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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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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Clause 1

When trust is a unit trust

ITA
108(2)

Subsection 108(2) sets out the requirements for a trust to be a "unit trust".

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the reference in paragraph 108(2)(c) to property described in paragraph (b) of the previous qualified investment definition in section 204 is updated to refer to subparagraph (c)(i) of the definition in 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 2

Definitions

ITA
122.1(1)

Subsection 122.1(1) sets out a number of definitions that apply for the purposes of the rules for SIFT trusts and, in some cases, SIFT partnerships.

"qualified REIT property"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the reference in paragraph (a) of the definition "qualified REIT property" to property described in paragraph (b) of the previous qualified investment definition in section 204 is updated to refer to subparagraph (c)(i) of the definition in 207.01(1).

This amendment comes into force on January 1, 2027.

"real estate investment trust"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the reference in paragraph (d) of the definition "real estate investment trust" to property

described in paragraph (b) of the previous qualified investment definition in section 204 is updated to refer to subparagraph (c)(i) of the definition in 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 3

General

ITA
132.2(3)

Subsection 132.2(3) sets out rules that apply to each mutual fund trust or each mutual fund corporation undergoing a qualifying exchange. Consequential to the repeal of the definition "qualified investment" in each of subsections 146(1), 146.1(1), 146.3(1) and 146.4(1), paragraph 132.2(3)(h) is updated to remove the references to these subsections.

This amendment comes into force on January 1, 2027.

Clause 4

Definitions

ITA
135.2(1)

Subsection 135.2(1) contains definitions for the application of section 135.2, which contains rules that apply in respect of the continuance of the Canadian Wheat Board under the *Canada Business Corporations Act*.

"eligible trust"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the reference in subparagraph (g)(iii) of the definition "eligible trust" to property described in paragraph (b) of the previous qualified investment definition in section 204 is updated to refer to subparagraph (c)(i) of the definition in 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 5

Definitions

ITA
146(1)

Subsection 146(1) defines a number of terms that apply to registered retirement savings plans (RRSPs). Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the qualified investment definition in subsection 146(1) is repealed.

This amendment comes into force on January 1, 2027.

No tax while trust governed by plan

ITA
146(4)

Subsection 146(4) provides that no tax is payable by an RRSP except in specified circumstances. While this exemption does not extend to income from the carrying on of a business, it does extend to business income from, or from the disposition of, a qualified investment for RRSPs.

Consequential to the replacement of the definition "qualified investment" in subsection 146(1) with the definition "qualified investment" in subsection 207.01(1), subparagraph 146(4)(b)(ii) is updated to refer to the latter.

This amendment comes into force on January 1, 2027.

Clause 6

Definitions

ITA
146.1(1)

Subsection 146.1(1) defines a number of terms that apply to registered education savings plans (RESPs). Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the qualified investment definition in subsection 146.1(1) is repealed.

This amendment comes into force on January 1, 2027.

Trust not taxable

ITA
146.1(5)

Subsection 146.1(5) provides that no income tax is payable by a trust governed by a RESP except if it holds property that is not a qualified investment.

Consequential to the replacement of the definition "qualified investment" in 146.1(1) with the definition "qualified investment" in subsection 207.01(1), the reference in subsection 146.1(5) to properties that are not qualified investments is updated to refer to property that is a non-qualified investment (as defined in subsection 207.01(1)).

This amendment comes into force on January 1, 2027.

Clause 7

Definitions

ITA
146.3(1)

Subsection 146.3(1) defines a number of terms that apply to registered retirement income funds (RRIFs).

"minimum amount"

A trusteed RRIF can hold two types of annuity contracts: prior to 2027, they are the commutable annuities described in paragraph (b.1) of the definition "qualified investment" in subsection 146.3(1) and locked-in annuities described in paragraph (b.2) of the definition "qualified investment" in subsection 146.3(1).

Consequential to the repeal of the qualified investment definition in subsection 146.3(1), variables A and C in the formula in the minimum amount definition are amended to refer to new paragraph (j) of the qualified investment definition in subsection 207.01(1). See additional commentary for that subsection.

These amendments come into force on January 1, 2027.

"qualified investment"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the qualified investment definition in subsection 146.3(1) is repealed.

This amendment comes into force on January 1, 2027.

Acceptance of fund for registration

ITA
146.3(2)

Subsection 146.3(2) sets out the conditions that a RRIF must comply with in order to be registered with the Canada Revenue Agency. Paragraphs (e.1) and (e.2) require a carrier to retain enough property to ensure a RRIF's minimum amount is paid to the annuitant when transferring all or part of the RRIF property to another RRIF or a registered pension plan (RPP).

Consequential to the repeal of the qualified investment definition in subsection 146.3(1), subsection 146.3(2) is amended in two ways. First, the reference to a qualified investment in

paragraph (e.1) is amended to refer to the revised qualified investment definition in subsection 207.01(1). Second, clause 146.3(2)(e.2)(i)(B) is updated to refer to paragraph (g) of the definition "qualified investment" in subsection 207.01(1) (commutable annuities).

These amendments come into force on January 1, 2027.

No tax while trust governed by fund

ITA
146.3(3)

Subsection 146.3(3) provides that no tax is payable by a RRIF except in specified circumstances. While this exemption does not extend to income from the carrying on of a business, it does extend to business income from, or from the disposition of, a qualified investment for RRIFs.

Consequential to the replacement of the definition "qualified investment" in subsection 146.3(1) with the definition "qualified investment" in subsection 207.01(1), subparagraph 146.3(3)(e)(ii) is updated to refer to the latter.

This amendment comes into force on January 1, 2027.

Subsection (6.3) not applicable

ITA
146.3(6.4)

Subsection 146.3(6.4) sets out two conditions which must generally be satisfied in order for the deduction under subsection (6.3) in respect of a post-death reduction in value to be available. One of these conditions is that the RRIF must have held no investments other than qualifying investments during the post-death period.

Consequential to the replacement of the definition "qualified investment" in subsection 146.3(1) with the definition "qualified investment" in subsection 207.01(1), paragraph 146.3(6.4)(a) is updated to refer to the latter.

This amendment comes into force on January 1, 2027.

Tax payable on income from non-qualified investment

ITA
146.3(9)

Subsection 146.3(9) provides that, if a trust governed by a RRIF acquires a non-qualified investment, any income earned by the trust from the investment is taxable under Part I.

Consequential to the replacement of the definition “qualified investment” in subsection 146.3(1) with the definition “qualified investment” in subsection 207.01(1), subsection 146.3(9) is updated to refer to the non-qualified investment definition in subsection 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 8

Definitions

ITA
146.4(1)

Subsection 146.4(1) defines a number of terms that apply to registered disability savings plans (RDSPs).

“qualified investment”

Consequential to the revisions to the definition “qualified investment” in subsection 207.01(1), the qualified investment definition in subsection 146.4(1) is repealed.

This amendment comes into force on January 1, 2027.

“specified maximum amount”

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

Consequential to the repeal of the qualified investment definition in subsection 146.4(1), variables A and B in the formula in the specified maximum amount definition are amended to refer to new paragraph (i) of the qualified investment definition in subsection 207.01(1) (locked-in annuities for RDSPs). See additional commentary for that subsection.

This amendment comes into force on January 1, 2027.

Plan conditions

ITA
146.4(4)

Subsection 146.4(4) sets out registration conditions applicable to RDSPs. Paragraph 146.4(4)(l) limits the amount of disability assistance payments that can be paid from an RDSP.

Consequential to the repeal of the qualified investment definition in subsection 146.4(1), two amendments to the formula in paragraph (4)(l) are made. The references in variable A and

subparagraph (i) of variable D are amended to refer to new paragraph (i) of the qualified investment definition in subsection 207.01(1) (locked-in annuities for RDSPs). See additional commentary for that subsection.

These amendments come into force on January 1, 2027.

Trust not taxable

ITA
146.4(5)

Subsection 146.4(5) provides that an RDSP trust is taxable only on income from carrying on a business or income earned on non-qualified investments.

Consequential to the replacement of the definition "qualified investment" in subsection 146.4(1) with the definition "qualified investment" in subsection 207.01(1), the reference in subsection 146.4(5) to properties that are not qualified investments is updated to refer to property that is a non-qualified investment (as defined in subsection 207.01(1)).

This amendment comes into force on January 1, 2027.

Clause 9

Definitions

ITA
204

Section 204 defines a number of terms that apply to deferred profit sharing plans (DPSPs).

"debt obligation"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the definition "debt obligation" in section 204 is repealed.

This amendment comes into force on January 1, 2027.

"qualified investment"

The definition "qualified investment" in section 204 sets out the types of property that a trust governed by a deferred profit sharing plan is permitted to hold. Moreover, the definitions "qualified investment" in each of subsections 146(1), 146.1(1), 146.3(1), 146.4(1) and 207.01(1) largely adopt the list of investments described by the definition in section 204.

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the qualified investment definition in section 204 is amended in several ways.

First, new paragraph (a) of the definition in section 204 now refers to paragraphs (a) to (g) of the revised definition "qualified investment" in subsection 207.01(1). This reference ensures that the types of property originally described in paragraphs (a) to (d) and (f) and (g), as well as paragraphs 4900(1)(b) and (c.1) of the *Income Tax Regulations*, remain qualified investments for DPSPs. Furthermore, by referencing paragraph (g) of the new qualified investment definition in 207.01(1), a DPSP will be permitted to hold certain commutable annuities as qualified investments as is currently the case for FHSAs, RDSPs, RESPs, RRIFs, RRSPs, and TFSAs.

Second, to replace paragraph (h) of the pre-2027 definition, new paragraph (b) of the definition references investments described in new Part L of the *Income Tax Regulations*. Investments described in section 5001, paragraphs 5002(a) to (c), and sections 5003 and 5004, which are prescribed investments for FHSAs, RDSPs, RESPs, RRIFs, RRSPs, and TFSAs, are generally qualified investments for DPSPs. However, the investments may not be shares of specified small business corporations, venture capital corporations, or specified cooperative corporations (described in new paragraphs 5002(d), (e) and (f), respectively), consistent with pre-2027 rules. Moreover, property that would not have been a qualified investment because of the involvement of a connected person (e.g., certain debt obligations issued by a connected person are not qualified investments under Part XLIX of the *Income Tax Regulations*) remain non-qualified investments for a DPSP. This result is achieved by excluding property in paragraphs 5006(a) to (e) from being a non-qualified investment under paragraph (b) through reading references in section 5006 to "a connected person under the registered plan" as "a beneficiary or an employer under the deferred profit sharing plan or revoked plan and any person who does not deal at arm's length with that person". See the additional commentary on section 5006 of the *Income Tax Regulations*.

Third, paragraph (e) of the pre-2027 definition, relating to equity shares of the corporation that has contributed to the DPSP, becomes new paragraph (c) of the revised definition.

Fourth, new paragraph (d) permits certain annuities as qualified investments for a DPSP, effectively replacing former subsection 4900(3) of the *Income Tax Regulations*. These annuities cannot have a guaranteed term exceeding 15 years and payments must commence no later than the end of the year in which the employee turns 71.

These changes are summarized in the following table.

Pre-2027 Qualified Investments for DPSPs	**Post-2026 Qualified Investments for DPSPs**
ITA 204 "qualified investment" (a)	ITA 207.01(1) "qualified investment" (a)[1]
ITA 204 "qualified investment" (b)	ITA 207.01(1) "qualified investment" (c)(i)[1]
ITA 204 "qualified investment" (c)	ITA 207.01(1) "qualified investment" (c)(ii) to (iv)[1]
ITA 204 "qualified investment" (c.1)	ITA 207.01(1) "qualified investment" (c)(v) to (vii)[1]
ITA 204 "qualified investment" (d)	ITA 207.01(1) "qualified investment" (d)[1]
ITA 204 "qualified investment" (e)	ITA 204 "qualified investment" (c)

ITA 204 “qualified investment” (f)	ITA 207.01(1) “qualified investment” (b)[1]
ITA 204 “qualified investment” (g)	ITA 207.01(1) “qualified investment” (f)[1]
ITA 204 “qualified investment” (h)	*n.a.*
ITR 4900(1)(a), (e.1), (i.12)	*n.a.*
ITR 4900(1)(b)	ITA 207.01(1) “qualified investment” (e)[1]
ITR 4900(1)(c), (d), (d.2), (e), (f), (g), (h), (i), (i.1), (i.11), (i.13), (i.14), (i.2), (j), (j.1), (j.2), (q), (r), (t), (u), (v), (w)	ITR 5001, 5002(a) to (c), 5003(c), 5004(a) to (b), subject to 5006(a) to (e)[2]
ITR 4900(1)(c.1)	ITA 207.01(1) “qualified investment” (c)(viii)[1]
ITR 4900(3)	ITA 204 “qualified investment” (d)
ITR 4900(7)	*n.a.* (ITR see 5003(d) and 5004(c))

1. via ITA 204 “qualified investment” (a)
2. via ITA 204 “qualified investment” (b)

These amendments come into force on January 1, 2027.

Clause 10

Tax in Respect of Registered Investments

ITA
Part X.2

Effective January 1, 2027, Part X.2 of the Act, relating to registered investments, is repealed.

Prior to the repeal of Part X.2, effective from November 4, 2025, subsections 204.6(1), (2), and (3), which impose special taxes on registered investments holding certain property, are amended to exclude trusts described in new paragraphs 4900(1)(d.21) and (d.22) of the *Income Tax Regulations* from being subject to these taxes.

Clause 11

Definitions

ITA
204.8(1)

Subsection 204.8(1) defines terms for the purposes of penalties and taxes under Part X.3 relating to labour-sponsored venture capital corporations (LSVCCs) registered under that Part.

“reserve”

The definition “reserve” is defined as property described in any of paragraphs (a), (b), (c), (f), and (g) of the definition “qualified investment” in section 204.

Consequential to the revisions to the definition “qualified investment” in subsection 207.01(1), the reference in paragraph (a) of the definition “reserve” in subsection 204.8(1) to property described in the previous qualified investment definition in section 204 is updated to refer to the relevant paragraphs and subparagraphs of the revised definition in 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 12

Definitions

ITA
205(1)

Subsection 205(1) defines various terms that apply for the purposes of section 205 (the Part XI tax in respect of Advanced Life Deferred Annuities). The definition “excess ALDA transfer” is relevant to the determination of whether a taxpayer has a “cumulative excess amount” in respect of amounts transferred to an ALDA.

Consequential to the revisions to the definition “qualified investment” in subsection 207.01(1), paragraphs (c) and (d) of the definition “excess ALDA transfer” are replaced by a single paragraph (c). This new paragraph (c) is updated to reference certain commutable annuities described in paragraph (g) of the revised qualified investment definition in subsection 207.01(1) and now refers to both RRSPs and RRIFs together in one paragraph rather than in two separate paragraphs.

This amendment comes into force on January 1, 2027.

Clause 13

Definitions

ITA
207.01(1)

Subsection 207.01(1) provides definitions for the purposes of Part XI.01 (as well as certain sections in Part I and Part XLIX of the *Income Tax Regulations*). Consequential to the replacement of Part XLIX with the introduction of new Part L of the Regulations, the preamble of subsection 207.01(1) is amended to refer to Part L instead of Part XLIX.

This amendment comes into force on January 1, 2027.

“excluded property”

The definition “excluded property” describes registered plan investments that are excluded from being prohibited investments for the plan that holds it. Paragraph (a) refers to certain insured

mortgages described in paragraph 4900(1)(j.1) of the Regulations. Paragraph (b) provides that specific equity in certain investment vehicles during the 24-month period on start-up or wind-up is considered "excluded property" and therefore is not subject to the prohibited investment rules.

The definition "excluded property" is amended in two respects. First, consequential to the repeal of Part XLIX of the Regulations, the reference in paragraph (a) to 4900(1)(j.1) is updated to refer to new subparagraph 5001(h)(ii). Second, consequential to the repeal of Part X.2 of the Act, references to registered investments in paragraph (b) are removed.

These amendments come into force on January 1, 2027.

"qualified investment"

This definition is amended to become the principal qualified investment provision for six types of registered plans. In particular, amendments are made to various provisions in sections 146 (registered retirement savings plans), 146.1 (registered education savings plans), 146.3 (registered retirement income funds), 146.4 (registered disability savings plans) to reference the revised qualified investment definition in subsection 207.01(1). In conjunction, the definition of "qualified investment" in each of these four sections is repealed. Moreover, paragraph (a) of the revised qualified investment definition in section 204 (relating to DPSPs) refers to various paragraphs of the qualified investment definition in subsection 207.01(1) to ensure property remains a qualified investment for a DPSP under the revised definition. See the additional commentary for amendments to these sections.

Paragraphs (a) through (d) and (f) of the revised definition "qualified investment" in subsection 207.01(1) are intended to replicate the provisions under paragraphs (a), (b), (c), (c.1), (d), (f), and (g) of the pre-2027 qualified investment definition in section 204. The table of concordance below identifies the provision in the revised definition that replaces the corresponding provision in the pre-2027 definition.

Pre-2027 provision (section 204 "qualified investment")	**Amended provision (subsection 207.01(1) "qualified investment")**
Paragraph (a)	Paragraph (a)
Paragraph (b)	Subparagraph (c)(i)
Paragraph (c)	Subparagraphs (c)(ii) – (iv)
Paragraph (c.1)	Subparagraphs (c)(v) – (vii)
Paragraph (d)	Paragraph (d)
Paragraph (f)	Paragraph (b)
Paragraph (g)	Paragraph (f)

New subparagraph (c)(viii) of the revised definition "qualified investment" in subsection 207.01(1) describes bonds, debentures, notes, or similar obligations of public corporations (excluding mortgage investment corporations) as a qualified investment. Such obligations are qualified investments under paragraph 4900(1)(c.1) of the *Income Tax Regulations*. Likewise, new paragraph (e) of the revised definition "qualified investment" in subsection 207.01(1)

describes shares of the capital stock of public corporations (excluding mortgage investment corporations) as a qualified investment. Such shares are qualified investments under paragraph 4900(1)(b) of the *Income Tax Regulations*.

Paragraph (g) of the revised definition "qualified investment" in subsection 207.01(1), describes certain commutable annuity contracts as qualified investments. It is intended to replace equivalent provisions in the former definitions of "qualified investment" in subsection 146(1) (paragraph (c.1)), subsection 146.1(1) (paragraph (c)), subsection 146.3(1) (paragraph (b.1)), subsection 146.4(1) (paragraph (b)), and subsection 207.01(1) (paragraph (b)).

Paragraphs (h) through (k) relate to specific registered plans:

- With respect to an RESP, paragraph (d) of the pre-2027 qualified investment definition in subsection 146.1(1) (relating to investments acquired by the trust before October 28, 1998) is replaced with paragraph (h) of the revised qualified investment definition in subsection 207.01(1).
- With respect to an RDSP, paragraph (c) of the pre-2027 qualified investment definition in subsection 146.4(1) (relating to certain locked-in annuities) is replaced with paragraph (i) of the revised qualified investment definition in subsection 207.01(1).
- With respect to a RRIF, paragraph (b.2) of the pre-2027 qualified investment definition in subsection 146.3(1) (relating to certain locked-in annuities) is replaced with paragraph (j) of the revised qualified investment definition in subsection 207.01(1).
- With respect to an RRSP, paragraphs (c) and (c.2) of the pre-2027 qualified investment definition in subsection 146(1) (relating to certain locked-in annuities) is replaced with paragraph (k) of the revised qualified investment definition in subsection 207.01(1).

Finally, paragraph (l) includes investments that are prescribed by regulation. Prescribed investments are outlined in new Part L of the *Income Tax Regulations*.

This amendment comes into force on January 1, 2027.

Exchange of property

ITA
207.01(12)

Subsections 207.01(12) and (13) provide transitional relief from the prohibited investment and advantage rules to non-cash property acquired by the trust in the course of a reorganization or exchange. One of the conditions is that the property acquired is, or would be if paragraph 4900(14)(b) of the *Income Tax Regulations* did not apply, a qualified investment for a trust governed by certain registered plans immediately after the exchange time.

Subsection 4900(14) of the *Income Tax Regulations* allows certain shares of small business corporations, venture capital corporations and cooperative corporations to be qualified investments provided they are not a prohibited investment at the time they are acquired by the plan trust (see paragraph 4900(14)(b)).

Consequential to the repeal of Part XLIX of the Regulations, the reference in paragraph 207.01(12)(c) to paragraph 4900(14)(b) is amended to instead directly state that the condition will be met if the property would be a qualified investment if it was not a prohibited investment at the time it was acquired by the exchanging trust.

This amendment comes into force on January 1, 2027.

Clause 14

Securities Lending Arrangements

If subsection 84(2) of Bill C-15 (Budget 2025 Implementation Act, No. 1) receives Royal Assent, a new subsection 207.04(7) will be introduced to ensure that rights to property received as consideration under certain securities lending arrangement are deemed not to be non-qualified investments.

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the references in paragraphs (a) and (f) of subsection 207.04(7) to property that is described by certain paragraphs of section 204 is updated to refer to the relevant paragraphs and subparagraphs of the revised qualified investment definition in 207.01(1).

These amendments come into force on January 1, 2027.

Clause 15

Definitions

ITA
211.6(1)

Subsection 211.6(1) contains the definitions that apply for purposes of the Part XII.4 (special tax on qualifying environmental trusts).

"excluded trust"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the reference in paragraph (d) and subparagraph (e)(i) of the definition "excluded trust" to property that is not described by certain paragraphs of section 204 is updated to refer to the relevant paragraphs and subparagraphs (as applicable) of the revised qualified investment definition in 207.01(1).

This amendment comes into force on January 1, 2027.

"prohibited investment"

Consequential to the revisions to the definition “qualified investment” in subsection 207.01(1), the reference in paragraph (a) of the definition “prohibited investment” to property that is described by certain paragraphs of section 204 is updated to refer to the relevant paragraphs and subparagraphs (as applicable) of the revised qualified investment definition in 207.01(1).

This amendment comes into force on January 1, 2027.

Clause 16

Filing information on foreign trusts

ITA
233.2(4)

Under subsection 233.2(4), reporting will generally be required for a taxation year of a person if the person is a “contributor”, “connected contributor” or “resident contributor” to a trust that is non-resident at a “specified time” in the taxation year, of the trust, that ends in that taxation year of the taxpayer. Subparagraph 233.2(4)(c)(ii) sets out a list of persons for whom reporting obligations are not imposed.

Consequential to the repeal of Part X.2 of the Act, clause (E), referencing registered investments, is repealed and the reference to clause (E) in clause (F) is removed.

This amendment comes into force on January 1, 2027.

Clause 17

Definitions

ITA
233.3(1)

Subsection 233.3(1) defines a number of terms for the purpose of section 233.3.

Consequential to the repeal of Part X.2 of the Act, the definition “specified Canadian entity” is amended to remove the reference to a registered investment by repealing subparagraph (a)(vii) of the definition and revising subparagraph (a)(viii) to no longer refer to repealed subparagraph (a)(vii).

These amendments come into force on January 1, 2027.

Clause 18

Definitions

ITA

248(1)

Consequential to the repeal of Part X.2 of the Act, the definition "registered investment" in subsection 248(1) is repealed.

This amendment comes into force on January 1, 2027.

Clause 19

Definitions

ITA
259(5)

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

"designated provisions"

The definition "designated provisions" in subsection 259(5) is first amended by adding reference to section 146.6 (relating to FHSAs). Then, consequential to the repeal of Part X.2 of the Act, the definition is amended to remove the reference to Part X.2.

The first amendment is deemed to come into force on April 1, 2023 (the date FHSAs came into force generally). The second amendment comes into force on January 1, 2027.

"qualified trust"

The definition "qualified trust" in subsection 259(5) is amended consequential to the repeal of Part X.2 of the Act to remove the reference to a registered investment.

This amendment comes into force on January 1, 2027.

"specified taxpayer"

The definition "specified taxpayer" in subsection 259(5) is first amended by adding reference to paragraph 149(1)(u.4) (relating to FHSAs). Then, consequential to the repeal of Part X.2 of the Act, the definition "specified taxpayer" in subsection 259(5) is updated to remove the reference to a registered investment.

The first amendment is deemed to come into force on April 1, 2023 (the date FHSAs came into force generally). The second amendment comes into force on January 1, 2027.

Clause 20

Qualified Investments

ITR
221

Section 221 of the Regulations requires certain types of corporations and trusts to file an annual information return where it claims to be a qualified investment for various registered plans (e.g., RRSPs and TFSAs).

Subsection 221(1) is amended to add the two new types of unit trusts introduced as qualified investments (see the additional commentary on subsection 4900(1)) as a "reporting person". Moreover, trusts that would be mutual fund trusts if paragraph 4801(b) is disregarded are removed as a "reporting person".

This amendment applies to the 2026 taxation year. Furthermore, as of January 1, 2027, subsections (1) and (2) are amended to refer to the new paragraphs 5003(a) and (b) that replace the subsection 4900(1) references to the two new trusts.

Clause 21

Registered Plans — Investments

ITR
4900(1)

Subsection 4900(1) lists the types of property that are qualified investments for a trust governed by a deferred profit sharing plan (DPSP), first home savings account (FHSA), registered retirement savings plan (RRSP), registered retirement income fund (RRIF), tax-free savings account (TFSA), registered education savings plan (RESP), or registered disability savings plan (RDSP).

Subsection 4900(1) is amended to add two new types of unit trusts as qualified investments. New paragraph (d.21) specifies the first type of trust as an NI 81-102 fund (i.e., a trust that is subject to, and substantially complies with, the requirements of *National Instrument 81-102 Investment Funds* of the Canadian Securities Administrators).

New paragraph (d.22) specifies the second type of trust. Subparagraph (i) requires the trust to have a class of units outstanding that either has been subject to a lawful distribution in a province to the public (for which a prospectus, registration statement, or similar document was not required) or is qualified for distribution to the public. Subparagraph (i) is based on paragraph 4801(a), disregarding clause 4801(a)(i)(B).

Subparagraph (ii) requires the trust to satisfy the substantive conditions (i.e., disregarding the preamble of paragraph (b), which imposes timing conditions) of an "investment fund" as defined in subsection 251.2(1). An investment fund must be a non-discretionary unitized trust that is factually resident in Canada. The trust must also

- follow a reasonable policy of investment diversification;
- limit its undertaking to the investing of its funds in property;
- not control, alone or as part of a group of persons or partnerships, a corporation;
- not hold property that is used in carrying on a business carried on by it or a non-arm's length person or partnership;
- not hold property that is real property, Canadian or foreign resource property or an interest, or right, in such property; and
- not hold more than 20% of any class of securities of an issuer, unless
    - the issuer is a trust that is an investment fund (or mutual fund corporation that would be an investment fund if it were at trust), or
    - the total fair market value of the trust's property that is equity of the issuer does not exceed 10% of the issuer's equity value and the total fair market value of the trust's property that is liabilities of the issuer does not exceed 10% of the total fair market value of all of the issuer's liabilities.

Finally, subparagraph (iii) requires that the investments of the trust must be managed by a registered investment fund manager (as described in *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* of the Canadian Securities Administrators).

These amendments come into force on November 4, 2025.

Clause 22

Qualified and Prohibited Investments for Registered Plans

ITR
Part L

Former Part XLIX of the Regulations prescribes additional qualified investments for certain registered savings plans and provides related rules. Part XLIX is repealed and replaced by new Part L of the Regulations.

New Part L is divided into several sections. First, section 5000 provides definitions that apply throughout Part L. Section 5001 prescribes a variety of debt instruments as qualified investments, section 5002 prescribes a variety of equity instruments as qualified investments, section 5003 prescribes a variety of trust units as qualified investments, and section 5004 prescribes investments that do not fall into the other three categories as qualified investments. Section 5005 prescribes credit rating agencies for the purposes of subparagraphs (c)(v) and (vi) of the qualified investment definition in subsection 207.01(1) of the Act. Finally, section 5006 prescribes various prohibited investments for the purposes of paragraph (d) of the prohibited investment definition in subsection 207.01(1) of the Act.

The table of concordance below identifies the amended provision that replaces the corresponding pre-2027 provision in Part XLIX, if applicable.

Pre-2027 provision (Part XLIX)	Amended provision
4900(1)(a)	n.a.
4900(1)(b)	ITA 207.01(1) “qualified investment” (e)
4900(1)(c)	ITR 5002(a), 5006(a)
4900(1)(c.1)	ITA 207.01(1) “qualified investment” (c)(viii)
4900(1)(d)	ITR 5003(c)
4900(1)(d.2)	ITR 5003(c)
4900(1)(e)	ITR 5004(a), 5006(b)
4900(1)(e.1)	n.a.
4900(1)(f)	ITR 5002(b)
4900(1)(g)	ITR 5001(c), 5006(c)
4900(1)(h)	ITR 5001(d), 5006(d)
4900(1)(i)	ITR 5001(b)(i) and (ii), 5001(e)
4900(1)(i.1)	ITR 5001(b)(iii) (Manitoba only)
4900(1)(i.11)	ITR 5002(e)
4900(1)(i.12)	n.a.
4900(1)(i.13)	ITR 5002(e)
4900(1)(i.14)	ITR 5002(e)
4900(1)(i.2)	ITR 5001(a), 5006(e)
4900(1)(j)	ITR 5001(h)(i)
4900(1)(j.1)	ITR 5001(h)(ii)
4900(1)(j.2)	ITR 5001(i)
4900(1)(q)	ITR 5001(f)
4900(1)(r)	ITR 5001(g)
4900(1)(t)	ITR 5004(b)(i)
4900(1)(u)	ITR 5004(b)(ii)
4900(1)(v)	ITR 5004(b)(iii)
4900(1)(w)	ITR 5002(c)
4900(3)	ITA 204 “qualified investment” (d)
4900(5)	n.a.
4900(6), (9)	n.a. (see ITR 5003(d) and 5004(c))
4900(7), (11)	n.a. (see ITR 5003(d) and 5004(c))
4900(14)	ITR 5002(d), (e), (f), 5006(f)
4900(15)	n.a.

Section 5000

Section 5000 provides three definitions: “connected person”, “specified cooperative corporation”, and “specified small business corporation”.

The connected person definition is based on the definition in former subsection 4901(2). The new definition differs in that it refers to controlling individuals of registered plans (terms defined in subsection 207.01(1) of the Act) instead of annuitants or subscribers under, or holders of, the

plans. Moreover, because deferred profit sharing plans are not within the scope of the registered plan definition in subsection 207.01(1) of the Act, the new connected person definition does not include a reference to a person who is an employer under the plan.

A connected person under an RRSP, RRIF, RESP, RDSP, TFSA, or FHSA governing a trust includes a person that is an annuitant, subscriber, or holder of the plan (a "controlling individual"), as the case may be, as well as a beneficiary of the registered plan trust. A connected person also includes any other person or partnership that does not deal at arm's length with the controlling individual or beneficiary.

The specified cooperative corporation definition and the specified small business corporation definition are intended to replicate the former definitions in subsection 4901(2).

A specified small business corporation is defined by reference to the definition "small business corporation" in subsection 248(1) of the Act. However, in place of being a Canadian-controlled private corporation (as required by the "small business corporation" definition), the corporation must be a Canadian corporation (as defined in subsection 89(1) of the Act) that is not controlled, directly or indirectly in any manner whatever, by one or more non-resident persons. A specified small business corporation may not be a cooperative corporation.

Following the "small business corporation" definition in 248(1) of the Act, a specified small business corporation must satisfy an asset-use condition. All or substantially all of the fair market value of the assets of the corporation must be attributable to assets that are used principally in an active business carried on primarily in Canada by the corporation or by a corporation related to it, shares or debt of connected small business corporations, or a combination of the two. Active business is defined in subsection 248(1) of the Act as any business that is carried on by a Canadian resident taxpayer other than a specified investment business or a personal services business.

Finally, to qualify as a specified small business corporation at a particular time, a corporation must satisfy these conditions either at that time or at the end of the corporation's preceding tax year.

A specified cooperative corporation includes a cooperative corporation (as defined in subsection 136(2) of the Act). Under that subsection, the purpose of the corporation must be either marketing natural products belonging to or acquired from its members or customers; purchasing supplies, equipment or household necessaries for or to be sold to its members or customers; or performing services for its members or customers. In addition, a specified cooperative corporation includes a corporation that would be a cooperative corporation if the purpose of the corporation was to provide employment to the corporation's members or customers (e.g., in the case of a worker co-operative).

Section 5001

New section 5001 prescribes a variety of debt instruments as qualified investments for the purposes of paragraph (l) of the qualified investment definition in subsection 207.01(1) of the Act.

Paragraph 5001(a) allows the indebtedness of a Canadian corporation represented by a bankers' acceptance to be a qualified investment. This qualified investment was originally provided for under former paragraph 4900(1)(i.2).

Note that a banker's acceptance is a prescribed prohibited investment under new paragraph 5006(e) where the indebtedness it represents is of a Canadian corporation that is a connected person under the registered plan governing the trust. For more information, see the commentary on new section 5006.

Paragraph 5001(b) allows a bond, debenture, note, or similar obligation of a Canadian corporation to be a qualified investment in three cases. The first kind of obligation, given by subparagraph (i), is one for which the payment of the principal and interest is guaranteed by a corporation or mutual fund trust listed on a designated stock exchange in Canada. This type of qualified investment was originally provided for under former subparagraph 4900(1)(i)(i).

The second kind of obligation, given by subparagraph (ii), is one of a Canadian corporation that is controlled, directly or indirectly, by one or more corporations or mutual fund trusts whose shares or units are listed on a designated stock exchange in Canada. This type of qualified investment was originally provided for under former subparagraph 4900(1)(i)(ii).

The last kind of obligation, given by subparagraph (iii), is one for which the payment of the principal is guaranteed by the government of a province under particular legislation. This type of qualified investment was originally provided for under former paragraph 4900(1)(i.1). Under that paragraph, community development bonds offered under four provincial statutes (from Manitoba, New Brunswick, Ontario, and Saskatchewan) were qualified investments. Three of these statutes have been repealed — only the Community Development Bonds Act of Manitoba remains enacted legislation.

Paragraph 5001(c) allows a bond, debenture, note or similar obligation issued by, or a deposit with, a credit union to be a qualified investment. This qualified investment was originally provided for under former paragraph 4900(1)(g).

Note that an obligation of or deposit with a credit union is a prescribed prohibited investment under new paragraph 5006(c) in cases where the credit union has granted a benefit or privilege to a connected person under a registered plan resulting from the investment. For more information, see the commentary on new section 5006.

Paragraph 5001(d) allows a bond, debenture, note or similar obligation issued by a cooperative corporation to be a qualified investment under certain conditions. This qualified investment was originally provided for under former paragraph 4900(1)(h). One of the conditions is that the corporation must have had at least 100 shareholders (or 50 shareholders, if all shareholders are corporations) throughout the taxation year immediately preceding the year in which the

registered plan trust acquires the obligation. However, the former condition requiring an average of 100 plan trusts to hold obligations of the corporation throughout a specified time period has been replaced with a simpler condition that no more than 5% of the fair market value of the corporation's obligations may be held by plan trusts that share the same controlling individual or beneficiary.

Note that an obligation issued by a cooperative corporation is a prescribed prohibited investment under new paragraph 5006(d) in cases where the corporation has granted a benefit or privilege to a connected person under a registered plan resulting from the investment. For more information, see the commentary on new section 5006.

Paragraph 5001(e) allows a bond, debenture, note or similar obligation of a Canadian corporation to be a qualified investment under specific conditions. First, at the time the obligation is acquired by the registered plan trust, the corporation that issued the obligation must be a corporation with issued and outstanding share capital carried in its books of at least $25 million (or be controlled by such a corporation). Second, at the time the obligation is acquired by the registered plan trust, the corporation that issued the obligation must have issued and outstanding obligations with an aggregate principal amount of at least $10 million held by at least 300 different persons. These obligations must have been issued by way of a lawful distribution to the public under one or more prospectus, registration statement, or similar document that were filed with, and where applicable accepted by, a public authority pursuant to federal or provincial law. This qualified investment was originally provided for under former subparagraph 4900(1)(i)(iii).

Paragraphs 5001(f) and (g) allow a debt issued by certain Canadian corporations without share capital that are exempt from Part I tax under the Act to be a qualified investment. Paragraph (f) relates to transactions whereby provincial or federal Crown assets are privatized. In general, the corporation must have acquired property from the federal or a provincial government for at least $25 million and put it to the same or similar use as before the acquisition. Alternatively, at the time the registered plan trust acquires the debt, it must have been reasonable to expect this condition to be met within a year of the acquisition of the debt. This qualified investment was originally provided for under former paragraph 4900(1)(q).

Paragraph (g) allows a debt issued by non-profit organizations to be a qualified investment under certain conditions. The debt must either be part of a debt issue by the corporation for an amount of at least $25 million or, at the time the debt is acquired by the registered plan, the corporation had issued at least $25 million of debt in a single issuance. This qualified investment was originally provided for under former paragraph 4900(1)(r).

Note that a debt is a prohibited investment (see the definition "prohibited investment" in subsection 207.01(1) of the *Income Tax Act*) where the debtor is a controlling individual of the registered plan or a person or partnership that does not deal at arm's length with the controlling individual.

Paragraph 5001(h) allows a debt obligation (or an interest or right in that debt obligation) that is secured by a mortgage, charge, hypothec, or similar instrument in respect of real or immovable property situated in Canada to be a qualified investment under certain conditions:

- The debt obligation is fully secured (or would be in the absence of a fair market value decline in the property after it is issued). This qualified investment was originally provided for under former paragraph 4900(1)(j).
- The debt obligation is administered by an approved lender under the *National Housing Act* or a qualified mortgage lender under the *Protection of Residential Mortgage or Hypothecary Insurance Act.* Moreover, the debt obligation must be insured under either of those statutes. This qualified investment was originally provided for under former paragraph 4900(1)(j.1), but is updated to reflect the introduction of the *Protection of Residential Mortgage or Hypothecary Insurance Act*. In particular, the updated language will ensure that qualified mortgage lenders that are not also approved lenders can administer such debt obligations.

Note that a debt is a prohibited investment (see the definition "prohibited investment" in subsection 207.01(1) of the *Income Tax Act*) where the debtor is a controlling individual of the registered plan or a person or partnership that does not deal at arm's length with the controlling individual. However, debt obligations described by 5001(h)(ii) are considered 'excluded property' for the purposes of the prohibited investment definition in subsection 207.01(1).

Paragraph 5001(i) allows a certificate representing an undivided interest or right in one or more mortgage obligations or hypothecary claims to be a qualified investment if

- all or substantially all of the fair market value of the certificate is attributable to property that is, or is incidental to, a mortgage obligation or hypothecary claim secured by real or immovable property situated in Canada or cash or government bonds (as described in paragraph (a) or subparagraph (c)(i) of the qualified investment definition in subsection 207.01(1) of the *Income Tax Act*);
- the certificate has an investment grade rating with a credit rating agency referred to in section 5005 when it is acquired by the plan trust; and
- the certificate is issued as part of an issue of certificates of at least $25 million.

This qualified investment was originally provided for under former paragraph 4900(1)(j.2).

Section 5002

New section 5002 prescribes a variety of equity instruments as qualified investments for the purposes of paragraph (l) of the qualified investment definition in subsection 207.01(1) of the Act.

Paragraph 5002(a) allows a share of the capital stock of a mortgage investment corporation to be a qualified investment. This qualified investment was originally provided for under former paragraph 4900(1)(c).

Note that a share of the capital stock of a mortgage investment corporation is a prescribed prohibited investment under new paragraph 5006(a) if it holds any indebtedness, whether by way

of mortgage or otherwise, of a person who is a connected person under the registered plan governing the trust. For more information, see the commentary on new section 5006.

Paragraph 5002(b) allows a share of, or similar interest in, a credit union to be a qualified investment. This qualified investment was originally provided for under former paragraph 4900(1)(f).

Paragraph 5002(c) allows an American Depositary Receipt (ADR) to be a qualified investment, provided that the underlying security that the ADR represents is listed on a designated stock exchange. This paragraph is intended to ensure that the de-listing of an ADR will not, in and of itself, result in the ADR becoming a non-qualified investment. Note that an ADR that is itself listed on a designated stock exchange would be covered by the general rule for listed securities in paragraph (d) of the definition "qualified investment" in subsection 207.01(1).

Paragraph 5002(d) allows a share of the capital stock of a specified small business corporation to be a qualified investment. A specified small business corporation is defined in new section 5000 (for more information, see the commentary on new section 5000). This type of qualified investment was originally provided for under subparagraph 4900(14)(a)(i).

Paragraph 5002(e) allows a share of the capital stock of a venture capital corporation described in section 6700, 6700.1, or 6700.2 to be a qualified investment. This type of qualified investment was originally provided for under subparagraph 4900(14)(a)(ii). This paragraph ensures that a share of the capital stock of a Canadian corporation registered under certain provincial legislation will be a qualified investment, as originally provided for under paragraphs 4900(1)(i.11), (i.13), and (i.14).

Paragraph 5002(f) allows a share of the capital or capital stock of a specified cooperative corporation to be a qualified investment. A specified cooperative corporation is defined in new section 5000 (for more information, see the commentary on new section 5000). This type of qualified investment was originally provided for under subparagraph 4900(14)(a)(iii). Note that such a share is a prescribed prohibited investment under new paragraph 5006(f) in certain circumstances. For more information, see the commentary on new section 5006.

Section 5003

New section 5003 prescribes four kinds of unit trusts as qualified investments for the purposes of paragraph (l) of the qualified investment definition in subsection 207.01(1) of the Act.

Paragraphs (a) and (b) of section 5003 refer to two types of unit trusts as qualified investments that were originally added as paragraphs 4900(1)(d.21) and (d.22). New paragraph 5003(a) specifies the first type of trust as an NI 81-102 fund (i.e., a trust that is subject to, and substantially complies with, the requirements of *National Instrument 81-102 Investment Funds* of the Canadian Securities Administrators).

Paragraph 5003(b) specifies the second type of trust. Subparagraph (i) requires the trust to have a class of units outstanding that either has been subject to a lawful distribution in a province to the

public (for which a prospectus, registration statement, or similar document was not required) or is qualified for distribution to the public. Subparagraph (i) is based on paragraph 4801(a), disregarding clause 4801(a)(i)(B).

Subparagraph (ii) requires the trust to satisfy the substantive conditions (i.e., disregarding the preamble of paragraph (b), which imposes timing conditions) of an "investment fund" as defined in subsection 251.2(1). An investment fund must be a non-discretionary unitized trust that is factually resident in Canada. The trust must also

- follow a reasonable policy of investment diversification;
- limit its undertaking to the investing of its funds in property;
- not control, alone or as part of a group of persons or partnerships, a corporation;
- not hold property that is used in carrying on a business carried on by it or a non-arm's length person or partnership;
- not hold property that is real property, Canadian or foreign resource property or an interest, or right, in such property; and
- not hold more than 20% of any class of securities of an issuer, unless
    - the issuer is a trust that is an investment fund (or mutual fund corporation that would be an investment fund if it were at trust), or
    - the total fair market value of the trust's property that is equity of the issuer does not exceed 10% of the issuer's equity value and the total fair market value of the trust's property that is liabilities of the issuer does not exceed 10% of the total fair market value of all of the issuer's liabilities.

Finally, subparagraph (iii) requires that the investments of the trust must be managed by a registered investment fund manager (as described in *National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations* of the Canadian Securities Administrators).

Paragraph 5003(c) allows units of a mutual fund trust (or a unit trust that would be a mutual fund trust if it had been created after 1999, which would allow the trust to meet the condition described in paragraph 4801(a) provided there has been a lawful distribution in a province to the public of units of the trust without the filing of a prospectus or similar document where the document was not required to be filed) to be qualified investments. This type of qualified investment was originally provided for under former paragraphs 4900(1)(d) and (d.2).

Paragraph 5003(d) allows units of small business investment trusts to be qualified investments if they were acquired before January 1, 2027. The units must have been qualified investments at the time they were acquired and would be, at the particular time, qualified investments under the *Income Tax Regulations* applicable on December 31, 2026. Units of small business investment trusts are not qualified investments if acquired after December 31, 2026. This paragraph is intended to provide grandfathering relief in respect of the transition to the new rules. Interests in small business investment trusts were originally provided for as qualified investments under former subsections 4900(6) and (7).

Section 5004

New section 5004 prescribes three kinds of property as qualified investments for the purposes of paragraph (l) of the qualified investment definition in subsection 207.01(1) of the Act.

Paragraph 5004(a) describes property that is an option, warrant, or a similar right to acquire an underlying property that is a qualified investment (or cash in lieu) under certain conditions. The underlying property is required to be a share or unit of (or a warrant on a share or unit of), or a debt issued by, the issuer of the right or a person or partnership with which the issuer does not deal at arm's length. This qualified investment was originally provided for under former paragraph 4900(1)(e).

Note that an option, warrant, or similar right is a prescribed prohibited investment under new paragraph 5006(b) in cases where the issuer of the right is a connected person under a registered plan. For more information, see the commentary on new section 5006.

Paragraph 5004(b) describes gold (with a minimum purity of 99.5%) or silver (with a minimum purity of 99.9%) in the form of a legal tender bullion coin or a bullion bar, ingot or wafer, or represented by a certificate. This qualified investment was originally provided for under former paragraphs 4900(1)(t), (u), and (v) and are reflected in new subparagraphs 5004(b)(i), (ii), and (iii), respectively.

Subparagraph (i) provides additional conditions in order for legal tender bullion coins to be a qualified investment. In particular, it must have been produced by the Royal Canadian Mint and be acquired either directly from the Mint or from a bank, trust company, credit union, insurance corporation or registered securities dealer whose business activities are regulated by the Superintendent of Financial Institutions or a similar provincial authority. In addition, the coin's fair market value must not exceed 110% of the fair market value of its precious metal content. This last condition applies at all times that the coin is held by the plan trust, ensuring that the coin is not held for its numismatic (collectible) value.

Subparagraph (ii) provides additional conditions in order for bullion bars, ingots, or wafers to be a qualified investment. In particular, the bar, ingot, or wafer must have been produced by a metal refiner accredited by the London Bullion Market Association and bear the refiner's hallmark along with an indication of its weight and purity. Moreover, the bar, ingot, or wafer must be acquired either directly from the refiner, the Mint, or from a bank, trust company, credit union, insurance corporation or registered securities dealer whose business activities are regulated by the Superintendent of Financial Institutions or a similar provincial authority.

Finally, subparagraph (iii) relates to gold and silver certificates where the underlying gold or silver would otherwise be a qualified investment for the plan trust under subparagraph (i) or (ii). The certificate must be acquired either directly from the Mint or from a bank, trust company, credit union, insurance corporation or registered securities dealer whose business activities are regulated by the Superintendent of Financial Institutions or a similar provincial authority.

Paragraph 5004(c) provides for an interest of a limited partner in a small business investment limited partnership to be a qualified investment if it was acquired before January 1, 2027. The

interest must have been a qualified investment at the time it was acquired and would be, at the particular time, qualified investments under the *Income Tax Regulations* applicable on December 31, 2026. Interests in small business investment limited partnerships are not qualified investments if acquired after December 31, 2026. This paragraph is intended to provide grandfathering relief in respect of the transition to the new rules. Interests in small business investment limited partnerships were originally provided for as qualified investments under former subsections 4900(6) and (7).

Section 5005

New section 5005 prescribes various credit rating agencies for the purposes of subparagraphs (c)(v) and (vi) of the definition "qualified investment" in subsection 207.01(1) of the Act (requiring certain debt obligations to have an investment grade rating with a prescribed credit rating agency). Section 5005 is also relevant for subparagraph 5001(i)(ii) (see commentary on new paragraph 5001(i) for more information).

Paragraphs (a) to (e) of Section 5005 prescribes the following organizations for this purpose: A.M. Best Company, Inc., DBRS Limited, Fitch Ratings, Inc., Moody's Investors Service, Inc., and Standard and Poor's Financial Services LLC. Paragraph (f) is added to recognize subsidiaries and affiliates that perform credited rating services in jurisdictions outside Canada on behalf of the credit rating agencies listed in paragraphs (a) to (e).

Prescribed credit rating agencies were originally provided for under former subsection 4900(2).

Section 5006

New section 5006 prescribes various property as prohibited investments for the purposes of paragraph (d) of the prohibited investment definition in subsection 207.01(1) of the Act. The property prescribed in new section 5006 are certain kinds of qualified investments where a connected person (as defined in new section 5000) is involved under specific circumstances.

Under former Part XLIX, specified property involving a connected person was not permitted to be a qualified investment, and therefore generally subject to non-qualified investment taxes (presuming the property was not also a prohibited investment). Non-qualified investments are subject to a tax under Part XI.01 of the Act (50% of fair market value), in addition to tax under Part I of the Act applying to income and gains earned on non-qualified investments.

Instead, as prescribed prohibited property, such investments would now be subject to prohibited investment taxes. The Act imposes two special taxes under Part XI.01 when a registered plan holds a prohibited investment: (1) a 50% tax on the fair market value of the investment and (2) a 100% advantage tax on any income or capital gain derived from the investment.

Under paragraph 5006(a), a share of the capital stock of a mortgage investment corporation is a prescribed prohibited investment if it holds any indebtedness, whether by way of mortgage or otherwise, of a person who is a connected person under the registered plan governing the trust. For instance, a share of the capital stock of a mortgage investment corporation would be a

prohibited investment for a RESP if the subscriber or beneficiary of the RESP is indebted to the corporation. In the case of a deferred profit sharing plan, paragraph (b) of the definition "qualified investment" in section 204 excludes as a qualified investment a share of the capital stock of a mortgage corporation of it holds any indebtedness of a person that is a beneficiary or an employer under the deferred profit sharing plan or revoked plan or any person who does not deal at arm's length with that person.

Under paragraph 5006(b), an option, warrant, or similar right is a prescribed prohibited investment if it is issued by a connected person under the registered plan governing the trust. For instance, an option would be a prohibited investment for a TFSA where it was issued by a corporation that does not deal at arm's length with the holder of the TFSA (e.g., where the holder controls the corporation). In the case of a deferred profit sharing plan, paragraph (b) of the definition "qualified investment" in section 204 excludes as a qualified investment an option, warrant, or similar right that is issued by a person that is a beneficiary or an employer under the deferred profit sharing plan or revoked plan or any person who does not deal at arm's length with that person.

Under paragraph 5006(c), an obligation of or deposit with a credit union is a prescribed prohibited investment in cases where the credit union has granted a benefit or privilege to a connected person under a registered plan because of the plan's ownership of a security of the credit union or a deposit with the credit union. For instance, a deposit with a credit union would be a prohibited investment for an RRSP where the credit union granted a benefit (e.g., a preferential interest rate or reduced fees) to the annuitant of the RRSP. In the case of a deferred profit sharing plan, paragraph (b) of the definition "qualified investment" in section 204 excludes as a qualified investment an obligation of or deposit with a credit union where a benefit or privilege is granted to a person that is a beneficiary or an employer under the deferred profit sharing plan or revoked plan or any person who does not deal at arm's length with that person.

Under paragraph 5006(d), an obligation of a cooperative corporation is a prescribed prohibited investment in cases where the corporation has granted a benefit or privilege to a connected person under a registered plan resulting from the plan's ownership of a security of the corporation. For instance, a bond of a cooperative corporation would be a prohibited investment for an RRSP where the corporation granted a benefit (e.g., a discount on products) to the annuitant of the RRSP. In the case of a deferred profit sharing plan, paragraph (b) of the definition "qualified investment" in section 204 excludes as a qualified investment an obligation of a cooperative corporation where a benefit or privilege is granted to a person that is a beneficiary or an employer under the deferred profit sharing plan or revoked plan, or any person who does not deal at arm's length with that person, as a result of the ownership by the plan of a share or obligation of the cooperative corporation.

Under paragraph 5006(e), a banker's acceptance is a prescribed prohibited investment where the indebtedness it represents is of a Canadian corporation that is a connected person under the registered plan governing the trust. For instance, banker's acceptance would be a prohibited investment for an FHSA where it represents an indebtedness of a Canadian corporation that does not deal at arm's length with the holder of the FHSA (e.g., where the holder controls the corporation). In the case of a deferred profit sharing plan, paragraph (b) of the definition

"qualified investment" in section 204 excludes as a qualified investment a banker's acceptance where it represents an indebtedness of a Canadian corporation that is a person that is a beneficiary or an employer under the deferred profit sharing plan or revoked plan and any person who does not deal at arm's length with that person.

Under paragraph 5006(f), a share of the capital or the capital stock of a specified cooperative corporation is a prescribed prohibited investment if ownership of the share (or an identical share) is a condition of membership of the corporation and a connected person under the registered plan governing the trust has received, or can reasonably be expected to receive, a payment pursuant to an "allocation in proportion to patronage" in respect of "consumer goods or services". "Allocation in proportion to patronage" and "consumer goods or services" have the meanings assigned by subsection 135(4) of the Act.

Paragraphs (c), (d) and (f) are intended to prevent registered plans from being used to secure personal benefits that would otherwise be taxable.

New Part L of the Regulations comes into force on January 1, 2027.

Clause 23

Part LI – Small Business Investments

ITR
Part LI

The heading for Part LI of the Regulations is relabelled as "Small Business Investments" instead of "Deferred Income Plans, Investments in Small Business".

This amendment comes into force on January 1, 2027.

Clause 24

Part LI – Small Business Investments

ITR
5100(1)

"specified property"

Consequential to the revisions to the definition "qualified investment" in subsection 207.01(1), the references in the definition "specified property" to property that is described by certain paragraphs of section 204 of the *Income Tax Act* are updated to refer to the relevant paragraphs and subparagraphs of the revised qualified investment definition in 207.01(1) of the *Income Tax Act*.

This amendment comes into force on January 1, 2027.

Reporting by Non-Profit Organizations

Clause 1

Information returns

ITA
149(12)

Subsection 149(12) requires a person that is an agricultural organization, board of trade, chamber of commerce or non-profit organization, which is exempt from tax under paragraph 149(1)(e) or (l), to file an information return if the person meets one or more of the enumerated conditions. In particular, the person must file an information return for the period if it has received dividends, interest, rentals or royalties in excess of $10,000 in that period, if the total assets of the person exceed $200,000 at the end of the immediately preceding fiscal period, or if the person was required to file an information return under this subsection for a previous fiscal period.

The preamble of subsection 149(12) is amended to clarify that the information return is required to be filed in prescribed form and manner.

Subsection 149(12) is also amended to add new paragraph (d) which requires the person to file an information return if the total of all amounts received in the period exceeds $100,000.

These amendments apply to fiscal periods that begin on or after January 1, 2027.

Short-form information returns

ITA
149(13)

Subject to the exceptions under new subsection 149(14), new subsection 149(13) requires a person exempt from tax under paragraph 149(1)(e) or (l) to file an information return containing prescribed information, including a description of the person's activities (including whether it conducts activities outside Canada), the person's total assets, total liabilities and total amounts received in the period, and the name of each director, officer or trustee of the person.

This amendment applies to fiscal periods that begin on or after January 1, 2027.

Exception

ITA
149(14)

New subsection 149(14) provides exceptions from the application of the short-form information return filing obligation under subsection 149(13) for persons exempt from tax under paragraph 149(1)(e) or (l). In particular, a person is not subject to new subsection 149(13) if:

a) the total of all amounts it received in the period does not exceed $10,000;
b) it is not an organization, whether incorporated or not; or
c) it is required to file an information return under subsection 149(12) for the period.

The exception under new paragraph (b) is intended to provide greater certainty that the new short-form information return filing requirement does not apply to loosely organized recreational activities, which generally would not constitute a person that meets the requirements for the tax exemption under paragraph 149(1)(e) or (l) (a person is defined under subsection 248(1) to include an entity exempt, because of subsection 149(1), from tax under Part I on all or part of the entity's taxable income). For the purpose of new paragraph (b), an unincorporated entity or group of individuals would need to be sufficiently organized to constitute an organization. Indicators of sufficient organization could include, but are not limited to, having a defined purpose, a constitution or bylaws, a particular organizational structure or hierarchy, and defined governance roles (such as members, directors and officers).

This amendment applies to fiscal periods that begin on or after January 1, 2027.

21-Year Rule

Clause 1

Trust transfers

ITA
104(5.8)

Subsection 104(5.8) is a rule designed to prevent the avoidance of the 21-year deemed realization rule through trust-to-trust transfers that do not involve dispositions of property at fair market value. This provision generally provides for a transferee trust to assume the next deemed disposition day of the transferor trust, if that day is earlier than the transferee's next deemed disposition day.

Subsection 104(5.8) is amended to address indirect trust-to-trust transfers. For example, a personal trust that transfers its capital property on a tax-deferred basis to a beneficiary that is a corporation owned, in whole or in part, by another personal trust would be an indirect trust-to-trust transfer subject to amended subsection 104(5.8).

This amendment applies in respect of transfers of property that occur on or after November 4, 2025.

Canada Carbon Rebate

Clause 1

Deemed payment on account of tax

ITA
122.8(4)

Subsection 122.8(4) provides for the calculation of the Climate Action Incentive (also referred to as the Canada Carbon Rebate). The amount of an eligible individual's Canada Carbon Rebate payment is determined by the formula in this subsection and is deemed to be a payment of tax by the individual at the end of a taxation year. An eligible individual is required to file a return of income for a taxation year to receive a Canada Carbon Rebate payment with respect to that taxation year.

Subsection 122.8(4) is amended to provide a deadline of October 30, 2026, for an eligible individual to file their return of income for a taxation year to receive a Canada Carbon Rebate payment in respect of that year.

This amendment comes into force on November 4, 2025.

End of deemed payment

ITA
122.8(4.3)

New subsection 122.8(4.3) provides that an eligible individual has until October 30, 2026 to request an adjustment to a return of income that has been previously filed or make an application for a determination in respect of a taxation year in order for the Minister of National Revenue to determine or redetermine the individual's Canada Carbon Rebate payment.

In cases where an eligible individual requests an adjustment or makes an application for a determination in respect of a taxation year after the October 30, 2026 deadline, the Minister of National Revenue will not determine an amount of a deemed payment under subsection 122.8(4) on account of the eligible individual's tax payable under this Part for the taxation year to which the return of income or application for a determination relates.

For example, if Bill, having filed his return of income for the 2024 taxation year before October 30, 2026, makes an application for a determination on November 2, 2026, to redetermine his Canada Carbon Rebate payments for the 2024 taxation year, the Minister will not redetermine the amount of the Canada Carbon Rebate that Bill may receive for the 2024 taxation year because Bill's application for a determination was not made on or before October 30, 2026.

This amendment comes into force on November 4, 2025.

Immediate Expensing for Manufacturing and Processing Buildings

Clause 1

Rules applicable

ITA
13(7)

Subsection 13(7) provides rules relating to capital cost that apply where there has been a change of use of depreciable property, where depreciable property is used partly for gaining or producing income and partly for some other purpose, and where depreciable property is transferred between persons not dealing at arm's length.

New paragraph (d.1) provides a recapture rule that applies if there is a change in use (a "manufacturing building recapture event", as defined in subsection (21)) of a building in respect of which an amount was deducted under paragraph 20(1)(a) pursuant to subparagraph 1100(1)(a.1)(i) of the *Income Tax Regulations* (the "Regulations"). For more information, see the commentary on the definition "manufacturing building recapture event".

Specifically, if a taxpayer is subject to a manufacturing building recapture event in respect of a building, the taxpayer is deemed to have disposed of the building for proceeds equal to the amount that would have been the undepreciated capital cost (UCC) of the building, at that time, if the building had never qualified for immediate expensing under subparagraph 1100(1)(a.1)(i) of the Regulations.

The UCC amount is determined as if the building had never qualified for immediate expensing, the building were the only property included in the prescribed class that would have applied, and the taxpayer had deducted the maximum available capital cost allowance (CCA) in respect of that class for all prior taxation years.

The taxpayer is also deemed to have reacquired the building (in a separate prescribed class) at a cost equal to the same UCC amount.

Example:

Company A acquires a building in 2026 for $1 million and uses more than 90% of the building's floor space for manufacturing, deducting the full capital cost of the building for the 2026 taxation year.

In 2029, Company A converts 50% of the building's floor space to office space, triggering a "manufacturing building recapture event".

Company A's deemed proceeds of disposition and reacquisition cost of the building are determined by the amount that would have been the UCC of the building if it never qualified for immediate expensing. Since the building was used for manufacturing in the years leading up to the recapture event, the maximum applicable CCA rates would have been: 15% in 2026

(assuming the building is Class 1 property that also qualified as reaccelerated investment incentive property, as proposed in Bill C-15) and 10% in 2027 and 2028.

This would result in $688,500 of recapture income under subsection 13(1) for Company A, and a remaining $688,500 UCC in a separate prescribed class for the building.

This amendment is deemed to have come into force on November 4, 2025.

Definitions

ITA
13(21)

"manufacturing building recapture event"

A "manufacturing building recapture event" is an event where a taxpayer has deducted an amount under paragraph 20(1)(a) pursuant to subparagraph 1100(1)(a.1)(i) of the Regulations in respect of a building (this would be an "eligible manufacturing building", which is defined in subsection 1104(2) of the Regulations), and within 10 calendar years of the end of the taxation year in which the deduction was made, the taxpayer (or a lessee of the taxpayer) begins to use more than 10% of the building's floor space for one or more income-earning purposes other than the manufacturing or processing (as defined in subsection 1104(9) of the Regulations) in Canada of goods for sale or lease.

If the taxpayer begins to use the building for a non-income earning purpose, paragraph 13(7)(a) or (d) would apply instead.

If an eligible manufacturing building is transferred on a tax-deferred "rollover" basis under subsection 85(1) or (2), subsection 85(5) would apply to deem the transferee to have acquired the building for the same capital cost as the transferor, and the difference between the capital cost and the elected proceeds of disposition amount is deemed to have been deducted by the transferee in respect of the property. As a result, paragraph (a) of the "manufacturing building recapture event" definition would apply to the transferee in the same way as it would have applied to the transferor.

This definition is deemed to have come into force on November 4, 2025.

Clause 2

Class 1

ITR
1100(1)(a.1)

Subsection 1100(1) of the Regulations sets out the capital cost allowance (CCA) rates that taxpayers may claim with respect to specified classes of depreciable property.

Paragraph 1100(1)(a.1) currently provides a 6% additional allowance in respect of an "eligible non-residential building" at least 90% of the floor space of which is used at the end of a taxation year for the purpose of manufacturing or processing in Canada goods for sale or lease.

Paragraph (a.1) is amended to provide immediate expensing (as an additional enhanced first-year allowance at an effective rate of 100%) in new subparagraph (i) for "eligible manufacturing buildings" that meet the same 90% "manufacturing floor space requirement", which are now defined in subsection 1104(2).

Full immediate expensing is available in respect of eligible manufacturing buildings that first meet the manufacturing floor space requirement before 2030. If the manufacturing floor space requirement is first met in 2030 or 2031, the applicable rate becomes 75%, and if the floor space requirement is first met in 2032 or 2033, the applicable rate would be 55%. The enhanced rate under this subparagraph would not be available after 2033.

The current 6% additional allowance in respect of eligible non-residential buildings that meet the manufacturing floor space requirement is now provided in subparagraph (ii). This subparagraph would also apply for eligible manufacturing buildings that still have undepreciated capital cost remaining in the relevant taxation year (e.g., buildings eligible for the 75% or 55% rates).

This amendment is deemed to have come into force on November 4, 2025.

Manufacturing buildings — first-year deductions

ITR
1100(1.01)

New subsection 1100(1.01) provides that, if a deduction is available in respect of an eligible manufacturing building of a taxpayer under subparagraph 1100(1)(a.1)(i) for a taxation year, then the taxpayer may not deduct any other capital cost allowance (CCA) amount in respect of that building for the year.

This provision seeks to prevent a taxpayer from claiming the accelerated deduction under subparagraph 1100(1)(a.1)(i) as well as CCA otherwise provided in respect of the same building in the same taxation year.

For example, if a building is eligible for a 75% or 55% rate under subparagraph 1100(1)(a.1)(i) in the year that it meets the manufacturing floor space requirement, the taxpayer would not be eligible for any other CCA deductions in respect of the building for that year.

This amendment is deemed to have come into force on November 4, 2025.

Property Acquired in the Year

ITR
1100(2)

Subsection 1100(2) 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. Generally, the first part (as expressed by elements A, B, A.1, and B.1) relates to the enhanced first-year CCA in respect of "accelerated investment incentive property" (AIIP) and "reaccelerated investment incentive property" (RIIP) of a taxpayer, as defined in subsection 1104(4) and (4.01), respectively. The second part (as expressed by element C) is the "half-year rule", which generally 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.

Element A.1, as proposed in Bill C-15, provides the relevant factors for determining the first-year accelerated CCA for a class. Classes 12, 13, 14, 15, 43.1, 44, 46, 50, 53, 54, 55, 56, and 59, as well as Class 43 in certain circumstances after 2025, are excluded from paragraph (a).

Subsection 1100(2) is amended to add a reference to subparagraph 1100(1)(a.1)(i) in paragraph (a) of element A.1 of the formula. This amendment excludes property eligible for the accelerated deduction under that subparagraph from being eligible for the enhanced first-year CCA as RIIP.

This amendment is deemed to have come into force on November 4, 2025.

Taxation Years Less Than 12 Months

ITR
1100(3)

Subsection 1100(3) of the Regulations provides for the proration of capital cost allowance deductions for taxation years that are less than 12 months.

Subsection 1100(3) is amended to provide that no proration is required in respect of the immediate expensing deduction in subparagraph 1100(1)(a.1)(i).

This amendment is deemed to have come into force on November 4, 2025.

Clause 3

Eligible Non-Residential or Manufacturing Building

ITR
1101(5b.1)

Subsection 1101(5b.1) currently provides that taxpayers may elect to include a building in a separate prescribed class if the building satisfies the definition "eligible non-residential

building", as defined in subsection 1104(2). A taxpayer who acquires such a building may be eligible to claim an additional CCA under paragraphs 1100(1)(a.1) or (a.2) in respect of the building if a separate class election has been filed with the Minister of National Revenue in the taxation year in which the building is acquired.

Subsection 1101(5b.1) is amended to add a reference to an "eligible manufacturing building", which is also defined in subsection 1104(2). A taxpayer who acquires an eligible manufacturing building may be eligible to claim an accelerated CCA under new subparagraph 1100(1)(a.1)(i) in respect of the building if the separate class election has been filed in the taxation year in which the building is acquired.

Since both eligible non-residential buildings and eligible manufacturing buildings are included in a separate prescribed class under this subsection, only one election would be needed if a building meets the requirements in both definitions.

This amendment is deemed to have come into force on November 4, 2025.

Clause 4

Non-arm's Length Exception

ITR
1102(20.1)

Subsection 1102(20.1) deems a taxpayer not to be dealing at arm's length with another person or partnership in certain circumstances and is intended to prevent taxpayers from contriving arm's length relationships in order to obtain the more favourable treatment that is available for various accelerated CCA provisions in respect of arm's length transfers.

Subsection 1102(20.1) is amended to include a reference to the new "eligible manufacturing building" definition in subsection 1104(2), to ensure that the anti-avoidance rule also applies in respect of the determination of whether a building is an eligible manufacturing building.

This amendment is deemed to have come into force on November 4, 2025.

Rules for Additions to and Alterations of Certain Buildings

ITR
1102(23)

Subsection 1102(23) provides a special rule that applies to additions to, or alterations of, a taxpayer's building that is not an "eligible non-residential building" (as that term is defined in subsection 1104(2)) and that is not included in a separate class under subsection 1101(5b.1).

The rule currently provides that the capital cost of an addition to, or alteration of, a building is deemed to be a separate building for the purpose of applying the additional allowances available

under paragraph 1100(1)(a.1) or (a.2), including the separate class election found in subsection 1101(5b.1). Consequently, a taxpayer who acquires an addition to, or alteration of, a building that itself is not an eligible non-residential building (e.g., the building was acquired before March 19, 2007) may qualify for an additional allowance in respect of the capital cost of the addition or alteration to that building if other conditions relating to claiming an additional allowance under those provisions are met.

Subsection 1102(23) is amended to apply in respect of additions to, or alterations of, an "eligible manufacturing building" as defined in subsection 1104(2).

The current rule continues to apply under new paragraph (a) in respect of eligible non-residential buildings.

New paragraph (b) provides that the capital cost of an addition to, or alteration of, a building is deemed to be a separate building for the purpose of applying the additional allowance available under subparagraph 1100(1)(a.1)(i), regardless of whether the existing building is an eligible manufacturing building.

For example, if a taxpayer builds an addition to an eligible manufacturing building that was fully expensed under subparagraph 1100(1)(a.1)(i), the addition could also be eligible for the accelerated deduction under subparagraph 1100(1)(a.1)(i), provided that the total floor space of the "separate building" (the addition) and the original building meet the manufacturing floor space requirement. For more information, see the commentary to subsection 1102(24).

This amendment is deemed to have come into force on November 4, 2025.

ITR
1102(24)

Subsection 1102(24) provides a special rule for determining whether an addition to, or alteration of, a building to which the deemed building rule in subsection 1102(23) applies is used in the manner required by the accelerated CCA provisions in paragraphs 1100(1)(a.1) and (a.2). In general terms, the use of an addition or alteration that is included as a building in a separate prescribed class (because of an election under subsection 1101(5b.1)) is deemed to be determined on the basis of the use of the total floor space of the building after taking the addition or alteration into account.

Subsection 1102(24) is amended to add a reference to the new "manufacturing floor space requirement" definition in subsection 1104(2), which provides the requirement for the use of the floor space of a building to be eligible for the accelerated CCA deductions provided under paragraph 1100(1)(a.1).

This amendment is deemed to have come into force on November 4, 2025.

Acquisition cost of eligible manufacturing buildings

ITR
1102(25.1)

New subsection 1102(25.1) ensures that the capital cost of an "eligible manufacturing building" that was under construction on November 4, 2025 includes the capital cost of the building that was incurred before November 4, 2025, excluding any CCA amounts that have been deducted (for example, if certain parts of the building became available for use under the "rolling-start" rule).

If the taxpayer files the election under subsection 1101(5b.1) in respect of the building, the taxpayer may be eligible for an accelerated CCA deduction (up to 100%) in respect of those costs under subparagraph 1100(1)(a.1)(i).

Similar to subsection 1102(25), this subsection also provides for an election that allows a taxpayer to not include capital costs incurred before November, 4, 2025 for the construction of an eligible manufacturing building in the cost of the building.

This subsection is deemed to have come into force on November 4, 2025.

Clause 5

Definitions

ITR
1104(2)

Subsection 1104(2) sets out definitions that apply for the purposes of Part XI of the Regulations and in Schedule II to the Regulations.

"*eligible manufacturing building*"

The definition "eligible manufacturing building" is added to describe a building that is eligible for the accelerated CCA deduction under new subparagraph 1100(1)(a.1)(i).

An "eligible manufacturing building" means a taxpayer's building that:

- is located in Canada;
- is acquired by the taxpayer after November 3, 2025;
- meets either of the conditions identified in paragraph (c), which are similar to those described in paragraph 1104(4)(b) in respect of accelerated investment incentive property; and
- is reasonably expected to meet the "manufacturing floor space requirement" (also defined in this subsection) once it is used at its intended capacity.

This definition is deemed to have come into force on November 4, 2025.

"manufacturing floor space requirement"

The "manufacturing floor space requirement" in respect of a building is the requirement that at least 90% of the floor space of the building is used by the taxpayer, or a lessee of the taxpayer, for the manufacturing or processing in Canada of goods for sale or lease. This definition is relevant for paragraph 1100(1)(a.1), which provides for accelerated CCA deductions that may apply to buildings that meet this requirement.

This definition is deemed to have come into force on November 4, 2025.

Manufacturing or Processing

ITR
1104(9)

Subsection 1104(9) lists various exclusions from the meaning of the phrase "manufacturing or processing" for the purposes of paragraph 1100(1)(a.1), the specified energy property rules in subsection 1100(26) and the manufacturing and processing property described in Class 29 in Schedule II to the Regulations.

Subsection 1104(9) is amended to apply for the purposes of subsection 1104(2), particularly for the new "manufacturing floor space requirement" definition, which is relevant to both immediate expensing under subparagraph 1100(1)(a.1)(i) and the existing 6% additional CCA in respect of eligible non-residential buildings used in manufacturing or processing.

This amendment is deemed to have come into force on November 4, 2025.

Clean Hydrogen Investment Tax Credit

Clause 1

ITA
127.48

Several changes are proposed for the clean hydrogen tax credit. The amendments that apply generally to the clean hydrogen tax credit are effective as of March 28, 2023, and the amendments that relate to the expansion to methane pyrolysis as an eligible production pathway are effective as of December 16, 2024.

Definitions

ITA
127.48(1)

Subsection 127.48(1) provides various definitions relevant for the purpose of the clean hydrogen tax credit.

"actual hydrogen use percentage"

The "actual hydrogen use percentage" is relevant where a clean hydrogen project produces hydrogen from the pyrolysis of eligible hydrocarbons. In general terms, it represents the percentage of hydrogen produced by the project during the compliance period that is sold or used for a "qualifying economic purpose". For more information on what constitutes a "qualifying economic purpose", see the commentary on that definition.

For this calculation, the quantity of "excluded hydrogen" is to be subtracted from both the numerator and the denominator to adjust for hydrogen produced by the project that should not be factored into the determination of the actual hydrogen use percentage. For more information, see the commentary on the "excluded hydrogen" definition.

The project's actual hydrogen use percentage is required to be included in the compliance report to be filed with the Minister of National Revenue and the Minister of Natural Resources in respect of the project's final operating year under paragraph 127.48(16)(d).

If, after the project's compliance period ends, the project's actual hydrogen use percentage is lower than 90%, then subsection 127.48(17.1) would apply to deem the project's average actual carbon intensity to be greater than 4.5, and the project could be liable for recovery tax under subsection 127.48(18). For more information, see the commentary on subsections 127.48(17.1) and (18).

"clean hydrogen project plan"

To qualify for the clean hydrogen tax credit, a "clean hydrogen project plan" must be filed with the Minister of Natural Resources for confirmation, in the form and manner determined by the Minister of Natural Resources.

New paragraph (c.1) is added to this definition to describe the additional requirements relevant for a clean hydrogen project that produces hydrogen from the pyrolysis of eligible hydrocarbons (i.e., methane pyrolysis). Specifically, two new requirements are added: the project's "expected hydrogen production" and an "end-use plan" in respect of the project. For more information, see the commentary on those two new definitions.

This amendment is deemed to have come into force on December 16, 2024.

"combustion"

It is possible for solid carbon to be used in a reaction that produces emissions of specified greenhouse gases but is not typically considered combustion.

The definition "combustion" is added to ensure that when solid carbon is used in these reactions, it receives the same treatment as regular combustion of solid carbon (for example, burning the

solid carbon for energy) for the purposes of determining the carbon intensity of a clean hydrogen project and any associated clean hydrogen tax credit.

"dual-use electricity and heat equipment"

The definition "dual-use electricity and heat equipment" describes certain equipment that is part of a clean hydrogen project and supports the production of hydrogen from eligible hydrocarbons.

Paragraph (a) of the definition describes equipment that generates electrical energy, heat energy or a combination of electrical and heat energy, if more than 50% of either the electrical energy or heat energy that is expected to be produced over the first 20 years of the project's operations, based on the most recent clean hydrogen project plan, is expected to support a qualified CCUS project or qualified clean hydrogen project.

Paragraph (a) is first amended to clarify, for greater certainty, that this equipment would meet this requirement if more than 50% of either the electrical energy or heat energy to be produced by the equipment is expected to support one or a combination of a qualified CCUS project and a qualified clean hydrogen project.

This paragraph is also amended to provide an exception to the requirement for equipment using fossil fuels to be subject to a CCUS process. Currently, because generation equipment using any amount of fossil fuels would be ineligible if no CCUS process is applied, certain equipment that would need to emit a small amount of carbon dioxide for startup purposes (e.g., a hydrogen turbine that requires fossil fuels for startup) may not be eligible. As amended, this equipment would be eligible if fossil fuels are used solely to start up the equipment and for no more than 72 hours per calendar year.

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

"dual-use hydrogen and ammonia equipment"

The "dual-use hydrogen and ammonia equipment" definition is repealed and replaced by the new definition "oxygen and nitrogen production equipment". For more information, see the commentary on the "oxygen and nitrogen production equipment" definition.

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

"eligible clean hydrogen property"

"Eligible clean hydrogen property" means property, other than "excluded property", that meets all three conditions in paragraphs (a) to (c).

Paragraph (c) lists six categories of eligible property in subparagraphs (i) to (vi).

Subparagraphs (c)(i) and (ii) are amended to clarify that the property described in these two subparagraphs must be used to produce all or substantially all hydrogen. For example, certain

equipment would be ineligible if it is used to produce oxygen that contributes to a substantial portion (generally, more than 10%) of the total revenues generated by a project.

In the case of property that is used to produce hydrogen from eligible hydrocarbons (described in subparagraph (ii)), any captured carbon that is also produced by that property may be disregarded in determining whether the property was used to produce all or substantially all hydrogen.

These clarifications are intended to prevent projects from "oversizing" certain equipment for the purpose of producing more co-products, especially where hydrogen production levels do not have a corresponding increase. Captured carbon does not raise a similar concern because the amount of carbon dioxide generated by a project is directly related to the amount of carbon dioxide generated by a project and capturing the carbon dioxide is necessary for the CCUS process to reduce emissions.

Example

A clean hydrogen project includes certain equipment that is expected to be used to produce hydrogen from eligible hydrocarbons, but will also produce oxygen using an air separation unit and captured carbon as co-products. The project is expected to generate $10 million in total revenue for its first operating year.

If the revenue from selling hydrogen is expected to be all or substantially all of the total revenues (generally, $9 million, or 90%, of $10 million), then the equipment could qualify as "eligible clean hydrogen property" under subparagraph (c)(ii) of the definition.

If the revenue from selling the oxygen co-product is expected to be more than $1 million (10% of $10 million), then the air separation equipment would generally not qualify under subparagraph (c)(ii).

If the project is also expected to sell captured carbon, the revenue from those sales may be disregarded in determining whether the equipment is expected to produce all or substantially all hydrogen.

Subparagraph (c)(ii) is also amended to add a reference to partial oxidation reactors, clarifying the intent for this equipment to be eligible.

Consequential on the introduction of the definition "oxygen and nitrogen production equipment" and the repeal of the definition "dual-use hydrogen and ammonia equipment", clause (c)(iii)(C) is amended to refer to the new defined term.

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

Further, as part of the introduction of the pyrolysis pathway, subparagraph (c)(ii) is amended to clarify that property used to produce hydrogen from eligible hydrocarbons using a pyrolysis process would not be included in this subparagraph and would be included under new subparagraph (c)(ii.1) instead.

New subparagraph (c)(ii.1) describes property used to produce all or substantially all hydrogen from the pyrolysis of eligible hydrocarbons, including property that is part of a pyrolysis reactor system, solid carbon separation equipment, and additional specified equipment.

Similar to subparagraph (ii), whether the equipment is used to produce all or substantially all hydrogen is determined without reference to any captured carbon or solid carbon that is produced. Solid carbon could have substantial economic value, but because it is a necessary product of hydrogen production under the pyrolysis pathway, solid carbon production is disregarded in determining whether a piece of equipment is used to produce all or substantially all hydrogen.

Amendments in respect of the pyrolysis pathway are deemed to have come into force on December 16, 2024.

"eligible pathway"

Producing hydrogen from an "eligible pathway" is a required condition for a clean hydrogen project to become a "qualified clean hydrogen project".

New paragraph (c) is added to this definition to include the production of hydrogen from the pyrolysis of eligible hydrocarbons (i.e., methane pyrolysis) as an eligible pathway.

This amendment is deemed to have come into force on December 16, 2024.

"eligible power purchase agreement"

An "eligible power purchase agreement" means an agreement or other arrangement in writing that meets the conditions described in paragraphs (a) to (c).

Subparagraph (a)(ii) requires that the source of the electricity be located:

- in the same province or territory as the clean hydrogen project of the taxpayer;
- in the exclusive economic zone of Canada; or
- in a neighbouring province, if the taxpayer has arranged for the necessary interprovincial transmission.

Clauses (a)(ii)(A) and (B) are amended to allow for the eligibility of power purchase agreements that provide electricity to a clean hydrogen project by direct connection, without necessarily being connected to the electricity grid of the province or territory in which the project is located.

Paragraph (b) requires the agreement to grant the taxpayer the sole and exclusive right to the environmental attributes associated with the purchased electricity. Under paragraph (b), an agreement will not qualify as an eligible power purchase agreement if the producer of the electricity sells the attributes of that electricity to another purchaser in a separate arrangement.

Paragraph (b) is amended to clarify that environmental attribute certificates issued through a provincially designated authority (e.g., the Midwest Renewable Energy Tracking System for Clean Energy Credits in Ontario), including renewable energy certificates, may be used as evidence of the taxpayer's sole and exclusive right to the environmental attributes associated with the electricity purchased by the taxpayer. For greater certainty, this clarification does not preclude other forms of evidence, such as the power purchase agreement itself.

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

New subsection 127.48(6.1) provides additional rules with respect to the retirement of environmental attribute certificates. For more information, see the commentary on subsection 127.48(6.1).

"eligible renewable hydrocarbon"

"Eligible renewable hydrocarbon" refers to a substance that meets the conditions in each of paragraphs (a) to (f) in respect of a taxpayer.

Paragraph (e) applies if the renewable hydrocarbons are acquired by the taxpayer under an agreement with another party. In such a case, the agreement must grant the taxpayer the sole and exclusive right to the environmental attributes associated with the substance. Similar to eligible power purchase agreements, this rule seeks to prevent the producers of renewable hydrocarbons from selling the environmental attributes associated with the renewable source to another purchaser in a separate arrangement.

Paragraph (e) is amended to clarify that environmental attribute certificates issued through a provincially designated authority may be used as evidence of the taxpayer's sole and exclusive right to the environmental attributes associated with the substance.

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

New subsection 127.48(6.1) provides additional rules with respect to the retirement of environmental attribute certificates. For more information, see the commentary on subsection 127.48(6.1).

"end-use plan"

An "end-use plan" is relevant where a clean hydrogen project is intended to produce hydrogen from the pyrolysis of eligible hydrocarbons. In general terms, it is intended to ensure that in such a case, the solid carbon produced by the project is not converted to carbon dioxide that is

subsequently released into the atmosphere, and the hydrogen produced is used for an economic purpose and is not wasted. As a result, taxpayers are required to set out the end use of their solid carbon and hydrogen through an "end-use plan" to be included as part of the project's clean hydrogen project plan.

Paragraph (a) requires the taxpayer to set out the expected end uses of any solid carbon produced for the first seven years of hydrogen production, including the quantity and percentage share of solid carbon that is expected to be:

- treated as a waste product and disposed of in a manner that would not lead to any of the carbon being released into the atmosphere (e.g., permanently disposed of in a landfill);
- used for combustion or incorporated into a product intended for combustion (e.g., transformed into coke for an industrial coke furnace);
- used in or incorporated into a product that is not intended for combustion (e.g., incorporated into tires for automobiles); and
- used for any other purpose.

If any solid carbon is expected to be sold during the seven-year "end-use period", paragraph (b) requires the inclusion of copies of any purchase agreements or other arrangements in writing supporting that sale. These agreements or arrangements must set out the expected uses of the solid carbon and allow the taxpayer to have access to information in relation to its actual use by the purchaser.

In respect of hydrogen produced by the project, paragraph (c) requires the end-use plan to include the project's "expected hydrogen use percentage", which generally involves the proportion of total hydrogen produced that is used for an economic purpose (e.g., sold to market or used to produce ammonia).

Paragraph (d) requires the end-use plan to include copies of any purchase agreements or other arrangements in writing supporting the sale of the hydrogen expected to be produced during the project's compliance period.

Finally, paragraph (e) requires the inclusion of any additional information required by guidelines published by the Minister of Natural Resources.

"excluded hydrogen"

The "excluded hydrogen" definition describes certain hydrogen in respect of a clean hydrogen project that should not be factored into the calculation of the project's expected hydrogen use percentage or actual hydrogen use percentage.

Specifically, hydrogen that is (or is expected to be) vented or flared for the purpose of safety or system integrity is always excluded from these calculations under paragraph (a).

In addition, under paragraph (b), where there is a *bona fide* termination of a hydrogen sale agreement or an unplanned change to an existing use of a project's hydrogen, any hydrogen that is vented or flared may be excluded for up to a cumulative maximum period of 180 days during the project's compliance period. Examples of situations where this exclusion could become temporarily available include when a genuine purchaser of a project's hydrogen becomes insolvent or when the project's hydrogen-consuming equipment breaks down.

Although the project may be able to vent or flare hydrogen in the situations described above without affecting its hydrogen use percentages, the effects of the venting and flaring would factor into the project's carbon intensity calculation.

For more information, see the commentary on the "expected hydrogen use percentage" and "actual hydrogen use percentage" definitions.

"excluded property"

"Excluded property" describes property that is ineligible for the clean hydrogen tax credit.

To clarify that electricity and heat generation equipment used in the production of hydrogen through electrolysis of water was not intended to be eligible for the clean hydrogen tax credit, this equipment is added to the list of excluded property as new paragraph (a.1). Depending on the nature of the electricity and heat generation equipment, it could be eligible for the clean technology investment tax credit or the clean electricity investment tax credit instead.

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

As part of the introduction of the pyrolysis pathway, new paragraph (a.2) is added to exclude certain property that may be used in the pyrolysis of eligible hydrocarbons, including property acquired before December 16, 2024 and equipment downstream of the point where hydrogen and solid carbon are separated (specifically, equipment used for the collection, processing, or storage of solid carbon and equipment used for the off-site transmission, transportation, or distribution of solid carbon).

This amendment is deemed to have come into force on December 16, 2024.

"expected hydrogen production"

The "expected hydrogen production" definition describes a clean hydrogen project's expected gross average annual hydrogen production, in tonnes, over the first 20 years of the project's operations.

This definition is relevant for the purpose of the limit on the capital cost of the project's pyrolysis reactor system. For more information, see the commentary on subsection 127.48(10.1).

"expected hydrogen use percentage"

The "expected hydrogen use percentage" definition is relevant where a clean hydrogen project is intended to produce hydrogen from the pyrolysis of eligible hydrocarbons. In general terms, it represents the percentage of the total hydrogen expected to be produced by such a project during the compliance period that is expected to be used for a "qualifying economic purpose". For more information on what constitutes a "qualifying economic purpose", see the commentary on that definition.

The quantity of hydrogen expected to be used for a qualifying economic purpose is also required to be evidenced in the project's clean hydrogen project plan, more specifically by the front-end engineering design study (for hydrogen to be consumed internally) and agreements or other arrangements in writing in the end-use plan (for hydrogen to be sold).

For the calculation, the quantity of "excluded hydrogen" is to be subtracted from both the numerator and the denominator. For more information, see the commentary on the "excluded hydrogen" definition.

This percentage is mainly relevant for the determination of the project's eligibility under new paragraph (d) of the "qualified clean hydrogen project" definition. If the project's expected hydrogen use percentage is below 90%, then the project cannot be confirmed as a qualified clean hydrogen project.

If the expected hydrogen use percentage of a taxpayer's project (as indicated in a revised clean hydrogen project plan) falls below the 90% threshold after the project is confirmed but before its compliance period begins, the project would no longer meet the requirements to be a qualified clean hydrogen project and recovery tax would apply on credit amounts previously deducted. For more information, see the commentary on subsections 127.48(8) and (18).

"Fuel LCA Model"

The "Fuel LCA Model" is the Government of Canada's Fuel Life Cycle Assessment Model. It is a tool that is published and periodically updated by the Minister of the Environment.

This definition is amended to ensure that taxpayers use a version of the Fuel LCA Model that is listed in the latest *Clean Hydrogen Investment Tax Credit – Carbon Intensity Modelling Guidance Document*. This would prevent the use of a version of the Fuel LCA Model if, for example, Environment and Climate Change Canada has determined it contains one or more errors.

For greater certainty, if a taxpayer has already received confirmation from the Minister of Natural Resources that the project is a qualified clean hydrogen project, but the version of the Fuel LCA Model that was used to calculate the project's expected carbon intensity has subsequently been removed from the *Clean Hydrogen Investment Tax Credit – Carbon Intensity Modelling Guidance Document*, the taxpayer may continue to use the same version of the Fuel LCA Model for calculating actual carbon intensity.

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

"ineligible use"

This definition is repealed as it only appears once in paragraph 127.48(6)(d) and the term is already defined in subsection 127.44(1). For more information, see the commentary on subsection 127.48(6).

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

"operating year"

A clean hydrogen project's "average actual carbon intensity" is calculated by reference to the "compliance period" of a project, which is in turn determined by reference to its "operating year". An "operating year" in the context of a clean hydrogen project means a cumulative 365-day period during which the project operates. As a result, any time during which the project is not operating is disregarded in the calculation of a project's operating year.

The "operating year" definition is amended to clarify that a project's operating year and compliance period do not run during the time that the project is not producing hydrogen.

For greater certainty, the operating year would be paused for each full day that hydrogen is not produced. For example, if hydrogen production is paused from midday December 1 until midday December 4, there are two days of shutdown (December 2 and 3) and the project would have two days of operations (December 1 and 4 would both count towards the operating year).

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

"oxygen and nitrogen production equipment"

The new definition "oxygen and nitrogen production equipment" replaces the existing definition "dual-use hydrogen and ammonia equipment".

This new defined term expands the equipment previously described under "dual-use hydrogen and ammonia equipment" to include oxygen and nitrogen production equipment that may be used in hydrogen or ammonia production, as well as processes that indirectly support hydrogen or ammonia production, specifically the on-site production of electricity or heat or a CCUS process.

To qualify under this definition, the equipment must be multi-use, in that the oxygen or nitrogen produced must be used all or substantially all in any combination of at least two of the processes listed in subparagraphs (b)(i) to (iv).

For example, if the project does not use any nitrogen, all or substantially all of the oxygen produced must be used in at least two listed processes to qualify under this definition. If the oxygen produced in this scenario is used solely in the production of hydrogen from eligible hydrocarbons, then the equipment would not be "oxygen and nitrogen production equipment",

but it could still qualify as “eligible clean hydrogen property” under subparagraph (c)(ii) of that definition.

Similarly, if the project does not use any oxygen produced by this equipment, then all or substantially all of the nitrogen produced would need to be used in at least two listed processes to qualify under this definition. If the nitrogen produced is used solely for ammonia production, then the equipment would fall under paragraph (c) of the “clean ammonia equipment” definition.

If the project uses both oxygen and nitrogen, then all or substantially all of either the oxygen or the nitrogen produced must be used in at least two of the listed processes.

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

The following definitions are introduced as part of the addition of the pyrolysis pathway and are deemed to have come into force on December 16, 2024.

“pyrolysis reactor system”

A “pyrolysis reactor system” may be a significant part of a clean hydrogen project that produces hydrogen from the pyrolysis of eligible hydrocarbons.

To better target the clean hydrogen tax credit towards clean hydrogen production rather than the production of solid carbon, the capital cost amount that would be eligible for the credit of the “pyrolysis reactor system” of a clean hydrogen project is limited to $3,000 per tonne of the project’s expected hydrogen production. This limitation is intended to avoid unduly subsidizing projects that make large investments in a pyrolysis reactor system that may produce significant amounts of high-grade solid carbon but do not result in a commensurate amount of clean hydrogen production.

The definition “pyrolysis reactor system” describes the property that would be subject to this limit. Specifically, the system consists of one or more pyrolysis reactors, any equipment that performs the function of a pyrolysis reactor (e.g., off-the-shelf components combined together to perform the function of a reactor) and any equipment that is physically and functionally integrated with the reactor (or with the alternative equipment performing the same function as a reactor).

For greater certainty, each clean hydrogen project can have only one pyrolysis reactor system (i.e., if a project has more than one reactor, all the reactors would be part of one pyrolysis reactor system).

<u>The technical guidance published by the Department of Natural Resources, referred to in subsection 127.48(32), will also apply with respect to engineering and scientific matters in the determination of whether a property is part of a pyrolysis reactor system.</u>

For more information on the capital cost limit, see the commentary on subsections 127.48(10.1) to (10.3).

"qualified clean hydrogen project"

A "qualified clean hydrogen project" is a clean hydrogen project where, after the clean hydrogen project plan in respect of the project is filed with the Minister of Natural Resources, the Minister of Natural Resources has confirmed in writing that the conditions in paragraphs (a) to (c) have been met.

Subparagraph (b)(i) of this definition is amended to clarify that for a project to constitute a "qualified clean hydrogen project", the expected carbon intensity included in the project plan must be less than four. For example, if the expected carbon intensity of the project is deemed to be greater than 4.5 under subsection 127.48(6) (e.g., because the taxpayer is proposing to use an ineligible electricity generation source), then the project cannot become a qualified project.

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

New paragraph (d) is added to this definition to add new conditions that apply to a clean hydrogen project that produces hydrogen from the pyrolysis of eligible hydrocarbons.

In that case, the taxpayer would need to demonstrate that:

- the expected hydrogen production can reasonably be expected to be achieved based on the project design;
- the expected hydrogen use percentage set out in the end-use plan is 90% or greater;
- the project is expected to consume less than 50% of the hydrogen produced during the compliance period; and
- the expectations set out in the end-use plan can reasonably be expected to be achieved.

If a project files a revised clean hydrogen project plan with an expected hydrogen use percentage that is less than 90%, paragraph 127.48(8)(c) may apply to deem that the project is no longer a "qualified clean hydrogen project" and there will be a full recovery of any prior credit amounts claimed.

This amendment is deemed to have come into force on December 16, 2024.

"qualifying economic purpose"

The clean hydrogen tax credit is intended to encourage investments in the production of clean hydrogen and clean ammonia in Canada. To ensure that the tax credit is genuinely targeted towards clean hydrogen production (rather than solid carbon production) in the context of projects using the pyrolysis pathway are introduced, various rules are introduced.

For example, to qualify for the tax credit, a project's "expected hydrogen use percentage" must be 90% or greater, and to avoid the potential recapture of the tax credit, its "actual hydrogen use percentage" must also be 90% or greater. However, to ensure that the hydrogen produced by

such projects is utilized for a *bona fide* economic purpose and is not wasted, both the expected use and the actual use of the hydrogen must be for a "qualifying economic purpose".

The definition sets out two types of qualifying purposes.

First, the hydrogen may be used by the taxpayer for a *bona fide* economic purpose, e.g., supplying energy to the project. However, to prevent projects from using most of the hydrogen produced as an energy source for solid carbon production, a project must be expected to consume less than 50% of the hydrogen to be produced during the compliance period to become a "qualified clean hydrogen project" (under new subparagraph (d)(iii) of that definition) and actually consume less than the 50% threshold during the compliance period. For more information, see the commentary on the "qualified clean hydrogen project" definition and new subsection 127.48(17.1).

Second, the hydrogen may be sold to a purchaser in circumstances where it is reasonable to conclude that the hydrogen will be used for a *bona fide* economic purpose. Uses that would not qualify as a *bona fide* economic purpose include discarding, wasting, venting, or flaring the hydrogen.

"solid carbon"

"Solid carbon" means a product that is in a solid state, contains the chemical element carbon, and is derived from the pyrolysis of eligible hydrocarbons.

This definition is mainly relevant for the purposes of determining a project's carbon intensity, as indicated in the project's "end-use plan" (in relation to expected carbon intensity) and in compliance reports required under subsection 127.48(16) (in relation to actual carbon intensity). For more information, see the commentary on the "end-use plan" definition and subsections 127.48(6) and (16).

Time limit for application

ITA
127.48(4)

Subsection 127.48(4) places a time limit on filing the form necessary to be eligible for the clean hydrogen tax credit.

Currently, the prescribed form claiming the clean hydrogen tax credit must be filed on or before the later of December 31, 2025 and the day that is one year after the taxpayer's filing-due date for the year. Bill C-15 includes an amendment to extend the first deadline to December 31, 2026 for clean hydrogen projects that produce hydrogen from the electrolysis of water or the reforming or partial oxidation of eligible hydrocarbons with carbon dioxide captured using a CCUS process.

As part of the introduction of the pyrolysis pathway, this subsection is further amended to extend the first deadline to December 31, 2027 for pyrolysis projects to allow more time for taxpayers

with such projects to file the prescribed form in respect of acquisitions of eligible clean hydrogen property.

This subsection is also restructured to improve readability.

This amendment is deemed to have come into force on December 16, 2024.

Calculation of carbon intensity

ITA
127.48(6)

Subsection 127.48(6) contains various rules that apply for the purposes of calculating the actual and expected carbon intensities of hydrogen produced and to be produced by a clean hydrogen project of a taxpayer.

Paragraph (6)(a) requires taxpayers to use the most recent Fuel LCA Model at the time of filing of the most recent related clean hydrogen project plan with the Minister of Natural Resources. The same version of the Fuel LCA Model will be used to determine expected and actual carbon intensities, unless the taxpayer elects to use a subsequent version for determining actual carbon intensity.

Consequential to the amendment of the "Fuel LCA Model" definition, paragraph (a) is amended to clarify that the most recent "version of" the Fuel LCA Model (now amended to include a requirement that it is listed in the latest *Clean Hydrogen Investment Tax Credit – Carbon Intensity Modelling Guidance Document*) must be used.

Paragraph (6)(d) provides that, if hydrogen is produced from eligible hydrocarbons, any captured carbon that is subject to an "ineligible use" (as defined in subsection 127.44(1)) is deemed not to be captured.

Paragraph (d) is updated to reflect the repeal of the definition "ineligible use" in subsection 127.48(1).

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

As part of the introduction of the pyrolysis pathway, paragraph (d) is amended to describe the impact of solid carbon produced by a project on the carbon intensity of the project, depending on its end use.

If the solid carbon is treated as a waste product and disposed of in a manner that would not lead to any of the carbon being released into the atmosphere, or if it is converted or incorporated into another product that is not intended for combustion, then it is deemed by subparagraph (d)(iii) to be permanently stored, similar to captured carbon subject to an eligible use.

If the solid carbon is used in any other manner, then it is deemed by subparagraph (d)(iv) to have been converted into carbon dioxide that is released into the atmosphere, similar to captured carbon subject to an ineligible use.

The contribution to expected carbon intensity of the solid carbon is to be weighted based on the aggregate quantity of solid carbon, in kilograms, in each expected use, as described in the project's end-use plan. For more information, see the commentary on the definition "end-use plan".

This amendment is deemed to have come into force on December 16, 2024.

Paragraph (6)(e) describes how electricity generated by the taxpayer or purchased (either from the provincial grid or under an eligible power purchase agreement) and used in connection with a clean hydrogen project is to be taken into account in calculating the carbon intensity of the project.

Clause (e)(i)(B) is amended to remove the requirement for on-site generation equipment using eligible hydrocarbons to have carbon dioxide captured using a CCUS process. This allows for certain equipment that uses fossil fuels (e.g., a hydrogen turbine that requires fossil fuels for startup) to be used as an energy source for the project without clause (D) applying. However, it should be noted that using hydrocarbons as an energy source without a CCUS process would be expected to result in a higher carbon intensity for the project.

Clause (e)(i)(D) is amended to clarify the impact on carbon intensity of the taxpayer generating electricity for the project using an ineligible generation source.

Subclause (D)(I) provides that if the project's compliance period has not started yet, the expected carbon intensity of the project is deemed to be greater than 4.5.

This subclause may apply in two possible scenarios.

First, if an ineligible generation source is included in the taxpayer's initial clean hydrogen project plan, the expected carbon intensity determined in accordance with subsection (6) would not be less than four, so the project could not become a qualified clean hydrogen project.

Second, if the ineligible generation source was not included in the initial plan and the project becomes a qualified clean hydrogen project, but it then starts using an ineligible source prior to the start of the compliance period, then this rule would trigger the requirement to file a revised clean hydrogen project plan under subparagraph 127.48(7)(b)(iii).

Because the compliance period has not started, the taxpayer would have an opportunity to rectify the situation by filing a revised project plan with a new design with respect to the type of electricity to be generated and used.

Subclause (D)(II) provides that if the project's compliance period has commenced, the average actual carbon intensity of the project is deemed to be greater than 4.5 and the taxpayer will be

subject to recovery tax under subsection (18) as if the compliance period of the project had ended. There are no further opportunities to rectify this situation, and the recovery tax would be equal to the full amount of any prior credits claimed (adjusted for prior recapture amounts payable).

New subparagraph (e)(ii.1) is added to address the situation where a taxpayer purchases electricity that is generated from an eligible generation source, but not pursuant to an eligible power purchase agreement (e.g., from a source that does not meet the additionality or geographic requirements). The contribution of this electricity to the project's carbon intensity would be calculated as the higher of the input carbon intensity of the technology-specific electricity and that of the provincial grid in the Fuel LCA Model.

Subparagraph (e)(iv) is also added to describe the impact of the taxpayer using electricity from a source that is not described in any of subparagraphs (i) to (iii).

Similar to clause (e)(i)(D), subparagraph (e)(iv) provides that the expected carbon intensity of the project is deemed to be greater than 4.5 if the project's compliance period has not yet commenced (the taxpayer would have an opportunity to rectify the situation by filing a revised project plan with a new design), and if the compliance period has commenced, then the project's average actual carbon intensity of the project is deemed to be greater than 4.5 and the taxpayer will be subject to recovery tax under subsection (18) as if the compliance period of the project had ended.

Paragraph (6)(h) is also amended to apply the same deeming rules in respect of the disposal of environmental attributes. If a taxpayer disposes of any environmental attributes in respect of electricity or eligible renewable hydrocarbons used by its clean hydrogen project, the project's expected carbon intensity or average actual carbon intensity would be deemed to be greater than 4.5, based on the timing of the disposal (before or after the start of the compliance period). This rule is subject to the exception described in paragraph 127.48(6.1)(a) for the retirement of environmental attributes.

Paragraph (6)(i) describes how certain types of eligible heat used in connection with hydrogen production or electricity production in support of a clean hydrogen project are to be taken into account in calculating the carbon intensity of the project.

If the heat source is not described in one of the categories listed in subparagraph (i)(i) or (ii), then, similar to clause (e)(i)(D), subparagraph (e)(iv), and paragraph (h), the expected carbon intensity of the project is deemed to be greater than 4.5 if the project's compliance period has not yet commenced (the taxpayer would have an opportunity to rectify the situation by filing a revised project plan with a new design), and if the compliance period has commenced, then the project's average actual carbon intensity of the project is deemed to be greater than 4.5 and the taxpayer will be subject to recovery tax under subsection (18) as if the compliance period of the project had ended. This is to ensure that clean hydrogen projects do not use heat produced from an ineligible source (e.g., heat produced from burning coal).

The amendments to paragraphs (6)(e), (h), and (i) are deemed to have come into force on March 28, 2023.

Paragraph (6)(k) provides that the emissions related to certain products of the hydrogen production process are to be attributed to the production of hydrogen.

As part of the introduction of the pyrolysis pathway, solid carbon (other than solid carbon used in or incorporated into a product that is not intended for combustion) is added to the list of products referred to in paragraph (k).

Projects that convert or incorporate their solid carbon into a product that is not intended for combustion would be able to allocate project emissions between the hydrogen and solid carbon co-product.

Subparagraph (k)(v) is deemed to have come into force on December 16, 2024.

Environmental attribute certificates

ITA
127.48(6.1)

Subsection 127.48(6.1) is added to address two issues relating to environmental attribute certificates.

First, paragraph (6.1)(a) clarifies that the retirement of environmental attribute certificates to the appropriate provincial authority would not be a "disposition" of environmental attributes (i.e., when a taxpayer retires the certificate to indicate that the environmental attributes associated with the electricity or eligible renewable hydrocarbons have been claimed). This is relevant for the purposes of paragraphs 127.48(6)(h) and (7)(d), which apply when a taxpayer disposes of environmental attributes associated with its clean hydrogen project.

Second, to prevent taxpayers from holding environmental attribute certificates only to sell them after the compliance period ends, paragraph (6.1)(b) creates a deemed disposition of environmental attributes if the relevant certificates associated with electricity or eligible renewable hydrocarbons used by the project during its compliance period are not retired before the filing of the compliance report in respect of the project's fifth operating year.

To prevent this deemed disposition from applying, taxpayers may retire the relevant certificates prior to obtaining the verification report at the end of the compliance period so that the retirement can be verified by the qualified verification firm.

This subsection is deemed to have come into force on December 16, 2024.

Changes to clean hydrogen project

ITA
127.48(7)

Subsection 127.48(7) sets out various situations where subsection 127.48(8) would apply in respect of a clean hydrogen project of a taxpayer. Each case would only arise before the first day of the compliance period of the project.

Paragraph (7)(d) is amended to ensure that subsection 127.48(8) applies when the taxpayer disposes of environmental attributes in respect of electricity purchased under an eligible power purchase agreement or in respect of eligible renewable hydrocarbons.

Paragraph (7)(e) is added to make it clear that taxpayers may voluntarily file a revised project plan by notifying the Minister of Natural Resources in writing. This allows for projects to improve their expected carbon intensity before the start of the compliance period in respect of property that becomes available for use after the confirmation of the revised plan. For more information, see the commentary on subsection 127.48(8).

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

As part of the introduction of the pyrolysis pathway, subsection 127.48(7) is amended to add paragraph (d.1), describing certain specific situations where subsection 127.48(8) would apply. This includes when the taxpayer reasonably expects a decrease (as compared to the most recent project plan for the project) to the project's expected hydrogen production and when an agreement for the sale of solid carbon or hydrogen referenced in the taxpayer's most recent end-use plan has not been finalized and executed or has been materially modified or terminated.

Paragraph (d.1) is deemed to have come into force on December 16, 2024.

Rules relating to revised project plan

ITA
127.48(8)

Subsection 127.48(8) contains several rules that apply after one of the events described in subsection 127.48(7) occurs.

Subparagraphs (8)(b)(ii) and (iii) are amended to clarify the treatment of clean hydrogen tax credits previously deducted or to be claimed when a revised clean hydrogen project plan is filed and subsequently confirmed.

If the taxpayer had previously deducted a clean hydrogen tax credit in respect of the project, the amount of the prior credit shall not be increased if there is a downward adjustment to the project's expected carbon intensity. If the project's expected carbon intensity increases, subsection 127.48(18) applies to add to the taxpayer's tax payable an amount equal to the difference between the credit claimed and the amount that would be the credit amount based on the revised expected carbon intensity.

Any new credits determined on or after the date that the Minister of Natural Resources confirms the revised plan would be based on the expected carbon intensity set out in the revised plan, regardless of whether the revised expected carbon intensity is higher or lower. This would allow for taxpayers to access a higher credit tier for newly acquired property if there are design improvements in the revised plan.

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

As part of the introduction of the pyrolysis pathway, certain pyrolysis-specific references are added to paragraph (8)(b), specifically clause (8)(b)(ii)(C) and subparagraph (8)(b)(iii).

If the revised plan contains a decrease to the pyrolysis project's expected hydrogen production that decreases the pyrolysis reactor system capital cost limit, subsection 127.48(10.3) would apply to recapture all or a portion of credits previously deducted.

If there is a decrease to the project's expected hydrogen use percentage to below 90%, the Minister of Natural Resources would be unable to confirm the revised plan and paragraph (8)(c) would apply.

As with expected carbon intensity, any new credits determined on or after the date that the Minister of Natural Resources confirms the revised plan would be based on the expected hydrogen production set out in the revised plan.

Amendments in respect of the pyrolysis pathway are deemed to have come into force on December 16, 2024.

Clean hydrogen project determination and rules

ITA
127.48(9)

Subsection 127.48(9) contains various rules that apply to clean hydrogen projects.

Paragraph (9)(e) empowers the Minister of Natural Resources to request any necessary documentation or information.

Paragraph (e) is reorganized into paragraphs (e) and (f) to address the situation where certain information is not yet available when the request is made and is still not available 180 days later, or where the information becomes available after a project is confirmed by the Minister of Natural Resources (*e.g.*, a finalized and legally binding power purchase agreement). Under amended paragraph (e), the taxpayer is required to submit the requested information by the later of the day that is 180 days after the information was requested and 60 days after the information becomes available.

New paragraph (9)(f) provides that if the taxpayer fails to provide the requested information in accordance with paragraph (e), the Minister of Natural Resources may refuse to confirm the taxpayer's clean hydrogen project plan or revised clean hydrogen project plan, and any general penalties under the Act in respect of the failure may also apply.

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

Capital cost of clean hydrogen property

ITA
127.48(10)

Subsection 127.48(10) contains several rules relating to the determination of the capital cost of eligible clean hydrogen property for the purpose of section 127.48.

Paragraph (10)(g) allocates the cost of certain property that is used in both hydrogen and ammonia production between two separate capital cost categories that would be subject to two different specified percentages.

Paragraph (g) is amended to refer to the new defined term "oxygen and nitrogen production equipment" and to clarify that, similar to paragraph (10)(f), this allocation is also based on expected use of the equipment over the first 20 years of the clean hydrogen project's operations, as indicated in the project's most recent clean hydrogen project plan.

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

Maximum capital cost of pyrolysis reactor system

ITA
127.48(10.1)

As part of the introduction of the pyrolysis pathway, new subsection 127.48(10.1) implements a "cap" on the capital cost of a pyrolysis reactor system that may be eligible for the clean hydrogen tax credit.

Paragraph (a) deems the aggregate capital cost of the system to be the lesser of two amounts: (i) the amount of the limit, and (ii) the aggregate capital cost of all eligible clean hydrogen property forming part of the system determined without reference to this subsection.

The limit in subparagraph (a)(i) is determined by the formula A × B, where variable A is $3,000 and variable B is the project's expected hydrogen production (in tonnes) set out in the project's most recent clean hydrogen project plan.

Paragraph (b) sets out a formula to determine the capital cost of the property that, when acquired, would make the aggregate capital cost of the system exceed the limit determined under subparagraph (a)(i). For the purposes of determining the taxpayer's clean hydrogen tax credit in

respect of this particular property, the capital cost of the property is deemed to be equal to the difference between the limit and the aggregate capital cost of all other property forming part of the system.

Paragraph (c) applies after paragraph (b) has applied (subject to subsection 127.48(10.2), if the limit increases) and states that the capital cost of any new property added to the system would be deemed to be nil.

This subsection is deemed to have come into force on December 16, 2024.

Example

A taxpayer with a clean hydrogen project following the methane pyrolysis pathway acquires a pyrolysis reactor with a capital cost of $2.5 million. The expected hydrogen production contained in the project's clean hydrogen project plan is 1,000 tonnes.

According to subparagraph (10.1)(a)(i), the pyrolysis reactor system's capital cost limit would be $3 million ($3,000 × 1,000 tonnes).

Since the aggregate capital cost of the system is currently at $2.5 million, paragraphs (10.1)(b) and (c) do not apply at this time.

The project then adds a new component part to the system (without changing the project's expected hydrogen production). The part has a capital cost of $600,000.

Because the aggregate capital cost of the system determined without reference to subsection (10.1) is now $3,100,000 ($2,500,000 + $600,000), paragraph (b) will then apply to deem the capital cost of the new part to be $500,000 ($3,000,000 – $2,500,000).

Now that paragraph (b) has applied, subject to future increases in the project's expected hydrogen production, paragraph (c) will deem the capital cost of all future acquisitions forming part of the pyrolysis reactor system to be nil.

Increase to capital cost limit

ITA
127.48(10.2)

New subsection 127.48(10.2) applies if the project's expected hydrogen production increases, which then increases the "cap" amount determined under subparagraph (10.1)(a)(i) in respect of a pyrolysis reactor system.

The treatment of this change is similar to the treatment of a decrease to a project's expected carbon intensity, where the increased limit applies only to property acquired after the date of the confirmation by the Minister of Natural Resources of the revised clean hydrogen project plan containing the increased expected hydrogen production.

Example

A clean hydrogen project following the methane pyrolysis pathway acquires a pyrolysis reactor with a capital cost of $3.5 million. The expected hydrogen production contained in the project's clean hydrogen project plan is 1,000 tonnes.

Under subsection (10.1), the capital cost of the reactor is deemed to be $3,000,000 ($3,000 × 1,000 tonnes) and the taxpayer claims a clean hydrogen tax credit for that year.

In a subsequent year before the start of the project's compliance period, the taxpayer submits a revised clean hydrogen project plan with a higher expected hydrogen production of 2,000 tonnes. The revised plan is confirmed by the Minister of Natural Resources in the same year. As a result, the system capital cost limit increases to $6,000,000 ($3,000 × 2,000 tonnes).

The first reactor would not be eligible for additional credit amounts, but if the taxpayer acquires another piece of property that is part of the pyrolysis reactor system after the confirmation, the new property would have an eligible capital cost of up to $3,000,000.

Pyrolysis system recapture – decrease in expected production

ITA
127.48(10.3)

New subsection 127.48(10.3) imposes a recapture tax if there is a decrease in a project's expected hydrogen production before the project's compliance period begins. If this is the case, the taxpayer will be required to file a revised clean hydrogen project plan under subsection 127.48(7).

The tax payable is determined by the formula [1 – (A ÷ B)] × C.

Variable A is the aggregate capital cost amount determined under paragraph (10.1)(a) using the expected hydrogen production included in the revised plan.

Variable B is the aggregate capital cost amount determined under paragraph (10.1)(a) using the expected hydrogen production used to determine the most recent clean hydrogen tax credit in respect of all property forming part of the system.

If there has been a sale or disposition of property forming part of the system before the filing of the revised plan, and the aggregate capital cost of the remaining property in the system (the aggregate of all such property's deemed capital cost determined under paragraph (22.1)(a)) is less than the amount determined under variable A (and the formula produces a negative number), there will be no recapture under subsection (10.3).

Variable C is the total clean hydrogen tax credit amount deducted in respect of all property forming part of the system.

Example

A taxpayer with a clean hydrogen project following the methane pyrolysis pathway acquires a pyrolysis reactor with a capital cost of $3.5 million. The expected hydrogen production contained in the project's initial clean hydrogen project plan is 1,000 tonnes, so the aggregate capital cost for the system determined under paragraph (10.1)(a) would be $3 million ($3,000 × 1,000 tonnes).

The project qualifies for the 25% credit rate, and the taxpayer claims $750,000 of clean hydrogen tax credits ($3 million capital cost × 25% specified percentage).

If the project's expected hydrogen production later decreases to 500 tonnes, the aggregate capital cost determined under paragraph (10.1)(a) would then be $1.5 million ($3,000 × 500 tonnes).

Under subsection (10.3), the recapture tax would be $375,000 ([1 – ($1.5 million ÷ $3 million)] × $750,000).

Compliance – annual carbon intensity reporting

ITA
127.48(16)

Subsection 127.48(16) sets out the requirement for a taxpayer that has deducted a clean hydrogen tax credit in respect of a qualified clean hydrogen project to file a compliance report containing certain information in respect of each operating year.

Paragraph (16)(c) is amended to clarify that the shutdown time to be included in each compliance report would be the time during which the project does not produce hydrogen.

Similar to the amendment to the "operating year" definition, this clarification seeks to align the project's shutdown time with the shutdown of hydrogen production, as the average actual carbon intensity of a project is based on the quantity of hydrogen produced in each operating year.

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

Subsection 127.48(16) is also amended as part of the introduction of the pyrolysis pathway to add a requirement to include in each compliance report the end use of the solid carbon produced by the project during the operating year.

In addition, the report to be prepared by a qualified verification firm and filed in respect of the final operating year must verify the project's actual hydrogen use percentage at the end of the compliance period and the end use of the solid carbon produced by the project during each operating year.

This amendment is deemed to have come into force on December 16, 2024.

Pyrolysis recapture – end of compliance period

ITA
127.48(17.1)

New subsection 127.48(17.1) describes the consequences where a qualified clean hydrogen project has failed to meet the expectations set out in subparagraph (d)(ii) or (iii) of the "qualified clean hydrogen project" definition at the end of the compliance period.

In particular, if the project's actual hydrogen use percentage is less than 90%, or if the project consumed 50% or more of the hydrogen produced during the compliance period, the average actual carbon intensity of the project is deemed to be greater than 4.5.

Subsection 127.48(18) will then apply to impose a recovery tax for the entire amount of any clean hydrogen tax credits deducted by the taxpayer.

This subsection is deemed to have come into force on December 16, 2024.

Recovery – change in carbon intensity

ITA
127.48(18)

Subsection 127.48(18) may require a taxpayer to pay a recovery tax if, at the end of the compliance period of its qualified clean hydrogen project, the project's average actual carbon intensity is higher than the most recent expected carbon intensity that was used to determine a clean hydrogen tax credit amount in respect of the project.

As part of the introduction of the pyrolysis pathway, subsection (18) is amended by updating variable C and adding a new variable D to the formula, making the formula (A – B) × C – D. This formula is applied to each eligible clean hydrogen property forming part of the project.

Variable C is generally the capital cost amount on which the clean hydrogen tax credit was deducted. Variable C is amended to provide that if the property is part of a pyrolysis reactor system and the aggregate capital cost of the system was capped under subsection (10.1), this amount would be the amount determined under paragraph (22.1)(a) (based on the proportion of the cost of the particular property compared to the aggregate capital cost of the system).

Variable D is added to adjust for the portion of any recapture tax previously payable by the taxpayer in respect of the property due to subsection (22) in respect of the property.

These amendments are deemed to have come into force on December 16, 2024.

Recapture of clean hydrogen tax credit

ITA
127.48(22)

Subsection 127.48(22) provides that, where recapture applies in respect of an eligible clean hydrogen property, a taxpayer is required to add to the tax otherwise payable for the year the amount determined by the formula (A – B) × (C ÷ D).

Variable B represents the portion of any recovery tax previously paid by the taxpayer in respect of the property due to subsection 127.48(18).

Variable B is amended to adjust for amounts that are payable by the taxpayer under subsection (18), so that the amount of recapture tax under this subsection can be determined when the tax becomes payable under subsection (18) (without having to track the timing of actual payment). This change would be consistent with new variable D in subsection (18).
This amendment is deemed to have come into force on December 16, 2024.

Recapture — pyrolysis reactor system

ITA
127.48(22.1)

Subsection 127.48(22.1) provides that for the purposes of determining recapture or recovery tax under subsections (10.3), (18), (21), and (22), if subsection (10.1) has applied to limit the capital cost of any property forming part of a pyrolysis reactor system, the capital cost and any clean hydrogen tax credits claimed in respect of the system will be allocated among all property forming part of the system.

Under paragraph (a), the capital cost amount of each property forming part of the system is deemed to be the amount determined by the formula A × (B ÷ C).

Variable A is the limit amount determined in respect of the system under paragraph (10.1)(a).

Variable B is the capital cost of the property determined without reference to subsection (10.1) and this subsection.

Variable C is the aggregate capital cost of all property forming part of the system, also determined without reference to subsection (10.1) and this subsection.

Under paragraph (b), the clean hydrogen tax credit amount in respect of the property is deemed to be the amount determined by the formula D × E, where variable D is the capital cost amount in respect of the property determined under paragraph (a) and variable E is the specified percentage that was applied to the property.

This subsection seeks to apply a proportionate recovery or recapture tax on all property forming part of a pyrolysis reactor system when the initial credit amount was limited for certain property within the system.

This subsection is deemed to have come into force on December 16, 2024.

Example

Facts

- A taxpayer has a clean hydrogen project expected to produce hydrogen through the pyrolysis of eligible hydrocarbons.
- The project's initial clean hydrogen project plan is first filed in 2026 and includes the following details:
    - The project's expected carbon intensity is 0.5;
    - The project's expected hydrogen use percentage is 95%; and
    - The project's expected hydrogen production is 1,000 tonnes.
- The project meets all other eligibility requirements, including the labour requirements in section 127.46.
- The taxpayer acquires two pyrolysis reactors with an aggregate capital cost of $5 million ($2.5 million each) and other pieces of eligible clean hydrogen property with an aggregate capital cost of $3 million.
    - The other pieces of eligible clean hydrogen property are not clean ammonia equipment or property that would be subject to paragraph 127.48(10)(f) or (g).
    - All the equipment becomes available for use in 2027.
- The project first produces hydrogen in 2027, and the taxpayer files both elections to delay the "first day of the compliance period" in respect of the project by two years.
- In 2028, the project sells one of the pyrolysis reactors to an arm's length purchaser for proceeds of $2 million.
- In 2029, and before the first day of the compliance period for the project, the taxpayer files a revised clean hydrogen project plan with a revised expected hydrogen production of 400 tonnes.
- After the project's compliance period ends in 2034, the project's actual hydrogen use percentage is 90% and actual carbon intensity is 1.5.

Analysis

<u>Pyrolysis reactor system capital cost</u>
The two pyrolysis reactors form one pyrolysis reactor system, so subsection (10.1) will apply to limit the aggregate capital cost of the system.

The limit on the aggregate capital cost amount in respect of the pyrolysis reactor system would be $3,000 × 1,000 tonnes = $3 million, as determined under paragraph (10.1)(a).

Since the capital cost of the two pyrolysis reactors is $5 million, the aggregate capital cost of the system would be limited to $3 million for the purposes of determining the taxpayer's clean hydrogen tax credit.

Clean hydrogen tax credit

The expected hydrogen use percentage is 95%, so the project would meet the requirement in subparagraph (d)(ii) of the "qualified clean hydrogen project" definition.

With an expected carbon intensity of 0.5, the applicable specified percentage would be 40%.

For the 2027 taxation year, the taxpayer claims a clean hydrogen tax credit equal to $2.4 million [40% × ($3,000,000 in respect of the pyrolysis reactor system + $3,000,000 in respect of other eligible clean hydrogen property)].

Recapture and recovery

For the 2028 taxation year, one of the pyrolysis reactors was sold, so there will be a recapture under subsection (22). In this case, subsection (22.1) would also apply to allocate a proportional capital cost and credit amount to the reactor.

Under paragraph (22.1)(a), the deemed capital cost for the purpose of determining the recapture amount would be $1.5 million [$3 million × ($2.5 million ÷ $5 million)].

Under paragraph (22.1)(b), the deemed clean hydrogen tax credit amount in respect of the reactor would be $600,000 ($1,500,000 × 40%).

The recapture tax under subsection (22) would then be $600,000, as determined by the formula (A – B) × (C ÷ D):

- Variable A: $600,000;
- Variable B: nil, as there have been no recovery amounts payable;
- Variable C: the taxpayer received proceeds of $2 million, but since this amount exceeds the amount determined for variable D, variable C would be equal to variable D ($1.5 million)
- Variable D: $1.5 million

For the 2029 taxation year, subsection (10.3) would apply due to the project's expected hydrogen production decreasing from 1,000 tonnes to 400 tonnes. As a result, the aggregate capital cost determined under paragraph (10.1)(a) would then become $1.2 million ($3,000 × 400 tonnes).

Because only one pyrolysis reactor remains in the system, variable C of subsection (10.3) would be determined based on the clean hydrogen tax credit amount deducted in respect of the remaining reactor.

Under subsection (10.3), the recapture amount would be $120,000 [1 – ($1.2 million ÷ $1.5 million)] × (40% × $1.5 million)].

At the end of the compliance period, subsection (18) would apply to each property as follows:

Property	Application of subsection (18) (A − B) × C – D	Recovery tax amount under subsection (18)
Pyrolysis reactor #1 (sold in 2028)	(40% – 25%) × $1,500,000 – $600,000	0 (negative)
Pyrolysis reactor #2	(40% – 25%) × $1,200,000	$180,000
Other eligible clean hydrogen property	(40% – 25%) × $3,000,000 – 0	$450,000
Total recovery under subsection (18)		$630,000

The total amount recaptured would be $1,350,000 ($600,000 + $120,000 + $630,000).

Recovery and recapture – partnerships

ITA
127.48(25)

When a member of a partnership has claimed a clean hydrogen tax credit in respect of a project allocated to it by a partnership under subsection 127.48(12), subsection 127.48(25) provides that subsections 127.48(18) to (23) apply to determine amounts in respect of the partnership as if it were a taxable Canadian corporation and as if the deemed corporation had claimed all the clean hydrogen tax credits that were claimed by any member of the partnership.

As part of the introduction of the pyrolysis pathway, subsection 127.48(25) is amended to add references to new subsections 127.48(10.3) and (17.1) so that any recapture tax applicable under those provisions apply to partnerships in the same way as subsections (18) to (23).

New subsection 127.48(22.1) (as well as amendments to existing subsections (18) and (22)) also apply to partnerships in the same manner.

This amendment is deemed to have come into force on December 16, 2024.

Credit after compliance period

ITA
127.48(30)

Subsection 127.48(30) provides rules for the purpose of determining a clean hydrogen tax credit for eligible clean hydrogen property acquired after the compliance period of a qualified clean hydrogen project.

As part of the introduction of the pyrolysis pathway, subsection (30) is split into paragraphs (a) and (b), where paragraph (a) contains the existing rule with respect to expected carbon intensity, and new paragraph (b) provides that if the project produces hydrogen under the pyrolysis pathway, the expected hydrogen use percentage of the project is deemed to be equal to the actual hydrogen use percentage of the project.

This amendment is deemed to have come into force on December 16, 2024.

Authority of the Minister of Natural Resources

ITA
127.48(32)

Subsection 127.48(32) gives the Department of Natural Resources the authority to publish technical guidance that will apply conclusively with respect to engineering and scientific matters, for the purpose of determining whether a property is an eligible clean hydrogen property.

As part of the introduction of the pyrolysis pathway, subsection (32) is amended to add that this technical guidance will also apply for the purpose of determining whether a property is part of a pyrolysis reactor system.

This amendment is deemed to have come into force on December 16, 2024.

Investment Tax Credit for Carbon Capture, Utilization and Storage

Clause 1

Definitions

ITA
127.44(1)

"*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 subsection (13).

Paragraph (b) of this definition is amended to also refer to a "portion of a jurisdiction" and to new subsection (13.1), which creates an ability for the Minister of the Environment to designate a specific geographic area or geological formation in a jurisdiction, instead of designating the entire jurisdiction. For more information, see the commentary on new subsection 127.44(13.1).

This amendment applies on or after January 1, 2022.

"*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 any of paragraphs (a) to (d) of the definition. In addition, in the case of property acquired before

the first day of commercial operations of the CCUS project, the equipment must be verified by the Minister of Natural Resources as being dual-use equipment.

In general terms, to qualify as “dual-use equipment” under subparagraph (a)(i) of the definition, the equipment must generate electrical energy, heat energy or a combination of electrical or heat energy, if more than 50% of either the electrical energy or heat energy that is expected to be produced over the total CCUS project review period, based on the most recent project plan, is expected to directly support a qualified CCUS project or a qualified clean hydrogen project.

Subparagraph (a)(i) is first amended to improve readability and clarify, for greater certainty, that the 50% test may be met through a combination of direct support of a qualified CCUS project and direct support of a qualified clean hydrogen project.

This subparagraph is also amended to provide an exception to the requirement for carbon dioxide emitted by equipment using fossil fuels to be subject to capture by a qualified CCUS project. Currently, because generation equipment using any amount of fossil fuels would be ineligible if the associated emissions were not subject to capture by a qualified CCUS project, certain equipment that would need to emit a small amount of carbon dioxide for startup purposes (e.g., a hydrogen turbine that requires fossil fuels for start-up) may not be eligible. As amended, this equipment would be eligible if fossil fuels were used solely to start up the equipment and for no more than 72 hours per calendar year.

These amendments apply on or after January 1, 2022.

“*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 subsection (4) and CCUS refurbishment tax credit under 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).

In general terms, variable A, in its paragraph (a), includes the capital cost to the taxpayer of certain property acquired by the taxpayer in the year that is used for, or related to, the capture aspect of a CCUS project. In paragraph (b), variable A also includes a portion of the capital cost of "dual-use equipment". The included portion as a qualified carbon capture expenditure is the proportion that the output from the dual-use equipment that is expected to be used in a CCUS project is of total output over the period of the project's "total CCUS project review period".

If the equipment is energy generation equipment described in subparagraph (a)(i) of the “dual-use equipment” definition, the proportion of the capital cost of the equipment that is to be included under subparagraph (b)(i) of variable A is the proportion that the amount of energy expected to be produced for use in a qualified CCUS project over the project's total CCUS project review period is of the total amount of energy expected to be produced by the equipment in that period based on the project's most recent project plan.

Subparagraph (b)(i) of variable A is amended to clarify that the amount of energy expected to be produced for use in a qualified CCUS project must be used directly in a qualified CCUS project. For greater certainty, this means that any energy transmitted by way of an electrical utility grid would be excluded.

This amendment applies on or after January 1, 2022.

"*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 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.

This definition is amended to broaden the scope of storage processes that may qualify to include any process by which carbon dioxide is incorporated into concrete, as opposed to only by injection.

This amendment applies on or after January 1, 2022.

Special rules — adjustments

ITA
127.44(9)

New paragraph 127.44(9)(j) is a relieving rule. It provides that once captured carbon dioxide has been stored in "dedicated geological storage" (as defined in subsection 127.44(1)), if the carbon dioxide is released into the atmosphere for bona fide reasons outside the control of the taxpayer, this will not be considered to be an ineligible use of the captured carbon dioxide. It is deemed to be used in an eligible use at the time of the release and all subsequent times.

This amendment applies on or after January 1, 2022.

Designation of specific formations

ITA
127.44(13.1) and (13.2)

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 generally 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.

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. 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.

Subsection (14.1) addresses certain situations where a geological formation either begins to be "dedicated geological storage" (e.g., because its jurisdiction is newly designated under subsection 127.44(13)) or ceases to be "dedicated geological storage" because it does not meet either of paragraphs (a) or (c) of that definition at the time of an expenditure that might otherwise qualify for a CCUS tax credit (i.e., the geological formation is either located in a jurisdiction that is not, at that time, a "designated jurisdiction" or it is not authorized or regulated under the laws of a designated jurisdiction).

In some cases, there may be multiple geological formations in a particular jurisdiction and a separate regulatory framework could apply to each. New subsection (13.1) enables the Minister of the Environment to designate a specific geological formation in the jurisdiction or geographic area of the jurisdiction, instead of designating all (or none) of the jurisdiction. For this purpose, the basic designation rule will apply, with such modifications as the circumstances require.

Similarly, new subsection (13.2) provides that subsections (14) (revocation) and (14.1) (effect of jurisdiction not being designated) also apply, with such modifications as the circumstances require, in circumstances involving the designation of a portion of jurisdiction pursuant to new subsection (13.1).

This amendment applies on or after January 1, 2022.

Clause 2

Class 57

ITR
Schedule II

Class 57 in Schedule II describes certain property that is part of a CCUS project. Generally, such property includes equipment that is to be used solely for capturing carbon dioxide, to prepare or compress captured carbon for transportation, for transporting captured carbon or for storage of captured carbon in a geological formation.

Currently, because generation equipment using any amount of fossil fuels would be ineligible for inclusion in Class 57 if the associated emissions were not subject to capture by a qualified CCUS project, certain equipment that would need to emit a small amount of carbon dioxide for startup purposes (e.g., a hydrogen turbine that requires fossil fuels for start-up) may not be eligible.

Subparagraph (a)(iii) of Class 57 is amended to provide an exception to the requirement for carbon dioxide emitted by generation equipment using fossil fuels to be subject to capture by a qualified CCUS project. Under the exception, this equipment would be eligible if fossil fuels were used solely to start up the equipment and for no more than 72 hours per calendar year.

This amendment applies on or after January 1, 2022.

Tax Deferral Through Tiered Corporate Structures

Clause 1

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. For certain enumerated purposes, this paragraph provides that the corporation formed as the result of an amalgamation under subsection 87(1) is considered to be the same corporation as, and a continuation of, each predecessor corporation. These continuity rules also apply in the context of a winding-up to which subsection 88(1) applies because of paragraph 88(1)(e.2).

Paragraph 87(2)(j.6) is amended to add references to new subsections 129(1.3) to 129(1.32). Briefly, under these new subsections, a dividend refund that a private corporation is otherwise entitled to receive in a taxation year under subsection 129(1) upon paying a taxable dividend to another affiliated corporation is suspended until a later taxation year if the affiliated corporation has a staggered year-end.

In general terms, this amendment ensures that new subsections 129(1.3) to 129(1.32) may continue to apply properly:

- where a private corporation (or a subject corporation within the meaning assigned by subsection 186(3)) that has a suspended dividend refund merges with another corporation to form an amalgamated corporation under subsection 87(1) or is wound-up into another corporation under subsection 88(1), or
- where an affiliated corporation that has received a taxable dividend from the private corporation or subject corporation merges with another corporation to form an amalgamated corporation under subsection 87(1) or is wound-up into another corporation under subsection 88(1).

This amendment applies to taxation years beginning on or after November 4, 2025.

Clause 2

Dividends deemed not to be taxable dividends

ITA
129(1.2)

Subsection 129(1.2) is an anti-avoidance rule that is intended to support the normal operation of subsection 129(1). Subsection 129(1) is part of the system for integrating the taxes paid on investment income by a private corporation and the taxes paid by the shareholders on the subsequent distribution of that income.

Subsection 129(1.2) is designed to prevent a corporation from structuring arrangements to obtain a dividend refund without the related shareholder tax being paid. The arrangements involve a dividend that is paid on a share of the capital stock of a corporation, and the share (or a substituted share) acquired by its holder as part of a transaction or series of transactions one of the purposes of which was to enable the corporation to obtain a dividend refund. When the rule applies, the taxable dividend is deemed not to be a taxable dividend for the purpose of subsection 129(1).

Notably, the rule can apply to arrangements where shares with high redemption value but low paid-up capital are issued by a corporation to accommodating tax-exempt entities or corporations that are not subject to tax on taxable dividends received on a subsequent share redemption if one of the main purposes of the transaction or series was to obtain a dividend refund for the issuer corporation.

Subsection 129(1.2) is amended to add a reference to new subsections 129(1.3) to (1.32). In general terms, these new subsections seek to prevent the deferral of the tax otherwise payable by a private corporation on investment income. When new subsection 129(1.3) applies, a dividend refund to which the dividend payer could otherwise be entitled is denied and may be released in a subsequent taxation year in which subsection (1.32) applies.

This amendment applies to dividends paid in taxation years beginning on or after November 4, 2025.

Staggered year-ends – dividend refund suspension

ITA
129(1.3)

New subsection 129(1.3) prevents the deferral of the refundable taxes on investment income otherwise payable by a private corporation or subject corporation under Parts I and IV using corporations with staggered taxation year-ends within an affiliated group.

Subsection 129(1.3) prevents a corporation from obtaining a dividend refund under subsection 129(1) in a taxation year upon the payment of a taxable dividend to an affiliated private corporation or subject corporation with a balance-due day for its taxation year in which the dividend was received that is after the balance-due day for the taxation year of the payer corporation in which the dividend was paid. In such a case, the taxable dividend paid by the

payer corporation is deemed not to be a taxable dividend for the purpose of subsection 129(1), effectively denying a dividend refund to the payer corporation in respect of that dividend. This deeming rule applies to the dividend payer only; accordingly, the taxable dividend keeps its character in the hands of the dividend payee.

The dividend payer could be entitled to a release of the suspended dividend refund in a subsequent taxation year if the affiliated payee corporation pays a taxable dividend during that taxation year in circumstances provided under new subsection 129(1.32). For more information, see the commentary on subsection (1.32).

Subsection 129(1.3) does not apply to dividends to which paragraphs 55(3)(a) or (b) apply in the course of a reorganization, or if one of the exclusions under new subsection 129(1.31) applies.

Example 1 – Application of subsection 129(1.3)

Investco and Holdco are private corporations. Holdco is the sole shareholder of Investco. Both corporations are affiliated.

Investco has a December 31 year-end and Holdco has a November 30 year-end.

Investco receives a $1,000 portfolio dividend in its 2026 taxation year from a corporation with which it is not connected and reinvests the dividend proceeds in marketable securities. Investco is subject to a $383 refundable tax under Part IV which is due by Investco's balance-due day for its 2026 taxation year (February 28, 2027). The $383 Part IV tax is included in Investco's NERDTOH at the end of its 2026 taxation year.

On December 31, 2026, Investco pays a $1,000 taxable dividend by issuance of a promissory note to Holdco. Holdco has received Investco's $1,000 taxable dividend during its 2027 taxation year. Holdco does not pay any taxable dividends in its 2027 taxation year.

Absent new subsection 129(1.3):

- *Investco would be entitled to obtain a dividend refund equal to its Part IV tax liability for its 2026 taxation year, resulting in no Part IV tax payable for the year.*
- *Holdco would have to pay $383 of refundable tax under Part IV on the $1,000 taxable dividend received on December 31, 2026. The tax would be payable by its balance-due day for the year in which it received the dividend (January 31, 2028).*
- *The affiliated corporate group would defer by nearly one year the Part IV tax liability of Investco in respect of the $1,000 portfolio dividend that it received.*

Under new subsection 129(1.3):

- *The $1,000 dividend paid by Investco to Holdco is deemed not to be a taxable dividend paid by Investco for the purposes of subsection 129(1) because Holdco's balance-due day for the year in which it received the dividend (January 31, 2028) is after Investco's balance-due day for the year during which it paid the dividend (February 28, 2027).*

- *Investco cannot obtain a dividend refund for its 2026 taxation year based on the taxable dividend that it paid to Holdco. Investco's liability for $383 Part IV tax remains payable as of its balance-due day of February 28, 2027.*
- *The taxable dividend received by Holdco on December 31, 2026, is exempted from Part IV tax to avoid double taxation (see the commentary to paragraph 186(1)(b)).*
- *Investco's dividend refund can be released in a subsequent taxation year if Holdco satisfies the conditions in subsection 129(3.2).*

Example 2 – Timing Dividends to Avoid Subsection 129(1.3)

Using the same facts as the example above, Investco would avoid subsection 129(1.3) (and the tax deferral concern it addresses) if, rather than paying the $1,000 taxable dividend to Holdco on December 31, 2026, it paid this dividend to Holdco on or before November 30, 2026 (in this case, Holdco's balance-due day of January 31, 2027 for the taxation year in which it received the dividend would fall before Investco's balance-due day of February 28, 2027 for the taxation year in which it paid the dividend).

Alternatively, Investco would avoid subsection (1.3) if it paid the dividend one day later, January 1, 2027. In this scenario, Investco would be subject to $383 of refundable Part IV tax on its balance-due day of February 28, 2027. The dividend paid to Holdco would not be subject to subsection (1.3) because Holdco's balance-due day of January 31, 2028 for the taxation year in which it received the dividend would fall before Investco's balance-due day of February 28, 2028 for the taxation year in which it paid the dividend. Investco would be entitled to a refund of the $383 of Part IV tax paid after filing its return for its 2027 taxation year.

In sum, subsection (1.3) does not apply to dividends paid by Investco to Holdco during the months of January to November. Consequently, provided that Investco does not pay a dividend to Holdco during the month of December, subsection (1.3) will not apply.

This amendment applies to dividends paid in taxation years beginning on or after November 4, 2025.

Exclusion

ITA
129(1.31)

New subsection 129(1.31) excludes from subsection 129(1.3) a taxable dividend paid by a payer corporation to a payee corporation under certain conditions. In general terms, under this exclusion, a payer corporation can be entitled to a dividend refund in a taxation year under subsection 129(1) upon paying a taxable dividend to a payee corporation if there is no deferral within the affiliated group of the tax payable on the investment income of the payer corporation, or if the payer corporation is subject to a loss restriction event within 30 days after paying the taxable dividend.

These two exclusions are provided in paragraphs (a) and (b).

Paragraph (a)

The exclusion under paragraph (a) applies if the payee corporation paid, on or before the payer corporation's balance-due day for the year in which it paid the dividend, one or more taxable dividends of the same character (e.g. an eligible dividend or a non-eligible dividend) as the original dividend it received from the payer corporation, the total amount of which is at least equal to the original dividend. Moreover, the exclusion in paragraph (a) applies only if no portion of the taxable dividend paid by a payee corporation (or a grand-parent corporation, if applicable) is otherwise relied upon by any taxpayer to avoid the application of subsection (1.3), as provided by its subparagraph (iii). This rule ensures that a taxable dividend paid by a payee corporation (or a grandparent corporation, if applicable) can be relied upon only once (e.g. no double counting) to prevent the application of (1.3).

Example

Investco, a Canadian-controlled private corporation (CCPC), receives $1,000 of rental income subject to the refundable tax on aggregate investment income under Part I of the Act, resulting in approximately $500 of Part I tax and a $300 addition to its NERDTOH. Investco has a December 31st, 2026 fiscal year-end and a February 28th, 2027 balance-due day.

On December 31st, 2026, Investco pays a $800 taxable dividend to Holdco (a CCPC). Holdco has a November 30, 2027 fiscal year-end and a January 31, 2028 balance-due day. However, on January 1, 2027 (before Investco's February 28, 2027 balance-due day) Holdco pays a $800 taxable dividend to its sole shareholder, Individual A, who resides in Canada.

Pursuant to the exclusion under new paragraph (a), subsection (1.3) does not apply to the taxable dividend paid by Investco because the payee corporation (Holdco), paid a subsequent taxable dividend on or before the payer corporation's (Investco) balance-due day in an amount that equals or exceeds the $800 paid on December 31st, 2026 by Investco. Because Individual A is subject to personal income tax on the taxable dividend paid by Holdco on January 1, 2027 (before Investco's balance-due day), the tax deferral advantage that would otherwise arise from the staggered taxation year-ends within the affiliated corporate group is effectively eliminated, thus subsection (1.3) does not apply.

Paragraph (b)

Paragraph (b) provides an exclusion from subsection (1.3) for taxable dividends paid by payer corporation if the corporation is subject to a loss restriction event within 30 days after it paid the dividend. A loss restriction event is defined for the purposes of the Act under subsection 251.2(2); in the case of a corporation, it involves an acquisition of control of the corporation by a person or group of persons. This exclusion allows for taxable dividends to be paid by a corporation within 30 days before its acquisition of control without subsection (1.3) applying in respect of those dividends.

This amendment applies to dividends paid in taxation years beginning on or after November 4, 2025.

Release of suspended dividend refund

ITA
129(1.32)

New subsection 129(1.32) is introduced to allow a payer corporation to obtain a dividend refund under subsection 129(1) in respect of a taxable dividend that it paid in a prior year for which a dividend refund could not be obtained because new subsection 129(1.3) applied to that dividend.

Under subsection 129(1), a corporation is entitled to a dividend refund in the taxation year in which it pays a taxable dividend, whether as an eligible dividend or as a non-eligible dividend. The amount of the dividend refund is based on the total of all taxable dividends that it pays in a taxation year, subject to the limitation provided by the corporation's balance in its "non-eligible refundable dividend tax on hand" (NERDTOH) or "eligible refundable dividend tax on hand" (ERDTOH).

New subsection 129(1.3) prevents a payer corporation from obtaining a dividend refund under subsection 129(1) in a taxation year in respect of a taxable dividend that it pays in the year to an affiliated private corporation or subject corporation that has a balance-due day for its taxation year in which the dividend was received that is after the balance-due day of the corporation for the taxation year in which the dividend was paid. In such a case, the taxable dividend paid by the payer corporation in the year is deemed not to be a taxable dividend for the purposes of subsection 129(1) and is disregarded in determining its dividend refund for the year.

Subsection 129(1.32) deems the payer corporation to have paid, for purposes of subsection 129(1), a taxable dividend in a particular taxation year that is equal to the amount of a taxable dividend paid by the corporation in a prior taxation year that was subject to 129(1.3) (or the portion thereof) - referred to as the "suspended dividend" - when certain conditions listed under paragraphs (a) to (c) are met in the period that is between the payment of the suspended dividend and the end of the particular taxation year. The taxable dividend deemed to have been paid under this new subsection has the same character as the suspended dividend that was subject to new subsection 129(1.3) (an eligible or a non-eligible dividend) to ensure that the dividend refund is calculated appropriately.

The conditions in paragraphs 129(1.32)(a) to (c) are cumulative. In general terms, and as further explained below, paragraph (a) requires the amount of the suspended dividend must be distributed out of the affiliated and connected corporate group to which the payee corporation (and any grandparent corporation, if applicable) belongs such that no corporate income tax deferral advantage remains in respect of the investment income of the payer corporation that was subject to subsection (1.3). Paragraphs (b) and (c) provide "no double counting" rules to ensure that only the payer corporation obtains a dividend refund in respect of the amount of the suspended dividend that is flowed out of the affiliated and connected corporate group.

Consequential amendments are made to paragraph 186(1)(b) to provide that the amount of the dividend refund that a payer corporation can obtain in a particular taxation year because it is deemed to have paid the suspended dividend in that year under new subsection 129(1.32) is not considered in determining the amount of Part IV tax that may be applicable to taxable dividends that the payer corporation pays to connected corporations in the year (for more information, see the commentary to paragraph 186(1)(b)).

Paragraph (a)

In general terms, new paragraph (a) sets out cumulative conditions that must be met between the time a suspended dividend was paid and the end of the particular taxation year of the payer corporation for a taxable dividend of the payer corporation that is equal to the amount of the suspended dividend to be deemed to have been paid by the payer corporation at the end of the particular taxation year.

The first condition, in subparagraph (i), requires that the payer corporation was not subject to a loss restriction event during the relevant time.

The second condition, in subparagraph (ii), requires that an amount that is equal to or exceeds the amount of the suspended dividend be distributed as taxable dividends by the payee corporation and, if applicable, by each grandparent corporation. (Briefly, a grandparent corporation is a corporation that is affiliated with the payer corporation immediately before the suspended dividend was paid and that has received a taxable dividend from a payee corporation.) The taxable dividends must be of the same character as the suspended dividend paid by the payer corporation (e.g., as an eligible or a non-eligible dividend). The total amount of the portion of the taxable dividends that exceed the suspended dividend is defined as “surplus dividends”, which is relevant for new paragraph (b).

Whether the second condition is satisfied depends on the identity of the dividend recipients. Reference below to a payee corporation includes a reference to a grandparent corporation.

The second condition can be satisfied if the taxable dividends paid by the payee corporation were received by a taxpayer that was neither a corporation that was affiliated with the payer corporation immediately before the payment of the suspended dividend, nor a private corporation or a subject corporation (within the meaning assigned by subsection 186(3)) that was connected with the payee corporation when the payee corporation paid the taxable dividend (subject to an exception explained below). A taxpayer is considered to have received a taxable dividend from the payee corporation if it has received it indirectly through a trust, a partnership or another corporation with which the payer corporation was affiliated immediately before the payment of the suspended dividend. Accordingly, taxable dividends paid to individuals, non-affiliated corporations and unconnected corporations would satisfy this condition.

If a taxable dividend is paid by a payee corporation to a connected corporation, the second condition can be satisfied to the extent that the following conditions are met:

- The connected corporation paid one or more taxable dividends the total amount of which equals or exceeds the amount of the taxable dividend received from the payee corporation, during the taxation year in which the connected corporation has received that taxable dividend, and the taxable dividends are not received by any other corporation that is not connected with the connected corporation immediately before those taxable dividends were paid.

- If the connected corporation paid a taxable dividend that was received by another corporation with which it was connected, the latter corporation paid one or more taxable dividends, the total amount of which equals or exceeds the amount of the dividend received. A corporation is considered to have received a taxable dividend if it has received it indirectly through a trust, a partnership or another connected corporation.

Paragraph (b)

Paragraph (b) prevents the double counting of taxable dividends paid by corporations in the circumstances described in subparagraph (a)(ii) to ensure the proper application of subsections 129(1), (1.3) and (1.32).

For subsection (1.32) to apply, subparagraph (a)(ii) requires that payee corporations and grandparent corporations in respect of the payer corporation pay taxable dividends the total amount of which equals or exceeds the amount of the suspended dividend with the total amount of any excess referred to as “surplus dividends”.

Paragraph (b) provides that no portion of the taxable dividends described in subparagraph (a)(ii) that exceed the amount of the surplus dividends is relied on by any taxpayer (other than the payer corporation in respect of the suspended dividend) to either obtain a dividend refund under subsection 129(1) or avoid the application of subsection (1.3). Surplus dividends can be relied upon to obtain a dividend refund under subsection 129(1) or to avoid the application of subsection (1.3).

Example

Investco, a private corporation, receives a $1,000 portfolio eligible dividend subject to $383 Part IV tax in its 2026 taxation year and giving rise to $383 of ERDTOH at the end of its taxation year. Investco has a December 31, 2026 taxation year-end and a February 28, 2027 balance-due day.

On December 31, 2026, Investco pays a $1,000 eligible dividend to Holdco which Holdco reinvests in marketable securities. Holdco, a private corporation wholly owned by Individual A, has a November 30, 2027 taxation year-end and a January 31, 2028 balance-due day. Holdco and Investco are affiliated.

Because Holdco receives an eligible dividend payment on December 31, 2026 (in its 2027 taxation year) and has a balance-due date after the balance-due date of Investco, subsection 129(1.3) applies to deem the $1,000 dividend paid to Holdco not to be a taxable dividend paid by

Investco for purposes of subsection 129(1). Consequently, Investco's dividend refund of $383 of ERDTOH under subsection 129(1) is denied and its liability for $383 of Part IV tax remains payable as of its February 28, 2027 balance-due day. Because Investco could not obtain the dividend refund, the $1,000 dividend received by Holdco is not subject to Part IV tax in respect of its 2027 taxation year.

On June 1, 2026, which is during Investco's 2027 taxation year, Holdco pays a $1,000 eligible dividend to Individual A. Holdco does not obtain a dividend refund under subsection 129(1) for its 2026 taxation year and the taxable dividend that it paid is not relied upon by any taxpayer to avoid the application of subsection 129(1.3).

Consequently, new subsection 129(1.32) applies to deem Investco to have paid a $1,000 eligible dividend for purposes of 129(1) during its 2026 taxation year, entitling Investco to a dividend refund of its $383 of ERDTOH.

Paragraph (c)

Paragraph (c) ensures that subsection (1.32) cannot apply more than once in respect of the same suspended dividend (for example, if subsection (1.32) applied once in respect of a suspended dividend of a payer corporation and the payee corporation again paid sufficient taxable dividends in a subsequent taxation year).

This amendment applies to dividends paid in taxation years beginning on or after November 4, 2025.

Assessments

ITA
129(1.33)

New subsection 129(1.33) provides the Minister of National Revenue the authority to make the assessments, reassessments, determinations and redeterminations that are necessary to give effect to subsections 129(1.3) to (1.32), notwithstanding that the taxation year in question is otherwise statute-barred from assessment.

This amendment applies to dividends paid in taxation years beginning on or after November 4, 2025.

Clause 3

Part IV

ITA
186(1)(b)

Paragraph 186(1)(b) is part of a set of rules that seek to prevent the use of private corporations to defer personal income tax on investment income.

A private corporation or subject corporation that receives a taxable dividend from a connected dividend payer (within the meaning assigned by subsection 186(4)) is subject to tax under Part IV based on the amount of the payer corporation's dividend refund. The Part IV tax payable by the recipient corporation corresponds to a proportion of the dividend refund of the dividend payer for its taxation year in which it paid the taxable dividend that the amount of the dividend received is of the total of all taxable dividends paid by the payer corporation in that year. The Part IV tax is in turn refundable to the recipient corporation upon payment of sufficient taxable dividends.

Under new subsection 129(1.3), a dividend refund which a dividend payer is otherwise entitled to receive for a taxation year during which it paid a taxable dividend to an affiliated corporation can be denied in certain circumstances involving staggered taxation year-ends; the dividend refund can be released in a subsequent taxation year of the dividend payer under new subsection 129(1.32).

Paragraph 186(1)(b) is amended consequential to the introduction of new subsections 129(1.3) to (1.32).

The consequential amendments to paragraph 186(1)(b) relate to the taxation year of the dividend payer in which a dividend refund is denied and to its subsequent taxation year in which the dividend refund is released. These consequential amendments seek to ensure that the interaction of subsection 186 with new subsections 129(1.3) to (1.32) does not result in double taxation under Part IV.

For the taxation year of the dividend payer in which it paid a taxable dividend and the corresponding dividend refund is denied under new subsection 129(1.3), that taxable dividend is excluded from subparagraph 186(1)(b)(i) and 186(1)(b)(ii) in respect of the affiliated dividend payee. Accordingly, an affiliated dividend payee is not subject to Part IV tax on a taxable dividend received from a dividend payer where the matching dividend refund of the payer for the taxation year is denied by new subsection 129(1.3).

For a subsequent taxation year of the dividend payer in which a suspended dividend refund is released under new subsection 129(1.32), the opening words of paragraph 186(1)(b) are amended to exclude that dividend refund from the total amount of its dividend refund for that taxation year that is relevant to determine the Part IV tax of connected corporations on taxable dividends paid to them in that year. For example, if in a subsequent taxation year of a private corporation (after the application of subsection 129(1.3)), the private corporation earns active business income and the only dividend refund in respect of the year for the private corporation is obtained under new subsection 129(1.32), the private corporation could pay a taxable dividend to a connected corporation in that year on which the connected corporation would not be subject to Part IV tax in respect of the taxable dividend received.

The amendments to paragraph 186(1)(b) are deemed to have come into force on November 4, 2025.

Eligible activities under the Canadian Exploration Expense

Clause 1

Definitions

ITA
66.1(6)

"Canadian exploration expense"

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

Paragraph (f) of the definition includes in CEE certain expenses incurred for the purpose of determining the existence, location, extent or quality of a mineral resource in Canada, with various specific exclusions. Historically, the determination of a mineral resource's "quality" for CEE purposes was considered to relate to the resource's underlying physical characteristics. As a result, expenses for technical studies (which are typically undertaken to assess a mineral resource's engineering feasibility and economic viability as a mining project, rather than its underlying or inherent physical characteristics) have generally been viewed as being excluded from CEE. However, a recent decision of the Supreme Court of British Columbia held that the reference to "quality" under the provincial equivalent of the federal CEE definition could be interpreted to include the economic viability or engineering characteristics, and not just the physical characteristics, of a mineral resource.

Paragraph (f) of the CEE definition is amended to clarify that expenses incurred for the purpose of determining the quality of a mineral resource in Canada must relate to the resource's underlying or inherent physical characteristics, and do not include expenses related to determining the economic viability of, or the engineering feasibility of extracting, the resource. A similar amendment is made to paragraph (a) of the CEE definition (which describes certain expenses relating to the oil and gas sector) to maintain consistency within the definition.

These amendments are deemed to have come into force on November 4, 2025.

Clause 2

Definitions

ITA
127(9)

"flow-through mining expenditure"

The definition "flow-through mining expenditure" in subsection 127(9) describes expenses that may qualify for the 15% investment tax credit in respect of specified surface "grass-roots" mineral exploration, often referred to as the "mineral exploration tax credit".

Paragraph (a) of the definition requires that the expense be a Canadian exploration expense (CEE) incurred in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence, location, extent or quality of certain specified mineral resources.

Paragraph (a) is amended to clarify that eligible CEE be incurred for the purpose of determining the existence, location, extent or inherent natural qualities of a specified mineral resource. This amendment is consequential to the amendment to paragraph (f) of the definition "Canadian exploration expense" in subsection 66.1(6). See the commentary to that amendment for further information.

This amendment applies in respect of expenses renounced under a flow-through share agreement entered into on or after November 4, 2025.

Hybrid Mismatch Rules

Clause 1

Secondary rule — consequences

ITA
12.7(3)

"Taxation year" references are added to this subsection, as well as subsections 18.4(3), (4), (11), (13) and (15) and the definition "hybrid mismatch amount" in subsection 18.4(1), to ensure that the hybrid mismatch rules apply to a hybrid mismatch amount attributable to a taxation year. For more information, see the commentary on the definition "hybrid mismatch amount" in subsection 18.4(1) and subsections 18.4(6) and (11). As a consequence, the rule in paragraph 12.7(3)(b) for determining the timing of a taxpayer's income inclusion is eliminated, as this timing now flows from the determination of the hybrid mismatch amount for a taxation year. For more information, see the commentary to subsections 18.4(11), (13), (15) and (15.4).

These amendments apply in respect of payments arising on or after July 1, 2026.

Investor hybrid payer mismatch amount

ITA
12.7(4)

New subsection 12.7(4) provides a specific operative rule applicable to an investor hybrid payer mismatch amount in respect of a payment, which arises under a hybrid payer arrangement. The mismatch is neutralized under this subsection by means of an income inclusion to the taxpayer equal to the investor hybrid payer mismatch amount. Paragraph (b) then deems this income inclusion to be from the same source as the income or loss, of the hybrid payer under the hybrid payer arrangement, that is computed taking into account a deduction in respect of the payment. For more information, see the notes to subsections 18.4(15.5) to (15.7).

Subsection 12.7(4) applies in respect of payments arising on or after July 1, 2026.

Clause 2

ITA
18.4

The existing hybrid mismatch rules (the "first package of rules") in sections 12.7 and 18.4, together with 113(5), primarily implemented the recommendations in Chapters 1 and 2 of the report under Action 2 of the Group of 20 and Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Project (the "BEPS Action 2 Report"), titled Final Report on Neutralising the Effects of Hybrid Mismatch Arrangements, with appropriate adaptations to the Canadian income tax context. The legislative amendments introduced at this time (the "second package of rules") to the hybrid mismatch rules implement the various other recommendations in the BEPS Action 2 Report. Specifically, these new rules implement the recommendations in Chapters 3, 4, and 6 to 8 of the BEPS Action 2 Report in order to address deduction/non-inclusion mismatches arising from payments under "reverse hybrid arrangements", "disregarded payment arrangements" and "imported hybrid arrangements", as well as double deduction mismatches arising from payments under "hybrid payer arrangements".

Key changes under the second package of rules

The legislative amendments introduced at this time include the following key provisions:

- *Amendments to key definitions:* Various amendments are made to the definitions "hybrid mismatch amount", "hybrid mismatch arrangement" and "structured arrangement" (each contained in subsection 18.4(1)) in order to incorporate the additional hybrid mismatch arrangements targeted under the second package of rules.

- *Reverse hybrid mismatch arrangement:* Subsection 18.4(15.1) determines if a payment arises under a reverse hybrid arrangement, consistent with the recommendations in Chapter 4 of the BEPS Action 2 Report. Subsection 18.4(15.2) determines the amount of the reverse hybrid mismatch and ensures that subsection 18.4(4) applies only to the extent that the deduction/non-inclusion mismatch amount arising from the actual payment exceeds the aggregate of the deduction/non-inclusion mismatch amounts that would have arisen had there been hypothetical payments made to the owners of the reverse hybrid entity.

- *Disregarded payment arrangement:* Subsection 18.4(15.3) determines if a payment arises under a disregarded payment arrangement. Consistent with the recommendations in Chapter 3 of the BEPS Action 2 Report, this generally occurs if a payment to a hybrid entity results in a deduction/non-inclusion mismatch by reason of the payment being disregarded under the income tax laws of the recipient country. Subsection 18.4(15.4) determines the amount of the disregarded payment mismatch and ensures that subsection 12.7(3) or 18.4(4) applies only to the extent that the portion of the deduction/non-inclusion mismatch amount satisfying the causal test exceeds the dual inclusion income of the hybrid entity.

- *Hybrid payer arrangement:* Subsection 18.4(15.5) determines if a payment arises under a hybrid payer arrangement. Consistent with the recommendations in Chapters 6 and 7 of the BEPS Action 2 Report, this generally occurs if a payer of a payment is a hybrid payer and the payment gives rise to a double deduction mismatch. In most cases, subsection 18.4(15.6) determines the amount of the hybrid payer mismatch and ensures subsection 18.4(4) applies only to the extent the double deduction mismatch amount exceeds the hybrid payer's dual inclusion income. If, however, the hybrid entity is a partnership, subsection 18.4(15.7) determines the investor hybrid payer mismatch amount and ensures subsection 12.7(4) applies to cause an income inclusion for an investor in the partnership to the extent that the investor's share of the double deduction mismatch amount exceeds the investor's investor dual inclusion income.

- *Imported hybrid arrangement:* Subsections (15.8) through (15.94) contain rules for determining if there is an offshore hybrid mismatch (that is, a hybrid mismatch that is in respect of a payment of which neither the payer nor the recipient is a Canadian taxpayer but which is determined in a manner that is consistent with the Canadian hybrid mismatch rules) and if the requisite link exists between a deductible payment made by a Canadian entity and the deducting entity in respect of the offshore hybrid mismatch to establish that the mismatch has effectively been imported to Canada. These rules apply to identify hybrid mismatches (either involving non-arm's length parties or arising from a structured arrangement) that have not been neutralized through the application of operative hybrid mismatch rules in Canada or a foreign country and have been functionally imported to Canada through a deductible payment (or a chain of deductible payments between entities). The deduction in respect of the Canadian importing payment is then denied to the extent that there is any otherwise outstanding offshore hybrid mismatch amount to be neutralized. These rules address attempts to circumvent the hybrid mismatch rules through the use of hybrid mismatches involving only non-implementing jurisdictions.

- *Double deduction mismatch:* Subsection 18.4(7.1) determines if a payment gives rise to a double deduction mismatch. This generally occurs if there is an amount deductible in respect of the payment for Canadian income tax purposes and there is also an amount deductible in respect of the payment for foreign income tax purposes. This accords with Recommendations 6.1 and 7.1 and the recommendations in Chapter 12 of the BEPS Action 2 Report.

- *Dual inclusion income:* Dual inclusion income is a new term added to subsection 18.4(1). Its main role is to determine the total of each amount of income of a hybrid payer that is both subject to tax in Canada and in another country (because of an inclusion by an investor in the hybrid payer). This is relevant in determining the amount of the disregarded payment mismatch or hybrid payer mismatch in subsections 18.4(15.4) and (15.6), respectively. This accords with Recommendations 3.1, 6.1 and 7.1 and the recommendations in Chapter 12 of the BEPS Action 2 Report.

Any dual inclusion income for a taxation year that is not fully used to shelter deduction/non-inclusion and double deduction mismatches for the year can be carried forward and applied to mismatches of a future taxation year, as set out in variable C of subsection 18.4(15.4) and variable E of subsection 18.4(15.6). New paragraph 20(1)(zz) also provides for a deduction for a particular taxation year where subsection 18.4(4) has restricted a deduction for a taxpayer for a prior year in respect of a payment and the taxpayer demonstrates that there is dual inclusion income in the particular taxation year that could be used to effectively reinstate the amount denied.

- *Investor dual inclusion income:* Investor dual inclusion income is a new term added to subsection 18.4(1) and generally performs a similar function to the definition "dual inclusion income" except that it applies to an investor in a hybrid entity. It is relevant in determining the amount of a disregarded payment mismatch in subsection 18.4(15.4) or the investor hybrid payer mismatch amount in subsection 18.4(15.7), which can result in an income inclusion for an investor under subsection 12.7(3) or (4), respectively. New paragraph 20(1)(aaa) provides for a deduction for a taxation year where an amount is included in income for a preceding taxation year under subsection 12.7(4) in respect of an investor hybrid payer mismatch amount and the taxpayer has investor dual inclusion income for the taxation year.

- *Anti-avoidance rule:* The existing anti-avoidance rule is amended in order to reflect the additional hybrid mismatch arrangements targeted under the second package of rules.

- *Part XIII*: Amendments are made to the existing rules that treat interest expense of a corporation resident in Canada that is not deductible because of the hybrid mismatch rules as a deemed dividend for the purposes of Part XIII of the Act, to reflect the additional hybrid mismatch arrangements targeted under the second package of rules and to ensure that an inclusion in a taxpayer's income for an investor hybrid payer mismatch amount under new subsection 12.7(4) is also subject to that same deemed dividend treatment.

- *Other ancillary rules:* Various ancillary rules and definitions are being added to and amended in section 18.4 in order to facilitate the application of the hybrid mismatch rules to the additional hybrid mismatch arrangements targeted under the second package of rules.

Effective date

These amendments generally apply in respect of payments arising on or after July 1, 2026, including payments under arrangements entered into before that date.

Definitions

ITA
18.4(1)

This subsection is amended consequential on the introduction of new paragraphs 20(1)(zz) and (aaa) and subsection 20(31). For more information, see the commentary to those provisions.

"*dual inclusion income*"

Dual inclusion income is relevant mainly for the determination of the amount of a disregarded payment mismatch for a payment arising under a disregarded payment arrangement, or the amount of a hybrid payer mismatch for a payment arising under a hybrid payer arrangement.

Very generally, the dual inclusion income of an entity is the total of the entity's income or profits that are subject to tax both in Canada and another relevant country. More specifically, it takes the total of all amounts that are both ordinary income in respect of Canada and in respect of another relevant country. For more information, see the commentary to the definition "ordinary income" in this subsection.

The relevance of dual inclusion income is that the mismatch arising under a disregarded payment arrangement or a hybrid payer arrangement results in the denial of a deduction for a taxpayer under subsection 18.4(4) (or, where there is a foreign deduction component to an arrangement, an income inclusion for a taxpayer under subsection 12.7(3)) only to the extent that the amount of the mismatch exceeds the dual inclusion income of the hybrid payer. This accords with Recommendations 3.1, 6.1 and 7.1, and the recommendations in Chapter 12, of the BEPS Action 2 Report.

Paragraph (a) of the definition applies when the payer of a payment is a hybrid entity resident in Canada. Paragraph (b) of the definition applies when the payer of a payment is a dual resident entity or a multinational entity (both as defined in subsection 18.4(1)). In cases where the hybrid payer is a hybrid entity that is a partnership, the new definition "investor dual inclusion income" is applicable. For more information, see the commentary to that definition.

Because each of paragraphs (a) and (b) requires the amount to be ordinary income in respect of both Canada and another country, dual inclusion income is effectively the lesser of the Canadian inclusion and the foreign inclusion. Further, ordinary income that is subject to foreign tax is only factored into the determination of the dual inclusion income of an entity for a taxation year if the ordinary income is for a foreign taxation year that begins on or before the day that is 12 months after the end of the taxation year. If, due to a difference in timing of when a foreign country taxes the income as compared to Canada, the ordinary income in respect of the foreign country arises

after the required timeframe (or only a portion arises within the required timeframe because it gets recognized in the foreign country over multiple foreign taxation years), new subsection 18.4(19.1) allows the Minister to permit the amount to nonetheless be included in dual inclusion income where just and equitable. Where dual inclusion income arises in a taxation year after the taxation year for which subsection 18.4(4) has denied a deduction, paragraph 20(1)(zz) may provide relief. For more information, see the commentary on subsection 18.4(19.1) and paragraph 20(1)(zz).

Further, while dual inclusion income is determined for a particular taxation year, where the dual inclusion income for the particular taxation year is not fully used to shelter deduction/non-inclusion and double deduction mismatches for the particular taxation year, the unused portion can be carried forward and applied to mismatches of a future taxation year, as set out in variable C of subsection 18.4(15.4) and variable E of subsection 18.4(15.6). For more information, see the commentary to subsections 18.4(15.3) to (15.6).

The existing "no double counting" rule in subsection 18.4(8) has been expanded to provide additional rules that apply in computing an entity's dual inclusion income or investor dual inclusion income. For more information, see the commentary to subsection 18.4(8).

This definition applies in respect of payments arising on or after July 1, 2026.

"*dual resident*"

The "dual resident" definition is relevant primarily for the hybrid mismatch rules concerning hybrid payers. A dual resident is any entity that is resident, for tax purposes, in at least two countries. Notably, subsection 18.4(19.2) provides an interpretive rule for the references, in the hybrid mismatch rules, to being resident in a country.

If a dual resident is a payer of a payment, it will qualify as a "hybrid payer" (as defined in this subsection) and be potentially subject to the application of the hybrid payer rules. For more information, see the notes to the definition "hybrid payer" and subsections 18.4(15.5) and (15.6).

This definition applies in respect of payments arising on or after July 1, 2026.

"*foreign hybrid payer mismatch rule*"

The "foreign hybrid payer mismatch rule" definition is a subset of the definition "foreign hybrid mismatch rule" and refers to a rule that is focused solely on counteracting mismatches that arise because a payer is a hybrid payer. It describes foreign tax laws that can reasonably be considered to have been intended to implement Chapter 6 or 7 of the BEPS Action 2 Report or to have an effect that is substantially similar to a provision of section 12.7 or 18.4 that is intended to implement one of those chapters.

This definition is used in the determination of whether a payment gives rise to a double deduction mismatch under subsection 18.4(7.1). More specifically, the effect of any foreign hybrid payer mismatch rule is ignored in determining whether there is, in respect of a payment,

an amount deductible for foreign tax purposes. In addition, this definition is used in determining whether a payment arises under a hybrid payer arrangement under subsection (15.5). In that context, the "foreign hybrid payer mismatch rule" definition works as part of an ordering rule to determine, in the case of a hybrid payer that is a hybrid entity resident in Canada or a multinational entity not resident in Canada (i.e., a multinational entity with a Canadian permanent establishment), whether the hybrid payer mismatch has been fully neutralized by the jurisdiction of the investor in the hybrid entity or the multinational entity. For more information, see the notes to subsections 18.4(7.1) and (15.5).

This definition applies in respect of payments arising on or after July 1, 2026.

"*foreign ordinary income*"

Consequential on the introduction of the new definition "income or profits tax" in this subsection, the parenthetical carve-out for income or profits that are subject to tax under certain types of taxation regimes is deleted because that parenthetical is redundant in light of that new definition.

This amendment applies in respect of payments arising on or after July 1, 2026.

"*foreign structured arrangement*"

The definition "foreign structured arrangement" is introduced as part of the imported hybrid mismatch rules and adapts the definition "structured arrangement" to apply in the context of offshore mismatches by reading out the existing paragraph (a) of the "structured arrangement" definition in favour of a new paragraph (a), which requires that the arrangement include a payment that gives rise to an offshore mismatch. A payment gives rise to an offshore mismatch if the conditions in subsection 18.4(15.8) are met.

The condition in paragraph (b) of the definition, which pertains to the pricing or design of the arrangement to secure the benefit of the mismatch, is retained but with the requirement that the mismatch in question is an offshore mismatch (as opposed to a deduction/non-inclusion or double deduction mismatch).

This amendment applies in respect of payments arising on or after July 1, 2026.

"*hybrid entity*"

The term "hybrid entity" is defined in subsection 18.4(1) as an entity that is tax resident (i.e., fiscally opaque in one country and treated as fiscally transparent in a second country, such that some portion of its income, profits, expenses or losses are treated, under the laws of that second country, as those of a resident of that second country for income tax purposes.

A hybrid entity may, for example, be an entity that is viewed, for income tax purposes under the laws of the country where it is incorporated, as a corporation resident in that incorporation

country, but is viewed, under the laws of the country where one of its investors is resident, as a branch of the investor with no separate existence for income tax purposes.

This definition is primarily relevant in determining the existence of a disregarded payment arrangement or a hybrid payer arrangement, which are described in subsections (15.3) and (15.5), respectively. For more information, see the commentary to those subsections.

This definition applies in respect of payments arising on or after July 1, 2026.

"*hybrid mismatch amount*"

The definition "hybrid mismatch amount" is used in the operative rules in subsections 12.7(3) and 18.4(4). Where the operative rules apply, the hybrid mismatch amount determines the amount of the deduction that will be denied (in the case of the primary rule in subsection 18.4(4)) and where applicable, the amount that will be included in income (in the case of the secondary rule in 12.7(3)) in respect of a payment.

This definition is amended to ensure that the operative rules also apply to reverse hybrid arrangements, disregarded payment arrangements and hybrid payer arrangements, which are set out in subsections (15.1) and (15.2), (15.3) and (15.4), and (15.5) and (15.6), respectively. For more information, see the commentary to those subsections. An investor hybrid mismatch amount, newly introduced in subsection 18(15.7), is not included in this definition and is subject to a standalone operative rule in new subsection 12.7(4).

To improve the operation of the existing rules and facilitate the addition of certain new hybrid mismatch arrangements, which in some cases require the determination of an entity's dual inclusion income for a taxation year, "taxation year" references are added to this definition and to subsections 12.7(3), 18.4(3), (4), (11), (13) and (15), so that the hybrid mismatch rules apply to a hybrid mismatch amount attributable to a taxation year. In general, these amendments are clarifying in nature. For more information, see the commentary to subsections 18.4(6) and (11).

These amendments apply in respect of payments arising on or after July 1, 2026.

"*hybrid mismatch arrangement*"

The definition of "hybrid mismatch arrangement" comprises the various categories of arrangements to which the hybrid mismatch rules apply. This term is used in the conditions of application of the operative rules in subsections 12.7(3) and 18.4(4), as well as the new operative rule that applies to Canadian resident partners of a partnership that is a hybrid entity in certain cases under subsection 12.7(4). In order for the operative rules to apply to a payment, the payment must arise under at least one category of hybrid mismatch arrangement. There are separate provisions in section 18.4 setting out the conditions for each type of hybrid mismatch arrangement.

The definition now includes a reverse hybrid arrangement, a disregarded payment arrangement and a hybrid payer arrangement, as described in subsections 18(15.1), (15.3) and (15.5), respectively. For more information, see the commentary on those subsections.

These amendments apply in respect of payments arising on or after July 1, 2026.

"*hybrid payer*"

The definition "hybrid payer" is relevant for the purposes of the hybrid payer arrangement rules, primarily contained in subsections 18.4(15.5) to (15.7). A hybrid payer is any payer that is a dual resident, a hybrid entity or a multinational entity, each as separately defined in this subsection. For more information, see the notes to those definitions.

This definition applies in respect of payments arising on or after July 1, 2026.

"*income or profits tax*"

The definition "income or profits tax" is introduced for the purposes of the hybrid mismatch rules, to exclude from that definition's scope (to the extent that it would not already have been so excluded) Part XIII withholding tax and its foreign equivalents, as well as any tax levied under a controlled foreign company tax regime or a specified minimum tax regime. The term "income or profits tax" otherwise has the same meaning as in the Act in general.

This definition applies in respect of payments arising on or after July 1, 2026.

"*investor*"

An "investor", in a hybrid entity, means a particular entity that holds a direct or indirect "equity interest" (defined in this subsection) in the hybrid entity and that treats the hybrid entity's income, profits, expenses or losses (or, if any such amounts existed, would treat such an amount) as the particular entity's own income, profit, expenses or losses, under the tax laws of the jurisdiction in which the particular entity is resident. Given that a hybrid entity is defined to be resident in a country, such that the hybrid entity's country of residence treats the hybrid entity's income as its own, it follows that an investor in a hybrid entity must be resident in a different country. An investor would include, for example, a Canadian partner in an entity that is a partnership from the perspective of Canadian tax law but is a hybrid entity because it is a tax resident in a country other than Canada.

This definition applies in respect of payments arising on or after July 1, 2026.

"*investor dual inclusion income*"

The new definition "investor dual inclusion income" is primarily relevant in determining the amount of a disregarded payment mismatch in subsection 18.4(15.4) or an investor hybrid payer mismatch amount in subsection 18.4(15.7), which can result in an income inclusion for an

investor under subsection 12.7(3) or (4), respectively. For more information, see the commentary on those subsections.

This definition is structured similarly to the definition "dual inclusion income". However, this definition is only applicable for an investor in a hybrid entity. It essentially aggregates each amount that is both the investor's "ordinary income" (which is defined in this subsection) subject to tax in Canada and the hybrid entity's ordinary income that is subject to tax in a foreign country. For more information, see the commentary to the definitions "dual inclusion income" and "ordinary income" in this subsection.

The existing "no double counting" rule in subsection 18.4(8) has been expanded to provide various rules that apply to the determination of dual inclusion income and investor dual inclusion income. For more information, see the commentary to subsection 18.4(8).

This definition applies in respect of payments arising on or after July 1, 2026.

"*multinational entity*"

The definition "multinational entity" is relevant for the hybrid payer arrangement rules, primarily contained in subsections 18.4(15.5) to (15.7). A multinational entity is an entity that is resident in one country and operates through a permanent establishment in another country, where the expression "permanent establishment" takes its meaning from either the tax treaty between those two countries (if there is such a tax treaty and it defines "permanent establishment") or from section 8201 of the Regulations (if there is no such tax treaty that defines "permanent establishment").

This definition applies in respect of payments arising on or after July 1, 2026.

"*ordinary income*"

The new definition "ordinary income" in subsection 18.4(1) is primarily relevant to the definitions "dual inclusion income" and "investor dual inclusion income" in this subsection, which are ultimately used to determine the amount of a disregarded payment mismatch or hybrid payer mismatch (or investor hybrid payer mismatch amount) when there is a payment arising under a disregarded payment arrangement (as described in subsections (15.3) to (15.4)) or hybrid payer arrangement (as described in subsections (15.5) to (15.7)), respectively.

This definition essentially describes an amount of income or profits that is included in the entity's income or profits subject to an "income or profits tax" (as defined in this subsection) in a country. For more information, see the commentary to the definition "income or profits tax".

Paragraph (a) provides that an amount is ordinary income of an entity, in respect of a country, if the amount is included in computing the entity's income or profits that are subject to tax and is not subject to any offsetting relief (other than relief that applies generally).

Paragraph (b) provides for a reduction in computing ordinary income to the extent a refund is available for the tax for the year in which the amount is included in taxable income or profits. In the case of a partial refund of taxes paid for a year, it is intended that an amount of income or profits that would otherwise be included in ordinary income for the year will be reduced by the proportion of that amount that the income or profits tax repaid or repayable is of the total income or profits tax paid for the year.

For example, an entity's income or profits is included in computing its ordinary income in respect of Canada if that amount is included in computing the entity's income from a business or property (or its taxable income earned in Canada, if the entity is a non-resident) or is the taxable portion of any capital gain that is included in computing the entity's income, and there is no offsetting relief or tax refund in respect of the amount.

This definition applies in respect of payments arising on or after July 1, 2026.

"*reverse hybrid entity*"

The definition "reverse hybrid entity" is relevant for the reverse hybrid arrangement rules, primarily contained in subsections 18.4(15.1) to (15.2).

An entity that is a recipient of a payment is a reverse hybrid entity in respect of the payment if the entity is treated as fiscally transparent in one country (paragraph (b) of this definition) and is treated as fiscally opaque in a country in which an equity interest holder is resident (paragraph (c) of this definition). Thus, when an entity is a reverse hybrid entity in respect of a payment, neither country treats the payment as income or profits of a resident of that country.

This definition applies in respect of payments arising on or after July 1, 2026.

"*specified minimum tax regime*"

The "specified minimum tax regime" definition is relevant in determining an entity's foreign ordinary income for a foreign taxation year. By virtue of the exceptions contained in the new definition "income or profits tax", amounts that are included in the entity's relevant foreign income or profits because of a specified minimum tax regime are not included in foreign ordinary income. For more information, see the commentary to those definitions in this subsection.

Paragraph (a) of this definition is amended in light of the replacement of the "global intangible low-taxed income" regime with the "net CFC tested income" regime applicable to American persons under the United States *Internal Revenue Code of 1986*.

These amendments apply in respect of foreign taxation years beginning after December 31, 2025.

"*structured arrangement*"

The definition “structured arrangement” is amended to reflect the expansion of the hybrid mismatch rules to include double deduction mismatches. For more information, see the notes to new subsections 18.4(7.1) and (15.5).

This definition applies in respect of payments arising on or after July 1, 2026.

Interpretation

ITA
18.4(2)

Subsection 18.4(2) provides an interpretive rule that applies for the purposes of sections 12.7 and 18.4 and subsection 113(5). These provisions implement the recommendations in, and are intended to be generally consistent with, the BEPS Action 2 Report. This is a key part of the context and purpose in light of which the text of the hybrid mismatch rules is to be interpreted.

This subsection is amended to add a reference to the additional report published by the OECD in 2017, titled *Neutralising the Effects of Branch Mismatch Arrangements, Action 2 — Inclusive Framework on BEPS*.

These amendments apply in respect of payments arising on or after July 1, 2026.

Primary rule — conditions for application

ITA
18.4(3)

This subsection is amended in line with the amendments to the definition “hybrid mismatch amount” in subsection 18.4(1). For more information, see the commentary to that definition.

These amendments apply in respect of payments arising on or after July 1, 2026.

Primary rule — consequences

ITA
18.4(4)

This subsection is amended in line with the amendments to the definition “hybrid mismatch amount” in subsection 18.4(1). For more information, see the commentary to that definition.

These amendments apply in respect of payments arising on or after July 1, 2026.

Structured arrangements — exception

ITA
18.4(5)

Subsection 18.4(5) is amended consequential on the expansion of the hybrid mismatch rules to include double deduction mismatches. For more information, see the notes to new subsections 18.4(7.1) and (15.5).

These amendments apply in respect of payments arising on or after July 1, 2026.

Deduction/non-inclusion mismatch — conditions

ITA
18.4(6)

Subsection 18.4(6) sets out the conditions for determining if a payment gives rise to a deduction/non-inclusion mismatch. Very generally, a payment gives rise to a deduction/non-inclusion mismatch if the total of the amounts deductible in respect of the payment for Canadian income tax purposes exceeds the total of the amounts included in respect of the payment in taxable income for foreign income tax purposes (more specifically, the total amount of "foreign ordinary income" in respect of the payment), or if the total of the amounts deductible for foreign income tax purposes exceeds the total of the amounts included for Canadian income tax purposes (more specifically, the total amount of "Canadian ordinary income" in respect of the payment).

The amendments to this subsection, along with amendments to subsections 12.7(3), 18.4(3), (4), (11), (13) and (15) and the definition "hybrid mismatch amount" in subsection 18.4(1), reflect that the hybrid mismatch rules are intended to apply on a year-by-year basis. In general, these amendments are clarifying in nature.

Paragraph (a) is amended to clarify that a payment gives rise to a deduction/non-inclusion mismatch if the total of the amounts deductible, in respect of the payment, for Canadian income tax purposes for any taxation year exceeds the total of the inclusions, in respect of those deductible amounts for the taxation year, in the foreign ordinary income for foreign taxation years — or in the Canadian ordinary income for taxation years — that begin on or before the day that is 12 months after the end of the taxation year. For example, assume the total of the deductible amounts in respect of a payment is $100, with $70 being deductible for the first taxation year and $10 being deductible in each of years 2, 3 and 4. The amendments to paragraph (a) clarify that, in determining whether the payment gives rise to a deduction/non-inclusion mismatch, it is necessary to determine what amounts in respect of the$70deductible for year 1are included in foreign ordinary income for a foreign taxation year, or Canadian ordinary income fora taxation year, that begins on or before the day that is 12 months after the end of year 1. The same determination would be necessary for each of the $10 amounts deductible for years 2 to 4. If, for example, all $100 in respect of the payment were included in foreign ordinary income of a recipient of the payment in year 4 (i.e., where the foreign taxation years and the taxation years are the same 12-month periods, a foreign taxation year that begins more than 12 months after the end of years 1 and 2 but not more than 12 months after the end of year 3 or 4), the total amount of relevant inclusions would be $20. Thus, there would be a deduction/non-inclusion mismatch.

Similar clarifying amendments are made to paragraph (b).

In effect, where a payment is deductible over multiple years (each referred to as a "deduction year"), variables A and C will include deductible amounts for each deduction year. Each of variable B and D is then applied on an iterative basis, once for each deduction year, and includes only those Canadian ordinary income or foreign ordinary income amounts that are included (in respect of the deductible amount) for foreign taxation years or taxation years, respectively, that begin no more than 12 months after the end of the deduction year. For more information on this year-by-year determination, see the commentary to subsection 18.4(11).

These amendments apply in respect of payments arising on or after July 1, 2026.

Special rule — purchase price of property

ITA
18.4(6.1)

New subsection 18.4(6.1) provides an exception for the purpose of determining whether a payment arises under a reverse hybrid arrangement or disregarded payment arrangement. In determining whether there is a deduction/non-inclusion mismatch under subsection 18.4(6) in respect of a payment that is for the purchase price of a property, variables A and C of the formula in subsection 18.4(6) exclude any amount deductible as an allowance in respect of depreciation, obsolescence or depletion. This accords with paragraph 121 of Chapter 3 and paragraph 145 of Chapter 4 of the BEPS Action 2 Report.

Subsection 18.4(6.1) applies in respect of payments arising on or after July 1, 2026.

Double deduction mismatch — condition

ITA
18.4(7.1)

New subsection 18.4(7.1) sets out the conditions for determining if a payment gives rise to a double deduction mismatch. A double deduction mismatch is a necessary condition for the existence of a hybrid payer arrangement under new subsection 18.4(15.5).

Essentially, a payment gives rise to a double deduction mismatch if an amount is deductible, in respect of the payment, for Canadian income tax purposes and an amount is deductible, in respect of the payment, for foreign income tax purposes. There is no requirement that:

- the amounts be deductible by the same entity;
- the deductible amounts be equal to each other, or within a certain range of each other; or
- a foreign deduction occur within a certain period of time from when a Canadian deduction occurs.

Where a hybrid payer that is a hybrid entity that is not resident in Canada claims a deduction in respect of a payment in its country of residence, the payment could give rise to a double

deduction mismatch if the hybrid entity is viewed as a partnership for Canadian purposes. In that case, the same amount may be deductible by the hybrid entity in computing its income from a business or property under the Act, and the partnership income would then be allocated to a Canadian resident partner that is an "investor" (as defined in subsection 18.4(1)) in the hybrid entity.

In general, the test for a double deduction mismatch is based on amounts that are actually deductible. This means that if another domestic or foreign rule, such as an interest restriction rule or a hybrid mismatch rule, applies to restrict a deduction, that deduction is not taken into account in applying the condition in paragraph (a) or (b). There is, however, one exception to this general rule, which is that both the Canadian deductibility and the foreign deductibility are tested without regard to the application of any hybrid mismatch rules that neutralize mismatches arising from hybrid payer arrangements. In paragraph (a), the test is whether an amount would be deductible, in respect of the payment, in computing an entity's income from business or property under Part I of the Act, in the absence of paragraph (f) of the definition "hybrid mismatch arrangement" (which relates to hybrid payer arrangements). In paragraph (b), the test is whether an amount would be (or would reasonably be expected to be) deductible, in respect of the payment, in computing an entity's relevant foreign income or profits in the absence of any foreign hybrid payer mismatch rule (as newly defined in subsection 18.4(1)). This exception for where deductions are denied under rules applicable to hybrid payer arrangements is necessary both to avoid circularity and to preserve the appropriate rule ordering as set out in Chapters 6 and 7 of the BEPS Action 2 Report, particularly in the case of a hybrid payer that is a dual resident, where both residence countries are expected to deny the deduction in their respective countries.

Finally, in keeping with the broad application of this provision, there is no rule applicable, in the determination of double deduction mismatches, equivalent to new subsection 18.4(6.1), which excludes deductions in respect of depreciation, obsolescence or depletion in the determination of a deduction/non-inclusion mismatch for purposes of the rules relating to reverse hybrid arrangements and disregarded payment arrangements. Consequently, amounts deductible in respect of depreciation (e.g., capital cost allowance) could give rise to a double deduction mismatch under this subsection.

New subsection 18.4(7.1) applies in respect of payments arising on or after July 1, 2026.

Double deduction mismatch — application

ITA
18.4(7.2)

New subsection 18.4(7.2) is analogous to subsection 18.4(7), but applies in the context of a double deduction mismatch rather than a deduction/non-inclusion mismatch. It acts as a "bridge" to connect the double deduction mismatch to the hybrid payer arrangement determined under new subsection 18.4(15.5) and to the operative rule in subsection 18.4(4).

First, paragraph (a) totals the amounts determined under paragraph 18.4(7.1)(a) – essentially, the Canadian deductions in respect of a payment – and labels that as the "deduction component" of

the double deduction mismatch. Because paragraph (a) aggregates all the amounts determined under paragraph 18.4(7.1)(a) in respect of the payment, the deduction component of the double deduction mismatch may in some cases reflect deductions over multiple taxation years. This deduction component will, if the necessary conditions are met, be the deduction component of a hybrid payer mismatch by virtue of paragraph 18.4(15.6)(b), allowing the condition in paragraph 18.4(3)(b) to be met and for subsection 18.4(4) to restrict all or a portion of the deduction.

Paragraph (b) provides that the amount of the double deduction arising from the payment is equal to the deduction component determined under paragraph (a). This is the amount that is the starting point in determining the amount of a hybrid payer mismatch in respect of the payment under new subsection 18.4(15.6) or, in certain cases, the investor hybrid mismatch amount in respect of the payment under new subsection 18.4(15.7).

For more information, see the notes to subsections 18.4(3) and (4) and (15.5) to (15.7).

Subsection 18.4(7.2) applies in respect of payments arising on or after July 1, 2026.

No double counting

ITA
18.4(8)

Subsection 18.4(8) is a rule against double counting, which applies where an amount has already been included in computing foreign ordinary income or Canadian ordinary income of an entity in respect of a payment. This subsection is reorganized and amended to incorporate rules against double counting in computing an entity's dual inclusion income or investor dual inclusion income. The terms "dual inclusion income" and "investor dual inclusion income" are defined in subsection 18.4(1).

The existing rule against double counting of foreign ordinary income or Canadian ordinary income is now contained in paragraph (a).

New paragraph (b) ensures that an amount of ordinary income that has already been included in computing dual inclusion income or investor dual inclusion income of an entity cannot be included in computing dual inclusion income or investor dual inclusion income of any other entity. Put differently, this rule clarifies that the same amount cannot be taken into consideration in computing more than one entity's dual inclusion income or investor dual inclusion income.

New paragraph (c) provides that an amount of ordinary income that is included in computing the dual inclusion income of an entity, and has been used to reduce a hybrid mismatch amount or investor hybrid mismatch amount, or to enable a deduction under paragraph 20(1)(zz) or (aaa), cannot also be included in computing the investor dual inclusion income of that entity (and vice versa). This double counting could otherwise arise where, for example, an investor ("Canco") in a hybrid entity is itself a hybrid entity. In that case, the lower-tier hybrid entity's ordinary income would be included in Canco's investor dual inclusion income, in respect of the lower-tier hybrid entity, and also in Canco's dual inclusion income. If, for example, the lower-tier entity and

Canco were both payers of payments arising under hybrid payer arrangements, Canco may have both a hybrid mismatch amount (i.e., the amount of the hybrid payer arrangement under which its payment arises) and an investor hybrid payer mismatch amount (in respect of the lower-tier hybrid entity's payment). In that case, paragraph (c) ensures that that amount of ordinary income may be used to reduce either – but not both – of those mismatch amounts, by being included either in Canco's dual inclusion income or in its investor dual inclusion income in respect of the lower tier hybrid entity.

These amendments apply in respect of payments arising on or after July 1, 2026.

Hybrid financial instrument arrangement — amount

ITA
18.4(11)

Subsection 18.4(11) is relevant in determining the extent to which the operative hybrid mismatch rules restrict a deduction under subsection 18.4(4), or include an amount in income under 12.7(3), in respect of a payment arising under a hybrid financial instrument arrangement.

This subsection is amended in line with the amendments to the definition "hybrid mismatch amount" in subsection 18.4(1) and to subsections 12.7(3), 18.4(3), (4), (11), (13) and (15), to ensure that the hybrid mismatch rules apply, in a particular taxation year, to a hybrid mismatch amount for that year. In general, these amendments are clarifying in nature.

Specifically, paragraph (a) is amended to provide that the amount of the hybrid financial instrument mismatch for a taxation year, in respect of a payment, is the portion of the deduction/non-inclusion mismatch amount, in respect of a payment, that can reasonably be considered to be attributable to the taxation year (and that meets the condition in paragraph 18.4(10)(d)). In many cases, the Canadian tax deductions in respect of the payment (which are included under variable A of subsection 18.4(6)) will be for a single taxation year. However, these amendments are made in recognition that a payment may instead be deductible over multiple taxation years (e.g., over five years under paragraph 20(1)(e)) and, in such cases, require taxpayers to consider the relevant Canadian tax deductions in respect of the payment on a year-by-year basis and determine the portion of the Canadian tax deductions for each taxation year that do not give rise to corresponding inclusions within the period specified in subsection 18.4(6).

In the case of a deduction/non-inclusion mismatch resulting from amounts deductible in computing taxable income for foreign income tax purposes (i.e., where paragraph 18.4(6)(b) applies), new subparagraph (a)(ii) requires a determination of the portion of the mismatch that can reasonably be considered to be attributable to a taxation year of a taxpayer that is a recipient of the payment (and that satisfies the conditions in paragraph 18.4(10)(d)). The taxation year to which the mismatch is attributable would generally be the last taxation year of the taxpayer that begins at or before the end of the foreign taxation year in which an amount in respect of the payment is (or would reasonably be expected to be) deductible in computing relevant foreign

income or profits.

These amendments apply in respect of payments arising on or after July 1, 2026.

Hybrid transfer arrangement — amount

ITA
18.4(13)

This definition is amended similarly to subsection 18.4(11), which is applicable for hybrid financial instrument arrangements. For more information, see the commentary on that subsection.

These amendments apply in respect of payments arising on or after July 1, 2026.

Substitute payment arrangement — amount

ITA
18.4(15)

This definition is amended similarly to subsection 18.4(11), which is applicable for hybrid financial instrument arrangements. For more information, see the commentary on that subsection.

These amendments apply in respect of payments arising on or after July 1, 2026.

Reverse hybrid arrangement — conditions

ITA
18.4(15.1)

New subsection 18.4(15.1) sets out the conditions to determine if a payment arises under a reverse hybrid arrangement.

A reverse hybrid arrangement essentially is one where differences in the income tax treatment, under the tax laws of different countries, of payments to a reverse hybrid entity (as defined in subsection 18.4(1)) give rise to a deduction/non-inclusion mismatch (as determined under subsection 18.4(6)) that would not have arisen in the hypothetical scenario where each entity that held a direct equity interest in the reverse hybrid entity at the time of the actual payment received a payment equal to the amount that can reasonably be considered to be the entity's share of the actual payment. However, there is also considered to be a reverse hybrid arrangement if a deduction/non-inclusion mismatch would have arisen in the hypothetical scenario and would have been the amount of a hybrid financial instrument mismatch, hybrid transfer mismatch or substitute payment mismatch, in respect of the hypothetical payment, for which a deduction would be denied under subsection 18.4(4). This ensures that the anti-hybrid mismatch rules

applicable to those types of arrangements cannot be circumvented by interposing a reverse hybrid entity.

Where all the conditions in subsection 18.4(15.1) are met, such that a payment is considered to arise under a reverse hybrid arrangement (and thus under a "hybrid mismatch arrangement", as defined in subsection 18.4(1)), the mismatch is neutralized under the operative hybrid mismatch rules. More specifically, if the payment is otherwise deductible for Canadian income tax purposes, subsection 18.4(4) restricts all or a portion of the deduction.

A payment is considered to arise under a reverse hybrid arrangement if four conditions are met.

The first condition, in paragraph 18.4(15.1)(a), requires that the payment is to a reverse hybrid entity. For more information, see the commentary on the definitions "payment" and "reverse hybrid entity" in subsection 18.4(1).

The second condition, in paragraph 18.4(15.1)(b), requires that either the payer of the payment and the recipient reverse hybrid entity not deal with each other at arm's length, or the payment arises under a structured arrangement. The term "structured arrangement" is defined in subsection 18.4(1).

The third condition, in paragraph 18.4(15.1)(c), requires that the payment give rise to a deduction/non-inclusion mismatch. For more information, see the commentary on subsection 18.4(6), which sets out the conditions for such a mismatch.

The final condition, in paragraph 18.4(15.1)(d), tests whether the mismatch is due to "hybridity". Under this test, a mismatch is generally considered hybrid if the deduction/non-inclusion mismatch (as determined under subsection 18.4(6)) would not have arisen in the hypothetical scenario.

In line with the recommendations under Chapter 4 of the BEPS Action 2 Report, this final condition ensures that a reverse hybrid arrangement arises only where the interposition of the reverse hybrid entity brought about the mismatch in tax outcomes (i.e., the deduction/non-inclusion mismatch) or the reverse hybrid entity was being used to circumvent the operation of the hybrid financial instrument arrangement rule, the hybrid transfer arrangement rule or the substitute payment arrangement rule.

The "hybridity" condition for a reverse hybrid arrangement is met when the amount determined for variable A in the formula in paragraph (d) is greater than the amount determined for variable B, where:

- Variable A is equal to the deduction/non-inclusion mismatch (as determined under subsection 18.4(6)) arising from the payment; and

- Variable B is equal to the deduction/non-inclusion mismatch that would have arisen in the hypothetical scenario.

Subsection 18.4(15.1) applies in respect of payments arising on or after July 1, 2026.

Reverse hybrid arrangement — amount

ITA
18.4(15.2)

New subsection 18.4(15.2) is relevant in determining the extent to which the operative hybrid mismatch rules restrict a deduction in respect of a payment arising under a reverse hybrid arrangement.

Paragraph 18.4(15.2)(a) determines the amount by which a deduction is restricted under subsection 18.4(4) in the case of a payment arising under a reverse hybrid arrangement. It ensures that this result applies only to the extent that a deduction/non-inclusion mismatch would not have arisen in the hypothetical scenario (set out in variable B in the formula in paragraph 18.4(15.1)(d)) where each entity that held a direct equity interest in the reverse hybrid entity at the time of the actual payment received a payment equal to the amount that can reasonably be considered to be the entity's share of the actual payment (or such a mismatch would have arisen and would have been the amount of a hybrid financial instrument mismatch, hybrid transfer mismatch or substitute payment mismatch, in respect of the hypothetical payment, for which a deduction would be denied under subsection 18.4(4)).

The starting point is the amount of the deduction/non-inclusion mismatch that arises from the payment, as determined for variable A in the formula in paragraph 18.4(15.1)(d). Under paragraph 18.4(7)(c), this mismatch is essentially the amount by which the amounts deductible in respect of the payment for Canadian or foreign income tax purposes exceed "Canadian ordinary income" and "foreign ordinary income" in respect of the payment (as defined in subsection 18.4(1)). For more information, see the commentary on subsection 18.4(7).

It is then necessary to determine the portion of the deduction/non-inclusion mismatch amount that would not have arisen in the hypothetical scenario described above. That portion of the mismatch amount is the difference between the amount determined for variable A in the formula in paragraph 18.4(15.1)(d) and the amount determined for variable B in that formula, with the latter amount being the deduction/non-inclusion mismatch that would have arisen in the hypothetical scenario. Once that portion of the mismatch amount is determined, it is necessary to then determine to what extent that portion can reasonably be considered to be attributable to the taxation year. In many cases, the Canadian tax deductions in respect of the payment (as determined under variable A of subsection 18.4(6)) will be for one single taxation year. However, in recognition that a payment may be deductible over multiple taxation years (e.g., over five years under paragraph 20(1)(e)), it is necessary to determine the extent to which the Canadian tax deductions for each taxation year are not matched with inclusions.

The portion of the amount of the deduction/non-inclusion mismatch that is described in paragraph 18.4(15.2)(a) is referred to as the "amount of the reverse hybrid mismatch" for the taxation year and, as a "hybrid mismatch amount" for the year (as defined in subsection 18.4(1)), it is the amount of the deduction that is restriction under 18.4(4) for the year.

If none of the deduction/non-inclusion mismatch would arise in the hypothetical scenario described above, or if any such mismatch that would arise in the hypothetical scenario would be the amount of a hybrid financial instrument mismatch, hybrid transfer mismatch or substitute payment mismatch for which a deduction would be denied under subsection 18.4(4), the entire amount of the deduction/non-inclusion mismatch that is attributable to the taxation year is the amount of the reverse hybrid mismatch.

Paragraph 18.4(15.2)(b) links subsection 18.4(15.1) with the operative rule in subsection 18.4(4), ensuring that the operative rule applies to restrict the amount deductible under Part I of the Act in respect of a payment arising under a reverse hybrid arrangement. This is achieved by labelling the amount that would otherwise be deductible under Part I in respect of the payment – which amount is referred to in paragraph 18.4(7)(a) as the "deduction component" of the deduction/non-inclusion mismatch – as the "deduction component of the reverse hybrid arrangement". This allows the conditions for the application of subsection 18.4(4) to be satisfied, since that provision applies in respect of the deduction component of a "hybrid mismatch arrangement" (which is defined in subsection 18.4(1) to include a reverse hybrid arrangement).

Subsection 18.4(15.2) applies in respect of payments arising on or after July 1, 2026.

Disregarded payment arrangement — conditions

ITA
18.4(15.3)

New subsection 18.4(15.3) sets out the conditions for determining if a payment arises under a disregarded payment arrangement. Along with subsection 18.4(15.4), this subsection is intended to implement the recommendations in Chapter 3 of the BEPS Action 2 Report.

In general terms, a payment arises under a disregarded payment arrangement where the payer of the payment is a hybrid entity that does not deal at arm's length with the recipient (or the payment is made as part of a structured arrangement) and the payment gives rise to a deduction/non-inclusion mismatch by virtue of being disregarded under the income tax laws of the recipient country. In other words, for there to be a disregarded payment arrangement a "hybridity condition" must be met, which requires that the hybrid entity's residence country considers a deductible payment to have been made for income tax purposes, but the recipient's residence country does not consider the recipient to have received a payment, and this gives rise to the mismatch.

The hybridity condition incorporates a similar counterfactual test to that used in the context of the hybrid financial instrument arrangement rule, which in effect ensures that a payment is considered to have arisen under a disregarded payment arrangement if the payment being disregarded in the recipient country is sufficient to cause the deduction/non-inclusion mismatch. Thus, if the disregarding of the payment would be enough to cause the mismatch even if all other causes of the mismatch (e.g., the tax-exempt status of the recipient or an exemption applicable to

a category of income) were absent, then the hybridity condition is met. This counterfactual test is set out in subparagraph (d)(ii).

The phrase “in whole or in part”, used in subparagraph (d)(i), contemplates that, in some cases, one portion of the deduction/non-inclusion mismatch may satisfy the hybridity condition and another portion may not. The rules are intended to neutralize the mismatch only to the extent it satisfies the hybridity condition.

The term “hybrid entity” is defined in subsection 18.4(1).

If all the conditions in subsection 18.4(15.3) are satisfied, the mismatch will be neutralized by either the denial of a deduction (under subsection 18.4(4)) or the inclusion of an amount in income (under subsection 12.7(3)), depending on which of the payer (i.e., the hybrid entity) or recipient is a Canadian resident. The maximum amount of the deduction that may be denied or the income that may be included to neutralize the mismatch is determined under paragraph 18.4(15.4)(a).

Subsection 18.4(15.3) applies in respect of payments arising on or after July 1, 2026.

Disregarded payment arrangement — amount

ITA
18.4(15.4)

New subsection 18.4(15.4) is relevant in determining the amount required to be included in income, or the amount of the deduction required to be denied, in respect of a payment arising under a disregarded payment arrangement.

Paragraph 18.4(15.4)(a) determines the amount included in income under subsection 12.7(3), or the maximum amount by which a deduction may be denied under subsection 18.4(4), for a taxation year in the case of a payment arising under a disregarded payment arrangement. In general terms, it ensures that these results apply only to the extent that the deduction/non-inclusion mismatch arising from the payment is ‘hybrid’ in nature, attributable to the taxation year, not already neutralized under another of the hybrid mismatch rules and not offset by an amount of dual inclusion income or investor dual inclusion income.

The starting point is to determine the amount of the deduction/non-inclusion mismatch that arises from the payment (under paragraph 18.4(7)(c)). This mismatch is essentially the amount by which the amounts deductible in respect of the payment for Canadian or foreign income tax purposes exceed any “Canadian ordinary income” and “foreign ordinary income” in respect of the payment (as defined in subsection 18.4(1)).

Second, it is necessary to apply a ‘causal’ test, by determining the extent to which the deduction/non-inclusion mismatch arises because the payment is disregarded under the laws of the recipient country (or would arise because the payment is disregarded if all other reasons for the mismatch were absent). The portion of the mismatch amount that both satisfies this causal

test and can reasonably be considered to be attributable to a given taxation year is the amount determined for variable A for that year. For these purposes, a portion of the mismatch can reasonably be considered to be attributable to a given taxation year if the underlying deductions giving rise to the mismatch would otherwise have been taken in the year or, in the case of foreign deductions, the foreign taxation year most closely associated with the year.

Next, variable B is the portion of the amount determined for variable A that is also included in a hybrid mismatch amount determined under another of the hybrid mismatch rules (and neutralized, either by a deduction denial under subsection 18.4(4) or an income inclusion under subsection 12.7(3)). The purpose of variable B is to prevent a double neutralization of the same mismatch, by giving priority to another hybrid mismatch rule (e.g., the hybrid financial instrument mismatch rule) in situations where such a rule applies to a deduction/non-inclusion mismatch that is also subject to the disregarded payment arrangement rule.

Finally, subtracting the amount determined for variable C allows any available dual inclusion income or investor dual inclusion income, as applicable, to be offset against the mismatch amount that remains after the amount determined for variable A is reduced by the amount determined for variable B. Since dual inclusion income (and investor dual inclusion income) represents amounts included in taxable income in at least two countries, where a deduction is taken against such income in one country, it is assumed that the income is still subject to income tax in at least one other country, effectively negating the tax benefit the deduction/non-inclusion mismatch would otherwise achieve. Based on this assumption, there is no need to counteract the mismatch except to the extent that the mismatch amount exceeds the available dual inclusion income (or investor dual inclusion income).

If there is a deduction component in respect of the deduction/non-inclusion mismatch (i.e., if amounts are otherwise deductible in Canada in respect of the payment), it is dual inclusion income (defined in subsection 18.4(1)) that is relevant. Dual inclusion income generally comprises amounts that are ordinary income of the hybrid entity (i.e., the payer of the payment) in respect of Canada and ordinary income of an investor in the payer in respect of another country. The amount of dual inclusion income included under variable C is any dual inclusion income of the hybrid entity for the taxation year and any preceding taxation years that has not been used to offset a hybrid mismatch amount (i.e., the amount of a disregarded payment mismatch or hybrid payer mismatch) for a preceding year or the amount of another disregarded payment mismatch in the year, thus avoiding the double use of dual inclusion income to shelter mismatches. The effect of reducing available dual inclusion income by amounts already used in respect of other disregarded payment mismatch amounts in the taxation year is to create an implicit ordering rule, whereby the dual inclusion income is allocated between multiple disregarded payment mismatches arising in a given year (with the choice as to which particular mismatches the dual inclusion income is allocated to being at the taxpayer's discretion).

If there is a foreign deduction component in respect of the deduction/non-inclusion mismatch (i.e., if the deductions in respect of the payment are for foreign tax purposes), it is investor dual inclusion income (defined in subsection 18.4(1)) that is relevant. Investor dual inclusion income generally comprises amounts that are ordinary income of the hybrid entity (i.e., the payer) in respect of a foreign country and ordinary income of an investor in the payer in respect of Canada.

The amount of available investor dual inclusion income is determined in much the same way as for dual inclusion income, with the main difference between dual inclusion income and investor dual inclusion income being that the latter does not reduce the amount of hybrid payer mismatches (but, instead, reduces investor hybrid payer mismatch amounts). Both dual inclusion income and investor dual inclusion income may reduce disregarded payment mismatches.

The amount, if any, determined under the formula in paragraph 18.4(15.4)(a) for a taxation year is a "hybrid mismatch amount" for the year (as defined in subsection 18.4(1)), which is the amount of the income inclusion under subsection 12.7(3), or the maximum deduction denial under subsection 18.4(4), for the year.

Paragraph 18.4(15.4)(b) links subsection 18.4(15.3) with the operative rule in subsection 18.4(4), ensuring that the operative rule will apply to restrict the amount deductible under Part I of the Act in respect of a payment arising under a disregarded payment arrangement. This is achieved by labelling the amount that would otherwise be deductible under Part I in respect of the payment – which amount is referred to in paragraph 18.4(7)(a) as the "deduction component" of the deduction/non-inclusion mismatch – as the "deduction component of the disregarded payment arrangement". This allows the conditions for the application of subsection 18.4(4) to be met, since that provision applies in respect of the deduction component of a "hybrid mismatch arrangement" (which is defined in subsection 18.4(1) to include a disregarded payment arrangement).

Paragraph 18.4(15.4)(c) similarly links subsection 18.4(15.3) with the operative rule in subsection 12.7(3).

Subsection 18.4(15.4) applies in respect of payments arising on or after July 1, 2026.

Hybrid payer arrangement — conditions

ITA
18.4(15.5)

New subsection 18.4(15.5) sets out the conditions for determining if a payment arises under a hybrid payer arrangement.

New subsection 18.4(15.5) sets out four conditions that must be met to determine that a payment gives rise to a hybrid payer arrangement. The first and fourth conditions, in paragraphs (a) and (d), are similar to the conditions for other hybrid mismatch arrangements under this section: a payer of the payment must be a hybrid payer, and the payment must give rise to a double deduction mismatch. Beyond this, the determination of the existence of a hybrid payer arrangement differs from the determination of other hybrid mismatch arrangements in certain important ways, beyond the obvious difference that a hybrid payer arrangement is the only hybrid mismatch arrangement concerned with double deduction mismatches, rather than deduction/non-inclusion mismatches.

First, paragraphs 18.4(15.5)(b) and (c) contain explicit ordering rules for determining when Canada's hybrid payer arrangement rules apply in priority to (or, in some cases, concurrently with) another country's equivalent provisions. These ordering rules reflect recommendations in Chapters 6 and 7 of the BEPS Action 2 Report and are referred to as "primary" and "defensive" rules in Chapter 6 of that report. The ordering rules are applicable to hybrid payer mismatches involving payments by hybrid entities or multinational entities and clarify that the "parent" or "residence" country should apply its hybrid mismatch rules first, with the "subsidiary" or "permanent establishment" country applying the defensive rule only if the first country fails to apply its primary rule.

For a hybrid payer arrangement involving a payment by a hybrid entity, this means that the country in which an investor in the hybrid entity is resident should neutralize the double deduction mismatch and, if that country fails to do so, the country in which the hybrid entity is resident should apply its defensive rule to neutralize the mismatch. For a hybrid payer arrangement involving a payment by a multinational entity, the country in which the entity is resident should neutralize the mismatch and, if that country fails to do so, the country in which the multinational entity carries on business through a permanent establishment should apply its defensive rule to neutralize the mismatch. Subparagraph (b)(ii) and paragraph (c) implement these ordering rules by conditioning the existence of a hybrid payer arrangement, in situations where Canada is the subsidiary or permanent establishment country, on the failure of the other country (or countries, where there are multiple investors) to fully neutralize the double deduction mismatch by applying a foreign hybrid payer mismatch rule (as defined in subsection 18.4(1)) in respect of the payment. Importantly, these ordering rules only apply to hybrid payers that are hybrid entities or multinational entities. For hybrid payers that are dual residents, the application of a foreign hybrid payer mismatch rule does not turn off the application of the Canadian rule, reflecting the recommendation in Chapter 7 of the BEPS Action 2 Report that in such cases, both affected countries should apply their respective hybrid payer mismatch rules.

Subparagraph (b)(i) further contains a relationship test, applicable only to hybrid payers that are hybrid entities resident in Canada (i.e., where the Canadian defensive rule applies). Similar to the rules for other hybrid mismatch arrangements, in this limited situation, the hybrid payer arrangement rule will only apply where the hybrid entity does not deal at arm's length with an investor in the hybrid entity or the payment arises under, or in connection with, a structured arrangement. For all other situations under the hybrid payer arrangement rule, no such relationship test is required to be met in order for a hybrid payer arrangement to exist.

Finally, unlike the other hybrid mismatch arrangements targeted under this section, the conditions for a hybrid payer arrangement do not include a causal test that looks at why the hybrid payer arrangement arises, or that limits the amount of the hybrid payer mismatch to the portion that can be considered to be caused by hybridity. The application of the hybrid mismatch rules to a hybrid payer arrangement is, however, limited by reducing the amount of the hybrid payer mismatch, or the investor hybrid payer amount, by any applicable dual inclusion income or investor dual inclusion income, as the case may be. For more information, see the notes to new subsections 18.4(15.6) and (15.7), and to the definitions "dual inclusion income" and "investor dual inclusion income" in subsection 18.4(1).

Where all the conditions in subsection 18.4(15.5) are met, such that a payment is considered to arise under a hybrid payer arrangement (and thus under a "hybrid mismatch arrangement", as defined in subsection 18.4(1)), the amount of the mismatch is neutralized under the operative hybrid mismatch rules, by way of either a denial of a deduction under subsection 18.4(4) for the amount of the hybrid payer mismatch (determined under new subsection 18.4(15.6)), or an income inclusion under new subsection 12.7(4). Such an income inclusion occurs where the hybrid payer is a hybrid entity that is not resident in Canada and an investor in that entity is a taxpayer under the Act. In that case, the income inclusion is to the Canadian investor, in an amount equal to the investor hybrid payer mismatch amount (determined under new subsection 18.4(15.7)). For more information, see the notes to subsections 18.4(15.6) and (15.7), and 12.7(4).

Subsection 18.4(15.5) applies in respect of payments arising on or after July 1, 2026.

Hybrid payer arrangement — amount

ITA
18.4(15.6)

New subsection 18.4(15.6) is relevant in determining the extent to which the operative hybrid mismatch rule in subsection 18.4(4) restricts a deduction for a taxation year in respect of a payment arising under a hybrid payer arrangement.

Analogously to the other hybrid mismatch arrangements described in this section, paragraph 18.4(15.6)(a) determines the amount of a hybrid payer mismatch for a taxation year, in respect of a payment arising under a hybrid payer arrangement. This is the amount by which a deduction may be restricted under subsection 18.4(4) in respect of the payment.

Unlike under the other hybrid mismatch arrangements addressed in this section, it is possible that a payment may arise under a hybrid payer arrangement under subsection 18.4(15.5) but no hybrid mismatch amount (as defined in subsection 18.4(1)) is determined in respect of the payment because an investor hybrid mismatch amount in respect of the payment is instead determined under new subsection 18.4(15.7). This possibility is reflected in subparagraph 18.4(15.6)(a)(i), which determines a nil amount for the hybrid payer mismatch in respect of the payment in that case, in order to cede the ground to the application of the investor hybrid payer mismatch amount.

Subparagraph (15.6)(a)(i) results in a nil determination for the amount of a hybrid payer mismatch in respect of a payment if the hybrid payer is a hybrid entity that is not resident in Canada, in which case the hybrid entity must be viewed in Canada as a fiscally transparent entity (i.e., a partnership) if it meets the definition "hybrid entity" in subsection 18.4(1). In that case, Canada, as the country in which an investor in the hybrid entity is resident (or is otherwise a taxpayer under the Act), has the primary right to neutralize the mismatch and will do so by means of an income inclusion to the investor in the amount determined under new subsection 18.4(15.7). This allows for a more targeted application of the primary rule that considers the investor's specific tax attributes – in particular, investor dual inclusion income – rather than

denying the deduction at the partnership level (which could adversely affect investors that would otherwise have sufficient investor dual inclusion income to offset the double deduction).

In any other case – i.e., where the hybrid payer is a hybrid entity resident in Canada, a dual resident or a multinational entity – the formula in subparagraph 18.4(15.6)(a)(ii) determines the amount of the hybrid payer mismatch for a taxation year in respect of a payment arising under a hybrid payer arrangement. Unlike the other hybrid mismatch amounts determined under this section, this formula determines that mismatch amount by, in effect, aggregating all of the hybrid payer's deductions in respect of payments under hybrid payer arrangements for the year and applying the amount of any restriction proportionally to each deductible amount. This is the result of the formula, which allocates dual inclusion income proportionally among all of the deductible amounts under hybrid payer arrangements, instead of relying on an ordering rule to apply the dual inclusion income to all of those deductible amounts.

Variable A of the formula determines the portion of the amount of the double deduction mismatch arising from a particular payment that can reasonably be attributed to the year and to the hybrid payer. This refers to the amounts that would otherwise be deductible (or, in the case of a discretionary expense such as capital cost allowance, any portion of the expense that is actually claimed) by the hybrid payer in the year in respect of the particular payment, recognizing that the amount of a double deduction mismatch may comprise amounts that would otherwise be deductible over multiple years.

Variable B determines the amount of the hybrid payer's dual inclusion income that is available to offset the double deduction. This available dual inclusion income is the hybrid payer's dual inclusion income for the year (minus any amount used to offset the amount of a disregarded payment mismatch for the year) (variable D), plus any unused dual inclusion income from previous years (variable E). Since, consistent with the BEPS Action 2 Report, the disregarded payment rule applies in priority to the hybrid payer rule, dual inclusion income for both the taxation year and prior taxation years is reduced by the amounts of any disregarded payment mismatches for the taxation year and prior years in determining the amount of dual inclusion income available to be applied against the amount of a hybrid payer mismatch for the year. Prior year dual inclusion income will also be reduced by any hybrid mismatch amounts for prior years. Subsection 18.4(8) provides no double-counting rules for the determination of dual inclusion income and investor dual inclusion income.

Variable C simply aggregates any variable A amounts for the hybrid payer for the year. In other words, variable C includes all amounts that would, in the absence of the hybrid payer arrangement rules, be deductible (or, in the case of a discretionary expense, be claimed) by the hybrid payer for the year in respect of any payments that arise under hybrid payer arrangements.

Under the formula, the amount of the hybrid payer mismatch in respect of a payment for a taxation year is the amount by which the otherwise deductible amount in the year in respect of the payment (variable A) exceeds the hybrid payer's available dual inclusion income for the year (variable B) multiplied by the proportion that the variable A amount is of all the otherwise deductible amounts in the year in respect of payments arising under hybrid payer arrangements (variable C). This effectively spreads the available dual inclusion income proportionally across

all potentially affected otherwise deductible amounts. The restricted amount in respect of a particular payment is therefore the amount of the hybrid payer mismatch for the year in respect of the particular payment, which is included under paragraph (f) of the definition "hybrid mismatch amount" in subsection 18.4(1) and subject to restriction under subsection 18.4(4).

Paragraph 18.4(15.6)(b) links the hybrid payer arrangement with the operative rule in subsection 18.4(4), by labelling the deduction component of the double deduction mismatch as the deduction component of the hybrid payer mismatch in respect of the particular payment. This ensures that the conditions in subsection 18.4(3) are met in respect of the particular payment, such that subsection 18.4(4) will apply to restrict the amount deductible for the year in respect of the particular payment to the extent of the amount of the hybrid payer mismatch.

Subsection 18.4(15.6) applies in respect of payments arising on or after July 1, 2026.

Hybrid payer arrangement — investor amount

ITA
18.4(15.7)

New subsection 18.4(15.7) is relevant in determining the amount of any income inclusion to a taxpayer for a taxation year under the new operative hybrid mismatch rule in subsection 12.7(4) in respect of a payment arising under a hybrid payer arrangement.

A payment arising under a hybrid payer arrangement may result in either an amount of a hybrid payer mismatch (under subsection 18.4(15.6)), or an investor hybrid payer mismatch amount (under subsection 18.4(15.7)). The latter amount results where Canada has the primary right (in accordance with the ordering rules set out in the BEPS Action 2 Report, as reflected in the hybrid mismatch rules in the Act) to neutralize the double deduction mismatch arising from a hybrid payer arrangement involving a hybrid payer that is a hybrid entity. In that case, Canada is necessarily the country in which an investor in that hybrid entity is resident (or is otherwise a taxpayer under the Act), and the hybrid entity is necessarily viewed as a partnership under the Act (given the definition of "hybrid entity"). To ensure that any neutralization of the mismatch occurs at the investor level (rather than at the partnership level) and on an investor-by-investor basis, the amount of the hybrid payer mismatch for the year is determined to be nil under subparagraph 18.4(15.6)(a)(i) and, instead, an investor hybrid payer mismatch amount is determined for the investor under paragraph 18.4(15.7)(a). This allows for a more targeted application of the primary rule, based on the investor's specific tax attributes – in particular, investor dual inclusion income – rather than denying the deduction at the partnership level (which could adversely affect investors that would otherwise have sufficient investor dual inclusion income to offset the double deduction).

The determination of the investor hybrid payer mismatch amount follows the same general approach as the determination of the amount of the hybrid payer mismatch under subparagraph 18.4(15.6)(a)(ii). For more information, see the note to new subsection 18.4(15.6).

In general terms, variable A of the formula is the portion of the amount of the double deduction mismatch arising from a particular payment that is attributable to the investor. In most cases, this amount will be determined under paragraph (a) of variable A, as the portion that is both deductible (and claimed) by the hybrid payer and can reasonably be considered to be the investor's share of that amount (with the investor's share being determined consistently with the determination of the investor's share of the partnership income under subsection 96(1)). Where expenses incurred by a partnership are directly flowed through to partners, however, paragraph (b) applies to identify those amounts that are deductible (and claimed) by the investor. The reference to "is claimed" is intended to clarify that, in the case of a discretionary expense such as capital cost allowance, only the portion, if any, of the expense that is actually claimed by the relevant taxpayer in the year is picked up under variable A.

Variable B determines the amount of the investor's available investor dual inclusion income, in respect of the hybrid payer, for the year.

Variable C aggregates all of the variable A amounts of the investor for the year in respect of payments by the hybrid payer under hybrid payer arrangements.

The formula then multiplies the investor dual inclusion income (variable B) by the proportion that the amount determined for variable A is of the amount determined for variable C, in effect spreading the available investor dual inclusion income proportionally across all the otherwise deductible amounts. The investor hybrid payer mismatch amount of the investor for the year, in respect of the particular payment, is then determined by subtracting the investor dual inclusion income that was allocated to the amount deductible in respect of the particular payment from that deductible amount.

One difference between subsection 18.4(15.7) and subsection 18.4(15.6) is that no deduction component is determined under the former subsection. This is because the investor hybrid payer mismatch amount is neutralized under a new operative rule in subsection 12.7(4) that does not require a deduction component.

Subsection 18.4(15.7) applies in respect of payments arising on or after July 1, 2026.

Offshore mismatch – conditions

ITA
18.4(15.8)

New subsection 18.4(15.8) sets out the conditions for determining if a payment gives rise to an offshore mismatch.

The determination of whether an offshore mismatch exists is the first step in ascertaining if a taxpayer has an imported hybrid mismatch. Subsequent steps involve testing the cause of the mismatch and whether there is sufficient linkage between the mismatch and an otherwise deductible cross-border payment by a Canadian taxpayer. Where an imported hybrid mismatch is

determined to exist in respect of such a deductible cross-border payment, the rules neutralize that mismatch by denying a deduction in respect of the cross-border payment.

In general terms, an offshore mismatch is a mismatch that would be a deduction/non-inclusion mismatch or double deduction mismatch if those concepts applied to payments between non-Canadian entities. However, if the mismatch has been substantially neutralized under a foreign hybrid mismatch rule (by the denial of a deduction, or inclusion in income, in an amount that is substantially all of the amount that would have been denied or included under the Canadian hybrid mismatch rules if they had applied), it is not an offshore mismatch. This reflects that the imported hybrid mismatch rules are intended to apply only when a mismatch has not been neutralized under another country's hybrid mismatch rules.

Paragraph 18.4(15.8)(a) sets out a two-step test in respect of deduction/non-inclusion mismatches. First, subparagraph (a)(i) imports the test from subsection 18.4(6) for determining if a payment gives rise to a deduction/non-inclusion mismatch but reads out paragraph (a) of that subsection, such that only mismatches involving deductions under foreign tax laws are in view. Second, subparagraph (a)(ii) tests if an income inclusion has been made under subsection 12.7(3) (or the equivalent provision under foreign hybrid mismatch rules) to neutralize the mismatch. Since the determination of the deduction/non-inclusion mismatch in the first step takes account of any foreign hybrid mismatch rule that denies deductions, if the test in the second step is also met, then it can be concluded that no foreign country has applied its hybrid mismatch rules to neutralize the mismatch. If both tests in paragraph (a) are met, there is an offshore mismatch.

Paragraph 18.4(15.8)(b) imports the test from subsection 18.4(7.1) for determining if a payment gives rise to a double deduction mismatch, but adapts that test to the offshore context by providing a read-as rule that makes two main alterations to that subsection. First, paragraph 18.4(7.1)(a) is altered to refer to an amount that is deductible, in respect of the payment, in computing the relevant foreign income or profits of an entity in respect of a particular country (other than Canada). Paragraph 18.4(7.1)(b) is then altered to refer to an amount that is deductible, in respect of the same payment, in computing the relevant foreign income or profits of an entity in respect of a second country (other than Canada). Under this read-as rule, the effects of hybrid mismatch rules (both Canadian and foreign) – which are disregarded under subsection 18.4(7.1) in determining if there is a deduction of the kind referred to in that subsection – are taken into account. Thus, if one or both of the deductions otherwise comprising the mismatch is denied by a foreign hybrid mismatch rule, there is no offshore mismatch.

Subsection 18.4(15.8) applies in respect of payments arising on or after July 1, 2026.

Offshore mismatch – amount

ITA
18.4(15.9)

New subsection 18.4(15.9) determines the amount of an offshore mismatch arising from a payment.

In the case of an offshore mismatch that meets the conditions in paragraph (15.8)(a), the amount of the mismatch is determined under paragraph (15.9)(a) to be the amount by which the amount determined for variable C in paragraph 18.4(6)(b) (i.e., the aggregate of the foreign deductible amounts in respect of the payment) exceeds the amount determined for variable D in that paragraph (i.e., the aggregate of the Canadian ordinary income and foreign ordinary income in respect of such foreign deductible amounts).

In the case of an offshore mismatch that meets the condition in paragraph 18.4(15.8)(b), the amount of the mismatch is determined under paragraph 18.4(15.9)(b) and is the lesser of the amount described in paragraph 18.4(7.1)(a) and the amount described in paragraph 18.4(7.1)(b) in respect of the payment (as those paragraphs are read applying the read-as rule in paragraph 18.4(15.8)(b)). In other words, the amount of the offshore mismatch is the lesser of the aggregate amount deductible in one country by an entity in respect of the payment, and the aggregate amount deductible in another country by an entity (which may be the same entity, for example in the case of a dual resident) in respect of the payment.

Subsection 18.4(15.9) applies in respect of payments arising on or after July 1, 2026.

Offshore hybrid mismatch amount – meaning

ITA
18.4(15.91)

New subsection 18.4(15.91) determines the offshore hybrid mismatch amount for a foreign taxation year in respect of a payment.

The determination of an offshore hybrid mismatch amount is the next step (after the determination that a payment gives rise to an offshore mismatch under subsection 18.4(15.8), and the amount of the offshore mismatch under subsection 18.4(15.9)) in the process of ascertaining if there is an imported hybrid mismatch. This involves a determination of whether the offshore mismatch is caused by “hybridity”, as required in order for the mismatch to be in scope of the imported hybrid mismatch rules and potentially neutralized through the denial of a deduction in respect of a linked cross-border payment by a taxpayer.

Subsection 18.4(15.91) contains two sets of read-as rules for the purpose of determining if any of the hybridity conditions in the hybrid mismatch rules are satisfied in respect of an offshore mismatch falling within paragraph (15.8)(a) or (b), respectively. The first set of read-as rules, in paragraph 18.4(15.91)(a), essentially adapts the hybrid mismatch rules in subsections 18.4(10) to (15.4), which generally identify deduction/non-inclusion mismatches that are caused by different forms of hybridity, to apply to offshore mismatches described in paragraph 18.4(15.8)(a). This is achieved by reading out the references to “deduction/non-inclusion mismatch” in favour of “offshore mismatch” and undertaking various other alterations to the wording of subsections 18.4(10) to (15.4) and the supporting definitions “dual inclusion income” and “investor dual inclusion income” to adapt their application to the offshore context. Any amount that would be the amount of a hybrid financial instrument mismatch, hybrid transfer mismatch, substitute

payment mismatch, reverse hybrid mismatch or disregarded payment mismatch, when applying these read-as rules, is an offshore hybrid mismatch amount.

The second set of rules, in paragraph 18.4(15.91)(b), essentially adapts the hybrid payer mismatch rule (as set out in subsections 18.4(15.5) and (15.6)), which generally applies to double deduction mismatches in respect of payments by hybrid payers, to apply to offshore mismatches described in paragraph 18.4(15.8)(b). Similarly to the first set of rules, this is achieved through the application of a series of alterations to those subsections. First, paragraphs 18.4(15.5)(b) and (c) are "read out" under subparagraph 18.4(15.91)(b)(i). This effectively disapplies certain rules that determine the order in which the hybrid payer mismatch rules of various countries apply in respect of hybrid entities and multinational entities, respectively. These ordering rules are not relevant in the context of imported hybrid mismatches since the imported hybrid mismatch rules only apply to the extent that a hybrid mismatch has not already been neutralized under any hybrid mismatch rule (whether primary or secondary) of any country.

Second, subparagraph 18.4(15.6)(a)(i) is "read out" under subparagraph 18.4(15.91)(b)(ii). Again, this is an ordering rule (this time governing which of the two hybrid payer mismatch rules in the Act applies) that applies in the case of a hybrid entity that is a partnership under Canadian tax law. This rule ensures that the more targeted investor-level rule in subsection 18.4(15.7) is applied in priority to the hybrid entity-level rule in subsection 18.4(15.5), such that each investor benefits from its own investor dual inclusion income. However, such an ordering rule is unnecessary in the context of the imported hybrid mismatch rules because the entity to which the deduction is denied under those rules is neither the payer of the payment that gave rise to the offshore hybrid mismatch amount, nor an investor in that payer.

Third, similar read-as rules to those in subparagraphs 18.4(15.91)(a)(i) and (ii) are included in subparagraphs 18.4(15.91)(b)(iii) and (iv). These read out the references to "double deduction mismatch" in favour of "offshore mismatch" and undertake various other alterations to the wording of subsections 18.4(15.5) and (15.6) and the supporting definition "dual inclusion income" to adapt their application to the offshore context.

Finally, subparagraph 18.4(15.91)(b)(v) removes the timing requirement for an ordinary income inclusion in subparagraphs (a)(ii) and (b)(ii) of the definition "dual inclusion income". Without this alteration, in order for dual inclusion income to arise, it would have been necessary for an income amount to be included in the ordinary income of an investor in an entity (in the case of paragraph (a)) or the entity itself (in the case of paragraph (b)) in a foreign taxation year that begins on or before the day that is 12 months after the end of the foreign taxation year in which the ordinary income inclusion set out in subparagraph (a)(i) or (b)(i), respectively, is made. That timing requirement is intended to prevent the creation of dual inclusion income where there are substantial timing differences in realization of the income between countries or entities. The reason for removing this timing requirement in the offshore mismatch context is that, in that context, there are no equivalents of the discretion in subsection 18.4(19.1) or the deductibility provisions in paragraphs 20(1)(zz) and (aaa). In the offshore mismatch context, however, it is still required that the two ordinary income inclusions (described, respectively, in subparagraphs (a)(i) and (b)(i) or subparagraphs (a)(ii) and (b)(ii) of the definition "dual inclusion income") be in respect of the same income item.

Subsection 18.4(15.91) applies in respect of payments arising on or after July 1, 2026.

Imported hybrid arrangement – conditions

ITA
18.4(15.92)

New subsection 18.4(15.92) sets out the conditions for determining if a payment (referred to as the "importing payment") arises under an imported hybrid arrangement in respect of an offshore hybrid mismatch amount in respect of another payment (referred to as the "mismatch payment").

This determination is the second-last step in determining if there is an amount of an imported hybrid mismatch to be neutralized under the imported hybrid mismatch rules and entails linking an offshore hybrid mismatch amount to a deductible cross-border payment (i.e., the importing payment) of a taxpayer. Where the conditions in subsection 18.4(15.92) are met, the deduction otherwise available in respect of the importing payment may be denied to neutralize the indirect impact of the offshore hybrid mismatch amount on the Canadian tax base.

The first condition, in paragraph 18.4(15.92)(a), is that the importing payment would have been deductible under the Act in the absence of the imported hybrid mismatch rules. This condition effectively gives priority to the other rules in section 18.4 (as well as any other restrictions on deductibility in the Act) because, to the extent that any rule in the Act has already applied to deny a deduction in respect of the importing payment, the condition in paragraph 18.4(15.92)(a) will not be satisfied.

The second condition, in paragraph 18.4(15.92)(b), is that the recipient of the importing payment is non-resident. This condition ensures that, where there is a series of payments that includes payments between Canadian entities followed by a cross-border payment, only the cross-border payment will be an importing payment and therefore none of the deductions in respect of payments between Canadian entities are denied under the imported hybrid mismatch rules.

The third and final condition, in paragraph 18.4(15.92)(c), sets out the requisite link between the importing payment and the mismatch payment (i.e., the payment in respect of which the offshore hybrid mismatch amount arises). This condition is satisfied if:

- The payer of the mismatch payment is the recipient of the importing payment (i.e., a direct link), and either
    - the payer of the mismatch payment does not deal at arm's length with the payer of the importing payment, or
    - both payments arise under, or in connection with, the same foreign structured arrangement; or

- The payer of the mismatch payment is the recipient of a payment that is included in a series of payments interposed between the mismatch payment and the importing payment

(i.e., an indirect link, involving a chain of payments, starting with the importing payment and ending with a payment made to the payer of the mismatch payment), and either

- the payers of the mismatch payment, the importing payment and all those interposed payments do not deal at arm's length with each other, or
- all those payments arise under, or in connection with, the same foreign structured arrangement.

For these purposes, the meaning of the term "series of payments" is modified by the interpretive rule in subsection 18.4(15.93).

If the three conditions described above are met, the payment will be considered to arise under an imported hybrid arrangement.

Subsection 18.4(15.92) applies in respect of payments arising on or after July 1, 2026.

Series of payments - interpretation

ITA
18.4(15.93)

New subsection 18.4(15.93) sets out an interpretive rule that narrows the scope of the term "series of payments" as it is used in subsections 18.4(15.92) and (15.94).

The rules in subsection 18.4(15.93) operate to exclude from a series of payments certain payments that would otherwise have been included in the series. As outlined in the note to subsection 18.4(15.92), the type of series contemplated by that subsection and subsection 18.4(15.94) is one in which there is a chain of payments between entities, starting with an importing payment and ending with a payment made to the payer of a mismatch payment. The payments in the chain need not follow in chronological order but must constitute an unbroken chain such that each payer in the chain (except the payer of the importing payment) is the recipient of another payment in the chain. Accordingly, if the rules in subsection 18.4(15.93) act to exclude from the series the only payment (otherwise within the series) between two entities in the chain, this breaks the series. If there are multiple payments between two entities that are within the series and not all of those payments are excluded under this subsection, however, then the series remains intact.

If either of the conditions in subsection 18.4(15.93) is met in respect of a particular payment, the payment is excluded from the series. The first condition, in paragraph (a), is that there is no amount that is deductible (or reasonably expected to be deductible) in respect of the payment in computing an entity's relevant foreign income or profits or, in the case of the importing payment, income from a business or property under Part I of the Act. For these purposes, the entity that is entitled to the deduction need not be the payer of the payment. For example, if the payer is resident in a country that has a consolidation or other similar tax regime that allows for the surrender of deductions between entities within a related group and a deduction in respect of the payment is surrendered to another group entity and deducted by that other entity, the condition in paragraph (a) is not met in respect of the payment. The second condition, in paragraph (b), is that

there is an offshore hybrid mismatch amount in respect of the payment. Accordingly, any payment that is itself a mismatch payment will meet the condition in paragraph (b) and be excluded from the series.

Subsection 18.4(15.93) applies in respect of payments arising on or after July 1, 2026.

Imported hybrid mismatch – amount

ITA
18.4(15.94)

New subsection 18.4(15.94) determines the amount of an imported hybrid mismatch in respect of an importing payment.

In order for there to be an imported hybrid mismatch, there must be a payment (i.e., the importing payment) arising under an imported hybrid arrangement in respect of an offshore hybrid mismatch amount. Once this has been established, subsection 18.4(15.94) determines the amount of that imported hybrid mismatch. As an imported hybrid mismatch amount may be attributable to multiple taxation years, the attribution of that amount to particular taxation years is performed under subsection 18.4(15.95).

The amount of an imported hybrid mismatch is the lesser of the two amounts set out in paragraphs 18.4(15.94)(a) and (b). The first amount, determined under paragraph (a), is essentially the portion of the offshore hybrid mismatch amount that has not previously been neutralized because of the application of subsection 18.4(15.95) to another importing payment or the application of an equivalent provision in the hybrid mismatch rules of another country to the equivalent of an importing payment under those foreign rules. Paragraph (a) ensures that the imported hybrid mismatch amount is no greater than the offshore hybrid mismatch amount that is linked to the importing payment. This prevents a denial of deductions in an amount beyond what is necessary to neutralize the offshore hybrid mismatch amount that is determined to have sufficient linkage to a taxpayer's cross-border payment (i.e., the importing payment) to conclude that the deduction in respect of that importing payment effectively imports some or all of the offshore hybrid mismatch amount into Canada.

The second amount, determined under paragraph (b), depends on the type of link between the importing payment and the mismatch payment. If there is a direct link between the importing payment and the mismatch payment (i.e., the payer of the mismatch payment is a recipient of the importing payment), then the paragraph (b) amount is equal to the offshore hybrid mismatch amount. This reflects the fact that the tax benefit of the offshore hybrid mismatch amount can be considered to have been fully imported into Canada through the importing payment. As described above, paragraph (a) limits the amount of the imported hybrid mismatch to the portion of the offshore hybrid mismatch amount that has not already been neutralized through the application of a country's imported hybrid mismatch rules.

If there is an indirect link between the importing payment and the mismatch payment (i.e., the payer of the mismatch payment is the recipient of a payment included in a series of payments

that satisfies the non-arm's length or foreign structured arrangement test in subparagraph 18.4(15.92)(c)(ii)), then the paragraph (b) amount is determined using the following four-step process:

- Step 1: For each series of payments that meets the condition in clause 18.4(15.92)(c)(ii)(A) or (B), identify all the entities that have deductible amounts in respect of payments (either the importing payment or an interposed payment) included in that series.
- Step 2: For each such entity in respect of a particular series, determine the total of the amounts deductible by the entity in respect of payments included in the particular series.
- Step 3: Determine which of those entities has the lowest such total.
- Step 4: Determine the total of all amounts, each of which is the amount determined under Step 3 in respect of a series of payments described in Step 1.

The total amount determined under Step 4 is the paragraph (b) amount. Paragraph (b) essentially performs a tracing function, determining the extent to which the importing payment has "funded" the mismatch payment. If at any point in the series an amount less than the amount of the importing payment is deductible by an entity in respect of the payments it makes as part of the series of payments, then this lower deductible amount acts as a "bottleneck", restricting the amount that can be said to have funded the mismatch payment and, correspondingly, the tax benefit of the offshore hybrid mismatch amount that can be said to have been imported to Canada.

Subsection 18.4(15.94) applies in respect of payments arising on or after July 1, 2026.

Imported hybrid mismatch – application

ITA
18.4(15.95)

New subsection 18.4(15.95) sets out how the hybrid mismatch rules apply where it is determined that there is an amount of an imported hybrid mismatch in respect of an importing payment.

Paragraph 18.4(15.95)(a) deems subsection 18.4(4) to apply in respect of the importing payment. As such, the usual conditions for the application of subsection 18.4(4), which are contained in subsection 18.4(3), need not be met. In particular, this obviates the need for a deduction component of a hybrid mismatch arrangement. In the context of the hybrid mismatch rules, the existence of a deduction component indicates that the type of mismatch in question concerns a Canadian tax deduction. There is no need for that condition in the case of an imported hybrid mismatch, which necessarily involves a Canadian tax deduction.

Paragraph 18.4(15.95)(b) deems the amount of the imported hybrid mismatch to be a hybrid mismatch amount for a taxation year for the purposes of subsection 18.4(4), except to the extent that deductions have been denied in respect of the importing payment in preceding taxation years. This rule serves two functions. First, it adapts the "hybrid mismatch amount" concept to the case of imported hybrid mismatches, to ensure that subsection 18.4(4) can apply in respect of

such mismatches. Second, it ensures that, in the first taxation year for which there is otherwise a deductible amount in respect of the importing payment, the deduction is denied to the extent of the amount of the imported hybrid mismatch. If the deduction denied is less than the amount of that imported hybrid mismatch, then subsection 18.4(15.95) may apply in subsequent taxation years, with the deductions in those subsequent years in respect of the importing payment being denied to the extent of the remaining amount of imported hybrid mismatch (until that amount is exhausted).

Subsection 18.4(15.95) applies in respect of payments arising on or after July 1, 2026.

Dual inclusion income — special cases

ITA
18.4(19.1)

In order to generate dual inclusion income or investor dual inclusion income of an entity for a taxation year, the ordinary income of the entity in respect of a country other than Canada must generally be for a foreign taxation year that begins on or before the day that is 12 months after the end of the taxation year. However, subsection 18.4(19.1) provides that, where it would be just and equitable to do so, the Minister of National Revenue may, in determining the dual inclusion income or investor dual inclusion income of an entity for a taxation year, allow foreign income inclusions of the entity for a foreign taxation year that begins more than 12 months after the end of the taxation year to be taken into account.

Subsection 18.4(19.1) applies in respect of payments arising on or after July 1, 2026.

Resident in a country

ITA
18.4(19.2)

New subsection 18.4(19.2) is an interpretive rule for the references to residence in a country in sections 18.4 and 12.7. Pursuant to subsection 18.4(19.2), an entity that is resident in a particular country for income tax purposes (according to the laws of the particular country) is a resident of that country for the purposes of those sections.

New subsection 18.4(19.2) applies in respect of payments arising on or after July 1, 2026.

Anti-avoidance

ITA
18.4(20)

Subsection 18.4(20) is an anti-avoidance rule that is intended to prevent the avoidance of the hybrid mismatch rules. In general terms, this rule applies where one of the main purposes of a transaction or series of transactions is to avoid the application of subsection 12.7(3), 18.4(4) or

113(5), or to limit the consequences of any of those provisions, and certain other conditions are met. These other conditions are intended to capture situations that, in substance, meet the essential characteristics of hybrid mismatch arrangements, as informed by the BEPS Action 2 Report, notwithstanding that one or more of the precise technical requirements of the rules is not met. Where applicable, subsection 18.4(20) is intended to ensure that a transaction is subject to the same consequences as if the avoided hybrid mismatch rule had applied.

As the hybrid mismatch rules are being amended to incorporate additional hybrid mismatch arrangements (i.e., reverse hybrid arrangements, disregarded payment arrangements and hybrid payer arrangements), the following key amendments are made to this anti-avoidance rule:

- "Double deduction mismatch" references are added to the preamble;
- New subsection 12.7(4) is added to the list of rules referred to in the avoidance test in paragraph (a); and
- The list of conditions in paragraph (b), which aim to capture the essential characteristics of hybrid mismatch arrangements, is consequentially amended to address the characteristics of these various hybrid mismatch arrangements.

More specifically, there are four main changes to paragraph (b). First, a reference to "deduction/non-inclusion" is added to existing subparagraph (b)(ii), to clarify that the condition in that subparagraph is relevant in the case of arrangements producing deduction/non-inclusion mismatches but not ones producing double deduction mismatches.

Second, the existing subparagraph (b)(iii) is replaced with a new condition, which reflects the policy that the hybrid mismatch rules (other than subsection 113(5)) generally apply in respect of deduction/non-inclusion mismatches that result from differences in the income tax treatment of an entity under the laws of two or more countries (i.e., the hybrid mismatch rules applicable in respect of reverse hybrid mismatch arrangements and disregarded payment arrangements), in addition to where such mismatches result from differences in tax treatment that are attributable to the terms or conditions of a transaction or series (as set out in subparagraph (b)(ii)).

Third, existing subparagraph (b)(iii) is renumbered as subparagraph (b)(iv) and amended to incorporate the additional reason, for a deduction/non-inclusion mismatch or other outcome, described in clause (b)(iii)(A) (i.e., because a hybrid entity participates in the transaction or series of transactions that includes the payment. Although this subparagraph uses language similar to the "causal test" in subparagraph 18.4(15.3)(d)(ii), applicable in relation to disregarded payment arrangements, it is intended to apply more broadly, including to arrangements that avoid the disregarded payment arrangement rules.

Finally, new subparagraph (v) incorporates an additional condition that reflects that the operative rule in subsection 18.4(4) is extended, and the new rule in subsection 12.7(4) is introduced, to address double deduction mismatches under hybrid payer arrangements (as set out in new subsection 18.4(15.5)).

These amendments apply in respect of payments arising on or after July 1, 2026.

Filing requirement

ITA
18.4(21)

Subsection 18.4(21) requires taxpayers to file, in their return of income for a taxation year, a prescribed form containing prescribed information, if the primary operative rule in subsection 18.4(4) or the secondary operative rule in subsection 12.7(3) applies in respect of a payment in computing their income for the year. This subsection is amended to include a reference to the operative rule in new subsection 12.7(4), which applies to cause an income inclusion for an investor in a hybrid entity where a payment arises under a hybrid payer arrangement (as set out in subsection 18.4(15.5)) and the payer is a partnership for Canadian tax purposes. For more information, see the commentary to subsections 12.7(4), 18.4(15.5) and (15.7).

This amendment applies in respect of payments arising on or after July 1, 2026.

Clause
Adjustment for hybrid mismatch—foreign ordinary income

ITA
20(1)(yy)

Paragraph 20(1)(yy) provides a deduction in computing a taxpayer's income for a taxation year from a business or property, generally where subsection 18.4(4) has applied to deny the taxpayer a deduction in respect of a payment for the year or a preceding taxation year, and the taxpayer demonstrates an amount is foreign ordinary income of an entity in respect of the payment.

Consequential on the expansion of the hybrid mismatch rules to cover additional types of hybrid mismatch arrangements, this paragraph is amended to ensure that the reinstatement of the previously denied deduction only applies in the case of certain arrangements for which foreign ordinary income is relevant—namely, hybrid financial instrument arrangements, hybrid transfer arrangements and substitute payment arrangements. New paragraphs 20(1)(zz) and (aaa) are introduced to provide a similar deduction for disregarded payment arrangements and hybrid payer arrangements, which are the arrangements for which dual inclusion income (or investor dual inclusion income) is relevant. For more information, see the commentary to those paragraphs.

A minor amendment is also made to this paragraph to remove the deeming rule contained in subparagraph 20(1)(yy)(ii), as this rule is relocated to new subsection 20(31).

These amendments apply in respect of payments arising on or after July 1, 2026.

Adjustment for hybrid mismatch—dual inclusion income

ITA
20(1)(zz)

New paragraph 20(1)(zz) is introduced to allow for a reinstatement in a taxation year of a deduction that was denied to a taxpayer in a prior year under subsection 18.4(4), if the taxpayer demonstrates it has dual inclusion income for the taxation year. New paragraph 20(1)(aaa) is also introduced to address similar circumstances involving investor dual inclusion income. These rules are similar to paragraph 20(1)(yy), which applies where a taxpayer's deduction for a taxation year is denied under subsection 18.4(4) and the taxpayer has foreign ordinary income in a later year.

Very generally, paragraph 20(1)(zz) applies to allow a deduction for a taxation year if the following two conditions are met:

- Subsection 18.4(4) has applied to deny the taxpayer a deduction (referred to as the "denied amount") in respect of a payment for a prior taxation year. The denied amount would generally be in respect of a payment under a disregarded payment arrangement that gives rise to a deduction/non-inclusion mismatch, or a payment under a hybrid payer arrangement that gives rise to a double deduction mismatch, where the taxpayer has insufficient dual inclusion income in the year of the denial; and
- The taxpayer demonstrates (by providing the relevant foreign tax returns and any other relevant supporting documentation to the Canada Revenue Agency) that an amount is dual inclusion income for the taxation year. To prevent double counting, the amount of dual inclusion income must not have already been taken into account in determining the amount of a previous deduction under this paragraph nor as a reduction in determining a hybrid mismatch amount (which includes the hybrid mismatch amount that was denied under subsection 18.4(4) in the first instance).

The amount that may be deducted under paragraph 20(1)(zz) is the lesser of two amounts. The first amount, under subparagraph 20(1)(zz)(i), is determined by subtracting, from the denied amount, the total of all amounts previously deducted under paragraph 20(1)(zz) or under any other provision of the Act. The second amount under subparagraph 20(1)(zz)(ii) is the unused dual inclusion income.

A deduction under paragraph 20(1)(zz) could be relevant, for example, where a taxpayer lacks dual inclusion income because the taxpayer's business is in a start-up or high growth phase. In this case, paragraph 20(1)(zz) may be used to reinstate a denied amount in a subsequent year when the taxpayer demonstrates it has dual inclusion income.

New paragraphs 18.4(8)(b) to (d) contain additional "no double counting" rules that apply to the determination of dual inclusion income and investor dual inclusion income, which may limit the availability of such amounts for use in determining an amount deductible under paragraph 20(1)(zz) or (aaa). For more information, see the commentary to subsection 18.4(8).

Where paragraph 20(1)(zz) applies, new subsection 20(31) ensures the deduction under that paragraph takes the character of the payment that gave rise to the denied amount, by deeming the deduction under paragraph 20(1)(zz) to be in respect of the payment. For more information, see the commentary to subsection 20(31).

Paragraph 20(1)(zz) applies in respect of payments arising on or after July 1, 2026.

Adjustment for hybrid mismatch—investor dual inclusion income

ITA
20(1)(aaa)

New paragraph 20(1)(aaa) is introduced to provide a similar rule to new paragraph 20(1)(zz), but which applies where a taxpayer has an income inclusion for a taxation year under subsection 12.7(4) (which has essentially the same effect as a denial of a deduction under subsection 18.4(4)) and can demonstrate it has investor dual inclusion income for a subsequent taxation year. In that case, paragraph 20(1)(aaa) allows the taxpayer a deduction for the subsequent year that effectively reverses the income inclusion in the prior year.

Paragraph 20(1)(aaa) applies in respect of payments arising on or after July 1, 2026.

Character—adjustment for hybrid mismatch

ITA
20(31)

The existing deeming rule, contained in subparagraph 20(1)(yy)(ii), is moved to new subsection 20(31) and expanded to also apply to amounts that are deductible under new paragraphs 20(1)(zz) and (aaa). This new subsection ensures that any amounts that are deductible under paragraph 20(1)(yy), (zz) or (aaa) take the character of the payment that previously gave rise to the denial of the deduction under subsection 18.4(4) or the income inclusion under subsection 12.7(4). Thus, if the payment in question is treated as interest for Canadian income tax purposes, for example, an amount that is deductible in respect of the payment under paragraph 20(1)(yy), (zz) or (aaa) is subject to any other restrictions in the Act that apply in respect of deductions for interest expense, such as the thin capitalization rules and the excessive interest and financing expenses limitation.

Subsection 20(31) applies in respect of payments arising on or after July 1, 2026.

Hybrid mismatch arrangements — deemed dividend

ITA
214(18)

Subsection 214(18) deems interest paid or credited by a corporation resident in Canada, that is not deductible because of the hybrid mismatch rule in subsection 18.4(4), to be a dividend and not interest for the purposes of Part XIII of the Act. This rule is analogous to paragraph 214(16)(a) in the thin capitalization context.

This subsection is reorganized and amended consequential on the various amendments made to sections 12.7 and 18.4, which are intended to target additional hybrid mismatch arrangements added under the second package of hybrid mismatch legislation. First, this subsection is amended so that the deeming rule can apply if an amount of interest is paid or credited by a partnership. Further, new subparagraph (a)(ii) ensures the deemed dividend treatment applies in cases where subsection 12.7(4) has applied, in respect of a hybrid payer arrangement, to cause an income inclusion to an investor in a hybrid payer. For more information, see the commentary to subsections 12.7(4) and 18.4(15.5) to (15.7).

Paragraph (b) is added to provide an exception for certain payments under hybrid payer arrangements. Consistent with the recommendations in the BEPS Action 2 Report, the rules applicable to hybrid payer arrangements (under subsections 18.4(15.5) to (15.7)) apply more broadly than the rules applicable to other forms of hybrid mismatch arrangements, in that the rules for hybrid payer arrangements are not limited to arrangements involving non-arm's length persons, "specified entities" or parties to structured arrangements. To ensure this deemed dividend rule applies only to amounts arising under hybrid payer arrangements that inappropriately avoid dividend withholding tax, paragraph (b) provides that the deemed dividend rule only applies if an amount of interest arising under a hybrid payer arrangement is paid or credited to a non-resident person that does not deal at arm's length with the corporation or partnership, as the case may be, or that is a party to a structured arrangement (as defined in subsection 18.4(1)).

These amendments apply in respect of payments arising on or after July 1, 2026.

Hybrid mismatch adjustment

ITA
227(6.3)

Subsection 227(6.3) provides for a refund of Part XIII tax where paragraph 20(1)(yy) applies (and the other conditions set out in that subsection are met). Consequential on the introduction of new paragraphs 20(1)(zz) and (aaa), that subsection is amended to also provide for refunds of Part XIII tax where one of those paragraphs applies. For more information, see the commentary to paragraphs 20(1)(zz) and (aaa).

These amendments apply in respect of payments arising on or after July 1, 2026.

Investment Income Derived from Assets Supporting Canadian Insurance Risks

Clause 1

ITA
95(2)

Subsection 95(2) provides rules for determining the income, of a foreign affiliate of a taxpayer resident in Canada, from a particular source. A foreign affiliate is considered to have three main sources of income—income from property, income from a business other than an active business and income from an active business. This sourcing is important since the affiliate's income from property and the affiliate's income from a business other than an active business are included in the foreign accrual property income ("FAPI") of the affiliate. Where the affiliate is a controlled foreign affiliate of the taxpayer, the taxpayer's share of the affiliate's FAPI must be included, under section 91, in the taxpayer's income for Canadian tax purposes whether or not the income is distributed. The income of a foreign affiliate of a taxpayer from an active business is included, under section 90, in the taxpayer's income for Canadian tax purposes only when paid to the shareholder as a dividend.

ITA
95(2)(a.2)

Paragraph 95(2)(a.2) is a rule designed to prevent erosion of the Canadian tax base that might otherwise result from the use of foreign affiliates by Canadian taxpayers to earn income from the insurance of Canadian risks or from the ceding of such risks that, if earned directly by the Canadian taxpayers, would be taxable in Canada.

Subparagraphs 95(2)(a.2)(i) and (ii) include in the income from a business other than an active business (and thus the FAPI) of a foreign affiliate of a taxpayer resident in Canada the income of the affiliate from the insurance of any risk (including income from the reinsurance of the risk) where the risk insured is a "specified Canadian risk".

"Specified Canadian risk" is defined in paragraph (a.23) as a risk in respect of

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

The definition also encompasses risks insured by a foreign affiliate that do not meet the conditions described above but are deemed to be specified Canadian risks under subparagraph (a.21) or (a.24).

Income of a foreign affiliate from the insurance of specified Canadian risks includes income derived from property held by the foreign affiliate for the purpose of backing the liabilities that result from those risks (i.e., providing sufficient funds to make any claim payouts in respect of the risks). Subparagraph 95(2)(a.2)(i) is amended to clarify that the insurance of specified Canadian risks includes the holding of property of a foreign affiliate backing specified Canadian risks of another entity, for instance, a Canadian-resident insurance corporation that owns the affiliate. This amendment addresses tax avoidance concerns that arise in situations where only the assets backing the risk, and not the risk itself, are held by a foreign affiliate. The amendment ensures that income from the holding of such assets is included in the affiliate's FAPI irrespective of whether the corresponding insurance contracts have been entered into by the affiliate itself.

Specifically, subparagraph 95(2)(a.2)(i) is amended to clarify that the insurance of specified Canadian risks (the income in respect of which is deemed to be FAPI) includes the holding of any property by the affiliate in connection with the insurance or reinsurance of specified Canadian risks by any person or partnership. This amendment is similar to the language in existing provisions that describe a connection with insurance contracts, or liabilities arising under those contracts. The amended rule includes property that is indicated as backing specified Canadian risks under internal actuarial and capital allocation practices including for regulatory purposes. However, it does not include property that is not backing specified Canadian risks, for instance property that is held to back foreign insurance risks in the course of a foreign insurance business.

Subparagraph 95(2)(a.2)(i) is also amended so that its 90% gross revenue safe harbour takes into account all revenue of the affiliate (as opposed to just premium revenue). This amendment recognizes that the gross premium revenue test is not appropriate in the context where the foreign affiliate solely or mainly earns income from the holding of assets that back specified Canadian risks but does not hold the risks themselves and, therefore, does not receive premiums.

These amendments apply to taxation years of a foreign affiliate of a taxpayer that begin after November 4, 2025.