their Canadian members is $1,000,000 or less; and
- certain standalone Canadian-resident corporations and trusts, and groups consisting exclusively of Canadian-resident corporations and trusts that carry on substantially all of their businesses, undertakings and activities in Canada. This exclusion applies only if, in general terms, no non-resident is a material foreign affiliate of, or holds a significant interest in, any group member, and no group member has any significant amount of interest and financing expenses payable to a non-arm's length person that is "tax-indifferent" (as defined in subsection 18.2(1)).

Excluded interest

The EIFEL rules allow two taxable Canadian corporations to jointly elect that one or more payments of interest or lease financing amounts (as defined in subsection 18.2(1)) made by one to the other in a taxation year be excluded from the new interest limitation under subsection 18.2(2). This exclusion applies if the conditions in the definition "excluded interest" in subsection 18.2(1) are met. Among other conditions, the two corporations must be "eligible group corporations" in respect of each other, which is defined in subsection 18.2(1) as, essentially, corporations that are related or affiliated (in determining affiliation for these purposes, section 251.1 is to be read without reference to the definition "controlled" in subsection 251.1(3)). This election is principally intended to ensure that the EIFEL rules do not negatively impact transactions that are commonly undertaken within Canadian corporate groups to allow the losses of one group member to be offset against the income of another group member.

Exempt interest and financing expenses

To ensure that the new rules do not apply to limit the deductibility of interest and financing expenses that are incurred in respect of certain Canadian public-private partnership infrastructure projects, where the economic cost of the expenses are borne by the public sector, an exception is provided for "exempt interest and financing expenses" (defined in subsection 18.2(1)).

The exception will generally apply to third-party interest and financing expenses that are incurred in respect of a borrowing or other financing that was entered into in respect of an agreement with a Canadian public sector authority to design, build and finance (or design, build, finance, operate and maintain) property that a Canadian public sector authority has an interest in, where those interest and financing expenses are economically borne by that (or another) Canadian public sector authority.

Group ratio rules

The “group ratio” rules are in new section 18.21. Where the conditions in new subsection 18.21(2) are met, the Canadian members of a group of corporations and/or trusts can jointly elect into the group ratio rules for a taxation year (special rules allow certain standalone entities that are not part of any group to also elect into the group ratio rules). In that case, instead of the maximum amount a group member is permitted to deduct in respect of interest and financing expenses for the year being determined by reference to the 30% fixed ratio (or 40%, for the transitional year), it is determined in accordance with the group ratio rule in subsection 18.21(2).

In essence, the group ratio rules allow a taxpayer to deduct interest and financing expenses in excess of the fixed ratio, provided the taxpayer is a member of an accounting consolidated group whose ratio of net third-party interest expense to book EBITDA (with a 10% up-lift) exceeds the fixed ratio and the group is able to demonstrate this based on audited consolidated financial statements. The “consolidated group” is defined in subsection 18.21(1) as an ultimate parent and all the entities that are fully consolidated in the parent’s consolidated financial statements, or that would be if the group were required to prepare such statements under IFRS.

The consolidated group’s net third-party interest expense and book EBITDA are referred to in these rules as the “group net interest expense” (“GNIE”) and “group adjusted net book income” (“GANBI”), respectively, and are defined in subsection 18.21(1). They are determined based on amounts in the group’s audited consolidated financial statements, with appropriate adjustments. There is an exclusion from group net interest expense for certain interest payments to persons or partnerships that are outside the consolidated group but that do not deal at arm’s length with one or more consolidated group members; that have a significant equity interest in any Canadian group member; or a significant equity interest in which is held by any Canadian group member. Where the consolidated group has positive GANBI, the group ratio is the ratio of GNIE to GANBI, multiplied by a factor of 1.1.

Under the group ratio rule in subsection 18.21(2), the maximum amount of interest and financing expenses the consolidated group members are collectively permitted to deduct is generally determined as the total of each Canadian group member’s adjusted taxable income multiplied by group ratio. The group allocates this maximum deductible amount among its Canadian group members in its group ratio election. This “flexible” allocation mechanism allows taxpayers to allocate the group ratio deduction capacity where it is most needed.

The group ratio rules contain certain limitations that are mainly intended to account for the possibility that some group members may have negative book EBITDA, or the group as a whole may have negative book EBITDA, such that a simple formulaic determination of the group ratio could give unreasonably high or meaningless results. These limitations are found in the definition “group ratio”, in subsection 18.21(1), and the “allocated group ratio amount” rule in subsection 18.21(2).

Excess capacity and cumulative unused excess capacity

If a taxpayer’s net interest and financing expenses exceed the maximum permitted for a taxation year, there are two mechanisms that could nonetheless enable the taxpayer to deduct all or a portion of this excess.

The first applies to the extent the taxpayer has “excess capacity” (as defined in subsection 18.2(1)) for any of its three immediately preceding taxation years that it has not used for another purpose in any of those preceding years (the rules, in effect, provide a three-year carry-forward of excess capacity). In general terms, the taxpayer’s “excess capacity” for a taxation year is the amount, if any, by which the maximum amount it is permitted to deduct in respect of interest and financing expenses for the year (determined as its fixed ratio multiplied by its adjusted taxable income, plus its interest and financing revenues for the year) exceeds its actual interest and financing expenses for the year. A taxpayer is treated as not having excess capacity for any taxation year in which it is subject to the group ratio. A taxpayer’s unused excess capacity is the portion that has not been either used to deduct the taxpayer’s own excess interest and financing expenses for another year, or transferred by the taxpayer to another group member in a previous year.

The taxpayer’s unused excess capacity carryforwards from the three taxation years immediately preceding a given taxation year are automatically applied to reduce the amount of interest and financing expenses whose deductibility would otherwise be denied under subsection 18.2(2) in the given year. The amount of excess capacity that is used in this manner is referred to as the taxpayer’s “absorbed capacity” for the given taxation year (defined in subsection 18.2(1)). This mechanism is intended to “smooth” the impact of earnings volatility under the EIFEL rules.

The second mechanism applies where the taxpayer does not have sufficient unused excess capacity carryforwards of its own, but has one or more other Canadian group members that have “cumulative unused excess capacity” they can transfer to the taxpayer. A group member’s cumulative unused excess capacity for a taxation year is the amount available to transfer to other group members in the year, and is essentially its excess capacity for the year plus its unused excess capacity carryforwards from the three immediately preceding taxation years. Transfers of cumulative unused excess capacity require a joint election by the transferor and transferee under new subsection 18.2(4), and can only be made between two entities where each is either a taxable Canadian corporation or a fixed interest commercial trust, and the entities are “eligible group entities” in respect of each other (as defined in subsection 18.2(1)). The transferee’s resulting “received capacity” amount can reduce the amount of interest and financing expenses whose deductibility is otherwise denied to the transferee under subsection 18.2(2). The transferor’s cumulative unused excess capacity is reduced by any amounts transferred to other group members, as well as by the taxpayer’s own absorbed capacity.

"Financial institution group entities" (defined in subsection 18.2(1)) are prohibited from transferring their cumulative unused excess capacity outside of their financial group. Financial institutions would be expected to often have excess capacity because their regular business activities tend to result in interest income exceeding their interest expense. This restriction is intended to ensure such net interest income cannot be used to shelter the interest and financing expenses of entities that do not carry on financial businesses or activities ancillary to those of a financial institution.

Carryforwards of denied interest and financing expenses

Interest and financing expenses that are denied under subsection 18.2(2), and amounts included in a taxpayer's income under paragraph 12(1)(l.2) in respect of the taxpayer's share of a partnership's interest and financing expenses, are carried forward indefinitely. There is no carry-back for such amounts; however, the three-year carry-forward of excess capacity (reflected in a taxpayer's "cumulative unused excess capacity") is in substance equivalent to a carry-back of denied interest and financing expenses.

The carry-forward of denied interest and financing expenses is provided under new paragraph 111(1)(a.1), which allows a taxpayer to deduct its prior-year "restricted interest and financing expenses" (defined in subsection 111(8)) in computing its taxable income. This deduction is available in two circumstances. First, a taxpayer can deduct its restricted interest and financing expenses to the extent of its excess capacity for a taxation year. Second, a taxpayer can deduct such amounts to the extent it has "received capacity" for a taxation year, as a result of having received a transfer out of the cumulative unused excess capacity of another group member.

A taxpayer's excess capacity or received capacity, as the case may be, is automatically reduced to the extent of its restricted interest and financing expense carryforwards. In effect, this reflects a mandatory "ordering rule", whereby those amounts must be applied to enable the deduction of prior-year restricted interest and financing expenses, before a taxpayer can transfer its excess capacity to another group member or use its received capacity to deduct its excess interest and financing expenses for the current year. Like the three-year carry-forward of excess capacity, the carry-forward of restricted interest and financing expenses is intended to smooth the impact of earnings volatility under the EIFEL rules.

Continuity rules for new tax attributes

In connection with the new EIFEL regime, amendments to sections 87 and 88 of the Act ensure that, where a particular corporation undergoes an amalgamation or winding-up, its carryforwards of restricted interest and financing expenses and cumulative unused excess capacity generally are inherited by the new corporation formed on the amalgamation or the parent corporation in respect of the winding-up.

Amendments are also made to sections 111 and 256.1, to address the impact of a change of control (or "loss restriction event") on a taxpayer's EIFEL tax attributes. Similar to the treatment of non-capital loss carryforwards under existing subsection 111(5), a taxpayer's carryforwards of restricted interest and financing expenses generally remain deductible following a loss restriction event, to the extent the taxpayer continues to carry on the same business following the loss restriction event. However, a taxpayer's cumulative unused excess capacity does not survive a loss restriction event.

Transitional rules

Transitional rules are included in the enacting legislation for the EIFEL regime. Under these rules, a taxpayer can elect, jointly with its other group members, if any, to have special rules apply for the purpose of determining the excess capacity of the taxpayer (and each group member, if any) for each of the three taxation years (referred to as the "pre-regime years") immediately preceding its first taxation year in respect of which the EIFEL rules apply. Absent these transitional rules, a taxpayer would not have excess capacity for any of the pre-regime years because the EIFEL rules otherwise do not apply in respect of the pre-regime years. The transitional rules, in effect, allow electing taxpayers a three-year carry-forward of their excess capacity (as determined under the special transitional rules) for pre-regime years, as this excess capacity is included in computing a taxpayer's cumulative unused excess capacity.

In determining a taxpayer's excess capacity for pre-regime years, the transitional rules seek to approximate what would have been the unused portion of the taxpayer's excess capacity – after being used for transfers to other group members with excess interest and financing expenses over the maximum permitted, and to deduct the taxpayer's own excess interest and financing expenses for any pre-regimes years – had the EIFEL rules applied in respect of the pre-regime years.

Effective date

The EIFEL rules generally apply in respect of taxation years that begin on or after October 1, 2023. An anti-avoidance rule applies, to cause the EIFEL rules to apply earlier for a particular taxpayer, if the taxpayer undertakes a transaction or series of transactions to trigger an early taxation year-end for the purpose of deferring the application of the EIFEL rules. The rules apply with respect to existing as well as new borrowings.

Clause 1

Partnership – interest and financing expenses add back

ITA
12(1)(l.2)

New paragraph 12(1)(l.2) provides an income inclusion for a taxpayer that is a member of a partnership, as part of the new excessive interest and financing expenses limitation (EIFEL) regime. The core rules for this new regime are in new sections 18.2 and 18.21. For more information, see the commentary on those sections.

In general terms, new paragraph 12(1)(l.2) includes an amount in a taxpayer's income for a taxation year – in respect of the taxpayer's share of the interest and financing expenses for the year of partnerships of which the taxpayer is a member – if the taxpayer's total interest and financing expenses for the year exceed the amount of such expenses that the taxpayer is permitted to deduct, as determined under subsection 18.2(2). This income inclusion is in lieu of a denial of a deduction under subsection 18.2(2), but with similar effect, and is analogous to paragraph 12(1)(l.1) of the thin capitalization rules.

The reason the income inclusion under paragraph 12(1)(l.2) is needed is that income is calculated at the partnership level and allocated to partners on a net basis (i.e., after any deduction of amounts at the partnership level in respect of the interest and financing expenses). Consequently, deductions for the partnership's interest and financing expenses cannot be denied at the partner level under subsection 18.2(2). The income inclusion effectively adds back to the partner's income the relevant portion of the interest and financing expenses that are deducted at the partnership level.

The amount included under paragraph 12(1)(l.2) in a taxpayer's income for a taxation year is determined by the formula A x B.

Variable A is essentially the total of the taxpayer's share of the interest and financing expenses for the year of all partnerships of which the taxpayer is a member. All of these amounts are included in computing the taxpayer's interest and financing expenses under paragraph (h) of the description of A in the definition "interest and financing expenses" in subsection 18.2(1), with an exclusion for any amounts included in the taxpayer's income under paragraph 12(1)(l.1) of the thin capitalization rules.

There is no income inclusion under paragraph 12(1)(l.2) in respect of "excluded interest" or "exempt interest and financing expenses". For more information, see the commentary on the definitions "excluded interest" and "exempt interest and financing expenses".

Variable B integrates the income inclusion under paragraph 12(1)(l.2) with the excessive interest and financing expenses limitation in subsection 18.2(2).

By virtue of subparagraph (i) of variable B, no amount will be included in the taxpayer's income under paragraph 12(1)(l.2) if the taxpayer is an "excluded entity" for a taxation year (as defined in subsection 18.2(1)), as such entities are similarly not subject to the limitation in subsection 18.2(2).

If the taxpayer is not an excluded entity, the amount determined for B is the proportion determined under the first formula in subsection 18.2(2) in respect of the taxpayer for the year. This is the proportion of the taxpayer's interest and financing expenses that exceeds the maximum permitted under subsection 18.2(2). While this proportion is generally used to determine the proportion of the taxpayer's deductions in respect of interest and financing expenses that is denied under subsection 18.2(2), the proportion can nonetheless be computed and applied for purposes of paragraph 12(1)(l.2), even in a year when the taxpayer's only interest and financing expenses are derived from its share of partnership expenses.

Thus, paragraph 12(1)(l.2), in effect, includes in a taxpayer's income an amount representing the proportion, of the taxpayer's share of the interest and financing expenses of partnerships of which it is a member, that is determined to be “excessive” based on the limitation under subsection 18.2(2).

New paragraph 12(1)(l.2) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Source of income

ITA
12(2.02)

Subsection 12(2.02) mainly ensures that any income inclusion under paragraph 12(1)(l.1) for a non-resident partner will be taxable in Canada to the same extent as income earned through the partnership.

This subsection is amended to provide for similar treatment in respect of any income inclusion under new paragraph 12(l)(l.2). For further information, see the commentary on paragraph 12(1)(l.2) and section 18.2.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 2

Limitation on deduction of interest

ITA
18(4)

Subsection 18(4) provides thin capitalization rules to limit deductions, by corporations and trusts, in respect of interest on debt owing to certain specified non-residents. If the amount of debt owing to specified non-residents exceeds a debt-to-equity ratio of 1.5-to-1, subsection 18(4) limits the deductibility of interest on that debt to the extent that the interest would otherwise be deductible (i.e., in the absence of subsection 18(4)).

Subsection 18(4) is amended, consequential on the introduction of new section 18.2, which contains the main operative provisions of the new excessive interest and financing expenses limitation regime. This amendment provides that the limitation under subsection 18(4) applies only in respect of interest that would, in the absence of section 18.2 (as well as subsection 18(4)), be deductible in computing income from business or property. This is intended to ensure that the thin capitalization rules apply in priority to the interest restriction in new section 18.2.

For more information, see the commentary on new section 18.2.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 3

Definitions

ITA
18.2(1)

New subsection 18.2(1) defines a number of terms that apply for the purposes of sections 18.2 and 18.21 in determining the application of the new excessive interest and financing expenses limitation.

“absorbed capacity”

A taxpayer’s absorbed capacity for a taxation year is essentially the amount of its excess capacity, carried forward from previous years, that is used in a taxation year to reduce or eliminate a denial of deductions in respect of interest and financing expenses that would otherwise occur under subsection 18.2(2).

More specifically, the taxpayer’s excess capacity for its three immediately preceding taxation years is included in its cumulative unused excess capacity for a taxation year, and its absorbed capacity is essentially the lesser of its cumulative unused excess capacity for the year (determined before the reduction resulting from the taxpayer’s absorbed capacity for the year) and its amount of interest and financing expenses that would otherwise be denied in the year.

The taxpayer’s absorbed capacity is automatically included in variable E of the formula in subsection 18.2(2), thus reducing or eliminating a denial of interest and financing expenses that would otherwise arise under that subsection. The taxpayer’s cumulative unused excess capacity is reduced to the extent of the taxpayer’s absorbed capacity.

In effect, the consequences of an amount of absorbed capacity under the rules reflect a mandatory “ordering rule”, whereby a taxpayer is required to use its own excess capacity carryforwards first to deduct its own otherwise denied interest and financing expenses, before it can use any remaining excess capacity (reflected in its cumulative unused excess capacity) to effect a transfer to another group member by way of an election under subsection 18.2(4). Consequently, a taxpayer cannot transfer an amount of cumulative unused excess capacity to another group member to deduct their otherwise denied interest and financing expenses for the year in priority to the taxpayer using its carryforwards to deduct its own otherwise denied interest and financing expenses for the year.

Notably, a taxpayer cannot have excess capacity for a taxation year if it has absorbed capacity for that year. This is because a taxpayer has absorbed capacity only for a year where it has interest and financing expenses that exceed its capacity to deduct those expenses in the year. For more information, see the commentary on the definition "excess capacity".

"adjusted taxable income"

A taxpayer's adjusted taxable income (ATI) is a measure of its earnings before interest, taxes, depreciation and amortization (EBITDA) and is determined based on tax, rather than accounting, concepts.

In basic terms, a taxpayer's adjusted taxable income for a taxation year is its taxable income (or, in the case of a non-resident, its taxable income earned in Canada) for the year, adjusted to reverse: (i) any deductions for interest and financing expenses, certain tax expenses and capital cost allowance; and (ii) income inclusions for interest and financing revenues, untaxed income, and certain other amounts.

Since the starting point in determining adjusted taxable income is a taxpayer's taxable income, notably, it effectively excludes dividends that are deductible under section 112 or 113 (being inter-corporate dividends and certain dividends received from foreign affiliates, respectively). It is also generally reduced by losses deducted by the taxpayer under section 111 (subject to an add-back under paragraph (h) of variable B to the extent a non-capital loss is attributable to deductions in respect of interest and financing expenses or other amounts described in paragraphs (b) to (g) or (j) to (m) of variable B, as discussed below).

A taxpayer's adjusted taxable income is relevant principally in determining the maximum amount a taxpayer is permitted to deduct in respect of interest and financing expenses, under the limitation in new subsection 18.2(2), in computing its income for a taxation year. Generally under subsection 18.2(2), a taxpayer's deductions in respect of such expenses (net of the taxpayer's interest and financing revenues) for a year are limited to no more than a fixed ratio of its adjusted taxable income for the year (although the limit is also a function of any carryforwards of excess capacity, or transfers of excess capacity received by the taxpayer in the year). For more information, see the commentary on new subsection 18.2(2).

Adjusted taxable income is also relevant in determining a taxpayer's absorbed capacity or excess capacity for a taxation year (both as defined in this new subsection 18.2(1)). For more information, see the commentary on those definitions.

Adjusted taxable income for a taxation year is determined by the formula: A + B – C.

Variable A is capable of being a positive or negative number. It is determined by taking either (i) the taxpayer's taxable income (or, for non-residents, taxable income earned in Canada) for the year, or (ii) the negative number equal to its non-capital loss, and then subtracting the foreign accrual property losses (FAPLs) of any controlled foreign affiliates of the taxpayer (or a partnership of which the taxpayer or another controlled foreign affiliate of the taxpayer is a member) to the extent the FAPLs derive from net relevant affiliate interest and financing expenses (as further discussed below).

Allowing variable A to be a negative number where the taxpayer has a non-capital loss ensures that the add-backs under variable B do not generate excessive adjusted taxable income. For example, if a taxpayer had a non-capital loss for a taxation year and its amount for variable A were treated as nil (instead of as a negative number), when its interest and financing expenses were added back under variable B, this could give the taxpayer adjusted taxable income – thus allowing it to deduct interest and financing expenses under subsection 18.2(2) – generated from the interest and financing expenses themselves, as opposed to operating earnings. This result would be inappropriate in policy terms.

Consistent with this rationale, in determining a taxpayer's variable A amount, it is similarly necessary to subtract an amount equal to the lesser of (i) a FAPL of a controlled foreign affiliate of the taxpayer for an affiliate taxation year, and (ii) the excess of the affiliate's relevant affiliate interest and financing expenses over its relevant affiliate interest and financing revenues for the affiliate taxation year.

The amounts in variable A are determined without regard to any denial of deductions for interest and financing expenses under subsection 18.2(2), or relevant affiliate interest and financing expenses of a controlled foreign affiliate under subclause 95(2)(f.11)(ii)(D)(I). Variable A is also determined without regard to income inclusions in respect of partnership-level interest and financing expenses under paragraph 12(1)(l.2) or subclause 95(2)(f.11)(ii)(D)(II). Thus, these denied amounts and income inclusions do not increase adjusted taxable income. Variable A is also determined without regard to deductions of restricted interest and financing expenses under paragraph 111(1)(a.1) since adjusted taxable income, by its inclusion in the computation of excess capacity, is a component in the determination of the maximum deduction that can be claimed under paragraph 111(1)(a.1).

Variable B "adds back" a number of amounts to, in effect, reverse the impact on the taxpayer's adjusted taxable income of a taxpayer's deductions for interest and financing expenses, certain tax expenses and capital cost allowance, among other deductions, all of which are reflected in its taxable income included under variable A. The amounts added back under variable B include:

- the taxpayer's interest and financing expenses for the year (paragraph (a) of variable B);
- any amount deducted under paragraph 20(1)(a) as capital cost allowance, or under the various provisions enumerated in paragraph (b) of variable B in relation to resource expenses, other than any portion of those amounts that is capitalized and therefore already added back under paragraph (a) of variable B as interest and financing expenses (paragraph (b) of variable B);
- any amount deducted under subsection 20(16) as a terminal loss for the year, other than any portion of that amount that can reasonably be considered to be attributable to interest

and financing expenses and therefore is already added back under paragraph (a) of variable B (paragraph (c) of variable B);

- any amounts deducted, in computing the taxpayer's taxable income for the year, under paragraph 110(1)(k) (in respect of Part VI.1 tax) (paragraph (f) of variable B);
- any amount deducted by the taxpayer under subsection 104(6), other than any portion of that amount that has been designated under subsection 104(19) for the year (i.e., deemed to be a taxable dividend received by the beneficiary and, for certain purposes, not by the trust), in order to ensure that deductions for interest and financing expenses of a trust are not denied solely because the trust claims a deduction in respect of income distributed to its beneficiaries (paragraph (g) of variable (b);
- the amount that would be the loss of the taxpayer, or would be the taxpayer's share of the loss of a partnership of which it is a member, if the taxpayer or partnership had no income or loss other than that which can reasonably be considered to be derived or realized from activities funded, in whole or in part, by a borrowing that results in exempt interest and financing expenses (paragraph (k) of variable B); and
- certain amounts deducted as tax credits or received as government assistance that reduced the cost or capital cost of certain properties (paragraphs (l) and (m) of variable B).

In the case of amounts deducted under paragraph 20(1)(a) or subsection 20(16) in computing the income of a partnership of which the taxpayer is a member, paragraph (d) of variable B adds back an amount in respect of the taxpayer's share of those deducted amounts (other than any capitalized interest and financing expenses portion of those amounts), in computing the taxpayer's adjusted taxable income for its taxation year in which the partnership's fiscal period ends. This provision applies on a source-by-source basis, with the partnership's deduction under paragraph 20(1)(a) or subsection 20(16) in computing its income from each source being attributed to the taxpayer based on its pro rata share of the partnership's income or loss from the source.

Adjusted taxable income is calculated without reference to any income or loss derived from activities funded, in whole or in part, by a borrowing that results in exempt interest and financing expenses. Losses are added back to adjusted taxable income under paragraph (k) of variable B, and income is deducted from adjusted taxable income under paragraph (j) of variable C. Amounts described in the remaining paragraphs of variable B are not added back under those paragraphs to the extent that they can reasonably be considered to be in respect of a borrowing that results in exempt interest and financing expenses, as these amounts are already included in the adjustments under paragraph (k) of variable B and paragraph (j) of variable C.

For more information, see the commentary on the definition "exempt interest and financing expenses".

Variable H in the formula in paragraph (d) reduces the amount of the add-back in respect of amounts that were deducted under paragraph 20(1)(a) or subsection 20(16) in computing a partnership's loss, to the extent the taxpayer is denied a deduction in respect of its share of the loss under the partnership "at-risk" rule in subsection 96(2.1).

To the extent the taxpayer deducts an amount, in respect of the previously denied loss, under paragraph 111(1)(e) in a later year, paragraph (e) of variable B in turn provides relief by way of an add-back in the later year. Where the previously denied loss was for a pre-regime year, the add-back applies in the same manner as in the case of denied losses for regime years. This is consistent with the intended application of the add-back under paragraph (h) of variable B in respect of non-capital losses for pre-regime years (see the commentary below).

Paragraph (h) of variable B adds back the portion of a non-capital loss for another taxation year (referred to in that paragraph as the “taxpayer loss year”) that is deducted by the taxpayer under paragraph 111(1)(a). The add-back applies to the extent that the loss can reasonably be considered to derive from amounts deducted by the taxpayer in the taxpayer loss year in respect of its interest and financing expenses or other amounts described in paragraphs (b) to (g) or (j) to (m) of variable B of the definition “adjusted taxable income” (notably, including capital cost allowance and amounts in respect of resource expenses). The add-back is reduced by the taxpayer’s interest and financing revenues and any amounts described in paragraphs (b) to (f), (h) or (j) of variable C of the definition “adjusted taxable income” for the taxpayer loss year, as well as any inclusion in the taxpayer’s income for the taxpayer loss year under paragraph 12(1)(l.2).

If the non-capital loss is for a taxpayer loss year that ends before February 4, 2022, the taxpayer may elect to treat the loss as a “specified pre-regime loss” (as defined in subsection 18.2(1)). In that case, paragraph (h) does not apply and paragraph (i) will add back 25% of the amount deducted by the taxpayer in the year under paragraph 111(1)(a) in respect of the specified pre-regime loss. This election is intended to ease compliance in respect of non-capital losses for taxation years that ended before the release of the initial draft legislation of the EIFEL rules.

Variable Y further reduces a taxpayer’s add-back in respect of a non-capital loss by any FAPL of a controlled foreign affiliate for an affiliate taxation year ending in the taxpayer loss year, to the extent that the FAPL derives from the affiliate’s relevant affiliate interest and financing expenses net of its relevant affiliate interest and financing revenues. This reduction also applies in the case of a FAPL of a controlled foreign affiliate of a partnership of which the taxpayer or another controlled foreign affiliate of the taxpayer is a member.

The add-back under paragraph (h) of variable B is consistent with the add-backs under variable B in respect of a taxpayer’s interest and financing expenses and other deductible amounts. Just as the add-backs under the other paragraphs of variable B, in effect, ensure that these deductible amounts do not reduce the taxpayer’s adjusted taxable income for the taxpayer loss year in which they were deducted, the add-back under paragraph (h) ensures that the application of a non-capital loss deriving from these amounts does not affect the taxpayer’s adjusted taxable income for a taxation year in which the loss is deducted.

The add-back under paragraph (h) of variable B applies not only where a taxpayer deducts a non-capital loss carried forward (or carried back) from a taxation year in respect of which the EIFEL rules apply, but also where a taxpayer claims a deduction in respect of a non-capital loss carried forward from a pre-regime taxation year that derives from an amount described in variable B. In this regard, although the EIFEL rules do not apply in respect of a pre-regime taxation year, it is intended that a taxpayer can nevertheless be considered to have interest and financing expenses and interest and financing revenues for those years, to the extent such amounts are relevant for the purposes of applying the EIFEL rules for a taxation year in respect of which the rules apply. In particular, those definitions are intended to apply in determining the extent to which a pre-regime loss derives from a variable B amount.

Notably, because a taxpayer's interest and financing expenses do not include "excluded interest" or "exempt interest and financing expenses" (both as defined in subsection 18.2(1)), this add-back does not apply to the extent the loss derives from excluded interest or exempt interest and financing expenses.

Paragraph (j) of variable B provides for an add-back where a FAPL of a controlled foreign affiliate for an affiliate taxation year (referred to as the "affiliate loss year") is applied under variable F of the definition "foreign accrual property income" in subsection 95(1) in computing the affiliate's FAPI for another affiliate taxation year that ends in the taxpayer's taxation year (or in the fiscal period of a partnership of which the taxpayer or a controlled foreign affiliate of the taxpayer is a member at any time). The rationale for this add-back is similar to the rationale for the add-back in paragraph (h) of variable B. Generally, it applies to the extent that a FAPL derives from deductions in respect of the affiliate's relevant affiliate interest and financing expenses (net of its relevant affiliate interest and financing revenues and any amount included in respect of the affiliate under subclause 95(2)(f.11)(ii)(D)(II) for the affiliate loss year).

Paragraph (k) adds back the taxpayer's loss, or the taxpayer's share of a partnership's loss, that can reasonably be considered to be derived from activities funded, in whole or in part, by a borrowing that results in exempt interest and financing expenses. Paragraph (j) of variable C similarly reduces the taxpayer's adjusted taxable income by the amount of any income derived from activities funded by a borrowing that results in exempt interest and financing expenses. Together, these paragraphs ensure that income or losses funded by borrowing on which the interest is exempt interest and financing expenses are excluded from adjusted taxable income. For more information, see the commentary to the definition "exempt interest and financing expenses".

Paragraphs (l) and (m) of variable B provide add-backs for certain amounts that are not included in income under paragraph 12(1)(t) or (x). Paragraphs 12(1)(t) and (x) include in income, subject to certain exceptions, amounts that are deducted under subsections 127(5) or (6), 127.44(3) or 127.45(6), or that are received as certain forms of government assistance. If these amounts are included in income, they are included in adjusted taxable income under variable A.

However, paragraphs 12(1)(t) and (x) do not include in income amounts that reduce the cost or capital cost of certain properties, and such amounts therefore would not otherwise be included in adjusted taxable income. Paragraphs (l) and (m) include these amounts in adjusted taxable income, ensuring that the receipt of government assistance and the deduction of certain tax credits do not erode interest deductibility capacity.

Paragraph (l) includes in adjusted taxable income an amount deducted under subsection 127(5) or (6), 127.44(3) or 127.45(6) that was not included in income under paragraph 12(1)(t) and was not included in calculating adjusted taxable income for a preceding year, to the extent to the amount is included in an amount determined under paragraph 13(7.1)(e), subparagraphs 53(2)(c)(vi) or 53(2)(h)(ii), or for I in the definition “undepreciated capital cost” in subsection 13(21).

Paragraph (m) adds back an amount received as government assistance under clause 12(1)(x)(i)(C) or subparagraph 12(1)(x)(ii) that reduces the cost or capital cost of property and is not included in income solely by operation of subparagraph 12(1)(x)(vi) or (vii).

Variable C effectively reverses income inclusions for several amounts that are included in computing the taxpayer’s taxable income (and thus income under variable A), by reducing the taxpayer’s adjusted taxable income for the year by the following amounts:

- the taxpayer’s interest and financing revenues for the year (paragraph (a) of variable C);
- an amount included in the taxpayer’s income for the year as “recapture” of capital cost allowance under subsection 13(1), including an amount included indirectly in the taxpayer’s income as the taxpayer’s share of a recapture amount of a partnership (paragraphs (b) and (c) of variable C);
- certain amounts included in the taxpayer’s income for the year in respect of the disposition of resource properties or other recovery of resource expenses (paragraph (d) of variable C);
- the taxpayer’s foreign-source income, to the extent it is sheltered from Canadian tax by foreign tax credits under subsection 126(1) (in respect of non-business income) or subsection 126(2) (in respect of business income) (paragraphs (e) and (f) of variable C);
- notional income included in the taxpayer’s income under section 110.5 (paragraph (g) of variable C);
- an amount included in the income of a taxpayer as a beneficiary of a trust under subsection 104(13), to reflect that this amount is effectively included in the adjusted taxable income of the trust by virtue of the add-back under paragraph (g) of variable B (paragraph (h) of variable C), other than any portion of that amount that
    - has been designated under subsection 104(19) for the year (i.e., deemed to be a taxable dividend received by the beneficiary and, for certain purposes, not by the trust), or
    - gives rise to a deduction under paragraph 94.2(3)(a) in computing the foreign accrual property income of a controlled foreign affiliate of the taxpayer;
- any amount of the taxpayer’s taxable income that is not subject to tax under Part I of the Act, because it is exempt from tax under the Act or any other Act of Parliament (paragraph (i) of variable C); and
- the amount that would be the income of the taxpayer, or would be the taxpayer’s share of the income of a partnership of which it is a member, if the taxpayer or partnership had no income or loss other than income that can reasonably be considered to be derived from activities funded, in whole or in part, by a borrowing that results in exempt interest and financing expenses (paragraph (j) of variable C).

“affiliate taxation year”

An affiliate taxation year of a controlled foreign affiliate of a taxpayer means the period for which the affiliate's accounts have been ordinarily made up, but no such period may exceed 53 weeks. This is the same as the definition of "taxation year" of a foreign affiliate in subsection 95(1).

"aggregate participating percentage"

The definition "aggregate participating percentage" has the same meaning as in subsection 91(1.3). In the context of the EIFEL regime, it is relevant in determining a taxpayer's specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year. For more information, see the commentary to the definition "specified participating percentage".

"cumulative unused excess capacity"

A taxpayer's cumulative unused excess capacity for a particular year is the total of the taxpayer's unused excess capacity for the year and the three immediately preceding years. Thus, cumulative unused excess capacity is the attribute that enables a three-year carry-forward of the taxpayer's excess capacity. The term "excess capacity" is also defined in new subsection 18.2(1).

This definition reflects the taxpayer's "unused" excess capacity in that the taxpayer's excess capacity for the three immediately preceding years is reduced, under this definition, by amounts of transferred capacity (which are amounts that the taxpayer has previously transferred to eligible group corporations under subsection 18.2(4)) and amounts of absorbed capacity (which are amounts that have been used to reduce or eliminate a denial under subsection 18.2(2) of the taxpayer's interest and financing expenses). The resulting balance, which is the taxpayer's cumulative unused excess capacity for the year, is the maximum amount that the taxpayer may transfer to other eligible group corporations in that year.

An amount of transferred capacity reduces the taxpayer's cumulative unused excess capacity for the year following a transfer year, whereas the reduction for absorbed capacity occurs in the same year in which the amount of absorbed capacity arises. This is because the taxpayer's cumulative unused excess capacity for a particular year represents the total amount available for transfer in that year. Consequently, although any amount transferred in that year effectively comes out of the taxpayer's excess capacity for that year and unused excess capacity for the three immediately preceding years, the consequent reductions to excess capacity apply for the purposes of determining the taxpayer's cumulative unused excess capacity for years following the transfer year.

Because a taxpayer's absorbed capacity for a taxation year reduces its cumulative unused excess capacity for that year, the total amount that a taxpayer can transfer to another group member in a year, by way of an election under subsection 18.2(4), is reduced by the taxpayer's absorbed capacity in that year. Thus, there is in effect a mandatory "ordering rule", whereby a taxpayer is required to use its excess capacity carryforwards first to deduct its own otherwise denied interest and financing expenses, before it can use any remaining excess capacity (reflected in its cumulative unused excess capacity) to effect a transfer to another taxpayer.

The reductions to excess capacity, in determining the taxpayer's cumulative unused excess capacity, are made under subparagraph (b)(i) (in respect of transferred capacity) and (b)(ii) (in respect of absorbed capacity). Both subparagraphs follow the same general structure:

- First, they provide the total amount by which excess capacity is to be reduced, being the taxpayer's total transferred capacity amount or absorbed capacity for the year when those amounts arose.
- Second, they specify the taxation years (each referred to as a "relevant year") for which excess capacity is to be reduced. In the case where the taxpayer has one or more amounts of transferred capacity for a taxation year, there are to be reductions (in a total amount equal to the total of the taxpayer's transferred capacity amounts for the year) to the taxpayer's excess capacity for one or more of that year and the three immediately preceding years. Where the taxpayer has an amount of absorbed capacity for a taxation year, the reductions (in a total amount equal to the absorbed capacity) are made to the taxpayer's excess capacity for one or more of the three immediately preceding years. Notably, in all cases, the relevant years are determined by reference to the transfer year or absorbed capacity year, as the case may be, rather than by reference to the taxation year for which the taxpayer's cumulative unused excess capacity is being determined.
- Third, they provide that the reductions are made to the unused portion of the taxpayer's excess capacity for the relevant years. The unused portion is the excess capacity remaining after reductions to reflect amounts of transferred capacity and amounts of absorbed capacity for the taxpayer's taxation years preceding the transfer year or absorbed capacity year, as the case may be. In addition, reductions to excess capacity resulting from absorbed capacity that arises in the transfer year are also effected in determining the taxpayer's unused excess capacity for the relevant years in respect of the transfer year. All of these reductions in determining the unused portion of excess capacity for the relevant years are made in accordance with the rules in paragraph (b) of this definition.
- Finally, they provide "ordering rules" to determine for which of the taxpayer's relevant years its unused excess capacity will be reduced. The ordering rules are in paragraph (b) of the definition and ensure that a reduction will apply first to the earliest relevant year; then to the next-earliest relevant year; and so on.

In determining a taxpayer's cumulative unused excess capacity for a particular taxation year, where one or more of the three taxation years immediately preceding the particular year is a taxation year in respect of which the EIFEL rules did not yet apply (subject to certain anti-avoidance rules, the EIFEL rules apply in respect of taxation years beginning on or after October 1, 2023), there are elective transitional rules that apply for the purpose of determining the taxpayer's excess capacity for those preceding years. For more information, see the commentary on the transitional rules, following the commentary on new subsection 18.21(8).

Example

Assumptions

- At all relevant times, a taxable Canadian corporation (“Canco1”) is a member of a group of related corporations (collectively, the “group”) consisting of one other taxable Canadian corporation (“Canco2”) and several non-resident corporations.
- At no time is Canco1 or Canco2 an excluded entity or a financial institution group entity.
- Canco1 and Canco2 both have a December 31 taxation year-end.
- Canco1 and Canco2 do not elect to have the group ratio rule in subsection 18.21(2) to apply for any taxation year.
- For both Canco1 and Canco2, the 2024 taxation year is the first year in respect of which section 18.2 applies. Canco1 and Canco2 both have nil excess capacity for taxation years preceding 2024.
- Canco1 has interest and financing expenses of $15 million for each taxation year.
- Neither Canco1 nor Canco2 has any interest and financing revenues for any taxation year.
- For the 2024 taxation year, Canco1 has the deductibility of $10 million of its interest and financing expenses denied under subsection 18.2(2).
- For the 2025 taxation year, Canco1 has base deduction capacity (which, in this example, means a taxpayer’s ratio of permissible expenses for the year multiplied by its adjusted taxable income for the year) of $50 million.
- For the 2026 taxation year, Canco1 has base deduction capacity of $35 million.
- For the 2027 taxation year, Canco1 has base deduction capacity of $5 million.
- For its 2024 to 2027 taxation years, Canco2’s interest and financing expenses and base deduction capacity are such that a “transfer” under subsection 18.2(4) of Canco1’s cumulative unused excess capacity for any of those years would not increase the amount of interest and financing expenses or restricted interest and financing expense deductible by Canco2 in any of those years.
- For the 2028 taxation year:
  - Canco1 has base deduction capacity of $30 million.
  - Canco2 has excess interest (determined as the excess of its interest and financing expenses over its base deduction capacity) of $20 million and does not have any cumulative unused excess capacity.
- For the 2029 taxation year:
  - Canco1 has no base deduction capacity for the year.
  - Canco2 has excess interest of $10 million.

Analysis

2025

In 2025, Canco1’s base deduction capacity of $50 million exceeds its interest and financing expenses of $15 million by $35 million. Thus, Canco1’s $10 million restricted interest and financing expense carryforward from 2024 is deductible under paragraph 111(1)(a.1).

Canco1’s excess capacity for its 2025 taxation year is $25 million, calculated as A – B – C where:

- A is its base deduction capacity of $50 million;
- B is its interest and financing expenses of $15 million; and
- C is its deductible restricted interest and financing expense of $10 million.

Canco1's cumulative unused excess capacity for its 2025 taxation year is also $25 million, since it did not have any excess capacity for prior years.

2026

In 2026, Canco1's base deduction capacity of $35 million exceeds its interest and financing expenses of $15 million by $20 million, and it has no remaining restricted interest and financing expense carryforwards. Therefore, Canco1's excess capacity for the 2026 taxation year is $20 million.

Canco1's cumulative unused excess capacity for its 2026 taxation year is $45 million, being the total of its excess capacity of $20 million for 2026 and $25 million for 2025.

Canco1's cumulative unused excess capacity for its 2026 taxation year is $45 million, being the total of its excess capacity of $20 million for 2026 and $25 million for 2025.

2027

In 2027, Canco1's base deduction capacity of $5 million is less than its $15 million of interest and financing expenses for the year. Therefore, Canco1 has no excess capacity for the year.

Canco1 has absorbed capacity of $10 million for its 2027 taxation year, being the lesser of:

- its cumulative unused excess capacity of $45 million for 2027 (which, for the purpose of determining a taxpayer's absorbed capacity for a year, is always computed before the reduction for that absorbed capacity); and
- the amount by which its interest and financing expenses exceed the total of its base deduction capacity and interest and financing revenues (which, in this case, are nil) for the year, which excess is $10 million for 2027.

Canco1's base deduction limit under subsection 18.2(2) is increased by its absorbed capacity, which is reflected in variable E of the formula in that subsection, allowing it to deduct all of its interest and financing expenses for 2027.

Canco1's cumulative unused excess capacity for 2027 is $35 million, calculated as A + B where:

- A is its excess capacity for 2027, which is nil; and
- B is the total of its excess capacity for 2024, 2025 and 2026. However, for the purpose of computing its cumulative unused excess capacity, its excess capacity for 2025 is reduced by its absorbed capacity for 2027. The relevant excess capacity amounts are as follows:

- Canco1's excess capacity for 2024 is nil;
- Canco1's 2025 excess capacity of $25 million is reduced to $15 million;
  - The reduction is the lesser of its 2025 excess capacity and its absorbed capacity for 2027, which is $10 million; and
- Canco1's 2026 excess capacity is $20 million.
  - It is not reduced to reflect Canco1's absorbed capacity for 2027, since the reduction applies first to the earliest year in which there is unused excess capacity, being 2025.

2028

In 2028, Canco1 can fully deduct its interest and financing expenses and has excess capacity of $15 million for the year (determined as its base deduction capacity of $30 million minus its interest and financing expenses of $15 million).

Canco1's cumulative unused excess capacity for its 2028 taxation year is $50 million, calculated as A + B where:

- A is its excess capacity for 2028, which is $15 million; and
- B is the total of its excess capacity for 2025, 2026 and 2027, with its excess capacity for 2025 being reduced to reflect its absorbed capacity for 2027.
  - Canco1's excess capacity for 2025 is $15 million (after the $10 million reduction for its absorbed capacity for 2027);
  - Canco1's excess capacity for 2026 is $20 million; and
  - Canco1's excess capacity for 2027 is nil.

Canco1 and Canco2 can jointly elect under subsection 18.2(4) to "transfer" $20 million of Canco1's cumulative unused excess capacity for 2028 to Canco2. This results in Canco2 having received capacity of $20 million for 2028, which increases Canco2's base deduction limit under subsection 18.2(2) (by being reflected in variable D of that subsection) and allows Canco2 to deduct all of its interest and financing expenses for the year.

2029

In 2029, as in 2027, Canco1's interest and financing expenses exceed its base deduction capacity for the year. Thus, as in 2027, Canco1 will have absorbed capacity – provided it has a positive cumulative unused excess capacity for the year (determined before any reduction for its absorbed capacity for 2029).

For the purpose of determining Canco1's absorbed capacity for 2029, its cumulative unused excess capacity for 2029 – which, for this purpose, is determined before the reduction for its absorbed capacity for 2029 – is $30 million, calculated as A + B where:

- A is Canco1's excess capacity for 2029, which is nil; and

- B is the total of Canco1's excess capacity for 2026, 2027 and 2028, taking into account reductions for its absorbed capacity of $10 million for 2027 and its transferred capacity of $20 million for 2028. The relevant excess capacity amounts are as follows:
  - Canco1's excess capacity for 2025 is not included (reflecting the three-year carry-forward period). However, its 2025 taxation year is a "relevant year" for the purpose of determining the reductions for its absorbed capacity for 2027 and transferred capacity for 2028, such that:
    - Its excess capacity for 2025 continues to be treated as having been reduced to $15 million, to reflect its $10 million absorbed capacity for 2027; and
    - This remaining $15 million of its excess capacity for 2025 is reduced to nil, to reflect its transferred capacity for 2028;
  - Canco1's $20 million excess capacity for 2026 is reduced to $15 million. This reduction is for the $5 million by which its $20 million transferred capacity for 2028 exceeds the $15 million reduction made to its excess capacity for 2025 in respect of that transferred capacity;
  - Canco1's excess capacity for 2027 is nil
  - Canco1's excess capacity for 2028 is $15 million;

Canco1's absorbed capacity for 2029 is, therefore, $15 million, being the lesser of:

- its cumulative unused excess capacity for the year (as determined above, before any reduction for its absorbed capacity for 2029), which is $30 million; and
- the excess of its interest and financing expenses over the total of its base deduction capacity and interest and financing revenues (which in this case, are nil) for the year, which excess is $15 million.

As a result of its absorbed capacity for 2029, Canco1's cumulative unused excess capacity for 2029 is $15 million (being its $30 million cumulative unused excess capacity calculated above, before the reduction for its absorbed capacity, minus its $15 million absorbed capacity). More specifically, for the purpose of determining Canco1's cumulative unused excess capacity for 2029, the 2029 absorbed capacity reduces the remaining portion of Canco1's excess capacity for 2026 (after the $5 million reduction for its transferred capacity for 2028) from $15 million to nil.

Canco1 and Canco2 can jointly elect under subsection 18.2(4) to "transfer" $10 million of Canco1's cumulative unused excess capacity for 2029 to Canco2. This results in Canco2 having received capacity of $10 million for 2029, which allows Canco2 to deduct all of its interest and financing expenses for the year. It also results in Canco1 having a $10 million transferred capacity for 2029, which will be applied as a reduction to its excess capacity for 2028 for the purpose of determining its cumulative unused excess capacity in subsequent taxation years.

"eligible group entity"

An eligible group entity, in respect of a taxpayer resident in Canada, at any time, is in general terms a corporation or trust that is resident in Canada and that the taxpayer is, at that time, related (other than because of a right referred to in paragraph 251(5)(b)) to or affiliated with.

For purposes of paragraphs (a) and (b) of this definition, subsections 18.2(16) and (17) contain supporting rules in determining whether persons are related or affiliated, specifically addressing trustees, control by His Majesty in right of Canada or a province or by an entity referred to in any of paragraphs 149(1)(c) to (d.6) (such as municipalities and Crown corporations), and beneficiaries that are arm's length registered charities or non-profit organizations. In addition, persons are not considered to be affiliated if they otherwise would be solely because of the definition "controlled" in subsection 251.1(3). The applicable standard of corporate control for these purposes is *de jure* control.

Paragraphs which and (d) are special rules for discretionary trusts. Paragraph which applies when the entity whose connection to the taxpayer is being tested is a trust, whereas paragraph (d) applies when the taxpayer itself is a trust. In either case, discretionary beneficiaries of a trust are effectively treated as meeting the requisite connection standard in respect of the trust, except, where the taxpayer is a trust, beneficiaries of the trust that are arm's length registered charities or non-profit organizations. A discretionary interest in a trust is an interest that is not a fixed interest as defined in subsection 94(1). Thus, the rules provide that a trust and a beneficiary with a discretionary interest in the trust are generally eligible group entities in respect of one another.

This definition is relevant for, among other things, the purposes of applying the definition "excluded entity", the transfer of cumulative unused excess capacity in subsection 18.2(4) and the group ratio rule in subsection 18.21(2).

An anti-avoidance rule is included in subsection 18.2(9) to address certain circumstances where a taxpayer is, becomes or ceases to be an eligible group entity in respect of another taxpayer. For more information, see the commentary on subsection 18.2(9).

"excess capacity"

A taxpayer's excess capacity for a taxation year is essentially a measure of the amount by which the taxpayer's "capacity" for deducting interest and financing expenses under the EIFEL rules, generated by its own taxable income and interest and financing revenues for the year, exceeds the amount of its actual interest and financing expenses for the year plus its carryforwards of restricted interest and financing expenses from previous years. Thus, the taxpayer's excess capacity for a taxation year is determined without regard to its excess capacity carried forward from preceding years, or any "received capacity" of the taxpayer resulting from transfers from other group entities in the year.

More specifically, a taxpayer's excess capacity for a taxation year is the amount determined by the formula A – B – C, where:

- Variable A represents the taxpayer's capacity to deduct interest and financing expenses for the year, measured as its ratio of permissible expenses multiplied by its adjusted

taxable income, plus its interest and financing revenues for the year (subject to the reduction described below).
- Variable B is the taxpayer's total interest and financing expenses for the year; and
- Variable C is the amount of restricted interest and financing expenses from previous years that are deductible by the taxpayer under paragraph 111(1)(a.1) in the year.

In determining a taxpayer's deduction capacity under variable A for a taxation year, there is a reduction that applies if:

- the taxpayer has net interest and financing revenues for the year (i.e., its interest and financing revenues exceed its interest and financing expenses), and
- the taxpayer would have "negative" adjusted taxable income for the year if the definition of that term allowed it to be a negative amount (i.e., if it contained an override of section 257).

The amount of this reduction is determined as the taxpayer's ratio of permissible expenses multiplied by the lesser of the absolute value of the amount that would be its negative adjusted taxable income for the year and its net interest and financing revenues for the year (i.e., variable H multiplied by variable I).

Absent this reduction, the amount that would be the taxpayer's negative adjusted taxable income would not, in these circumstances, be appropriately reflected in its deduction capacity.

In general, negative adjusted taxable income is reflected as a non-capital loss, which reduces the "positive" adjusted taxable income – and thus the taxpayer's deduction capacity – that would otherwise arise in the year in which the non-capital loss carry-over is deducted. This ensures the taxpayer does not have deduction capacity to the extent it does not have adjusted taxable income on a net basis across those years.

If a taxpayer has net interest and financing revenues for a taxation year, however, its non-capital loss, if any, will be less than the absolute value of its negative adjusted taxable income. Thus, the deduction of the non-capital loss carry-over by the taxpayer in another year will not reduce the taxpayer's deduction capacity by an amount commensurate with its negative adjusted taxable income. The reduction described above ensures that the portion of the negative adjusted taxable income that is not reflected as a non-capital loss is nonetheless reflected as a reduction to deduction capacity.

For an illustration of this reduction in determining a taxpayer's excess capacity, see the example in the commentary to the definition "excluded interest".

A taxpayer's excess capacity can be used for three purposes.

First, pursuant to paragraph 111(1)(a.1), a taxpayer's restricted interest and financing expense carryforwards from previous years are deductible to the extent of the taxpayer's excess capacity for the year (as determined without regard to such deductions). By virtue of variable C in the definition "excess capacity", a taxpayer's deductible restricted interest and financing expense carryforwards from previous years automatically reduce its excess capacity for the year. This reduction occurs regardless of whether the taxpayer in fact deducts these amounts in the year, to ensure that it cannot choose to effectively preserve its cumulative unused excess capacity to transfer to other group members, in preference to deducting its restricted interest and financing expense carryforwards. This reflects a mandatory “ordering rule”, whereby a taxpayer is, in effect, required to first apply its excess capacity against its restricted interest and financing expense carryforwards from previous years (to enable their deduction), before it can use any remaining excess capacity to effect a transfer of excess capacity to another group member by way of an election under subsection 18.2(4).

Second, a taxpayer’s excess capacity for a taxation year is included in its cumulative unused excess capacity for the year and for the three immediately following years, which a corporate taxpayer can effectively transfer to an eligible group corporation in respect of the taxpayer for the year by designating it as “received capacity” of the transferee in an election under subsection 18.2(4). For more information, see the commentary on the definition “cumulative unused excess capacity” and subsection 18.2(4).

Third, a taxpayer can use its excess capacity to allow the deduction of interest and financing expenses for a later taxation year that would otherwise be denied under subsection 18.2(2). More specifically, a taxpayer’s cumulative unused excess capacity for a taxation year – which, as noted, includes the taxpayer’s excess capacity from the three immediately preceding years – is automatically applied to enable the taxpayer to deduct amounts of interest and financing expenses that would otherwise have been denied in the year. This occurs by virtue of the taxpayer’s “absorbed capacity” for the year being included in variable E of the formula in subsection 18.2(2). For more information, see the commentary on the definition “absorbed capacity”.

A taxpayer that elects, along with its corporate group, to have the group ratio rules in section 18.21 apply for a taxation year is treated as having nil excess capacity for that year. This reflects, first, that the group ratio rules in subsection 18.21(2) provides a separate mechanism for calculating the capacity to deduct interest and financing expenses at the group level and then allocating this capacity among group members for a year. Second, it reflects an intention that, for any taxation year in respect of which a taxpayer is subject to the group ratio, it cannot accrue excess capacity that is carried forward to later years as cumulative unused excess capacity.

“excluded entity”

A taxpayer that is an excluded entity for a taxation year is not subject to the deduction restrictions under new subsection 18.2(2), nor an income inclusion under new paragraph 12(1)(l.2), in respect of its interest and financing expenses for the year.

Excluded entities generally do not pose significant base erosion and profit shifting risks targeted by the new EIFEL rules.

A taxpayer is an excluded entity for a particular taxation year if it satisfies the conditions in any of paragraphs (a) to (c).

Under paragraph (a), a taxpayer is an excluded entity for a particular taxation year if, throughout the particular year, it is a Canadian-controlled private corporation that, together with any associated corporations, has taxable capital employed in Canada of less than $50 million (i.e., the top end of the phase-out range for the small business deduction). These entities are relieved from the application of the EIFEL rules because they are Canadian controlled and are small or medium sized businesses.

Under paragraph (b), a taxpayer is an excluded entity for a taxation year if it is part of a group whose Canadian members have total interest and financing expenses (net of interest and financing revenues) for the year of $1,000,000 or less. These taxpayers are excluded from the application of the EIFEL rules because they do not have significant net interest and financing expenses on a Canadian group-wide basis. The group can include corporations and trusts. Notably, the interest and financing revenues of any group member that is a financial institution group entity are excluded to ensure their net interest and financing revenues do not shelter the interest and financing expenses of other group members.

Exempt interest and financing expenses are included in determining if the group’s net interest and financing expenses exceed $1,000,000. For more information, see the commentary on the definition “exempt interest and financing expenses”.

Under paragraph which, a particular Canadian-resident taxpayer is an excluded entity if it is a standalone entity or a member of a group (defined to include all “eligible group entities” in respect of the particular taxpayer) that consists exclusively of Canadian-resident taxpayers, provided that four conditions are met.

The first condition is that the particular taxpayer and all other group members carry on all or substantially all of their businesses, if any, undertakings and activities in Canada. A taxpayer or an eligible group entity in respect of the taxpayer whose undertakings and activities do not rise to the level of carrying on a business will meet this requirement if all or substantially all of its activities and undertakings are carried on in Canada. The holding, by the taxpayer or another eligible group entity of indebtedness or shares of a foreign affiliate is not an undertaking or activity that is taken into consideration in applying this condition. For example, where a Canadian holding company’s only activity is the holding of shares or debt of a foreign affiliate, it will be considered to carry on all or substantially all of its businesses, undertakings and activities in Canada.

The second condition is that the group’s foreign affiliate holdings, if any, are *de minimis*, meaning the greater of the book cost of all foreign affiliate shares held by the group and the fair market value of the assets of all foreign affiliates held by the group does not exceed $5,000,000. For this purpose, book value is to be determined only by reference to the taxpayer’s (or taxpayer group’s) ownership interest in the affiliate.

The third condition is that no person or partnership is

- a specified shareholder or specified beneficiary (both as defined in subsection 18(5), for the purposes of the thin capitalization rules) of the particular taxpayer, or any eligible group entity, that is a non-resident; or
- a partnership where more than 50% of the fair market value of the interests in the partnership are held by non-residents, and the property of the partnership includes more than 25% of the equity in the particular taxpayer or any eligible group entity; and

The final condition is that all or substantially all of the interest and financing expenses of the particular taxpayer and each eligible group entity in respect of the particular taxpayer, are paid or payable to persons or partnerships that are not tax-indifferent (as defined in subsection 18.2(1)) and do not deal at arm's length with the particular taxpayer or any eligible group entity.

Subsection 18.2(14) provides an anti-avoidance rule that deems certain recipients of interest and financing expenses to be non-arm's length and tax-indifferent. For more information, see the commentary on subsection 18.2(14).

"excluded interest"

The definition "excluded interest" sets out the conditions that must be satisfied in order for two members of the same corporate group to elect to have a payment of interest or a lease financing amount (as defined in subsection 18.2(1)) made from one to the other excluded from the limitation under subsection 18.2(2). This election is principally intended to ensure that the EIFEL rules do not negatively impact on corporate transactions that are often undertaken within Canadian corporate groups to allow the losses of one group member to be offset against the income of another group member.

More specifically, excluded interest is not included in determining the interest and financing expenses (as defined in subsection 18.2(1)) of a taxpayer for a taxation year. As a result, a deduction in respect of excluded interest will not be denied under subsection 18.2(2) or result in an income inclusion under paragraph 12(1)(l.2). However, excluded interest is also not included in the interest and financing revenues of the payee, which limits the extent to which it can "shelter" the payee's interest and financing expenses from the limitation under subsection 18.2(2) or increase the payee's excess capacity (as defined in subsection 18.2(1)), as the case may be.

In general, interest expenses and interest income are disregarded in computing a taxpayer's adjusted taxable income. This occurs by virtue of the "add-back" for interest and financing expenses under variable B of the definition "adjusted taxable income" in subsection 18.2(1), and the exclusion of interest and financing revenues under variable C of that definition. Because excluded interest is not reflected in the payer's interest and financing expenses or the payee's interest and financing revenues, however, it is not disregarded in computing adjusted taxable income, but rather generally reduces that of the payer and increases that of the payee.

For an amount of interest or a lease financing amount to be excluded interest it must satisfy a number of conditions.

Notably, the amount must be paid or payable by a corporation or partnership to another corporation or partnership (referred to as the "payer" and "payee", respectively) in respect of a debt or lease. Throughout the period during which the amount accrued (referred to as the "relevant period"), the debt must be owed by the payer to the payee, or the lease must be between them. Thus, excluded interest treatment is not available, for example, where interest accrues during a period when the debt is held by another person or partnership, and the debt is subsequently transferred to the payee, or assumed by the payer, before the interest is paid or payable.

In addition, throughout the relevant period and at the time of payment, the payer and payee must both be taxable Canadian corporations, and eligible group entities (as defined in subsection 18.2(1)) in respect of one another, unless one or both are partnerships. If the payer or payee is a partnership, similar conditions apply in respect of the members of the partnership. If the payer is not a "financial institution group entity" (as defined in subsection 18.2(1)), the election will only be available if the payee is also not such an entity.

Finally, the payer and payee (or, if the payer or payee is a partnership, each member of the payer or payee) are required to jointly elect in writing in prescribed manner and specify the amount of interest, or the lease financing amount, which they wish to have treated as excluded interest, as well as the amount of the debt at the beginning and end of the relevant period or the fair market value of the leased property at the time the lease began. Taxpayers may treat all or any portion of an interest payment, or lease financing amount, as excluded interest. The result of this election is that the amount is excluded interest for the single taxation year in respect of which the election was filed.

The joint election must be filed in respect of the taxation year or fiscal period of the payer and payee in which the amount of interest or the lease financing amount is paid, or in respect of which the amount is payable. It is intended that the election be filed for the year or fiscal period when the amount paid or payable is deductible or is included in income. For example, if accrued interest is deductible in a particular taxation year but becomes paid or payable in a later taxation year, the election must be filed for the particular year.

Example

Assumptions

- Canco is a wholly-owned subsidiary of Forco, a non-resident corporation.
- For its taxation year ending December 31, 2025, Canco has a non-capital loss carryforwards balance of $50 million, consisting of losses incurred as a result of transactions entered into in the ordinary course of its retail sales business.
- Canco is the sole shareholder of CanSub, which is expected to have significant income from its wholesale business in its taxation year ending December 31, 2025.
- Canco and CanSub enter into a series of transactions, the effect of which is that CanSub becomes indebted to Canco and has $10 million in interest (the "Interest") paid and payable in 2025 in respect of the debt. The series of transactions has no material interprovincial effects.

- In 2025, CanSub would have taxable income of $10 million, before taking into account the Interest.
- Canco deducts $10 million under paragraph 111(1)(a) in respect of its non-capital loss carryforwards, in computing its taxable income for 2025.
- Throughout the period during which Interest accrues, both Canco and CanSub are taxable Canadian corporations and Canco is an eligible group corporation in respect of CanSub.
- The group ratio rule in subsection 18.21(2) does not apply in respect of Canco or CanSub for their 2025 taxation year.

Analysis – with "excluded interest" election

If CanSub and Canco duly elect under paragraph (e) of the definition "excluded interest" in respect of the Interest, this amount is treated as excluded interest.

Because excluded interest is not included in computing CanSub's interest and financing expenses, subsection 18.2(2) does not limit the amount that CanSub may deduct in respect of the Interest in computing its income for its 2025 taxation year.

As a result of the Interest, CanSub's taxable income for 2025 is nil. Consequently, in computing CanSub's adjusted taxable income, the amount determined for variable A in the definition "adjusted taxable income" is nil. No amount in respect of the Interest is added back under paragraph (a) of variable B of that definition, since excluded interest is not included in CanSub's interest and financing expenses. Thus, assuming CanSub does not have any other amounts described in variable B (e.g., interest and financing expenses) or C (e.g., interest and financing revenues) of that definition, its adjusted taxable income for 2025 is nil.

The Interest is included in computing Canco's income for its 2025 taxation year. Canco's $10 million deduction in respect of its non-capital loss carryforwards reduces its taxable income – and thus the amount determined for variable A in computing its adjusted taxable income for the year – to nil. In addition, since excluded interest is not included in computing Canco's interest and financing revenues, the Interest is not subtracted in computing Canco's adjusted taxable income, under variable C of the definition of that term. Assuming Canco does not have any amounts described in variable B or C of that definition, Canco's adjusted taxable income for 2025 is nil.

Because excluded interest is not included in computing Canco's interest and financing revenues, the Interest does not increase Canco's deduction capacity (under variable C in subsection 18.2(2)) or its excess capacity (under variable F of the definition of that term).

Analysis – without "excluded interest" election

If CanSub and Canco do not jointly elect to treat the Interest as excluded interest, $10 million will be included in CanSub's interest and financing expenses and in Canco's interest and financing revenues for their 2025 taxation year.

As a result, the amount that CanSub may deduct in respect of the Interest is subject to the limitation in subsection 18.2(2).

In determining CanSub's adjusted taxable income for 2025, the amount determined for variable A of the definition of that term (which is determined without regard to any interest deductions denied under subsection 18.2(2)) is nil, since CanSub's taxable income is nil. However, because the Interest is included in CanSub's interest and financing expenses, it is added back under paragraph (a) of variable B in computing CanSub's adjusted taxable income. Thus, assuming CanSub does not have any other amounts described in variable B or C, its adjusted taxable income for 2025 is $10 million.

CanSub's adjusted taxable income of $10 million results in $3 million of deduction capacity under subsection 18.2(2) (determined, under paragraph (b) of variable B of that subsection, by multiplying $10 million of adjusted taxable income by a ratio of permissible expenses of 30%). In order for CanSub to deduct the remaining $7 million of the Interest, absent any cumulative unused excess capacity or interest and financing revenues of its own, CanSub will require a transfer, under the election in subsection 18.2(4), out of Canco's cumulative unused excess capacity.

In determining Canco's adjusted taxable income, Canco's $10 million deduction in respect of its non-capital loss carryforwards reduces its taxable income – and thus the amount determined for variable A in the definition "adjusted taxable income" – to nil. The $10 million included in Canco's interest and financing revenues in respect of the Interest (as a result of not electing "excluded interest" treatment) is subtracted under variable C in computing its adjusted taxable income. In the absence of section 257, this would cause Canco's adjusted taxable income for 2025 to be negative $10 million. However, because of section 257, Canco's adjusted taxable income cannot be a negative amount and is thus nil.

Although Canco has nil adjusted taxable income, it nonetheless has excess capacity, derived from its interest and financing revenues, by virtue of variable F in paragraph (b) of the definition "excess capacity". However, because Canco's adjusted taxable income would, absent section 257, be negative $10 million, variables H and I of the "excess capacity" definition reduce Canco's excess capacity deriving from its interest and financing revenues from $10 million to $7 million (i.e., $10 million minus the product of 30% and $10 million). For further information on this reduction, see the commentary to the definition "excess capacity".

Assuming Canco does not have any interest and financing expenses or deductible restricted interest and financing expense for the year, its excess capacity for 2025 is $7 million. This amount is included in determining Canco's cumulative unused excess capacity for 2025, under paragraph (a) of the definition of that term.

Provided that the requirements of subsection 18.2(4) are met, Canco and CanSub may jointly elect to designate Canco's $7 million cumulative unused excess capacity as an amount of transferred capacity of Canco and received capacity of CanSub for the 2025 taxation year. In computing CanSub's interest deduction limit for the year under subsection 18.2(2), this $7 million received capacity is, under variable D in that subsection, added to CanSub's $3 million deduction capacity deriving from its adjusted taxable income, such that CanSub is entitled to deduct $10 million in respect of the Interest.

"excluded lease"

A "lease financing amount", representing an implicit interest expense in respect of a lease, is included in the lessee's interest and financing expenses, and the lessor's interest and financing revenues, unless the lease is an excluded lease.

A lease to which subsection 16.1(1) applies is treated as an excluded lease, because the effect of the lessor and lessee jointly electing under that subsection is that the lessee has a deemed interest expense in respect of the lease, which is already included in its income and financing expenses (as defined under subsection 18.2(1)).

In recognition that the specified leasing property rules in the Regulations, like the new EIFEL rules, generally seek to distinguish leases that are (or are more likely to be) used as substitutes for financing from those that are used for operational purposes (which are generally excluded from the rules), the other categories of excluded lease are based on exclusions from the "specified leasing property" definition in of subsection 1100(1.11) of the Regulations. Generally, these other categories of excluded lease are leases with a term of less than one year, leases of property with a fair market value of $25,000 or less, and leases in respect of "exempt property".

The reason that paragraphs (b) and (c) of the definition "excluded lease" refer to leases or property that would (or would not) be considered, for the purposes of the specified leasing property rules, to satisfy certain requirements for exclusions from the definition "specified leasing property", is to ensure that various anti-avoidance and application rules in section 1100 also apply for the purposes of determining whether a lease or property satisfies the requirements in the definition "excluded lease". These include, for example, the various rules relating to exempt property in paragraphs 1100(1.13)(a) to (a.2); and the anti-avoidance rules in paragraphs 1100(1.13)(b) and (c), relating to leases with a term of less than one year and leases of property with a fair market value of $25,000 or less, respectively.

Certain other types of lease (or leases in respect of certain types of property) that are excluded from the "specified leasing property" definition are not excluded leases for the EIFEL rules. For example, leases in respect of non-depreciable property and intangible property, and leases entered into between non-arm's length persons, are specifically excluded from "specified leasing property" but are not excluded leases (unless they meet the specific requirements in the definition "excluded lease").

"exempt interest and financing expenses"

The definition of "exempt interest and financing expenses" is relevant for purposes of providing an exemption from the EIFEL rules for interest and financing expenses incurred in respect of the financing of typical Canadian public-private partnership (P3) infrastructure projects.

Exempt interest and financing expenses do not pose significant base erosion and profit shifting risks targeted by the new EIFEL rules.

Pursuant to variable A of the definition “interest and financing expenses”, exempt interest and financing expenses are not included in a taxpayer’s interest and financing expenses. Accordingly, they are not subject to a deduction denial under subsection 18.2(2) or an income inclusion under paragraph 12(1)(l.2).

Other effects flow from not including exempt interest and financing expenses in interest and financing expenses. For example while the latter are added back in computing adjusted taxable income (paragraph (a) of variable B of the definition of that term), there is no such add-back for exempt interest and financing expenses. However, there is an add-back to adjusted taxable income for income or losses that may reasonably be considered to arise in respect of a borrowing that results in exempt interest and financing expenses (paragraph (j) of variable C, and paragraph (k) of variable B, each of the definition of adjusted taxable income).

Expenses that would otherwise be interest and financing expenses of a taxpayer will be exempt interest and financing expenses to the extent they were incurred by the taxpayer or a partnership of which the taxpayer is a member in respect of a borrowing or other financing where

- the taxpayer or partnership entered into an agreement with a “public sector authority” (also as defined in subsection 18.2(1)) to design, build and finance, or design, build, finance, maintain and operate, property that a public sector authority (which may be a different public sector authority than the one that entered into the agreement) owns, or has a leasehold interest in or a right to acquire;
- the borrowing or other financing was entered into in respect of the agreement;
- it can reasonably be considered that all or substantially all of the expenses were economically borne by the public sector authority that has the interest in the property or that entered into the agreement with the taxpayer or partnership (for example, where the public sector authority makes capital payments under a project agreement to cover the financing expenses of the project); and
- the expenses were paid or payable to arm’s length persons, or paid or payable to a particular non-arm’s-length person in a back-to-back financing arrangement where it may reasonably be considered that the particular person paid all or substantially all of the amount on to a person that deals at arm’s length with the taxpayer or partnership (for example, where for commercial or regulatory purposes a subsidiary entity of the taxpayer or partnership borrows from arm’s length third parties and on-lends to the taxpayer or partnership).

“financial holding corporation”

The definition “financial holding corporation” is relevant for the purposes of the restrictions on the ability of financial institution group entities to transfer their cumulative unused excess capacity under subsection 18.2(4), and for the purposes of the anti-avoidance rule in subsection 18.2(13). For more information, see the commentary on those provisions.

“financial institution group entity”

The definition “financial institution group entity” is relevant mainly in applying the restrictions on the ability of such an entity to transfer its cumulative unused excess capacity to other members of its corporate group under subsection 18.2(4). These restrictions are intended to address anomalies in applying the EIFEL rules in respect of corporate groups that include financial institutions. For certain financial institutions, the nature of their regular business activities is such that interest income and expenses may more appropriately be considered as in the nature of operating amounts. Relatedly, the interest income of these entities will often exceed their interest expense. The restrictions on transfers by financial institution group entities are intended to ensure that this net interest income cannot be used to inappropriately shelter the interest and financing expenses of taxpayers that are members of the same corporate group, but which do not principally carry on financial businesses or activities.

In general terms, financial institution group entities are entities whose regular business activities involve the lending of money, dealing or investing in indebtedness or other financing transactions, or that are eligible group entities in respect of such an entity and, generally, either provide regulated financial services or carry on activities all or substantially all of which support the activities or business of other financial institution group entities. This would include, for example, an entity that is an eligible group entity in respect of a bank and provides routine or specialized “back office” services to the bank, such as information technology or risk analysis. There are three restrictions imposed in respect of financial institution group entities.

First, for the purpose of paragraph (b) in the definition “excluded entity” in subsection 18.2(1), which generally provides an exclusion from the limitation in subsection 18.2(2) for taxpayers that are members of groups with net interest and financing expenses of $1,000,000 or less in a taxation year, the interest and financing revenues of a financial institution group entity are excluded in computing the group’s net interest and financing expenses.

Second, a financial institution group entity can only transfer, under subsection 18.2(4), its cumulative unused excess capacity to another financial institution group entity or, subject to certain limitations, to a financial holding corporation or a special purpose loss corporation.

Third, under the anti-avoidance rule in subsection 18.2(13), payments received by a taxpayer that is not a financial institution group entity or a financial holding corporation from a non-arm’s length financial institution group entity (or financial holding corporation) are excluded from the taxpayer’s interest and financing revenues (and do not reduce the taxpayer’s interest and financing expenses).

Additionally, under the transitional rules, the “group net excess capacity” (essentially the excess capacity available to be carried forward into the EIFEL regime) is determined without reference to any income or expense amounts of financial institution group entities.

For more information, see the commentary on the definition “excluded entity” in this subsection and on subsection 18.2(4).

“fixed interest commercial trust”

The definition “fixed interest commercial trust” is relevant for purposes of the transfer of cumulative unused excess capacity between certain eligible group entities under subsection 18.2(4), as only entities that are taxable Canadian corporations or fixed interest commercial trusts may make or receive transfers under that subsection. The definition relies on concepts and conditions found in subsection 94(1), specifically the definition “fixed interest” and clauses (h)(ii)(A) to (C) of the definition “exempt foreign trust”. Essentially, a fixed interest commercial trust is a trust resident in Canada that is a non-discretionary trust (i.e., a fixed interest trust) and meets any of the conditions in the above-noted clauses of the definition “exempt foreign trust”, which generally test the commerciality of the trust.

“foreign accrual property loss”

The definition “foreign accrual property loss” has the meaning assigned by subsection 5903(3) of the Regulations. This definition is relevant in applying the EIFEL rules in respect of controlled foreign affiliates of taxpayers.

“interest and financing expenses”

The definition “interest and financing expenses” includes interest and various other financing-related expenses and losses, but does not include any exempt interest and financing expenses (which are generally expenses incurred in respect of certain public-private partnership infrastructure projects). For more information, see the commentary on the definition “exempt interest and financing expenses”.

The deductibility of a taxpayer’s interest and financing expenses that are described in any of paragraphs (a) to (g) or (i) of variable A of this definition is potentially subject to denial under new subsection 18.2(2). If the expenses are incurred at the level of a partnership and attributed to the taxpayer under paragraph (h) of variable A of this definition, they may instead give rise to an income inclusion to the taxpayer under new paragraph 12(1)(l.2).

A taxpayer’s interest and financing expenses are “added back” in determining its adjusted taxable income for the year, under paragraph (a) of variable B of that definition.

A taxpayer’s interest and financing expenses for a particular taxation year are the total of the amounts described in paragraphs (a) to (j) of variable A, minus the total of the amounts described in variable B.

Variable A

Paragraph (a) of variable A includes, in a taxpayer’s interest and financing expenses for a particular taxation year, amounts paid or payable as, on account of, in lieu of payment of or in satisfaction of, interest. This description is similar to that in paragraph 12(1)(c), which is the rule requiring a taxpayer to include interest received or receivable in computing its income. For greater certainty, it includes amounts that are deemed or treated as interest under the Act (e.g., under subsection 16(1)), but specifically excludes amounts that are paid or payable by a credit union in respect of its shares and are deemed to be interest under subsection 137(4.1).

The amounts described in subparagraph (a)(i) are included if, absent the new limitation under subsection 18.2(2), they would be deductible in the particular year. The year in which they are deductible need not be the same year in, or in respect of which, they are paid or payable.

These amounts are included regardless of the particular provision of the Act under which they are deductible, except that paragraph (a) does not include amounts that are deductible under a provision referred to in subparagraph (c)(i). In addition to preventing double-counting in computing interest and financing expenses, this exception is intended to ensure that certain discretionary deductions in respect of mainly capitalized interest and financing expenses are included in interest and financing expenses (by virtue of paragraph (c) in this definition) only to the extent that a deduction is in fact claimed for the year.

The following amounts are not included in the taxpayer's interest and financing expenses under paragraph (a):

- "Excluded interest", which is generally interest, or a lease financing amount, paid or payable by the taxpayer to another member of its corporate group that the parties have jointly elected to treat as such. For more information, see the commentary on the definition "excluded interest";
- An amount deemed to be interest under subsection 137(4.1); and
- An amount that is interest and financing expenses under another paragraph of the definition, to prevent double-counting of such amounts in determining interest and financing expenses.

Paragraph (b) of variable A includes in a taxpayer's interest and financing expenses for the particular year amounts that, absent subsection 18.2(2), would otherwise be deductible in the particular year

- under any of subparagraphs 20(1)(e)(ii) to (ii.2) and paragraphs 20(1)(e.1) and (e.2), in respect of various financing-related expenses; or
- under paragraph 20(1)(f), for amounts paid in respect of the principal amount of certain debt obligations issued at a discount.

In certain cases, financing expenses may be otherwise described in, for example, paragraph 20(1)(e) but a taxpayer may take the position that the expenses are deductible under another provision of the Act (such as section 9), such that they are not deductible under paragraph 20(1)(e). In paragraph (b), the phrase "and on the assumption that [the amount] is not deductible under another provision of this Act" is intended to ensure that these expenses are nonetheless included in a taxpayer's interest and financing expenses.

Paragraph (c) of variable A includes in interest and financing expenses amounts that are in respect of interest, or any of the various financing-related expenses that would otherwise be included in the taxpayer's interest and financing expenses for some year by virtue of paragraph

(b) of this definition, but that generally have been “capitalized” or otherwise included in resource-expense pools (for example, by virtue of subsection 18(3.1) for certain costs in relating to construction; or as a result of an election under any of subsections 21(1) to (4), in respect of interest or various financing expenses). These amounts are included in the taxpayer’s interest and financing expenses for the particular year in which the taxpayer claims them as deductions in respect of capital cost allowance under paragraph 20(1)(a), or in respect of resource expenses under any of the provisions listed in subparagraph (c)(i). This includes where the taxpayer claims a deduction under section 66.7 in respect of amounts that have been included in successor pools. Because amounts are included in interest and financing expenses under paragraph (c) only in the year in which they are claimed, they are not included for any year in which they have become deductible but have not yet been claimed as deductions by the taxpayer.

To facilitate compliance, paragraph (c) only includes in interest and financing expenses capitalized amounts that are paid or payable on or after February 4, 2022.

Since a taxpayer’s undepreciated capital cost, or remaining balance in its resource expense pools, generally will not be attributable exclusively to interest and financing expenses, paragraph (c) of variable A requires that the taxpayer determine the portion of an amount it claims in respect of its capital cost allowance or resource expenses for a particular year that can "reasonably be considered" to be attributable to the interest or financing expenses. It is expected that this portion would generally correspond to the proportion of the claimed amount that the interest and financing expenses included in the relevant expense pool are of the taxpayer’s undepreciated capital cost or undeducted balance of a resource expense pool, as the case may be.

If subsection 18.2(2) denies a deduction for any portion of an amount included in the taxpayer’s interest and financing expenses by virtue of paragraph (c) or (d) of variable A of this definition, then the rule provided in subsection 18.2(3) ensures that the taxpayer’s undepreciated capital cost or resource expense pool is reduced to the extent of the denied portion. For more information, see the commentary on subsection 18.2(3).

Under paragraph (d) of variable A, where a taxpayer suffers a terminal loss in a year, any portion that can reasonably be considered to represent capitalized interest or financing expenses described in subparagraph (c)(ii) of variable A is included in the taxpayer’s interest and financing expenses.

Paragraph (e) of variable A includes in interest and financing expenses certain amounts that are not included under any of the other paragraphs in this definition, but can reasonably be considered to be part of the cost of funding with respect to a borrowing or other financing of the taxpayer or a non-arm’s length person or partnership. This is intended to include amounts that are, in economic terms, part of the costs incurred in relation to the funding of a business or investment. This would include, for example, an amount that is not included under paragraph (a) because it does not have the legal character of interest, but which is economically equivalent to interest.

An amount is included in a taxpayer’s interest and financing expenses for a particular taxation year under paragraph (e) only if all the conditions in that paragraph are met.

First, subparagraph (e)(i) requires that the amount be paid or payable by, or a loss of, the taxpayer and deductible in computing its income for the particular year (absent section 18.2). Alternatively, the amount must be a capital loss that is offset against the taxpayer's taxable capital gains for the particular year, or is deductible under paragraph 111(1)(b) in computing its taxable income for the particular year. It is not expected that equity financings would satisfy all the requirements of paragraph (e). These types of financings do not typically give rise to a deduction, a loss or a capital loss that would satisfy the requirement in subparagraph (e)(i), and that subparagraph specifically excludes amounts that are deductible under subparagraph 20(1)(e)(i) (as expenses incurred in the course of issuing equity interests in the taxpayer). Second, subparagraph (e)(ii) requires that the amount arise under or as a result of an agreement or arrangement that is entered into as, or in relation to, a borrowing or other financing of the taxpayer or a non-arm's length person or partnership. Thus, the agreement or arrangement can either itself constitute or provide a financing, or be ancillary to a financing. The reference to "borrowing or other financing" is intended to describe a range of agreements or arrangements that procure financing, in an economic sense.

The agreements and arrangements contemplated by subparagraph (e)(ii) include, among other things, derivative contracts used in a wide range of situations. For example, it can include a derivative contract that is entered into for the purpose of hedging any risk in relation to a borrowing or other financing (including currency, interest rate or payment risk), and a derivative contract that itself includes a material financing or funding component. The types of derivative contracts that can meet the conditions in paragraph (e) of this definition include cash or physically-settled swap agreements, forward purchase or sale agreements, forward rate agreements, futures agreements, securities lending agreements, sale and repurchase agreements ("repos"), and option agreements.

Derivative contracts can be considered to include a financing or funding component, for example, where they have mismatched payment or delivery requirements, which can, in economic terms, result in a financing or funding of either party during all or part of the term of the particular contract. This can result from either party having the right to use any cash, cash equivalents or other securities transferred or delivered to them during the term of the particular agreement or arrangement (net of any amounts they are obligated to transfer or deliver to the other party during the term of the particular agreement or arrangement). Examples include (i) forward agreements with material prepayment or pre-delivery obligations, (ii) swap agreements with material mismatched payment or collateralization requirements, and (iii) securities lending agreements or repos (whether or not they are "securities lending arrangements" for the purposes of section 260).

An amount under a derivative contract could satisfy the necessary conditions in subparagraph (e)(ii) of variable A even where the derivative contract is in relation to a borrowing or other financing that is anticipated to be entered into sometime in the future, and even if it is subject to a contingency, since subparagraph (e)(ii) provides that the borrowing or financing can be entered into "currently or in the future, and absolutely or contingently".

Third, to be included in interest and financing expenses under paragraph (e) of variable A, the amount paid or payable must satisfy the requirement in subparagraph (e)(iii) such that it can reasonably be considered to increase or be "part of" the "cost of funding"; this includes amounts that increase the cost of funding as a result of any hedge of the cost of funding or of the borrowing or other financing. In the case of a derivative contract entered into for the purpose of hedging a risk in relation to a borrowing or other financing, an amount paid or payable under, or a loss resulting from, the contract constitutes a cost of funding. The phrase "cost of funding" would include any amount that can reasonably be considered compensation for the time value of money. In the context of the derivative contracts examples outlined above, where the effect of the agreement or arrangement is to fund a business or investment, the combined cash flows must economically include an amount that can reasonably be considered to be in respect of compensation for the use of the cash, cash equivalents or securities that constitute the funding. While not definitive for purposes of paragraph (e) of variable A, the manner in which an amount is characterized under the applicable generally accepted accounting principles may provide guidance with respect to the types of amounts considered economically equivalent to interest or otherwise treated as financing expenses.

Paragraph (f) of variable A includes in interest and financing expenses generally any expenses or fees, in respect of agreements or arrangements described in paragraph (e) of variable A, that would, in the absence of section 18.2, be deductible by the taxpayer in the year and are not included in the taxpayer's interest and financing expenses under paragraph (b) of variable A of this definition. The policy is that expenses and fees in respect of an agreement or arrangement that is treated as a financing transaction should themselves be included in the taxpayer's interest and financing expenses. Because these agreements or arrangements may, in many cases, not be described in any of the provisions listed in paragraph (b) of variable A, the associated expenses and fees would consequently not be included under that paragraph. Including these expenses and fees in a taxpayer's interest and financing expenses ensures neutrality between taxpayers' choice of financing arrangements. These expenses and fees are included if they are incurred in contemplation of, in the course of entering into or in relation to, the agreement or arrangement. Expenses or fees incurred "in relation to the agreement or arrangement" would include, for example, those incurred in making payments under the agreement or arrangement, taking steps to secure the receipt of payments under the agreement or arrangement, or modifying the terms and conditions of the agreement or arrangement.

Paragraph (g) of variable A includes in interest and financing expenses the portion, of any lease payment that would be deductible in the absence of subsection 18.2(2), that is a "lease financing amount". This essentially imputes a financing cost to lessees in respect of their lease payments. Lease payments made in respect of excluded leases, or in respect of which an "excluded interest" election is made, do not give rise to interest and financing expenses under paragraph (g). For more information, see the commentary on the definitions "lease financing amount", "excluded interest" and "excluded lease".

Paragraph (h) of variable A essentially includes in a taxpayer's interest and financing expenses its share of the interest and financing expenses of a partnership of which the taxpayer is a member. This includes interest and financing expenses described in paragraphs (a) to (g) of variable A that are deducted in computing the income of a partnership. It also includes the relevant affiliate interest and financing expenses of a controlled foreign affiliate (described in paragraph (j) of variable A) held through a partnership.

The attribution of partnership-level interest and financing expenses applies on a source-by-source basis, with the partnership's interest and financing expenses in respect of each source being attributed to the taxpayer based on its pro rata share of the partnership's income or loss from the source. These amounts are included in the taxpayer's interest and financing expenses for its taxation year in which the partnership's fiscal period ends.

The amount included under paragraph (h) of variable A is subject to reductions under variable E and F of that paragraph, if applicable. The reduction under variable E ensures that, if paragraph 12(1)(l.1) of the thin capitalization rules applies to include an amount in the taxpayer's income in respect of the taxpayer's share of partnership-level interest and financing expenses, that amount reduces the amount that is included in the taxpayer's interest and financing expenses under paragraph (h).

The reduction under variable F applies where the partnership deducts interest and financing expenses in computing its loss from a source, and the limited partnership "at-risk" rule in subsection 96(2.1) applies to restrict the taxpayer's ability to deduct its share of the partnership loss.

Paragraph (i) of variable A is related to variable F of paragraph (h). It applies where the taxpayer claims an amount under paragraph 111(1)(e), in respect of a partnership loss, that was previously denied under subsection 96(2.1) for a preceding taxation year. In that case, the portion of the amount claimed that would, in the absence of subsection 18.2(2), be deductible under paragraph 111(1)(e) that is attributable to a variable F amount from a previous taxation year is included in the taxpayer's interest and financing expenses.

Paragraph (j) of variable A essentially includes in the taxpayer's interest and financing expenses for the particular year its share of a controlled foreign affiliate's relevant affiliate interest and financing expenses for an affiliate taxation year ending in the particular year.

In general terms, relevant affiliate interest and financing expenses consists of the amounts described in the definition "interest and financing expenses" that are taken into account in determining the foreign accrual property income of a controlled foreign affiliate for an affiliate taxation year. The extent to which the relevant affiliate interest and financing expenses are attributed to a taxpayer is determined by reference to the taxpayer's specified participating percentage in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on the definitions "relevant affiliate interest and financing expenses" and "specified participating percentage".

Variable B

The amounts described in variable B are deducted from the amounts described in variable A and reduce the amount of interest and financing expenses of a taxpayer for a particular taxation year.

Paragraph (a) of variable B includes amounts received or receivable (other than as a dividend or an amount in respect of exempt interest and financing expenses) by the taxpayer in a year, or a gain for a year, in connection with an agreement or arrangement entered into in relation to a borrowing or other financing of the taxpayer, or a non-arm's length person or partnership, to hedge the cost of funding with respect to the borrowing or other financing or to hedge the borrowing or other financing. The amounts must be included in computing the income of the taxpayer for the year and must reasonably be considered to reduce the cost of funding with respect to the borrowing or other financing. In effect, the amounts described in paragraph (a) are limited to amounts received or receivable in respect of a hedge, including any gain realized on a derivative contract that hedges a risk (including currency, interest rate or payment risk) in relation to the borrowing or other financing. Subparagraph (a)(iv) ensures that such an amount does not reduce a taxpayer's interest and financing expenses to the extent the amount is effectively sheltered from Canadian tax by virtue of a credit or deduction in respect of foreign taxes (other than foreign withholding taxes).

Paragraph (b) of variable B ensures that a taxpayer's interest and financing expenses are reduced where an amount that would be described under paragraph (a) of variable B, if it were received by the taxpayer, is received or receivable by a partnership of which the taxpayer is a member.

"interest and financing revenues"

The interest and financing revenues of a taxpayer for a taxation year include interest income and certain other financing-related income and gains, to the extent that these amounts are included in computing the taxpayer's income for the year.

This definition is relevant in two key respects. First, a taxpayer's interest and financing revenues for a taxation year increase the amount of interest and financing expenses it is permitted to deduct in that year under subsection 18.2(2). In effect, the limitation under that subsection applies to the taxpayer's net interest and financing expenses (i.e., its interest and financing expenses minus its interest and financing revenues).

Second, interest and financing revenues are included in computing a taxpayer's "excess capacity" for a taxation year. For more information, see the commentary on the definition "excess capacity".

A taxpayer's interest and financing revenues for a year are subtracted in determining the taxpayer's adjusted taxable income for the year, under paragraph (a) of variable C of that definition.

A taxpayer's interest and financing revenues for a taxation year are the total of the amounts described in paragraphs (a) to (g) of variable A, minus the amount described in variable B.

Variable A

Variable A is the total of all amounts described in paragraphs (a) to (g), other than any amount described in variable B of the definition "interest and financing expenses" (this exclusion is to prevent taxpayers from, in effect, double-counting certain amounts). For more information, see the commentary on the definition "interest and financing expenses".

Paragraph (a) of variable A includes amounts received or receivable as, on account of, in lieu of payment or in satisfaction of interest, but does not include:

- "Excluded interest", which is generally interest, or a lease financing amount, received or receivable by the taxpayer from another member of its corporate group that the parties have jointly elected to treat as such. For more information, see the commentary on the definition "excluded interest".
- Amounts paid or payable by a credit union, in respect of its shares, that are deemed to be interest under subsection 137(4.1).
- An amount that is interest and financing revenues under another paragraph of this definition, to prevent double-counting of such amounts in determining interest and financing revenues.

Paragraph (b) includes in a taxpayer's interest and financing revenues for the year amounts included in the taxpayer's income because of the deeming rule in subsection 12(9) or section 17.1, which would not otherwise be included under paragraph (a) (or any other paragraph of this definition).

Paragraph (c) of variable A includes in a taxpayer's interest and financing revenues for the year amounts in respect of a guarantee, or similar credit support, to the extent they are included in computing the taxpayer's income for the year.

Paragraph (d) of variable A includes in interest and financing revenues certain amounts that are received or receivable by the taxpayer and that are not included under any of the other paragraphs in this definition, but that effectively increase, or are part of, the return of the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, on a loan or other financing owing to or provided by the taxpayer or the person or partnership that does not deal at arm's length with the taxpayer, including from any hedge of the return on the loan or other financing or of the loan or other financing. These amounts are roughly the converse of the amounts included in a taxpayer's interest and financing expenses under paragraph (e) of variable A of that definition, and include amounts that are not included under paragraph (a) of variable A of this definition because they do not have the legal character of interest, but which are economically equivalent to interest. See the commentary on paragraph (e) of variable A of the definition "interest and financing expenses".

The amounts under paragraph (d) of variable A are included in the taxpayer's interest and financing revenues for a taxation year only if all of the conditions in that paragraph are met. The amount must be included in computing the taxpayer's income for the year (if the amount is a capital gain, only the taxable portion will be included in interest and financing revenues). In addition, the amount must be received or receivable (other than as a dividend), or be a gain, under or as a result of an agreement or arrangement that is entered into as, or in relation to, a loan or financing owing to or provided by the taxpayer or a person or partnership that does not deal at arm's length with the taxpayer. An example of such an agreement or arrangement is a derivative contract entered into to hedge a risk (including currency, interest and payment risk) in relation to a loan or other financing.

Paragraph (e) of variable A includes in a taxpayer's interest and financing revenues the portion of a lease payment included in the taxpayer's income that is a "lease financing amount" (as defined in subsection 18.2(1)). This essentially imputes a financing return on lease payments received by lessors. Lease payments received in respect of excluded leases, or in respect of which an "excluded interest" election has been made, do not give rise to interest and financing revenues. For more information, see the commentary on the definitions "lease financing amount", "excluded interest" and "excluded lease".

Paragraph (f) of variable A essentially includes in a taxpayer's interest and financing revenues its share of interest and financing revenues of a partnership of which the taxpayer is a member. This includes interest and financing revenues described in paragraphs (a) to (e) of variable A that are included in computing the income of a partnership. It also includes the relevant affiliate interest and financing revenues of a controlled foreign affiliate held through a partnership.

The attribution of partnership-level interest and financing revenues applies on a source-by-source basis, with the partnership's interest and financing revenues in respect of each source being attributed to the taxpayer based on its pro rata share of the partnership's income or loss from the source. These amounts are included in the taxpayer's interest and financing revenues for its taxation year in which the partnership's fiscal period ends.

Paragraph (g) of variable A essentially includes in the taxpayer's interest and financing revenues for the year its share of a controlled foreign affiliate's relevant affiliate interest and financing revenues for an affiliate taxation year ending in the year.

In general terms, relevant affiliate interest and financing revenues consist of the amounts described in the definition "interest and financing revenues" that are taken into account in computing the foreign accrual property income of a controlled foreign affiliate for an affiliate taxation year. The extent to which these amounts are attributed to the taxpayer is determined by reference to the taxpayer's specified participating percentage in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on the definitions "relevant affiliate interest and financing revenues" and "specified participating percentage".

Under variable G of the formula in paragraph (g), any deduction under subsection 91(4) in respect of foreign accrual tax (within the meaning of subsection 95(1)) – other than any portion that is in respect of Canadian withholding tax paid under subsection 212(1) – reduces the amount included in the taxpayer's interest and financing revenues in respect of the relevant affiliate interest and financing revenues to which the foreign accrual tax relates. A tracing approach is to be used to determine the extent to which an amount of foreign accrual tax is in respect of a particular amount of relevant affiliate interest and financing revenues.

The reduction under variable G applies if an amount is deducted under subsection 91(4) in any taxation year. Thus, if relevant affiliate interest and financing revenues are included in a taxpayer's interest and financing revenues for a particular taxation year and the taxpayer deducts an amount (other than any portion of the amount that is in respect of Canadian withholding tax) under subsection 91(4) for foreign accrual tax in respect of those revenues in a subsequent taxation year, the amount included in the taxpayer's interest and financing revenues for the particular year is reduced to reflect the subsection 91(4) deduction in the subsequent year.

Variable B

The amounts described in variable B are deducted from the amounts described in variable A and reduce the amount of interest and financing revenue of a taxpayer for a taxation year.

Paragraph (a) of variable B applies if a taxpayer has an amount paid or payable, or a loss or capital loss, under or as a result of an agreement or arrangement entered into in relation to a loan or other financing owing to or provided by the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, to hedge the return in respect of the loan or other financing. This amount is subtracted in computing the taxpayer's interest and financing revenues, to the extent it was deductible in computing the taxpayer's income and can reasonably be considered to reduce the return of the taxpayer, or a person or partnership that does not deal at arm's length with the taxpayer, in respect of the loan or other financing. In effect, the amounts described in paragraph (a) are limited to amounts paid or payable in respect of a hedge, including any loss realized on a derivative contract that hedges a risk (including currency, interest rate or payment risk) in relation to the loan or other financing.

Paragraph (b) of variable B ensures that a taxpayer's interest and financing revenues are reduced where an amount that would be described under paragraph (a) of variable B, if it were received by the taxpayer, is received or receivable by a partnership of which the taxpayer is a member.

Paragraph (c) of variable B reduces an amount otherwise included in a taxpayer's interest and financing revenues under variable A, to the extent the amount is effectively sheltered from Canadian tax by virtue of a credit or deduction in respect of foreign taxes. The reduction under this paragraph in computing a taxpayer's interest and financing revenues does not apply if the credit or deduction is in respect of foreign withholding taxes. As a result, where a Canadian parent company borrows funds and on-lends to a foreign subsidiary, which in turn pays interest to the Canadian parent that is subject to foreign withholding tax, the reduction under paragraph (c) generally does not apply in respect of the withholding tax.

In addition, there is an anti-avoidance rule in subsection 18.2(13) that can cause an amount not to be included in interest and financing revenues. For more information, see the commentary on that subsection.

"lease financing amount"

The portion of any lease payment (other than in respect of an excluded lease) that is a lease financing amount that would, absent subsection 18.2(2), be deductible by a lessee or included in income of a lessor, is included in the lessee's interest and financing expenses and the lessor's interest and financing revenues, respectively. For more information, see the commentary on the definition "excluded lease".

A lease financing amount is an implicit financing expense that is imputed in respect of certain lease payments for purposes of determining a taxpayer's interest and financing expenses or interest and financing revenues. This approach is intended to reflect that, economically, a lease and a loan may be readily substitutable for one another.

The quantum of the lease financing amount is calculated in accordance with the rules and assumptions set out in paragraphs (a) to (c) of the definition. Essentially, the lease is treated as a notional loan with a principal amount equal to the fair market value of the leased property, and the lease payments are re-characterized as blended payments of principal and interest, with the interest (which is the lease financing amount) being calculated in accordance with the prescribed rate in effect at the time the lease began, determined under section 4302 of the Regulations.

"public sector authority"

This definition is relevant for the purpose of determining a taxpayer's exempt interest and financing expenses for a taxation year. For more information, see the commentary on that definition in this subsection.

A public sector authority includes His Majesty in right of Canada or a province, certain government authorities or entities described in paragraphs 149(1)(c) to (d.6) of the Act, as well as certain registered charities that are school authorities, public colleges, universities or hospital authorities as defined in subsection of the *Excise Tax Act*.

"ratio of permissible expenses"

A taxpayer's ratio of permissible expenses is the percentage that is multiplied by the taxpayer's adjusted taxable income in determining the taxpayer's capacity to deduct interest and financing expenses under the formula in subsection 18.2(2), before amounts in respect of a taxpayer's interest and financing revenues, received capacity and absorbed capacity for the year are added. A taxpayer's ratio of permissible expenses is also relevant to the determination of its excess capacity and absorbed capacity for a taxation year. For more information, see the commentary on the definitions of those terms.

For most years and for most purposes, a taxpayer's ratio of permissible expenses is 30%.
To facilitate the transition to the EIFEL rules, however, this percentage is 40% for any taxation year of the taxpayer that begins on or after October 1, 2023 and before January 1, 2024, subject to an anti-avoidance rule that is included in transitional rules in the enacting legislation for the EIFEL rules. The anti-avoidance rule applies a ratio of 30% (instead of 40%) for a taxpayer's taxation years beginning on or after October 1, 2023 and before January 1, 2024, if a transaction or event, or series of transactions or events, results in the taxpayer having an "early" year-end in

that calendar year, and it is reasonable to consider that one of the reasons for the transaction, event or series was to delay the application of the 30% ratio (in other words, to have the 40% ratio apply for a longer period, or for more taxation years, than it otherwise would have).

Because the purpose of providing a 40% ratio for the 2023 transitional year is to facilitate taxpayers' adjustment to the new EIFEL regime, rather than to allow the creation of additional tax attributes that can be realized in later years, the 40% ratio does not apply for the purpose of determining the taxpayer's cumulative unused excess capacity for any taxation year in which the 30% ratio applies (i.e., any taxation year beginning after 2023). Instead, for any such taxation year, the taxpayer's cumulative unused excess capacity is determined on the basis that its excess capacity for any taxation year beginning on or after October 1, 2023 and before January 1, 2024 is computed using the 30% ratio. In effect, this ensures that a taxpayer does not accumulate excess capacity based on a 40% ratio and then carry this forward (through its cumulative unused excess capacity) to a year in which a 30% ratio applies.

"received capacity"

A taxpayer has received capacity for a taxation year if the taxpayer is the transferee in respect of an election under subsection 18.2(4) for the year and all the conditions of subsection 18.2(4) are met. In that case, the amount designated in the election is an amount of received capacity of the taxpayer for the year. A taxpayer can have multiple amounts of received capacity for a taxation year, if it is the transferee under multiple elections filed under subsection 18.2(4) for the year. A taxpayer's received capacity for a taxation year is relevant in determining the amount the taxpayer can deduct in the year under paragraph 111(1)(a.1) in respect of its carryforwards of restricted interest and financing expense. It is also relevant in determining the amount of a taxpayer's restriction for interest and financing expenses under subsection 18.2(2) (received capacity is variable D in the formula in that subsection).

For more information, see the commentary on subsections 18.2(2) and 18.2(4), and paragraph 111(1)(a.1).

"relevant affiliate interest and financing expenses"

A controlled foreign affiliate's relevant affiliate interest and financing expenses is, essentially, the amount that would be its interest and financing expenses if the affiliate were considered a taxpayer resident in Canada (and thus subject to the EIFEL rules) for the purpose of computing its foreign accrual property income (FAPI) (this hypothetical is set out in paragraph (b) of this definition, which requires a determination of the amount that would be the affiliate's interest and financing expenses, if clause 95(2)(f.11)(ii)(A) were read without regard to its reference to subsection 18.2(2)).

Relevant affiliate interest and financing expenses generally includes the affiliate's interest and various other financing-related expenses described in variable A of the definition "interest and financing expenses", less the amounts described in variable B of that definition, to the extent that those amounts described in variables A and B are taken into account in computing the amounts referred to in subparagraph 95(2)(f)(i) or (ii). The one exception is that, for this purpose, amounts described in paragraph (j) of variable A of the definition “interest and financing expenses” are excluded, to ensure that a lower-tier controlled foreign affiliate’s relevant affiliate interest and financing expenses are not, in effect, double-counted by also being included in those of an upper-tier controlled foreign affiliate.

If the affiliate has an amount of “relevant inter-affiliate interest” (as defined in subsection 18.2(1)), its relevant affiliate interest and financing expenses in respect of the amount are determined under new paragraph 18.2(19)(a). For more information, see the commentary on the definition “relevant inter-affiliate interest” and subsection 18.2(19).

A taxpayer’s share of the relevant affiliate interest and financing expenses of its controlled foreign affiliates for affiliate taxation years ending in a taxation year of the taxpayer is included in the taxpayer’s interest and financing expenses for the year. To the extent that the deductibility of the taxpayer’s interest and financing expenses is denied under subsection 18.2(2), clause 95(2)(f.11)(D) will generally apply to deny the deductibility of relevant affiliate interest and financing expenses of a controlled foreign affiliate of the taxpayer in computing FAPI.
For more information, see the commentary on paragraph (j) of variable A of the definition “interest and financing expenses” and new clause 95(2)(f.11)(D).

Interest and various other financing-related expenses that are deductible in computing a foreign accrual property loss of a controlled foreign affiliate are included in the affiliate’s relevant affiliate interest and financing expenses. This is because the amounts referred to in subparagraph 95(2)(f)(ii) include an affiliate’s loss from a property, from a business other than an active business or from a non-qualifying business.

To avoid circularity, paragraph (a) of this definition ensures that an affiliate’s relevant affiliate interest and financing expenses is determined without regard to any deductions denied, or amounts included in income, under clause 95(2)(f.11)(ii)(D).

Only amounts that are deductible in computing income or loss that is included in determining FAPI are included in relevant affiliate interest and financing expenses. As a result, amounts that are deductible in computing an income or loss that is re-characterized as income or loss from an active business under paragraph 95(2)(a) are not included. Also excluded are amounts paid or payable under financing structures described in clause 95(2)(a)(ii)(D) and treated as nil for the purposes of determining an amount for variable A or D in the formula in the definition “foreign accrual property income” in subsection 95(1).

“relevant affiliate interest and financing revenues”

A controlled foreign affiliate’s relevant affiliate interest and financing revenues is, essentially, the amount that would be its interest and financing revenues if the affiliate were considered a taxpayer resident in Canada (and thus subject to the EIFEL rules) for the purpose of computing its FAPI (i.e., if the reference to subsection 18.2(2) in clause 95(2)(f.11)(ii)(A) were disregarded).

Relevant affiliate interest and financing revenues generally includes the affiliate's interest income and certain other financing-related income and gains described in variable A of the definition "interest and financing revenues", less the amounts described in variable B of that definition, to the extent that those amounts are taken into account in computing the amounts referred to in subparagraph 95(2)(f)(i) or (ii). The one exception is that, for this purpose, amounts described in paragraph (g) of variable A of the definition "interest and financing revenues" are excluded, to ensure that a lower-tier controlled foreign affiliate's relevant affiliate interest and financing revenues are not, in effect, double-counted by also being included in those of an upper-tier controlled foreign affiliate.

If the affiliate has an amount of "relevant inter-affiliate interest" (as defined in subsection 18.2(1)), its relevant affiliate interest and financing revenues in respect of the amount are determined under new paragraph 18.2(19)(b). For more information, see the commentary on the definition "relevant inter-affiliate interest" and subsection 18.2(19).

A taxpayer's share of the relevant affiliate interest and financing revenues of its controlled foreign affiliates for affiliate taxation years ending in a taxation year of the taxpayer is included in the taxpayer's interest and financing revenues for the year.

For more information, see the commentary on paragraph (g) of variable A of the definition "interest and financing revenues".

Because the affiliate's relevant affiliate interest and financing revenues are included in determining the taxpayer's interest and financing revenues, the specific anti-avoidance rule in new subsection 18.2(13) applies in determining the amount that is the relevant affiliate interest and financing revenues and the portion of that amount that is attributable to the taxpayer.

Only amounts that are actually included in computing FAPI are included in relevant affiliate interest and financing revenues. As a result, amounts that are re-characterized as income or loss from an active business under paragraph 95(2)(a) or (2.44)(b) are not included.

"relevant inter-affiliate interest"

The relevant inter-affiliate interest of a controlled foreign affiliate of a taxpayer for an affiliate taxation year is, essentially, an amount of interest that is paid or payable by the affiliate to – or that is received or received by the affiliate from – a controlled foreign affiliate of the taxpayer or of an eligible group entity in respect of the taxpayer.

An amount of interest is only considered relevant inter-affiliate interest if it would, absent new subsection 18.2(19), be included in the payer affiliate's relevant affiliate interest and financing expenses and the recipient affiliate's relevant affiliate interest and financing revenues. In general terms, this means the amount must be interest that, in the absence of the EIFEL rules, would be deductible in computing the FAPI of the payer affiliate, and that is included in computing the FAPI of the recipient affiliate.

The definition “relevant inter-affiliate interest” is relevant in determining what portion of the amount of interest is excluded and what portion of that amount is included in determining both the payer affiliate’s relevant affiliate interest and financing expenses under paragraph 18.2(19)(a) and the recipient affiliate’s relevant affiliate interest and financing revenues under paragraph 18.2(19)(b). For more information, see the commentary on subsection 18.2(19).

“special purpose loss corporation”

The definition “special purpose loss corporation” is relevant for the purposes of the restrictions on the ability of financial institution group entities to transfer their cumulative unused excess capacity under subsection 18.2(4). For more information, see the commentary on that subsection.

“specified participating percentage”

A taxpayer’s specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year is the percentage that is the taxpayer’s aggregate participating percentage (as defined in subsection 91(1.3) of the stub-period FAPI rules) in respect of the affiliate for the affiliate taxation year, determined without regard to any deductions denied or amounts included in income under new clause 95(2)(f.11)(ii)(D) in computing FAPI. Paragraphs (a) and (b) of the definition “specified participating percentage”, in effect, ensure that a taxpayer has a specified participating percentage in respect of an affiliate where the affiliate’s FAPI is less than $5,000 or the affiliate has a FAPL.

A taxpayer’s specified participating percentage in respect of a controlled foreign affiliate for an affiliate taxation year is relevant in determining, among other things, the taxpayer’s share of the affiliate’s relevant affiliate interest and financing expenses for the affiliate taxation year (which is included in the taxpayer’s interest and financing expenses), and the taxpayer’s share of the affiliate’s relevant affiliate interest and financing revenues (which is included in determining the taxpayer’s interest and financing revenues).

For more information, see the commentary on the definitions “interest and financing expenses” and “interest and financing revenues”, as well as the definition “restricted interest and financing expense” in amended subsection 111(8).

“specified pre-regime loss”

A taxpayer’s specified pre-regime loss, in respect of a taxation year in which it is subject to the EIFEL rules (the “regime year”), is the taxpayer’s loss for a taxation year that ends before February 4, 2022 (the release date of the initial draft legislation for the EIFEL rules) in respect of which the taxpayer files an election for the regime year and deducts an amount under paragraph 111(1)(a). The effect of the election is that 25% of the amount deducted is added back in computing the taxpayer’s adjusted taxable income for the regime year under paragraph (i) of variable B of the definition “adjusted taxable income”.

For more information, see the commentary on the definition “adjusted taxable income”.

“tax-indifferent”

The definition “tax-indifferent” refers to person that is exempt from tax under section 149 or is a non-resident (paragraphs (a) and (b)), as well as a partnership or trust the interests in which are primarily held by persons exempt from tax under section 149 or who are non-residents (paragraphs (c) and (d)).

The definition “tax-indifferent” is relevant to subparagraph (c)(iv) of the “excluded entity” definition, which requires that all or substantially all of the interest and financing expenses of the taxpayer and of each eligible group entity of the taxpayer be payable to person or partnerships that are not tax-indifferent and who do not deal at arm’s length with the taxpayer.

“taxpayer”

The definition “taxpayer” provides that references to a taxpayer in sections 18.2 and 18.21 do not include a natural person or a partnership. As a result, the limitation on deductions for interest and financing expenses in subsection 18.2(2) applies only to corporations and trusts, including in respect of their share of the interest and financing expenses of any partnerships of which they are members.

For further information on the application of the EIFEL rules in relation to corporations and trusts that are members of partnerships, see the commentary on paragraph (h) of the definition “interest and financing expenses”, as well new paragraph 12(1)(l.2).

“transaction”

The definition “transaction” provides that a transaction includes an arrangement or an event. This is relevant for the purposes of the anti-avoidance rules in new subsections 18.2(13) and (14), and subsection 18.21(8).

“transferred capacity”

A taxpayer has an amount of transferred capacity for a taxation year if the taxpayer is the transferor in respect of an election under subsection 18.2(4) for the year and all the conditions of subsection 18.2(4) are met. In that case, the amount designated in the election is an amount of transferred capacity of the taxpayer for the year. A taxpayer can have multiple amounts of transferred capacity for a taxation year, if it is the transferor under multiple elections filed under subsection 18.2(4) for the year.

A taxpayer’s transferred capacity for a taxation year reduces the taxpayer’s cumulative unused excess capacity, starting in the following year. The total of a taxpayer’s amounts of transferred capacity for a taxation year can never exceed its cumulative unused excess capacity for that year.

For more information, see the commentary on the definition “cumulative unused excess capacity” and subsection 18.2(4).

Excessive interest and financing expenses limitation

ITA
18.2(2)

New subsection 18.2(2) is the main operative rule of the new EIFEL regime, which implements the recommendations of the BEPS Action 4 report to limit certain taxpayers' deductions for interest and financing expenses to a proportion of their earnings. It applies to taxpayers that are corporations or trusts ("taxpayer" is defined in subsection 18.2(1) to exclude natural persons and partnerships), including non-resident corporations and trusts. The rule does not apply to a taxpayer for a taxation year if the taxpayer is an excluded entity for the year. For more information, see the commentary on the definition "excluded entity" in subsection 18.2(1).
In general terms, subsection 18.2(2) denies a deduction for a proportion (determined under the formula in that subsection) of each of a taxpayer's interest and financing expenses. So, for example, if the formula calculates to 1/5 in respect of a taxpayer for a particular taxation year, and the taxpayer's interest and financing expenses for the year consist of $180 million of interest payable in respect of a particular loan and a $50 million guarantee fee payable, then $36 million of the interest expense and $10 million of the guarantee fee are non-deductible under new subsection 18.2(2) (and become a restricted interest and financing expense within the meaning of new subsection 111(8)).

However, subsection 18.2(2) does not apply to a taxpayer's share of the interest and financing expenses of any partnerships of which it is a member, which is included in the taxpayer's interest and financing expenses under paragraph (h) of that definition in subsection 18.2(1). Instead, the taxpayer is subject to an income inclusion under new paragraph 12(1)(l.2) in respect of such expenses. For more information, see the commentary on that paragraph.

The proportion determined for the taxpayer under subsection 18.2(2) also applies under new subclause 95(2)(f.11)(ii)(D)(I) in determining the deductibility of the "relevant affiliate interest and financing expenses" (defined in subsection 18.2(1)) of a controlled foreign affiliate of the taxpayer in computing the affiliate's FAPI. Thus, using the example above, if a controlled foreign affiliate of the taxpayer had $50 million of relevant affiliate interest and financing expenses for its affiliate taxation year ending in the taxpayer's taxation year, then $10 million of the relevant affiliate interest and financing expenses is non-deductible in computing the affiliate's FAPI under subclause 95(2)(f.11)(ii)(D)(I). The same proportion is also applied in determining the amount included in FAPI under subclause 95(2)(f.11)(ii)(D)(II) in respect of the interest and financing expenses of a partnership of which the affiliate is a member.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

Subsection 18.2(2) only denies a deduction in respect of amounts of interest and financing expenses that would be deductible absent section 18.2. Thus, if another provision of the Act (e.g., the thin capitalization rules in subsection 18(4)) denies a deduction for a portion of an interest or financing expense, subsection 18.2(2) does not apply in respect of that non-deductible portion, which is not included in the taxpayer's interest and financing expenses for the purposes of these rules.

In addition to denying deductions for interest and financing expenses in computing income from a business or property, subsection 18.2(2) denies deductions in computing taxable income (under subdivision C of Part I) in the case of amounts, in respect of limited partnership losses, included under paragraph (i) of variable A of the definition "interest and financing expenses".

The proportion of a taxpayer's interest and financing expenses that are denied is determined by the formula (A – (B + C + D + E))/F. In general terms, variable A is the taxpayer's total interest and financing expenses for the year, and B + C + D + E represents the maximum amount the taxpayer is permitted to deduct in the year in respect of interest and financing expenses. Thus, the numerator in the formula represents the taxpayer's "excessive" interest and financing expenses: the amount by which the taxpayer's expenses exceed the amount it is allowed to deduct in the year.

Variable F is the denominator and represents the total of the otherwise deductible amounts in respect of interest and various other financing-related expenses that are included in computing the taxpayer's interest and financing expenses under variable A of that definition and that may be subject to limitation under subsection 18.2(2). Thus, variable F does not take into account any reductions, under variable B of the definition "interest and financing expenses", for income or gains that reduce the taxpayer's cost of funding. This is to ensure that the proportion determined under the formula represents the proportion of each of the taxpayer's interest and other financing-related expenses for which deductibility is denied under subsection 18.2(2), which would in many cases be overstated if variable F took into account the reductions under variable B of the definition "interest and financing expenses".

Consistent with this general approach in variable F, where the taxpayer's interest and financing expenses for the year includes any amount in respect of the relevant affiliate interest and financing expenses of a controlled foreign affiliate, paragraph (b) of variable F, in effect, excludes from variable F any reductions that apply in computing the relevant affiliate interest and financing expenses by virtue of variable B of the definition "interest and financing expenses".

The proportion determined by the formula is, therefore, the proportion of the otherwise deductible interest and financing expenses for the year that exceed the amount of deductions in respect of such expenses that it is permitted under subsection 18.2(2) for the year.

As noted, variable A is the taxpayer's total interest and financing expenses for the year. Notably, this amount includes the taxpayer's share of the interest and financing expenses of a partnership (included under paragraph (h) of that definition); thus, these expenses are relevant in determining the proportion under the formula, notwithstanding that subsection 18.2(2) does not deny a deduction in respect of these expenses (but, as noted, they are instead subject to an income inclusion under new paragraph 12(1)(l.2)).

The taxpayer's interest and financing expenses do not include "excluded interest", which is generally interest, or a "lease financing amount", paid or payable to another taxable Canadian corporation in the same group that the taxpayer and the other corporation jointly elect to have treated as such (and that satisfies the other conditions in the "excluded interest" definition in subsection 18.2(1)). Thus, subsection 18.2(2) does not restrict the deductibility of such intra-group payments of interest or lease financing amounts. For more information, see the commentary on the definitions "excluded interest" and "lease financing amount".

A taxpayer's interest and financing expenses also exclude its "exempt interest and financing expenses", such that the latter are not restricted under subsection 18.2(2). In general terms, exempt interest and financing expenses are interest and various other financing-related expenses that are paid to third parties and that are incurred in respect of certain Canadian public-private partnership infrastructure projects. For more information, see the commentary on the definition "exempt interest and financing expenses".

Variable B reflects the "earnings stripping" approach of the new rules, which generally limit the amount of interest and financing expenses (net of interest and financing revenues) that may be deducted in computing a taxpayer's income to no more than a fixed ratio of the taxpayer's "adjusted taxable income" (defined in subsection 18.2(1)). A taxpayer's adjusted taxable income is a version of earnings before interest, taxes, depreciation and amortization (EBITDA) that is based on tax, rather than accounting, concepts.

Unless the taxpayer is a member of a corporate group that elects into the "group ratio" rules for a taxation year, the amount determined for variable B for the year is the taxpayer's adjusted taxable income for the year multiplied by its ratio of permissible expenses for the year (being 40%, if the year begins on or after January 1, 2023 but before January 1, 2024; and 30% for all subsequent years).

If the taxpayer is a member of a group that elects to apply the group ratio for a taxation year, then the amount for variable B is determined under subsection 18.21(2). In essence, the group ratio rules allow a taxpayer to deduct interest and financing expenses in excess of the 30% fixed ratio (or 40% for the transitional year) where the taxpayer is able to demonstrate that the ratio of its consolidated group's net third-party interest expense to book EBITDA (referred to as the "group ratio") exceeds the fixed ratio. For more information, see the commentary on section 18.21.

If the taxpayer's interest and financing expenses for a taxation year exceed the applicable ratio of its adjusted taxable income, the taxpayer may nonetheless be able to avoid having the deductibility of this excess denied under subsection 18.2(2). There are three additional sources of "capacity" to deduct interest and financing expenses, reflected in variables C, D and E, respectively.

Variable C is the taxpayer's interest and financing revenues for the year. It reflects that the EIFEL regime is intended to limit a taxpayer's net interest and financing expenses (i.e., its interest and financing expenses net of interest and financing revenues) to a fixed percentage of adjusted taxable income.

Variable D is only available to corporate taxpayers and fixed interest commercial trusts, and is the taxpayer's total received capacity for the year, which essentially represents any amounts of excess capacity of another group member that have been “transferred” to the taxpayer for the year under the joint election in new subsection 18.2(4). This amount must, however, first be reduced by any amounts deductible by the taxpayer in the year under new paragraph 111(1)(a.1) in respect of restricted interest and financing expense for a preceding taxation year. In effect, these rules require the taxpayer to apply its received capacity first against its restricted interest and financing expenses from previous years, before it can apply received capacity to enable the deduction of current-year interest and financing expenses that would otherwise be non-deductible under the EIFEL rules.

For more information, see the commentary on the definition “cumulative unused excess capacity” in subsection 18.2(1), subsection 18.2(4) and paragraph 111(1)(a.1).
Variable E of the formula is relevant where the taxpayer would otherwise have interest or financing expenses denied under subsection 18.2(2) for the year but has excess capacity carried forward from any of the three immediately preceding taxation years that it has not yet used. In these circumstances, the taxpayer has “absorbed capacity” for the year, which increases its deduction capacity and thereby reduces the amount of its interest and financing expenses that are denied under subsection 18.2(2) for the year. The absorbed capacity essentially is the portion of the taxpayer’s excess capacity carryforwards that are automatically applied to allow the taxpayer to deduct interest and financing expenses that would otherwise be denied under subsection 18.2(2). For more information, see the definition “absorbed capacity” in subsection 18.2(1).

Amount deemed deducted

ITA
18.2(3)

Subsection 18.2(3) applies where new subsection 18.2(2) denies the deductibility, in computing a taxpayer’s income for a taxation year, of all or a portion of a particular amount that is described in paragraph (c) or (d) of the definition “interest and financing expenses”. The amounts described in those paragraphs are generally amounts of interest or other financing-related expenses that are capitalized or otherwise included in resource-expense pools, and are claimed by the taxpayer as deductions in respect of capital cost allowance, foreign exploration and development expenses, foreign resource expenses, Canadian exploration expenses, Canadian development expenses, Canadian oil and gas property expenses or section 66.7 successor expenses, or as a terminal loss. For more information, see the commentary on the definition “interest and financing expenses” in subsection 18.2(1).)

Subsection 18.2(3) deems the denied portion of the particular amount to have been deducted by the taxpayer, to ensure it is deducted in computing a taxpayer’s total depreciation allowed for property of a prescribed class (as defined in subsection 13(21)) or the balance of its undeducted resource expenses, as the case may be. This is intended to ensure that the taxpayer does not get a “double benefit”, by retaining these amounts within its undepreciated capital cost or undeducted resource expenses and deducting them in a future year, while at the same time deducting an amount under paragraph 111(1)(a.1) in a later year as a restricted interest and financing expense in respect of the denied portion.

The deeming rule in this subsection applies for the purposes of determining the amounts referred to in paragraphs 18.2(3)(a) to (g) in respect of any taxpayer at any time, and not only the taxpayer that incurred the expense or had its deduction denied under subsection 18.2(2). This ensures the rule applies, for example, in relation to "successor pools" of resource expenses, as well as in cases where expense pools are "inherited" by a new corporation on an amalgamation or by a parent corporation on a winding-up.

Transfer of cumulative unused excess capacity

ITA
18.2(4)

New subsection 18.2(4) provides an election that allows a taxable Canadian corporation or a fixed interest commercial trust (referred to as the "transferor") to effectively transfer all or a portion of its cumulative unused excess capacity to another taxable Canadian corporation or fixed interest commercial trust (referred to as the "transferee") that is a member of the same corporate group. This transfer mechanism is intended to accommodate misalignments between net interest and financing expenses and adjusted taxable income among the Canadian group members, which could result in some group members exceeding the 30% fixed ratio (or 40% fixed ratio, for the transitional year) permitted under the EIFEL rules, and other group members having ratios below the permitted fixed ratio.

Where all of the conditions of subsection 18.2(4) are met, the amount that a transferor and a transferee designate in their joint election is an amount of "transferred capacity" of the transferor and an amount of "received capacity" of the transferee for their respective taxation years. A transferor's transferred capacity for a taxation year reduces its cumulative unused excess capacity for the following year. For more information, see the commentary to the definition "cumulative unused excess capacity" in subsection 18.2(1).

To ensure the integrity of the rules, paragraph 18.2(4)(e), in effect, renders all of the transferor's transfers for the year invalid if the total of the transferred capacity amounts designated by the transferor in elections for the year exceeds its cumulative unused excess capacity for that year. As a consequence, all of the amounts of received capacity otherwise accruing to the transferees under those elections would be nullified. To accommodate situations where a reassessment results in an over-transfer (e.g., by increasing the amount of the transferor's interest and financing expenses for its taxation year in which the transfer election was made), paragraphs 18.2(4)(d), (h) and (i) provide for the filing of an amended election. Paragraph 18.2(4)(h) ensures that an amended election supersedes the prior election.

However, the ability to file an amended election is provided for the sole purpose of allowing taxpayers to alter the amount designated in the election in cases where a reassessment results in a change in the transferor's cumulative unused excess capacity, or in the transferee's interest and financing expenses or restricted interest and financing expense; it is not intended to be used for retroactive tax planning. In particular, paragraph 18.2(4)(i) provides that an amended election is not available in respect of a taxation year if the transferor "over-transferred" in a prior election for that year, where the over-transfer does not result from any change under a reassessment. An amended election is also not available where subsection 18.2(9) applies because there has been a manipulation of entity status in order to obtain a tax benefit, unless the Minister grants permission to amend the prior election under subsection 18.2(5).

Although the mechanism under subsection 18.2(4) is described as a “transfer”, the transferred amount is not included in the transferee’s excess capacity or cumulative unused excess capacity. Thus, the transferee cannot carry it forward for use in later years or transfer it to other taxpayers. Rather, as noted, the transferred amount is “received capacity” of the transferee, which can be used only in the taxation year of the transferee in respect of which it was received – and in only two ways.

First, received capacity is automatically applied against any restricted interest and financing expense of the transferee (which is defined in subsection 111(8) generally as carryforwards of interest and financing expenses denied under subsection 18.2(2) in a previous year), thereby allowing the taxpayer to deduct these under paragraph 111(1)(a.1).

Second, any remaining received capacity is included in variable D of the formula in subsection 18.2(2), which has the effect of reducing the amount of the transferee’s interest and financing expenses for which deductibility is denied under that subsection.

Because received capacity can only be used by the transferee in the year in respect of which it is received, and for only the two purposes described above, if, by virtue of one or multiple transfers under subsection 18.2(4) in a taxation year, a transferee is transferred received capacity in excess of the amount it can use in the year, this excess reduces the transferor’s cumulative unused excess capacity but cannot be used by the transferee for any purpose (and thus is of no benefit).

The deduction of restricted interest and financing expense under paragraph 111(1)(a.1) is discretionary. However, the fact that the amount of received capacity of the taxpayer that is included in variable D of subsection 18.2(2) is reduced for amounts deductible in the year under paragraph 111(1)(a.1) effectively creates an “ordering rule”, which prevents a transferee from using its received capacity to deduct its current-year interest and financing expenses in priority to any restricted interest and financing expense carryforwards.

Notable aspects of the conditions in paragraphs 18.2(4)(a) to (j), all of which must be met to have an effective transfer, are as follows:

- Paragraph (a) requires that the transfer is of the cumulative unused excess capacity of the transferor for a taxation year that ends in the taxation year of the transferee in which the transferee receives the received capacity. Paragraph 249(2)(a) allows this condition to be met where the taxation year of the transferor is coterminous with that of the transferee.
- Paragraph (b) requires that the transferor and transferee be eligible group entities (as defined in subsection 18.2(1)) in respect of one another at the end of their respective taxation years, which is intended to ensure they are members of the same corporate group. The taxpayers are not required to be eligible group entities in respect of one another throughout the entirety of their respective taxation years, since such a requirement would not accommodate certain corporate reorganizations. However, the

manipulation of eligible group entity status in order to meet this condition and be eligible to make an election under subsection 18.2(4) could trigger the application of the anti-avoidance rule in subsection 18.2(9).

- Paragraph (c) provides that a transferor that is a financial institution group entity or a financial holding corporation is permitted to transfer only to other financial institution group entities or financial holding corporations, or to special purpose loss corporations, subject to certain limitations. For more information, see the commentary on the definition “financial institution group entity” in subsection 18.2(1).
- Paragraph (d) provides certain filing requirements in respect of the election, including that it must specify the amount of transferred capacity, which will also be received capacity of the transferee. Subparagraph (d)(ii) requires that the joint election be filed by the transferor, which is intended to facilitate filing in cases where one transferor transfers cumulative unused excess capacity to multiple transferees.
- Paragraphs (f) and (g) are special rules applicable where a financial institution group entity transfers to either a financial holding corporation or a special purpose loss corporation, respectively. In these cases, the amount of cumulative unused excess capacity that may be transferred to these entities is capped, essentially, at the amount that is necessary to give effect to certain loss consolidation (or “debt push-down”) transactions within financial institution groups. The caps are intended to ensure that a financial institution group entity’s cumulative unused excess capacity can only be used (through the transfer mechanism) to support the deductibility of interest expense that has been shifted into financial institutions group entities and that relates to debt used to fund the financial businesses, and not to interest expense that has been shifted into related group entities that are not financial institution group entities.
- Paragraph (h) in effect provides that the transfer is not valid and effective unless the transferee files (or is deemed by subsection 18.2(7) to have filed) an information return that meets the requirements of subsection 18.2(6). This essentially requires reporting of all the transfers under subsection 18.2(4) received by group members within the calendar year. For more information, see the commentary on subsections 18.2(6) and (7).

Late or amended election

ITA
18.2(5)

New subsection 18.2(5) enables an election under subsection 18.2(4) to be late-filed, or amended in circumstances beyond those in which subsection 18.2(4) allows for amended elections, with Ministerial permission.

Summary – cumulative unused excess capacity transfers

ITA
18.2(6)

New subsection 18.2(6) applies if a transferor and a particular transferee jointly elect under subsection 18.2(4) to designate all or a portion of the transferor's cumulative unused excess capacity to be received capacity of the particular transferee for a taxation year.

The particular transferee is required to file an information return within six months after the end of the calendar year in which its taxation year, in respect of which it has received capacity, ends. The return must contain the information required by the Canada Revenue Agency to be reported in respect of all elections under subsection 18.2(4) that are filed by:

- the particular transferee for the year; or
- any other transferee that is an eligible group entity in respect of the particular transferee for a taxation year ending in the calendar year.

Summary – filing by designated filer

ITA
18.2(7)

New subsection 18.2(7) allows transferees that are eligible group entities in respect of one another to jointly elect to designate a taxpayer (referred to as the "designated filer") to file an information return required by subsection 18.2(6) for a calendar year. The effect of designating a designated filer is to relieve the electing transferees (other than the designated filer) of the reporting requirement under subsection 18.2(6) for the calendar year.

Assessment

ITA
18.2(8)

New subsection 18.2(8) requires the Minister of National Revenue to assess or reassess any taxpayer to take into account an election or amended election filed under subsection 18.2(4), even where the assessment or reassessment would otherwise be statute-barred.

Anti-avoidance – group status

ITA
18.2(9)

New subsection 18.2(9) is an anti-avoidance provision that prevents the manipulation of eligible group entity, financial institution group entity or financial holding corporation status where it is reasonable to consider that one of the main purposes of being, becoming or ceasing to be an eligible group entity in respect of another taxpayer, a financial institution group entity or a financial holding corporation is to enable any taxpayer to obtain a "tax benefit", as that term is defined in subsection 245(1).

There are a number of scenarios in which the manipulation of eligible group entity, financial institution group entity or financial holding corporation status could give rise to a tax benefit and thus trigger the application of this subsection. For example, a taxpayer may seek to become an eligible group entity in respect of another taxpayer in order to be eligible to elect to make or receive a transfer of cumulative unused excess capacity under subsection 18.2(4), to treat certain interest payments or “lease financing amounts” (as defined in subsection 18.2(1)) as “excluded interest” or to have the group ratio rule in subsection 18.21(2) apply. Conversely, a taxpayer may seek to cease being an eligible group entity in respect of another taxpayer in order to qualify (or allow another taxpayer to qualify) as an “excluded entity” for the year. Another example is that a taxpayer could seek to either become or cease to be an eligible group entity in respect of one or more other taxpayers in order to obtain a certain advantage under the transitional rules (contained in the enacting legislation for section 18.2) that apply for the purposes of determining taxpayers’ excess capacity for pre-regime years. As transfers of cumulative unused excess capacity from a financial institution group entity or a financial holding corporation are generally limited to other financial institution group entities or financial holding corporations, taxpayers may seek to manipulate financial institution group entity or financial holding corporation status in order to become eligible to receive such a transfer, or to avoid the restrictions applicable where a transferor is a financial institution group entity or financial holding corporation.

In all of these scenarios, tax benefits would generally result, directly or indirectly, in the absence of this anti-avoidance rule.

The reference in subsection 18.2(9) to enabling “any taxpayer” to obtain a tax benefit allows the anti-avoidance rule to apply whether the tax benefit sought is that of either of the taxpayers that have become or ceased being eligible group entities in respect of one another, the taxpayer that has become or ceased to be a financial institution group entity or a financial holding corporation, or that of any other taxpayer.

Benefits conferred

ITA
18.2(10)

New subsection 18.2(10) provides that, for the purpose of Part I, a benefit is not considered to have been conferred on a transferee as a consequence of an election or amended election under subsection 18.2(4) between the transferor and the transferee. This new subsection applies whether or not property is acquired by the transferor as consideration for filing the election or amended election.

Consideration for election

ITA
18.2(11)

New subsection 18.2(11) provides rules that apply where property is acquired by a transferor as consideration for filing an election or amended election under subsection 18.2(4). If the property is owned by the transferee immediately before that time, the transferee is deemed to have disposed of the property at its fair market value but is not entitled to deduct any amount in respect of the transfer except any loss resulting from the deemed disposition. The cost at which the property was acquired by the transferor is considered to be equal to the property's fair market value. Neither the transferor nor the transferee is required to add any amount in computing income only because of the acquisition of the property or because of the filing of the election or amended election under subsection 18.2(4) (although the deemed disposition could result in an amount being added in computing the transferee's income).

Partnerships

ITA
18.2(12)

New subsection 18.2(12) is intended to effectively "look through" tiers of partnerships for the purposes of subsection 18.2.

Subsection 18.2(12) provides that a person or partnership that is a member of a partnership that is in turn a member of another partnership is also deemed to be a member of the other partnership. It also provides that a person's share of a partnership's income or loss includes the person's direct or indirect, through one or more other partnerships, share of that income or loss. In other words, a member's share of the income or loss of a lower-tier partnership includes the amount to which it is directly or indirectly entitled.

Anti-avoidance – interest and financing revenues and expenses

ITA
18.2(13)

New subsection 18.2(13) is an anti-avoidance rule that is intended to prevent a taxpayer's interest and financing revenues from being inflated, or its interest and financing expenses from being understated, as a result of certain types of transactions. If it applies, a particular amount that would otherwise be included in a taxpayer's interest and financing revenues under variable A of the definition of that term is not so included, or a particular amount that would otherwise be deducted in computing its interest and financing expenses under variable B of definition of that term is not so deducted.

Amounts included in a taxpayer's interest and financing revenues, or deducted in computing its interest and financing expenses, generally reduce a taxpayer's net interest and financing expenses that may be subject to the limitation in subsection 18.2(2) (or, in other cases, increase the taxpayer's "excess capacity", which can be used to allow the taxpayer to deduct interest and financing expenses from prior or future years, or to allow other group members to deduct interest and financing expenses). Although these amounts are included in computing the taxpayer's income or loss, the purpose of the anti-avoidance rule is to ensure these amounts are not taken into account in determining interest and financing revenues or expenses in appropriate circumstances.

The anti-avoidance rule applies if any of the requirements set out in paragraphs 18.2(13)(a) to (c) are satisfied. However, even if none of these requirements is satisfied in respect of a particular amount, the general anti-avoidance rule in section 245 may apply in appropriate circumstances.

Paragraph (a)

Paragraph 18.2(13)(a) addresses transactions involving non-controlled foreign affiliates. It applies if the particular amount is connected with a deduction in computing the foreign accrual property income (FAPI) of a corporation that is a foreign affiliate, but not a controlled foreign affiliate, of the taxpayer or of a person or partnership not dealing at arm's length with the taxpayer. This would be the case where, for example, a taxpayer receives an interest payment directly from a non-controlled foreign affiliate of the taxpayer, or indirectly from such an affiliate through an intermediary, and the interest payment is deductible in computing the affiliate's FAPI. These transactions raise integrity concerns in the context of the EIFEL rules in that, if they were to result in interest and financing revenues (or reductions to interest and financing expenses), this could effectively convert amounts that would otherwise have been included in an affiliate's taxable surplus or reduced an affiliate's taxable deficit – and thus could ultimately have resulted in an increase to the amount included in the taxpayer's adjusted taxable income on a subsequent distribution from the affiliate – into interest and financing revenues, while the affiliate's interest expense would not be included in computing the taxpayer's interest and financing expenses. This would provide an inappropriate tax benefit, since a dollar of interest and financing revenues results in greater capacity to deduct interest and financing expenses than a dollar of adjusted taxable income.

Paragraph (b)

Paragraph 18.2(13)(b) applies if the particular amount is, directly or indirectly and in whole or in part, received or receivable by the taxpayer (or a partnership of which it is a member) from

- a non-arm's length person that is
    - not subject to the EIFEL regime by reason of being an "excluded entity" (as defined in subsection 18.2(1)) or a natural person; or
    - if the taxpayer is not a "financial institution group entity" or a "financial holding corporation" (both as defined in subsection 18.2(1)), a financial institution group entity or a financial holding corporation; or
- a partnership, any member of which is a non-arm's length person that is an excluded entity, a natural person or, if the taxpayer is not a financial institution group entity or financial holding corporation, a financing institution group entity or a financial holding corporation.

The transactions described in paragraph (b) raise integrity concerns because, absent subsection 18.2(13), they would allow payments between non-arm's length persons that have the effect of increasing the recipient's capacity to deduct interest and financing expenses (e.g., by generating interest and financing revenues), while a payer is indifferent to any corresponding increase in their interest and financing expenses because they are not subject to the EIFEL rules (e.g., an excluded entity or a natural person). In the case of a payment from a financial institution group entity to a non-arm's length person that is not such an entity, if an amount in respect of the payment were included in the payee's interest and financing revenues, this could allow, in substance, the same result as a transfer of cumulative unused excess capacity that is prohibited by paragraph 18.2(4)(c). A similar concern arises with respect to payments from a financial holding corporation, given that the financial holding corporation can receive capacity-increasing payments from a financial institution group entity and could in turn use the proceeds to fund interest payments to an entity that is not a financial institution group entity.

Paragraph (c)

Unlike paragraph (b), paragraph (c) is not limited to transactions among non-arm's length persons. In addition, the requirements set out in paragraph 18.2(13)(c) are conditioned on a "main purpose" requirement.

In particular, one of the main purposes of a transaction (defined in subsection 18.2(1) to include an arrangement or event) or series of transactions must be to include the particular amount under variable A of the definition "interest and financing revenues", in computing the taxpayer's interest and financing revenues, or under variable B of the definition "interest and financing expenses", in computing the taxpayer's interest and financing expenses. If a main purpose of any transaction in a series, or of the series as a whole, is to achieve one of these effects, this purpose test is met.

It is not necessary that all participants in a transaction or series intend that the transaction or series cause the amount to increase interest and financing revenues or reduce interest and financing expenses. Rather, the focus is on whether it is reasonable to consider that one of its main purposes is to have this effect. This would generally be determined from the perspective of the taxpayer whose interest and financing revenues and interest and financing expenses are being determined, or any other person or partnership that would benefit from an increase to the taxpayer's interest and financing revenues or a decrease in its interest and financing expenses (e.g., a person that may receive a transfer from the taxpayer's cumulative unused excess capacity as a result of an election under subsection 18.2(4)).

Two types of transactions or series of transactions are targeted by paragraph 18.2(13)(c).

Subparagraph (i)

The first is a transaction or series that results in a deductible amount that effectively offsets, in whole or in part, the income inclusion to the taxpayer in respect of the particular amount, where there is an asymmetry in treatment between that deductible amount and the particular amount under the EIFEL regime.

More particularly, the test is satisfied if the deduction is available to the taxpayer, or a person or partnership not dealing at arm's length with the taxpayer, in computing its income or loss for a taxation year, and the amount (for which the deduction is available) is not included in variable B of the "interest and financing revenues" definition or variable A of the "interest and financing expenses" definition. In other words, the test in this subparagraph is met if the deductible amount does not reduce interest and financing revenues or increase interest and financing expenses, such that there is an asymmetry between the treatment of the deductible amount and the particular amount under the EIFEL regime. This could occur, for example, where a taxpayer that is otherwise subject to an interest limitation under subsection 18.2(2) receives an interest payment (which, absent subsection 18.2(13), would be included in its interest and financing revenues) from a person or partnership that is indifferent to an increase in its interest and financing expenses (for example, because it has unused interest deduction capacity, or it is an excluded entity, a tax-exempt entity, a natural person or a non-resident) and, as part of the same transaction or series, the taxpayer makes a deductible payment back to the person or partnership that is not included in the taxpayer's interest and financing expenses (e.g., a service fee or royalty).

These transactions (or series) raise integrity concerns in that, absent subsection 18.2(13), the overall result is an increase to the taxpayer's interest and financing revenues in an amount that exceeds the net income inclusion to the taxpayer (or a person or partnership that does not deal at arm's length with the taxpayer). This result is, in substance, contrary to the basic principle that an amount is to be included in interest and financing revenues only to the extent it is included in computing income subject to tax.

Subparagraph (ii)

The second type of transaction targeted by paragraph 18.2(13)(c) is a transaction or series in which an amount that does not increase interest and financing revenues (or reduce interest and financing expenses) is converted, replaced or otherwise substituted with another amount that does. In other words, this subparagraph addresses transactions or series that put taxpayers in a more favorable position in terms of determining results under the EIFEL regime without otherwise materially altering the computation of income or loss for a taxation year.

This test is satisfied if two conditions are met, both of which compare how the particular amount, or an amount for which the particular amount is substituted, may reasonably be considered to have been treated had the transaction or series not occurred.

The first requires that the particular amount – or, if the particular amount was substituted for another amount, the other amount – would have been included in computing the income or loss of the taxpayer or a non-arm's length person or partnership. This condition is not satisfied if the particular amount or other amount, as the case may be, would have been included in computing the income or loss as a dividend. Thus, the rule does not apply where, for example, an equity instrument is replaced with a debt instrument.

The second test requires that the particular amount or other amount would not be included under variable A of the "interest and financing revenues" definition, or variable B of the "interest and financing expenses" definition. This ensures that the application of subparagraph 18.2(13)(c) is limited to cases where the transaction or series effectively converts or substitutes amounts that would not increase interest and financing revenues (or reduce interest and financing expenses) with amounts that, absent subsection 18.2(13), would result in such an increase or reduction.

For example, subparagraph (ii) may apply where one of the main purposes of the transaction or series was for the particular amount to increase interest and financing revenue or reduce interest and financing expenses and, absent the transaction or series, an amount would have been included in income but would not have increased interest and financing revenues or reduced interest and financing expenses. This can occur, for example, where the transaction or series results in a service or royalty agreement being replaced with a loan agreement.

GAAR

Subsection 18.2(13) does not purport to address all scenarios in which a transaction or series that increases interest and financing revenues or reduces interest and financing expenses is considered not to be appropriate in policy terms. It is intended that the general anti-avoidance rule may apply to any transaction that results in an increase of interest and financing revenues or a reduction in interest and financing expenses in appropriate circumstances, even where new subsection 18.2(13) may not otherwise apply.

Anti-avoidance – excluded entity

ITA
18.2(14)

New subsection 18.2(14) is an anti-avoidance rule for the definition "excluded entity" in new subsection 18.2(1). In general terms, an excluded entity is not subject to the deduction restrictions under new subsection 18.2(2), nor an income inclusion under paragraph 12(1)(l.2), in respect of its interest and financing expenses for the year.

The new definition "excluded entity" contains a condition, in subparagraph (c)(iv), that requires that, in order for a taxpayer to be an excluded entity, all or substantially all of the interest and financing expenses of the taxpayer and of any eligible group entity in respect of the taxpayer must be paid or payable to persons or partnerships that are not tax-indifferent and non-arm's length. For this purpose, new subsection 18.2(14) deems a person or partnership to be tax-indifferent and non-arm's length if an amount of interest and financing expenses is paid or payable to the person or partnership as part of a transaction or event or series of transactions or events, and it can reasonably be considered that one of the main purposes of the transaction, event or series is to avoid that amount being paid or payable to a non-arm's length tax-indifferent person or partnership.

See also the commentary to the definition of "tax indifferent" in subsection 18.2(1).

<u>Example – Back-to-Back Transaction</u>

Assumptions

- Canco1 is a corporation resident in Canada;
- Pensionco is a Canadian pension fund that is tax-indifferent;

- Canco2 is a corporation resident in Canada that is not tax-indifferent;
- Pensionco and Canco1 do not deal with each other at arm's length;
- Pensionco enters into a transaction with Canco2, and Canco2 enters into a transaction with Canco1 (the "Back-to-Back Transactions"); and
- Under the Back-to-Back Transactions, Pensionco loans funds to Canco2, and Canco2 loans funds to Canco1 on which interest is paid or payable to Canco2.

Analysis

If it can reasonably be considered that one of the main purposes of either of the Back-to-Back Transactions, or of the series that includes those transactions, is to avoid any portion of the interest and financing expenses of Canco1 being paid or payable to a non-arm's length tax-indifferent (in this case Pensionco), Canco2 will be deemed to be a non-arm's length tax-indifferent in respect of Canco1.

Example – Interest Strip Transaction

Assumptions

- Canco1 is a corporation resident in Canada;
- Forco is a non-resident corporation that is tax-indifferent;
- Canco1 and Forco do not deal with each other at arm's length;
- Canco2 is a corporation resident in Canada that is not tax-indifferent;
- Forco loans funds to Canco1 on which interest is paid or payable (the "Loan"); and
- Canco2 enters into a transaction with Forco (the "Interest Strip Transaction"), whereby Canco2 acquires the right to receive the amount of interest paid or payable on the Loan from Canco1, but not the principal amount of the Loan.

Analysis

If it can reasonably be considered that one of the main purposes of the Interest Strip Transaction is to avoid any portion of the interest and financing expenses of Canco1 being paid or payable to a non-arm's length tax-indifferent (in this case Forco), Canco2 will be deemed to be a non-arm's length tax-indifferent in respect of Canco1.

Deemed eligible group entities

ITA
18.2(15)

New subsection 18.2(15) is a deeming rule for the definition "eligible group entity" in new subsection 18.2(1). It deems two taxpayers to be eligible group entities in respect of each other where they are eligible group entities in respect of the same third taxpayer. The use of the term "taxpayer" in this provision is meant to include both corporations and trusts.

Eligible group entities – related

ITA
18.2(16)

New subsection 18.2(16) provides two rules relevant in determining whether entities are eligible group entities in respect of each other by reason of being related. For these purposes, a reference to a trust does not include the trustee (this rule is provided for greater certainty and based on paragraph 251.1(4)(c) in respect of "affiliated persons") and entities are not deemed to be related solely because of control by the Crown or an entity referred to in paragraphs 149(1)(c) to (d) (such as municipalities and Crown corporations).

Eligible group entities – affiliated

ITA
18.2(17)

New subsection 18.2(17) provides two rules relevant in determining whether entities are eligible group entities in respect of each other by reason of being affiliated. For these purposes, entities are deemed not to be affiliated solely because of control by the Crown or an entity referred to in paragraphs 149(1)(c) to (d) (such as municipalities and Crown corporations), or because an entity is a beneficiary that is a "majority-interest beneficiary" (within the meaning of subsection 251.1(3)) that is also an arm's-length registered charity or non-profit organization.

Filing Requirement

ITA
18.2(18)

New subsection 18.2(18) requires taxpayers (excluding natural persons) to file in their return of income for the year a prescribed form containing prescribed information with respect to the deductibility of their interest and financing expenses. New paragraph 152(4)(b.9) permits the Minister to reassess taxpayers who fail to file the prescribed form, or who file the prescribed form without including all of the information required by the form, outside of the normal reassessment period. For more information, see the commentary on paragraph 152(4)(b.9).

Relevant inter-affiliate interest

ITA
18.2(19)

New subsection 18.2(19) provides rules for determining the portion of relevant inter-affiliate interest that is included in a controlled foreign affiliate's relevant affiliate interest and financing expenses or relevant affiliate interest and financing revenues.

Relevant inter-affiliate interest (defined in subsection 18.2(1)) refers, generally, to interest paid or payable by a controlled foreign affiliate (referred to in subsection 18.2(19) as the "payer affiliate”) of a taxpayer to another controlled foreign affiliate (referred to in subsection 18.2(19) as the “recipient affiliate”) of the taxpayer, or of an eligible group entity in respect of the taxpayer.

Although subsection 18.2(19) is similar to the excluded interest election available for certain interest payments between taxable Canadian corporations, it differs from that election in several respects. In particular, subsection 18.2(19) applies automatically rather than electively, does not provide a full exclusion in all cases and does not necessarily provide for symmetrical treatment in respect of the payer affiliate and recipient affiliate (as discussed below).

Paragraph 18.2(19)(a) determines the portion of the relevant inter-affiliate interest that is included in the payer affiliate’s relevant affiliate interest and financing expenses for an affiliate taxation year (referred to in subsection 18.2(19) as the “payer affiliate year”). This portion is determined by the formula A + B.

Variable A is essentially the portion of the relevant inter-affiliate interest that can be regarded as eroding the tax base by reducing an income inclusion in respect of foreign accrual property income (“FAPI”) under subsection 91(1). This erosion occurs where the total of the specified participating percentages (determined without regard to the payment of the relevant inter-affiliate interest), in respect of the payer affiliate, of the taxpayer and any eligible group entities in respect of the taxpayer (each referred to in this commentary as a “relevant taxpayer”) exceeds the total of the specified participating percentages, in respect of the recipient affiliate, of relevant taxpayers.

By virtue of variable A, the portion of the relevant inter-affiliate interest that can be seen as reducing the subsection 91(1) income inclusion in this manner is included in the relevant affiliate interest and financing expenses of the payer affiliate. In contrast, the remaining portion is excluded, subject to variable B.

If the total of the specified participating percentages, in respect of the payer affiliate, of relevant taxpayers is less than that in respect of the recipient affiliate, the amount determined for A is nil (by application of section 257). Thus, all of the relevant inter-affiliate interest is excluded from relevant affiliate interest and financing expenses in these cases, subject to variable B.

Variable B includes a portion of the relevant inter-affiliate interest in the payer affiliate’s relevant affiliate interest and financing expenses, where the portion so included is equal to the net relevant affiliate interest and financing revenues of the payer affiliate allocable to that relevant inter-affiliate interest. In effect, this ensures the payer affiliate must treat the relevant inter-affiliate interest as relevant affiliate interest and financing expenses to the extent these would offset against net relevant affiliate interest and financing revenues.

The payer affiliate’s net relevant affiliate interest and financing revenues are determined as F – G, and are equal to its relevant affiliate interest and financing revenues for the payer affiliate year, net of the amount that would be its relevant affiliate interest and financing expenses for the payer affiliate year if that amount were determined without regard to all amounts of relevant inter-affiliate interest of the payer affiliate for the payer affiliate year. A portion of these net relevant affiliate interest and financing revenues is allocated to each amount of relevant inter-affiliate interest of the payer affiliate for the payer affiliate year, based on the proportion that that amount of relevant inter-affiliate interest is of the total of all amounts of relevant inter-affiliate interest of the payer affiliate for the payer affiliate year that would, in the absence of paragraph 18.2(19)(a), be included in the payer affiliate's relevant affiliate interest and financing expenses. This *pro rata* allocation occurs under the formula (F – G) x E ÷ H.

Paragraph 18.2(19)(b) determines the portion of the relevant inter-affiliate interest that is included in the recipient affiliate's relevant affiliate interest and financing revenues for the recipient affiliate's affiliate taxation year.

If the payer affiliate does not have net relevant affiliate interest and financing revenues for the payer affiliate year, none of the relevant inter-affiliate interest will be included in the recipient affiliate's relevant affiliate interest and financing revenues. This will be so even if a portion of the relevant inter-affiliate interest is included in the payer affiliate's relevant affiliate interest and financing expenses by virtue of variable A of the formula in paragraph 18.2(19)(a).

If the payer affiliate has net relevant affiliate interest and financing revenues, the portion of the relevant inter-affiliate interest included in the recipient affiliate's relevant affiliate interest and financing revenues is equal to the portion of the payer affiliate's net relevant affiliate interest and financing revenues that is allocated to the relevant inter-affiliate interest under variable B of the formula in paragraph 18.2(19)(a), as adjusted to reflect the total specified participating percentages of relevant taxpayers in respect of the payer affiliate and recipient affiliate. Paragraph 18.2(19)(b) ensures the payment of the relevant inter-affiliate interest does not inappropriately convert net relevant affiliate interest and financing revenues of the payer affiliate into FAPI that does not have that character in the hands of the recipient affiliate.

Example

Assumptions

- Canco is a corporation resident in Canada with a taxation year ending December 31, 2025.
- CFA 1 and CFA 2 are controlled foreign affiliates of Canco at all relevant times.
- In the affiliate taxation year ending December 31, 2025, CFA 1's only income is $70 million in relevant affiliate interest and financing revenues and $40 million in dividends that are included in its income from property and are from corporations that are not foreign affiliates of any taxpayer.
- In its 2025 affiliate taxation year, CFA 1 makes the following interest payments, which are its only expenses for the year and are deductible (determined without regard to the EIFEL rules) in computing its FAPI:
  - $50 million to CFA 2 (Payment 1);
  - $50 million to CFA 2 (Payment 2); and
  - $10 million to a non-resident lender that is not a controlled foreign affiliate of Canco or of an eligible group entity in respect of Canco (Payment 3).
- CFA 2 has no expenses and its only income for its 2025 affiliate taxation year is from Payments 1 and 2.

- As a result of the interest payments (and before applying the EIFEL rules),
    - CFA 1's FAPI for its 2025 affiliate taxation year is nil; and
    - CFA 2's FAPI for its affiliate taxation year ending December 31, 2025 is $100 million.
- The total of the specified participating percentages of Canco and all eligible group entities of Canco is,
    - in respect of CFA 1 for its 2025 year, 80% (determined as if Payments 1 and 2 were not paid or payable); and
    - in respect of CFA 2 for its 2025 year, 60%.

<u>*Analysis*</u>

Payments 1 and 2 are relevant inter-affiliate interest of CFA 1 for its 2025 year and of CFA 2 for its 2025 year.

Payment 3, however, is not relevant inter-affiliate interest and is included in CFA 1's relevant affiliate interest and financing expenses for its 2025 year.

The amount included, in respect of Payment 1, in CFA 1's relevant affiliate interest and financing expenses for its 2025 year under variable A of the formula in subparagraph 18.2(19)(a)(ii) is determined by the formula (C – D) x E ÷ C, where:

- C is Canco's specified participating percentage in respect of CFA 1, which is 80%;
- D is Canco's specified participating percentage in respect of CFA 2, which is 60%; and
- E is the amount of Payment 1, which is $50 million.

Accordingly, in respect of Payment 1, the amount determined for variable A is $12.5 million. This amount will be included in CFA 1's relevant affiliate interest and financing expenses for purposes of determining Canco's interest and financing expenses.

The amount determined for variable B of the formula in subparagraph 18.2(19)(a)(ii)) is determined by the formula (F – G) x E ÷ H, where:

- F is CFA 1's relevant affiliate interest and financing revenues for its 2025 year, which is $70 million;
- G is the amount that would be CFA 1's relevant affiliate interest and financing expenses for its 2025 year if CFA 1 had no relevant inter-affiliate interest, which is $10 million;
- E is the amount of Payment 1, which is $50 million; and
- H is CFA 1's total relevant inter-affiliate interest for its 2025 year, which is $100 million.

Accordingly, in respect of Payment 1, the amount determined for variable B is $30 million. This amount will be included in CFA 1's relevant affiliate interest and financing expenses.

As a result, $42.5 million of Payment 1 is included in CFA 1's relevant affiliate interest and financing expenses for its 2025 year.

Applying the same calculations under the same formulas, $42.5 million of Payment 2 is also included in CFA 1's relevant affiliate interest and financing expenses for its 2025 year.

The amount included, in respect of Payment 1, in CFA 2's relevant affiliate interest and financing revenues for its 2025 year is determined under paragraph 18.2(19)(b) by the formula B x C ÷ D, where:

- B is the amount included in CFA 1's relevant affiliate interest and financing expenses for its 2025 year under variable B in respect of Payment 1, which is $30 million.
- C is Canco's specified participating percentage in respect of CFA 1, which is 80%; and
- D is Canco's specified participating percentage in respect of CFA 2, which is 60%

Accordingly, CFA 2's relevant affiliate interest and financing revenues, in respect of Payment 1, are $40 million. CFA 2's relevant affiliate interest and financing revenues, in respect of Payment 2, are also $40 million.

CFA 1's relevant affiliate interest and financing expenses for its 2025 year are $95 million and its relevant affiliate interest and financing revenues are $70 million. CFA 2's relevant affiliate interest and financing revenues for its 2025 year are $80 million.

Based on Canco's 80% specified participating percentage in respect of CFA 1,

- $76 million is included in Canco's interest and financing expenses for its 2025 taxation year under paragraph (j) of variable A of the formula in the definition of that term; and
- $56 million is included in Canco's interest and financing revenues for its 2025 taxation year under paragraph (g) of variable A of the formula in the definition of that term.

Based on Canco's 60% specified participating percentage in respect of CFA 2, $48 million is included in Canco's interest and financing revenues for its 2025 taxation year.

Accordingly, in respect of its combined shareholdings in CFA 1 and CFA 2, Canco's interest and financing expenses are $76 million and its interest and financing revenues are $104 million for its 2025 year.

Allocated Group Ratio Amount

Section 18.21 sets out the "group ratio" rules that are available to potentially reduce a taxpayer's excessive interest and financing expenses limitation under subsection 18.2(2). In general terms, the group ratio rules allow a taxpayer to deduct interest in excess of the fixed ratio where the taxpayer is able to demonstrate that the ratio of the consolidated group's net third-party interest expense (referred to in the rules as "group net interest expense", as defined in subsection 18.21(1)) to the consolidated group's book EBITDA (referred to in the rules as the "group adjusted net book income", also defined in subsection 18.21(1)) exceeds the fixed ratio. In that case, Canadian group members can jointly elect to determine their deductible amount of interest and financing expenses based on the consolidated group's ratio multiplied by the adjusted taxable incomes of the Canadian group members, subject to certain limitations. The group then allocates this deductible amount among the Canadian group members in the form that effects the election. This "flexible" allocation mechanism allows taxpayers to allocate the group ratio deduction capacity where it is most needed. The amount so allocated, referred to in these notes as the "allocated group ratio amount" or AGRA, replaces the fixed ratio amount otherwise applicable for variable B of the formula in subsection 18.2(2).

The group ratio rules contain certain limitations that are mainly intended to account for the possibility that some group members may have negative book EBITDA, or the group as a whole may have negative book EBITDA, such that a simple formulaic determination of the group ratio could give unreasonably high or meaningless results. Paragraph 18.21(2)(c) limits the AGRA to the lesser of the consolidated group's net third-party interest expense and the net adjusted taxable income of the Canadian group members.

Group ratio – definitions

ITA
18.21(1)

Subsection 18.21(1) sets out definitions that apply in determining the "allocated group ratio amount" (AGRA) of a taxpayer. Certain definitions in subsection 18.2(1) also apply in determining AGRA.

"acceptable accounting standards"

The definition "acceptable accounting standards" is relevant for the definition "consolidated financial statements" and, by virtue of subsection 18.21(6), the definitions "consolidated group", "equity-accounted entity", "group adjusted net book income", "specified interest expense", "specified interest income" and "ultimate parent". It means International Financial Reporting Standards (IFRS) and generally accepted accounting principles in Canada, Australia, Brazil, member states of the European Union or the European Economic Area, Hong Kong (China), Japan, Mexico, New Zealand, the People's Republic of China, the Republic of India, the Republic of Korea, Singapore, Switzerland, the United Kingdom and the United States. This list is predicated on the notion that differences between IFRS and generally accepted accounting principles in these jurisdictions would not provide a material competitive advantage or disadvantage to any entity using these standards.

"consolidated financial statements"

The definition "consolidated financial statements" is relevant for the definitions "consolidated group", "equity-accounted entity", "fair value amount", "group adjusted net book income", "net fair value amount", "relevant period", "specified interest expense", "specified interest income" and "ultimate parent". It is also referred to in subsections 18.21(2), (6) and (7). It means financial statements prepared in accordance with a relevant "acceptable accounting standard", also defined in subsection 18.21(1), in which the assets, liabilities, income, expenses and cash flows of two or more entities are presented as those of a single economic entity.

For greater certainty, the consolidated financial statements include, for these purposes, the notes to the financial statements. The use of the word "relevant" before "acceptable accounting standards" is meant to ensure that there must be a logical connection between the entities so consolidated and the accounting standards that are used to present their economic results. For example, generally accepted accounting principles in New Zealand would not likely be relevant for presenting the financial results of a group of companies based entirely in North America.

This definition is subject to the interpretation rule in paragraph 18.21(6)(a), as described below.

"consolidated group"

The definition "consolidated group" is central to the AGRA rules in section 18.21.

A consolidated group means two or more entities in respect of which "consolidated financial statements" (also defined in subsection 18.21(1)) are required to be prepared for financial reporting purposes, or would be so required if the entities were subject to IFRS. Within the "consolidated group" definition, a "member of the consolidated group" is also defined for the purposes of section 18.21, being each such entity of the group, which includes an "ultimate parent" (also defined in subsection 18.21(1)). An "equity-accounted entity", also defined in subsection 18.21(1), is not considered a member of the group.

There are interpretive rules in paragraph 18.21(6)(a) and subsection 18.21(7) that apply for the purposes of this definition.

"equity-accounted entity"

The definition "equity-accounted entity" is relevant for the definitions "consolidated group", "group adjusted net book income", "specified interest expense" and "specified interest income". It means an entity the net income or loss of which is included in the consolidated financial statements of a consolidated group under the equity method of accounting. In general terms, these entities are not accounted for on a line-by-line basis in consolidated financial statements. This definition is subject to the interpretive rule in paragraph 18.21(6)(a).

"equity interest"

The definition "equity interest" is relevant for the definition "specified non-member", also defined in subsection 18.21(1). It means a share of the capital stock of a corporation, an interest as a beneficiary under a trust, an interest as a member of a partnership or any similar interest in respect of any entity.

"fair value amount"

The definition “fair value amount” is relevant for the definition of “net fair value amount”, which in turn, is relevant in the computation of “group adjusted net book income” (GANBI). It means an amount reflected in the net income or loss reported in the consolidated financial statements of the consolidated group where the carrying value of any asset or liability is measured using the fair value method of accounting and the amount reflects a change in the carrying value of the asset or liability that is included in either variable C (net income reported in the consolidated financial statements) or H (net loss reported in the consolidated financial statements) of GANBI. This definition is subject to the interpretive rule in paragraph 18.21(6)(a).

“group adjusted net book income”

The definition “group adjusted net book income” (GANBI) is a key term in the AGRA rules as it is the amount used as the denominator in the “group ratio” determination. In essence, it is a consolidated group’s EBITDA, as adjusted for certain items. It is based on the consolidated financial statements of the group for a relevant period.

GANBI is calculated by formula, in a similar fashion to the calculation of EBITDA in that items in respect of interest, tax, depreciation and amortization are added back to the net profit or loss of the enterprise to obtain an adjusted net profit or loss amount. The items identified to determine the GANBI, or the information required to determine the amount of certain items, generally will be found in the consolidated financial statements of the group, or may be found in the notes to such statements. Further work to determine amounts in the relevant working papers or from other sources may be necessary in order to properly calculate the GANBI.

Variables C, D, E, F and G are additions, and variables H, I, J, K, L, M and N are subtractions, in determining GANBI.

Variable C is the amount, if any, of the group’s net income for the year as reported in its consolidated financial statements for the relevant period. If the group has a net loss for the year, it is picked up in variable H. “Relevant period” is also defined in subsection 18.21(1) and is described below.

Representing the “T” in EBITDA, variable D adds back the income tax expense of the group as reported in the consolidated financial statements.

Representing the “I” in EBITDA, variable E adds back the group’s interest expense, by reference to the definition “specified interest expense”, as described below. However, the latter definition is modified for GANBI purposes so that capitalized interest is not included in the add back, as it should be taken into account in the group’s depreciation and amortization amount, because it is generally added to the capital cost of an asset and depreciated over time.

Variable F is generally intended to represent the “DA” in EBITDA, being the add backs for depreciation and amortization. Variable F also adds back charges taken in computing profit that are in respect of the impairment or the write-off of a fixed asset, any loss from the disposition of a fixed asset and, if the Canadian group members have elected to exclude fair value amounts from the calculation of GANBI in accordance with subsection 18.21(4), a negative net fair value amount. Finally, variable F adds back any expenses, charges, deductions or losses that are similar to those specifically enumerated.

Variable G relates to equity-accounted entities. As a general matter, the AGRA rules are intended to recognize the income (or loss) generated by such entities for purposes of GANBI. However, consistent with the EBITDA concept, the portions of such income or loss that relate to the typical EBITDA addbacks must also be accounted for. As such, it is necessary to obtain information in respect of the income tax (per variable D) and depreciation and amortization (per variable F) amounts of any equity-accounted entities and to add back the consolidated group's share of these amounts in the calculation of GANBI. As the definition "specified interest expense" already includes interest and related expenses in respect of equity-accounted entities, no further adjustment is required in this regard.

Variable H is the first of the negative adjustments in GANBI and addresses net losses reported in the consolidated financial statements.

Variables I to M essentially mirror the addback items but reflect income or receipts rather than expenses or charges that have been taken into account in the computation of the group's net profit or loss. In particular, variable K allows Canadian group members that have elected to exclude fair value amounts from the calculation of GANBI in accordance with subsection 18.21(4) to add back a positive net fair value amount.

Variable N excludes in calculating GANBI any portion of net income reported in the consolidated financing statements that can reasonably be considered to be derived from activities funded, in whole or in part, by a borrowing resulting in exempt interest and financing expenses.

If the result of the GANBI formula is negative, it is intended that section 257 would make GANBI nil.

This definition is subject to the interpretive rule in paragraph 18.21(6)(a) in respect of the use of accounting terms.

"group net interest expense"

The definition "group net interest expense" (GNIE) is a key term in the AGRA rules as it is the amount used as the numerator in the "group ratio" determination. In essence, it is a consolidated group's net third party interest expense for a relevant period.

Variable A is the main component of the GNIE and is the amount by which the "specified interest expense" of the group exceeds the "specified interest income" of the group, for a relevant period. For more information, see the commentary on these defined terms.

Variable B represents the amount by which the variable A amount is reduced in arriving at the GNIE. It is generally meant to back out any interest paid to "specified non-members", which are essentially entities that are not members of the consolidated group but that have a significant connection with the group. For more information, see the commentary on that defined term.

Variable E is the main component of variable B in that it adds up all amounts of “specified interest expense” that are paid or payable to specified non-members of the group. Variable F represents the amount by which the variable E amount is reduced for “specified interest income” received or receivable from the specified non-member in respect of which “specified interest expense” is paid or payable. Section 257 is intended to make E minus F nil in respect of a particular “specified non-member” where the amount for variable F is greater than the amount for variable E. In other words, “specified interest income” in respect of a “specified non-member” is only taken into account to the extent that it does not exceed “specified interest expense” in respect of the “specified non-member”.

“group ratio”

The definition “group ratio”, as its name suggests, is a key component of the group ratio rules in section 18.21. However, it is only one component of the AGRA – determined under subsection 18.21(2) – which is the ultimate amount that is used in the EIFEL provision in subsection 18.2(2).

The “group ratio” definition contemplates two scenarios. Paragraph (a) provides that, if GANBI is a positive amount, the “group ratio” is determined as the ratio of GNIE to GANBI, multiplied by a factor of 1.1. For example, a taxpayer with GNIE of $50 and GANBI of $100 would have a group ratio of 0.55 (1.1 x 50/100). The formula includes a 10% up-lift to account for book-tax timing differences. GNIE and GANBI are based on an accounting measure of income and expenses, while the calculation of the fixed ratio in section 18.2 is based on tax measures. The 10% up-lift is recommended in the BEPS Action 4 Report to mitigate against book-tax timing differences that may arise from the group ratio calculation. If GANBI is not a positive amount, paragraph (b) provides that the group ratio is nil.

“net fair value amount”

The definition “net fair value amount” is relevant for paragraph (d) of variable F, and variable K, in the computation of “group adjusted net book income” (GANBI). It means the positive or negative total amount of all positive or negative fair value amounts in the consolidated financial statements.

“relevant period”

The definition “relevant period” refers to the period for which the consolidated financial statements of a consolidated group are presented. It is essentially the period in respect of which the amounts under section 18.21 are computed.

“specified interest expense”

The definition “specified interest expense” is a key component of the numerator (i.e., the GNIE) in the group ratio determination. It generally includes amounts of interest and similar types of financing expenses, as determined for financial reporting purposes.

Variable A adds up the various interest and financing expenses referred to in paragraphs (a) to (d). Variable B backs out any dividends included in those variable A amounts.

Paragraph (a) is the principal component of “specified interest expense” and includes all amounts of interest expense, whether reported as a line item itself in the consolidated financial statements or included in determining other such amounts.

Paragraph (b) deals with capitalized interest. This is generally intended to capture interest that is included in the balance sheet value of an asset.

Paragraph (c) includes guarantee fees, standby charges and arrangement or similar fees. These expense are not interest but are similar in nature in that they are generally related to borrowings or other credit facilities.

Paragraph (d) includes the consolidated group’s share of the interest and similar expenses of equity-accounted entities.

Exempt interest and financing expenses in respect of a Canadian public-private partnership infrastructure project are not included in “specified interest expenses”. For more information, see the commentary on the definition “exempt interest and financing expenses” in subsection 18.2(1).

Variable B is the total amount of dividends included in the determination of the amounts referred to in paragraphs (a) to (d) of variable A. It addresses the fact that some shares of corporations may be treated as debt for financial reporting purposes. Thus, any payment of dividends on such shares may be treated as a payment of interest expense for financial reporting purposes. However, these dividend payments are not deductible in computing the income of the paying corporation for tax purposes. As such, these dividends are excluded from “specified interest expense”.

This definition is subject to the interpretation rules in paragraphs 18.21(6)(a) and (b).

“specified interest income”

The definition “specified interest income” is the income analogue to the definition “specified interest expense” and is structured in a similar manner. The only exception is that capitalized interest has no income analogue.

“specified non-member”

The definition “specified non-member” is relevant for the GNIE definition. GNIE does not include any amount of “specified interest expense” that is paid or payable to a specified non-member. (These excluded amounts are reduced by “specified interest income” that is received or receivable from the specified non-member). Essentially, the concept of a “specified non-member” is intended to identify those persons or partnerships that are considered to have a close connection to a consolidated group, while not being members of the group.

Paragraph (a) includes certain persons or partnerships that do not deal at arm's length with a member of the consolidated group.

Paragraph (b) looks up an ownership chain and targets certain situations where a person or partnership, alone or together with non-arm's length parties, has "equity interests" (as defined, and discussed elsewhere in these notes) that give it 25% or more of the votes or value of a member of the consolidated group.

Paragraph (c) looks down an ownership chain and targets certain situations where a member of the consolidated group, alone or together with non-arm's length parties, has "equity interests" (as defined, and discussed elsewhere in these notes) that give it 25% or more of the votes or value of another entity.

This definition is subject to the anti-avoidance rule in subsection 18.21(8).

"ultimate parent"

The definition "ultimate parent" is mainly relevant in relation to the definition "consolidated group" and refers to the top entity in the group's organizational structure. It is the entity in respect of which the consolidated financial statements of the group are prepared. Where the top entity in a group's organizational structure is the Crown or an entity referred to in any of paragraphs 149(1)(c) to (d.6) (such as a Crown corporation or municipality), the ultimate parent is the highest-level entity that is not the Crown or an entity referred to in any of paragraphs 149(1)(c) to (d.6).

This definition is subject to the interpretation rule in paragraph 18.21(6)(a).

Allocated group ratio amount

ITA
18.21(2)

Subsection 18.21(2) is the operative provision of the group ratio rule in section 18.21 and determines the "allocated group ratio amount" (AGRA) that may be used as an alternative to the fixed ratio's interest deduction capacity under subsection 18.2(2).

If all conditions in subsection 18.21(2) are satisfied, corporations and trusts that are "eligible group entities" in respect of each other and that are members of the same consolidated group throughout a relevant period may elect to allocate an amount to each such entity (referred to as a "Canadian group member") under paragraph 18.21(2)(b) for each taxation year ending in the relevant period (referred to as a "relevant taxation year"). That amount (referred to in these notes as the "allocated group ratio amount" or AGRA) becomes, subject to the limitations set out in paragraph 18.21(2)(c), the amount determined under this subsection that replaces the amount otherwise used in variable B of subsection 18.2(2) under the fixed ratio rules. The joint election may be filed by the taxpayer or by any Canadian group member of the taxpayer, allowing one Canadian group member to file the election on behalf of the entire group.

A taxpayer that is a single member group under subsection 18.2(7) does not have any Canadian group members and therefore must file an election, rather than a joint election, for subsection 18.2(2) to apply.

“Eligible group entity” is defined in subsection 18.2(1) and requires each such entity to be resident in Canada.

Paragraph 18.21(2)(c) sets a limit on the total amount allocated. If that limit is exceeded, the AGRA is nil.

The AGRA limitation is the least of the following amounts:

i. The total of each amount that is a Canadian group member’s adjusted taxable income multiplied by the “group ratio” of the consolidated group.
ii. The “group net interest expense” (GNIE) of the consolidated group.
iii. The total of the “adjusted taxable income”, determined without reference to section 257, of each Canadian group member for the year. The override of section 257 is intended to ensure that aggregate taxable income is reduced by losses of any Canadian group members.

Similar to the transfer mechanism in subsection 18.2(4), subsection 18.21(2) allows for amended elections, subject to conditions, where a Canadian group member is reassessed, necessitating a reallocation of the allocated group ratio amount. For more information, see the commentary to subsection 18.2(4).

Late or amended election

ITA
18.21(3)

New subsection 18.21(3) authorizes the Minister to allow late-filed, amended or revoked elections under subsection 18.21(2) where the Canadian group members meet certain conditions and the Minister considers that it would be just and equitable to permit the change. This provision may be needed where, for example, the financial statements of the group are restated such that amounts relevant to the group ratio must be re-determined.

Fair value amounts - election

ITA
18.21(4)

Subsection 18.21(4) is the election required for “fair value amounts” to be excluded by Canadian group members from the calculation of GANBI. See the commentary to the definitions of “fair value amount”, “group adjusted net book income” and “net fair value amount”.

There is only one opportunity for Canadian group members to jointly make this election – which is the first time that a joint election is made under subsection 18.21(2) for the group ratio to apply. If this election under subsection 18.21(4) is made, an election under subsection 18.21(4) is deemed to have been made in each subsequent taxation year of each Canadian group member, and if such an election is not made, an election under subsection 18.21(4) is deemed not to have been made in each subsequent taxation year of each Canadian group member.

Assessment

ITA
18.21(5)

New subsection 18.21(5) requires the Minister of National Revenue to assess or reassess any taxpayer to take into account an election or amended election filed under subsection 18.21(2), even where the assessment or reassessment would otherwise be statute-barred.

Use of accounting terms

ITA
18.21(6)

Subsection 18.21(6) ensures that the allocated group ratio amount (AGRA) is determined largely by reference to accounting concepts. However, a specific exception is provided in the case of the term “dividend”, as used in the definitions “specified interest expense” and “specified interest income”. For these purposes, the term “dividend” is to be given its meaning for the purposes of the Act.

Single member group

ITA
18.21(7)

Subsection 18.21(7) provides a number of deeming rules in respect of a “single member group”. These rules are intended to enable the application of the group ratio rules in section 18.21 to taxpayers resident in Canada that are not members of a consolidated group.

Anti-avoidance

ITA
18.21(8)

Subsection 18.21(8) provides an anti-avoidance rule in respect of the “group net interest expense” (GNIE) computation. It is intended to address the risk that the allocated group ratio amount could be deliberately inflated with amounts of interest and similar expenses that are paid or payable to certain third parties outside the consolidated group.

Specifically, where a portion of “specified interest expense” is paid or payable by a member of a consolidated group to a person or partnership that is not a member of the group as part of a transaction or a series of transactions, and it can reasonably be considered that one of the main purposes of the transaction or series is to avoid that portion being carved out of GNIE (which is what variable E of that definition would otherwise do), then the person or partnership is deemed to be a “specified non-member” in respect of the group for the relevant period. This would bring that portion and any other amount of specified interest expense paid or payable by a group member to that person or partnership for the relevant period squarely into variable E of the GNIE definition.

Example – Back-to-Back Transactions

Assumptions

- Canco is a corporation resident in Canada that is a member of a consolidated group (the “Group”);
- Forco1 is a non-resident corporation that is not a member of the Group nor is it (absent the application of subsection 18.21(8)) a specified non-member of the Group;
- Forco2 is a non-resident corporation that is not a member of the Group but is a specified non-member of the Group;
- Forco2 loans funds to Forco1, and Forco1 loans funds to Canco on which interest is paid or payable to Forco1.

Analysis

If it can reasonably be considered that one of the main purposes of these transactions is to avoid the inclusion of any portion of the interest paid or payable by Canco in the amount for variable E in the GNIE definition, Forco1 will be deemed to be a specified non-member. If this is the case, the interest would be included in variable E of GNIE.

Example – Interest Strip Transaction

Assumptions

- Canco is a corporation resident in Canada that is a member of a consolidated group (the “Group”);
- Forco1 is a non-resident corporation that is not a member of the Group nor is it (absent the application of subsection 18.21(8)) a specified non-member of the Group;
- Forco2 is a non-resident corporation that is not a member of the Group but is a specified non-member of the Group;
- Forco2 loans funds to Canco on which interest is paid or payable (the “Loan”);

- Forco2 enters into a transaction with Forco1 (the “Interest Strip Transaction”) whereby Forco1 acquires the right to receive the amount of interest paid or payable on the Loan from Canco, but not the principal amount of the Loan.

<u>Analysis</u>

If it can reasonably be considered that one of the main purposes of the Interest Strip Transaction is to avoid the inclusion of any portion of the interest paid or payable by Canco on the Loan in the amount for E in the GNIE definition, Forco1 will be deemed be a specified non-member. If this is the case, the interest would be included in variable E of GNIE.

Coming Into Force

New sections 18.2 and 18.21 apply in respect of taxation years of a taxpayer that begin on or after October 1, 2023, subject to an anti-avoidance rule and a transitional election.

Where applicable, the anti-avoidance rule accelerates the application of sections 18.2 and 18.21, as well as various related provisions, to a taxation year that begins before 2023 and ends in that year. The anti-avoidance rule applies if, as a result of a transaction or event, or series of transactions or events, any of the taxpayer’s three taxation years immediately preceding its first taxation year that begins on or after January 1, 2023, is a “short” taxation year, and it is reasonable to consider that one of the purposes for the transaction, event or series was:

- to defer the application of the EIFEL rules to the taxpayer, or
- in effect, to increase the amount of any taxpayer’s excess capacity, as determined under the transitional rules discussed below, for a taxation year preceding the effective date of the EIFEL rules.

Transitional Rules

There are two separate sets of transitional rules included in the enacting legislation for the EIFEL rules. The first is an anti-avoidance rule that denies a taxpayer the benefit of the 40% ratio of permissible expenses otherwise applicable for taxation years that begin on or after October 1, 2023 and before January 1, 2024, generally where the taxpayer undertakes a transaction to extend the period for which the 40% ratio applies. For more information, see the commentary on the definition “ratio of permissible expenses” in subsection 18.2(1).

The second set of transitional rules applies for the purpose of determining the cumulative unused excess capacity of a taxpayer that is a corporation or a fixed interest commercial trust for a taxation year, which is by definition determined based on the taxpayer’s excess capacity for the year plus its excess capacity for the three immediately preceding taxation years (reflecting a three-year carry-forward of excess capacity). Absent these transitional rules, such a taxpayer would not have excess capacity for any of the three taxation years (referred to as the “pre-regime years”) immediately preceding its first taxation year (referred to as the “first regime year”) in respect of which the EIFEL rules apply, because the EIFEL rules otherwise do not apply in respect of the pre-regime years. These transitional rules, in effect, allow taxpayers to elect to determine their excess capacity for the pre-regime years in accordance with special rules and carry forward their excess capacity so determined for a pre-regime year for three taxation years, by including it in computing their cumulative unused excess capacity.

In order to benefit from these transitional rules, a taxpayer and all eligible group entities in respect of the taxpayer that are also corporations or fixed interest commercial trusts (referred to in the transitional rules as “eligible pre-regime group entities”) must jointly elect to have these rules apply. Absent a valid joint election, the taxpayer’s excess capacity for all its pre-regime years is deemed to be nil. For the purposes of these transitional rules, the eligible pre-regime group entities in respect of the taxpayer are determined at the end of the taxpayer’s first regime year. The joint election must be filed by the filing-due date of the group member with the earliest filing-due date for the first regime year. The joint election may be filed by the taxpayer or by any of its eligible pre-regime group entities, allowing one eligible pre-regime group entity to file the completed joint election on behalf of the entire group. The election must allocate the “group net excess capacity” (described below) for the pre-regime years among the taxpayer and eligible pre-regime group entities in respect of the taxpayer, and these allocated amounts are treated as their excess capacity for the specific pre-regime years to which they are allocated. The rules governing these allocations are explained in more detail below.

If a valid joint election is filed, a taxpayer’s excess capacity for the pre-regime years is determined in accordance with special rules, which are required because a taxpayer’s cumulative unused excess capacity for a taxation year is intended to include only the unused portions of its excess capacity for the three immediately preceding taxation years. In the steady-state system after the rules apply generally, the unused portion of excess capacity is determined, under the definition “cumulative unused excess capacity”, by reducing excess capacity by the taxpayer’s “absorbed capacity” and “transferred capacity”, which represent the portions of its excess capacity that the taxpayer has already used to deduct its own excess interest and financing expenses (i.e., such expenses exceeding the amount it would have been permitted to deduct for the year under subsection 18.2(2)) or to allow other group members to deduct their excess interest and financing expenses in prior years. Since the EIFEL rules do not otherwise apply in respect of the pre-regime years, however, the taxpayer necessarily will not have used any of its excess capacity for pre-regime years for these purposes.

Special transitional rules are therefore provided to determine the taxpayer’s unused excess capacity for the pre-regime years, in order to ensure consistency with the usual rules for determining a taxpayer’s cumulative unused excess capacity and prevent it from being overstated. They are intended to approximate what the taxpayer’s unused excess capacity would have been had the EIFEL rules applied in respect of the pre-regime years. Thus, they seek to replicate, in a relatively simple and administrable way, the extent to which the excess capacity of the taxpayer and eligible pre-regime group entities for pre-regime years would have been used to allow for the deduction of the excess interest and financing expenses of the taxpayer and eligible pre-regime group entities for pre-regime years.

In effect, the transitional rules net any excess interest and financing expenses of the taxpayer and eligible pre-regime group entities in respect of the taxpayer for any pre-regime years against any excess capacity of the taxpayer and those eligible pre-regime group entities for those years, in determining a taxpayer’s excess capacity (as well as the excess capacity of the eligible pre-regime group entities). This is intended to approximate reductions for transfers of excess capacity to other group members that have excess interest and financing expenses in pre-regime years, which would have occurred had the EIFEL rules applied for pre-regime years, as well as reductions for where a taxpayer’s excess capacity for one pre-regime year would have been used to allow the taxpayer to deduct its own excess interest and financing expenses in another pre-regime year.

The special rules for determining the taxpayer’s excess capacity for each pre-regime year (which is, notionally, the unused portion of its excess capacity) can be broken down into three main steps.

The first step is to determine the “excess capacity otherwise determined” or “excess interest” of the taxpayer and each eligible pre-regime group entity for each pre-regime year. A taxpayer’s “excess capacity otherwise determined” for a pre-regime year is the amount that would be determined as its excess capacity for that year if that definition applied in respect of the pre-regime year. A taxpayer’s “excess interest” for a pre-regime year is the amount by which its interest and financing expenses for the year exceed the amount of interest and financing expenses that it would have been permitted to deduct for that year had subsection 18.2(2) applied in respect of that year. Subject to any group ratio election made by the taxpayer, the amount the taxpayer would have been permitted to deduct is determined as its ratio of permissible expenses multiplied by its adjusted taxable income, plus its interest and financing revenues.

In determining the excess capacity otherwise determined or excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime year:

- If a taxpayer was subject to a loss restriction event in a pre-regime year, its excess capacity otherwise determined or excess interest for any pre-regime year preceding that event is deemed to be nil.
- The ratio of permissible expenses that is to be used in determining these amounts is the one that, under the definition “ratio of permissible expenses” in subsection 18.2(1) (and subject to the above-noted anti-avoidance rule provided in the transitional rules), applies for the taxation year for which the taxpayer’s cumulative unused excess capacity is being determined. Thus, for some corporate groups, the excess capacity otherwise determined or excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime must be determined twice: once using the 40% ratio of permissible expenses that generally applies for taxation years beginning on or after October 1, 2023 and before January 1, 2024, for the purpose of determining the taxpayer’s cumulative unused excess capacity for those years; and a second time using the 30% ratio that applies for subsequent taxation years, for the purpose of determining the taxpayer’s cumulative unused excess capacity for those subsequent years (this will generally be relevant for taxation years that begin in 2024 and 2025, and in 2026 for many taxpayers, given the three-year carry-forward period for excess capacity).
- As an alternative to using the applicable ratio of permissible expenses in determining excess capacity otherwise determined or excess interest, corporate groups can elect to have the group ratio rule in subsection 18.21(2) apply for one or more pre-regime years,

> provided they meet the conditions in that subsection (but with the filing deadline for the requisite election being determined by reference to the first regime year rather than a pre-regime year). While a group ratio election results in the taxpayer and eligible pre-regime group entities having nil excess capacity for the group ratio year, electing into the group ratio for a pre-regime year can nonetheless be beneficial in certain cases, in that it generally results in lower amounts of excess interest of the taxpayer or eligible pre-regime group entities for a pre-regime year.

The reason that taxpayers for which the 40% transitional fixed ratio applies for their first regime year are required to determine excess capacity otherwise determined and excess interest twice – once using the 40% ratio, and then again using the 30% ratio – is that no excess capacity that derives from the 40% transitional fixed ratio (in excess of what would be derived under a 30% ratio) is permitted to be carried forward to a taxation year in which the 30% ratio applies. Thus, these amounts must be computed using the 30% ratio in determining cumulative unused excess capacity for any taxation year for which the 30% ratio applies.

The second step is to determine the "group net excess capacity" for the pre-regime years, which is the total of the excess capacity otherwise determined of the taxpayer and all eligible pre-regime group entities for all pre-regime years, net of the total of the excess interest of the taxpayer and eligible pre-regime group entities for all pre-regime years. Thus, the group net excess capacity represents the net excess capacity of the corporate group for the period spanning the pre-regime years. Consistent with the approach under the EIFEL rules more generally, the excess capacity otherwise determined of any financial institution group entity is excluded in the determination of group net excess capacity.

In the case of taxpayers for whom the 40% ratio applies for their first regime year, the group net excess capacity is computed twice: the first time based on the excess capacity otherwise determined and excess interest of the taxpayer and each eligible pre-regime group entity for each pre-regime year as determined using the 40% ratio, and the second time based on those amounts determined using the 30% ratio.

The third step is to allocate, in the joint election under the transitional rules, the group net excess capacity to the taxpayer and the eligible pre-regime group entities for specific pre-regime years. The portion of the group net excess capacity that is allocated to a taxpayer or eligible pre-regime group entity for a pre-regime year is deemed to be the excess capacity of the taxpayer or eligible pre-regime group entity, as the case may be, for that pre-regime year. The allocated amount for a given pre-regime year thus effectively replaces the amount that would otherwise have been determined as the taxpayer's excess capacity (the taxpayer's "excess capacity otherwise determined") for the given pre-regime year under the definition "excess capacity" in subsection 18.2(1), if that definition applied in respect of pre-regime years. The taxpayer's deemed excess capacity for a pre-regime year is, in effect, subject to both the usual three-year carry-forward by virtue of being included in the taxpayer's cumulative unused excess capacity, and the ordinary rules under that definition that reduce excess capacity to reflect its utilization in the form of amounts of transferred capacity and absorbed capacity.

Where applicable, the group must make two allocations in its joint election: one for the group net excess capacity as determined using the 40% ratio, and the other for the group net excess capacity determined using the 30% ratio. The first allocation determines the excess capacity, for each pre-regime year, of the taxpayer and each eligible pre-regime group entity, for the purpose of determining their respective cumulative unused excess capacity for taxation years in which the 40% ratio applies (generally, taxation years beginning on or after October 1, 2023, and before January 1, 2024). The second allocation applies for the purpose of determining the respective cumulative unused excess capacity of the taxpayer and eligible pre-regime group entities for subsequent taxation years (given the three-year carry-forward period for excess capacity, this will generally be relevant for taxation years beginning in 2024 and 2025, and in 2026 for taxpayers whose first regime year is 2024). This means that, for some taxpayers, the amount deemed to be their excess capacity for a given pre-regime year will be different for the purpose of computing their cumulative unused excess capacity for their first regime year than for the purpose of computing their cumulative unused excess capacity for subsequent years.

In addition, these allocations must meet three specific requirements set out in the transitional rules, or else the taxpayer’s excess capacity for a pre-regime year is deemed to be nil. The first requirement is that the total amount of excess capacity that a taxpayer is allocated for its pre-regime years, from the group net excess capacity, cannot exceed its net excess capacity for its pre-regime years. A taxpayer’s net excess capacity for its pre-regime years is the amount, if any, by which the total of all amounts each of which is its excess capacity otherwise determined for any pre-regime year exceeds the total of all amounts each of which is its excess interest for any pre-regime year. Thus, if a taxpayer’s total excess interest for its pre-regime years is greater than or equal to its total excess capacity otherwise determined for its pre-regime years, then it cannot be allocated any excess capacity for any pre-regime years, and thus its excess capacity for each of those years will be nil for the purpose of determining its cumulative unused excess capacity for any taxation year. In that case, any net group excess capacity for the pre-regime years can be allocated only to eligible pre-regime group entities in respect of the taxpayer that have net excess capacity for the pre-regime years.

The second requirement is that the excess capacity allocated to a taxpayer for a given pre-regime year cannot exceed its excess capacity otherwise determined for that pre-regime year.

The third requirement is that the total excess capacity allocated to the taxpayer and eligible pre-regime group entities for their pre-regime years cannot exceed the group net excess capacity. If the corporate group allocates a total amount greater than the group net excess capacity, then the excess capacity of the taxpayer and all of the eligible pre-regime group entities for each of their pre-regime years is deemed to be nil.

Clause 4

Commercial Debt Obligation

ITA
80(1)

For a debt obligation to be a "commercial debt obligation" as defined in subsection 80(1), interest on the debt obligation must be deductible if the Act were read without reference to certain subsections. Paragraph (b) of the definition "commercial debt obligation" is amended to add subsection 18.2(2) to the provisions that the Act is read without reference to when applying the definition of commercial debt obligation.

Clause 5

Non-capital losses, etc., of predecessor corporations

ITA
87(2.1)

Subsection 87(2.1) allows a corporation formed on an amalgamation of two or more other corporations (referred to as a "new corporation" and the "predecessor corporations", respectively) to deduct the unclaimed losses of its predecessor corporations, subject to the restrictions on the use of losses imposed by section 111 and subsection 149(10) of the Act.

Consequential on the introduction of new section 18.2 and new paragraph 111(1)(a.1), which are part of the new excessive interest and financing expenses limitation regime, paragraphs 87(2.1)(a) and (b) are amended to provide similar "continuity" treatment in respect of unused restricted interest and financing expense of each predecessor corporation. "Restricted interest and financing expense" is the amount of interest and financing expenses for which deductions were denied under subsection 18.2(2) (or amounts were included in income under paragraph 12(1)(l.2)) in prior years. For more information, see the commentary on paragraph 111(1)(a.1) and the definition "restricted interest and financing expense" in subsection 111(8).

Subsection 87(2.1) is also amended to add new paragraph 87(2.1)(a.1).

New subparagraph 87(2.1)(a.1)(i) provides a similar continuity treatment in respect of the various amounts that are relevant in computing a taxpayer's cumulative unused excess capacity, which is defined in new subsection 18.2(1) and essentially reflects the three-year carry-forward of a taxpayer's excess capacity (as also defined in that subsection). This is intended to allow the cumulative unused excess capacity of the new corporation to be determined as though the new corporation were the same corporation as, and a continuation of, the predecessor corporations.

If new subsection 111(5.01) applies on a loss restriction event to restrict the cumulative unused excess capacity of a predecessor corporation, this restriction will also apply to the new corporation because subsection 111(5.01) provides that the restriction applies in respect of all taxpayers for all taxation years ending after the loss restriction event. For further information, see the commentary on that subsection.

New subparagraph 87(2.1)(a.1)(ii) applies a continuity rule where a non-capital loss of a predecessor corporation is attributable to deductions in respect of net interest and financing expenses. To the extent the new corporation deducts an amount in respect of the loss in a post-amalgamation year, this continuity rule is intended to ensure that an amount in respect of the portion of the loss deriving from the net interest and financing expenses is added back in determining the new corporation's "adjusted taxable income" (as defined in new subsection 18.2(1)) for the year. Thus, for the limited purpose of determining this add-back amount, subparagraph 87(2.1)(a.1)(ii) deems the new corporation to be the same corporation as the predecessor corporation, such that, for this purpose, the predecessor's interest and financing expenses and interest and financing revenues for the pre-amalgamation years are considered those of the new corporation.

Finally, paragraph 87(2.1)(d) is amended to ensure that the general rule that subsection 87(2.1) has no effect on the income of the new corporation does not prevent an amount in respect of interest and financing expenses from being deductible in a post-amalgamation year where the new corporation has cumulative unused excess capacity resulting from subparagraph 87(2.1)(a.1).

The amendments to paragraphs 87(2.1)(a) and (b) apply in respect of amalgamations that occur on or after October 1, 2023. New paragraph 87(2.1)(a.1) and amended paragraph 87(2.1)(d) apply in respect of amalgamations that occur in any taxation year.

Clause 6

Non-capital losses, etc., of subsidiary

ITA
88(1.1)

Subsection 88(1.1) allows a parent corporation under certain circumstances to carry forward the non-capital losses, restricted farm losses, farm losses and limited partnership losses of a subsidiary corporation that has been wound up.

Consequential on the introduction of new section 18.2 and new paragraph 111(1)(a.1), which are part of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 88(1.1) is amended in a number of respects to provide similar carry-forward treatment to a parent corporation in respect of the wound-up subsidiary's unused restricted interest and financing expense. A "restricted interest and financing expense" is the amount of the subsidiary's interest and financing expenses for which deductions were denied under new subsection 18.2(2), or amounts were included in income under paragraph 12(1)(l.2), in a prior taxation year. For more information, see the commentary on paragraph 111(1)(a.1) and the definition "restricted interest and financing expense" in subsection 111(8).

Subsection 88(1.1) is amended such that the carry-forward treatment in respect of the subsidiary's restricted interest and financing expense applies in respect of a parent corporation for the purposes of paragraph 111(1)(a.1), which is the provision that in certain circumstances allows such amounts to be deducted in computing a taxpayer's taxable income.

Consistent with the current approach to losses under subsection 88(1.1), the subsidiary's restricted interest and financing expense for a particular taxation year (referred to as the "subsidiary expense year") is allocated between a particular business carried on by the subsidiary (referred to as the "subsidiary's expense business"), to the extent it can reasonably be regarded as an expense or loss incurred in the course of carrying on the subsidiary's expense business, and any other source.

New paragraph 88(1.1)(d.2) deems the portion of the subsidiary's restricted interest and financing expense that is attributable to the subsidiary's expense business to be restricted interest and financing expense of the parent from carrying on the subsidiary's expense business for the parent's year in which the subsidiary's expense year ended. However, this deeming rule applies only to the extent that the conditions in paragraphs (a) and (b) of subsection 88(1.1) are met, which essentially require that the portion of a restricted interest and financing expense was not deducted by the subsidiary and would have been deductible to the subsidiary after the commencement of the winding-up. Consistent with the current treatment of losses under this subsection, the deemed restricted interest and financing expense is also deemed not to have been deductible by the parent for years beginning before the winding-up commenced.

New paragraph 88(1.1)(d.3) provides for similar treatment of the subsidiary's restricted interest and financing expense allocated to any other source.

Paragraph 88(1.1)(e) currently limits the use that can be made of the subsidiary corporation's non-capital losses and farm losses if either the parent or the subsidiary undergoes an acquisition of control. This paragraph is amended to ensure that this limitation applies similarly in respect of the subsidiary corporation's restricted interest and financing expenses.

Finally, paragraph 88(1.1)(f) currently allows the parent to elect to deem a loss of the subsidiary that would otherwise be a loss of the parent for a taxation year beginning after the commencement of the winding up to be a loss of the parent for the immediately preceding taxation year. New paragraph 88(1.1)(g) allows the parent to make a similar election if a portion of the subsidiary's restricted interest and financing expense would otherwise be the parent's restricted interest and financing expense for a taxation year beginning after the commencement of the winding up.

These amendments apply in respect of windings-up that begin on or after October 1, 2023.

Cumulative unused excess capacity of subsidiary

ITA
88(1.11)

New subsection 88(1.11) is part of the new excessive interest and financing expenses limitation regime located mainly in sections 18.2 and 18.21.

If a subsidiary corporation has been wound up in circumstances described in subsection 88(1.1), new subsection 88(1.11) applies for the purposes of determining the parent's cumulative unused excess capacity, which is defined in new subsection 18.2(1) and essentially reflects a three-year carry-forward of excess capacity (as also defined in that subsection).

This subsection is introduced to provide continuity treatment to the parent in respect of the subsidiary’s cumulative unused excess capacity.

This is achieved by attributing to the parent the principal amounts that are relevant in determining the subsidiary’s cumulative unused excess capacity. In particular, any absorbed capacity, excess capacity or transferred capacity (each as defined in subsection 18.2(1)) of the subsidiary for a taxation year is deemed to be absorbed capacity, excess capacity or transferred capacity, respectively, of the parent for its taxation year in which the subsidiary’s year ends. By attributing to the parent not only the subsidiary’s excess capacity, but also its absorbed capacity and transferred capacity, this rule, in effect, provides continuity in the parent only in respect of the subsidiary’s excess capacity that is not “used” by the subsidiary before the winding-up.

Notably, if new subsection 111(5.01) applies on a loss restriction event to restrict the cumulative unused excess capacity of the subsidiary, that restriction will also apply to the parent because that subsection provides that the restriction applies in respect of all taxpayers for all taxation years ending after the loss restriction event. For further information, see the commentary on subsection 111(5.01).

New subsection 88(1.11) applies in respect of windings-up that begin in any taxation year.

Clause 7

Deemed year-end

ITA
91(1.2)

Subsection 91(1.2) is the operative provision of the “stub-period FAPI” rules. Its general effect is to ensure 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.

Subsection 91(1.2) is amended to include a reference to new clause 95(2)(f.11)(ii)(D), to make the stub-period FAPI rules applicable for the purposes of applying the new excessive interest and financing expenses limitation (EIFEL) rules in respect of taxpayers with controlled foreign affiliates.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 8

Adjusted cost base of share of foreign affiliate

ITA
92(1)

Subsection 92(1) provides additions and deductions that apply in computing, at any time in a taxation year, the adjusted cost base (ACB) to a taxpayer resident in Canada of any share owned by the taxpayer of the capital stock of a foreign affiliate of the taxpayer.

Paragraph 92(1)(a) is amended consequential on the introduction of new clause 95(2)(f.11)(ii)(D), which applies the new excessive interest and financing expenses limitation (EIFEL) to the computation of the foreign accrual property income (FAPI) of a controlled foreign affiliate.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

This amendment ensures that any ACB adjustments under subsection 92(1) are determined without regard to any denials of deductions under new subclause 95(2)(f.11)(ii)(D)(I) in respect of relevant affiliate interest and financing expenses of a controlled foreign affiliate, or income inclusions under new subclause 95(2)(f.11)(ii)(D)(II) in respect of such expenses of a partnership of which a controlled foreign affiliate is a member.

If clause 95(2)(f.11)(ii)(D) applies with the overall effect of reducing a foreign accrual property loss (FAPL), this can result in the amount included in the taxpayer’s income under subsection 91(1) in a year when the FAPL is claimed being greater than it would have been in the absence of the application of that clause. In that case, the amendment to paragraph 92(1)(a) ensures that the ACB adjustment is determined based on the lesser amount that would have been included under subsection 91(1) if clause 95(2)(f.11)(ii)(D) had never applied.

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 9

Deemed corporation

ITA
94.2(2)

Subsection 94.2(2) of the Act provides certain deeming rules that are relevant for the purposes of applying a number of provisions of the Act in respect of a trust that meets the conditions in subsection 94.2(1). Paragraph 94.2(2)(a) deems such a trust to be a non-resident corporation that is controlled by the beneficiary referred to in that subsection and, where applicable, by a taxpayer whose controlled foreign affiliate is such a beneficiary. Paragraph 94.2(2)(b) deems each beneficiary to own a proportion of the issued shares of each class that is commensurate with the fair market value of the beneficiary's beneficial interest in the corresponding class of interests in the trust.

Consequential on the introduction of new section 18.2, which is part of the new excessive interest and financing expenses limitation (EIFEL), subsection 94.2(2) is amended to provide that the deeming rules in that subsection also apply for the purposes of section 18.2 and the new definition "restricted interest and financing expense" in subsection 111(8).

This amendment applies in respect of taxation years beginning on or after October 1, 2023.

However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 10

ITA
95(2)(f.11)

Paragraph 95(2)(f.11) provides certain application rules for the purposes of the foreign affiliate income, gain and loss computation rules in paragraph 95(2)(f). Subparagraph 95(2)(f.11)(ii) applies in respect of income or loss from property and non-active businesses of a foreign affiliate of a taxpayer, as required to be computed under subparagraph 95(2)(f)(ii) in respect of the taxpayer.

Clause 95(2)(f.11)(ii)(A) is amended to provide that the Act is to be read without reference to subsection 18.2(2) – the main operative rule in the new excessive interest and financing expenses limitation (EIFEL) regime – in determining the income or loss from property, non-active businesses and non-qualifying businesses of a controlled foreign affiliate of a taxpayer, which are generally required by subparagraph 95(2)(f)(ii) to be computed on the basis the affiliate is resident in Canada. The effect of this amendment is that, in computing a foreign affiliate's foreign accrual property income (FAPI), there is no separate determination under subsection 18.2(2) of the proportion of the affiliate's interest and financing expenses that are "excessive" and the deductibility of which would thus be denied if that subsection applied in computing FAPI. Since no such proportion is separately determined in respect of the affiliate under subsection 18.2(2), paragraph 12(1)(l.2) also does not apply to include amounts in the affiliate's FAPI in respect of interest and financing expenses of a partnership of which it is member. There is similarly no determination under the EIFEL rules of a foreign affiliate's "excess capacity" or "cumulative unused excess capacity", and no ability for a foreign affiliate to transfer or receive such amounts under subsection 18.2(4). Deduction capacity deriving from the affiliate's FAPI or relevant affiliate interest and financing revenues is instead reflected in the excess capacity or cumulative unused excess capacity of the taxpayer, to the extent of its specified participating percentage in respect of the affiliate.

While subsection 18.2(2) applies only in respect of a taxpayer and not a foreign affiliate of the taxpayer, new subclause 95(2)(f.11)(ii)(D)(I) provides that where a proportion of a taxpayer's interest and financing expenses for a taxation year (referred to as a "taxpayer year") are determined under subsection 18.2(2) to be excessive and thus subject to denial under that subsection, the same proportion of a controlled foreign affiliate's "relevant affiliate interest and financing expenses" (as defined in subsection 18.2(1)) is denied in computing the affiliate's FAPI for an affiliate taxation year ending in the taxpayer year. Similarly, subclause 95(2)(f.11)(ii)(D)(II) includes in computing a controlled foreign affiliate's FAPI an amount, in respect of interest and financing expenses of partnerships of which the affiliate is member, that is also determined by reference to the proportion of the taxpayer's interest and financing expenses determined to be excessive under subsection 18.2(2).

Clause 95(2)(f.11)(ii)(D) applies only in respect of a foreign affiliate that is a controlled foreign affiliate of a taxpayer at the end of the affiliate taxation year. Thus, the EIFEL regime does not impact the computation of FAPI of foreign affiliates that are not controlled foreign affiliates. In addition, this clause does not apply in computing FAPI of a foreign affiliate in respect of a taxpayer that is an "excluded entity" (as defined in subsection 18.2(1)) for a taxation year in which the affiliate's taxation year ends.

New clause 95(2)(f.11)(ii)(E) provides an election to, in effect, forgo a foreign accrual property loss (FAPL) in order to avoid having to include expenses that gave rise to the FAPL in a taxpayer's interest and financing expenses. Because a foreign affiliate's FAPL can only be applied against its FAPI and not against the Canadian shareholder's own income, there are cases where a FAPL may never actually be used to reduce Canadian taxable income. Absent an election under this clause, however, interest and financing expenses underlying a FAPL are nonetheless included in a controlled foreign affiliate's relevant affiliate interest and financing expenses, which are attributed to the Canadian shareholder and can negatively impact its ability to deduct its own interest and financing expenses.

Under this election, the Canadian shareholder elects in respect of one or more items of the affiliate's otherwise deductible interest and financing expenses, and can elect in respect of all or a portion (each referred to clause 95(2)(f.11)(ii)(E) as an "elected amount") of each such item. The elected amount is not deductible in computing its income or loss from property, a business other than an active business or a non-qualifying business. This non-deductibility has two effects:

- First, each elected amount is not included in the affiliate's relevant affiliate interest and financing expenses, which only include deductible amounts. Thus, the elected amounts are not included in the taxpayer's interest and financing expenses and will not impact the taxpayer's interest deduction capacity.
- Second, the affiliate's FAPL is reduced to the extent of the total of the elected amounts.

To ensure the elected amounts reflect only interest and financing expenses otherwise resulting in a FAPL, the total of the elected amounts in an affiliate taxation year is limited to the lesser of the FAPL and the affiliate's relevant affiliate interest and financing expenses for the affiliate taxation year (with each of those amounts being determined without regard to the election under clause 95(2)(f.11)(ii)(E)).

These amendments apply in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, they also apply in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 11

Agreement or election of partnership members

ITA
96(3)

Subsection 96(3) 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.

Consequential on the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 96(3) is amended to add a reference to the definition "excluded interest" in new subsection 18.2(1). As a result, a member of a partnership that is a payee or payer of an amount of interest or a "lease financing amount" (as defined in subsection 18.2(1)) may make an election on behalf of all members of the partnership under paragraph (e) of that definition to treat that amount as excluded interest for purposes of the EIFEL regime (provided the other requirements of that definition are satisfied).

This amendment applies in respect of taxation years that begin on or after October 1, 2023.

Clause 12

Restricted interest and financing expenses

ITA

111(1)(a.1)

New paragraph 111(1)(a.1) permits taxpayers to deduct in computing taxable income for a taxation year such portion as they may claim of their restricted interest and financing expense for taxation years preceding the year, not exceeding the amount determined by the formula A + B included in the provision, as described below.

A taxpayer’s “restricted interest and financing expense” for a taxation year is a new defined term in subsection 111(8). Generally, it represents the amount of the taxpayer’s interest and financing expenses for the year for which deductions were denied under new subsection 18.2(2) (or in respect of which amounts were included in income under new paragraph 12(1)(l.2)).

For more information, see the commentary on the new definition “restricted interest and financing expense” in subsection 111(8).

The amount a taxpayer may deduct under paragraph 111(1)(a.1) for a taxation year in respect of its restricted interest and financing expense for prior years is limited to the taxpayer’s excess capacity for the year plus its total received capacity for the year (where both of those terms are as defined in new subsection 18.2(1)). For this purpose, the taxpayer’s excess capacity is the amount it would be if no amount were deductible by the taxpayer under paragraph 111(1)(a.1). The effect, when taken together with the reduction to excess capacity under variable C in the definition of that term, is that a taxpayer’s excess capacity for a taxation year is first applied to allow the taxpayer to deduct its unused restricted interest and financing expense from prior years, and the taxpayer can then elect to transfer any remaining excess capacity to other group members under subsection 18.2(4). For more information, see the commentary to the definition “excess capacity” in subsection 18.2 and to subsection 18.2(4).

While, unlike certain losses to which subsection 111(1) applies, restricted interest and financing expense can only be carried forward to future taxation years, and not back to prior years, the rules, in effect, provide a three-year carry-forward of excess capacity, as reflected in the taxpayer’s cumulative unused excess capacity (as defined in subsection 18.2(2)). This provides comparable results to a three-year carry-back of restricted interest and financing expense.
New paragraph 111(1)(a.1) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Limitation on deductibility

ITA
111(3)

Subsection 111(3) of the Act sets out limitations on the amount that can be deducted or claimed under subsection 111(1) in respect of a non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss.

Subparagraph 111(3)(a)(i) reduces the amount that a taxpayer can deduct, in computing taxable income for a particular taxation year, in respect one of these losses for a taxation year by the total of amounts deducted in respect of the loss in preceding taxation years. Paragraph 111(3)(b) is an ordering rule that provides that no amount is deductible in respect of a non-capital loss, net capital loss, restricted farm loss, farm loss or limited partnership loss for a taxation year until a loss of the same type for a preceding taxation year has been deducted (i.e., losses of each type must be deducted in the order in which they arose).

Subparagraph 111(3)(a)(i) and paragraph (b) are amended consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation regime whose core rules are in new sections 18.2 and 18.21. These amendments ensure that deductions under paragraph 111(1)(a.1) for restricted interest and financing expense are subject to limitations similar to those that already apply to losses.

The amendment to subparagraph 111(3)(a)(i) ensures that amounts deducted in respect of a restricted interest and financing expense in preceding taxation years under paragraph 111(1)(a.1), in computing taxable income or a non-capital loss, will reduce the amount deductible in respect of the restricted interest and financing expense in later taxation years. As a result of the amendment to the ordering rule in paragraph 111(3)(b), the same first-in, first-out rules that apply to losses will also apply to restricted interest and financing expense.

Paragraph 111(3)(a) is also amended to include new subparagraph (a)(iii), which is relevant where subsection 18.2(2) restricts a deduction under paragraph 111(1)(e) in respect of an amount claimed by a taxpayer in respect of a limited partnership loss. For more information, see the commentary on paragraph (i) of the definition “interest and financing expenses” in subsection 18.2(1).

New subparagraph (a)(iii) ensures that the portion of the claimed amount that is restricted under subsection 18.2(2) can only be applied in future taxation years as a restricted interest and financing expense and subject to the requirements of paragraph 111(1)(a.1).

These amendments apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Loss restriction event – certain losses and expenses

ITA
111(5)(a)

Paragraph 111(5)(a) of the Act provides that, if a taxpayer is subject to a loss restriction event, the taxpayer’s non-capital losses and farm losses for a taxation year ending before that event are deductible by it in computing its taxable income for later years only if certain conditions are met.

Consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation (EIFEL) regime whose core rules are in new sections 18.2 and 18.21, paragraph 111(5)(a) is amended to restrict, in a manner similar to non-capital losses and farm losses, the deductibility of a taxpayer's restricted interest and financing expenses for taxation years ending before a loss restriction event. Such expenses will be deductible by the taxpayer in a taxation year ending after that event only to the extent they can reasonably be regarded as having been incurred in the course of carrying on a business, the taxpayer carries on that business in the later year and the conditions in subparagraphs 111(5)(a)(i) and (ii) are satisfied.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Loss restriction event – cumulative unused excess capacity

ITA
111(5.01)

New subsection 111(5.01) of the Act is introduced in connection with the new excessive interest and financing expenses limitation (EIFEL) regime, the core rules of which are in new sections 18.2 and 18.21. This subsection is intended to ensure that, where a particular taxpayer is subject to a loss restriction event at any time, its excess capacity for taxation years ending before that time cannot be utilized by the particular taxpayer (or any other taxpayer) in a taxation year ending after that time.

To ensure this result, in general terms, certain pre-loss-restriction-event amounts are disregarded for taxation years ending after the loss restriction event. In particular, the cumulative unused excess capacity of any taxpayer for any taxation year ending after that time is determined without regard to the various amounts of the particular taxpayer for taxation years ending before that time that are otherwise relevant to the determination of cumulative unused excess capacity (specifically, the particular taxpayer's absorbed capacity, excess capacity and transferred capacity).

A taxpayer's "cumulative unused excess capacity" for a taxation year generally represents the unused portion of its excess capacity for the three immediately preceding years. It can be used by a taxpayer, in certain circumstances, to either deduct interest and financing expenses that would otherwise be denied under subsection 18.2(2), or to allow another member of the corporate group to do so by designating a portion of the cumulative unused excess capacity as "received capacity" of the other member in an election under subsection 18.2(4). Thus, the main effect of subsection 111(5.01) is to prevent the excess capacity of the particular taxpayer that was subject to the loss restriction event, for taxation years ending before that event, from being used for any of these purposes in taxation years ending after that event. For more information, see the commentary on the definition “cumulative unused excess capacity” in new subsection 18.2(1).

Notably, the restriction in subsection 111(5.01) applies in respect of “any taxpayer for any taxation year” that ends after the loss restriction event. Thus, for example, if the particular corporation that was subject to the loss restriction event subsequently amalgamates with another corporation, the restriction in subsection 111(5.01) will apply in determining the cumulative unused excess capacity of the new corporation resulting from the amalgamation, notwithstanding subsection 87(2.1).

New subsection 111(5.01) applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Definitions

ITA
111(8)

Subsection 111(8) set out the definitions that apply for the purpose of section 111. The amendments to this subsection apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

“non-capital loss”

The definition “non-capital loss” determines a taxpayer’s non-capital loss for a taxation year using a formula. Variable E of this formula lists certain amounts to be included in a taxpayer’s non-capital loss.

Consequential on the introduction of new paragraph 111(1)(a.1), which is part of the new excessive interest and financing expenses limitation regime, variable E is amended to include, in determining a taxpayer’s non-capital loss for a taxation year, an amount deducted in the year under paragraph 111(1)(a.1), in respect of the taxpayer’s restricted interest and financing expense for a preceding taxation year.

“restricted interest and financing expense”

New definition “restricted interest and financing expense” is introduced in conjunction with the new excessive interest and financing expenses limitation in new section 18.2.

A taxpayer’s restricted interest and financing expense for a taxation year is, in general terms, the portion of its interest and financing expenses for the year (as defined in subsection 18.2(1)) for which a deduction is denied by ne subsection 18.2(2), or that results in an income inclusion under paragraph 12(1)(l.2) in respect of the taxpayer’s share of the interest and financing expenses of a partnership of which it is a member.

A taxpayer’s restricted interest and financing expense also includes its share of the portion of a controlled foreign affiliate’s relevant affiliate interest and financing expenses (as defined in subsection 18.2(1)) for which a deduction is denied by new clause 95(2)(f.11)(ii)(D) in computing foreign accrual property income (FAPI). It also includes the taxpayer’s share of a FAPI inclusion under that clause in respect of the affiliate’s share of the interest and financing expenses of a partnership of which it is a member. In both cases, the taxpayer’s share is determined by reference to its specified participating percentage (as defined in subsection 18.2(1)) in respect of the affiliate for the affiliate taxation year.

For more information, see the commentary on new clause 95(2)(f.11)(ii)(D) and the definition “specified participating percentage” in subsection 18.2(1).

The definition “restricted interest and financing expense” is most directly relevant to new paragraph 111(1)(a.1), which generally allows a taxpayer to carry forward its restricted interest and financing expense for a taxation year and deduct it in computing its taxable income for any of its subsequent taxation years, to the extent of its excess capacity and received capacity for any of those years, subject to any applicable restrictions under subsection 111(3), paragraph 111(5)(a) and section 256.1.

For more information, see the commentary on paragraph 111(1)(a.1).

The amendments to section 111 apply in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Exception

ITA
111(9)(a)

Subsection 111(9) restricts the loss carryovers that a taxpayer may claim for a year during which the taxpayer was not resident in Canada. The general purpose of the rule is to ensure that non-residents cannot apply, against Canadian-source income, losses from sources that are outside the Canadian tax system.

The preamble of this subsection is amended to add a reference to a taxpayer’s restricted interest and financing expense for a taxation year. This amendment ensures that a taxpayer’s restricted interest and financing expense for a year during which it is not resident in Canada is subject to the same restrictions that apply in respect of loss carryovers.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 13

Assessment and Reassessment

ITA
152(4)(b.9)

Subsection 152(4) of the Act generally provides that the Minister of National Revenue may, at any time, assess tax and other amounts payable by a taxpayer for a taxation year, but may not assess after the normal reassessment period for the year. Exceptions to this general rule are described in paragraphs 152(4)(a) to (d) and include exceptions where a taxpayer fails to provide to the Minister certain information required under the Act.

New subsection 18.2(18) requires taxpayers (excluding natural persons) to file in their return of income for the year a prescribed form containing prescribed information with respect to the deductibility of their interest and financing expenses.

Paragraph 152(4) of the Act is amended to add new paragraph 152(4)(b.9), which permits the Minister to reassess taxpayers who fail to file the prescribed form as required by subsection 18.2(18), or who file the prescribed form without including all of the information required by the form, outside of the normal reassessment period. When this paragraph applies, the Minister may reassess the taxpayer within four years (in the case of a corporation) or three years (in the case of a trust) from the date on which the taxpayer files the form and information required by subsection 18.2(18), in effect, delaying the commencement of the normal reassessment period until the required information is provided. The Minister’s ability to reassess under this paragraph is limited to reassessments related to the application of the EIFEL rules.

Clause 14

Section 216 Filers

ITA
216(1)(e)

Subsection 216(1) of the Act allows non-resident taxpayers who receive payments on account of rent on real or immovable property in Canada or a timber royalty to elect to pay tax under Part I rather than paying Part XIII tax on the payments. Paragraph 216(1)(a) requires the non-resident to calculate Part I tax as though it was a person resident in Canada and not exempt from tax under section 149.

Subsection 216(1) of the Act is amended to add paragraph (e), which provides that the calculation of Part I tax under subsection 216(1) is made without applying the definitions “eligible group entity”, “excluded entity”, and “fixed-interest commercial trust”, and without applying section 18.21. As a result, non-resident taxpayers who file returns under subsection 216(1) cannot be excluded entities, eligible group entities or fixed-interest commercial trusts as defined in subsection 18.2(1) and are not eligible to apply the group ratio rule in section 18.21.

Non-resident taxpayers who file returns under subsection 216(1) continue to be subject to the rules in paragraphs 216(1)(a) to (d) in applying the EIFEL rules. In particular, paragraph 216(1)(c) prevents such taxpayers from deducting restricted interest and financing expenses under paragraph 111(1) (a.1).

Clause 15

Definitions

ITA
248(1)

Subsection 248(1) of the Act defines various terms that apply for the purposes of the Act. Subsection 248(1) is amended to add the definitions “absorbed capacity”, “cumulative unused excess capacity”, “excess capacity”, “interest and financing expenses”, “interest and financing revenues” and “transferred capacity”, so that the definitions of these terms in subsection 18.2(1) apply for the purposes of the Act (except, in the case of the definition “interest and financing expenses”, for the purposes of the definition “economic profit” in subsection 126(7)). Subsection 248(1) is also amended to add the definition “restricted interest and financing expense”, so that the definition of this term in subsection 111(8) applies for the purposes of the Act.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 16

Definitions

ITA
256.1(1)

“specified provision”

The definition “specified provision” is relevant in applying the anti-avoidance rules in subsections 256.1(3) and (6), which deem an acquisition of control to occur in certain circumstances.

This definition is amended to add a reference to new subsection 111(5.01), which restricts the extent to which amounts may be included in determining a taxpayer’s cumulative unused excess capacity (as defined in new subsection 18.2(1)) following a loss restriction event. This amendment ensures that the restriction in subsection 111(5.01) is treated similarly to other provisions referred to in this definition.

This amendment applies in respect of taxation years beginning on or after October 1, 2023. However, it also applies in respect of a taxation year that begins before and ends after that date if any of the three immediately preceding taxation years is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 17

ITR
5903(5)

Subsection 5903(5) provides for the flow-through of foreign accrual property losses (FAPLs) on certain foreign mergers or liquidations involving foreign affiliates.

Consequential on the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, subsection 5903(5) is amended to extend its application to new section 18.2. This ensures that, in computing the adjusted taxable income (as defined in new subsection 18.2(1)) of a taxpayer, a foreign merger or liquidation does not prevent the application of certain add-backs in respect of FAPLs of controlled foreign affiliates.

For more information, see the commentary on the definition “adjusted taxable income” in subsection 18.2(1).

This amendment applies in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, it also applies in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the purposes of the transaction, event or series was to defer the application of the EIFEL regime.

Clause 18

Interpretation

ITR

5907(1)

Subsection 5907(1) provides definitions for the purposes of Part LIX of the Regulations. In connection with the introduction of the new excessive interest and financing expenses limitation (EIFEL) regime, the definitions “earnings”, “net earnings” and “net loss” are being amended.

These amendments apply in respect of taxation years of foreign affiliates ending in taxation years of taxpayers beginning on or after October 1, 2023. However, they also apply in respect of a taxation year of a foreign affiliate that ends in an earlier taxation year of a taxpayer if any of the three immediately preceding taxation years of the taxpayer is shorter as a result of a transaction or event or series of transactions or events and it can reasonably be considered that one of the reasons for the transaction, event or series was to defer the application of the EIFEL regime.

“earnings”

The definition “earnings” is relevant for the purpose of computing the surpluses and deficits of a foreign affiliate. Subparagraph (a)(iii) of the definition provides that earnings from an active business of a foreign affiliate of a taxpayer resident in Canada for a taxation year means the amount that would be the affiliate’s income from the active business for the year under Part I of the Act if the business were carried on in Canada, the foreign affiliate were resident in Canada and the Act were read without reference to certain of its provisions. That subparagraph applies only where the affiliate is not required by the income tax law of the country in which it is resident, or carries on the business, to compute the income or profits from the active business. Subparagraph (a)(iii) is amended to add a reference to new subsection 18.2(2) so that, in determining the amount that would be the foreign affiliate’s income from an active business, the Act is to be read without reference to the main operative rule of the new EIFEL regime.

“net earnings”

The definition “net earnings” is relevant for the purposes of computing the surpluses and deficits of a foreign affiliate. Paragraph (b) of the definition ensures that the foreign accrual property income (FAPI) of a foreign affiliate is included in computing the affiliate’s "taxable earnings" and, ultimately, “taxable surplus” or “taxable deficit”.

Paragraph (b) is amended to provide that a controlled foreign affiliate’s FAPI for purposes of determining its net earnings is to be determined without regard to the application of new clause 95(2)(f.11)(ii)(D) of the EIFEL rules. This ensures that the affiliate’s “taxable earnings” and “taxable surplus” or “taxable deficit” are determined without regard to any of the following:

- a denied deduction under new subclause 95(2)(f.11)(ii)(D)(I) in respect of the affiliate’s relevant affiliate interest and financing expenses; and
- a FAPI inclusion under new subclause 95(2)(f.11)(ii)(D)(II) in respect of interest and financing expenses of partnerships of which the affiliate is a member.

For more information, see the commentary on clause 95(2)(f.11)(ii)(D).

“net loss”

The definition “net loss” is relevant for the purposes of computing the surpluses and deficits of a foreign affiliate. Subclause (b)(i)(A)(I) of the definition is amended on a similar basis to the amendment to paragraph (b) of the definition “net earnings”, described above. Similarly, where an election is made under new clause 95(2)(f.11)(ii)(E) to, in effect, forgo deductions for interest and financing expenses that would otherwise have given rise to a foreign accrual property loss, a net loss is determined without regard to that election.