Explanatory Notes

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PREFACE

These explanatory notes describe proposed amendments to the *Income Tax Act* and various other Acts. Draft amendments to the *Income Tax Regulations*, with corresponding explanatory notes, are also included. These explanatory notes describe these amendments, clause by clause, for the assistance of Members of Parliament, taxpayers and their professional advisors.

The Honourable Paul Martin
Minister of Finance

These explanatory notes are provided to assist in an understanding of proposed amendments to the *Income Tax Act* and various other Acts. 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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EXPLANATORY NOTES TO DRAFT AMENDMENTS 1998 BUDGET INCOME TAX PROPOSALS

Clause 1

Employment Benefits

ITA
6

Section 6 of the Act provides for the inclusion in an employee's income of most employment-related benefits other than those specifically excluded.

Subclause 1(1)

Allowances for Personal or Living Expenses

ITA
6(1)(*b*)(viii)

Paragraph 6(1)(*b*) of the Act requires the inclusion in computing an employee's income of employer-provided allowances subject to certain specified exceptions, such as the $500 exemption for allowances paid to volunteer firefighters. The repeal of subparagraph 6(1)(*b*)(viii) is consequential on the replacement of the $500 exemption with a $1,000 deduction provided under paragraph 8(1)(*a*). This $1,000 deduction is also extended to other emergency service volunteers.

This amendment applies to 1998 and subsequent taxation years.

Subclause 1(2)

Housing Loss and Housing Cost Benefits

ITA
6(19) to 6(23)

New subsections 6(19) to (22) of the Act concern the income tax treatment of employer-provided compensation for losses relating an

employee's residence where an employee is relocated. New subsection 6(23) confirms that financing subsidies or other amounts paid by an employer to an employee in respect of an employee's residence are employment benefits.

New subsection 6(19) of the Act generally provides that, for the purpose of the general provision in paragraph 6(1)(*a*) requiring the inclusion in income of employment benefits, an amount paid in respect of a housing loss (other than an eligible housing loss), to a taxpayer in respect of an office or employment, is to be treated as a benefit received because of the office or employment.

New subsection 6(20) provides a special tax treatment for eligible housing losses. Generally only one half of the amount in excess of $15,000 of employer-paid amounts in respect of eligible housing losses is treated as an employment benefit received by the taxpayer.

New subsection 6(21) defines a housing loss for the purposes of section 6. Generally, a taxpayer's housing loss is defined as the amount by which the adjusted cost base or the fair market value of the house (whichever is greater) exceeds the lesser of the proceeds of disposition or the fair market value of the house. While in many cases proceeds of disposition are the best evidence of fair market value, proceeds of disposition may be less than fair market value where an employer has instructed an employee to sell the residence immediately to facilitate a quick transfer to the new work location. In contrast, proceeds of disposition may exceed fair market value where the employer or a related party agrees to purchase a home at a higher price to absorb the employee's loss. In circumstances where the taxpayer has not disposed of the residence before the end of the first taxation year beginning after the time at which the loss is being calculated, the taxpayer's housing loss is the amount by which the adjusted cost base of the house exceeds the fair market value of the house at the time at which the loss is being calculated.

New subsection 6(22) defines an "eligible housing loss". Generally, a taxpayer's eligible housing loss is the taxpayer's housing loss in respect of one, and only one, residence which occurs in the period during which the taxpayer has an eligible relocation. The new definition "eligible relocation" is added to subsection 248(1) of the Act. For more information, see the commentary on that provision.

EXAMPLE 1

Paul purchases a home in 1992 in his home town for $100,000 and begins work at a national corporation. In 1994, the land bordering Paul's home is rezoned to permit the development of an industrial park. In January, 1999, Paul is offered a promotion on the condition that he relocates to a new community (1000 kilometres from his home town) by March 1, 1999. Paul has trouble selling his home because of the heavy industry that now surrounds the property, however, he eventually accepts an offer of $60,000 and completes the sale in August, 1999. His employer has agreed to compensate him for any loss he incurs on the sale of his property. Because of the size of the loss, the employer pays out the compensation as two payments of $20,000. Paul receives $20,000 in 1999 and $20,000 in 2000. The amount of Paul's employment benefit in year one is $2500 (one half of the portion of $20,000 that exceeds $15,000).

In year two, Paul's employment benefit is $10,000. This is calculated as follows:

1/2 x ($40,000 - $15,000) (the total of all such amounts received in the year or a preceding year that exceeds $15,000) - $2,500 (amount included in income in respect of the loss in a prior year) = $10,000.

New subsection 6(23) clarifies that an amount paid or assistance provided in respect of an individual's office or employment in respect of the acquisition or use of a residence is an employment benefit. For more information regarding the calculation and tax treatment of benefits relating to employer-provided loans, see existing provisions 80.4 and 110(1)(*j*) of the Act, as well as the definition "home relocation loan" in subsection 248(1) and the commentary to new subsection 80.4(1.1) of the Act below.

These amendments apply to the 1998 and subsequent taxation years, except that, for employees undertaking an eligible relocation and beginning employment at the new work location before October, 1998, the amendments apply to the 2001 and subsequent taxation years.

Clause 2

Employee Options

ITA
7

Section 7 deals with employee stock options. It sets out the rules for determining the amount to be included in an employee's income in respect of the exercise or sale of rights under an employment-related arrangement to sell or issue shares.

As set out below in greater detail, these rules are being amended (together with consequential amendments to subsection 8(12), section 53, paragraph 110(1)(*d*) and subsection 164(6.1)) to provide similar treatment with regard to the issue or sale of mutual fund trust units to employees.

These amendments apply to the 1998 and subsequent taxation years, except as otherwise described below. However, unless an election to the contrary is made as described in the commentary on new subsection 7(7), the amendments do not affect the tax consequences resulting from the disposition of rights in respect of trust units that were acquired before March 1998.

Subclauses 2(1) to (4)

Agreement to Issue Securities to Employees

ITA
7(1) to (1.11)

Under subsection 7(1) of the Act, tax consequences for an employee will generally arise in the event that a corporation has agreed to sell or issue its shares (or shares of a non-arm's length corporation) to an employee of the corporation (or a non-arm's length corporation). In general, the recognition of an employee benefit in respect of an option to issue a share in the capital stock of a corporation occurs when the option is exercised or the employee dies. These tax consequences are modified under subsection 7(1.1) in some cases where the shares involved are of the capital stock of a Canadian-controlled private corporation (CCPC). The recognition of a

employee benefit in respect of a share issued by a CCPC generally occurs when the share is disposed of or the employee dies.

Subsection 7(1) is amended, in conjunction with the introduction of new definitions "security" and "qualifying person" in subsection 7(7), so that a mutual fund trust is treated essentially in the same manner as a public corporation. Consequently, options to acquire units of a mutual fund trust that are granted to employees of the trust (or of a corporation considered not to deal at arm’s length with the trust) are treated in the same manner as options granted to acquire the capital stock of a public corporation.

Subsection 7(1.1) is amended to reflect consequential wording changes to subsection 7(1).

It is intended that, pursuant to subsections 104(1) and (2), a person be viewed for income tax purposes as an employee of a mutual fund trust where the person is employed by the trustee of the trust in connection with the property of the trust. Under new subsection 7(1.11), a corporation is considered not to deal at arm’s length with a mutual fund trust for the purposes of section 7 only where the mutual fund trust controls the corporation.

Subclause 2(5)

Exchange of Options

ITA
7(1.4)

Under subsection 7(1) of the Act, an employee who disposes of an employee stock option will generally be treated for income tax purposes as having received a benefit from employment at the time of the disposition. Subsection 7(1.4) provides an exception to this treatment in connection with qualifying dispositions under which an employee’s option is exchanged for a new option. Where subsection 7(1.4) applies to an exchange, the new option is treated as a continuation of the exchanged option and subsection 7(1) does not apply on the exchange. As set out in paragraph 7(1.4)(*c*), for subsection 7(1.4) to apply the net benefit associated with the new options cannot exceed the net benefit associated with the exchanged option. A qualifying disposition by an employee of an option to

acquire shares of a particular corporation includes a disposition where the employee receives no consideration for the exchanged option (other than similar rights under an agreement with the particular corporation or a non-arm's length corporation).

Subsection 7(1.4) is amended, in conjunction with the introduction of the definitions "qualifying person" and "security" in new subsection 7(7), so that the continuation rule in subsection 7(1.4) also applies in respect of mutual fund trusts and corporations not dealing at arm's length with them. Pursuant to new subsection 7(1.11), the only corporations not dealing at arm's length with a mutual fund trust are those controlled by the trust.

Subsection 7(1.4) is also amended so that a qualifying disposition includes a transfer of property between two mutual funds to which subsection 132.2(1) applies.

Subsection 7(1.4) is also amended to eliminate unnecessary cross-references to paragraph 110(1)(*d*).

Subclause 2(6)

Securities Held by Trustee

ITA
7(2)

Subsection 7(2) of the Act provides "look-through" rules where a trust holds shares, whether or not on a contingent or conditional basis, for an employee. Subject to subsection 7(6), for the purpose of the rules in section 7 and paragraphs 110(1)(*d*) and (*d*.1), acquisitions and dispositions by the trust are treated as acquisitions and dispositions by the employee.

Subsection 7(2) is amended, in conjunction with the new definition "security" in subsection 7(7), so that the "look-through" rules also apply with regard to units in mutual fund trusts. Reference should also be made to the commentary to related amendments to subsection 8(12).

Special Provision

ITA
7(3)

Subsection 7(3) of the Act contains two rules that apply in connection with agreements to sell or issue shares to employees. The first rule is that any benefit determined in connection with such an agreement is determined exclusively under section 7. For example, section 7 ensures that no benefit need be determined merely because of the granting of an option pursuant to such an agreement. The effect of the second rule is that an employer (or non-arm's length person) cannot reduce its income by claiming a deduction in connection with the sale or issue of its shares to the employee (or a person who has acquired the employee's rights).

Subsection 7(3) is amended, in conjunction with the introduction of the definition "security" in subsection 7(7), so that these rules also apply in connection with agreements to sell or issue units of mutual fund trusts to employees.

This amendment applies to the 1995 and subsequent taxation years. However, unless an employee makes the election contemplated under the definitions contained in new subsection 7(7), the amendment does not result in any change in the tax consequences for an employee in connection with agreements entered into before March 1998. In addition, this amendment does not affect the entitlement of an employer to a deduction in respect of benefits conferred before March 1998.

Subclause 2(7)

Sale to Trustee for Employees

ITA
7(6)

Subsection 7(6) of the Act provides a special rule which applies where a particular corporation has entered an agreement under which shares of its capital stock (or a non-arm's length corporation) are sold or issued to a trustee for sale to an employee of the corporation (or a non-arm's length corporation). In these circumstances, for the

purposes of section 7 and paragraphs 110(1)(*d*) and (*d*.1), the rights of the employee are treated as having arisen under agreement between the employee and the particular corporation. In addition, the look-through rules under subsection 7(2) do not apply in these circumstances.

Subsection 7(6) is amended, in conjunction with the new definitions "qualifying person" and "security" in subsection 7(7), so that this special rule also applies in connection with units of mutual fund trusts. The provision has also been restructured to improve its readability.

Definitions

ITA
7(7)

New subsection 7(7) of the Act defines the expressions "qualifying person" and "security".

A "qualifying person" is a corporation or a mutual fund trust. A "security" is a share issued by the corporation or a unit of the mutual fund trust. These expressions are used throughout section 7.

These definitions apply after 1994, rather than after 1997, in order to allow for the operation of the relieving rule in amended paragraph 7(3)(*a*) on a retroactive basis where an election described below is made. However, the references to trust units and mutual fund trusts in these definitions are ignored in respect of a right under an agreement to sell or issue trust units to an individual that was entered into before March 1998 unless the following conditions are satisfied:

- the right was outstanding at the end of February 1998 and was not disposed of before March 1998 in circumstances to which paragraph 7(1)(*b*) applied, and

- the individual so elects in writing filed with the Minister of National Revenue on or before the filing-due date for the individual's taxation year that includes (a) the time that the right was first disposed of after February 1998, or (b) where earlier, the time of the individual's death. (Note: The individual is also

permitted to file the election within 6 months after the month of Royal Assent to the bill containing these changes.)

Clause 3

Income from Office or Employment – Deductions

ITA
8(1)

Subsection 8(1) of the Act specifies the amounts that a taxpayer may deduct in computing income from an office or employment.

Subclause 3(1)

Volunteers' Deduction

ITA
8(1)(*a*)

New paragraph 8(1)(*a*) of the Act provides for a deduction of up to $1,000 in respect of amounts received by an individual (and included in the individual's income) from a government, municipality or public authority for the performance, as a volunteer, of the taxpayer's duties as an ambulance technician, a firefighter or a person who assists in the search or rescue of individuals or in other emergency situations. The deduction replaces the $500 exemption previously available to volunteer firefighters under subparagraph 6(1)(*b*)(viii). The deduction will not, however, be available to a volunteer who is also employed by the same government, municipality or public authority to perform, otherwise than as a volunteer, the same or similar duties.

This amendment applies to 1998 and subsequent taxation years.

Subclause 3(2)

Certificate of Employer

ITA
8(10)

Subsection 8(10) of the Act provides that expenses will not be deductible by an employee under certain provisions unless the employee files with the return of income a prescribed form signed by the employer to the effect that the employee met the requirements of the relevant provisions for the deductibility of such expenses. Subsection 8(10) is amended to include a reference to new paragraph 8(1)(*a*) which allows a deduction of up to $1,000 in respect of amounts received by certain emergency service volunteers.

This amendment applies to 1998 and subsequent taxation years.

Subclause 3(3)

Forfeiture of Securities by Employee

ITA
8(12)

Subsection 8(12) of the Act deals with the situation where an employee forfeits shares allocated contingently to the employee under a trust to which subsection 7(2) applies. In general, the employee is allowed to deduct an amount in computing income to offset the net amount in respect of the acquisition of the share that, after taking into account paragraphs 110(1)(*d*) and (*d*.1), is included in the employee's taxable income.

Subsection 8(12) is amended so that the same rule applies in connection with the forfeiture of trust units. This amendment is consequential to the new rules in section 7 allowing the tax treatment under that section to apply in connection with agreements to issue mutual fund trust units to employees.

This amendment applies to the 1998 and subsequent taxation years.

Clause 4

Income from Business or Property

ITA
12

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

Subclause 4(1)

Indirect Assistance

ITA
12(1)(*x*)

Paragraph 12(1)(*x*) of the Act provides that certain inducements, reimbursements, contributions, allowances and assistance received by a taxpayer in the course of earning income from a business or property must be included in income to the extent that the amounts have not otherwise been included in income or reduced the cost of a property or the amount of an outlay or expense.

Subparagraph 12(1)(*x*)(i) is amended by adding to the list of circumstances in which a payment may be subject to income inclusion under paragraph 12(1)(*x*). Payments made in circumstances where it is reasonable to conclude that the payment would not have been made but for the receipt by the payer of funds from an entity (generally a business or a government authority) already described in the provision will be treated in the same manner as payments received directly from the listed entity. This amendment ensures that the imposition of an intermediate non-government non-business organization between the original payer and the ultimate recipient will not affect the tax treatment of the amount in the hands of the ultimate recipient.

This amendment applies to amounts received after February 23, 1998, except for amounts received before 1999 pursuant to a written agreement made before February 24, 1998.

Subclause 4(2)

Refund of Countervailing Duties

ITA
12(1)(*z*.6)

New paragraph 12(1)(*z*.6) requires the inclusion in income of any amount received by the taxpayer in the year in respect of a refund of an amount that was deducted under paragraph 20(1)(*vv*) in computing income for any taxation year. This would include the refund of the duties paid as well as any other amount (i.e. interest or any other compensation) included in the refunded amount. New paragraph 20(1)(*vv*), described in more detail in the commentary on that provision, generally permits the deduction of payments on account of countervailing or anti-dumping duties.

New paragraph 12(1)(*z*.6) applies to amounts received after February 23, 1998.

Clause 5

Depreciable Capital Property

ITA
13

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

Subclause 5(1)

Replacement of a Former Property

ITA
13(4.1)(*c*)

Subsection 13(4) of the Act is a "replacement property rule". It allows a taxpayer in certain circumstances to treat one depreciable

property (the "replacement property") as taking the place of another (the "former property"),and thus limit the recognition of income that would otherwise be considered to have been realized on the disposition of the former property.

Subsection 13(4.1) of the Act describes the conditions under which a depreciable property acquired by a taxpayer will be a replacement property for the purposes of subsection 13(4). Paragraph 13(4.1)(*c*) provides that where the former property was taxable Canadian property, the replacement property rule is available only if the replacement property also is taxable Canadian property.

As a consequence of the introduction of the definition "treaty-protected property" in subsection 248(1) of the Act, paragraph 13(4.1)(*c*) is replaced by two new paragraphs. New paragraph 13(4.1)(*c*) reproduces the effect of the existing paragraph. New paragraph 13(4.1)(*d*) adds a new requirement: that where the former property was a taxable Canadian property other than treaty-protected property, the replacement property must be as well.

New paragraphs 13(4.1)(*c*) and (*d*) apply to dispositions that occur in taxation years ending after 1997.

Subclauses 5(2) to (4)

Definitions

ITA
13(21)

"undepreciated capital cost"

Subsection 13(21) provides definitions for the purposes of section 13 relating to the tax treatment of depreciable property.

The definition "undepreciated capital cost" (UCC) is amended by adding new variable D.1 to the list of amounts to be added in calculating UCC. New variable K is added to the list of amounts to be subtracted in calculating UCC.

New variable D.1 will require the addition to the UCC of a class of amounts paid by the taxpayer as or on account of a countervailing or anti-dumping duty in respect of depreciable property of the class.

New variable K will require the subtraction from the UCC of a class of amounts received by the taxpayer in respect of a refund of an amount added to the undepreciated capital cost of depreciable property of the class because of the description of D.1. This would include the refund of the duties paid as well as any other amount (i.e. interest or any other compensation) included in the refunded amount.

These amendments apply to amounts that become payable, or are received, as the case may be, after February 23, 1998.

Clause 6

Amount Owing by Non-resident

ITA
17

Section 17 will generally apply if a corporation resident in Canada loans money to a non-resident person and the loan remains outstanding for a year or more without interest on the loan computed at a reasonable rate being included in computing the corporation's income. However, there are two exceptions. Section 17 does not apply if Part XIII withholding tax was paid on the amount of the loan or if the non-resident is a subsidiary controlled corporation of the corporation resident in Canada that uses the money to earn business income.

The amendments to section 17 expand both the scope of the general rule and the scope of one of the exceptions. Under the expanded general rule, subsection 17(1) applies to any amount owing by a non-resident to a corporation resident in Canada, not just to loans. In addition, a number of anti-avoidance rules have been added in subsections 17(2) to (6) that apply where a corporation resident in Canada has loaned an amount to a non-resident indirectly through an intermediary. In such cases, the non-resident is deemed to owe to the corporation resident in Canada an amount equal to, or equal to some portion of, the amount it owes to the intermediary. Subsection 17(1)

then applies to the amount deemed to be owing to the corporation resident in Canada.

Under the exceptions, subsection 17(1) will not apply, as before, if Part XIII withholding tax has been paid on the amount owing. However, the exception relating to subsidiary controlled corporations has been expanded to include any amount owing by a corporation that is a "controlled foreign affiliate" (as defined in section 17) of the corporation resident in Canada, provided that the amount owing by the affiliate either is used to earn active business income or arose in the course of an active business carried on by the affiliate.

The amendments to section 17 all apply to taxation years that begin after February 23, 1998.

Amount Owing by Non-resident

ITA
17(1)

Subsection 17(1) of the Act applies where a corporation resident in Canada has lent money to a non-resident and that loan remained outstanding for one year or longer without the corporation including interest on the loan, computed at a reasonable rate, in computing its income. Where subsection 17(1) applies, it treats the corporation as having received interest on the loan, computed at a prescribed rate, at the end of each taxation year during which the loan was outstanding.

As amended, subsection 17(1) will apply to all amounts owing by a non-resident person to a corporation resident in Canada where the amount owing remains outstanding for more than a year and a reasonable amount of interest has not been included in computing the corporation’s income in respect of the amount owing for the portion of the corporation’s taxation year during which the amount owing was outstanding.

Where amended subsection 17(1) applies, it provides some recognition of the amount, if any, the corporation has included in income in respect of interest on the amount owing under other provisions of the Act.

First, the subsection 17(1) income inclusion is reduced by any amount the corporation included in computing its income for the year in respect of interest on the amount owing under any other provision of the Act. For example, a corporation resident in Canada that makes a low-interest loan directly to a non-resident person will be required to include an amount in its income for the year with respect to interest actually paid or payable with respect to that loan. That amount will reduce the amount the corporation is required to include in income under subsection 17(1).

Second, the subsection 17(1) income inclusion is reduced by any amount the corporation included in computing its income for the year in respect of an amount received or receivable by the corporation from a trust, where that amount is reasonably attributable to interest on the amount owing. This could apply, for example, where a corporation resident in Canada transfers property to a trust in which it holds a beneficial interest and the trust makes a low-interest loan to a non-resident. If the trust distributes to the corporation the interest it receives on the loan to the non-resident, the amount received by the corporation will reduce the amount the corporation is required to include in income under subsection 17(1) in respect of the amount owing (the look-through rule in subsection 17(5) will deem the non-resident to owe an amount to the corporation resident in Canada for the purpose of section 17).

Anti-Avoidance Rule – Indirect Loan

ITA
17(2)

New subsection 17(2) of the Act is an anti-avoidance rule intended to support subsection 17(1). Where a non-resident person owes an amount to a particular person or partnership (other than a corporation resident in Canada) and it is reasonable to conclude that the particular person or partnership extended credit to the non-resident person because a corporation resident in Canada loaned or transferred property, directly or indirectly, to any person or partnership (not necessarily the particular person or partnership), the non-resident is deemed to owe an amount to the corporation resident in Canada equal to the amount owing to the particular person or partnership. New subsection 17(2) does not apply in the circumstances outlined below in new subsection 17(3).

Exception to Anti-avoidance Rule – Indirect Loan

ITA
17(3)

New subsection 17(3) of the Act provides an exception to the application of the anti-avoidance rule in new subsection 17(2). New subsection 17(2) does not apply where the non-resident owes the amount to a person that is a "controlled foreign affiliate" (as defined in new subsection 17(10)) of the corporation resident in Canada if all amounts included in computing the income of the affiliate that is derived from amounts paid or payable in respect of the amount owing would be treated as active business income of the controlled foreign affiliate under subparagraph 95(2)(*a*)(ii).

Anti-Avoidance Rule – Loan through Partnership

ITA
17(4)

New subsection 17(4) of the Act applies where a non-resident owes an amount to a partnership and that amount is not treated by subsection (2) as owing to a corporation resident in Canada. Where subsection 17(4) applies, it treats the non-resident as owing a portion of the amount owing to the partnership to each member of the partnership (on the same terms as that debt was owed to the partnership). Each member's portion of the debt is based on the fair market value of the member's interest in the partnership relative to the fair market value of all interests in the partnership.

Where a debt is treated as being owing to a member of a partnership and that member is itself another partnership, the portion of the debt treated as being owed to that other partnership will be treated in turn as owing to the members of that other partnership, and so on, up through any number of tiered partnerships. This subsection can also act in conjunction with subsection 17(5) to attribute an amount owing up through alternating partnerships and trusts.

The purpose of subsection 17(4) is to broaden the scope of amended subsection 17(1) by looking through any intervening partnerships in determining whether a corporation resident in Canada has made a loan to a non-resident.

Anti-Avoidance Rule – Loan through Trust

ITA
17(5)

New subsection 17(5) of the Act applies where a non-resident owes an amount to a trust and that amount is not treated by subsection (2) as being owed to a corporation resident in Canada.

If the trust is a "non-discretionary trust" (as defined in new subsection 17(10)), paragraph 17(5)(*a*) treats the non-resident as owing to each beneficiary of the trust a portion of the amount owing to the trust (on the same terms as that debt was owed to the trust). The size of each beneficiary's portion is based on the fair market value of the beneficiary's interest in the trust relative to the fair market value of all the beneficial interests held in the trust at that time.

If the trust is not a non-discretionary trust, paragraph 17(5)(*b*) treats the non-resident as owing to each "settlor" in respect of the trust (as defined in new subsection 17(10)) an amount equal to the amount owing to the trust.

Where an amount owing to a trust is treated under this subsection as being owed to a beneficiary or a settlor of the trust and that beneficiary or settlor is itself another trust, the amount treated as being owed to that other trust will be treated in turn as being owed to either the beneficiaries or the settlor(s) of that other trust, and so on, up through any number of tiered trusts. This subsection can also act in conjunction with subsection 17(4) to attribute an amount owing up through alternating tiers of partnerships and trusts.

The purpose of subsection 17(5) is to broaden the scope of amended subsection 17(1) by looking through any intervening trusts in determining whether a corporation resident in Canada has made a loan to a non-resident.

Anti-Avoidance Rule – Loan to Partnership

ITA
17(6)

New subsection 17(6) of the Act applies where a partnership owes an amount to any person or any other partnership (the "lender), and treats each member of the partnership as owing, for the purposes of section 17, a portion of the amount owed by the partnership to the lender (on the same terms as that amount was owed by the partnership to the lender). The portion of the partnership's debt that is treated as being owed by each member is based on the fair market value of the member's interest in the partnership relative to the fair market value of all interests in the partnership.

Where a member of a partnership is treated as owing an amount to the lender and that member is itself another partnership, portions of the amount treated as being owed by that other partnership will be treated in turn as being owed by the members of that other partnership, and so on, up through any number of tiered partnerships.

The purpose of subsection 17(6) is to broaden the scope of amended subsection 17(1) by recognizing that a loan made to a partnership is effectively a number of smaller loans made to each of the partnership's members.

Exception

ITA
17(7)

New subsection 17(7) of the Act is a slightly amended version of former subsection 17(2). New subsection 17(7) provides an exception to the application of subsection 17(1) where a non-resident owes an amount to a corporation resident in Canada and Part XIII tax has been paid on the amount owing. As a consequence of the addition of the look-through rules in new subsections 17(2) to (6), the provision now also applies to any amount treated as being owed to a corporation resident in Canada by a non-resident if Part XIII tax has been paid on that amount.

Exception

ITA
17(8)

New subsection 17(8) of the Act is an amended version of former subsection 17(3). New subsection 17(8) provides that subsection 17(1) will not apply in respect of an amount owing to a corporation resident in Canada by a "controlled foreign affiliate" (as defined in new subsection 17(10)) of the resident corporation if:

- the amount owing arose as a loan or advance to the affiliate that the affiliate has used, throughout the period during which the loan or advance has been owing, to earn income that is "income from an active business" (as defined in subsection 95(1) of the Act); or

- the amount owing arose in the course of an "active business" (as defined in subsection 95(1) of the Act) that was carried on by the affiliate throughout the period during which the amount has been owing.

Determination of Controlled Foreign Affiliate Status

ITA
17(9)

New subsection 17(9) of the Act contains three look-through rules that apply, for the purpose of section 17, in determining whether a non-resident corporation is a controlled foreign affiliate of a corporation resident in Canada.

First, under paragraph 17(9)(*a*), each member of a partnership is treated as owing a portion of the shares of any corporation owned by the partnership. Each member's portion is based on the fair market value of the member's interest in the partnership relative to the fair market value of all interests in the partnership.

Where a member of a partnership is treated as owing a portion of the shares owned by the partnership and the member is itself another partnership, the members of that other partnership will be treated, in turn, as owing a portion of the shares considered to be owned by that

other partnership, and so on, up through any number of tiered partnerships.

Second, under paragraph 17(9)(*b*), each beneficiary of a "non-discretionary trust" (as defined in subsection 17(10)) is deemed to own a portion of the shares of any corporation owned by the trust. Each beneficiary's portion at any time is to be determined on the basis of the fair market value of the beneficiary's interest at that time in the trust relative to the fair market value of all the beneficial interests in the trust at that time.

Third, under paragraph 17(9)(*c*), each "settlor" (as defined in subsection 17(10)) in respect of a discretionary trust is treated as owing, at any time, an equal portion of the shares of any corporation owned by the trust at that time.

Where shares owned by a trust are considered under paragraph 17(9)(*b*) or (*c*) to be owned by a beneficiary or a settlor of the trust and that beneficiary or settlor is itself another trust, the shares treated as being owned by that other trust will be treated in turn to be owned by either the beneficiaries or the settlor(s) of that other trust, and so on, up through any number of tiered trusts. Paragraphs 17(9)(*b*) and (*c*) can also act in conjunction with paragraph 17(9)(*a*) to attribute ownership of shares up through tiers of alternating partnerships and trusts.

The purpose of subsection 17(9) is to broaden the scope of the exception to subsection 17(1) provided under subsection 17(8) by looking through any intervening partnerships or trusts in determining whether a non-resident is a controlled foreign affiliate of a corporation resident in Canada.

Definitions

ITA
17(10)

New subsection 17(10) of the Act defines a number of terms that apply for the purpose of section 17.

"controlled foreign affiliate"

The term "controlled foreign affiliate" is defined to have the same meaning as it does under subsection 95(1) of the Act, except that a non-resident corporation must be controlled by Canadian residents in order to be treated as a controlled foreign affiliate of a taxpayer resident in Canada for the purpose of section 17.

"non-discretionary trust"

The term "non-discretionary trust" is defined as a trust in which all the interests were vested indefeasibly at the beginning of the trust's taxation year in which the definition is being applied. In order for all the interests in the trust to have vested indefeasibly, the trust must have one or more beneficiaries, the trust arrangement must not permit the creation of any new beneficiaries in the future and the trust arrangement must not give anyone a discretionary power with respect to any of the income or capital of the trust.

"settlor"

The term "settlor" in respect of a trust is defined as a person or partnership that has made a loan or transfer of property, directly or indirectly, to or for the benefit of the trust at or before that time. A loan or transfer made for the benefit of the trust would include, for example, a low-interest loan or a transfer at less than fair market value to an entity in which the trust has an interest. However, if, at any particular time, a person or partnership deals at arm's length with the trust, any loan made directly to the trust at a reasonable rate of interest, and any transfer made directly to the trust for fair market value consideration, at or before that time by that person or partnership will be ignored in determining whether the person or partnership is a settlor in respect of the trust at that time.

Clause 7

Income from Business or Property – Deductions

ITA
20

Section 20 of the Act provides rules relating to the deductibility of certain outlays, expenses and other amounts in computing a taxpayer's income for a taxation year from a business or property.

Subclause 7(1)

Countervailing or Anti-Dumping Duty

ITA
20(1)(*vv*)

New paragraph 20(1)(*vv*) provides for the deduction of an amount paid by the taxpayer in the year as or on account of an existing or proposed countervailing or anti-dumping duty in respect of property (other than depreciable property). Such amounts paid in respect of depreciable property are generally added to the undepreciated capital cost of the class. See the commentary on the amendments to the subsection 13(21) definition "undepreciated capital cost" for further information.

This amendment applies to amounts that become payable after February 23, 1998.

Subclause 7(2)

Foreign Tax Where Insubstantial Economic Profit

ITA
20(12.1)

New subsection 20(12.1) of the Act provides a deduction in computing income from a business for certain foreign taxes that are not eligible for the foreign tax credit under section 126 of the Act as a result of the limitation in new subsection 126(4.1). Eligible foreign taxes are those paid in respect of a property used in the business, or

in respect of related transactions (newly defined in subsection 126(7) of the Act), that would otherwise be included in the taxpayer's business-income tax or non-business-income tax for foreign tax credit purposes but for the operation of subsection 126(4.1). No deduction is provided, however, for foreign tax in respect of a dividend received by a corporate taxpayer from a foreign affiliate; such foreign tax is dealt with in subsections 20(13) and 91(5) and section 113 of the Act.

The deduction of foreign tax paid for a year in respect of a period of ownership of the property is limited under this provision to the portion of the taxpayer's income from the business, for the year for which the tax is paid, that is attributable to the property for that period or to a related transaction. Income is calculated for this purpose as provided in the Act. If the property is held for more than one non-contiguous period in a single year, the rule operates independently in respect of each period. In essence, the deduction may not be used to create a loss in respect of the property and related transactions. If a related transaction involves acquisition of another property in respect of which subsection 126(4.1) could apply independently, foreign tax in respect of that property may not be deducted a second time if it has already been deducted as tax in respect of a related transaction relative to the first property. Such double deduction is prevented by subsection 248(28) of the Act. No provision is made for carry-over of foreign tax amounts that are not deductible in the year.

New subsection 20(12.1) applies to the 1998 and subsection taxation years.

Clause 8

PHSP Premiums

ITA
20.01

Subject to certain conditions, new section 20.01 of the Act permits an individual to deduct, in computing the individual's income from a business carried on by the individual and in which the individual is actively engaged on a regular and continuous basis (directly or as a member of a partnership), amounts payable under a private health

services plan (PHSP) for the benefit of the individual, the individual's spouse and members of the individual's household.

PHSP Premiums

ITA
20.01(1)

Subsection 20.01(1) of the Act provides that, in order for the amounts to be deductible, either the individual's total incomes (excluding losses) from businesses in which the individual is actively engaged on a regular and continuous basis must represent more than 50% of the individual's income for the year, or the individual's income from other sources do not exceed $10,000. To be deductible by the individual, the amounts have to be payable under a contract between the individual and

- a person licensed or otherwise authorized under federal or provincial law to carry on in Canada an insurance business or the business of offering services as trustee,
- a person (or partnership) offering to the public its services as a PHSP administrator, or
- a tax-exempt entity that is a business or professional organization of which the individual is a member or a trade union of which the individual or the majority of the individual's employees are members.

Limit

ITA
20.01(2)

Paragraph 20.01(2)(*a*) of the Act stipulates that no deduction may be claimed under subsection 20.01(1) by an individual in respect of an amount payable under a PHSP to the extent that the amount is deducted under that subsection by another individual or is claimed under section 118.2 (as a medical expense) by any individual for any taxation year.

Paragraph 20.01(2)(*b*) provides that, where one or more persons are employed on a full-time basis and have accumulated at least 3 months of service in a business carried on by the individual, a partnership of which the individual is a majority interest partner or a corporation affiliated with the individual, the deduction is restricted to the lowest cost of equivalent coverage made available to any arm's length employee.

Paragraph 20.01(2)(*c*) provides that, where an individual has no employees or where the employees dealing at arm's length with the individual and to whom coverage is extended under a PHSP represent less than 50% of the persons who carry on, or are employed in, such a business and to whom coverage is extended under the plan, the deduction is further restricted by a dollar maximum, which is, on an annual basis, equal to $1,500 for each of the individual, the individual's spouse and members of the individual's household you are 18 years of age or over and $750 for other members of the individual's household.

Equivalent Coverage

ITA
20.01(3)

Subsection 20.01(3) determines when an amount payable in respect of an individual under a PHSP does not exceed, in relation to a particular period, the individual's cost of coverage under the plan in respect of another person. The calculation provided in that subsection is illustrated in the following examples. In the examples, it is assumed that the individual's cost of coverage is $1,700 on an annual basis.

EXAMPLE 1

An individual is the sole proprietor of a business in which the individual employs 5 arm's length full-time persons. While the coverage and benefits under the plan made available to the employees are identical to the coverage and benefits enjoyed by the individual, the individual agreed to pay only 30% of the premiums payable in respect of the employees' coverage. In this case, the individual's deduction for his or her own coverage is $510, i.e., 30% of $1,700. The remainder ($1,190) may, once paid, be

included in the individual's total medical expenses for the purposes of the medical expense tax credit under section 118.2 of the Act.

EXAMPLE 2

Same as in example 1, except that the individual now pays 90% of the employees' premiums, each employee's coverage being restricted to $3,000 in benefits while the individual's coverage in terms of maximum benefits is set at $5,000. For the purposes of this example, assume that the cost of $3,000 coverage is $1,200. In this case, the individual's deduction for his or her own coverage is $1,080, i.e. 90% of ($1,700 x $1,200/$1,700). Again, the non-deductible portion ($620 in this example) may, once paid, be included in the individual's total medical expenses. Where the costs are not constant, the eligible amounts would be calculated by reference to the actual costs.

EXAMPLE 3

Same as in example 1, except that the individual agrees to pay 100% of the employees' premiums, and the cost of equivalent coverage and benefits for each of those employees is $700 less than for the individual (presumably due to the better health of the employees). In this case, the individual may deduct the full cost of his or her own coverage.

EXAMPLE 4

A partnership of 2 single doctors, of which the individual is a member, operates a medical clinic. The partners are related to each other and the partnership has 1 arm's length employee. Assuming that both partners and the employee are covered to the same extent under the plan and the partnership pays the full amount of the premiums, the amount payable ($1,700) allocated to the individual is, for the purpose of the deduction, restricted to $1,500, since less than 50% of the total number of persons to whom coverage under the plan is extended and who either carry on the business or are full-time employees of the business deal at arm's length with the individual.

For the purpose of determining the number of persons dealing at arm's length with an individual, the individual is considered not to deal at arm's length with him or herself.

This amendment applies to taxation years that begin after 1997.

Clause 9

Scientific Research and Experimental Development

ITA
37(1)

Section 37 of the Act sets out rules governing the deductibility of expenditures incurred by a taxpayer for scientific research and experimental development (SR&ED).

Under subsection 37(1), certain expenditures incurred by a taxpayer for SR&ED carried on in Canada are accumulated in an SR&ED pool. All or a portion of the undeducted balance of the pool at the end of a taxation year may be deducted in that year. Any remaining balance may be carried forward to be deducted in a subsequent taxation year.

The balance of this pool is reduced by investment tax credits claimed in respect of amounts that have been included in the pool. Amendments to the rules governing the investment tax credit in section 127 of the Act may, however, recapture a portion of a taxpayer's SR&ED investment tax credit (SR&ED ITC) in circumstances where a taxpayer disposes of, or converts to commercial use, property which has been the subject of an SR&ED ITC claim by the taxpayer. Where the amount of an expenditure that would otherwise be eligible for recognition under section 37 has been reduced because of a previous SR & ED ITC claim, and a portion of that ITC claim has been recaptured because of the application of new subsection 127(28) of the Act, it is appropriate that the taxpayer be able to add the recaptured ITC back to the taxpayer's SR&ED pool. Accordingly, new paragraph 37(1)(*c*.2) increases a taxpayer's subsection 37(1) SR&ED pool by the total of all amounts added because of new subsection 127(28) to the taxpayer's tax payable under this Part for any preceding taxation year.

This amendment applies to the 1998 and subsequent taxation years. For further information, see the commentary to the amendments to section 127 of the Act.

Clause 10

Exchanges of Property – Replacement Property

ITA
44(5)

Section 44 of the Act provides "replacement property rules" for capital property. These rules allow a taxpayer in certain circumstances to treat one property as having taken the place of another, and thus limit the recognition of income that would otherwise be considered to have been realized on the disposition of the replaced property.

Subsection 44(5) of the Act describes the conditions under which a particular capital property will be a replacement property for these purposes. Paragraph 44(5)(*c*) provides that where the former property was taxable Canadian property, the replacement property rules are available only if the replacement property also is taxable Canadian property.

As a consequence of the introduction of the definition "treaty-protected property," in subsection 248(1) of the Act, paragraph 44(5)(*c*) is replaced by two new paragraphs. New paragraph (*c*) reproduces the effect of the existing paragraph. New paragraph (*d*) adds a new requirement: that where the former property was a taxable Canadian property other than treaty-protected property, the replacement property must be as well.

New paragraphs 13(4.1)(*c*) and (*d*) apply to dispositions that occur in taxation years ending after 1997.

Clause 11

Cost of Certain Properties – Cost of Shares of Immigrant Corporation

ITA
52(8)

Section 52 of the Act sets out rules for determining the cost of certain property for the purposes of measuring any gain or loss on its disposition.

Subsection 52(8) of the Act establishes the cost to a non-resident taxpayer of shares of a corporation that has become resident in Canada. This provision is amended as a consequence of the amendments to subsections 128.1(1) to (3) of the Act. If the share was not taxable Canadian property immediately before the time of immigration, the cost is deemed to be equal to the fair market value of the share at the time of immigration. Cost is re-set in this case because immigration of the corporation in most cases causes the share to become taxable Canadian property. The re-set ensures that gains and losses are calculated for Canadian purposes only from the time of immigration.

This amendment applies in respect of corporations that become resident in Canada after February 23, 1998.

Clause 12

Adjustments to Cost Base

ITA
53

Section 53 of the Act sets out rules for determining the adjusted cost base (ACB) of capital property for the purpose of calculating any capital gain or loss on its disposition.

Subclause 12(1)

ITA
53(1)(*b*.1)

New paragraph 53(1)(*b*.1) of the Act provides that where new paragraph 128.1(1)(*c*.2) of the Act deems a dividend to have been received by a resident shareholder of a corporation that becomes resident in Canada, the amount of the deemed dividend is added to the shareholder's adjusted cost base of the share. Where an immigrating corporation elects to increase the paid-up capital of its shares to their net fair market value - which value can subsequently be returned to shareholders free of tax - the deemed dividend ensures that the increase in paid-up capital is a tax-paid amount. Since the deemed dividend from the foreign corporation prior to immigration will have been included in the income of the resident shareholder, the addition to adjusted cost base prevents double taxation of the accrued surplus in the immigrating corporation. In essence, resident shareholders of an immigrating corporation are treated as if they had received a taxable distribution of the corporation's accrued surplus by way of dividend and then reinvested the same amount in the corporation.

This amendment applies after February 23, 1998.

Subclause 12(2)

ITA
53(1)(*j*)

Paragraph 53(1)(*j*) of the Act provides for an addition in computing a taxpayer's ACB of a share of a corporation's capital stock, to the extent that an employee benefit in respect of its acquisition is deemed to be received under section 7 by the taxpayer (or a non-arm's length person).

Paragraph 53(1)(*j*) is amended so that the same rule applies in respect of trust units. This amendment is consequential to the new rules in section 7 allowing the tax treatment under that section to apply in connection with agreements to issue mutual fund trust units to employees.

This amendment applies to trust units acquired after February 1998.

Subclause 12(3)

ITA
53(2)(*c*)(xii)

Paragraph 53(2)(*c*) provides for certain deductions in computing the ACB of a partnership interest. New subparagraph 53(2)(*c*)(xii) requires a taxpayer that is a member of a partnership to reduce the ACB of the partnership interest by the amount payable by the partnership under a private health services plan to the extent that the amount is deductible under new subsection 20.01(1) in computing the taxpayer's income for any taxation year beginning before the time at which the ACB of the taxpayer's partnership interest is being computed.

This amendment applies after 1997.

Subclause 12(4)

ITA
53(2)(*t*)

This amendment is discussed in the commentary below relating to an amendment to subsection 164(6.1).

Clause 13

Amounts Included in Income – Lifelong Learning Plan

ITA
56(1)(*h*.2)

Section 56 of the Act lists income of certain types that are required to be included in computing a taxpayer's income from a source other than an office, employment, business or property.

Paragraph 56(1)(*h*.2) is introduced to refer to certain amounts required to be included in income pursuant to the Lifelong Learning Plan (LLP) described in detail in the commentary on section 146.02. Under the LLP, a student may withdraw up to $20,000 of RRSP

funds while enrolled in certain educational programs. Amounts may be included in income pursuant to new subsections 146.02(4), (5) and (6).

The amendment applies to 1999 and subsequent taxation years.

Clause 14

Deductions in Computing Income – CES Grant Repayment

ITA
60(*x*)

Section 60 of the Act provides for a variety of deductions in computing income, many of which relate to certain income inclusions required under section 56.

New paragraph 60(*x*) provides for the deduction of repayments of amounts attributable to Canada Education Savings Grants (CES Grants) that were previously included in a beneficiary's income under a registered education savings plan (RESP). Specifically, paragraph 60(*x*) provides that, where amounts attributable to CES Grants were previously included in an individual's income because of subsection 146.1(7) and the individual is subsequently required to repay the amounts under Part III.1 of the *Department of Human Resources Development Act*, the repayment may be deducted by the individual.

Part III.1 of the *Department of Human Resources Development Act* sets out rules relating to the CES Grant program. Under the program, the federal government pays a 20% CES Grant on the first $2,000 of annual contributions made to registered education savings plans (RESPs) in respect of a qualifying beneficiary. The contributions and the CES Grants are held in the RESP trust to generate income to be used to help finance the costs of the beneficiary's post-secondary education. Once the beneficiary is enrolled as a full-time student in a qualifying educational program, the accumulated RESP income (including CES Grants) can be paid to the beneficiary as educational assistance payments.

The CES Grant rules provide a lifetime limit of $7,200 on the amount of CES Grants that a beneficiary can receive out of RESPs as

educational assistance payments. For this purpose, a specific portion of each educational assistance payment paid to a beneficiary under an RESP is considered to be attributable to the CES Grants paid to the plan. In general terms, the CES Grant portion of an educational assistance payment is based on the ratio of CES Grants paid to the plan to the total investment earnings and CES Grants held in the plan. RESP trustees are required to limit CES Grant payments made to each beneficiary under the plan to $7,200. However, if an individual is a beneficiary under more than one RESP, the total amount of CES Grants paid to the individual as educational assistance payments may exceed the lifetime limit. In such a case, the individual is required to repay the excess to the federal government. Since the CES Grants would have previously been included in the individual's income as educational assistance payments, paragraph 60(*x*) allows an offsetting deduction for the repayment.

Paragraph 60(*x*) applies to the 1998 and subsequent taxation years.

Clause 15

Moving Expenses

ITA
62

Section 62 of the Act provides a deduction for the qualifying moving expenses of an individual who moves to a new location in Canada to take up employment, start a business, or pursue higher education.

Subclause 15(1)

Moving Expenses

ITA
62(1) and (2)

Subsection 62(1) of the Act sets out the circumstances under which moving expenses may be deducted in computing a taxpayer's income. A number of the requirements set out in this subsection have application to other provisions of the Act – most notably, new subsections 6(19) to (22). For this reason, a definition incorporating

those requirements is being added to subsection 248(1), and subsection 62(1) is being amended to make reference to that new definition. Similarly, subsection 62(2) is being amended to draw upon the requirements set out in the new "eligible relocation" definition in subsection 248(1).

The amendments to subsection 62(1) also eliminate paragraph (*e*) of the former subsection, on the basis that subsection 248(28) of the Act currently operates to provide the same effect.

These amendments apply after 1997.

Subclause 15(2)

Definition of "Moving Expenses"

ITA
62(3)

Subsection 62(3) of the Act lists the expenses which may qualify for deduction by a taxpayer where subsection 62(1) applies. The amendment to subsection 62(3) expands the list of eligible moving expenses to include:

- interest, property taxes, insurance premiums and heating and utility costs, to a maximum of $5,000, where those expenses are incurred for the period during which reasonable efforts are being made to sell the residence, provided that it is not rented out or occupied by the taxpayer or a member of the taxpayer's household, and

- the cost of utility connections and disconnections, changing addresses on legal documents and replacing drivers' licenses and vehicle permits.

These amendments apply to expenses incurred after 1997.

Clause 16

Child Care Expenses

ITA
63

Section 63 of the Act provides rules concerning the deductibility of child care expenses in computing a taxpayer's income.

Subclauses 16(1) and (2)

Child Care Expenses

ITA
63(1)(*e*)(ii)

Clause 63(1)(*e*)(ii)(A) of the Act sets out the annual maximum amount of child care expenses that may be claimed for a year in respect of eligible children who are under 7 years of age at the end of the year, or in respect of whom a disability tax credit may be claimed for the year. This amendment increases from $5,000 to $7,000 the annual maximum amount that may be claimed in respect of these children.

Clause 63(1)(*e*)(ii)(B) of the Act sets out the annual maximum amount of child care expenses that may be claimed for a year in respect of eligible children who are 7 years of age or older at the end of the year. This amendment increases from $3,000 to $4,000 the annual maximum amount that may be claimed in respect of these children.

The amendments to subsection 63(1) apply to 1998 and subsequent taxation years.

Subclause 16(3)

Income exceeding Income of Supporting Person

ITA
63(2)(*b*)

When more than one taxpayer contributes to the support of an eligible child, the child care expense deduction for a year must generally be claimed by the taxpayer with the lower income for the year. However, in the circumstances specified in paragraph 63(2)(*b*) of the Act, the supporting person with the higher income may claim a deduction based on the number of weeks in the year throughout which the lower-income person is separated, infirm, confined to a bed or wheelchair, in prison, or in attendance at a designated educational institution or a secondary school and enrolled in a program of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program (a full-time program).

The amendment to paragraph 63(2)(*b*) increases the weekly maximum amount of the deduction from $150 to $175 with respect to child care expenses paid for eligible children who are under 7 years of age at the end of the year or in respect of whom a disability tax credit may be claimed, and from $90 to $100 with respect to child care expenses paid for other eligible children. It also expands the claim for child care expenses available to a higher-income supporting person to include months (other than months that include weeks used in computing the weekly maximum amount of the deduction) during which the lower-income person is in attendance at a designated educational institution or secondary school and enrolled in a program of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 12 hours per month on courses in the program. In these circumstances, the maximum amount of deduction available for a month is the revised maximum weekly amounts (i.e. $175 or $100 described above) that would otherwise apply if the program qualified as a full-time program, also described above.

This amendment applies to 1998 and subsequent taxation years.

Subclauses 16(4) to (7)

Child Care Expenses while at School

ITA
63(2.2) and (2.3)

Subsection 63(2.2) of the Act provides a deduction for child care expenses in respect of periods during which the taxpayer is a student in attendance at a designated educational institution or a secondary school and enrolled in a program of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program. As well, to be eligible for the deduction, the taxpayer must be either the sole supporting person of an eligible child or, if there is another supporting person, the supporting person with the higher income. The amendment to subsection 63(2.2) provides that a taxpayer who cannot satisfy the weekly course-work requirement described above may nonetheless deduct an amount (calculated under subsection 63(2.3)) on account of child care expenses if the taxpayer is enrolled in a program of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 12 hours per month on courses in the program. It also reflects the amendment to subsection 118.6(1) which extends the application of the definition "designated educational institution" to section 63.

Subsection 63(2.3) of the Act contains the calculation of the deduction provided under subsection 63(2.2) for child care expenses paid while a taxpayer is in attendance at a designated educational institution or a secondary school. The amendments to the descriptions of A and B in paragraph 63(2.3) (c) are consequential on the increase of the weekly maximum amounts from $150 and $90 to $175 and $100, respectively.

The amendment to the description of C in paragraph 63(2.3)(c) is consequential on the extension of the deduction for child care expenses to include expenses paid while in attendance at such institution or school in a program of not less than 3 consecutive weeks duration that provides that each student spend not less than 12 hours per month on courses in the program. In this case, an amount equal to the applicable weekly maximum provided under subsection 63(2.3) may be claimed for each month (other than a

month that includes a week already taken into account in the calculation of the deduction) of such an attendance. See commentary to paragraph 63(2)(*b*) for further information on this deduction.

These amendments apply to 1998 and subsequent taxation years.

Subclauses 16(8) and (9)

Definitions

ITA
63(3)

"child care expense"

Subsection 63(3) of the Act contains the definition "child care expense". The definition provides that expenses incurred by a taxpayer in respect of child care services are considered to be child care expenses only if the services enabled the taxpayer to perform certain activities. Currently, subparagraph (*a*)(v) of that definition includes as an eligible activity attendance at a designated educational institution or secondary school where the taxpayer is enrolled in a program of not less than 3 consecutive weeks duration that provides that each student in the program spend not less than 10 hours per week on courses or work in the program.

This amendment expands the list of eligible activities to include attendance at such an institution or school if the taxpayer is enrolled in a program of not less than 3 consecutive weeks duration and the program provides that each student spend not less than 12 hours per month on courses in the program.

These amendments also increase from $150 and $90 to $175 and $100, respectively, the weekly maximum amounts deductible in respect of an eligible child's attendance at a boarding school or camp.

These amendments apply to 1998 and subsequent taxation years.

Subclause 16(10)

ITA
63(3)

"eligible child"

Subsection 63(3) of the Act contains the definition "eligible child" for the purpose of the deduction of child care expenses. One of the criteria used in determining the eligibility of a child is whether the child's income does not exceed the basic personal amount, currently set at $6,456.

The amendment to this definition is consequential on the introduction of the $500 supplementary tax credit in paragraph 118(1)(*b*.1), which effectively increases from $6,456 to $6,956 the amount of income that can be earned on a tax-free basis.

This amendment applies to 1998 and subsequent taxation years.

Clause 17

Individuals Absent from Canada

ITA
64.1

Section 64.1 of the Act provides a special rule for individuals who are absent from, but resident in, Canada to permit the deduction of child care and attendant care expenses incurred outside Canada. Existing section 64.1 also permits Canadian residents who are absent from Canada to deduct expenses incurred in moving to or from a location outside Canada.

The effect of section 64.1 in relation to moving expenses will be provided by the terms of a new definition "eligible relocation" in subsection 248(1) of the Act. As a result, the amendment to section 64.1 eliminates its application with respect to such expenses. (For further information, see the commentary on that definition.)

This amendment applies after 1997.

Clause 18

Meal and Entertainment Expenses – Exceptions

ITA
67.1(2)

Subsection 67.1(2) of the Act provides exemptions from the application of the rule in subsection 67.1(1) which limits the deductibility of business-purpose meal and entertainment expenses to 50% of the lesser of a reasonable amount and the amount actually incurred.

Paragraph 67.1(2)(*d*) is amended to exempt from the application of subsection 67.1(1) amounts required to be included in computing *any taxpayer's* income because of the application of section 6 in respect of food, beverages or entertainment consumed or enjoyed by the taxpayer or a person with whom the taxpayer does not deal at arm's length. This amendment ensures that the exemption is available in circumstances where a person incurs meal or entertainment expenses that give rise to a taxable benefit for employees of another person. In addition, amounts that are payable for meals or meal allowances at remote work sites, which constitute non-taxable benefits in the hands of an employee because of subparagraph 6(6)(*a*)(ii), are also exempted by paragraph 67.1(2)(*d*) from the 50% limitation on deductibility in subsection 67.1(1). Amended paragraph 67.1(2)(*e*) extends the exemption from subsection 67.1(1) to expenses paid in respect of work at certain special work sites. Meal and entertainment expenses are exempt from the application of subsection 67.1(1) if they:

- are not paid or payable in respect of a conference, convention, seminar or similar event;

- give rise to employment benefits that are not required to be included in computing an individual's income because of subparagraph 6(6)(*a*)(i) (benefits from employment arising in respect of a special work site); and

- are paid or payable in respect of the taxpayer's duties performed at a special work site in Canada that is at least 30 kilometres from the

nearest boundary of any urban area that has a population of at least 40,000 people.

"Urban area" is defined by Statistics Canada in the *Census Dictionary* to be an area that has a minimum population concentration of 1,000 and that has a population density of at least 400 individuals per square kilometre. For assistance in determining whether a specific work site meets the new criterion relating to distance from an urban area of at least 40,000 people, reference may be made to information available on Revenue Canada's website at www.rc.gc.ca or from any Revenue Canada Tax Services Office.

New paragraph 67.1(2)(*f*) is an amended version of existing paragraph 67.1(2)(*e*). As indicated in the explanatory notes issued contemporaneously with the introduction of section 67.1, paragraph 67.1(2)(*e*) was intended to allow for the full deductibility of meal and entertainment expenses associated with special events such as "a Christmas party or similar event to which all employees at a particular location have access". This paragraph has, however, been interpreted to apply more broadly than this. Accordingly, paragraph 67.1(2)(*f*), which replaces the original paragraph 67.1(2)(*e*) limits the exemption for food, beverages or entertainment generally available to all employees at a place of business to such expenses incurred in respect of 6 or fewer special events held in a calendar year.

Amended paragraph 67.1(2)(*d*) of the Act applies to the 1987 and subsequent taxation years.

New paragraphs 67.1(2)(*e*) and (*f*) of the Act apply to expenses incurred after February 23, 1998.

Clause 19

Debt Forgiveness – Definitions

ITA
80(1)

Section 80 of the Act sets out rules that apply where an obligation of a debtor to pay an amount is settled or extinguished for less than its principal amount and the amount for which it was issued.

"excluded property"

The term "excluded property," defined in subsection 80(1) of the Act, describes a property the adjusted cost base of which (or a capital loss from the disposition of which) is not taken into account in determining the effect of a forgiven amount. An excluded property is currently, in effect, a property of a non-resident debtor that is not taxable Canadian property. As a consequence of the introduction of the definition "treaty-protected property," in subsection 248(1) of the Act, the definition "excluded property" is extended to include such treaty-protected properties. This ensures that property that is, because of a tax treaty, outside the Canadian tax system cannot be used to absorb a forgiven amount.

This amendment applies to the 1998 and subsequent taxation years.

Clause 20

Loans – Interpretation

ITA
80.4(1.1)

Section 80.4 determines the amount to be included in a taxpayer's income in respect of low interest or interest-free loans provided because of an individual's office or employment or because of services performed by a corporation carrying on a personal services business.

New subsection 80.4(1.1) clarifies that the intended use of funds that are advanced to a taxpayer is not relevant in determining whether the loan is received because of an individual's employment or the services performed by a corporation carrying on a personal services business. The new provision treats a loan or debt as having been received or incurred because of an individual's office or employment, or because of services performed by a corporation carrying on a personal services, if it is reasonable to conclude that the loan or debt would not have been received or incurred, or its terms would have been different, but for the individual's employment or the corporation's services.

New subsection 80.4(1.1) generally applies to loans received or debts incurred after February 23, 1998, except that it will not apply for the purposes of determining the amount of a benefit of a loan made or a debt incurred after February 23, 1998 in respect of an eligible relocation (as defined in subsection 248(1) of the Act) of an individual in connection with which the individual begins employment at the new work location before October 1998 for taxation years that end before 2001.

Clause 21

Transactions That Give Rise to a Deemed Dividend – When Deemed Dividend Payable

ITA
84(7)

Section 84 of the Act provides that certain transactions involving the shares of a corporation, such as share redemptions, winding-up distributions and certain increases and reductions of paid-up capital, will be treated as producing dividends for tax purposes.

Subsection 84(7) of the Act provides that dividends deemed to have been paid under section 84, 84.1 or 212.1 of the Act at a particular time are also to be regarded for the purposes of Subdivision h of Division B in Part I and sections 131 and 133 of the Act as having been payable at that time. This rule is relevant to the elections for capital dividends under subsection 83(2) and capital gains dividends under subsection 131(1) and 133(7.1), which require that a dividend be payable. This amendment adds to the list dividends deemed by new provisions in section 128.1 of the Act dealing with corporations that become resident in Canada.

This amendment applies after February 23, 1998.

Clause 22

Amalgamations

ITA
87

Section 87 of the Act provides rules that apply where there has been a merger of two or more corporations to form a new corporation.

Subclauses 22(1) and (2)

Foreign Merger

ITA
87(8) and (8.1)

Subsections 87(8) and (8.1) of the Act provide tax-deferred "rollover" treatment to a shareholder of a foreign corporation (a predecessor) in respect of a disposition of shares of the predecessor where the predecessor undergoes a vertical or horizontal merger with one or more other foreign corporations and the other corporation and the predecessor are residents of the same foreign jurisdiction.

The amendments to subsections 87(8) and (8.1) provide a shareholder the same tax-deferred rollover in respect of the disposition of shares of the predecessor in the case of a triangular foreign merger. In this case, the shareholder of the predecessor receives shares of the foreign corporation (the foreign parent) that controls the new corporation formed on the merger rather than shares of the new corporation. The foreign parent and the new corporation must be residents of the same foreign jurisdiction.

New subsection 87(8) of the Act also provides a shareholder of a predecessor a tax-deferred rollover in respect of a disposition of options of the predecessor in the case of a vertical or horizontal foreign merger, or a triangular foreign merger.

These amendments apply to foreign mergers that occur after February 24, 1998 and, unless the shareholder elects otherwise, to foreign mergers that occur before that date if the shareholder’s normal

reassessment period has not ended before 1999, and to mergers that occur after 1994 if the shareholder was tax-exempt.

Subclause 22(3)

Share Deemed Listed

ITA
87(10)

Subsection 87(10) of the Act provides a rule dealing with an amalgamation of two or more corporations where a predecessor corporation's listed shares are temporarily replaced by unlisted shares of the new corporation. Subsection 87(10) deems those temporary shares to have been listed on a prescribed stock exchange. This deemed listing applies for the purposes of subsections 115(1) and 116(6), and the definition "qualified investment" in subsections 146(1) and 146.3(1) and in section 204.

Subsection 87(10) is amended to add a reference to the definition "qualified investment" in subsection 146.1(1). This amendment, which applies after 1997, is consequential to the introduction of qualified investment rules for trusts governed by registered education savings plans.

Clause 23

Taxable Income – Deductions – Employee Options

ITA
110(1)(*d*)

Section 110 provides various deductions that may be claimed in computing a taxpayer's taxable income.

Where certain conditions are met, paragraph 110(1)(*d*) of the Act allows a taxpayer to deduct an amount in computing the taxpayer's taxable income for a taxation year equal to 1/4 of an employee benefit deemed by subsection 7(1) to have been received by the taxpayer in the year in respect of an agreement to sell or issue shares.

Paragraph 110(1)(*d*) is amended so that the same deduction applies in respect of mutual fund trust units. This amendment is consequential to the new rules in section 7 allowing the tax treatment under that section to apply in connection with agreements to issue mutual fund trust units to employees. However, whereas shares are required to be "prescribed shares", trust units are instead required under clause 110(1)(*d*)(i)(C) or (D) to be of a widely-held class of units which permit the trust to satisfy the condition described in paragraph 132(6)(*c*) for qualification as a mutual fund trust.

Paragraph 110(1)(*d*) has also been restructured and amended for clarity and to improve its readability.

These amendments apply to the 1998 and subsequent taxation years.

Clause 24

Residing in Prescribed Zone –
Board and Lodging Allowances etc.

ITA
110.7(4)

Section 110.7 of the Act provides a special deduction (the "Northern Residents' Deduction") for certain travel benefits and living costs for individuals who reside in a northern or isolated area prescribed under section 7303 of the *Income Tax Regulations*.

Subsection 110.7(4) provides that non-taxable benefits received by employees at special work sites reduce the amount of the recipients' Northern Residents' Deductions. Subsection 110.7(4) is amended as a consequence of providing full deductibility for meals and entertainment expenses incurred at special work sites which are more than 30 kilometres from an urban area of at least 40,000 people. The amendment to subsection 110.7(4) provides that only those non-taxable benefits received in respect of special work sites that are within 30 kilometres of such an area will reduce the amount of the recipients' Northern Residents' Deduction.

This amendment applies to the 1998 and subsequent taxation years.

Clause 25

Loss Carryovers – Non-resident's Losses

ITA
111(9)

Section 111 establishes the extent to which a taxpayer is permitted to deduct amounts in computing the taxpayer's taxable income for a taxation year in respect of losses of other years.

Subsection 111(9) of the Act restricts the loss carryovers that a taxpayer may claim for a year during which the taxpayer was not resident in Canada. The general purpose of the rule is to ensure that non-residents cannot apply, against Canadian-source income, losses from sources that are outside the Canadian tax system. The rule does this by treating the non-resident as having had: no income other than income included in taxable income earned in Canada under subparagraphs 115(1)(*a*)(i) to (vi); no taxable capital gains or allowable capital losses from dispositions of property other than taxable Canadian property; and no losses other than allowable business investment losses and losses from Canadian employment and businesses.

One effect of Canada's tax treaties is to limit Canada's ability to tax the Canadian-source gains and income of residents of treaty countries. As a result, certain of the sources of gains, income and losses that subsection 111(9) allows to affect a non-resident's loss carryovers are excluded from the Canadian tax system by treaty. A loss from one of these sources may thus be available to be carried over to another year, even though any income or gain from that source would not be subject to tax.

As part of a series of amendments to ensure that Canada's tax law reflects the existence and effect of tax treaties, subsection 111(9) is amended to remove this asymmetry. Under the amended provision, losses from "treaty-protected properties" and "treaty-protected businesses" (as newly defined in subsection 248(1) of the Act) will be ignored in determining a taxpayer's losses for a year during which the taxpayer was non-resident.

This amendment applies for the purpose of computing taxable income (or taxable income earned in Canada) for the 1998 and subsequent taxation years.

Clause 26

Non-resident's Taxable Income Earned in Canada

ITA
115

Section 115 of the Act provides rules for the calculation of the "taxable income earned in Canada" by a non-resident person, which is subject to tax under Part I. This amount includes Canadian-source employment and business income, taxable capital gains on taxable Canadian property, and certain other income amounts.

Subclauses 26(1) and (2)

Non-resident's Taxable Income Earned in Canada

ITA
115(1)

Subsection 115(1) describes the general rules to be applied in calculating a non-resident's "taxable income earned in Canada". Paragraphs 115(1)(*a*) to (*c*) of the Act describe conditions that apply in computing a non-resident's taxable income earned in Canada, while paragraphs 115(1)(*d*) to (*f*) describe the deductions that are available for the purposes of that computation.

As part of a series of amendments to ensure that Canada's tax law reflects the existence and effect of Canada's tax treaties, subsection 115(1) is amended in several respects.

A structural rather than substantive change is made to the preamble to subsection 115(1). The amended preamble makes it clearer that the subsection is intended to operate as a subtraction formula, that a non-resident's taxable income earned in Canada is the amount, if any, by which (1) the amount that would be determined under the general income rule in section 3 of the Act if certain conditions (described in

paragraphs (*a*) to (*c*)) applied exceeds (2) the total of certain deductions (listed in paragraphs (*d*) to (*f*)).

Paragraph 115(1)(*b*) of the Act describes the taxable capital gains and allowable capital losses of a non-resident that are included in computing the non-resident's taxable income earned in Canada under subsection 115(1). The gains and losses in question are those from dispositions of "taxable Canadian property" (TCP) a term which paragraph 115(1)(*b*) itself defines and which is used throughout the Act for a variety of purposes.

New paragraph 115(1)(*b*.1) provides that taxable capital gains and allowable capital losses from dispositions of TCP are not included in computing a non-resident's taxable income earned in Canada if the TCP is "treaty-protected property," as newly defined in subsection 248(1) of the Act. This means, for example, that what would otherwise be an allowable capital loss on an item of TCP cannot be used to offset a taxable capital gain on another property if a tax treaty has removed the loss property from the Canadian tax system.

In a related substantive change, paragraph 115(1)(*c*) is amended to make use of the term "treaty-protected business," newly defined in subsection 248(1) of the Act. Paragraph 115(1)(*c*) in effect provides that in computing a non-resident's taxable income earned in Canada for a year, a business, employment or property loss (or an allowable business investment loss) for the year is counted only if the loss has a Canadian source. In other words, a non-resident may not deduct a current-year loss from a particular source unless the source is within the Canadian tax system. By adding the further requirement that a business loss may be deducted only if the business in question is not a treaty-protected business, amended paragraph (*c*) applies this principle more consistently.

Paragraph 115(1)(*d*) allows a non-resident to deduct, in computing taxable income earned in Canada for a year, certain deductions set out in subsections 110(1) and 110.1(1) of the Act. The deductions in subsection 110(1) include amounts that are exempt from Canadian tax because of a tax treaty, deductions in respect of employee stock options, prospector's and grubstaker's shares, certain social assistance and workers' compensation payments, and income from employment with certain international organizations. Subsection 110.1(1) includes deductions for certain charitable and similar gifts by corporations.

(Unlike individuals, corporations do not receive tax credits for these gifts.) Paragraph 115(1)(*d*) is amended to clarify that these deductions are available to a non-resident only to the extent that they relate to amounts that are included in determining the amount determined under paragraphs (*a*) to (*c*).

Structurally, this amendment combines the existing paragraphs 115(1)(*d*) and (*e*) into a single new paragraph (*d*). The new paragraph's reference to the deductions (of losses) permitted by section 111 of the Act is simplified as well, as a consequence of the amendment of subsection 111(9).

Existing paragraph (*d*.1) is renamed as (*e*), and its wording is updated.

Finally, the "midamble" text between paragraphs (*c*) and (*d*) is revised to reflect the clearer structure of amended subsection 115(1).

These amendments apply for the 1998 and subsequent taxation years.

Subclause 26(3)

Persons Deemed Employed in Canada

ITA
115(2)(*c*)

Subsection 115(2) deems certain non-residents to have been employed in Canada, making them subject to tax under Part I but providing special rules with respect to the calculation of their taxable income earned in Canada under subsection 115(1).

Paragraph 115(2)(*c*) deems an individual to be employed in Canada for a taxation year if, in any previous year, the individual was resident in Canada and, in the year, the individual received remuneration in respect of an office or employment, directly or indirectly, from a person resident in Canada.

Paragraph (*c*) is amended in two respects. First, the reference to "remuneration" in paragraph (*c*) is changed to "salary, wages or other remuneration". This change is clarifying only, and does not represent a change in policy.

Second, the application of paragraph (*c*) is specifically limited to an individual who is entitled to an exemption from an income tax otherwise payable in another country in respect of the salary, wages or other remuneration, because of the application of an agreement or convention between Canada and one or more other countries.

These amendments apply to the 1998 and subsequent taxation years.

Subclause 26(4)

Persons Deemed Employed in Canada

ITA
115(2)(*f*)

Subsection 115(2) deems certain non-residents to have been employed in Canada, making them subject to tax under Part I but providing special rules with respect to the calculation of their taxable income earned in Canada under subsection 115(1).

Paragraph 115(2)(*f*) permits the deduction of certain moving expenses by certain non-residents by modifying the application of subsection 62(1). Paragraph 115(2)(*f*) is amended as a consequence of the amendments restructuring subsection 62(1) which, in turn, are based on the introduction of the definition "eligible relocation" in subsection 248(1). For more information, see the commentary on those provisions.

This amendment applies after 1997.

Clause 27

Annual Adjustment of Deductions and Other Amounts

ITA
117.1(1)(*b*)

Subsection 117.1(1) of the Act provides for the indexing of various amounts, including the amounts on which the personal tax credits are based. The indexing is based on annual increases in the Consumer Price Index in excess of 3 per cent.

The amendment to paragraph 117.1(1)(*b*) provides for the indexing of the caregiver tax credit starting in 1999 and for the indexing of the supplementary personal tax credit starting in 2000. These two new credits are described in the commentary to subsection 118(1).

Clause 28

Personal Credits

ITA
118

Section 118 of the Act provides for the calculation of various personal tax credits. These include the single, married status, equivalent-to-spouse, infirm dependant, age and pension tax credits.

Subclause 28(1)

Supplementary Amount

ITA
118(1)(*b*.1)

New paragraph 118(1)(*b*.1) of the Act implements the supplementary personal tax credit which increases, through a $500 supplement to the basic personal and spousal amounts, the amount of income that low-income individuals can receive on a tax-free basis. The $500 supplement is phased out at a rate of 4 per cent of income over $6,956.

This amendment applies to 1998 and subsequent taxation years except that, for the 1998 taxation year, the amount of the supplement is equal to 50% of the supplement otherwise determined.

Subclause 28(2)

In-home Care of Relative

ITA
118(1)(*c*.1)

New paragraph 118(1)(*c*.1) of the Act provides a tax credit to an individual who provides in-home care for an adult relative. To be eligible for the new credit, the individual has to maintain a dwelling in which the individual and the relative ordinarily reside, and the relative has to be the individual's child, grandchild, parent, grandparent, brother, sister, aunt, uncle, nephew or niece. Except where the relative is the individual's child or grandchild, the relative must be resident in Canada. Also, except where the relative is the individual's parent or grandparent who is 65 years old or over, the relative must be dependent on the individual because of the relative's mental or physical infirmity. The credit is equal to $400 minus 17% of the relative's income in excess of $11,500. No credit is available when the relative's income exceeds $13,853.

This amendment applies to 1998 and subsequent taxation years.

Subclause 28(3)

Additional Amount

ITA
118(1)(*e*)

With the introduction of the caregiver tax credit under paragraph 118(1)(*c*.1) of the Act, in certain circumstances it will be possible for an individual to qualify for both the equivalent-to-spouse tax credit and the caregiver tax credit in respect of the same relative. The rules in subsection 118(4) are being amended to restrict the individual to claiming only one credit in respect of the same person.

However, paragraph 118(1)(*e*) already provides for a top-up amount where an individual would otherwise be entitled to both the equivalent-to-spouse tax credit and the infirm dependant tax credit in respect of the same dependant to ensure that the individual's equivalent-to-spouse tax credit in respect of that dependant is not less

than the infirm dependant tax credit otherwise available. The amendment to this paragraph is designed to provide similar tax assistance where both the new caregiver tax credit and the equivalent-to-spouse tax credit would be available in respect of the same relative.

This amendment applies to 1998 and subsequent taxation years.

Subclauses 28(4) and (5)

Limitations re subsection (1)

ITA
118(4)(*a*.1) and (*c*) to (*e*)

Subsection 118(4) of the Act provides several rules limiting the personal tax credits available under subsection 118(1).

New paragraph 118(4)(*a*.1) provides that, if a married tax credit is claimed for a taxation year in respect of a person by an individual and the individual and that person are, throughout the year, married to each other and are not separated, neither the individual nor any other individual may claim an equivalent-to-spouse tax credit in respect of that person for the year.

Paragraph 118(4)(*c*) of the Act provides that, where an individual is entitled to the equivalent-to-spouse tax credit in respect of a person, neither the individual nor any other individual may claim the infirm dependant tax credit in respect of that person. Paragraph 118(4)(*c*) is amended as a result of the introduction of the caregiver tax credit under paragraph 118(1)(*c*.1). This amendment provides that, where an individual is entitled to the equivalent-to-spouse tax credit in respect of a person, no claim under either the caregiver credit or the infirm dependant tax credit may be made in respect of the same person.

New paragraph 118(4)(*d*) provides that, where an individual is entitled to the caregiver tax credit in respect of a person, neither the individual nor any other individual may claim an infirm dependant tax credit in respect of that person.

Paragraph 118(4)(*e*) provides that, where more than one individual is entitled to the infirm tax dependant credit in respect of the same

person, the total amounts claimed by those individuals can not exceed the maximum amount that would be allowed if only one individual were claiming the person as a dependant. Paragraph 118(4)(*e*) is amended as a result of the introduction of the caregiver tax credit under paragraph 118(1)(*c*.1). This amendment ensures that, where more than one individual is entitled to the caregiver tax credit in respect of the same person, the total amounts claimed cannot exceed the maximum amount that would be allowed if only one individual were claiming the credit.

All of these amendments apply to 1998 and subsequent taxation years.

Clause 29

Charitable Gifts – Determination of Fair Market Value

ITA
118.1(10.1)

Section 118.1 of the Act provides for the tax credit that may be claimed by individuals who make charitable donations, gifts to the Crown and certain other gifts of cultural property and ecologically sensitive land. It also provides rules applicable to such gifts made by either individuals or corporations.

Existing subsection 118.1(10) provides that the valuation of a gift of cultural property by the Canadian Cultural Property Export Review Board (the "Board") is determinative for the purposes of calculating the tax deduction or credit available in respect of a gift of cultural property.

New subsection 118.1(10.1) applies, for the purposes of section 118.1 (donations and gifts by individuals) and section 110.1 (donations and gifts by corporations) in circumstances where the Board has determined the fair market value of a property. If that property is the subject of a gift that is made within two years of the Board's valuation, and is claimed as a charitable donation that is not a gift of cultural property, the Board's valuation is deemed to be the fair market value of the property for the purposes of section 110.1 (relating to charitable donations by corporations) and 118.1 of the

Act. In these circumstances, the Board's valuation is, subject to subsection 110.1(3) and subsections 118.1(6) and (7) allowing an election that an amount of a gift and its proceeds of disposition be less than fair market value, also deemed to be the proceeds of disposition of the property.

New subsection 118.1(10.1) applies to determinations and redeterminations made after February 23, 1998.

Clause 30

Transitional Provision

ITA
118.1

Under section 118.1, an individual may deduct an amount in computing the individual's tax payable if the individual has made any charitable donations, any gifts to the Crown or any gifts of certain cultural property or certain ecologically sensitive land in the year. Under section 110.1, a corporation is entitled to deduct an amount in respect of any such donations or gifts in computing its taxable income. In either case, the donation has to be made before the end of the donor's taxation year to be claimed in the donor's return filed for that year.

To ensure that the postal service interruption that took place towards the end of 1997 would not adversely impact the campaign drives of Canadian charities, an extension of the deadline for making certain charitable donations deductible in 1997 was announced in Finance Canada's Press Release 97-115 dated December 8, 1997.

This clause is designed to implement that announcement. By its terms, donations made up to the end of January 1998 by cash, cheque, credit card or money order and donations of tangible property (other than real estate) will be treated as having been made in the taxpayer's last taxation year ending before 1998. However, this relief does not apply to gifts of intangible property, such as shares and other securities, and to donations made through payroll deductions or through an individual's will where the individual died after 1997.

This special rule applies to taxation years that ended after November 15, 1997 and before 1998.

Clause 31

Medical Expense Credit

ITA
118.2

Section 118.2 provides rules for determining the amount which may be claimed as a tax credit in respect of an individual's medical expenses.

Subclause 31(1)

Medical Expense Credit

ITA
118.2(1)(*b*)

Subsection 118.2(1) of the Act provides for the calculation of the amount that may be deducted from an individual's tax payable in respect of medical expenses. When an individual claims an expense in respect of a dependant (other than the individual's spouse) whose income is in excess of the basic personal amount for the year ($6,456 for 1998), the amount of eligible medical expenses is reduced by 68% of the excess. The amendment to paragraph 118.2(1)(*b*) is consequential on the introduction of the $500 supplementary tax credit in paragraph 118(1)(*b*.1), which effectively increases from $6,456 to $6,956 the amount of income that can be earned on a tax-free basis.

This amendment applies to 1998 and subsequent taxation years.

Subclause 31(2)

Medical Expenses

ITA
118.2(2)(*l*.8)

Subsection 118.2(2) of the Act contains a list of expenditures which qualify as eligible medical expenses. New paragraph 118.2(2)(*l*.8) adds to this list reasonable expenses of an individual for training courses relating to the care of a mentally or physically infirm person who is related to the individual and who is either a member of the individual's household or is dependent on the individual for support.

This amendment applies to 1998 and subsequent taxation years.

Subclause 31(3)

Medical Expenses

ITA
118.2(2)(*q*)

Subsection 118.2(2) of the Act sets out the expenses that may be included in the computation of an individual's medical expense credit. Under paragraph 118.2(2)(*q*) a premium, contribution or other consideration paid to a private health services plan in respect of the individual, the individual's spouse and members of the individual's household who are related to the individual qualify as a medical expense. Paragraph 118.2(2)(*q*) is amended as a result of the addition of section 20.01 to the Act, which allows certain self-employed individuals to deduct in computing their business income amounts payable under such a plan. The amendment ensures that these amounts are not claimed both under the proposed deduction provision and the existing medical expense credit.

This amendment applies to 1998 and subsequent taxation years.

Clause 32

Disability Tax Credit

ITA
118.3

Section 118.3 provides a tax credit for individuals who have a severe and prolonged mental or physical impairment.

Subclause 32(1)

Credit for Mental or Physical Impairment

ITA
118.3(1)(*a*.2)

Subsection 118.3(1) of the Act provides the formula for calculating the disability credit and the conditions for entitlement to the credit for those individuals with a severe and prolonged mental or physical impairment. Generally, only medical doctors are allowed to certify impairments for the purpose of the credit. Exceptions are made for audiologists and optometrists who, currently, are allowed to certify hearing impairments and sight impairments, respectively. This amendment allows occupational therapists to certify impairments with respect to individuals' ability in walking or in feeding and dressing themselves. It also allows psychologists to certify impairments with respect to individuals' ability in perceiving, thinking and remembering.

This amendment applies to certifications made after February 24, 1998.

Subclause 32(2)

Dependant having Impairment

ITA
118.3(2)(*a*)

Subsection 118.3(2) provides criteria for determining the entitlement of a supporting individual of a disabled person to claim that person's

unused disability tax credit. The amendment allows such a transfer to the individual for a year if the individual is allowed an equivalent-to-spouse tax credit in respect of the disabled person or would be allowed such a credit if the individual was not married and the disabled person had no income. Where the disabled person is the individual's parent, grandparent, child or grandchild, the transfer to the individual of the disabled person's unused disability tax credit is permitted where the individual is allowed to claim an infirm dependant tax credit in respect of the disabled person or would be allowed such a credit if the disabled person was 18 years of age or over and had no income for the year. The amendment to this paragraph provides the same opportunity to transfer the unused disability tax credit if a caregiver tax credit is or would be allowed in these circumstances.

This amendment applies to 1998 and subsequent taxation years.

Clause 33

Nature of Impairment – Reference to Medical Practitioners, etc.

ITA
118.4(2)

Section 118.4 of the Act sets out the circumstances under which an individual is considered to have a severe and prolonged impairment, in order to determine whether the individual may be eligible for the disability credit. Subsection 118.4(2) provides a definition of the group of practitioners to whom various references in section 63 (relating to child care expenses), section 118.2 (relating to medical expenses) and section 118.3 (relating to the disability tax credit) of the Act apply. The amendment adds to this group occupational therapists and psychologists.

The amendment applies after February 24, 1998.

Clause 34

Education Tax Credit

ITA
118.6

Section 118.6 of the Act provides rules for determining eligibility for the education tax credit.

Subclause 34(1)

Definitions

ITA
118.6(1)

Subsection 118.6(1) of the Act provides for various education-related definitions for the purposes of subdivision a of Division E of Part I of the Act. This amendment extends the application of these definitions to the child care expense deduction provided under section 63.

This amendment applies to 1998 and subsequent taxation years.

Subclause 34(2)

Definitions

ITA
118.6(1)

"specified educational program"

Subsection 118.6(1) of the Act provides the definitions "designated educational institution" and "qualifying educational program" for the purposes of the education tax credit. The definition "specified educational program" is added to that subsection to identify which educational programs qualify for the education tax credit with respect to part-time education. Under this new definition, a "specified educational program" is a program that would be a qualifying educational program if the requirement that a student enrolled in the

program spend not less than 10 hours per week on courses or work in the program were replaced by the requirement that the student spend not less than 12 hours per month on courses in the program.

This amendment applies to 1998 and subsequent taxation years.

Subclause 34(3)

Education Credit

ITA
118.6(2)

Subsection 118.6(2) of the Act contains the formula for calculating an individual's education credit. This amount is currently determined by multiplying the appropriate percentage (17%) by $200 and the number of calendar months in the year during which the individual was enrolled as a full-time student in a qualifying educational program at a designated educational institution. The amendment to subsection 118.6(2) allows an individual to include in calculating the individual's education tax credit an amount of $60 for each calendar month in the year (other than a month for which an amount of $200 is already included in calculating the individual's credit) during which the individual is enrolled in a specified educational program at a designated educational institution. The expressions "designated educational institution", "qualifying educational program" and "specified educational program" are defined in subsection 118.6(1).

This amendment applies to 1998 and subsequent taxation years.

Subclause 34(4)

Disabled Students

ITA
118.6(3)(*b*)

Section 118.6 of the Act provides an education tax credit to students enrolled on a full-time basis in qualifying educational programs at designated educational institutions. Subsection 118.6(3) removes the requirement that a student be enrolled on a full-time basis where the student is eligible for the disability tax credit or cannot be enrolled on

a full-time basis because of the student's mental or physical impairment, as certified in writing by a medical doctor. The amendment to paragraph 118.6(3)(*b*) is consequential on the addition of audiologists, occupational therapists and psychologists to the list of practitioners who are allowed to certify mental or physical impairments for the purpose of the disability tax credit.

With respect to hearing impairments, this amendment applies to certifications made by audiologists after February 18, 1997; for other impairments, it applies to certifications made after February 24, 1998.

Clause 35

Credit for Interest on Student Loan

ITA
118.62

New section 118.62 of the Act provides a tax credit in respect of interest paid by an individual or a person related to the individual on a student loan made to the individual. This credit is equal to 17% of the amount of interest paid in the year or in any of the 5 preceding taxation years that are after 1997, to the extent that the amount is not included in computing the credit for another taxation year. To be eligible for the credit, the interest must have been paid on a loan made to, or other amount owed by, the individual under the *Canada Student Loans Act*, the *Canada Student Financial Assistance Act* or a law of a province providing similar financial assistance to students at post-secondary school level. Forgiven interest and interest accrued but not paid do not qualify for the credit.

This amendment applies to 1998 and subsequent taxation years.

Clause 36

Transfer of Unused Credits to Spouse

ITA
118.8

Section 118.8 of the Act governs the transfer to a spouse of certain unused tax credits. The credits which may be transferred are the tuition and education tax credits and the age, pension and disability tax credits. The amendment to section 118.8 is consequential on the introduction of the supplementary personal tax credit under new paragraph 118(1)(*b*.1), and is designed for the purpose of this section to treat the supplementary credit in the same manner as the basic personal tax credit.

This amendment applies to 1998 and subsequent taxation years.

Clause 37

Part-Year Residents

ITA
118.91(*b*)(i)

Section 118.91 of the Act provides rules with respect to non-refundable tax credits allowed to individuals residing in Canada for only part of a taxation year. The amendment to subparagraph 118.91(*b*)(i) adds a reference to new section 118.62, the provision under which a credit in respect paid on a student loan may be claimed.

This amendment applies to 1998 and subsequent taxation years.

Clause 38

Ordering of Credits

ITA
118.92

Section 118.92 of the Act provides that the tax credits allowed in computing any individual's tax payable are to be applied in a specific order. The amendment to this section adds a reference to new section 118.62, the provision under which a credit in respect of interest paid on a student loan may be claimed.

This amendment applies to 1998 and subsequent taxation years.

Clause 39

Credits in Year of Bankruptcy

ITA
118.95(*a*)

When an individual becomes bankrupt, subsection 128(2) of the Act divides the calendar year in which the bankruptcy occurs into two taxation years: one that runs from January 1 to the day before the bankruptcy; and a second that begins on the day of the bankruptcy and runs to December 31. Section 118.95 ensures that non-refundable tax credits that are based on expenditures or the receipt of certain types of income are determined by reference to the amounts that relate to the relevant taxation year. In all cases, the total of the amounts claimed in respect of each of the credits for the two taxation years cannot be greater than the amount that could be claimed in respect of the calendar year as a whole. The amendment to paragraph 118.95(*a*) adds a reference to new section 118.62, the provision under which a credit in respect of interest paid on a student loan may be claimed.

This amendment applies to 1998 and subsequent taxation years.

Clause 40

Canadian Film or Video Production Tax Credit – Definitions

ITA
125.4(1)

"assistance"

Subsection 125.4(1) of the Act provides definitions that apply for the purposes of computing the Canadian film or video production tax credit. In general, the amount of the credit is 25% of qualified labour expenditures. In computing the credit, however, qualified labour expenditures are taken into account only up to 48% of the amount by which the cost or capital cost of the film exceeds any "assistance" in respect of that cost.

The definition "assistance" in subsection 125.4(1) is amended to exclude a prescribed amount. It is intended that prescribed amounts will be defined by regulation to include certain amounts received from the Canada Television and Cable Production Fund (CTCPF) under its Licence Fee Program.

Draft regulations describing the prescribed amount are attached to these notes as "Appendix A".

This amendment applies after February 23, 1998.

Clause 41

Foreign Tax Credit

ITA
126

Section 126 of the Act provides rules under which a taxpayer may deduct, from tax otherwise payable under Part I, amounts in respect of foreign taxes paid by the taxpayer.

Subclause 41(1)

Foreign Tax Credit – Non-Business-Income Tax

ITA
126(1)(*b*)

Subsection 126(1) of the Act provides a tax credit in respect of non-business-income tax, which generally includes foreign tax levied on investment and other non-business income and on income from carrying on business in Canada. In broad terms, the credit for such tax paid in a foreign country is limited to the proportion of the taxpayer's tax otherwise payable under Part I that the taxpayer's income from sources in that country bears to the taxpayer's total income.

Subparagraph 126(1)(*b*)(i), the numerator of the income ratio, represents the taxpayer's income for the year (or for the part or parts of the year during which the taxpayer is resident in Canada) from sources in the particular country calculated on certain assumptions. The amendment provides that the income amount is the excess of the taxpayer's "qualifying incomes" over "qualifying losses", both of which are newly defined in subsection 126(7) of the Act. These definitions encompass the existing exclusions for income in respect of which the taxpayer claims a capital gains deduction and income that is exempt from tax in Canada under a tax treaty. A new exclusion is made for "tax-exempt income", newly defined in subsection 126(7) as income that is protected from taxation in the foreign country by a tax treaty (as defined in subsection 248(1) of the Act) and not subject to any foreign tax to which the treaty does not apply. This exclusion ensures that the foreign tax credit does not reduce Canadian tax on any portion of foreign income that is not subject to foreign tax.

This amendment applies to taxation years that begin after February 23, 1998.

Subclause 41(2)

Foreign Tax Credit – Business-Income Tax

ITA
126(2.1)(*a*)

Subsection 126(2.1) of the Act sets out rules for determining the amount that may be deducted by a taxpayer under subsection 126(2) on account of business-income tax, which generally is foreign tax in respect of businesses carried on by the taxpayer outside Canada. In broad terms, the credit for such tax paid in a foreign country is limited to the proportion of the taxpayer's tax otherwise payable under Part I of the Act that the taxpayer's income from sources in that country bears to the taxpayer's total income.

Subparagraph 126(2.1)(*a)*(i), the numerator of the income ratio, represents the taxpayer's income for the year (or for the part or parts of the year during which the taxpayer is resident in Canada) from sources in the particular country calculated on certain assumptions. The amendment provides that the income amount is the excess of the taxpayer's "qualifying incomes" over "qualifying losses", both of which are newly defined in subsection 126(7) of the Act. These definitions encompass the existing exclusion for income that is exempt from tax in Canada under a tax treaty. A new exclusion is made for "tax-exempt income", newly defined in subsection 126(7) as income that is protected from taxation in the foreign country by a tax treaty (as defined in subsection 248(1) of the Act) and not subject to any foreign tax to which the treaty does not apply. This exclusion ensures that the foreign tax credit does not reduce Canadian tax on any portion of foreign income that is not subject to foreign tax.

This amendment applies to taxation years that begin after February 23, 1998.

Subclause 41(3)

Foreign Tax Credit – Business-Income Tax

ITA
126(2.1)(*b*)

The amendment to subparagraph 126(2.1)(*b*)(i) of the Act is consequential on the amendment to subparagraph (*a*)(i) that introduces the terms qualifying incomes and qualifying losses. This amendment, which ensures the correct reference to subparagraph (*a*)(i), applies to taxation years that begin after February 23, 1998.

Subclause 41(4)

Economic Profit Insubstantial

ITA
126(4.1)

New subsection 126(4.1) of the Act denies a foreign tax credit for foreign taxes paid in respect of a property if it is reasonable to expect that the taxpayer's economic profit (newly defined in subsection 126(7) of the Act as profit net of foreign taxes) in respect of the property will be insubstantial relative to the amount of the foreign tax. The rule is not applicable to capital property.

The foreign tax credit operates on a country-by-country pooling basis, with the result that income from a source that is taxed in a foreign country at a higher rate than in Canada creates excess credits that may be used to reduce Canadian tax on income from other sources in the country that are taxed at rates lower than the Canadian rate. This cross-crediting can make an otherwise uneconomic transaction attractive to a taxpayer, and can amount to a subsidy by the Canadian tax system for such transactions. To limit this effect, the new rule denies the credit in situations where, without the credit, any expected economic profit is insubstantial relative to the foreign tax.

The assessment of expected profitability is made as of the time the property is acquired. Profitability is estimated over the entire period for which it is expected that the property will be continuously held. If the reasonably expected economic profit is insubstantial relative to

the total amount of foreign tax that is expected to be payable in respect of the property and related transactions (also newly defined in subsection 126(7)), the foreign tax is not included in the taxpayer's "business-income tax" or "non-business-income tax" – the foreign taxes for which credit may potentially be claimed - for any taxation year. Where the credit is so denied, however, a deduction from income may be available for the foreign tax under new subsection 20(12.1). If a related transaction involves acquisition of another property, the rule in subsection 126(4.1) is not applied independently in respect of the other property.

This amendment applies to properties acquired after February 23, 1998.

Short-Term Securities Acquisitions

ITA
126(4.2) and (4.3)

New subsection 126(4.2) of the Act limits the foreign tax credit in respect of dividends or interest on a share or debt obligation that is held by the taxpayer for one year or less. The credit is limited to the amount of Canadian tax that would be payable at a notional rate on the gross income from the security for the hold period. The effect is generally to prevent an excess credit that could be used to shelter other income from the foreign country in respect of which the tax was paid. As set out in new subsection 126(4.3) of the Act, this new rule does not apply to capital property or to a debt obligation having a term of one year or less that is issued to the taxpayer and held to maturity. The rule applies only in situations where the more general limit in subsection 126(4.1) does not already deny a credit.

The rule applies to foreign taxes on dividends or interest that are similar to the non-resident withholding tax levied on non-residents of Canada under Part XIII of the Act. The rule limits the amount of foreign tax included in the taxpayer's business-income tax or non-business-income tax to 40 per cent (in the former case) or 30 per cent (in the latter case) of the taxpayer's gross profit from the share or debt. The difference in rates reflects the fact that non-business foreign income of a corporate taxpayer resident in Canada is typically taxable by a province, in which case the taxpayer is entitled to a 10% per cent abatement under subsection 124(1). Foreign business income

earned through a permanent establishment outside Canada is not taxable by a province.

Gross profit is not defined as such but is in effect measured by a formula as the total of the taxpayer's proceeds from disposing of the property and interest or dividends received during the ownership period, less the taxpayer's cost of acquiring the property and expenses of disposition. No deduction is made for carrying charges.

If the ownership period falls into more than one taxation year, the allowable foreign tax is allocated between the periods through elements D and E in the formula in the same proportion by which it would be allocated in the absence of the limit. In these circumstances, if the taxpayer's tax payable for the first year increases as a result of the operation of subsection 126(4.2) following the disposition of the property in the second year, amended subsection 161(6.1) of the Act provides some relief from payment of arrears interest. The resulting reduction in foreign tax credit is also considered a "specified future tax consequence" within the amended definition in subsection 248(1) of the Act.

This amendment applies to properties acquired after February 23, 1998.

Deemed Dispositions Ignored

ITA
126(4.4)

New subsection 126(4.4) of the Act provides that a disposition or acquisition of property deemed to be made by certain provisions of the Act is not a disposition or acquisition for the purposes of the limits on the foreign tax credit in new subsections 126(4.1) and (4.2) of the Act and the new definition "economic profit" in subsection 126(7) of the Act. As a result, such deemed dispositions and acquisitions are not relevant in calculating the threshold holding period for the application of subsection (4.2) or the period of ownership over which profit is calculated under either tax credit limit. Likewise, proceeds deemed to be received on such dispositions and costs deemed to be paid on such acquisitions are not taken into account in computing the taxpayer's profit for purposes of the tax credit limits.

The deemed dispositions and acquisitions included are:

- subsection 45(1) (change of use)
- section 70 (death of taxpayer)
- section 128.1 (immigration of taxpayer to Canada)
- paragraph 132.2(1)(*f*) (mutual fund restructuring)
- subsection 138(11.3) (change of use of designated insurance property)
- subsection 142.5(2) (mark-to-market property)
- paragraph 142.6(1)(*b*) (becoming a financial institution)
- subsection 149(10) (becoming or ceasing to be an exempt corporation)

This amendment applies to the 1998 and subsequent taxation years.

Subclauses 41(5) to (7)

Definitions

ITA
126(7)

Subsection 126(7) of the Act sets out definitions that apply for the foreign tax credit rules in section 126.

"business-income tax"

"non-business-income tax"

Subsection 126(7) of the Act defines the terms "business-income tax" and "non-business-income tax" paid by a taxpayer for a taxation year for the purposes of determining the taxpayer's foreign tax credit. These definitions are amended to make them subject to new subsections 126(4.1) and (4.2), which deny or limit the inclusion in business-income tax and non-business-income tax of certain foreign tax amounts. These amendments apply to the 1998 and subsequent taxation years.

"economic profit"

This amendment adds a new definition "economic profit" to subsection 126(7) of the Act. The definition describes the economic profit of a taxpayer in respect of a property for a period for the purposes of the rule in new subsection 126(4.1) of the Act. That provision denies the ability to claim a credit for foreign taxes paid in respect of the property where, at the time the property was acquired, it was reasonable to expect that the economic profit in respect of the property would be insubstantial.

The taxpayer's economic profit in respect of a property is calculated in respect of a continuous period of ownership, from the time of acquisition to the time the property is next disposed of. It includes the part of the profit from the business in which the property is used that is attributable to either the property or related transactions (also defined in subsection 126(7)). It is intended for this purpose that profit be calculated in the same manner as for section 9 of the Act except that deductions are made in calculating profit only for interest

and other financing expenses attributable to the property or a related transaction, for foreign taxes in respect of the property or a related transaction, and for other expenses directly attributable to the acquisition, holding or disposition of the property or to a related transaction. Therefore, general overhead expenses (other than interest and financing charges) are not deducted unless they are directly attributable to the property or a related transaction.

This new definition applies to the 1998 and subsequent taxation years.

"qualifying incomes"

This amendment adds a new definition "qualifying incomes" to subsection 126(7) of the Act. A taxpayer's qualifying incomes from sources in a foreign country is an element in the calculation of the taxpayer's income from sources in that country under subparagraphs 126(1)(*b*)(i) and (2.1)(*a*)(i) of the Act, which is relevant to the determination of the taxpayer's foreign tax credit. The definition encompasses the existing exclusion for income that is exempt from tax in Canada under a tax treaty and, for the purposes of subsection 126(1) only, income in respect of which the taxpayer claims a capital gains deduction. A new exclusion is made for "tax-exempt income", also newly defined in subsection 126(7).

This new definition applies to taxation years that begin after February 24, 1998

"qualifying losses"

This amendment adds a new definition "qualifying losses" to subsection 126(7) of the Act. A taxpayer's qualifying losses from sources in a foreign country is an element in the calculation of the taxpayer's income from sources in that country under subparagraphs 126(1)(*b*)(i) and (2.1)(*a*)(i) of the Act, which is relevant to the determination of the taxpayer's foreign tax credit. The definition calculates losses by excluding any portion of income that is exempt from tax in Canada under a tax treaty and, for the purposes of subsection 126(1) only, income in respect of which the taxpayer claims a capital gains deduction. The calculation also excludes a loss from a source if any income from the source would be "tax-exempt income", also newly defined in subsection 126(7).

This new definition applies to taxation years that begin after February 24, 1998.

"related transactions"

This amendment adds a new definition "related transactions" to subsection 126(7) of the Act. The definition applies in respect of a taxpayer's ownership of a property for a period for the purposes of the new rule in subsection 126(4.1) of the Act and the new definition "economic profit" in subsection 126(7). Related transactions are transactions that the taxpayer enters into as part of the arrangement under which the property was owned. These may include incidental transactions, for such purposes as financing the acquisition of the property and hedging or insuring risks relating to the holding of the property, that would not have been entered into if the property had not been acquired. The term would also encompass another transaction with the same counterparty as is involved with the property, if the two transactions are part of a single arrangement such that the acquisition of the property is contingent on the other transaction being entered into.

This amendment applies to the 1998 and subsequent taxation years.

"tax-exempt income"

This amendment adds a new definition "tax-exempt income" to subsection 126(7) of the Act. The definition applies for the purposes of the definitions "qualifying incomes" and "qualifying losses" and subsection 126(8) of the Act. Income from a source in a country is considered to be tax-exempt if it is protected from tax in that country by the terms of a tax treaty (newly defined in subsection 248(1) of the Act) with Canada, and is not subject to any tax, in that country or any country other than Canada, to which the treaty does not apply. As a result of amended subparagraphs 126(1)(*b*)(i) and (2.1)(*a*)(i) of the Act, a taxpayer is not entitled to credit foreign taxes against Canadian tax payable on such tax-exempt income.

This new definition applies to taxation years that begin after February 23, 1998.

Subclause 41(8)

Deemed Separate Source

ITA
126(8)

New subsection 126(8) of the Act provides that where income from a source in a foreign country is exempt from tax in that country under a tax treaty, but some part of the income is subject to an income or profits tax to which the treaty does not apply, in that country or another country and either at the national or sub-national level, that part is deemed to be income from a separate source in the country. This ensures that the portion of the foreign income that is not subject to foreign tax is treated as tax-exempt and thus excluded from qualifying incomes and qualifying losses for foreign tax credit purposes under the definitions in subsection 126(7) of the Act. As a result of amended subparagraphs 126(1)(*b*)(i) and (2.1)(*a*)(i) of the Act, a taxpayer is not entitled to credit foreign taxes against Canadian tax payable on income that is exempt from foreign tax.

This amendment applies to taxation years that begin after February 23, 1998.

Clause 42

Investment Tax Credit

ITA
127

Section 127 of the Act includes a set of provisions governing a taxpayer's entitlement to claim an investment tax credit (ITC).

Subclauses 42(1) and (2)

Definitions

ITA
127(9)

Subsection 127(9) provides definitions used in provisions relating to investment tax credits.

"investment tax credit"

New paragraph (*e*.3) of the definition "investment tax credit" requires a taxpayer to add back to the taxpayer's ITC the amount of recaptured ITC that has been included in the taxpayer's Part I tax payable for any of the 10 preceding taxation years because of new subsection 127(28), described below. This accounting prevents the recaptured ITC from being counted again in reducing a positive ITC balance, or in creating a negative balance, in subsequent years.

Paragraph (*h*) of the definition is amended to reduce a taxpayer's investment tax credit by amounts described in new subsections 127(27) or (29), described below.

These amendments apply for all taxation years.

Subclause 42(3)

Reduction of investment tax credit

ITA
127(27)

New subsection 127(27) of the Act is designed to reduce a taxpayer's ITC pool where property originally acquired for use in scientific research and experimental development (SR&ED) has, after February 23, 1998, been sold or converted to commercial use.

The reduction of the taxpayer's ITC pool is generally based on the applicable percentage rate of ITC multiplied by the lesser of the proceeds of disposition of the property and the original cost of the property.

For example, in year one a taxpayer acquires some equipment at a cost of $100 with the intention that it be used for all of its expected useful life for SR&ED. The taxpayer is entitled to and claims an ITC of 20% in respect of the cost of the equipment. However, the research runs ahead of schedule, and, at the completion of the project in year four, the equipment is still useable. The taxpayer sells the equipment for $60 in year four. This sale will reduce the taxpayer's ITC in year four by 20% x $60 = $12.

Similarly, a taxpayer could undertake SR&ED to develop a better product. In undertaking this SR&ED, in year one, the taxpayer purchases two lots of materials for $50 each which it incorporates into two batches of test product. The taxpayer is entitled to and claims an ITC of 35%. The first batch of test product is basically a failure; however, in year two the taxpayer manages to sell the first batch as clean fill for $10. Under this measure, the taxpayer's ITC in year two will be reduced by $3.50 (35% of $10). In year three, the taxpayer's second batch of test product is a success, and the taxpayer sells the second batch to its major client for $150. In year three, the taxpayer must reduce its ITC by $17.50. This represents 35% of $50. $50 is the lesser of the proceeds of disposition and the original cost of the materials for which the ITC was claimed.

As stated above, the amount of the reduction of the taxpayer's ITC is the lesser of two amounts. The first amount is the amount that can reasonably be considered to have been included in the taxpayer's investment tax credit in respect of the particular property. Where the property (or another property containing the property) is disposed of to a person dealing at arm's length with the taxpayer, the second amount is the same percentage (for example, 20%) that the taxpayer applied in calculating the original ITC claim in respect of the property multiplied by the proceeds of disposition of the property. In any other case (where the property is converted to commercial use or sold to a non-arm's length party), the second amount is the same percentage (20%) that the taxpayer applied in calculating the original ITC claim in respect of the property multiplied by the fair market value of the property (or the other property that contains the property).

Addition to Tax

ITA
127(28)

New subsection 127(28) of the Act applies where, at the end of a taxation year, the calculation of a taxpayer's "investment tax credit" yields a negative amount. Where the total of the amounts that are to be deducted in computing a taxpayer's "investment tax credit" in subsection 127(9) exceeds the total of the amounts to be added,, the excess is to be added to the taxpayer's tax otherwise payable under Part I of the Act for the year. Any amounts payable under this new provision for a particular taxation year will increase the amount of the taxpayer's SR&ED pool under subsection 37(1) for subsequent years. See the commentary to subsection 37(1) for information concerning this adjustment to the balance calculated under that subsection.

Investment Tax Credit of Partnership

ITA
127(29)

New subsection 127(29) of the Act provides for the allocation of a reduction in the ITC of a partnership caused by the application of new subsection 127(27). It requires a taxpayer who is a partner to deduct from the partner's ITC the portion that can reasonably be considered to be the taxpayer's share of the amount that would be determined under new subsection 127(27) in respect of the partnership, for its taxation year that ends in the particular year, if the partnership were a person and its fiscal period were its taxation year. This is consistent with the calculation of the allocation of the investment tax credits earned on the expenditures of a partnership under subsection 127(8).

These amendments apply to the 1998 and subsequent taxation years.

Clause 43

**Labour-sponsored Funds Tax Credit –
Deemed Original Acquisition**

ITA
127.4(5.1)

Section 127.4 of the Act provides a tax credit to individuals in respect of the acquisition of "approved shares" issued by prescribed labour-sponsored venture capital corporations. The tax credit is up to $525 per taxation year for acquisitions in the year and in the first sixty days of the following taxation year.

Subsection 127.4(5.1) is introduced to allow the Minister of National Revenue to treat an approved share that was acquired in a taxation year as having been acquired at the beginning of the year, in the event that it was actually acquired more than 60 days after the beginning of the year. This will typically allow an individual to claim the tax credit under section 127.4 for the preceding taxation year.

A similar rule for RRSP contributions in new subsection 146(22) allows the Minister to treat RRSP contributions made more than 60 days after the beginning of a taxation year as having been made at the beginning of the year.

The amendment applies to acquisitions that occur after 1997.

Clause 44

Minimum Tax – Adjusted Taxable Income Determined

ITA
127.52(1)(*a*)

Subsection 127.52(1) of the Act defines the "adjusted taxable income" of an individual for the purposes of determining the individual's minimum tax liability under Division E.1 of Part I of the Act. The adjusted taxable income of an individual for a taxation year is the amount that would be the individual's taxable income for that year if the assumptions set out it paragraphs 125.52(1)(*a*) to (*j*) were made.

Paragraph 127.52(1)(*a*) denies the deduction of amounts paid into deferred income plans in computing an individual's adjusted taxable income.

The repeal of paragraph 127.52(1)(*a*) will allow individuals to deduct, in computing their minimum tax liability, amounts paid into those plans to the same extent that these amounts are deductible in computing the individuals' regular tax liability.

This amendment applies generally to the 1998 and subsequent taxation years. A special transitional rule will, in effect, apply the amendment to the 1994 and subsequent taxation years of individuals who had to pay minimum tax in any of their 1994 to 1997 taxation years as a result of the application of paragraph 127.52(1)(*a*). However, this retroactive relief will apply only to the extent that they have been unable to totally recover during that period the ensuing additional tax, and only if those individuals were resident in Canada at the end of 1997 and were not bankrupt at any time during the period commencing after the end of the year for which they had to pay minimum tax and that ended at the end of 1997.

Clause 45

Bankruptcies

ITA
128

Section 128 of the Act contains rules that apply to taxpayers who become bankrupt.

Subclause 45(1)

ITA
128(2)(*d*)

For most purposes, paragraph 128(2)(*d*) of the Act divides the calendar year in which an individual becomes bankrupt into two taxation years. The first taxation year runs from January 1 to the day before bankruptcy and the second taxation year begins on the day of bankruptcy and runs to December 31.

Under the Lifelong Learning Plan, described in the commentary on section 146.02, an individual may withdraw up to $20,000 of RRSP funds on a tax-free basis to fund the enrolment of the individual or the individual's spouse in a qualifying educational program. Repayments of withdrawals are generally scheduled throughout a 10 year period following the completion of the program. Where an individual fails to make a scheduled repayment, the shortfall is included in computing the individual's income under subsection 146.02(4).

Paragraph 128(2)(*d*) is amended so that it does not apply for the purposes of subsection 146.02(4). As a consequence, an income inclusion will arise under that subsection only in respect of the taxation year of a bankrupt that ends at the end of a calendar year. If an individual has two taxation years due to bankruptcy in one calendar year, no income inclusion will arise under subsection 146.02(4) in connection with the first taxation year.

Paragraph 128(2)(*d*) is also amended to remove the references to subsections 146.01(9) and (10), as both subsections have been repealed.

These amendments apply to 1999 and subsequent taxation years.

Subclauses 45(2) to (4)

ITA
128(2)(*e*), (*f*) and (*g*)

A trustee in bankruptcy for a bankrupt individual is required under paragraph 128(2)(*e*) of the Act to file an income tax return as if the individual were not allowed to claim various credits and deductions generally available to individuals. Subparagraph 128(2)(*e*)(iii) is amended to allow the trustee to deduct an amount under section 118.62 with respect to interest paid on a student loan by the bankrupt (or a person related to the bankrupt) before the individual became bankrupt.

An individual who is bankrupt at any time in a taxation year is required under paragraph 128(2)(*f*) of the Act to file an income tax return for the year. This return is in addition to the return that is required under paragraph 128(2)(*e*) to be filed by the trustee of

bankruptcy on behalf of the individual for the same taxation year. Paragraph 128(2)(*f*) is amended to deny the bankrupt individual a deduction under section 118.62 (interest paid on student loan). However, the trustee may claim a deduction under that section in the return filed under paragraph 128(2)(*e*).

Paragraph 128(2)(*g*) of the Act prohibits an individual who is discharged absolutely from bankruptcy from claiming certain non-refundable tax credits, particularly those credits computed by reference to expenditures made before the individual became bankrupt. Paragraph 128(2)(*g*) is amended to restrict the individual from deducting an amount under section 118.62 in respect of interest paid on a student loan before the individual became bankrupt.

The amendments to paragraphs 128(2)(*e*), (*f*) and (*g*) of the Act apply to bankruptcies that occur after 1997.

Clause 46

Corporate Immigration

ITA
128.1

Section 128.1 of the Act sets out the income tax effects of becoming or ceasing to be resident in Canada.

Subclause 46(1)

Deemed Disposition

ITA
128.1(1)(*b*)

Subsection 128.1(1) of the Act sets out rules that apply when a taxpayer becomes resident in Canada.

Paragraph 128.1(1)(*b*) treats the taxpayer as having disposed of each property owned by the taxpayer, other than certain specified properties, for proceeds equal to the property's fair market value. The properties disposed of are deemed by paragraph 128.1(1)(*c*) to be

reacquired at the time of immigration at a cost equal to the deemed proceeds. The properties exempt from the deemed disposition are essentially those which are, ignoring any relevant tax treaty, already subject to tax in Canada. In this category are taxable Canadian property, inventory and eligible capital property in respect of a Canadian business and employee stock options subject to section 7. In addition, if a taxpayer elected on an earlier emigration not to be deemed to have disposed of a given property, such property is excepted from the deemed disposition if the taxpayer later becomes resident in Canada again.

The amendment to paragraph 128.1(1)(*b*) provides that the exceptions from the deemed disposition upon immigration will only apply where the immigrating taxpayer is an individual. Under the amended rule, therefore, a corporation that becomes resident in Canada is deemed to dispose of all its properties, without exception. Any accrued gain or loss in respect of properties that are taxable in Canada is therefore recognized for Canadian tax purposes, subject to any relevant treaty, in the taxation year that ends immediately before the time of immigration. After immigration, the cost of each of the corporation's properties is the fair market value of the property as at the time of immigration.

This amendment applies to corporations that become resident in Canada after February 23, 1998.

Subclause 46(2)

Deemed Dividend to Immigrating Corporation

ITA
128.1(1)(*c*.1)

New paragraph 128.1(1)(*c*.1) of the Act provides that if an immigrating corporation ("Forco") at the time of immigration holds a share of another corporation resident in Canada ("Canco"), Canco is deemed to have paid a dividend to Forco immediately before the time at which Forco is deemed to dispose of its Canco shares. Generally, the deemed dividend is equal to the amount by which the fair market value of the share exceeds the paid-up capital in respect of the share. There is an exception, however, if the Canco share is taxable Canadian property and Canada's right to tax any gain on the share

realized by Forco is not removed by a tax treaty. In that case, the amount of the deemed dividend is in effect reduced by the amount of any capital gain realized by Forco on the deemed disposition of the Canco share.

The effect of this rule is to treat Canco as if it had distributed to Forco the portion of Canco's surplus allocable to the shares held by Forco, except to the extent that surplus has been realized as a capital gain that is taxable in Canada. Since the dividend is deemed to be paid to Forco prior to immigration, it is subject to non-resident withholding tax. Where Canco and Forco deal at arm's length, new subsection 215(1.1) of the Act relieves Canco of the requirement to withhold tax under Part XIII of the Act on behalf of Forco.
Where a corporation immigrates to Canada, unremitted profits of a Canadian branch will be treated in a manner similar to the undistributed surplus of a Canadian corporation in which it holds shares.

Section 808 of the *Income Tax Regulations* will be amended (see Appendix D) to specify that where a corporation becomes resident in Canada, its allowance in respect of its investment in property in Canada will be nil for the taxation year that is deemed to end prior to immigration. Since the corporation will be unable to claim an investment allowance, it will be liable to pay branch tax on any unremitted profits of a Canadian branch arising in the year or deferred in respect of previous years.

This amendment and the corresponding amendment to Section 808 of the Regulations apply to corporations that become resident in Canada after February 23, 1998.

Deemed Dividend to Shareholder of Immigrating Corporation

ITA
128.1(1)(*c*.2)

New paragraph 128.1(1)(*c*.2) of the Act provides that if a corporation becomes resident in Canada and elects to increase the paid-up capital in respect of a class of its shares under paragraph 128.1(2)(*b*), the corporation is deemed to have paid a dividend on the shares of that class prior to immigrating. The deemed dividend is equal to the amount by which the paid-up capital of the class is increased. Since

paid-up capital generally can be returned to shareholders free of tax, the dividend ensures that the paid-up capital increase reflects tax-paid surplus. The dividend is of consequence primarily to shareholders resident in Canada, for whom a dividend from a foreign corporation is generally taxable. No dividend is deemed to be received, however, by a shareholder in respect of whom the immigrating corporation is a foreign affiliate. Taxation of the accrued surplus of a foreign affiliate that becomes resident in Canada is dealt with by paragraph 128.1(1)(*d*).

Where a resident shareholder is deemed to receive a dividend from an immigrating corporation by new paragraph 128.1(1)(*c*.2), the amount of the deemed dividend, since it has been included in the taxpayer's income, is added to the shareholder's adjusted cost base of the share under new paragraph 53(1)(*b*.1).

This amendment applies to corporations that become resident in Canada after February 23, 1998.

Subclause 46(3)

Paid-up capital adjustment

ITA
128.1(2)

Subsection 128.1(2) of the Act adjusts the paid-up capital in respect of the shares of a corporation that immigrates to Canada to ensure that the paid-up capital does not exceed the difference between the cost of the corporation's assets (as determined for Canadian tax purposes) and its outstanding liabilities. If the total paid-up capital exceeds this amount, the pro-rata portion of the excess is deducted from the paid-up capital in respect of each class of the corporation's shares.

Subsection 128.1(2) is amended as a consequence of the amendment to paragraph 128.1(1)(*b*) which deems an immigrating corporation to dispose of all its assets. Under amended paragraph 128.1(2)(*a*), where a corporation immigrates to Canada, a "paid-up capital adjustment" amount is determined for each class of its shares in accordance with a formula. This amount, which may be positive or negative, is the difference between the proportion of the corporation's

net asset value attributable to that class of shares less the existing paid-up capital in respect of the class. Net asset value of the class is calculated by subtracting the value of all debts and obligations owed by the corporation from the fair market value of all of its assets. The difference is then pro-rated for each class of shares by multiplying it by the ratio of the fair market value of all of the shares of the particular class to the aggregate amount for all classes. From the resulting figure – the target paid-up capital – is subtracted the paid-up capital otherwise determined. The result is a positive or negative paid-up capital adjustment amount.

If the amount of the paid-up capital adjustment is negative, it is subtracted from the paid-up capital otherwise determined. This reduction in paid-up capital is similar to that currently provided by subsection 128.1(2), except that under the amended provision, all assets are counted at fair market value since all will have been deemed to be disposed of upon immigration. If the amount of the adjustment is positive, it may be added to paid-up capital, provided the corporation makes the election set out in subparagraph 128.1(2)(*b*)(i) within 90 days after the corporation becomes resident in Canada. If the election is made, an amount equal to the amount of the adjustment is deemed to have been paid by the corporation as a dividend to its shareholders before the time of immigration. As paid-up capital generally can be returned to shareholders free of tax, the deemed dividend ensures that the paid-up capital increase reflects tax-paid surplus. The dividend is of consequence primarily to shareholders resident in Canada, for whom a dividend from a foreign corporation is generally taxable.

This amendment applies to corporations that become resident in Canada after February 23, 1998. A special transitional rule accommodates corporations that become resident during the initial period after that date. An election under subparagraph 128.1(1)(*b*)(i) is deemed to have been made in a timely manner if it is made by the corporation before April 1, 1999 and with the consent of all who were shareholders of the corporation immediately before the time the corporation was deemed to dispose of its assets prior to immigration.

Paid-up Capital Adjustment

ITA
128.1(3)

Subsection 128.1(3) of the Act ensures that the adjustment to paid-up capital made by subsection 128.1(2) does not provide an inappropriate result where, because of a share redemption, acquisition, or cancellation or a reduction of paid-up capital, subsection 84(3), (4) or (4.1) of the Act subsequently treats the corporation as having paid a dividend on those shares. In that circumstance, subsection 128.1(3) effects an add-back to paid-up capital to the extent that the reduction in paid-up capital which results from subsection (2) has increased the amount of any dividends deemed to have been paid on the subsequent section 84 transaction. The paid-up capital reduction is thus cancelled for future purposes to the extent that it has already created a taxable dividend.

Subsection 128.1(3) is amended as a consequence of the amendment to subsection 128.1(2). Since subsection (2) is amended to provide for additions to paid-up capital, as well as subtractions, the adjustment in subsection (3) is also amended to work in both directions. For example, assume that upon immigration to Canada, a corporation makes the election under subparagraph 128.1(2)(*b*)(i) to increase the paid-up capital of its shares to net fair market value. The corporation subsequently redeems some of its shares, resulting in a deemed dividend under subsection 84(3) equal to the excess of the amount paid over the paid-up capital in respect of the shares. At any subsequent time, in computing paid-up capital, subsection 128.1(3) mandates that the paid-up capital be reduced by the amount by which the deemed dividend on redemption was reduced by the operation of subsection 128.1(2). Since the paid-up capital associated with the redeemed shares has been finally accounted for on the redemption, this adjustment ensures that subsection (2) does not continue to add an amount to paid-up capital in respect of the redeemed shares.

This amendment applies to corporation that become resident in Canada after February 23, 1998.

Clause 47

Mutual Funds – Qualifying Exchange

ITA
132.2(1)(*k*)

Section 132.2 of the Act provides for "qualifying exchanges" between mutual funds. In a qualifying exchange, one mutual fund transfers all or substantially all of its property to another mutual fund, and takes back units of the transferee fund. The transferor fund's investors then exchange their shares or units of the transferor for those units of the transferee fund. Both sets of transactions take place on a tax-deferred or "rollover" basis. The qualifying exchange thus allows two mutual funds to be merged with no immediate tax consequence.

Subsection 132.2(1) sets out a number of rules that apply to qualifying exchanges. Paragraph 132.2(1)(*k*) ensures that a qualifying exchange will not cause shares of the transferor fund to cease to be qualified investments for trusts governed by registered retirement savings plans, registered retirement income funds and deferred profit sharing plans.

Paragraph 132.2(1)(*k*) is amended to add a reference to the definition "qualified investment" in subsection 146.1(1). This amendment, which applies after 1997, is consequential to the introduction of qualified investment rules for trusts governed by registered education savings plans.

Clause 48

Securities Held by Financial Institutions – Definitions

ITA
142.2(1)

Subsection 142.2(1) of the Act defines several terms for the purposes of the rules set out in sections 142.2 to 142.6 of the Act relating to securities held by financial institutions.

"financial institution"

The definition "financial institution" in subsection 142.2(1) is amended as a consequence of a change to the definition "restricted financial institution" in subsection 248(1) of the Act. As a result of these two changes, a corporation prescribed to be a financial institution for the purposes of the Tax on Large Corporations in Part I.3 of the Act will be a financial institution for the purposes of sections 142.2 to 142.6 of the Act.

If such a corporation was not a restricted financial institution prior to these changes, the special rules in subsection 142.6(1) of the Act applicable to taxpayers becoming or ceasing at any time to be a financial institution for the purposes of subsections 142.2 to 142.6 will apply. These rules include a deemed year-end immediately before that time, and a deemed disposition and reacquisition of certain properties held by the taxpayer at that time.

These changes apply to taxation years that begin after 1998.

Clause 49

Registered Retirement Savings Plans

ITA
146

Section 146 of the Act provides rules relating to registered retirement savings plans (RRSPs).

Subclauses 49(1) and (2)

Definitions

ITA
146(1)

Subsection 146(1) of the Act defines a number of terms that apply for purposes of section 146.

"premium"

Subsection 146(1) of the Act generally defines the expression "premium" as a payment made by an individual for benefits provided under an RRSP. As an exception to the existing definition, RRSP contributions designated as repayments of amounts withdrawn pursuant to the Home Buyers' Plan (HBP) are for most purposes not considered to be "premiums". As a consequence, these repayments are not deductible in computing income and are not taken into account in determining the overcontributions penalty tax under Part X.1.

The definition is amended to update the description of HBP repayments in the exception referred to above. This technical amendment is consequential to a restructuring of the definition "excluded withdrawal" in subsection 146.01(1).

The definition is also amended so that repayments under the Lifelong Learning Plan (LLP) are subject to the same treatment as repayments under the HBP. LLP repayments are provided for under paragraph (*b*) of the definition "excluded withdrawal" in subsection 146.02(1) and subsection 146.02(3), both of which are discussed in the commentary below.

The definition is also amended so that the exception referred to above does not apply for the purpose of new subsection 146(22), explained in the commentary below. For the purpose of that subsection, all RRSP contributions are treated as premiums.

Finally, the definition is amended so that the exception referred to above does not apply for the purpose of the definition "excluded premium" in subsection 146.02(1). The objective of this amendment is to ensure that HBP repayments are treated as premiums for the purpose of the definition "excluded premium" in subsection 146.02(1), so that these repayments cannot also be treated as repayments under the LLP.

These amendments apply to the 1997 and subsequent taxation years.

"refund of premiums"

The definition "refund of premiums" is relevant for the purposes of determining the amount that is received as a consequence of the death

of an RRSP annuitant and that can be transferred on a tax-deferred basis by the recipient. If the annuitant had no spouse at the time of death, each amount paid out of an RRSP to a "financially dependent" child or grandchild of the annuitant is a refund of premiums. For this purpose, it is assumed that a child or grandchild was not financially dependent if, for the year preceding that of the annuitant's death, the income of the child or grandchild exceeded the basic personal amount, currently set at $6,456. The amendment to this definition is consequential on the introduction of the $500 supplementary tax credit under new paragraph 118(1)(*b*.1), which effectively increases from $6,456 to $6,956 the amount of income that can be earned on a tax-free basis.

This amendment applies to 1998 and subsequent taxation years.

Subclause 49(3)

Amount of RRSP Premiums Deductible

ITA
146(5)(*a*)(iv.1)

Under subsection 146(5) of the Act, in computing income an individual may deduct for a taxation year an amount not exceeding the lesser of two amounts. The first amount is the individual's RRSP deduction limit for the year. The second amount, as determined under paragraph 146(5)(*a*), is the undeducted portion of the individual's pool of post-1990 RRSP contributions made on or before the 60th day of the following year to RRSPs under which the individual is the annuitant. Subparagraph 146(5)(*a*)(iv.1) excludes from the second amount any contribution that is withdrawn as an eligible amount under the HBP less than 90 days after the date of the contribution.

Subparagraph 146(5)(*a*)(iv.1) is amended so that the exclusion from the second amount also applies to contributions that are withdrawn as eligible amounts under the LLP less than 90 days after being contributed. For details on the LLP, see the commentary on section 146.02.

This amendment applies to 1998 and subsequent taxation years.

Subclause 49(4)

Amount of Spousal RRSP Premiums Deductible

ITA
146(5.1)(*a*)(iv)

Under subsection 146(5.1) of the Act, in computing income an individual may deduct for a taxation year an amount not exceeding the lesser of two amounts. The first amount is the individual's RRSP deduction limit for the year, minus the amount deducted by the individual for the year under subsection 146(5) with respect to RRSPs under which the individual is the annuitant. The second amount, as determined under paragraph 146(5.1)(*a*), is the undeducted portion of the individual's pool of post-1990 RRSP contributions made on or before the 60th day of the following year to RRSPs under which the individual's spouse is the annuitant. Subparagraph 146(5.1)(*a*)(iv) excludes from the second amount any contributions that are withdrawn as eligible amounts under the HBP less than 90 days after being contributed.

Subparagraph 146(5.1)(*a*)(iv) is amended so that the exclusion from the second amount also applies to contributions that are withdrawn as eligible amounts under the LLP less than 90 days after being contributed. For details on the LLP, see the commentary below on section 146.02.

This amendment applies to 1998 and subsequent taxation years.

Subclause 49(5)

Benefits Taxable

ITA
146(8)

Subsection 146(8) of the Act generally provides that amounts received by an individual in a taxation year out of an RRSP are required to be included in computing the individual's income for the year. However, "excluded withdrawals" under the HBP (as defined in subsection 146.01(1)) are not required to be included in computing income.

Subsection 146(8) is amended so that "excluded withdrawals" received by an individual pursuant to the LLP are likewise not required to be included in computing the individual's income. These amounts are described in greater detail in the commentary on the definitions of "eligible amount" and "excluded withdrawal" in subsection 146.02(1).

This amendment applies to 1999 and subsequent taxation years.

Benefits Taxable – Subsequent Re-Calculation

ITA
146(8.01)

Subsection 146(8.01) of the Act applies where an amount is withdrawn by an individual from an RRSP pursuant to the HBP and it is ultimately determined that the amount is not an "excluded withdrawal". Subsection 146(8.1) ensures that the Minister is able to assess or reassess the tax, interest and penalties to recognize that the amount never was an "excluded withdrawal" (as defined in subsection 146.01(1)).

Subsection 146(8.01) is amended to refer to such an amount as a "designated withdrawal" under the HBP. This amendment is consequential on the introduction of the definition "designated withdrawal" in subsection 146.01(1).

Subsection 146(8.01) is also amended so that it likewise applies to an amount received pursuant to the LLP, where the amount is ultimately determined not to be an "excluded withdrawal" under the LLP. For more information, see the commentary below on section 146.02.

These amendments apply to 1998 and subsequent taxation years.

Subclause 49(6)

Deemed Payment of RRSP Premiums and Provincial Pension Plan Contributions

ITA
146(22)

Subsection 146(22) of the Act is introduced to allow contributions made after the first 60 days of a taxation year to an RRSP or a prescribed provincial pension plan to be treated as if made at the beginning of the year, where the Minister so permits. A similar rule in subsection 127.4(5.1) applies to the acquisition of shares issued by a labour-sponsored venture capital corporation.

It is expected that the Minister will exercise discretion under subsection 146(22) only in response to a hardship that affects a community or group of individuals. For example, the Minister has already indicated that this rule will be used to respond to the January 1998 ice storm which affected many communities in Eastern Canada.

If the Minister makes a direction under subsection 146(22), contributions that have been made to RRSPs after the first 60 days of a taxation year are generally deemed to have been made at the beginning of the year. In addition, designations required in connection with RRSP contributions under paragraphs 60(*j*), (*j*.1) and (*l*) and subsections 146.01(3) and 146.02(3) are considered to have been made in the manner required under those provisions.

Subsection 146(22) is not effective for the purposes of subparagraphs 146(5)(*a*)(iv.1) and 146(5.1)(*a*)(iv). These subparagraphs prevent the deduction of contributions made to RRSPs when they have been withdrawn under the HBP or LLP within 90 days of their contribution. For example, if an amount were contributed to an RRSP on March 15, 1999 and withdrawn under the HBP on April 15, 1999, the application of subsection 146(22) would not allow the 90-day rule to be satisfied.

This amendment applies to amounts paid after 1997.

Clause 50

Home Buyers' Plan

ITA
146.01

The Home Buyers' Plan (HBP) allows first-time home buyers to withdraw funds from a registered retirement savings plan (RRSP) on a tax-free basis to purchase a home. Currently, individuals may generally only use the HBP in one calendar year during their lifetimes. Individuals are allowed a period of up to 15 years to repay the withdrawn funds. For the purposes of the HBP, an individual is generally considered to be a first-time home buyer when withdrawing RRSP funds to purchase a home if neither the individual nor the individual's spouse owned and lived in another home in the calendar year of the RRSP withdrawal or in any of the four preceding calendar years.

The HBP measures announced in the 1998 Budget are summarized below.

Summary of HBP Measures Announced in the 1998 Budget

1. Multiple Uses of the HBP

Under existing rules, an individual cannot withdraw amounts under the HBP in a calendar year after having withdrawn an eligible amount in a previous calendar year. This restriction applies even if the individual otherwise qualifies for the purposes of the HBP as a first-time home buyer in the subsequent calendar year.

This restriction is being eliminated for amounts received after 1998. Instead, an individual who has repaid all amounts previously received under the HBP may subsequently withdraw amounts from the individual's RRSP under the HBP if the individual is a first-time home buyer for the purposes of the HBP and satisfies other conditions for participating in the HBP. For this purpose, a "repayment" of an individual includes not only an amount designated under subsection 146.01(3) by the individual as a "repayment" but also amounts added in computing the individual's income because of

any failure to repay a scheduled amount (subsection 146.01(4)) or because the individual emigrated from Canada (subsection 146.01(5)).

For more detail, see the commentary on the definitions "HBP balance", "regular eligible amount" and "participation period" in subsection 146.01(1).

2. HBP and the Disabled

As described above, the HBP restricts eligible RRSP withdrawals to first-time home buyers. This restriction is being eliminated in connection with RRSP withdrawals made after 1998 by or for the benefit of disabled persons who are entitled to the disability tax credit under subsection 118.3(1). For the HBP to apply in this context, the purpose for purchasing the home must be to enable the disabled person to live in a more accessible dwelling, or one that is better suited for the personal needs and care of the disabled person.

For more detail, see the commentary on the definition "supplemental eligible amount" in subsection 146.01(1).

Subclauses 50(1) to (4)

Definitions

ITA
146.01(1)

Subsection 146.01(1) of the Act defines various expressions for the purposes of the HBP. Definitions have been changed and added to implement the HBP measures announced in the 1998 Budget.

Except as noted below, the amendments to subsection 146.01(1) apply after 1998.

"designated withdrawal"

The definition "designated withdrawal" is added to subsection 146.01(1) of the Act.

A "designated withdrawal" is an RRSP withdrawal requested by the recipient to be made under the HBP, but which may or may not

subsequently qualify as an "eligible amount" for the purposes of the HBP. The definition has been added because "eligible amounts" under the HBP are now subdivided into "regular eligible amounts" and "supplementary eligible amounts", as a consequence of the extension of the HBP for disabled persons. The definition provides a convenient way of referring to all RRSP withdrawals requested under the HBP, including those withdrawals made before 1999.

The definition is used in amended subsection 146(8.01), the amended definition "replacement property" in subsection 146.01(1) and amended paragraph 146.01(2)(*c*). For further detail, see the commentary on those provisions.

"eligible amount"

The definition "eligible amount" in subsection 146.01(1) of the Act is the key definition under the HBP. An "eligible amount" received by an individual under the HBP qualifies as an "excluded withdrawal" and, as such, it is not included in computing the individual's income under subsection 146(8) and is required to be repaid pursuant to subsection 146.01(4).
As a result of the amendments to the HBP for disabled persons, the definition "eligible amount" is amended to provide that an "eligible amount" is simply a "regular eligible amount" or a "supplemental eligible amount". The definition "regular eligible amount" corresponds to the existing definition "eligible amount". The definition "supplemental eligible amount" allows for the extension of the HBP with regard to homes acquired by or for the benefit of disabled persons. For further detail, see the commentary on the definitions "regular eligible amount" and "supplemental eligible amount".

This amendment applies to amounts received after 1998.

"excluded withdrawal"

An "excluded withdrawal" is an amount received by an individual out of or under the individual's RRSP, pursuant to the HBP. It is not included in computing the individual's income under subsection 146(8) of the Act.

Under existing rules, an excluded withdrawal is one of three types of amounts. The most common type of excluded withdrawal is an

"eligible amount" under the HBP. The second type of excluded withdrawal is an amount that fails to be an "eligible amount" received by an individual because the individual dies before the end of the year following the year of withdrawal of the amount and prior to acquiring a home as required under the HBP. The third type of excluded withdrawal is also an amount that fails to be an eligible amount of an individual because the individual fails to acquire a home as required under the HBP, but which the individual repays on a timely basis to the issuer of the RRSP from which the amount was withdrawn. If an individual dies and an election is not made under subsection 146.01(7), the first and second types of withdrawal are included under subsection 146.01(6) in computing the individual's income for the year of death.

The definition is amended so that it no longer includes the second type of "excluded withdrawal" described above. Instead, the definitions "regular eligible amount" and "supplemental eligible amount" are structured so that an amount that was previously this type of "excluded withdrawal" is now considered to be an "eligible amount". This amendment has been made for drafting convenience and does not represent any change in policy. The amendment applies to amounts received after 1998.

The definition is also amended to change the conditions to be met for the repayment of an amount withdrawn from an RRSP in order for that amount to be an "excluded withdrawal" of the third type, as described above. Repayments made after 1999 need not be made to the issuer from which the related RRSP amount was withdrawn. Instead, repayments after 1999 will be treated by RRSP issuers as normal RRSP contributions and only designated by individuals as repayments in prescribed forms filed with the Minister.

The definition is also amended to make technical changes to take into account the new definitions "regular eligible amount" and "supplemental eligible amount". This amendment applies to amounts received after 1998.

Except as noted above, these amendments apply to amounts received after 1996. The purpose of generally applying the amendments to amounts received after 1996 (and not only to amounts received after 1998) is to ensure that the change to the repayment rules described

above applies to the repayment of amounts that were originally received in 1997 and 1998 under the existing HBP rules.

"HBP balance"

The definition "HBP balance" is added to subsection 146.01(1) of the Act.

An individual's "HBP balance" at any time in a taxation year is equal to the total eligible amounts received by the individual, minus the individual's designated HBP repayments under subsection 146.01(3) for previous taxation years and all amounts included under subsections 146.01(4) and (5) in computing the individual's income for previous taxation years.

The definition is part of the new rules that allow individuals to participate in the HBP in more than one calendar year. The definition is used to determine the beginning and end of a "participation period", as described in the commentary on the definition of that expression. It is also relevant for the purposes of paragraph (*i*) of the definition "regular eligible amount" in subsection 146.01(1) and paragraph (*b*) of the definition "supplemental eligible amount" in the same subsection.

"participation period"

The definition "participation period" is added to subsection 146.01(1) of the Act.

An individual's "participation period" starts at the beginning of a year in which an individual receives an eligible amount under the HBP and ends immediately before the first subsequent year at the beginning of which the individual's HBP balance has been eliminated. As described in the definition "HBP balance", an individual's HBP balance will be eliminated where previous eligible amounts withdrawn by the individual are fully offset by the individual's designated HBP repayments under subsection 146.01(3) and previous HBP income inclusions under subsection 146.01(4) or (5). The definition "participation period" is used only in amended subsections 146.01(4) and (7), as described in the commentary below. The definition is part of the new rules that allow individuals to participate in the HBP in more than one calendar year.

Where an amount equal to an individual's HBP balance at the end of a particular taxation year is repaid in the first 60 days of the following taxation year and is designated under subsection 146.01(3) for the particular year, the participation period of the individual ends at the end of the particular year.

"regular eligible amount"

The definition "regular eligible amount" is added to subsection 146.01(1) of the Act. As discussed in the commentary on the amendment to the definition "eligible amount", the new definition corresponds closely to the existing definition "eligible amount". The conditions that qualify a particular amount received by an individual as a "regular eligible amount" are set out in paragraphs (*a*) to (*i*) of the definition.

Paragraphs (*a*) and (*b*) essentially require that the individual withdraw the particular amount in a prescribed form and that, at the time the withdrawal is made, an agreement be in place to purchase or construct the qualifying home in respect of which the particular amount was withdrawn. These conditions are identical to the conditions in paragraphs (*a*) and (*b*) of the existing definition "eligible amount", except that an additional condition requiring the individual to be resident in Canada is included in paragraph (*g*) of the new definition rather than in paragraph (*b*) of the existing definition.

Paragraph (*c*) requires that the individual acquire either the qualifying home or "replacement property" for it by October 1 of the year following the withdrawal of the particular amount, except where the individual dies before the end of that following year. This condition is identical to the condition in paragraph (*c*) of the existing definition "eligible amount", except that the existing definition does not provide for a special rule on death. This exception on death does not represent a change in policy, but is consequential to amendments to the definition "excluded withdrawal", described in the commentary above.

Paragraph (*d*) provides that neither the individual nor the individual's spouse can have acquired the qualifying home more than 30 days before the withdrawal of the particular amount. This condition is identical to the condition in paragraph (*d*) of the existing definition "eligible amount".

Paragraphs (*e*) and (*f*) essentially require that the individual be a first-time home buyer. An individual counts as a first-time home buyer for this purpose where, during the 4 calendar years preceding the particular year in which the withdrawal was made, and in the period in the particular year ending 30 days before the withdrawal was made, neither the individual nor the individual's spouse owned and lived in a home. These conditions are identical to the conditions in paragraph (*d*.1) of the existing definition "eligible amount".

Paragraph (*g*) provides that the individual must be resident in Canada at the time in the calendar year that the particular amount is withdrawn. In addition, where the qualifying home has not yet been acquired, the individual must be resident in Canada until the qualifying home or replacement property for it is acquired (or until the individual's death, if the individual dies before the end of the following calendar year and before acquiring the qualifying home or replacement property). Paragraph (*g*) corresponds to paragraph (*e*) of the existing definition.

Paragraph (*h*) requires that the total of the particular amount and all other eligible amounts withdrawn at or before the time of withdrawal of the particular amount and in the calendar year of withdrawal be no more than $20,000. Paragraph (*f*) of the existing definition had also contained a $20,000 limit, but the limit has been changed so that individuals are not precluded from participating in the HBP in more than one calendar year.

Paragraph (*i*) requires that an individual's "HBP balance" be nil at the beginning of the calendar year in which the particular amount was withdrawn. For further detail in this regard, see the commentary above on the definitions "HBP balance" and "participation period". In addition, it should be noted that a special deeming rule in amended paragraph 146.01(2)(*d*) provides relief in some cases for individuals who make RRSP withdrawals under the HBP over 2 years. Paragraph (*i*) of the new definition corresponds to paragraph (*i*) of the existing definition "eligible amount", but has been modified in order not to prevent individuals from participating in the HBP in more than one calendar year where other conditions (most notably the first-time home buyer requirement in paragraph (*d*) of the new definition) are satisfied.

The definition applies to amounts received after 1998.

"replacement property"

The definition "replacement property" in subsection 146.01(1) of the Act is relevant for the purposes of determining whether an RRSP withdrawal is an "eligible amount", and thus excluded from income under subsection 146(8) of the Act for the year of its withdrawal. For an RRSP withdrawal made in a particular year to qualify as an eligible amount, it is normally required that the qualifying home in respect of which the withdrawal was made be acquired by October 1 of the following year. However, an individual may substitute a replacement property for a qualifying home that was not purchased if certain conditions are met.

The definition is amended to allow replacement property to be acquired by a disabled person, in the event that the disabled person was not the person withdrawing RRSP funds under the HBP. The amendment is consistent with the new HBP rules for disabled persons found mostly in the definition "supplemental eligible amount".
"specified disabled person"

The definition "specified disabled person" is added to subsection 146.01(1) of the Act. The expression is used in the definitions "replacement property" and "supplemental eligible amount".

A "specified disabled person" in respect of an individual is a person who is the individual (or who is related to the individual), where the person is entitled to the disabled tax credit under subsection 118.3(1) or would be so entitled if the restriction in that subsection with respect to attendant care were ignored.

A "specified disabled person" is able to withdraw funds from an RRSP as an "eligible amount" without qualifying as a first-time home buyer. In addition, an individual may withdraw RRSP funds in order to allow the individual, or a specified disabled person in respect of the individual, to purchase a home for occupancy by the disabled person.

"supplemental eligible amount"

The definition "supplemental eligible amount" is added to subsection 146.01(1) of the Act in order to allow greater access to the HBP for disabled persons.

The conditions for a particular amount received by an RRSP annuitant to qualify as a "supplemental eligible amount" are set out in paragraphs (*a*) to (*h*) of the definition. The definition is broadly similar to the definition "regular eligible amount". However, as more fully described below, it does not contain any condition that the disabled person or the RRSP annuitant be a first-time home buyer or that the particular amount be for the benefit of the RRSP annuitant.

Paragraph (*a*) requires the particular amount be received by the RRSP annuitant pursuant to the annuitant's request in a prescribed form that identifies a "specified disabled person" (as described above). The form must also set out a location of a "qualified home" (as defined in subsection 146.01(1)) that the disabled person has begun to use as a principal place of residence or that the RRSP annuitant intends the disabled person to use as a principal place of residence within a specified period.

Paragraph (*b*) requires that the purpose of receiving the particular amount is to enable the disabled person to live in a more accessible dwelling or in an environment better suited to the personal needs and care of the disabled person.

Paragraph (*c*) requires that either the disabled person or the RRSP annuitant have entered into an agreement to acquire or construct the qualifying home before the withdrawal of the particular amount.

Paragraph (*d*) requires that the RRSP annuitant or the disabled person acquire either the qualifying home or "replacement property" after 1998 and before October 1 of the year following the year of the withdrawal of the particular amount, except where the RRSP annuitant dies before the end of that following year.

Paragraph (*e*) provides that no specified individual can have acquired the qualifying home more than 30 days before the withdrawal. The individuals so specified are the RRSP annuitant, the RRSP annuitant's spouse, the disabled person and the disabled person's spouse.

Paragraph (*f*) provides that the RRSP annuitant must be resident in Canada at the time in the calendar year that the particular amount is withdrawn. In addition, where the qualifying home has not yet been acquired, the RRSP annuitant must be resident in Canada until the qualifying home or replacement property for it is acquired by the

RRSP annuitant or the disabled person (or until the annuitant's death, if the annuitant dies before the end of the following calendar year and before the qualifying home or replacement property for it is acquired by the annuitant or the disabled person).

Paragraph (*g*) requires that the total of the particular amount and all other eligible amounts withdrawn at or before the time of withdrawal of the particular amount and in the calendar year of withdrawal not exceed $20,000. This paragraph is identical to paragraph (*h*) of the definition "regular eligible amount".

Paragraph (*h*) requires that an individual's "HBP balance" be nil at the beginning of the calendar year in which the particular amount was withdrawn. This paragraph is identical to paragraph (*i*) of the definition "regular eligible amount".

The definition applies to amounts received after 1998.

Subclause 50(5)

Special Rules

ITA
146.01(2)(*c*) and (*d*)

Subsection 146.01(2) of the Act provides a number of special rules that are relevant for the purposes of section 146.01.

Existing paragraph 146.01(2)(*c*) applies where an individual has withdrawn an amount from an RRSP pursuant to the HBP in respect of a qualifying home, but has not acquired the home (or replacement property for it) before the completion date. Where one of two sets of conditions are satisfied, the individual is treated as having acquired such property by the completion date with the result that the withdrawn amount can qualify as an "eligible amount". For this rule to apply, the individual must, by the completion date, have agreed in writing to acquire the qualifying home or replacement property for it and actually acquire the property within a further 12 months from that completion date. Alternatively, if an individual is constructing a home and has not done enough work on it by the completion date to be considered to have acquired it by that date, the individual will still be considered to have acquired it by that date if payments to third

parties before that date for its construction total at least the total of amounts withdrawn pursuant to the HBP by the individual.

Paragraph 146.01(2)(*c*) is amended to provide the same relief where a home is purchased or constructed by a "specified disabled person". This amendment is consequential to the new rules for disabled persons under the HBP, reflected in the definitions "specified disabled person" and "supplemental eligible amount" in subsection 146.01(1).

Paragraph 146.01(2)(*c*) is also restructured for simplicity and to take into account the structure of the definitions "regular eligible amount" and "supplemental eligible amount". For example, the existing explicit requirement that an individual be resident in Canada is no longer necessary because of the structure of these definitions.

Paragraphs 146.01(2)(*d*) and (*e*) are repealed, as they are no longer have any effect.

Existing paragraph 146.01(2)(*f*) applies to a withdrawal made by an individual in January of a year (or a subsequent month in the year where the Minister so permits) following the withdrawal by the individual of an eligible amount in the preceding year. In these circumstances, the subsequent amount is treated as having been withdrawn at the end of the preceding year if the individual had requested before the end of the preceding year that the later amount be withdrawn. This can allow the subsequent amount to qualify as an eligible amount under the HBP.

Paragraph 146.01(2)(*f*), renumbered as paragraph 146.01(2)(*d*) as a consequence of the repeal of paragraphs 146.01(2)(*d*) and (*e*), is amended so that this treatment can arise whether or not there is a request to withdraw the subsequent amount by the end of the preceding calendar year.

These amendments apply to amounts received after 1998.

Subclauses 50(6) and (7)

Repayment of Eligible Amount

ITA
146.01(3)

Subsection 146.01(3) of the Act provides that amounts contributed by individuals to their RRSPs may be designated as non-deductible repayments under the HBP. If the individual designates sufficient amounts in this manner, there is no income inclusion for the individual under subsection 146.01(4). Subsection 146.01(3) provides that an individual's RRSP contribution may be designated as a repayment in prescribed form filed with the individual's income tax return for a taxation year or, where an individual is not required to file a return of income for the year, by filing a form with the Minister by the deadline for filing the return (typically April 30 of the following year).

Subsection 146.01(3) is amended to provided that, in all cases, individuals are required to designate HBP repayments for a taxation year in prescribed forms filed with their income tax returns for the year. This amendment is consequential to amended subsection 150(1), under which an individual is required to file an income tax return for each taxation year at the end of which the individual has a positive HBP balance (as defined by subsection 146.01(1)). This amendment applies to 1999 and subsequent taxation years.

Paragraph 146.01(3)(*a*) is amended to clarify that the RRSP contributions designated as repayments under subsection 146.01(3) by an individual cannot include repayments already taken into account under paragraph (*b*) of the definition "excluded withdrawal" in subsection 146.01(1).

This amendment applies to 1996 and subsequent taxation years.

Subclauses 50(8) to (11)

Portion of Eligible Amount not Repaid

ITA
146.01(4)

Subsection 146.01(4) of the Act provides for an income inclusion for an individual for a taxation year to the extent that the individual fails, for that year, to designate a repayment under subsection 146.01(3) of at least a portion – referred to below as the "specified amount" – of the individual's HBP balance outstanding at the end of that year. The subsection generally begins to operate for the second taxation year beginning after the receipt by the individual of an eligible amount under the HBP, and continues to operate if the individual has a positive HBP balance at the end of a taxation year. However, for that second year, designated repayments in the two preceding years are treated as if they had been made for that second year. Consequently, for that second year an individual is given full credit for early HBP repayments. (Note: Under the new rules referred to below, that second year is the third year of a participation period.)

The specified amount for a taxation year is a fraction of the individual's HBP balance at the end of the year. An individual's HBP balance at the end of a taxation year is the total of the individual's eligible amounts previously received under the HBP, minus designated repayments for preceding taxation years under subsection 146.01(3) and income inclusions under subsections 146.01(4) and (5) for those years. The fraction is 1/15 for that second following year, 1/14 for the next year, 1/13 for the next year and so on until the sixteenth following taxation year, at which point the specified amount consists of the individual's entire remaining HBP balance.

Subsection 146.01(4) is amended so that, in determining an individual's income inclusion for a taxation year in a "participation period" of the individual, all amounts received, designated or included in income for a taxation year in a preceding participation period of the individual are ignored. As described in the commentary on the definition "participation period" in subsection 146.01(1), an individual's participation period begins at the beginning of a taxation year in which an eligible amount under the HBP is received by the individual and ends once all eligible amounts received by the

individual in that year have been repaid under subsection 146.01(3) or otherwise recognized under subsection 146.01(4) or (5). This amendment is consequential to the amendments in the definitions "regular eligible amount" and "supplemental eligible amount" that allow individuals to participate in the HBP in more than one calendar year.

The description of B in the formula in subsection 146.01(4) is amended so that repayments designated for first and second taxation years in a participation period are ignored for the purpose of determining the specified amount for the third taxation year in the repayment period. As described above, these repayments are treated like repayments made for the third taxation year of the participation period. From a policy perspective, it is not appropriate to double count these repayments through a reduction of the specified amount.

Subsection 146.01(4) is also amended to eliminate provisions that are relevant only for past taxation years.

These amendments apply to 1999 and subsequent taxation years.

Subclause 50(12)

Where Individual Becomes a Non-resident

ITA
146.01(5)

Subsection 146.01(5) of the Act is a special rule that applies where an individual ceases to be resident in Canada after having withdrawn an eligible amount under the HBP. The rule provides for an income inclusion for an individual in these circumstances equal to the total of all eligible amounts previously withdrawn by the individual minus the total of

- all previous income inclusions under subsection 146.01(4) resulting from shortfalls in repayments, and

- all HBP repayments under subsection 146.01(3) made not more than 60 days after the date on which the individual ceased to reside in Canada and before the individual files a return of income for the year in which he or she became non-resident.

Paragraph 146.01(5)(*c*) is amended to provide that previous income inclusions under subsection 146.01(5) itself are treated in the same manner as previous income inclusions under subsection 146.01(4). In this context, it is conceivable that an individual might participate in the HBP, emigrate from Canada and have a resulting income inclusion under subsection 146.01(5), immigrate to Canada, participate again in the HBP and then emigrate again from Canada. In these unusual circumstances, the original income inclusion for the individual under subsection 146.01(5) will be taken into account in determining the income inclusion for the taxation year of the individual's second emigration from Canada.

The amendment applies to 1999 and subsequent taxation years.

Subclauses 50(13) and (14)

Death of Individual

ITA
146.01(6)

Subsections 146.01(6) and (7) of the Act provides rules that apply in the event that an individual dies and has previously received "excluded withdrawals" under the HBP that have not been repaid to RRSPs. Where the total of such amounts exceeds the sum of designated amounts repaid by the individual and income inclusions of the individual under subsections 146.01(4) and (5), the excess is included in computing the individual's income for the year of death. An exception to this rule is made where an election in writing is made under subsection 146.01(7).

Subsection 146.01(6) is amended so that those "excluded withdrawals" which are not "eligible amounts" are ignored for the purpose of calculating the income inclusion on death. This amendment is consequential to amendments which extend the meaning of "eligible amount". For further detail, see the commentary on amendments to the definitions "regular eligible amount" and "supplemental eligible amount" in subsection 146.01(1) and on the amendments to the definition "excluded withdrawal" in the same subsection.

As a consequence of the above amendment, the income inclusion under subsection 146.01(6) is an individual's "HBP balance" immediately before death, less any amount that is designated as a repayment under subsection 146.01(3) for the year of death. While an individual is not able to contribute to an RRSP after death, it is possible that previously made RRSP contributions may be designated by the deceased's legal representatives as repayments for the year of death. The expression "HBP balance" is defined in subsection 146.01(1).

These amendments apply to 2000 and subsequent taxation years. In addition, for the 1997 to 1999 taxation years, technical changes to subsection 146.01(6) are being made as a consequence of the reorganization of the definition "excluded withdrawal" in subsection 146.01(1) in connection with amounts received after 1996.

Subclause 50(15)

Exception

ITA
146.01(7)

Where an individual dies in a taxation year and has a surviving spouse, subsection 146.01(7) of the Act generally provides an election which prevents the amount determined under subsection 146.01(6) (referred to below as the "deceased's balance") from being included in computing the deceased's income for the year. The deceased's balance is treated as having been received as an eligible amount by the surviving spouse at the time of the death. Existing paragraph 146.01(7)(*c*) prevents an election in the case where, in different calendar years, the deceased and the surviving spouse received eligible amounts before the death. In addition, a repayment schedule for the surviving spouse is established under paragraph 146.01(7)(*g*) by providing for an explicit "completion date" in respect of the eligible amount.

Subsection 146.01(7) is amended by eliminating the restriction on the election currently contained in paragraph 146.01(7)(*c*). This will allow more opportunity for surviving spouses to elect under this subsection 146.01(7), rather than having an amount included in the income of the deceased.

New paragraph 146.01(7)(*c*) simplifies the rules under which the "completion date" in respect of the deceased's balance is determined. Subparagraph 146.01(*c*)(i) applies if the surviving spouse received another eligible amount before death (other than an eligible amount received in a participation period of the surviving spouse that ended before the year of death). In this case, the completion date in respect of the deceased's balance is the same as the completion date in respect of the other eligible amount. Consequently, after the year of death, the remaining period under subsection 146.01(4) for the repayment of the deceased's balance will be the same as the remaining period for the repayment of the spouse's other eligible amounts.

Where subparagraph 146.01(7)(*c*)(i) does not apply, the completion date in respect of the deceased's balance is the same as the completion date for the last eligible amount that was received by the deceased. In this case, after the year of death, the remaining period under subsection 146.01(4) for repayment of the deceased's balance will be the same as the period that would be the remaining period for the payment of the deceased's balance if the deceased had not died.

These amendments apply to deaths that occur after 1998. However, the new rules in paragraph 146.01(1)(*c*) apply somewhat differently for deaths that occur in 1999 to take into account the unusual case where an "excluded withdrawal" was received by the deceased but neither the deceased nor the surviving spouse received any relevant "eligible amount" before the deceased's death. In this case, the completion date in respect of the deceased's balance is considered to be October 1, 2000.

Clause 51

Lifelong Learning Plan

ITA
146.02

New section 146.02 of the Act sets out the rules governing the Lifelong Learning Plan (LLP) announced in the 1998 Budget. It will allow individuals to withdraw funds from their RRSPs to finance their education and the education of their spouses, without including

the withdrawal in computing income. To ensure that the role of RRSPs in providing funds for retirement is not compromised, those who participate in the LLP will be required to repay the amount they withdraw to their RRSP over ten years or face an income inclusion with respect to any shortfall. Individuals will be able to withdraw up to $10,000 of RRSP funds from their RRSPs in a calendar year under the LLP, to a maximum of $20,000 over a period of up to four calendar years. For more details, see the commentary on the definition "eligible amount" in subsection 146.02(1).

Under the LLP, an individual is permitted to withdraw funds in respect of the education of the individual or the individual's spouse, but the individual cannot have a positive LLP balance in respect of the education of more than one individual. Nonetheless, both individuals could withdraw funds from their RRSPs in respect of the same spouse. For more detail, also see the definition "eligible amount" in subsection 146.02(1).

RRSP withdrawals under the LLP are repayable to the withdrawing individual's RRSPs in equal instalments over a 10-year period, beginning no later than 60 days following the fifth year after the year in which the individual first received the funds. The repayment period begins sooner where the designated student is not entitled to annual full-time education tax credits for at least three months in two consecutive years that end before that fifth year. If an individual withdraws $10,000 under the LLP, the annual repayment is $1,000 per year ($10,000 divided by 10 years) for 10 years in the event that the individual does not accelerate repayments. For more detail, see the definition "repayment period" in subsection 146.02(1) and subsections 146.02(3) and (4).

If an individual decides to repay less than the scheduled amount for a taxation year, the shortfall is included under subsection 146.02(4) in computing the individual's income for the year. For example, if an individual with a scheduled annual repayment of $1,000 per year were to repay only $700 for a taxation year, the $300 shortfall would be included in the individual's income for the year.

Most individuals participating in the LLP will wish to restore the balance in their RRSP as soon as circumstances permit to better provide for their retirement. Consequently, individuals have the option of making more than the scheduled annual repayment for a

taxation year. This will result in a lower outstanding LLP balance and lower scheduled annual repayments for the remainder of the repayment period.

Examples 1 to 4 illustrate the operation of the basic rules with respect to the LLP, including the definition "repayment period" in subsection 146.02(1). The operation of the special rules on death and with respect to non-residents is illustrated in further examples contained in the commentary on subsections 146.02(5) to (7).

EXAMPLE 1

Paul withdraws an eligible amount of $5,000 from his RRSP in July 1999 after accepting an offer of enrolment from a community college for a full-time 3-month retraining course that runs from September to November 1999. He completes the course. Paul makes payments of $500 on February 28 of each year from 2002 to 2011 to an RRSP under which he is the annuitant. These payments are designated as repayments in Paul's return for each of the taxation years from 2001 to 2010.

Results:

1. The $5,000 withdrawal is not included in computing Paul's income for 1999 because he had received notification that he was entitled to enroll in the course before March 2000 and he completed the program before April 2000. As a consequence, the $5,000 withdrawal is an "eligible amount" under subsection 146.02(1).

2. The annual repayments to the RRSP are not deductible in computing Paul's income. The repayment period for Paul begins in 2001 because he is not entitled to an education credit under 118.6(2) for at least three months in either 2000 or 2001. The repayment period ends at the end of 2010 although the last payment is not made until February 28, 2011.

EXAMPLE 2

Susan withdraws an eligible amount of $5,000 from her RRSP in September 1999 and uses the funds for a full-time 12 month course running from September 1999 to August 2000 that she completes.

In January 2003, she makes a designated repayment of $300 for the year 2002.

Results:

1. Because it is an eligible amount, the $5,000 withdrawal is not included in Susan's income for the 1999 taxation year.

2. The required repayment for the year 2002 is $500 ($5,000/10). As only $300 is repaid for that year, the shortfall of $200 is included in computing Susan's income for that year. The "repayment period" starts at the beginning of the year 2002 because Susan was not entitled to an education credit for at least three months under 118.6(2) during the years 2001 and 2002.

EXAMPLE 3

Jules enrolls in a four-year university program running from September 1999 to April 2003 that he completes. He withdraws an eligible amount of $10,000 from his RRSP in September 1999, a further $5,000 in September 2000, and a further $5,000 in September 2001.

In January 2005, a designated repayment of $2,900 is made. In January 2006, a designated repayment of $1,500 is made.

Results:

1. The eligible amounts are not included in Jules' income for the 1999, 2000 and 2001 taxation years. The $20,000 limit under the LLP is met as of September 2001 and Jules is prevented from making further LLP withdrawals.

2. The repayment period does not begin until the year 2004 because Jules is entitled to claim a full-time education tax credit for at least three months in 2000, 2001 and 2002. The repayment period begins in 2004 in this case because the repayment period can start no later than the beginning of the sixth year of the participation period.

3. The minimum scheduled repayment for 2004 is $2,000 (i.e., $20,000/10). Since more than the minimum amount was repaid in 2004, there is no income inclusion required for 2004.

4. The minimum scheduled repayment for 2005 is $1,900 (($20,000 - $2,900)/9). The shortfall of $400 for 2005 is required to be included in Jules' income for 2005. Once a repayment period begins, there is no opportunity to apply an "excess" payment for a taxation year against the shortfall for a subsequent taxation year.

EXAMPLE 4

Carol receives an eligible amount in 2000 to enroll full-time in a multi-year program. In 2001, she stops attending the program and is not entitled to any education tax credit for that year. In 2002, she enrolls again in the program and is entitled to an education tax credit for 8 months. Carol is not entitled to an education tax credit in 2003 or 2004.

Results:

1. The eligible amounts are not included in computing Carol's income.

2. The repayment period is designed so that the one year absence by Carol does not affect when repayments begin. In this example, the repayment period starts at the beginning of 2004 because the year 2004 is the second consecutive year for which Carol was not entitled to full-time education tax credits for at least 3 months.

3. As a consequence, repayments for the year 2004 will be required on or before the 60th day of 2005 in order to avoid an income inclusion under subsection 146.02(4) for the year 2004.

The commentary below provides further details on the operation of the LLP. Except as noted below, these amendments apply after 1998.

Definitions

ITA
146.02(1)

Subsection 146.02(1) of the Act defines various expressions for the purposes of the LLP. Many of the new definitions are similar to definitions used for the purposes of the Home Buyers' Plan (HBP).

"annuitant"

The expression "annuitant" is defined by reference to the existing definition in subsection 146(1) that is used for the purposes of the provisions relating to RRSPs in section 146.

"benefit"

The expression "benefit" is defined by reference to the existing definition in subsection 146(1) that is used for the purposes of the provisions relating to RRSPs in section 146.

"eligible amount"

A particular amount is an "eligible amount" under the LLP where it is received by an individual as a benefit out of the individual's RRSP and a number of additional conditions are satisfied. These conditions are set out in paragraphs (*a*) to (*i*) of the definition.

Paragraph (*a*) requires that the particular amount be received after 1998 pursuant to the written request of the RRSP annuitant. This request must be made on a form prescribed by the Minister that the RRSP annuitant submits to the RRSP issuer so that tax is not withheld on the particular amount.

Paragraph (*b*) requires that the form designate a person in respect of whose education the particular amount is received. This person can be the RRSP annuitant or the annuitant's spouse and is referred to in the definition and below as the "designated person". Note, however, that the Minister has discretion under subsection 146.02(2) to allow a person to be subsequently designated for the purposes of this paragraph.

Paragraph (*c*) requires that the total of the particular amount and other eligible amounts received by the RRSP annuitant at or before the time of the withdrawal of the particular amount and in the year of the withdrawal be no more than $10,000.

Paragraph (*d*) of the definition requires that the total of the particular amount withdrawn and all other eligible amounts received by the RRSP annuitant at or before the time of the withdrawal be no more than $20,000. However, an RRSP annuitant is permitted to receive up to $20,000 in connection with each "participation period" under the LLP. (For more detail, see the commentary below on the definition "participation period".)

Paragraph (*e*) requires that the RRSP annuitant designate the same person as was designated in respect of any eligible amounts previously received by the RRSP annuitant in the current participation period. This requirement is intended to ease the administrative burden associated with the LLP, especially the determination of repayments. It should be emphasized, however, that this requirement does not preclude two RRSP annuitants who are married to each other from participating separately in the LLP and designating the same spouse as the designated person.

Paragraph (*f*) requires that the designated person either be enrolled as a "full-time student" (as defined in subsection 146.02(1)) or have received notification of his or her entitlement to enroll in a "qualifying educational program" (as described below) before March of the year following the year of the withdrawal of the particular amount. If the designated person is not enrolled at the time of the withdrawal of the particular amount, then the designated person must have received an offer to enroll in the program, including any type of contingent offer. Because of the definition "full-time student", a disabled person entitled to a full-time education tax credit is treated as a "full- time" student for the purposes of paragraph (*f*).

The expression "qualifying educational program" is used in paragraphs (*f*) and (*h*). It is defined in subsection 146.02(1) as a program that would be a "qualifying educational program" under the definition of that expression in subsection 118.6(1) if that definition were read without reference to paragraphs (*a*) and (*b*) of that definition and if the program were of at least three months duration. The conditions in paragraph (*a*) and (*b*) of that definition limit the

ability of a taxpayer to claim the education tax credit when the taxpayer receives any reimbursement for the program or receives income from an employer while attending the program in the course of employment. For administrative simplicity, these conditions are not considered when determining whether a program is a "qualifying educational program" for the purposes of section 146.02. However, the program is required to be at a "designated educational institution", as defined in subsection 118.6(1).

Paragraph (*g*) requires that the RRSP annuitant be resident in Canada during the period from the time of the receipt in a calendar year of the particular amount to the end of that year. However, paragraph (*g*) will also be satisfied where the RRSP annuitant was resident in Canada continuously after the withdrawal of the particular amount and before death.

Paragraphs (*h*) generally requires that the designated person must enroll in a "qualifying educational program" (as described above) before March of the year following the year of receipt of the particular amount. In addition:

- the designated person must complete that program before April of that following year,
- the designated person must be enrolled in that program at the end of March of that following year; or
- where the above additional conditions are not satisfied, less than 75% of the tuition paid after the beginning of the calendar year in which the particular amount was received and before April of the following year, in respect of the designated person and the program, is refundable.

It should be noted, however, that paragraph (*h*) does not apply where the RRSP annuitant dies before April of the year following the year of receipt of the particular amount. In this case, the particular amount will generally qualify as an "eligible amount". However, the rules on death in subsections 146.02(6) and (7) would apply.

Paragraph (*i*) provides that the particular amount will not be an "eligible amount" if received in the RRSP annuitant's repayment period for a participation period or, unless the Minister so permits,

after January in the fifth year of a participation period of the annuitant. For greater certainty and to ensure that the definition is not circular, paragraph (*i*) applies only where an amount that was previously determined to be an eligible amount was received by the RRSP annuitant before the receipt of the particular amount. For more detail, see the commentary on the definition "repayment period".

If the particular amount meets all of the above conditions, it qualifies as an "eligible amount" under the LLP. "Eligible amounts" are not included in computing an RRSP annuitant's income. Rather, they are "excluded withdrawals" (as defined in subsection 146.02(1)) and excluded from income under amended subsection 146(8).

"excluded premium"

An "excluded premium" is a specified type of RRSP contribution. Under the definition "excluded withdrawal", an "excluded premium" cannot be designated as a cancellation repayment under the LLP. In addition, an "excluded premium" cannot be designated under subsection 146.02(3) as a repayment of an amount withdrawn under the LLP.

An "excluded premium" is:

- an amount that has been designated for the purposes of paragraph 60(*j*) (lump sum transfers to RRSP from foreign pension plans and arrangements), paragraph 60(*j*.1) (transfer of retiring allowance to RRSP), paragraph 60(*l*) (transfer of refund of premiums on death and certain other amounts) or subsection 146.01(3) (HBP repayments),

- an RRSP contribution designated as an HBP cancellation repayment under paragraph (*b*) of the definition "excluded withdrawal" in subsection 146.01(1);

- an amount transferred directly from an RRSP, registered pension plan, registered retirement income fund, deferred profit sharing plan or provincial pension plan prescribed for the purposes of 60(*v*) (i.e. the Saskatchewan Pension Plan) to an RRSP; or

- an RRSP premium deductible under subsection 146(6.1) (re-contributions of certain withdrawals made for the purposes of acquiring past service benefits under a registered pension plan).

The inclusion in the above definition of HBP repayments ensures that repayments under the LLP and HBP are not double counted. When the same amounts are purported to be designated as repayments under the two programs, the purported designation under the LLP will have no effect.

"excluded withdrawal"

An "excluded withdrawal" is an amount received by an individual out of or under the individual's RRSP, pursuant to the LLP. It is not included in computing the individual's income under subsection 146(8). The most common excluded withdrawal will be an "eligible amount", as defined in subsection 146.02(1).

A particular amount can also qualify as an "excluded withdrawal" if the conditions necessary for the amount to qualify as an "eligible amount" are ultimately not satisfied because the individual does not comply with the enrolment requirement in paragraph (*h*) of the definition "eligible amount" or the residence requirement in paragraph (*g*) of the same definition. Where this is the case, the particular amount generally qualifies as an "excluded withdrawal" if it is repaid before the end of the calendar year following the year of its receipt and is designated as a repayment in prescribed form filed with the Minister before the end of that following year.

A variation to the above rule applies where the individual is not resident in Canada at the time of filing a tax return for the year in which the particular amount was withdrawn. Where this is the case, the repayment must be made at the earlier of the time otherwise determined and the time the individual files the return for that year.

"full-time student"

A "full-time student" includes a part-time disabled student who is entitled to the full-time education credit as a result of subsection 118.6(3). This definition allows greater access to the LLP for disabled students. For more detail, see the commentary above on the definition "eligible amount".

"LLP balance"

An individual's "LLP balance" at any time in a taxation year is equal to the total eligible amounts received by the individual, minus the individual's designated LLP repayments under subsection 146.02(3) for previous taxation years and all amounts included under subsections 146.02(4) and (5) in computing the individual's income for previous taxation years.

The definition is used in the LLP rules to determine the beginning and end of the individual's "participation period", as described in the commentary below on that expression. The definition is also used in subsection 146.02(6), which applies in the event of the individual's death.

"participation period"

An individual's "participation period" starts at the beginning of a year during which an individual receives an eligible amount where, at the beginning of that year, the individual had a nil "LLP balance". To have a nil LLP balance, the individual must either have not previously participated in the LLP or have fully offset prior LLP receipts by any combination of repayments under subsection 146.02(3) and income inclusions under subsections 146.02(4) and (5). The participation period ends immediately before the first subsequent year at the beginning of which the individual's LLP balance is nil.

An individual may designate a payment made to an RRSP during the year, or the first 60 days of the following year, as a repayment of an LLP balance. Where, for example, Dorothy makes a payment in the first 60 days of 2006 to her RRSP equal to her LLP balance at the end of 2005 and subsequently designates this payment as an LLP repayment in her return of income for 2005 filed in 2006, Dorothy's participation period would end at the end of 2005. Dorothy would be able to participate in the LLP again in 2006 (assuming that she can meet the other conditions of the program).

An individual is not permitted to begin a new participation period in the LLP until the completion of any prior participation period. Extending the example above, if Dorothy had made a repayment equal to her HBP balance in June 2005, she would still not be eligible to participate in the HBP again until 2006.

"premium"

The expression "premium" is defined by reference to the existing definition in subsection 146(1) that is used for the purposes of the provisions relating to RRSPs in section 146.

"qualifying educational program"

The definition "qualifying educational program" defines the type of educational program in which a designated person must be enrolled in order for an "eligible amount" to be withdrawn. This definition is discussed in the commentary above on "eligible amount".

"repayment period"

The definition "repayment period" defines a period of no more than 10 years for which designated repayments must be made under subsection 146.02(3) to avoid an income inclusion under subsection 146.02(4).

In the absence of complete early repayment, an individual has a repayment period for each of the individual's participation periods under the LLP. An individual's first participation period under the LLP begins at the beginning of the year in which the individual receives an eligible amount under the LLP. The repayment period for that participation period begins no later than the beginning of the sixth year within that participation period and continues for up to ten years until the LLP balance is reduced to nil. When an LLP balance is reduced to nil as of the beginning of any calendar year, the participation period and the repayment period with which the LLP balance is associated both end immediately before the beginning of that year.

However, the start of a repayment period for a participation period may begin earlier than the sixth year of the participation period. It will begin at the beginning of the second of two specified consecutive years within the participation period if that time is earlier than the beginning of the sixth year in the participation period. For two consecutive years to be so specified in respect of an individual's participation period, the second of those years must be the third, fourth or fifth year within the participation period and the individual must be entitled to the full-time education tax credit for fewer than

three months in each of those years. (Note: In the event that an individual's education tax credit is transferred to a parent or spouse or carried forward for future use, it is intended that the individual still be regarded as entitled to the credit for this purpose.)

The general commentary above on section 146.02 contains examples in which this definition is applied.

Rule of Application

ITA
146.02(2)

Subsection 146.02(2) of the Act is explained in the commentary on paragraph (*b*) of the definition "eligible amount" in subsection 146.02(1).

Repayment of Eligible Amount

ITA
146.02(3)

Subsection 146.02(3) of the Act provides that an individual may designate a contribution to an RRSP under which the individual is the annuitant as a repayment of an "eligible amount". A repayment for a taxation year must be made in the year or in the first 60 days of the following taxation year. The designation must be made on a prescribed form submitted by the individual with the individual's return of income for the year. As a consequence of the definition "premium" in subsection 146(1), the result of such a designation is that the repayment is disregarded for the purposes of determining deductible RRSP contributions under subsection 146(5) and the special penalty tax on overcontributions under Part X.1.

The contributions designated as repayments cannot include "excluded premiums" (as defined in subsection 146.02(1)) or, in the case of contributions made in the first 60 days of a taxation year, those contributions deducted in computing income or designated as LLP repayments for the preceding taxation year. For further detail, see the commentary above on the definition "excluded premium" in subsection 146.02(1).

The total amount designated as a repayment for a taxation year by an individual under subsection 146.02(3) also cannot exceed the individual's LLP balance at the end of the year of the designation. For further detail, see the commentary on the definition "LLP balance" in subsection 146.02(1).

Because of the RRSP registration rules, an individual cannot be the annuitant of an RRSP after the end of the calendar year in which the individual attains 69 years of age. As a consequence, subsection 146.02(3) will not apply to an individual after that time.

If Portion of Eligible Amount not Repaid

ITA
146.02(4)

Subsection 146.02(4) of the Act provides for an income inclusion for an individual for a taxation year to the extent that the individual fails to designate under subsection 146.02(3) at least a specified amount for the year (described below) as a repayment of an LLP balance as of the end of a taxation year.

The subsection generally begins to operate for the first taxation year included in an individual's repayment period for a participation period and continues to operate if the individual has a positive LLP balance at the end of a taxation year in the participation period. However, the subsection does not apply to an individual for a taxation year during which the individual dies or emigrates as subsections 146.02(5) to (7) apply in these cases. In addition, for the first taxation year within the repayment period, designated repayments in preceding years are treated as if they had been made for that first year. Consequently, an individual is given full credit for that first year for early LLP repayments.

An individual's first participation period begins at the beginning of the year in which the individual first received an eligible amount under the LLP. The repayment period for that participation period begins no later than the beginning of the sixth calendar year in that participation period. The participation period and the repayment period for it end once the LLP balance is reduced to nil. For further detail in this regard, see the commentary on the definitions "participation period", "repayment period" and "LLP balance" in

subsection 146.02(1) and examples in the general commentary on section 146.02.

The specified amount for a taxation year is generally a fraction of the individual's LLP balance at the end of the year. An individual's LLP balance at the end of a taxation year is the total of the individual's eligible amounts previously received under the LLP, minus designated repayments for preceding taxation years under subsection 146.02(3) and income inclusions under subsections 146.02(4) and (5) for those years. The fraction is 1/10 for the first year in the repayment period, 1/9 for the next year, 1/8 for the next year and so on until the tenth year, at which point the specified amount consists of the individual's entire remaining LLP balance.

However, the specified amount for the first taxation year in a repayment period is computed without regard to designated repayments under subsection 146.01(3) for preceding taxation years in order that such designations not be double counted. In addition, in the event that an individual's taxation year is included within a second or subsequent participation period of the individual under the LLP, amounts received, designated and included in income for taxation years in preceding participation periods are ignored.

Ceasing Residence in Canada

ITA
146.02(5)

Subsection 146.02(5) of the Act is a special rule that applies where an individual ceases to be resident in Canada after having withdrawn an eligible amount under the LLP. The rule provides for an income inclusion for an individual in these circumstances equal to the total of all eligible amounts previously withdrawn by the individual minus the total of

- all previous income inclusions under subsection 146.02(4) required as a result of shortfalls in repayments and under subsection 146.02(5) as a consequence of any prior emigration from Canada, and

- all LLP repayments designated under subsection 146.02(3) made not more than 60 days after the date on which the individual

ceased to reside in Canada and before the individual files a return of income for the year in which he or she became non-resident.

The two examples below illustrate the tax consequences of emigration under the LLP.

EXAMPLE 1

Brian withdraws two eligible amounts of $6,000 from his RRSP in September 1999 and September 2000 respectively and uses the funds for an educational program to be completed in April 2001. In 2003 (the first year of Brian's repayment period), he makes the required repayment of $1,200 to his RRSP. In December 2003, Brian ceases to be resident in Canada. In January 2004, he makes a further designated repayment of $1,000. Brian files his income tax return for 2003 in March 2004.

Result:

Brian is required under subsection 146.02(5) to include $9,800 ($12,000 - $1,200 - $1,000) in computing his income for the period in the 2003 taxation year during which he was resident in Canada. If he had repaid the outstanding balance of $9,800 before filing in March 2004, this income inclusion would be avoided.

EXAMPLE 2

Chantal withdraws funds from her RRSP in 1999 to attend university. On December 15, 1999, Chantal emigrates from Canada. On February 14, 2000, she filed an income tax return for her 1999 taxation year.

Result:

1. Paragraph (g) of the definition "eligible amount" prevents the amount received by Chantal from being an eligible amount under the LLP because she ceased to be resident of Canada before the year 2000.

2. Chantal is entitled to cancel her participation in the LLP under paragraph (b) of the definition "excluded withdrawal" by contributing to RRSPs and designating contributions as repayments

of the withdrawn fund. The repayments must be made by February 14, 2000. To the extent that that these repayments are made, Chantal's income inclusion for 1999 is reduced accordingly. (See the commentary on the definition "excluded withdrawal" in subsection 146.02(1).)

Death of Individual

ITA
146.02(6) and (7)

Subsection 146.02(6) of the Act provides rules that apply in the event that an individual dies and has a positive LLP balance at the time of death. Subject to subsection 146.02(7), the individual's LLP balance immediately before death, less any amount that is designated as a repayment under subsection 146.01(3) for the year of death, is included in the individual's income for the year of death. While an individual is not able to contribute to an RRSP after death, it is possible that previously-made RRSP contributions may be designated by the deceased's legal representatives as repayments for the year of death. (For details on the calculation of the LLP balance, see the commentary for the definition "LLP balance" in subsection 146.02(1).)

Under subsection 146.02(7), the spouse of a deceased individual who is resident in Canada at the time of the individual's death and the legal representatives of the deceased individual can together elect to have the spouse assume the repayment obligations of the deceased individual.

Where the election is made, paragraph 146.02(7)(*a*) provides that there is no income inclusion for the deceased individual under subsection 146.02(6). Instead, paragraph 146.02(7)(*b*) treats the LLP balance as having been received as an eligible amount by the surviving spouse at the time of the death. Paragraph 146.02(7)(*b*) applies whether or not the spouse has already withdrawn $20,000 of eligible amounts in a participation period. However, the deemed eligible amount will limit the extent to which future LLP withdrawals by the spouse qualify as eligible amounts.

Paragraph 146.02(7)(*c*) generally treats the surviving spouse as the person in respect of whose education the deemed eligible amount was

received. Paragraph 146.02(7)(*d*) is an exception to this rule. If the spouse has already received an eligible amount in a participation period that includes the time of death and the designated person in respect of whose education that other amount was received was a person other than the surviving spouse, the deemed eligible amount is treated as having been received in respect of the education of that other person. The purpose of paragraphs 146.02(7)(*c*) and (*d*) is to identify a person in respect of whose education the amount was received. This is relevant for the purposes of determining the repayment period for the surviving spouse, pursuant to the definition "repayment period" in subsection 146.02(1) and the operation of subsection 146.02(4).

The two examples below illustrate the operation of the LLP rules on death.

EXAMPLE 1

Mary withdraws an eligible amount of $10,000 from her RRSP in July 1999 and uses the funds for a qualifying educational program in 1999. In 2001, a designated repayment of $3,000 is made. In November 2002, Mary dies.

Result:

Mary's income inclusion for 2002 would be $7,000 ($10,000-$3,000=$7,000). This amount must be reported in Mary's tax return for the year of her death.

EXAMPLE 2

Same facts as in the above example, except that an election is made by Hani (Mary's widower) and Mary's legal representatives under subsection 146.02(7). Hani received $5,000 from his own RRSP in 2001 as an eligible amount in respect of his own education, and a further $5,000 in 2002 prior to Mary's death. Hani is planning on continuing his education until 2003.

Results:

1. No amount is included in Mary's income under subsection 146.01(6).

2. In addition to the $5,000 he withdrew for himself in 2002, Hani is deemed to have received an eligible amount of $7,000 on Mary's death, even though this causes the total eligible amounts received by him in 2002 to exceed $10,000. (Note: If Hani had not withdrawn $5,000 prior to the Mary's death, he would be limited to a further withdrawal of $3,000 in 2002 due to the $10,000 annual limit. In addition, Hani is permitted to withdraw only $3,000 in 2003 because of the $20,000 program limit.)

3. Under paragraph 146.02(7)(c), Hani is deemed to be the person in respect of whose education the eligible amount on death is received. Pursuant to the definition "repayment period" in subsection 146.02(1) and the operation of subsection 146.02(4), required repayments begin for the year 2005.

Clause 52

Registered Education Savings Plans

ITA
146.1

Section 146.1 of the Act contains rules relating to registered education savings plans (RESPs). A number of technical amendments are being made to section 146.1 to accommodate the introduction of the Canada Education Savings Grant (CES Grant) program for RESPs. In addition, other amendments are being made to:

- restrict the amount of educational assistance payments that may be made during the first three months of a beneficiary's education;

- allow disabled part-time students to qualify to receive educational assistance payments;

- allow the Minister to waive the "10 year" and "age 21" conditions for paying accumulated income payments where a beneficiary is mentally impaired;

- prohibit an individual aged 21 years or older from becoming a beneficiary under a family plan; and

- limit the investments that may be held by RESP trusts.

Background on CES Grant program

Part III.1 of the *Department of Human Resources Development Act* sets out rules relating to the CES Grant program. Under the program, the federal government pays a 20% CES Grant on the first $2,000 of annual contributions made to RESPs in respect of a qualifying beneficiary. The contributions and the CES Grants are held in the RESP trust to generate income to be used to help finance the costs of the beneficiary's post-secondary education. CES Grants are not included in calculating the beneficiary's annual and lifetime RESP contribution limits. Once the beneficiary is enrolled as a full-time student in a qualifying educational program at a post-secondary educational institution, the accumulated RESP income (including CES Grants) can be paid to the beneficiary as an educational assistance payment. If the beneficiary does not pursue post-secondary education, the RESP trustee is generally required to repay the CES Grants to the federal government. RESP trustees are also required to repay CES Grants in other situations, such as when an RESP subscriber withdraws contributions for non-educational purposes. Technical amendments are being made to the RESP registration rules in section 146.1 of the Act to ensure that repayments of CES Grants by an RESP trustee to the federal government are accommodated. It should be noted that, under certain circumstances, RESP beneficiaries are required to repay CES Grants directly to the federal government. For details on these repayments, see the commentary on new paragraph 60(*x*) of the Act.

Subclauses 52(1) to (3)

Definitions

ITA
146.1(1)

Subsection 146.1(1) of the Act defines a numbers of terms that apply to RESPs. All of the new and amended definitions in subsection 146.1(1) described below apply after 1997.

"accumulated income payment"

An accumulated income payment is defined as any distribution out of an education savings plan, other than a distribution that is an educational assistance payment, a refund of payments, a payment to an educational institution in Canada or a transfer to another RESP. Accumulated income payments are required under subsection 146.1(7.1) to be included in computing the recipient's income and are relevant in computing the special 20% tax in Part X.5 of the Act.

The definition is amended to ensure that the repayment of CES Grants from an RESP to the federal government does not constitute an accumulated income payment.

"trust"

For the purpose of the RESP rules, a "trust" is defined to be any person who irrevocably holds property pursuant to an education savings plan for a number of limited purposes.

The definition is amended so that a trust can provide for the repayment of CES Grants to the federal government when required under Part III.1 of the *Department of Human Resources Development Act*.

"contribution"

Several provisions in section 146.1 of the Act restrict contributions that may be made to RESPs. Paragraph 146.1(2)(*g*.2) requires that each contribution made to an RESP either be a contribution made by a subscriber in respect of a beneficiary under the plan or a transfer

from another RESP. Paragraph 146.1(2)(*k*) limits the annual amount of contributions that can be made to an RESP in respect of a beneficiary to the RESP annual limit.

Subsection 146.1(1) is amended to add the definition "contribution" to ensure that, for the purposes of these rules, the payment of CES Grants from the federal government to an RESP is not considered to be a contribution to the plan. It should be noted that CES Grants are also excluded in calculating a beneficiary's cross-plan annual and lifetime contribution limits for the purpose of the Part X.4 penalty tax on RESP over-contributions.

"qualified investment"

The definition "qualified investment" is added to subsection 146.1(1) of the Act. The definition sets out the types of property that a trust governed by an RESP is permitted to hold. All property that was acquired by an RESP trust on or before the release date of the draft legislation that includes this new definition is considered to be a qualified investment for the trust. With the exception of certain annuity contracts described in paragraphs (*c*) and (*c*.2) of the definition "qualified investment" in subsection 146(1), the types of investments that qualify for an RESP are identical to those investments that qualify for an RRSP. In general, the following are defined to be qualified investments for an RESP:

- money and deposits;
- guaranteed investment certificates issued by a trust company;
- bonds and other debt obligations of the Government of Canada, a province, a municipality, or a Crown corporation;
- shares listed on prescribed stock exchanges in Canada or in a foreign country;
- bonds and other debt obligations of a corporation whose shares are listed on a prescribed stock exchange in Canada or in a foreign country;
- segregated fund policies; and

- prescribed investments.

It is proposed to amend section 4900 of the *Income Tax Regulations* so that investments that are prescribed for RRSPs will also be prescribed for RESPs. Types of investments that are listed in section 4900 include certain mortgages, units or shares of a mutual fund, and certain shares of small business corporations. For further details, see Appendix C to these explanatory notes.

If a trust governed by an RESP acquires property that is not a qualified investment, or if property held by the trust ceases to be a qualified investment, new subsection 146.1(2.1) provides that the plan is revocable. Under amended subsection 146.1(12.1), Revenue Canada may revoke the registration of an RESP that becomes revocable. In addition, amended Part XI.1 requires an RESP trust to pay a 1% tax on the fair market value of all property held by the trust at the end of each month that is not a qualified investment.

Subclauses 52(4) to (8)

Conditions for Acceptance of Plan for Registration

ITA
146.1(2)(*b*.1), (*d*.1), (*g*.1), (*j*) and (*n*)

Subsection 146.1(2) of the Act sets out the requirements that must be satisfied in order to register an education savings plan.

New paragraph 146.1(2)(*b*.1) requires that an application for registration of an education savings plan be made by the promoter in prescribed form containing prescribed information. It is expected that the application form will require basic information relating to the plan including the name and Social Insurance Number of each beneficiary and of each subscriber under the plan. New paragraph 146.1(2)(*b*.1) applies to plans entered into after 1998.

Paragraph 146.1(2)(*d*.1) allows an RESP to make a distribution after 1997 of accumulated income to a subscriber (or other person) where certain conditions are met, including that the plan has existed for at least 10 years and each of the beneficiaries has attained 21 years of age. Paragraph 146.1(2)(*d*.1) is amended so that it is subject to new subsection 146.1(2.2), which allows the Minister to waive the "10

year" and "age 21" conditions in respect of an RESP where a beneficiary under the plan is mentally impaired. Amended paragraph 146.1(2)(*d*.1) applies after 1997.

Paragraph 146.1(2)(*g*.1) provides that educational assistance payments made after 1996 to an individual under an RESP may be made only where the individual is enrolled in a qualifying educational program as a full-time student at a post-secondary educational institution.

Paragraph 146.1(2)(*g*.1) is amended in two ways. First, it is amended for plans entered into after February 20, 1990 to allow a disabled part-time student to qualify to receive educational assistance payments. The requirement that an individual be enrolled on a full-time basis no longer applies where the individual cannot reasonably be expected to be enrolled as a full-time student because of a mental or physical impairment, as certified in writing by a medical doctor or other person authorized to issue a certification for the purpose of the disability tax credit. This exception is similar to the rule in subsection 118.6(3), which allows a disabled part-time student to claim a full-time education tax credit.

Second, paragraph 146.1(2)(*g*.1) is amended for plans entered into after 1988 to introduce a $5,000 limit on the amount of educational assistance payments that can be made to an individual under an RESP before the individual has completed 13 consecutive weeks in a qualifying educational program.

The $5,000 limit applies only until the individual has completed 13 consecutive weeks in the program. Thereafter, the individual is permitted to receive any amount of educational assistance payments from the plan provided the individual continues to be enrolled in the program. The Minister of Human Resources Development may approve a greater amount of educational assistance payments on a case-by-case basis. However, because the limit applies for a short period, it is expected that the Minister will approve a greater amount only in exceptional cases, such as where the cost of tuition for a particular program is substantially higher than average.

Paragraph 146.1(2)(*j*) sets out conditions that apply to plans that permit more than one beneficiary at any given time (referred to in these notes as "family plans"). Family plans, which are typically established for several siblings under age 18, provide an element of flexibility for the subscriber as educational assistance payments need not be limited to the proportion of each beneficiary's "share" of contributions. To ensure that family plans do not provide unintended benefits, paragraph 146.1(2)(*j*) requires that each beneficiary under a family plan be connected by blood relationship or adoption to each of the living subscribers under the plan (or to have been connected to a deceased original subscriber). Another condition allows contributions to be made to a family plan in respect of a beneficiary only where:

- the beneficiary has not attained 21 years of age at the time the plan was entered into, or

- the contribution is made by way of a transfer from another RESP or after such a contribution, provided that another contribution in respect of the beneficiary had been made before the transfer into the other plan.

Paragraph 146.1(2)(*j*) is amended in two ways in order to tighten the rules that apply to family plans entered into after 1998. First, the restriction on contributions is being modified so that a contribution into a family plan in respect of a beneficiary will be allowed only if:

- the beneficiary has not attained 21 years of age at the time of the contribution, or

- the contribution is made by way of a transfer from another RESP that is a family plan.

Second, a new condition is introduced to prohibit an individual who is 21 years of age or older from becoming a beneficiary under a family plan. To ensure that property can be transferred from one family plan to another replacement family plan after one or more beneficiaries have attained 21 years of age, the condition does not apply to a new beneficiary who, immediately before becoming a beneficiary under the plan, was a beneficiary under another family plan.

New paragraph 146.1(2)(*n*) enables Revenue Canada to refuse to register an education savings plan if it is apparent that, immediately or in the future, the plan may become revocable. In general, new subsection 146.1(2.1) provides that an RESP is revocable, at any time after the release date of the draft legislation that includes this proposed amendment, where a trust governed by the plan acquires or otherwise holds a non-qualified investment, borrows money or carries on a business. For further details, see the commentary on that subsection. New paragraph 146.1(2)(*n*) applies after 1997.

Subclause 52(9)

RESP is Revocable

ITA
146.1(2.1)

New subsection 146.1(2.1) of the Act lists a number of rules that apply once an education savings plan is registered. These rules are intended to prevent an RESP trust from acquiring or holding a non-qualified investment, carrying on a business or borrowing money. If any of these events occur, the RESP is revocable and, under subsections 146.1(12.1) to (13), its registration may be revoked.

These rules are also relevant at the time of registration, by virtue of new paragraph 146.1(2)(*n*), but only in a limited respect. Paragraph 146.1(2)(*n*) enables Revenue Canada to refuse to register an education savings plan if it is apparent that, immediately or in the future, the plan may become revocable.

The circumstances that result in an RESP becoming revocable generally relate to matters that are under the control of the RESP promoter or trustee and that do not require specific language in the plan documents to ensure compliance. Although the tax consequences differ, these rules are comparable to those imposed on registered retirement savings plans, registered retirement income funds and deferred profit sharing plans.

More specifically, an RESP is revocable at any time, after the release date of the draft legislation that includes this proposed amendment, at which:

- a trust governed by the plan begins carrying on a business;

- a trustee of a trust governed by the plan borrows money for the purposes of the plan (except where the term of the loan is 90 days or less, the borrowing is not part of a series of loans and repayments and the property of the trust is not pledged as security for the loan);

- a trust governed by the plan acquires property that is not a qualified investment, or

- property already held by a trust governed by the plan ceases to be a qualified investment (except that the plan does not become revocable if the non-qualifying property is disposed of within 60 days).

For details on the types of property that qualify for an RESP, see the commentary on the definition "qualified investment" in subsection 146.1(1). In the event that Revenue Canada chooses not to revoke the registration of an RESP for holding property that is not a qualified investment (or delays revocation), amended Part XI.1 imposes a special 1% penalty tax on the RESP trust. New subsection 207.1(3), which applies to the 1999 and subsequent taxation years, requires an RESP trust to pay a 1% tax on the fair market value of all property held by the trust at the end of each month that is not a qualified investment. It is expected that Revenue Canada would generally revoke the registration of a plan that holds non-qualified property only in abusive situations where the Part XI.1 tax is insufficient or where the RESP trustee fails to take reasonable and timely steps to dispose of the property.

New subsection 146.1(2.1) applies after 1997.

Waiver of Conditions for Accumulated Income Payments

ITA
146.1(2.2)

Paragraph 146.1(2)(*d*.1) of the Act allows an RESP to make a distribution after 1997 of accumulated income to a subscriber (or other person) where certain conditions are met. Two of these conditions are that:

- each beneficiary in respect of whom contributions were made by a subscriber has attained 21 years of age and is not eligible to receive educational assistance payments, and

- the RESP has been in existence for at least 10 years.

New subsection 146.1(2.2) permits Revenue Canada to waive these conditions in respect of an RESP where it is reasonable to expect that a beneficiary under the plan will be unable to pursue post-secondary education because he or she suffers from a severe and prolonged mental impairment. Application for the waiver must be made in writing by the RESP promoter.

New subsection 146.1(2.2) applies after 1997.

Subclause 52(10)

Notice of Intent to Revoke Registration

ITA
146.1(12.1)

Subsections 146.1(12.1) to (13) of the Act provide that the Minister may revoke the registration of an RESP in certain specified circumstances. Subsection 146.1(12.1) sets out the circumstances and specifies the earliest date on which the revocation can be effective.

Subsection 146.1(12.1) is amended to add additional grounds for revocation of an RESP. These are set out in new paragraphs 146.1(12.1)(*d*) and (*e*).

New paragraph 146.1(12.1)(*d*) allows the Minister to revoke the registration of an RESP that is revocable. In general, new subsection 146.1(2.1) provides that an RESP is revocable at any time, after the release date of the draft legislation that includes this proposed amendment, that a trust governed by the plan acquires or holds a non-qualified investment, borrows money or begins carrying on a business. The revocation may be effective on or after the day on which the RESP becomes revocable. For further details, see the commentary on new subsection 146.1(2.1).

New paragraph 146.1(12.1)(*e*) allows the Minister to revoke the registration of an RESP if any person fails to comply with a condition or obligation imposed under Part III.1 of the Department of Human Resources Development Act relating to any CES Grants paid to the plan. The revocation may be effective on or after the day of the failure.

New paragraphs 146.1(12.1)(*d*) and (*e*) apply after 1997.

Clause 53

Filing Returns of Income – General Rule

ITA
150(1) and (1.1)

Subsection 150(1) of the Act describes which persons must file returns of income under Part I of the Act, and sets out the time limits for filing that apply to various kinds of taxpayers.

Subsection 150(1) is amended in three respects. First, the subsection is amended in order to ensure that Revenue Canada is better able to monitor balances under the Home Buyers' Plan (HBP) and Lifelong Learning Plan (LLP) for participants, whether or not the individual has tax payable for a particular year. Under amended subsection 150(1) and new subsection 150(1.1), an individual is required to file a return for each taxation year at the end of which the individual's HBP balance or LLP balance is a positive amount. The expressions "HBP balance" and "LLP balance" are defined in subsections 146.01(1) and 146.02(1), respectively. This new requirement is in addition to the existing requirements that individuals file an income tax return for a taxation year for which tax is payable by an individual or in which the individual has disposed of capital property or has a capital gain.

Second, the provision is amended to clarify the filing obligations of corporations. In its current form, subsection 150(1) can be read as requiring every corporation, both those resident and Canada and non-residents, to file returns of income for all taxation years. As part of the new information-filing requirement for non-resident corporations that claim to be exempt, because of a tax treaty, from

Canadian tax on Canadian-source business income, this amendment clarifies which corporations must file returns.

Under amended paragraph 150(1)(*a*), a corporation is required to file a return of income for a taxation year only under certain circumstances. First, a corporation must file a return for a year if in the year it is resident in Canada, carries on business in Canada, has a taxable capital gain or disposes of a taxable Canadian property. Second, a corporation must file a return for any year for which tax under Part I is payable by the corporation, or would be payable but for a tax treaty.

Among other effects, the amended paragraph clarifies that a non-resident corporation that carries on business in Canada in a year must file a return for the year, even if the corporation's income from the business is exempt from Canadian tax because of a tax treaty. The return will thus serve as a source of information about claims of treaty exemption.

Third, the filing requirements for non-resident individuals are clarified in new subsection 150(1.1). In its current form, subsection 150(1) can be read as requiring any non-resident who disposes of a capital property in a year to file a Canadian income tax return for the year, even if the property in question has no connection to Canada. New subparagraphs 150(1.1)(b)(ii) and (iii) clarify that while a resident individual must file a return for a year if the individual disposes of any capital property in the year, the same obligation applies to a non-resident individual only in respect of taxable Canadian property.

All of these amendments apply to taxation years that begin after 1998.

Clause 54

Interest – Foreign Tax Credit Adjustment

ITA
161(6.1)

Section 161 provides that interest is payable by a taxpayer on any outstanding amount of tax payable under Part I for a taxation year, as well as any late or deficient instalments in respect of such tax.

Subsection 161(6.1) of the Act provides relief from payment of interest, in respect of an underpayment of Canadian tax resulting from an adjustment of foreign tax, for the period ending 90 days after the taxpayer is first notified of the amount of the foreign tax adjustment. This provision is amended to provide similar relief where the underpayment of Canadian tax for a particular taxation year results from the limiting of foreign tax credits under new subsection 126(4.2) of the Act.

Subsection 126(4.2) applies where a security is held for less than one year. If a security is acquired in the particular year and is still held at the time the taxpayer files its return of income for that year some months into the subsequent year, the taxpayer may not know whether the security will ultimately be disposed of before the one year holding period is met nor what amount of income and proceeds will be received in respect of the security. Therefore, the taxpayer may not be able to determine at the time of filing whether and how the rule in subsection 126(4.2) will affect its foreign tax credit in the particular year.

The amendment to subsection 161(6.1) provides that interest is not payable in respect of any increase in tax payable as a result of the application of the credit limiting rule until the date the security is disposed of. This amendment applies to the 1998 and subsequent taxation years.

Clause 55

Failure to File – Non-resident Corporations

ITA
162(2.1)

Section 162 of the Act provides penalties for failure to comply with the Act's requirements.

New subsection 162(2.1) of the Act is a special rule for the computation of penalties under subsections 162(1) (failure to file return) and 162(2) (repeated failure to file) of the Act. The rule, which applies to all non-resident corporations, provides that a penalty under either of those subsections is to be computed as the greater of two amounts. The first amount is the amount determined under subsection 162(1) or 162(2). The second amount is the greater of $100 and $25 for each day, up to 100, that the failure to file continues. New subsection 162(2.1) thus operates to subject non-resident corporations to the effect of the "regular" penalties under subsections 162(1) and (2) in respect of a failure to file an income tax return and, consistent with the role of that tax return as an information return for those corporations that claim an exception from Canadian tax as a result of the application of a tax treaty, to the alternative penalties that would apply under subsection 162(7) of the Act if a separate information return had been required in respect of those corporations.

New subsection 162(2.1) applies to taxation years that begin after 1998.

Clause 56

Refunds – Realization of Deceased Employees' Options

ITA
164(6.1)

Subsection 164(6.1) of the Act applies where an employee or former employee dies and, within the first taxation year of the deceased's estate, the deceased's legal representative exercises a right to acquire

shares under an agreement to sell or issue shares to which subsection 7(1) applied. Where this is the case and the legal representative so elects, the deceased's gain in respect of the right that arises under paragraph 7(1)(*e*) for the taxation year of death is offset under paragraph 164(6.1)(*a*) by a specified amount.

The specified amount in respect of a right is treated as a loss from employment of the deceased. It is equal to the decline in value of the right after the death and before the exercise of the right, offset by an amount not exceeding the 25% deduction under paragraph 110(1)(*d*) in respect of the associated gain. The adjusted cost base of the right to the estate will generally be its fair market value at the time of the death of the employee or former employee. However, where the election is made, the adjusted cost base of the option to the estate is reduced under paragraph 164(6.1)(*b*) by the specified amount. (Paragraph 53(2)(*t*) also refers to this reduction with reference to paragraph 164(6.1)(*b*).)

Subsection 164(6.1) and paragraph 53(2)(*t*) are amended so that the same rules apply in connection with trust units. These amendments are consequential to the new rules in section 7 allowing the tax treatment under that section to apply in connection with agreements to issue mutual fund trust units to employees.

This amendment applies to deaths that occur after February 1998.

Clause 57

Individual Surtax

ITA
180.1(1)(*a*)

Section 180.1 of the Act imposes a general surtax on individuals at a rate of 3% of tax payable under Part I. An additional 5% surtax is imposed on that portion of an individual's Part I tax in excess of $12,500.

The amendment to paragraph 180.1(1)(*a*) implements a reduction in the general 3% surtax. This reduction will be phased out at a rate of 6 per cent of basic federal tax over $8,333. For 1999 and

subsequent taxation years, the general surtax reduction will reach a maximum of $250 while for 1998 the reduction will be equal to 50% of the reduction otherwise determined.

This amendment applies to 1998 and subsequent taxation years.

Clause 58

Calculation of Capital Tax – Additional Tax Payable by Deposit-Taking Institutions

ITA
190.1(1.2)

Section 190.1 is in Part VI of the Act. Part VI levies a tax on the taxable capital employed in Canada of financial institutions. In general terms, a financial institution's taxable capital employed in Canada is the amount of its long-term debt, equity and non-deductible reserves that are considered to be used in connection with its activities carried on in Canada.

Subsection 190.1(1.2) of the Act imposes an additional temporary Part VI tax on the taxable capital employed in Canada of financial institutions, other than life insurance corporations. The additional tax is equal to 0.15 per cent of the corporation's taxable capital employed in Canada in excess of its "enhanced capital deduction" of $400 million. Where the corporation is related to another financial institution at the end of the year, the enhanced capital deduction must be shared by members of the related group.

The additional tax, which was introduced in the 1995 budget and extended in the 1996 and 1997 budgets, is scheduled to expire on October 31, 1998. This amendment extends the application of the additional tax until October 31, 1999. For taxation years that include October 31, 1999, the additional tax will be prorated on the basis of the number of days in the taxation year that are before November 1, 1999.

This amendment applies to taxation years that end after February 27, 1995.

Clause 59

Tax on Overpayments to RESPs – New Beneficiary

ITA
204.9(4)

Section 204.9 is in Part X.4 of the Act. Part X.4 provides for a special tax to be paid by subscribers with respect to overcontributions made to registered education savings plan (RESPs).

Subsection 204.9(4) contains an anti-avoidance rule that applies when one beneficiary under an RESP is replaced by another. Except as noted below, paragraph 204.9(4)(*a*) provides that the contributions previously made to the plan for the former beneficiary are deemed to have been made for the new beneficiary. Consequently, the contributions would be taken into account in determining RESP overcontributions and unused limits with respect to the new beneficiary. This is intended to ensure that the contribution limits are not multiplied by having a number of plans for different beneficiaries and changing the beneficiary designation before making educational assistance payments under the plans.

This deeming rule does not apply where an individual under 21 years of age replaces a brother or sister as a beneficiary under an RESP. In this situation, the designation of a new beneficiary can be made without penalty tax implications.

Subsection 204.9(4) is amended so that this deeming rule also does not apply where an individual replaces another individual as a beneficiary under an RESP and both beneficiaries are under 21 years of age and are connected by blood relationship or adoption to an original subscriber under the plan. (Subsection 251(6) provides rules for determining connection by blood relationship and adoption.) The amendment is intended to provide comparable treatment of individual and family plans.

EXAMPLE

Anne establishes individual RESPs for her two grandchildren – Bill and Marie – and contributes $2,000 per year to each plan for the next 15 years. Bill and Marie are cousins. When Bill turns 20

years old, Anne decides to designate Marie as the beneficiary under Bill's plan, as it is apparent that Bill will not be pursuing post-secondary education. Marie is 19 years of age at the time. Since both Bill and Marie are under 21 year of age and are connected by blood relationship to the plan's subscriber, the replacement of beneficiaries does not result in any adverse tax consequences.

This amendment applies to replacements of beneficiaries that occur after 1997.

Clause 60

Payments under RESPs – Charging Provision

ITA
204.94(2)

Subsection 204.94(2) of the Act sets out a special 20% tax on "accumulated income payments" from RESPs. Subject to a $40,000 lifetime limit, the tax can generally be reduced to the extent that the recipient of an accumulated income payment makes deductible RRSP contributions under subsection 146(5) or (5.1) for the year in which the payment is made.

Subsection 204.94(2) is amended to increase the $40,000 lifetime limit to $50,000, which will provide additional flexibility to individuals with limited resources attempting to save for both education and retirement.

This amendment applies to 1999 and subsequent taxation years.

Clause 61

Tax Payable by Trust under Registered Education Savings Plan

ITA
207.1(3)

Section 207.1 is in Part XI.1 of the Act. Part XI.1 imposes a 1% monthly penalty tax in respect of certain property held by a trust governed by a registered retirement savings plan (RRSP), deferred profit sharing plan (DPSP) or registered retirement income fund (RRIF).

New subsection 207.1(3) extends the application of this special tax to trusts governed by registered education savings plans (RESPs). Under new subsection 207.1(3), a trust governed by an RESP is required to pay a 1% penalty tax on the fair market value of all property held by the trust at the end of each month that is not a "qualified investment". For the purpose of this tax, "qualified investment" has the meaning assigned under subsection 146.1(1). For details on the types of property that qualify for an RESP, see the commentary on the definition "qualified investment" in subsection 146.1(1). However, note that any property that an RESP trust acquired on or before the release date of the draft legislation that includes this proposed amendment is automatically a qualified investment for the trust.

The base on which the 1% tax is charged under subsection 207.1(3) includes all property held by the trust at the end of a month that does not constitute a qualified investment. This differs from the other taxes imposed under Part XI.1 that apply to RRSP, DPSP and RRIF trusts. Those taxes only apply to a property that was qualified at the time it was acquired but later became a non-qualified investment.

Holding non-qualified investments can have other consequences for a trust governed by an RESP. If a trust governed by an RESP acquires or otherwise holds at any time a property that is not a qualified investment, subsection 146.1(2.1) provides that the plan is revocable. Under amended subsection 146.1(12.1), Revenue Canada may revoke the registration of an RESP that becomes revocable. However, it is expected that Revenue Canada would generally revoke the registration of an RESP that holds non-qualified property only in abusive

situations where the Part XI.1 tax is insufficient or where the RESP trustee fails to take reasonable and timely steps to dispose of the property.

New subsection 207.1(2) applies to the 1999 and subsequent taxation years.

Clause 62

Tax Payable by Institution or Public Authority

ITA
207.3

Section 207.3 of the Act imposes a tax where an institution or public authority disposes of certified cultural property within five years of the time it was acquired by the institution or authority. Section 207.3 is amended to extend, from five to ten years, the period during which an institution or public authority must retain certified cultural property to avoid liability for this tax.

This amendment applies to dispositions of property made after February 23, 1998.

Clause 63

Non-resident Withholding Tax – Certificates of Exemption

ITA
212(14)(*c*)(ii)

Section 212 imposes a tax of 25% (reduced by many treaties) on certain amounts paid or credited to non-residents by residents of Canada.

Subsection 212(14) of the Act permits a non-resident pension or charity to apply to the Minister of National Revenue for a certificate (certificate of exemption) that exempts the holder from the non-resident withholding tax under Part XIII which would otherwise be payable on interest.

Paragraph 212(14)(*c*) sets out some of the conditions that a non-resident person, corporation, trust or other organization must meet to be eligible for a certificate of exemption under subsection 212(14). To meet the test in paragraph (*c*), a non-resident must demonstrate that it would be exempt, if resident in Canada, under s. 149 of the Act (subparagraph (*c*)(i)), that it is constituted and operated exclusively for charitable purposes (subparagraph (*c*)(iii)), or that it is a fund or corporation established, incorporated or operated principally for the purpose of providing benefits under a pension, retirement or superannuation fund (subparagraph (*c*)(ii)).

Subparagraph 212(14)(*c*)(ii) is amended to provide that a non-resident trust or corporation must demonstrate that it is operated exclusively to administer or provide benefits under pension, retirement or superannuation funds to be eligible for a certificate of exemption. This amendment is intended to ensure that non-resident trusts or corporations that were established or incorporated to provide pension, retirement or superannuation benefits, but that no longer have this as their exclusive activity, are ineligible for certificates of exemption. In doing so, the amendment adopts the same exclusivity requirement as already exists for charitable institutions in subparagraph 212(14)(*c*)(iii) of the Act and for non-resident trusts or corporations that provide these benefits in Article XXI (Exempt Organizations), paragraph 2 of the Canada-US Tax Convention.

Amended subparagraph 212(14)(*c*)(ii) applies to all applications for certificates of exemption submitted after February 23, 1998. However, for applications submitted before 1999, the reference in the amendment to "operated exclusively" is deemed to be a reference to the less restrictive test of "operated principally".

Clause 64

Surplus Stripping

ITA
212.1

Subsection 212.1 is an anti-avoidance rule designed to prevent the removal of taxable corporate surplus as a tax-free return of capital

through a non-arm's length transfer by a non-resident of shares from one Canadian corporation to another Canadian corporation.

Subclause 64(1)

Non-Arm's Length Sales of Shares by Non-Residents

ITA
212.1(1)

Subsection 212.1(1) is intended to prevent the conversion of a corporation's surplus – which would be subject to withholding tax under Part XIII of the Act upon distribution to a non-resident shareholder – into proceeds from the disposition of the corporation's shares, thereby giving rise to a capital gain that may not be subject to tax in Canada. The provision applies where shares of a Canadian corporation held by a non-resident person or a non-resident-owned investment corporation are transferred to another Canadian corporation with which the transferor does not deal at arm's length. Where subsection 212.1(1) applies, it treats a dividend as having been paid to the non-resident to the extent that any non-share consideration, including debt, received on the disposition exceeds the paid-up capital of the shares.

This amendment extends the application of subsection 212.1(1) in two respects. First, it is amended to apply explicitly where the transferor of the subject shares is a "designated partnership", defined in new paragraph 212.1(3)(d) as a partnership of which either a majority interest partner or every member of a majority interest group of partners is a non-resident person or a non-resident-owned investment corporation. Secondly, the qualifications for the subject corporation and the purchaser corporation are expanded to encompass any corporation resident in Canada, whether or not it is a Canadian corporation.

This amendment applies after February 23, 1998.

Subclause 64(2)

Interpretation

ITA
212.1(3)(*b*)

Paragraph 212.1(3)(*a*) of the Act treats certain persons as not dealing at arm's length for the purposes of section 212.1 of the Act. Specifically, the provision treats a non-resident taxpayer as not dealing at arm's length with a "purchaser corporation" if the taxpayer was, immediately before the disposition, one of a group of fewer than 6 persons that controlled the "subject corporation" and, immediately after the disposition, one of a group of fewer than 6 persons that controlled the purchaser corporation. For the purposes of applying this rule, paragraph 212.1(3)(*b*) treats shares that are owned by the taxpayer's minor child or spouse, certain trusts and certain corporations as being owned by the taxpayer and not by the person who actually owned them. This amendment adds new paragraph 212.1(3)(*b*)(iv), which adds to this list partnerships of which the taxpayer or a person in one of the other existing categories is a majority interest partner or a member of a majority interest group of partners.

This amendment applies after February 23, 1998.

Subclause 64(3)

Interpretation

ITA
212.1(3)(*e*) and (*f*)

Subsection 212.1(3) sets out certain interpretive rules for the purposes of applying the substantive rules in subsection 212.1. This amendment adds new paragraph 212.1(3)(*e*), which defines "designated partnership" as a partnership in respect of which a majority interest partner or every member of a majority interest group of partners is a non-resident person or non-resident-owned investment corporation. New subsection 212.1(3)(*f*) specifies that for the purposes of subsection (3), such as the rule in paragraph (*a*) regarding

control by a group of fewer than 6 persons, a person is considered to include a partnership.

This amendment applies after February 23, 1998.

Clause 65

Deduction and Payment of Tax – Corporate Immigration

ITA
215(1.1)

Section 215 of the Act provides rules that set out when a person paying or crediting an amount to a non-resident must withhold a portion of the amount paid or credited.

Subsection 215(1) of the Act provides that where a resident of Canada pays or is deemed to pay an amount to a non-resident in respect of which the non-resident is liable for withholding tax under Part XIII of the Act, the payer is required to withhold the tax from the amount and remit it to the Receiver General on behalf of the non-resident. New subsection 215(1.1) provides that this rule does not apply where a corporation resident in Canada is deemed to have paid a dividend to an arm's length corporate shareholder under subsection 128.1(1)(*c.1*) of the Act prior to the shareholder becoming resident in Canada. This recognizes that the resident corporation may not be aware that the shareholder has immigrated.

This amendment applies after February 23, 1998.

Clause 66

Transfer Pricing – Exclusion for Loans to Certain Controlled Foreign Affiliates

ITA
247(7)

Section 247 applies to property and services acquired or provided in cross-border transactions, determining the amounts to be used for tax purposes in such cases.

Subsection 247(7) of the Act exempts loans described in subsection 17(3) of the Act – that is, loans made by a corporation resident in Canada to a non-resident subsidiary controlled corporation -- from the application of the transfer pricing adjustment in subsection 247(2) of the Act.

The amendments to subsection 247(7) are consequential to the amendments to section 17 of the Act. Amended subsection 247(7) ensures that a transaction that is a loan described in new subsection 17(8) of the Act will also be exempt from the transfer pricing adjustment in subsection 247(2). New subsection 17(8) describes loans (and certain other forms of indebtedness) that are used by a controlled foreign affiliate to generate active business income, or that arose in the course of the affiliate's active business.

Amended subsection 247(7) applies to taxation years that begin after February 23, 1998.

Clause 67

Definitions

ITA
248

Section 248 of the Act defines a number of terms that apply for the purposes of the Act, and sets out various rules relating to the interpretation and application of various provisions of the Act.

Subclauses 67(1) to (11)

"eligible relocation"

Subsection 248(1) is amended to introduce the definition "eligible relocation". This new definition is introduced as a consequence of the changes to the tax treatment of moving expenses and employment benefits related to relocations. The definition is similar to the existing criteria for deductibility of moving expenses described in the mid-amble to existing subsection 62(1). This definition is relevant for the purposes of the tax treatment of eligible housing losses (subsection 6(22)) and the deductibility of moving expenses (section 62 and paragraph 115(2)(*f*)).

Generally, an "eligible relocation" is a relocation of a taxpayer where the relocation occurs to enable the taxpayer to be employed at a location in Canada, or to be a student in full-time attendance at a location of a post-secondary institution if

- both the taxpayer's old residence and the taxpayer's new residence are in Canada, and

- the distance between the old residence and the new work location is not less than 40 kilometres greater than the distance between the new residence and the new work location.

In addition, the modification of the requirement that the relocation take place within Canada for Canadian residents who are absent from Canada, which is found in section 64.1 of the existing Act, has been relocated to the definition "eligible relocation" in this proposed amendment to apply for the purposes of the moving expenses deduction as well as subsections 6(19) to (22) relating to housing losses.

This amendment applies after 1997.

"income bond" or "income debenture"

An "income bond" or "income debenture" is a bond or debenture of a corporation on which the corporation is required to pay interest or dividends only to the extent that the corporation has made a profit and in respect of which paragraph (a), (b) or (c) of the definition

applies. Paragraphs (a) includes a bond or debenture issued before November 17, 1978. Paragraph (b) includes a bond or debenture issued after November 16, 1978 and before 1980 if it was issued pursuant to an agreement in writing to issue it made before November 17, 1978.

Paragraph (*e*) of the definition sets out circumstances in which a bond or debenture is treated, for the purpose of the definition, to have been issued at a time that is later than the time it was actually issued, possibly causing the bond or debenture to lose its status as an income bond or income debenture. Several of these circumstances relate specifically to transactions involving "specified financial institutions", which are also defined in subsection 248(1).

Subparagraphs (*e*)(iv) and (v) of the definition "income bond" or "income debenture" are amended as a consequence of the addition of new paragraph (*e*.1) to the definition of "specified financial institution." In addition, the subparagraphs are restructured to be simpler and clearer.

Subparagraph (*e*)(iv) applies, generally, to a bond or debenture that is acquired by a specified financial institution (or by a partnership or trust of which the institution or a related person is a member or beneficiary). Subject to three exceptions, the bond or debenture will in this case be treated as having been issued at the time it was acquired by the institution (or by the partnership or trust).

The first exception is that subparagraph (*e*)(iv) does not apply in respect of bonds or debentures that otherwise satisfy the criteria set out in paragraphs (*a*) or (*b*), where they were issued to certain specified financial institutions. New clause (*e*)(iv)(B) of the definition clarifies that this exception does not extend to bonds or debentures issued to corporations that are specified financial institutions only because they are described in new paragraph (*e*.1) of the definition "specified financial institution". This reflects the fact that those corporations were not specified financial institutions during the period when the instruments in question were issued.

The second exception to subparagraph (*e*)(iv) is that it does not apply in respect of bonds or debentures that one specified financial institution (call it the purchaser) acquires from any of certain other specified financial institutions (the vendor). New clause (*e*)(iv)(C) of

the definition provides that a bond or debenture acquired from a vendor described in new paragraph (*e*.1) of the definition "specified financial institution" is within this exception if the vendor was a specified financial institution both when the purchaser acquired the instrument and when the vendor itself last acquired the instrument.

The third exception to subparagraph (*e*)(iv) applies in respect of bonds or debentures that are acquired pursuant to an agreement in writing made before October 24, 1979. This exception is set out in new clause (*e*)(iv)(D) of the definition.

Subparagraph (*e*)(v) applies, generally, to a bond or debenture (other than one referred to in paragraph (*c*) of the definition "income bond" or "income debenture") that is acquired:

- after November 12, 1981,
- by a specified financial institution, or by a partnership or trust of which the institution or a related person is a member or beneficiary,
- from any of certain specified financial institutions, and
- subject to, or conditional on, a guarantee agreement.

New clause (*e*)(v)(B), together with its coming-into-force provision, clarifies that bonds or debentures acquired from a corporation described in new paragraph (*e*.1) of the definition "specified financial institution" are subject to subparagraph (v), if that corporation was a specified financial institution at the time the acquisition took place.

The amendments to subparagraphs (*e*)(iv) and (v) of the definition apply generally to taxation years that begin after 1998. Special coming-into-force rules ensure that the definition's references to the definition "specified financial institution" work appropriately where a bond or debenture is acquired from a corporation that last acquired the bond or debenture in a taxation year that began before 1999.

"private health services plan"

The definition "private health services plan" in subsection 248(1) of the Act excludes, among other things, a plan created by or pursuant

to a law of a province that establishes a health care insurance plan in respect of which the province receives contributions from Canada pursuant to the *Federal-Provincial Fiscal Arrangements and Federal Post-Secondary Education and Health Contributions Act*. The amendment to paragraph (*c*) of that definition changes the reference to that statute strictly as a consequence of the enactment of the *Canada Health Act*.

This amendment applies as of April 1, 1996, which is the date on which section 2 of that Act came into force.

"restricted financial institution"

A "restricted financial institution" is defined in subsection 248(1) of the Act to mean a bank, a trust company, a credit union, an insurance corporation, a corporation whose principal business is the lending of money to persons with whom the corporation deals at arm's length or a corporation controlled by one or more such corporations. The status of a taxpayer as a restricted financial institution is relevant, for example, in determining the application of the "mark-to-market" rules in sections 142.2 to 142.6 of the Act, and the tax on "taxable RFI shares" under Part IV.1 of the Act.

The definition is amended to add new paragraph (*e*.1). As a result of this change, a corporation that is prescribed to be a financial institution for the purposes of the Tax on Large Corporations in Part I.3 of the Act will also be a restricted financial institution. Corporations that are controlled by corporations described in new paragraph (*e*.1), or by a combination of corporations described in new paragraph (*e*.1) and other restricted financial institutions, will also be restricted financial institutions for the purposes of the Act.

This amendment applies to taxation years that begin after 1998.

"specified financial institution"

A "specified financial institution" is defined in subsection 248(1) of the Act to mean a bank, a trust company, a credit union, an insurance corporation, a corporation whose principal business is the lending of money to arm's length persons, a corporation controlled by one or more such corporations or a corporation related to a corporation described in the definition. The status of a taxpayer as a specified

financial institution is relevant for the purposes of subsections 112(2.1) and (2.2), Parts IV.1 and VI.1 and certain other provisions of the Act.

This definition is amended in three respects. The first change is an addition to the preamble to the definition that clarifies that the definition "specified financial institution" applies to determine the status of a corporation at any given time.

The second change is the addition of new paragraph (*e*.1), which provides that a corporation that is prescribed to be a financial institution for the purposes of the Tax on Large Corporations in Part I.3 of the Act is a specified financial institution for all purposes of the Act. Paragraphs (*f*) and (*g*) of the definition are amended as a consequence of this change and provide, in general, that corporations that are controlled by or related to corporations described in new paragraph (*e*.1), or by a combination of corporations described in new paragraph (*e*.1) and other specified financial institutions, are also specified financial institutions for the purposes of the Act.

The third change is an exception to the application of paragraph (*g*) of the definition, which otherwise provides that a corporation that is related to a specified financial institution is itself a specified financial institution. Where a corporate group establishes a separate corporation to buy trade receivables from the operating companies in the group, for the purpose of either collecting the receivables or selling them to third parties, it is not intended that the operating companies, for that reason alone, be treated as specified financial institutions for the purposes of the Act. For this reason, paragraph (*g*) is being amended to exclude from its application, at any time, a corporation that satisfies the following criteria:

- it is related to a particular corporation described in paragraph (*e*) or (*e*.1) of the definition,

- the particular corporation’s principal business is the factoring of trade accounts receivable,

- the trade accounts receivable arose in the course of an active business carried on by an operating company in the group (referred to in the definition as the "business entity") that is related, at that time, to the particular corporation, and

- the trade accounts receivable were not held before that time by a person that was not related to the business entity.

These amendments apply in taxation years that begin after 1998.

"specified future tax consequence"

The term "specified future tax consequence" for a taxation year refers to changes in the tax payable in respect of the year as a result of an event or action taken in a future period. Under the Act, various amounts including thresholds for exemption from instalments, interest on instalments, and penalties for failure to report income or to file a return are based on tax payable for a year calculated before specified future tax consequences are taken into account. This amendment adds a new paragraph (*c*) to the definition, which provides that two additional events will be considered specified future tax consequences if they increase a taxpayer's tax payable:

- an adjustment in the amount of a foreign tax in respect of a taxation year, and

- a reduction in foreign tax credits for the year as a result of the disposition of a security within one year of its acquisition and in the subsequent taxation year.

This amendment applies to the 1998 and subsequent taxation years.

"tax treaty"

Canada has in force over 60 bilateral international conventions and agreements relating to income taxation. Although it is necessary or helpful for a number of the Act's provisions to refer to these conventions and agreements, there is currently no single description of them for all purposes of the Act.

This new definition fills that void. A "tax treaty" – the informal term by which the conventions and agreements are universally known – is defined at any time as a comprehensive agreement for the elimination of double taxation on income, between the Canadian and a foreign government, that has the force of law in Canada at that time.

This new definition applies to the 1998 and subsequent taxation years.

"term preferred share"

In general, a "term preferred share" is a share issued after November 16, 1978 which can reasonably be regarded as a debt substitute. Under subsection 112(2.1), dividends received by a specified financial institution on a term preferred share acquired in the ordinary course of its business are not deductible in computing its taxable income – they do not qualify for the intercorporate dividend deduction.

A share is a term preferred share under paragraph (*b)* of the definition if it was issued after November 16, 1978, and acquired after October 23, 1979 by an entity listed in the paragraph which, either alone or together with other listed entities, controls or has an absolute or contingent right to control or acquire control of the issuing corporation. The entities listed in paragraph (*b*) are:

i) a corporation described in any of paragraphs (*a*) to (*e*) of the definition "specified financial institution" in subsection 248(1) of the Act,

ii) a corporation controlled by one or more corporations described in i),

iii) if the share was acquired after December 11, 1979, a corporation that is related to a corporation described in i) or ii), and

iv) a partnership or trust of which a corporation referred to in i) or ii) or a person related to the corporation is a member or beneficiary.

The first item in this list is amended as a consequence of the addition of new paragraph (*e*.1) to the definition of "specified financial institution" in subsection 248(1). The amendment ensures that a share acquired by a corporation described in new paragraph (*e*.1) of the definition "specified financial institution", or by another corporation, partnership or trust associated with the corporation in the

manner set out in ii), iii) or iv), above, will be a "term preferred share" if it otherwise satisfies the criteria of paragraph (*b*).

Amended paragraph (*b*) applies to taxation years that begin after 1998.

Paragraph (*h*) of the definition "term preferred share" sets out circumstances in which a share that was issued at a particular time is treated, for the purpose of the definition, to have been issued at a later time, which may cause a share that was not a "term preferred share" to become one. Subparagraphs (*h*)(iv) and (vi) of the definition are amended as a consequence of the addition of new paragraph (*e*.1) to the definition "specified financial institution" in subsection 248(1).

Subparagraph (*h*)(iv) applies generally to shares issued before November 17, 1978 or under an established agreement, and that are acquired, after October 23, 1979 and before November 13, 1981, by a specified financial institution or by a partnership or trust of which the institution or a related person is a member or beneficiary. There are three exceptions to the application of subparagraph (*h*)(iv). A share that satisfies any of the exceptions may avoid treatment as a term preferred share, even though it is held by a specified financial institution or by a partnership or trust of which the institution or a related person is a member or beneficiary.

The first exception to subparagraph (*h*)(iv) applies to shares that were issued to certain specified financial institutions. New clause (*h*)(iv)(B) clarifies that this exception does not apply to shares issued to corporations described in new paragraph (*e*.1) of the definition "specified financial institution" in subsection 248(1).

The second exception to subparagraph (*h*)(iv) applies to shares that were acquired under an agreement in writing made before October 24, 1979. This exception is now set out in new clause (*h*)(iv)(D) of the definition.

The third exception to subparagraph (*h*)(iv) applies to shares that were acquired from certain specified financial institutions. New clause (*h*)(iv)(C) ensures that this final exception does not include shares acquired from a corporation described in new paragraph (*e*.1) of the definition "specified financial institution".

The amendments to subparagraph (*h*)(iv) of the definition reflect the fact that corporations that are specified financial institutions only because of new paragraph (*e*.1) of the definition "specified financial institution" were not specified financial institutions during the period in question.

Amended subparagraph (*h*)(iv) of the definition applies to taxation years that begin after 1998.

Subparagraph (*h*)(vi) of the definition "term preferred share" applies generally to shares issued before November 13, 1981 or under a specified agreement that are, after November 12, 1981, acquired by a specified financial institution or by a partnership or trust of which the institution or a related person is a member or a beneficiary. (For the purposes of this definition, a "specified agreement" is an agreement made in writing before November 13, 1981 to issue a share after November 12, 1981 and before 1983.) There are four exceptions to the application of subparagraph (*h*)(vi). A share that satisfies any of the exceptions may avoid treatment as a term preferred share, even though it is held by a specified financial institution or by a partnership or trust of which the institution or a related person is a member or beneficiary.

The first exception to subparagraph (*h*)(vi) is for shares referred to in paragraph (*e*) of the definition "term preferred share". Paragraph (*e*) describes shares issued by a corporation, for a term of five years or less, in circumstances in which the corporation is in financial difficulty.

The second exception is for shares that are acquired under an agreement in writing made before October 24, 1979. This exception is set out in new clause (*h*)(vi)(D) of the definition.

The third exception is for shares acquired from certain specified financial institutions. New clause (*h*)(vi)(B) of the definition, together with its coming-into-force provision, provides that the third exception applies to shares acquired from corporations described in new paragraph (*e*.1) of the definition "specified financial institution" in subsection 248(1), if the corporation from which the share was acquired was a specified financial institution at the time of the acquisition.

The fourth exception, in new clause (*h*)(iv)(C), is for shares that are acquired in acquisitions that are neither subject to, nor conditional on, a guarantee agreement entered into after November 12, 1981.

Amended subparagraph (*h*)(vi) applies to taxation years that begin after 1998.

"treaty-protected business"

The Income Tax Act has not fully recognized the effects of Canada's bilateral tax treaties. For example, losses from a source that is, because of a treaty, not subject to tax in Canada may nonetheless figure in the calculation of a non-resident's taxable income earned in Canada. As part of a series of amendments to better co-ordinate the Act and tax treaties, the new definition "treaty-protected business" is introduced. A taxpayer's "treaty-protected business" at any time is a business in respect of which any income of the taxpayer for a period that includes that time would, because of a tax treaty with another country, be exempt from tax under Part I of the Act.

It should be noted that a business may be a treaty-protected business even if it has generated no treaty-exempt income. For example, assume that a resident of a treaty country carries on two businesses in Canada: one through a permanent establishment (PE), and the other without a PE in Canada. Any income of the non-PE business would, under a typical tax treaty, be exempt from Part I tax. That business is therefore a treaty-protected business, whether or not it in fact generates any income.

This definition applies to the 1998 and subsequent taxation years.

"treaty-protected property"

The new definition "treaty-protected property" is in many respects similar to the definition "treaty-protected business," described above. A taxpayer's "treaty-protected property" at any time means property any income or gain from the disposition of which by the taxpayer at that time would, because of a tax treaty with another country, be exempt from tax under Part I. Note that it is not necessary, for this definition to apply, that there be income or gain from the disposition of the property, or even that the property be disposed of at all.

The definition "treaty-protected property' applies to the 1998 and subsequent taxation years.

Clause 68

Deemed Residence

ITA
250

Section 250 of the Act sets out a number of rules relating to residence.

Subclause 68(1)

Person deemed resident

ITA
250(1)(*e*)

Subsection 250(1) of the Act deems certain persons to be resident in Canada.

Paragraph 250(1)(*e*) of the Act applies to the spouse of a person who is deemed to be resident in Canada by any of certain other of the rules in the subsection. In such a case, the spouse is also deemed to be resident in Canada if the spouse lived with the person at any time in the year and was a resident in Canada in any previous year.

Paragraph 250(1)(*e*) is repealed, with effect to persons who cease to be resident in Canada after February 23, 1998. Persons who, but for the application of paragraph 250(1)(*e*), would have ceased to be resident in Canada before February 24, 1998 and would not have re-established residence in Canada before that date may elect that the repeal apply to them with effect after February 23, 1998.

Subclause 68(2)

Person Deemed Resident

ITA
250(1)(*f*)

Under paragraph 250(1)(*f*), children who are dependent on certain persons deemed to be resident in Canada, and whose income does not exceed the basic personal amount (currently set at $6,456), are also deemed to be Canadian residents. The amendment to paragraph 250(1)(*f*) is consequential on the introduction of the $500 supplementary tax credit under new paragraph 118(1)(*b*.1), which effectively increases from $6,456 to $6,956 the amount of income that can be earned on a tax-free basis.

This amount applies to 1998 and subsequent taxation years.

Subclause 68(3)

Person deemed resident

ITA
250(1)(*g*)

New paragraph 250(1)(*g*) of the Act adds a new basis upon which a person may be deemed to be resident in Canada for the purposes of the Act. New paragraph (*g*) applies to a person who:

i) at any time in the year was, under an agreement or convention between Canada and one or more other countries, entitled to an exemption from an income tax that would otherwise be payable in another country, in respect of income from any source; and

ii) was entitled to the exemption because the person was related to, or a member of the family of, an individual (other than a trust) who was resident in Canada at the time.

Under paragraph 250(1)(*g*), an individual is deemed to have been resident in Canada in a year, unless the agreement in question does not exempt the individual from tax on all or substantially all of the individual's income from all sources.

New paragraph 250(1)(*g*) applies after February 23, 1998.

Subclause 68(4)

Deemed Non-resident

ITA
250(5)

Subsection 250(5) is a deeming rule that currently applies only to corporations. In general terms, the rule applies where a corporation that would otherwise be resident in Canada is, under a tax treaty between Canada and another country, resident in the other country. This may occur where both Canada and the other country treat the corporation as resident, bringing the treaty's "tie-breaker" rules into play and causing a determination that for purposes of the treaty the corporation is resident in the other country. To ensure that the corporation's tax status in Canada reflects its status under the treaty, subsection 250(5) treats the corporation in such a case as a non-resident for the purposes of the Act.

This amendment to subsection 250(5) extends the rule to persons other than corporations. Amended subsection 250(5) applies to any person who would otherwise be resident in Canada but is, under a tax treaty, resident in another country and not in Canada. "Tax treaty" is newly defined for this and other purposes in subsection 248(1) of the Act: for more information readers may refer to the notes to that definition. Where it applies, subsection 250(5) treats the person as a non-resident for all purposes of the Act.

Two points in particular should be noted with respect to the application and effect of the rule. First, subsection 250(5) applies not only where a taxpayer that is otherwise resident in Canada makes use of a treaty reduction or exemption, but at any time at which the taxpayer is resident in another country under a tax treaty. For example, assume that a person is, under Canada's tax treaty with another country, resident in that country, but that all of the person's income is from carrying on business in Canada through a permanent establishment. Under the Canadian tax treaty with that country, the person may pay Canadian tax on all of that income. The person is nonetheless resident in the other country under the treaty, and

subsection 250(5) will apply to ensure that the person is non-resident in Canada for purposes of the Act as well.

Second, an indirect effect of subsection 250(5) may be that a taxpayer ceases to be resident in Canada. The provision deems the taxpayer not to be resident in Canada whenever, under a tax treaty, the taxpayer is resident in another country and not in Canada. This means that if, at a particular time, a taxpayer who would otherwise be resident in Canada becomes resident in another country under a tax treaty, the taxpayer has gone from being resident in Canada immediately before the particular time to being non-resident at the particular time. The ordinary effects of ceasing to be resident in Canada, notably those provided in subsection 128.1(4) of the Act, will apply.

Amended subsection 250(5) generally applies after February 24, 1998. However, the subsection does not apply immediately to an individual who was already on that date, under a tax treaty between Canada and another country, resident in the other country. Such an individual will be subject to subsection 250(5) only when the individual next becomes resident in another country, under that treaty or a different one.

For example, assume the following:

- a typical tax treaty has been in force between Canada and Treatyland for many years;

- in 1995 an individual, N., moved from Canada to Treatyland;

- because of N.'s continuing ties to Canada, N. remained resident in Canada under the Act;

- since 1996, Treatyland's income tax law has treated N. as resident in Treatyland; and

- under the treaty tie-breaker rule, N. was resident in Treatyland, and not in Canada, on February 24, 1998.

On these facts, subsection 250(5) will apply to N. only from the time (if any) when N. next becomes resident, under a treaty, in a country

other than Canada. That could happen in several different ways. For example:

- N. could cease to be resident in Treatyland, then become resident there again; or

- N. could move from Treatyland to another treaty country, and become resident there under Canada's treaty with that country.

Note that as long as N. remains resident in Treatyland, N. can cease to be resident in Canada under the Act, then become resident here again, without causing subsection 250(5) to start to apply. What is important is not the continuity of N.'s residence in Canada, but rather the continuity of N.'s residence, under the Canada-Treatyland treaty, in Treatyland.

Clause 69

United States Tax Refunds – Social Security

This clause enacts special rules for the application of the most recent Protocol to the Canada-United States Income Tax Convention.

The main effect of the Protocol, which was signed at Ottawa on July 29, 1997, is to change the tax treatment of social security benefits paid by one country to residents of the other country. Such benefits are no longer taxable by the country that pays them. Instead, the benefits are taxable only in the country where the recipient lives.

For many recipients this change applies not only prospectively, but also to benefits received for 1996 and 1997. As a result, many residents of Canada who receive United States social security benefits are entitled to refunds of some or all of the United States tax that was withheld from their benefits for those years.

Although the tax being refunded is United States tax, the Government of Canada is administering the refund program. The Government of Canada will also pay amounts in lieu of interest to these residents of Canada. The amounts will be computed according to the normal rules for refund interest under Canada's tax system. The Government will also pay each refund recipient an additional $50 for each refund year,

as compensation for the period before normal income tax refund interest would apply.

These special rules apply to the 1996 and 1997 taxation years.

Subclause 69(1)

Definitions

Subclause (1) defines several terms for the purposes of these special rules.

"Convention"

"Convention" is defined by reference to the Canada-United-States Tax Convention Act, 1984. In effect, "convention" means the existing Canada-US Income Tax Convention as it has been amended and as it may be amended in future.

"creditable United States tax"

Under the Protocol, the United States is required to refund certain amounts of tax it withheld from Canadian resident recipients' 1996 and 1997 benefits. The amount of the refund for any given recipient for a particular year is the amount, if any, by which the U.S. tax withheld from that year's benefits exceeds the additional Canadian tax the recipient would pay on the benefit. This refundable amount is defined as the recipient's "creditable United States tax" for the particular year. It is important to note that "creditable United States tax" does not include all U.S. tax paid on 1996 and 1997 benefits, but only that portion that is refundable under the Protocol.

"United States social security benefits"

For the purposes of these rules, the term "United States social security benefits" is defined to include benefits of both the U.S. Social Security Administration and Tier 1 railroad benefits of the U.S. Railroad Retirement Board, and to exclude unemployment benefits. The term is defined in respect of an individual for a taxation year, and treats a benefit paid in one year for the following year as having been paid in that following year. This ensures that benefits

that were paid in advance are included in the total for the appropriate year.

Subclause 69(2)

Additional amount

Subclause (2) provides for the additional $50 amount that is payable to each recipient of a refund of United States tax on U.S. social security benefits. The subsection treats any individual who has paid creditable United States for a year as having also paid $50 on account of the individual's Canadian Part I tax liability for the year. This has the effect, assuming the individual does not owe any other amounts of tax or have other debts against which tax overpayments may be applied, of entitling the individual to receive the $50. Since the payment is treated as having been made on the individual's balance-due day for the year, refund interest may also arise on the amount.

Subclause 69(3)

Interest

For the purposes of the Income Tax Act's interest rules, subclause (3) treats an individual's creditable United States tax for a year as having been paid, on the individual's balance-due day for the year, on account of the individual's Canadian Part I tax liability for the year. The subsection then goes on to treat the creditable United States tax as having been refunded when the Minister of National Revenue pays an amount on its account to or for the benefit of the individual, or applies an amount on its account to a liability of the individual.

The general effect of this provision is to require that interest be computed as though the refundable United States tax were a payment on account of the individual's Canadian tax liability.

Clause 70

Definitions

Income Tax Conventions Interpretation Act
5

Section 5 of the Act defines a number of terms both for the purposes of interpreting Canada's tax conventions ("tax treaties") and for the purposes of applying the Act itself. Several of these terms are amended to ensure that the tax conventions deal as intended with various sorts of income.

"annuity"

The definition "annuity" is amended to provide that no pension payment is an annuity. This amendment is made possible by the clarification of what a "pension" is, as described below.

"periodic pension payment"

The existing definition "periodic pension payment" excludes certain pension payments arising in Canada. The definition does not, however, provide clear positive guidance as to what a periodic pension payment is. This amendment improves the definition by clarifying that a periodic pension payment is, where the payment arises in Canada, any pension payment other than one of the excluded payments. The amendment thus relies on the new definition of "pension," described below.

"pension"

Section 5.1 of the Act currently defines "pension," but does so only to the extent of including certain payments arising in Canada, and only for the purposes of the existing definitions "annuity" and "periodic pension payment." That partial definition is replaced by a definition, in section 5, that applies both to the Act and to the conventions.

This new definition provides that, in respect of payments arising in Canada, the meaning of "pension" depends on the terms of the convention under consideration. If the convention does not itself

define "pension," paragraph (*a*) of the new definition applies. Under paragraph (*a*), a pension is a payment under any of a list of plans and arrangements – including registered pension plans, RRSPs, RRIFs, and so on – that would ordinarily be considered pension or retirement plans under Canada's domestic system.

If the convention does define "pension," paragraph (*b*) applies. Under paragraph (*b*), a pension is not only a payment included in the convention's definition, but also a periodic payment under any of the plans listed in paragraph (*a*). Mechanically, this effect is achieved by including in "pension" under paragraph (*b*) any payment (other than of social security benefits) that would be a "periodic pension payment" if the paragraph (*a*) meaning of "pension" were used (as it would be if the convention did not define "pension").

These amendments apply to amounts paid after 1996.

Clause 71

Definition – "specified portion"

Income Tax Conventions Interpretation Act
5.1

Section 5.1 of the Act provides a limited definition of "pension." As discussed above, this definition is replaced with a more complete definition in section 5 of the Act.

The repeal of section 5.1 applies with respect to amounts paid after 1996.

Clause 72

Gains Arising in Canada

Income Tax Conventions Interpretation Act
6.3

New section 6.3 of the Act confirms that income, gains or losses on taxable Canadian property are considered to arise in Canada, unless a convention expressly provides otherwise.

Under some conventions, one country can tax certain amounts realized by residents of the other country if the amounts "arise in" the first country. The *Income Tax Act* subjects non-residents to Canadian tax on their gains on "taxable Canadian property." New section 6.3 makes the relationship between these two principles more explicit.

New section 6.3 applies to dispositions after February 23, 1998.

Clause 73

Definitions

Old Age Security Act
2

Section 2 of the *Old Age Security Act* (OAS Act) contains definitions that apply for purposes of the OAS Act.

Subclauses 73(1) and (2)

Old Age Security Act

"income"

The "income" of a person for the purposes of the OAS Act is defined to be the income of that person computed in accordance with the *Income Tax Act*, subject to modifications set out in the definition. The income of a person in a calendar year affects the benefits payable under the OAS Act starting in July of the following year.

The definition "income" is amended in two respects, first as it applies for the purposes of determining the benefits payable under the OAS Act for months after June 1999, and second as it applies for the purposes of determining the benefits payable under the OAS Act for months after June 2000.

First, the definition "income" is amended, as it applies for the purposes of determining benefits payable under the OAS Act for months after June 1999, to provide a deduction for employment expenses (set at the lesser of $500 and 20% of the person's employment income for the year), Canada Pension Plan/Quebec Pension Plan contributions and Employment Insurance premiums.

Second, the definition "income" is amended, as it applies for the purposes of determining benefits payable under the OAS Act for months after June 2000, to provide an additional deduction in respect of dividends in certain cases. Under the amended definition, income is further reduced by three times the amount of any dividend tax credits the individual was unable to use to reduce federal income tax payable. That is, income for the purposes of the OAS Act is reduced by three times the amount, if any, by which the total dividend tax credits the individual is entitled to claim for a year exceeds the individual's tax otherwise payable under Part I of the Income Tax Act. "Tax otherwise payable" is defined by reference to subsection 126(7) of that Act, and is calculated before any deduction in respect of the dividend tax credit and certain other credits and deductions.

The *Income Tax Act*'s treatment of dividend income requires, under subparagraph 82(1)(b) of that Act, an additional one-quarter of the amount of any dividend received by an individual from a Canadian-resident corporation to be included in the individual's income. The grossed-up amount of income from dividends reflects an assumed level of corporate income before income taxes.

Section 121 of *the Income Tax Act* allows an individual with dividend income to reduce tax otherwise payable by means of a dividend tax credit, which generally compensates for tax that may have been payable at the corporate level. The dividend tax credit is equal to two-thirds of the additional amount required to be included in income under subparagraph 82(1)(*b*). The dividend tax credit is non-refundable; any part of the credit which cannot be used to reduce tax otherwise payable in the year is lost. The dividend gross-up and

credit system allows for a significant degree of integration of the corporate and personal income tax systems.

The interaction of the dividend taxation system with the definition of income in the OAS Act can have unintended consequences for recipients of income-tested benefits under the OAS Act who have dividend income. Some of these individuals may be unable to take full advantage of the dividend tax credit because they otherwise have little or no tax liability, and yet their benefits under the OAS Act are affected by the grossed-up amount of dividends.

The amendment reduces the inclusion rate of dividends in income under the OAS Act to three-quarters of dividends received for persons who are unable to make any use of the dividend tax credit (i.e. for whom Part I income tax otherwise payable is nil). The reduction is phased out in the proportion 3:1 for any amounts of the dividend tax credit which a person is able to use. Persons who are able to make full use of the dividend tax credit will continue to have 125% of dividends received included in income for purposes of the OAS Act.

Clause 74

Old Age Security Act
12(2), (5) and (6)(b)

These provisions are all amended to allow for the rounding in the benefit calculations under the OAS Act after June 30, 1999.

Clause 75

Old Age Security Act
22(1), (2), (3) and (4)

These provisions are all amended to allow for the rounding in the benefit calculations under the OAS Act after June 30, 1999.

Clause 76

Definitions

War Veterans Allowance Act
7

Subsection 7(1) of the *War Veterans Allowance Act* defines "income" for the purposes of that Act as having the same meaning as in section 2 of the *Old Age Security Act* subject to the modifications set out in that subsection. The amendment to this subsection provides that paragraph (d) of the definition "income" in the *Old Age Security Act* (which provides a deduction in respect of unused dividend tax credits) does not apply for the purposes of calculating income under the *War Veterans Allowance Act.*

APPENDIX A

DRAFT *INCOME TAX REGULATION* AND EXPLANATORY NOTE

Canadian Film or Video Production Tax Credit

1. Section 1106 of the *Income Tax Regulations* is amended by adding the following after subsection (7):

Prescribed Amount

(8) For the purpose of the definition "assistance" in subsection 125.4(1) of the Act, "prescribed amount" means an amount paid or payable to a taxpayer under the License Fee Program of the Canada Television and Cable Production Fund or the Canada Television Fund/Fonds canadien de télévision.

2. Section 1 applies to amounts received after February 23, 1998.

Explanatory Note

ITR
1106(8)

Section 1106 of the *Income Tax Regulations* provides rules related to the Canadian Film or Video Production Tax Credit.

New subsection 1106(8) prescribes amounts paid or payable under the License Fee Program of the Canada Television and Cable Production Fund for the purpose of the definition "assistance" in subsection 125.4(1) of the *Income Tax Act*. As a result, such payments will not be considered assistance for the purposes of the Canadian Film or Video Production Tax Credit provided under section 125.4 of the Act.

New subsection 1106(8) applies to amounts received after February 23, 1998.

APPENDIX B

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Scientific Research and Experimental Development

1. (1) Subsection 2900(1) of the *Income Tax Regulations* is repealed.

(2) Paragraph 2900(2)(*a*) of the Regulations is replaced by the following:

(*a*) the cost of materials consumed or transformed in the prosecution;

2. The portion of paragraph 2902(*e*) before subparagraph (i) is replaced by the following:

(*e*) for the purpose of sections 194 and 195 of the Act, an expenditure of a current or capital nature, to the extent that the taxpayer has received or is entitled to receive a reimbursement in respect of the expenditure from

3. Subparagraph (*b*)(ii) of the definition "cost of labour" in section 5202 of the Regulations is replaced by the following:

(ii) scientific research and experimental development, or

4. (1) Subsection 1(1) applies to work performed after February 27, 1995 except that, for the purposes of paragraphs 149(1)(*j*) and (8)(*b*) of the Act, subsection 1(1) does not apply to work performed pursuant to an agreement in writing made by the taxpayer before February 28, 1995.

(2) Subsection 1(2) applies to costs incurred after February 23, 1998.

(3) Section 2 applies to amounts that become receivable after December 20, 1991.

(4) Section 3 applies to costs incurred after February 27, 1995.

Explanatory Notes

ITR
2900(1)

Subsection 2900(1) of the *Income Tax Regulations* defines "scientific research and experimental development" ("SR&ED").

This definition is repealed, consequential on the introduction of the definition "scientific research and experimental development" in subsection 248(1) of the Act. The introduction of this definition in the Act will give it application to the Regulations as well, thus making the definition in subsection 2900(1) of the Regulations unnecessary.

This amendment generally applies to work performed after February 27, 1995.

ITR
2900(2)

Subsection 2900(2) of the Regulations provides a description of expenditures that are considered directly attributable to the prosecution of scientific research and experimental development. These expenditures are eligible for deduction under section 37 of the Act and may earn investment tax credits under section 127 of the Act.

Paragraph 2900(2)(*a*) is amended, pursuant to the announcement in the 1998 Budget, to add to the list of such expenditures the cost of materials transformed in the prosecution of SR&ED.

This amendment applies to costs incurred after February 23, 1998.

ITR
2902

Section 2902 defines a prescribed expenditure for the purposes of subsection 127(9) of the *Income Tax Act*. Prescribed expenditures are not eligible for investment tax credits.

Paragraph 2902(*e*) of the Income Tax Regulations is amended consequential on the amendments to the definition "contract payment" in subsection 127(9) of the Act. Those amendments provided that a contract payment included certain payments for scientific research and experimental development that is performed for or on behalf of a person entitled to a deduction in respect of the amount because of subparagraph 37(1)(*a*)(i) or (i.1) of the Act. Contract payments received reduce the base upon which a taxpayer's ITC in respect of SR&ED is calculated. Those amendments were effective for amounts that became payable after December 20, 1991. In view of the amended definition of "contract payment" applicable to ITCs in respect of SR&ED, the provisions of paragraph 2902(*e*) became redundant for ITC purposes. However, paragraph 2902(*e*) of the Regulations is still relevant in respect of claims for refunds of Part VIII Refundable Tax on Corporations in Respect of the Scientific Research and Experimental Development Tax Credit. Regulation 2902(*e*) is, therefore, amended to apply only for the purposes of the Part VIII Refundable Tax. This amendment applies to amounts that become receivable after December 20, 1991.

ITR
5202

"cost of labour"

Section 5202 of the Regulations sets out a number of definitions relevant to the calculation of the manufacturing and processing tax credit.

The definition "cost of labour" in section 5202 is amended as a consequence of the introduction of the definition "scientific research and experimental development" in subsection 248(1) of the Act.

This amendment applies to costs incurred after February 27, 1995.

APPENDIX C

DRAFT *INCOME TAX REGULATIONS* AND EXPLANATORY NOTES

Qualified Investments for RESPs

1. Subsection 221(2) of the *Income Tax Regulations* is replaced by the following:

(2) Where in any taxation year a reporting person (other than a registered investment) claims that a share of its capital stock issued by it, or an interest as a beneficiary under it, is a qualified investment under section 146, 146.1, 146.3 or 204 of the Act, the reporting person shall, in respect of the year and within 90 days after the end of the year, make an information return in prescribed form.

2. (1) The portion of subsection 4900(1) of the Regulations before paragraph (*a*) is replaced by the following:

4900. (1) Subject to subsection (2), for the purposes of paragraph (*d*) of the definition "qualified investment" in subsection 146(1) of the Act, paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act, paragraph (*c*) of the definition "qualified investment" in subsection 146.3(1) of the Act and paragraph (*i*) of the definition "qualified investment" in section 204 of the Act, each of the following investments is prescribed to be a qualified investment for a plan trust at a particular time if at that time it is

(2) Paragraph 4900(1)(*c*) of the Regulations is replaced by the following:

(*c*) a share of the capital stock of a mortgage investment corporation that does not hold as part of its property at any time during the calendar year in which the particular time occurs any indebtedness, whether by way of mortgage or otherwise, of a person who is an annuitant, a beneficiary, an employer or a subscriber under the governing plan of the plan trust or of any other person who does not deal at arm’s length with that person;

(3) The portion of paragraph 4900(1)(*g*) of the Regulations before subparagraph (i) is replaced by the following:

(*g*) a bond, debenture, note or similar obligation (in this paragraph referred to as the "obligation") issued by, or a deposit with, a credit union that has not at any time during the calendar year in which the particular time occurs granted any benefit or privilege to a person who is an annuitant, a beneficiary, an employer or a subscriber under the governing plan of the plan trust, or to any other person who does not deal at arm's length with that person, as a result of the ownership by

(4) The portion of subparagraph 4900(1)(*h*)(iii) of the Regulations before clause (A) is replaced by the following:

(iii) that has not at any time during the calendar year in which the particular time occurs granted any benefit or privilege to a person who is an annuitant, a beneficiary, an employer or a subscriber under the governing plan of the plan trust, or to any other person who does not deal at arm's length with that person, as a result of the ownership by

(5) Paragraph 4900(1)(*i*.2) of the Regulations is replaced by the following:

(*i*.2) indebtedness of a Canadian corporation (other than a corporation that does not deal at arm's length with a person who is an annuitant, a beneficiary, an employer or a subscriber under the governing plan of the plan trust) represented by a bankers' acceptance;

(6) The portion of paragraph 4900(1)(*q*) of the Regulations before subparagraph (i) is replaced by the following:

(*q*) a debt issued by a Canadian corporation (other than a corporation with share capital or a corporation that does not deal at arm's length with a person who is an annuitant, a beneficiary, an employer or a subscriber under the governing plan of the plan trust) where

(7) Subsection 4900(4) of the Regulations is replaced by the following:

(4) For the purposes of paragraph (*d*) of the definition "qualified investment" in subsection 146(1) of the Act, paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act and paragraph (*c*) of the definition "qualified investment" in subsection 146.3(1) of the Act, a mortgage secured by real property situated in Canada, or an interest therein, is a qualified investment for a registered retirement savings plan, a registered education savings plan and a registered retirement income fund unless the mortgagor is a person who is an annuitant, a beneficiary or a subscriber under the plan or fund or any other person who does not deal at arm's length with that person.

(8) Subsection 4900(5) of the Regulations is replaced by the following:

(5) For the purposes of paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act, a property is a qualified investment for a trust governed by a registered education savings plan at any time if at that time the property is an interest in a trust or a share of the capital stock of a corporation that was a registered investment for a trust governed by a registered retirement savings plan during the calendar year in which the time occurs or the preceding year.

(9) The portion of subsection 4900(6) of the Regulations before paragraph (*b*) is replaced by the following:

(6) For the purposes of paragraph (*d*) of the definition "qualified investment" in subsection 146(1) of the Act, paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act and paragraph (*c*) of the definition "qualified investment" in subsection 146.3(1) of the Act, except as provided in subsections (8) and (9), a property is a qualified investment for a trust governed by a registered retirement savings plan, a registered education savings plan and a registered retirement income fund at any time if at that time the property is

(*a*) a share of the capital stock of an eligible corporation (within the meaning assigned by subsection 5100(1)), unless a person who

is an annuitant, a beneficiary or a subscriber under the plan or fund is a designated shareholder of the corporation;

(10) The portion of paragraph 4900(8)(*a*) of the Regulations before subparagraph (i) is replaced by the following:

(*a*) a trust governed by a registered retirement savings plan, a registered education savings plan or a registered retirement income fund holds

(11) Paragraph 4900(8)(*b*) of the Regulations is replaced by the following:

(*b*) a person who is an annuitant, a beneficiary or a subscriber under the plan or fund provides services to or for the issuer of the share or small business security, or to or for a person related to that issuer, and it can reasonably be considered, having regard to all the circumstances (including the terms and conditions of the share or small business security or of any related agreement, and the rate of interest or the dividend provided on the share or small business security), that any amount received in respect of the share or small business security is on account, in lieu or in satisfaction of payment for the services,

(12) The portion of paragraph 4900(9)(*a*) of the Regulations before subparagraph (i) is replaced by the following:

(*a*) a trust governed by a registered retirement savings plan, a registered education savings plan or a registered retirement income fund holds

(13) Paragraph 4900(9)(*b*) of the Regulations is replaced by the following:

(*b*) a person who is an annuitant, a beneficiary or a subscriber under the plan or fund is a designated shareholder of the corporation,

(14) Subsection 4900(10) of the Regulations is replaced by the following:

(10) For the purposes of paragraphs (9)(*f*) and (*g*), a trust governed by a plan or fund shall be deemed not to deal at arm's length with a trust governed by another plan or fund if a person who is an annuitant or a subscriber under the plan or fund is the same person as, or does not deal at arm's length with, the annuitant or subscriber under the other plan or fund.

(15) The portion of subsection 4900(12) of the Regulations before paragraph (*a*) is replaced by the following:

(12) For the purposes of paragraph (*d*) of the definition "qualified investment" in subsection 146(1) of the Act, paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act and paragraph (*c*) of the definition "qualified investment" in subsection 146.3(1) of the Act, a property is a qualified investment for a trust governed by a registered retirement savings plan, a registered education savings plan or a registered retirement income fund at any time if, at the time the property was acquired by the trust,

(16) The portion of subsection 4900(12) of the English version of the Regulations after paragraph (*c*) is replaced by the following:

and, immediately after the time the property was acquired by the trust, each person who is an annuitant, a beneficiary or a subscriber under the plan or fund at that time was not a connected shareholder of the corporation.

(17) Paragraph 4900(13)(*a*) of the Regulations is replaced by the following:

(*a*) a share that is otherwise a qualified investment for the purposes of paragraph (*d*) of the definition "qualified investment" in subsection 146(1) of the Act, paragraph (*e*) of the definition "qualified investment" in subsection 146.1(1) of the Act and paragraph (*c*) of the definition "qualified investment" in subsection 146.3(1) of the Act solely because of subsection (12) is held by a trust governed by a registered retirement savings plan, registered education savings plan or registered retirement income fund,

3. (1) The definition "governing plan" in subsection 4901(2) of the Regulations is replaced by the following:

"governing plan"
« *régime régissant* »

"governing plan" means a registered retirement savings plan, a registered education savings plan, a registered retirement income fund, a deferred profit sharing plan or a revoked plan;

(2) The portion of the definition "qualifying share" in subsection 4901(2) of the Regulations before subparagraph (*b*)(i) is replaced by the following:

"qualifying share"
« *part admissible* »

"qualifying share", in respect of a specified cooperative corporation and a registered retirement savings plan, registered education savings plan or registered retirement income fund, means a share of the capital or capital stock of the corporation where

(*a*) ownership of the share or a share identical to the share is not a condition of membership in the corporation, or

(*b*) a person who is an annuitant, a beneficiary or a subscriber under the plan or fund (or any other person related to that person)

4. (1) Section 1 applies to the 1999 and subsequent taxation years.

(2) Sections 2 and 3 apply to property acquired after ANNOUNCEMENT DATE.

Explanatory Notes

This appendix contains proposed regulations to reflect the introduction of new rules in section 146.1 of the *Income Tax Act*, which limit the types of investments that registered education savings plans (RESPs) are permitted to hold.

ITR
221(2)

Subsection 221(2) of the *Income Tax Regulations* requires certain types of corporations and trusts to file an information return in respect of a taxation year, where the corporation or the trust claims that a share of its capital stock, or an interest of a beneficiary under it, is a qualified investment for an registered retirement savings plan (RRSP), registered retirement income fund (RRIF) or deferred profit sharing plan (DPSP). The requirement for the information return is limited to the types of corporations and trusts described in subsection 221(1) of the Regulations that are not registered investments.

Subsection 221(2) is amended to extend the requirement for filing an information return to a corporation or a trust that claims that a share of its capital stock, or an interest of a beneficiary under it, is a qualified investment for an RESP. This amendment is consequential on the introduction of qualified investment rules for RESPs.

This amendment applies to 1999 and subsequent taxation years.

ITR
Part XLIX

Part XLIX of the Regulations lists a number of qualified investments for RRSPs, RRIFs and DPSPs. Part XLIX is amended to reflect the introduction of qualified investment rules for RESPs. Generally, the types of property that will qualify for an RESP are those that qualify for an RRSP.

All of the amendments described below to Part XLIX of the Regulations apply to property acquired after the date on which the changes are released to the public.

ITR
4900(1)(*c*), (*g*), (*h*), (*i*.2) and (*q*)

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

The preamble to subsection 4900(1) is amended so that the listed types of property are also qualified investments for a trust governed by an RESP. It is also amended to delete an obsolete reference to section 146.2 of the Act, which dealt with registered home ownership savings plans.

Paragraph 4900(1)(*c*) allows a share of a mortgage investment corporation (as defined in subsection 130.1(6) of the Act) to be a qualified investment, provided the RRSP or RRIF annuitant or any beneficiary or employer under the DPSP is not indebted to the corporation. Paragraph 4900(1)(*c*) is amended so that the restriction on indebtedness also applies to RESP subscribers and beneficiaries.

Paragraph 4900(1)(*g*) prescribes, as a qualified investment, a bond, debenture, note or similar obligation issued by, or a deposit with, a credit union that has not at any time in the year granted a benefit, resulting from the investment, to the RRSP or RRIF annuitant or any beneficiary or employer under the DPSP. Paragraph 4900(1)(*g*) is amended so that the restriction on granting a benefit also applies to RESP subscribers and beneficiaries.

Paragraph 4900(1)(*h*) prescribes, as a qualified investment, a bond, debenture, note or similar obligation issued by a cooperative corporation (as defined in subsection 136(2) of the Act) provided certain conditions are met. One of the conditions is that the cooperative corporation has not at any time in the year granted a benefit, resulting from the investment, to the RRSP or RRIF annuitant or any beneficiary or employer under the DPSP. Paragraph 4900(1)(*h*) is amended so that the restriction on granting a benefit also applies to RESP subscribers and beneficiaries.

Paragraph 4900(1)(*i*.2) allows the indebtedness of a Canadian corporation represented by a bankers' acceptance to be a qualified investment, provided the corporation deals at arm's length with the RRSP or RRIF annuitant or each person who is a beneficiary or an employer under the DPSP. Paragraph 4900(1)(*i*.2) is amended so that the restriction on non-arm's length dealings also applies to RESP subscribers and beneficiaries.

Paragraph 4900(1)(*q*) allows 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, provided the corporation deals at arm's length with the RRSP or RRIF annuitant or each person who is a beneficiary or employer under the DPSP. Paragraph 4900(1)(*q*) is amended so that the restriction on non-arm's length dealings also applies to RESP subscribers and beneficiaries.

ITR
4900(4)

Subsection 4900(4) of the Regulations allows a mortgage secured by real property situated in Canada, or an interest therein, to be a qualified investment for RRSPs and RRIFs, if the mortgagor deals at arm's length with the RRSP or RRIF annuitant.

Subsection 4900(4) is amended so that such a mortgage is also a qualified investment for an RESP, provided the mortgagor deals at arm's length with each person who is a subscriber or beneficiary under the RESP.

ITR
4900(5)

Subsection 4900(5) of the Regulations prescribes certain annuity contracts to be qualified investments for registered home ownership savings plans (RHOSPs). Since the provisions relating to RHOSPs were repealed, effective after 1985, existing subsection 4900(5) is obsolete. It is being replaced by a provision relating to RESPs.

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

ITR
4900(6), (8) to (10)

Subsection 4900(6) of the Regulations prescribes the following types of property to be qualified investments for RRSPs and RRIFs:

- a share in the capital stock of an "eligible corporation", provided the annuitant under the RRSP or RRIF is not a "designated shareholder" of the corporation;

- an interest of a limited partner in an small business investment limited partnership; and

- an interest in an small business investment trust

The expressions "designated shareholder", "eligible corporation", "small business investment limited partnership" and "small business investment trust" are defined in subsections 4901(2), 5100(1), 5102(1) and 5103(1) of the Regulations, respectively.

Subsection 4900(6) is amended so that the types of investments described therein also qualify for an RESP. In the case of a share of an eligible corporation, each person who is a subscriber or beneficiary under the RESP must not be a "designated shareholder" of the corporation.

Subsection 4900(6) is subject to the rules in subsections 4900(8) and (9). These rules provide that an investment that would otherwise qualify under subsection 4900(6) will not be a qualified investment in certain circumstances. Subsection 4900(10) provides a special interpretative rule that applies for the purposes of subsection 4900(9).

Subsections 4900(8) to (10) are amended to reflect the extension of subsection 4900(6) to RESPs.

ITR
4900(12)

Subsection 4900(12) of the Regulations allows certain shares of small business corporations, venture capital corporations and cooperative corporations to be qualified investments for RRSPs and RRIFs, provided the RRSP or RRIF annuitant is not a "connected shareholder" of the corporation. The expression "connected shareholder" is defined in subsection 4901(2).

Subsection 4900(12) is amended so that such shares also qualify for an RESP, if each person who is a subscriber or beneficiary under the RESP is not a "connected shareholder" of the corporation.

ITR
4900(13)

Subsection 4900(13) of the Regulations is an anti-avoidance rule intended to ensure that amounts received in respect of any shares described in subsection 4900(12) by an RRSP or RRIF trust must be in the nature of a return from an investment.

Subsection 4900(13) is amended so that it also applies for the purposes of an RESP trust.

ITR
4901(2)

Subsection 4901(2) defines a number of terms that apply for the purposes of Part XLIX.

"governing plan"

A "governing plan" is defined as an RRSP, RRIF, RHOSP, DPSP or revoked plan. The expression is used in describing conditions that apply to various types of investments that qualify for these plans under subsection 4900(1) of the Regulations.

The definition is amended to add a reference to "registered education savings plan" and to remove an obsolete reference to "registered home ownership savings plan".

"qualifying share"

The definition "qualifying share" is relevant for the purposes of determining whether a share of a cooperative corporation is a qualified investment under paragraph 4900(12)(*c*) of the Regulations for an RRSP or RRIF.

The definition is amended to reflect the extension of subsection 4900(12) to RESPs.

APPENDIX D

DRAFT *INCOME TAX REGULATION* AND EXPLANATORY NOTE

Branch Tax – Corporate Immigration

1. Section 808 of the *Income Tax Regulations* is amended by adding the following after subsection (1):

(1.1) Notwithstanding subsection (1), if a corporation becomes resident in Canada at a particular time, the corporation's allowance in respect of its investment in property in Canada for its last taxation year that ended before the particular time is prescribed to be nil.

2. Section 1 applies to corporations that become resident in Canada after February 23, 1998.

Explanatory Note

ITR
808(1.1)

Subsection 808(1) of the Regulations specifies the amount of a corporation's allowance in respect of investment in property in Canada for the purposes of the "branch tax" imposed under Part XIV of the Act.

New subsection 808(1.1) provides that where a corporation becomes resident in Canada, the corporation's investment allowance for the taxation year that is deemed to end immediately before immigration is nil. Since the corporation will be unable to claim an investment allowance, it will be liable to pay branch tax on any unremitted profits of a Canadian branch arising in the year or deferred in respect of previous years. Effectively, for an immigrating corporation, unremitted profits of a Canadian branch are treated similarly to the undistributed surplus of a Canadian corporation in which the immigrating corporation holds shares, which is deemed to be distributed as a dividend by paragraph 128.1(1)(*c.1*) of the Act.

New subsection 808(1.1) applies to corporations that become resident in Canada after February 23, 1998.