Notice of Ways and Means Motion to Amend the *Income Tax Act* and Other Tax Legislation

That it is expedient to amend the *Income Tax Act* (the "Act") and other tax legislation as follows:

Resolution 1: Adoption Expense Tax Credit

1. (1) Paragraph (*a*) of the definition "adoption period" in subsection 118.01(1) of the Act is replaced by the following:

(*a*) begins at the earlier of the time that an application is made for registration with a provincial ministry responsible for adoption (or with an adoption agency licensed by a provincial government) and the time, if any, that an application related to the adoption is made to a Canadian court; and

(2) Subsection 1(1) applies to the 2013 and subsequent taxation years.

Editorial Comment: The adoption expense tax credit applies a 15% federal tax credit to adoption expenses incurred by adoptive parents in the year that an adoption of an eligible child is completed. An eligible child is defined in s. 118.01(1) and must be a child under the age of 18. The eligible adoption expenses allowed are those incurred between the time that the parents are matched with the child and the time that the adoption is completed. The Budget proposes to broaden the eligibility rules relating to allowable expenses incurred prior to the time that the child is matched with the parents. Frequently expenses are incurred in order to qualify as adoptive parents, prior to being matched with a child. The Budget changes will recognize these expenses as being qualified expenses for the purpose of this credit.

For adoptions finalized after 2012, expenses incurred on or after the earliest time that:

- an adoptive parent registers with a provincial ministry or an adoption agency; or
- an application is made to a Canadian court,

will be recognized as eligible adoption expenses.

The maximum eligible adoption expenses that may be claimed for 2013 is $11,669 per child. This amount is indexed annually.

Resolution 2: First-Time Donor's Super Credit

2. (1) Subsection 118.1(1) of the Act is amended by adding the following in alphabetical order:

"first-time donor", for a taxation year, means an individual (other than a trust)

(*a*) who has not deducted an amount under subsection (3) for a preceding taxation year that ends after 2007, and

(*b*) who is not, at the end of the year, married to a person (other than a person who was at that time separated from the individual by reason of a breakdown of their marriage), or in a common-law partnership with a person, who has deducted an amount under subsection (3) for a taxation year that ends after 2007 and before the year;

(2) Section 118.1 of the Act is amended by adding the following after subsection (3):

(3.1) For the purpose of computing the tax payable under this Part by a first-time donorfor a taxation year that begins after 2012 and ends before 2018, the first-time donor may deduct an amount not exceeding the lesser of $250 and the amount that is 25% of the total of all amounts, each of which is an eligible amount of a gift of money in the year or in any of the four preceding taxation years and in respect of which the first-time donor, or a person who is, at the end of the year, the first-time donor's spouse (other than a person who was at that time separated from the first-time donor by reason of a breakdown of their marriage) or common-law partner, has deducted an amount for the year under subsection (3).

(3.2) If, at the end of a taxation year, both an individual and a person with whom theindividual is married (other than a person who was at that time separated from the individual by reason of a breakdown of their marriage) or in a common-law partnership may deduct an amount under subsection (3.1) for the year, the total of all amounts so deductible by the individual and the other person shall not exceed the maximum amount that would be deductible for the year by either person if the individual were the only one entitled to deduct an amount under subsection (3.1), and where the individual and the other person cannot agree as to what portion of the amount each can deduct, the Minister may fix the portions.

(3) The definition "first-time donor" in subsection 118.1(1) of the Act and subsections 118.1(3.1) and (3.2) of the Act, as enacted by subsections 2(1) and (2), are repealed.

(4) Subsections 2(1) and (2) apply in respect of gifts made on or after Budget Day.

(5) Subsection 2(3) applies to the 2018 and subsequent taxation years.

Editorial Comment: The Charitable Donations Tax Credit allows an individual to claim a credit of 15% on the first $200 of donations and a credit of 29% for donations exceeding the first $200. The taxpayer may claim both his or her own donations as well as those of his or her spouse or common-law partner.

The Budget proposes to supplement the existing credit with a new temporary "super credit" of an additional 25%. For a "first time donor" the credit will become 40% on the first $200 of donations and 54% of the amount donated in excess of $200, up to a maximum donation amount of $1,000. This super credit will only apply to cash donations.

An individual will be considered as a "first time donor" if neither the individual nor the individual's spouse or common-law partner has claimed any donation credits in any taxation year after 2007. The individual's spouse or common-law partner is the person designated as such at December 31 of the year in which the super credit is being claimed. The super credit may be split between such couples, however the total credit being claimed may not be more than what would be allowed if only one person were to claim the credit.

The super credit applies to donations made on or after March 21, 2013 and may be claimed only once in the 2013 year or any taxation year before 2018.

Resolution 3: Lifetime Capital Gains Exemption

3. The Act is modified in accordance with the proposals relating to the increase in, and indexation of, the lifetime capital gains exemption described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Editorial Comment: Currently taxpayers are allowed a lifetime capital gains exemption of up to $750,000 on the disposition of qualified small business corporation shares or qualified farm or fishing properties. Commencing in the 2014 taxation year this exemption will be increased by $50,000 to $800,000 and will be indexed to inflation for taxation years after 2014. The new limit will apply to all individuals, even those who have previously fully used the lifetime capital gains exemption.

Resolution 4: Deduction for Safety Deposit Boxes

4. (1) Subsection 18(1) of the Act is amended by striking out "and" at the end of paragraph (*v*), by adding "and" at the end of paragraph (*w*), as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), and by adding the following after paragraph (*w*):

(*x*) an amount paid or payable in respect of the use of a safety deposit box of a financial institution.

(2) Subsection 4(1) applies to taxation years that begin on or after Budget Day.

Editorial Comment: Taxpayers have for many years been able to deduct reasonable expenses related to the earning of investment income, one of them being the deduction of the cost of renting a safety deposit box to store paper copies of documents and securities. Since the advent of electronic records, the importance of storing paper records has declined, and as a result most safety deposit boxes are not used for income producing purposes but rather to store personal items and other valuables. Commencing with taxation years beginning on or after March 21, 2013, the cost of renting a safety deposit box will no longer be allowed as a deduction for tax purposes.

Resolutions 5 to 6: Dividend Tax Credit

5. (1) Subparagraph 82(1)(*b*)(i) of the Act is replaced by the following:

(i) 18% of the amount determined under paragraph (*a*) in respect of the taxpayer for the taxation year, and

(2) Subsection 5(1) applies to dividends paid after 2013.

6. (1) Paragraph 121(*a*) of the Act is replaced by the following:

(*a*) 13/18 of the amount, if any, that is required by subparagraph 82(1)(*b*)(i) to be included in computing the individual's income for the year; and

(2) Subsection 6(1) applies to dividends paid after 2013.

Editorial Comment: The Budget proposes to adjust the "gross-up and credit" mechanism that applies to taxable dividends other than "eligible dividends" paid by a corporation resident in Canada to a Canadian resident individual (excluding a trust that is a registered charity). Since 2006, the Canadian tax system has recognized two "types" of dividends, in light of the two levels of corporate tax that can generally apply (i.e. income taxed at the lower "small business rate" and income subject to ordinary taxation rates). Since 2010, the enhanced dividend tax credit ("DTC") in respect of "eligible dividends" (as defined in subsection 89(1)) has been adjusted to reflect changes in the underlying corporate tax rates. As a result of the changes in the corporate tax rates, the assumptions underlying the DTC regime for dividends other than eligible dividends ("non-eligible dividends") have become skewed, resulting in a lower overall level of tax on income payable by an individual when that income is earned through a corporation rather than earned directly.

Under existing legislation, the amount required to be included in the income of an individual receiving a non-eligible dividend is: (i) the amount of the dividend under paragraph 82(1)(*a*), and (ii) a "gross-up" under subparagraph 82(1)(*b*)(i) of 25% of the amount determined under paragraph 82(1)(*a*). Pursuant to paragraph 121(*a*), the individual is entitled to claim a credit equal to 2/3 of the amount required to be included under subparagraph 82(1)(*b*)(i), thereby resulting in an effective tax credit of 13–1/3% of the grossed-up dividend.

For dividends paid after 2013, both the "gross up" required under subparagraph 82(1)(*b*)(i) and the DTC available under paragraph 121(*a*) will be adjusted to effectively require additional tax to be paid at the shareholder level on non-eligible dividends paid by a corporation resident in Canada to an individual. The "gross up" required to be included in income pursuant to subparagraph 82(1)(*b*)(i) will be reduced from 25% to 18%, which will result in a smaller income inclusion in respect of the dividend received. The computation of the DTC under paragraph 121(*a*) will be increased from 2/3 to 13/18. However, as a result of the DTC applying to a lower grossed up amount, the result of these changes is to reduce the effective rate of the DTC for non-eligible dividends to 11% beginning in 2014.

No changes were announced in the 2013 Budget in respect of the DTC rules that apply to dividends that are "eligible dividends".

Resolution 7: Registered Pension Plans: Correcting Contribution Errors

7. (1) Subsection 56(1) of the Act is amended to require the inclusion in income of the refund of an amount that was deducted as a contribution to a registered pension plan, where the refund relates to a contribution that was made as the result of a reasonable error.

(2) Section 147.1 of the Act is amended to allow the administrator of a registered pension plan to refund an amount from the plan, to a member or a participating employer in respect of the plan, to correct a contribution that was made as the result of a reasonable error, provided that the refund is made no later than December 31 of the year following the year in which the contribution was made and is reported to the Minister of National Revenue in prescribed form.

(3) Subsections 7(1) and (2) apply in respect of registered pension plan contributions made on or after the later of January 1, 2014 and the day on which the enacting legislation receives royal assent.

Editorial Comment: Currently, an over-contribution to a registered pension plan (RPP) may be refunded to a plan member or employer if the refund is made to avoid the revocation of the RPP (see paragraph 147.1(2)(*a*) of the Act and paragraph 8502(*d*)(iii) of the *Income Tax Regulations*). However, where the RPP contribution limits have not been exceeded, there is no provision that allows the refund of a contribution that was made as a result of a reasonable error. Currently, the refunds of such contributions are allowed by the CRA on a case-by-case basis.

Budget 2013 proposes to amend subsection 56(1) and section 147.1 of the Act to allow administrators of RPPs to make refunds of contributions to correct reasonable errors without first obtaining the approval of the CRA. Such refunds must be made no later than December 31 of the year following the year in which the error was made (and for refunds after the deadline the administrator must obtain CRA approval).

Refunds to an RPP member will be included in his/her income in the year received and a prior deduction claimed by a member will not be adjusted. For employers, a refund of RPP contributions will normally reduce the RPP contribution expense for the year to which it relates.

These proposed amendments would apply in respect of RPP contributions made on or after the later of (i) January 1, 2014 and (ii) the day of Royal Ascent to the enacting legislation.

Resolution 8: Extended Reassessment Period: Tax Shelters and Reportable Transactions and Form T1135

8. (1) Paragraph 152(4)(*c*) of the Act is replaced by the following:

(*b.1*) an information return described in subsection 237.1(7) or 237.3(2) that is required to be filed in respect of a deduction or claim made by the taxpayer in relation to a tax shelter, or in respect of a tax benefit (as defined in subsection 245(1)) to the taxpayer from an avoidance transaction (as defined in subsection 245(3)), is not filed as and when required, and the assessment, reassessment or additional assessment is made within the period that ends three years after the date, if any, that the information return is filed;

(*b.2*) the assessment, reassessment or additional assessment is made before the day that is three years after the end of the normal reassessment period for the taxpayer in respect of the year and the taxpayer

(i) has failed to file for the year a prescribed form as and when required under subsection 233.3(3) or to report on the prescribed form the information required in respect of a specified foreign property held by the taxpayer at any time during the year, and

(ii) has failed to report an amount, in respect of a specified foreign property, that is required to be included in computing the taxpayer's income in a return filed under section 150 for the year;

(*c*) the taxpayer or person filing the return has filed with the Minister a waiver in prescribed form within the additional three-year period referred to in paragraph (*b*) or (*b.1*);

(*c.1*) the taxpayer or person filing the return has filed with the Minister a waiver in prescribed form within the additional three-year period referred to in paragraph (*b.2*); or

(2) The portion of subsection 152(4.01) of the Act that is before paragraph (*a*) is replaced by the following:

(4.01) Notwithstanding subsections (4) and (5), an assessment, reassessment or additional assessment to which paragraph (4)(*a*), (*b*), (*b.1*) or (*c*) applies in respect of a taxpayer for a taxation year may be made after the taxpayer's normal reassessment period in respect of the year to the extent that, but only to the extent that, it can reasonably be regarded as relating to,

(3) The portion of paragraph 152(4.01)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) if paragraph 4(*b*), (*b.1*) or (*c*) applies to the assessment, reassessment or additional assessment,

(4) Paragraph 152(4.01)(*b*) of the Act is amended by striking out "or" at the end of subparagraph (v), by adding "or" at the end of subparagraph (vi) and by adding the following after subparagraph (vi):

(vii) the deduction, claim or tax benefit referred to in paragraph (4)(*b*.1).

(5) Subsection 152(4.1) of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), is replaced by the following:

(4.1) If the Minister would, but for this subsection, be entitled to reassess, make an additional assessment or assess tax, interest or penalties by virtue only of the filing of a waiver under subparagraph (4)(*a*)(ii) or paragraph (4)(*c*) or (*c.1*), the Minister may not make such a reassessment, additional assessment or assessment after the day that is six months after the date on which a notice of revocation of the waiver in prescribed form is filed.

(6) Subsections 8(1) and (5) apply to the 2013 and subsequent taxation years, except that, in its application to taxation years that end before Budget Day, subsection 152(4) of the Act, as amended by subsection 8(1), is to be read without reference to paragraph 152(4)(*b*.1).

(7) Subsections 8(2) to (4) apply to taxation years that end on or after Budget Day.

Editorial Comment: Generally, the CRA may reassess a taxpayer in respect of a taxation year within the "normal reassessment period", which in the case of an individual is three years from the date of assessment (see subsections 152(4) and (3.1)). For certain other taxpayers, it may be extended by another three years for any of the reasons in paragraph 152(4)(*b*). Absent a waiver or a misrepresentation in the return attributable to neglect, carelessness or willful default or a specific provision that overrides subsection 152(4), the CRA may not reassess a taxpayer beyond the normal reassessment period.

Where a taxpayer invested in a tax shelter (see section 237.1) and the promoter of the tax shelter failed to file or late-filed a prescribed information return with the CRA, the Act does not provide for an extension of the normal reassessment period for an individual taxpayer who participated in that tax shelter. The same result arises where an information return in respect of a "reportable transaction" (see section 237.3) was not filed or was late-filed. In such circumstances, the CRA may not have had sufficient time to carry out a review after the information was filed.

Consequently, the 2013 Budget proposes to extend the normal reassessment period for participants in tax shelters or reportable transactions where the prescribed information returns for such tax shelters or reportable transactions are not filed on time. In such cases, the assessment period will be three years from the date the relevant information return is filed.

This new measure will apply to taxation years ending on or after March 21, 2013.

In addition, the 2013 Budget extends the normal reassessment period where a taxpayer has failed to report income from certain foreign property and has not filed a Foreign Income Verification Statement (Form T1135) on time, or a specified foreign property was not identified or improperly identified on the Form T1135. In such a case, the normal reassessment period will be extended by three years. This applies to 2013 and subsequent tax years.

Resolutions 9 to 10: Taxes in Dispute and Charitable Donation Tax Shelters

9. (1) Subparagraph 164(1.1)(*d*)(ii) of the Act is replaced by the following:

(ii) 1/2 of the amount so assessed that is in controversy if

(A) the taxpayer is a large corporation (within the meaning assigned by subsection 225.1(8)), or

(B) the amount is in respect of a particular amount claimed under section 110.1 or 118.1 and the particular amount was claimed in respect of a tax shelter.

(2) Subsection 9(1) applies in respect of amounts assessed for taxation years that end after 2012.

10. (1) The portion of subsection 225.1(7) of the Act before paragraph (*a*) is replaced by the following:

(7) If an amount has been assessed under this Act in respect of a corporation for a taxation year in which it was a large corporation, or in respect of a particular amount claimed under section 110.1 or 118.1 where the particular amount was claimed in respect of a tax shelter, then subsections (1) to (4) do not apply to limit any action of the Minister to collect

(2) Subsection 10(1) applies in respect of amounts assessed for taxation years that end after 2012.

Editorial Comment: Provisions of the Act generally prohibit the CRA from taking collection action in instances where an individual taxpayer has objected to an assessment. In order to discourage a taxpayer from participating in questionable charitable donation tax shelters, the Budget has introduced new legislation that will allow the CRA to collect 50% of the tax, interest and penalties assessed in respect of charitable donations in tax shelters, whether or not an objection has been filed.

This new measure will be effective for amounts assessed for the 2013 taxation year and beyond.

Resolution 11: Mineral Exploration Tax Credit for Flow-Through Share Investors

11. (1) Paragraph (*a*) of the definition "flow-through mining expenditure" in subsection 127(9) of the Act is replaced by the following:

(*a*) that is a Canadian exploration expense incurred by a corporation after March 2013 and before 2015 (including, for greater certainty, an expense that is deemed by subsection 66(12.66) to be incurred before 2015) in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence, location, extent or quality of a mineral resource described in paragraph (*a*) or (*d*) of the definition "mineral resource" in subsection 248(1),

(2) Paragraphs (*c*) and (*d*) of the definition "flow-through mining expenditure" in subsection 127(9) of the Act are replaced by the following:

(*c*) an amount in respect of which is renounced in accordance with subsection 66(12.6) by the corporation to the taxpayer (or a partnership of which the taxpayer is a member) under an agreement described in that subsection and made after March 2013 and before April 2014, and

(*d*) that is not an expense that was renounced under subsection 66(12.6) to the corporation (or a partnership of which the corporation is a member), unless that renunciation was under an agreement described in that subsection and made after March 2013 and before April 2014;

(3) Subsections 11(1) and (2) apply to expenses renounced under a flow-through share agreement entered into after March 2013.

Editorial Comment: The rules in the Act permit an investor to enter into an agreement to subscribe for common shares of certain types of resource corporations. The subscription proceeds are used to incur certain qualifying exploration expenses which these corporations then renounce or "flow through" to the investor who can deduct the expenses in calculating their own taxable income. Certain individuals who invest in flow-through shares are also entitled to an additional benefit equal to 15 per cent of certain qualifying mineral exploration expenses incurred in Canada as described in the definition of "flow-through mining expenditure" in subsection 127(9). This mineral exploration tax credit was introduced as part of the October 18, 2000 Budget and is currently scheduled to expire at the end of March 2013.

Consistent with prior years, Budget 2013 proposes to extend the eligibility for the mineral exploration tax credit for one year, to flow-through share agreements entered into before April 1, 2014. Additionally, flow-through share proceeds raised in one calendar year with the benefit of the credit can be spent on eligible exploration up to the end of the next calendar year under the existing "look-back" rule. Accordingly, Budget 2013 confirms that flow-through share funds raised during the first three months of 2014 can support qualifying expenses until the end of 2015.

Resolutions 12 to 18: Labour-Sponsored Venture Capital Corporations Tax Credit

12. (1) Paragraph 127.4(5)(*a*) of the Act is amended to replace “$750” with “$500”.

(2) Paragraph 127.4(5)(*a*) of the Act, as amended by subsection 12(1), is amended to replace “$500” with “$250”.

(3) Subsection 127.4(5) of the Act, as amended by subsection 12(2), is repealed.

(4) Paragraph 127.4(6)(*a*) of the Act is amended to replace “15%” with “10%”.

(5) Paragraph 127.4(6)(*a*) of the Act, as amended by subsection 12(4), is amended to replace “10%” with “5%”.

(6) Subsection 127.4(6) of the Act, as amended by subsection 12(5), is repealed.

(7) Subsections 12(1) and (4) apply to the 2015 taxation year.

(8) Subsections 12(2) and (5) apply to the 2016 taxation year.

(9) Subsections 12(3) and (6) apply to the 2017 and subsequent taxation years.

13. (1) The portion of subsection 204.81(1) of the Act before paragraph (*a*) is replaced by the following:

204.81.

(1) The Minister may register a corporation for the purposes of this Part if the corporation’s application for registration was received prior to Budget Day and if, in the opinion of the Minister, the corporation complies with the following conditions:

(2) Subsection 13(1) is deemed to have come into force on Budget Day.

14. (1) The definition “labour-sponsored funds tax credit” in subsection 211.7(1) of the Act is amended by striking out “and” at the end of paragraph (*a*) and by replacing paragraph (*b*) with the following:

(*b*) if the original acquisition of the share occurred before 2017, the amount that would be determined under subsection 127.4(6) — as that subsection read at the time of the original acquisition and if that subsection were read without reference to paragraphs 127.4(6)(*b*) and (*d*) — in respect of the share; and

(*c*) in any other case, nil.

(2) Subsection 14(1) is deemed to have come into force on Budget Day.

15. (1) Section 211.81 of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), is replaced by the following:

211.81. If a particular amount is payable under a prescribed provision of a provincial law for a taxation year of an individual as determined for the purposes of that provincial law (in this section referred to as the “relevant provincial year”), and an amount has been included in the computation of the labour-sponsored funds tax credit of the individual under subsection 127.4(6) in respect of an approved share that has been disposed of by a qualifying trust in respect of the individual, the individual shall pay a tax for the taxation year in which the relevant provincial year ends equal to the amount determined by the formula

$$A \times B / C$$

where

A is the particular amount,

B is the labour-sponsored funds tax credit in respect of the share, and

C is the tax credit provided under a law of a province in respect of any previous acquisition of the share.

(2) Subsection 15(1) is deemed to have come into force on October 24, 2012.

16. (1) Paragraph 211.9(*b*) of the Act is replaced by the following:

(*b*) the amount that is

(i) 15% of the net cost of the share on the original acquisition by the individual (or by a qualifying trust for the individual in respect of the share) if the original acquisition was made before 2015,

(ii) 10% of the net cost of the share on the original acquisition by the individual (or by a qualifying trust for the individual in respect of the share) if the original acquisition was made in 2015,

(iii) 5% of the net cost of the share on the original acquisition by the individual (or by a qualifying trust for the individual in respect of the share) if the original acquisition was made in 2016, and

(iv) in any other case, nil.

(2) Subsection 16(1) is deemed to have come into force on Budget Day.

17. (1) *The Income Tax Regulations* are amended by adding the following after section 6701:

6701.1. Notwithstanding section 6701, for the purposes of the definition "approved share" in subsection 127.4(1) of the Act and the definition "eligible investment" in subsection 204.8(1) of the Act, a corporation that submits its application for registration under a provincial statute listed in section 6701 on or after Budget Day is not a prescribed labour-sponsored venture capital corporation.

(2) Subsection 17(1) is deemed to have come into force on Budget Day.

18. The Act and the *Income Tax Regulations* are further modified in accordance with the proposals relating to labour-sponsored venture capital corporations described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Editorial Comment: Labour-sponsored venture capital corporations (LSVCCs) are a type of mutual fund corporation, sponsored by labour unions or other labour organizations. A 15% federal tax credit is available to individuals who acquire shares of an LSVCC on investments up to $5,000 each year (i.e., $750 in federal tax relief).

The 2013 Budget proposes a staged "phase out" of the LSVCC regime by reducing and ultimately eliminating the LSVCC tax credit available for investments in LSVCC shares and by eliminating the registration of new LSVCCs (or in the case of provincial LSVCCs, by not prescribing any new LSVCCs for purposes of section 6701 of the *Income Tax Regulations*).

The LSVCC Tax Credit

As part of the phase out of the LSVCC program, the LSVCC tax credit will be reduced beginning in 2015 and ultimately eliminated by 2017. Under existing subsection 127.4(6) of the Act, an investment in an "approved share" as defined in subsection 127.4(1) of the Act entitles an investor who is an individual (or, generally, an RRSP or TFSA under which the individual is an annuitant, or an RRSP under which the individual's spouse or common law partner is an annuitant that is a "spousal or common law partner plan" within the meaning of subsection 146(1), provided that the investor's spouse or common law partner is not claiming the credit) to a tax credit equal to 15% of the investor's "net cost" of the "original acquisition" (each as defined in subsection 127.4(1)) of the share, up to a maximum credit of $750 in a particular taxation year (due to the limit in paragraph 127.4(5)(*a*)). Thus, under existing rules the LSVCC tax credit is available in respect of the first $5,000 invested in an LSVCC per taxation year.

Budget Resolutions 12(1) and 12(4) apply to the 2015 taxation year. In accordance with these Resolutions, the maximum credit allowable under paragraph 127.4(5)(*a*) will be reduced from $750 to $500 and the value of the credit will be reduced from 15% to 10% under paragraph 127.4(6)(*a*). Therefore, the credit will still effectively apply to the first $5,000 invested in LSVCC shares for 2015, but at the new, lower rate.

For 2016, Resolutions 12(2) and 12(5) will reduce the maximum allowable credit to $250 and the LSVCC tax credit rate to 5%, respectively.

Effective for 2017 and future years, both subsection 127.4(5) and 127.4(6) will be repealed, thereby bringing to an end the federal LSVCC tax credit regime. It is not clear whether the provinces will eliminate their respective LSVCC regimes under the same timetable as the federal government, or at all. The 2013 Budget Overview indicates that the federal government will work with the provinces with respect to the phase-out of the federal credit.

Under Part XII.5 of the Act, where shares of an LSVCC that were acquired on or after March 6, 1996 are disposed of (including by way of redemption, acquisition or cancellation by the corporation) the LSVCC tax credit is "recovered" by way of a penalty tax under section 211.8. Where the investor claimed less than the maximum credit under subsection 127.4(6), section 211.9 provided a refund mechanism of the penalty tax imposed under section 211.8. Resolutions 14-16 propose to amend Part XII.5 of the Act to reflect the phase out of the LSVCC tax credit.

Labour-Sponsored Venture Capital Corporations

In order for a corporation to qualify as an LSVCC, the corporation must either (i) meet a number of conditions for registration under subsection 204.81(1) of the Act, or (ii) more commonly, must be registered under provincial legislation and be prescribed under section 6701 of the *Income Tax Regulations*. As part of eliminating the LSVCC regime, Resolution 13 will amend subsection 204.81(1) of the Act to provide that no new registrations under the Act will be permitted unless the application for registration was received prior to March 21, 2013. Resolution 17 includes an equivalent amendment to Part LXVII of the *Income Tax Regulations*. Effective March 21, 2013, new section 6701.1 of the *Income Tax Regulations* will provide that a corporation that submits its application for registration under one of the provincial statutes enumerated in section 6701 on or after March 21, 2103, is not a "prescribed labour-sponsored venture capital corporation".

In the 2013 Budget Overview, the federal government indicated that it will be accepting public input in drafting additional amendments to the Act related to the elimination of the LSVCC regime, including with respect to investment requirements, wind-ups and redemptions. Stakeholders are invited to submit comments by May 31, 2013.

Resolutions 19 to 22: Synthetic Dispositions

19. (1) The Act is amended by adding the following after section 80.5:

80.6.

(1) If, at any time, a synthetic disposition arrangement in respect of a property owned by a taxpayer is entered into, the taxpayer is deemed

(*a*) to have disposed of the property immediately before that time for proceeds equal to its fair market value; and

(*b*) to have reacquired the property at that time at a cost equal to its fair market value.

(2) Subsection (1) does not apply in respect of an exchange of property to which subsection 51(1) applies.

(2) Subsection 19(1) applies to agreements and arrangements entered into on or after Budget Day. Subsection 19(1) also applies to an agreement or arrangement entered into before Budget Day, the term of which is extended on or after Budget Day, as if the agreement or arrangement were entered into at the time of the extension.

20. (1) Section 112 of the Act is amended by adding the following after subsection (7):

(8) For the purposes of paragraphs (3.01)(*b*) and (3.11)(*b*), subclauses (3.2)(*a*)(ii)(C)(I) and (3.3)(*a*)(ii)(C)(I) and paragraphs (3.31)(*b*), (3.32)(*b*), (4.01)(*b*), (4.11)(*b*), (4.21)(*b*), (4.22)(*b*), (5.1)(*b*) and (5.21)(*b*), if a taxpayer is deemed to dispose of a property under subsection 80.6(1) at a particular time, or would be deemed to dispose of the property under subsection 80.6(1) at that particular time if the references to "one year" in the definition "synthetic disposition arrangement" in subsection 248(1) were "30 days", and the taxpayer did not own the property throughout the 365-day period that ended immediately before the particular time, the taxpayer is deemed not to own the property while the one or more agreements or other arrangements that resulted, or would have resulted, in the deemed disposition continue to have the effect described in paragraph (*b*) of the definition "synthetic disposition arrangement" in subsection 248(1).

(2) Subsection 20(1) is deemed to have come into force on Budget Day.

21. (1) Section 126 of the Act is amended by adding the following after subsection (4.4):

(4.5) For the purpose of determining whether the period referred to in subsection (4.2) is one year or less, if a taxpayer is deemed to dispose of a property under subsection 80.6(1) at a particular time, or would be deemed to dispose of the property under subsection 80.6(1) at the particular time, if the references to "one year" in the definition "synthetic disposition arrangement" in subsection 248(1) were "30 days", and the taxpayer acquired the property less than one year before the particular time, the taxpayer is deemed to have last acquired the property at the earlier of

(*a*) the time that is immediately before the particular time referred to in subsection (4.2), and

(*b*) the time that the one or more agreements or other arrangements that resulted, or would have resulted, in the deemed disposition no longer have the effect described in paragraph (*b*) of the definition "synthetic disposition arrangement" in subsection 248(1);

(2) Subsection 21(1) is deemed to have come into force on Budget Day.

22. (1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"synthetic disposition arrangement", in respect of a property owned by a taxpayer, means one or more agreements or other arrangements (other than a lease of tangible property or, for civil law, corporeal property) that

(*a*) are entered into by the taxpayer or by a person or partnership that does not deal at arm's length with the taxpayer, (*b*) have the effect, or would have the effect if entered into by the taxpayer instead of the person or partnership, of eliminating all or substantially all the taxpayer's risk of loss and opportunity for gain or profit in respect of the property for a period of more than one year,

(*c*) can, in respect of any agreement or arrangement entered into by a person or partnership that does not deal at arm's length with the taxpayer, reasonably be considered to have been entered into, in whole or in part, with the purpose of obtaining the effect described in paragraph (*b*), and

(*d*) do not (other than as a consequence of subsection 80.6(1)) result in a disposition of the property within one year of the time that they are entered into;

(2) Subsection 22(1) applies to agreements and arrangements entered into on or after Budget Day. Subsection 22(1) also applies to an agreement or arrangement entered into before Budget Day, the term of which is extended on or after Budget Day, as if the agreement or arrangement were entered into at the time of the extension.

Editorial Comment: A new concept has been introduced in Budget 2013 to address transactions designed to allow a taxpayer to effectively liquidate an asset having an accrued gain for tax purposes without any immediate income tax consequences.

These arrangements were quite common in sale transactions where a tax-deferred rollover for the vendor (the "Vendor") was incorporated into the planning. For example, the Vendor would sell shares or assets to a public company purchaser (the "Purchaser") in exchange for shares of the Purchaser (the "Pubco Shares") in order to defer (pursuant to section 85 or 85.1 of the Act) all or part of the gain that would otherwise be realized on the sale. The deferred gain would then be imbedded in the Pubco Shares and would be realized by the Vendor upon a subsequent disposition, assuming that the Pubco Shares maintained their value. However, the Vendor may not have wanted the economic exposure arising from changes in the value of the Pubco Shares during the period in which the tax deferral was sought.

Accordingly, the Vendor and a financial institution (the "Bank") would enter into an arrangement whereby cash would be provided to the Vendor by way of a loan (the "Loan") equal to some negotiated percentage of the current fair market value of the Pubco Shares. Contractual arrangements would be entered into at the same time which would effectively provide the Bank with a right to acquire the Pubco Shares at some time in the future (typically five or ten years after inception) for a purchase price essentially equal to the Loan, together with interest payable on the Loan. The Loan arrangement would provide that the Loan would be treated as fully paid by the Vendor when the Vendor delivered the Pubco Shares to the Bank. The Bank would also be effectively entitled to dividends paid on the Pubco Shares, if any, which would also be factored into the ultimate "pricing" of the transactions between the parties.

For income tax purposes, the disposition of the Pubco Shares would be recognized by the Vendor when the actual disposition occurred in the future (*i.e.*, when the Pubco Shares were delivered to settle the Loan). Accordingly, the economic risk to the Vendor in holding the Pubco Shares was essentially eliminated since price fluctuations in the Pubco Shares would not increase or decrease the Vendor's obligation with respect to the Loan.

A "synthetic disposition arrangement" (a new definition contained in subsection 248(1) of the Act) in respect of a property owned by a taxpayer means one or more agreements or other arrangements that (a) are entered into by the taxpayer (or by a person or partnership that does not deal at arm's-length with the taxpayer), (b) have the effect of eliminating all or substantially all the taxpayer's risk of loss and opportunity for gain or profit in respect of the property for a period of more than one year, (c) include arrangements entered by non-arm's length persons or partnerships that can be reasonably considered to have been entered into in whole or part to provide the economic consequences described in (b), and (d) do not result in an actual disposition of the property within one year of the time that they are entered into. It should be noted that this new definition of "synthetic disposition arrangement" specifically excludes leases of tangible personal property, or under civil law, corporeal property.

Two main consequences arise where a taxpayer enters into a "synthetic disposition arrangement". First, new subsection 80.6(1) provides that the property in question will be deemed to have been disposed at fair market value at such time, and reacquired with a cost equal to such fair market value (with an exception for transactions that would otherwise be governed by section 51). Second, the property will be treated as not having been owned throughout the requisite time periods for the purposes of the "stop-loss" rules contained in section 112 and the foreign tax credit rules contained in subsection 126(4.2). Furthermore, if the taxpayer later regains the risk of loss or opportunity for gain or profit, the property would be considered to be owned from that point onward for these purposes.

These new "synthetic disposition" rules will apply to agreements and arrangements entered into on or after March 21, 2013. The new rules will also apply to arrangements entered into before March 21, 2013 the term of which is extended on or after March 21, 2013 (such extended agreements will be treated as if they were entered into on the date of the extension).

Resolutions 23 to 26: Character Conversion Transactions

23. (1) Subsection 12(1) of the Act is amended by striking out "and" at the end of paragraph (z.5), by adding "and" at the end of paragraph (z.6) and by adding the following after paragraph (z.6):

(*z.7*) the total of all amounts each of which is

(i) if the taxpayer acquires a property under a derivative forward agreement in the year, the amount by which the fair market value of the property at the time it is acquired by the taxpayer exceeds the cost to the taxpayer of the property, or

(ii) if the taxpayer disposes of a property under a derivative forward agreement in the year, the amount by which the sale price of the property exceeds the adjusted cost base to the taxpayer of the property at the time it is disposed of, determined without reference to paragraph 53(1)(*t*);

(2) Subsection 23(1) applies to agreements entered into on or after Budget Day. Subsection 23(1) also applies to an agreement entered into before Budget Day, the term of which is extended on or after Budget Day, as if the agreement were entered into at the time of the extension.

24. (1) Subsection 20(1) of the Act is amended by striking out "and" at the end of paragraph (*vv*), by adding "and" at the end of paragraph (*ww*) and by adding the following after paragraph (*ww*):

(*xx*) in respect of a derivative forward agreement of a taxpayer, the amount determined by the formula

$$A - B$$

where

A is the lesser of

(*a*) the total of all amounts each of which is

(i) if the taxpayer acquires a property under the agreement in the year or a preceding taxation year, the amount by which the cost to the taxpayer of the property exceeds the fair market value of the property at the time it is acquired by the taxpayer, or

(ii) if the taxpayer disposes of a property under the agreement in the year or a preceding taxation year, the amount by which the adjusted cost base to the taxpayer of the property at the time it is disposed of, determined without reference to paragraph 53(2)(*x*), exceeds the sale price of the property, and

(*b*) the amount that is,

(i) if final settlement of the agreement occurs in the year, the amount determined under paragraph (*a*), or

(ii) in any other case, the total of all amounts included under paragraph 12(1)(z.7) in computing the taxpayer's income in respect of the agreement for the year or a preceding taxation year,

B is the total of all amounts deducted under this paragraph in respect of the agreement for a preceding taxation year.

(2) Subsection 24(1) applies to agreements entered into on or after Budget Day. Subsection 24(1) also applies to an agreement entered into before Budget Day, the term of which is extended on or after Budget Day, as if the agreement were entered into at the time of the extension.

25. (1) Subsection 53(1) of the Act is amended by striking out "and" at the end of paragraph (*q*) and by adding the following after paragraph (*r*):

(*s*) if the property was acquired under a derivative forward agreement, any amount required to be included in respect of the property under subparagraph 12(1)(z.7)(i) in computing the income of the taxpayer for a taxation year; and

(*t*) if the property is disposed of under a derivative forward agreement, any amount required to be included in respect of the property under subparagraph 12(1)(z.7)(ii) in computing the income of the taxpayer for the taxation year that includes that time.

(2) Subsection 53(2) of the Act is amended by striking out "and" at the end of paragraph (*u*) and by adding the following after paragraph (*v*):

(*w*) if the property was acquired under a derivative forward agreement, any amount deductible in respect of the property under paragraph 20(1)(*xx*) in computing the income of the taxpayer for a taxation year; and

(*x*) if the property is disposed of under a derivative forward agreement, any amount deductible in respect of the property under paragraph 20(1)(*xx*) in computing the income of the taxpayer for the taxation year that includes that time.

(3) Subsections 25(1) and (2) are deemed to have come into force on Budget Day.

26. (1) Subsection 248(1) of the Act is amended by adding the following in alphabetical order:

"derivative forward agreement", of a taxpayer, means an agreement entered into by the taxpayer to purchase or sell a capital property where

(*a*) the term of the agreement exceeds 180 days or the agreement is part of a series of agreements with a term that exceeds 180 days,

(*b*) in the case of a purchase agreement, the amount of the property to be delivered to the taxpayer on settlement, including partial settlement, of the agreement is determined, in whole or in part, by reference to an underlying interest (including a value, price, rate, variable, index, event, probability or thing) other than

(i) the value of the property,

(ii) income or capital gains in respect of the property, or

(iii) if the property is an interest in a partnership, trust or corporation, a return or distribution of capital in respect of the interest in the partnership, trust or corporation, and

(*c*) in the case of a sale agreement, the sale price of the property is determined, in whole or in part, by reference to an underlying interest (including a value, price, rate, variable, index, event, probability or thing) other than

(i) the value of the property,

(ii) income or capital gains in respect of the property, or

(iii) if the property is an interest in a partnership, trust or corporation, a return or distribution of capital in respect of the interest in the partnership, trust or corporation;

(2) Subsection 26(1) applies to agreements entered into on or after Budget Day. Subsection 26(1) also applies to an agreement entered into before Budget Day, the term of which is extended on or after Budget Day, as if the agreement were entered into at the time of the extension.

Editorial Comment: Budget 2013 addresses certain financial arrangements which have been designed to convert ordinary income into capital gains by the use of derivative contracts — which Budget 2013 describes as "character conversion transactions". The essential components of such an arrangement typically involves a forward agreement to buy or sell a capital property at a future date. However, the purchase price for the capital property is not based on its own investment performance, but referenced to some other measure.

Budget 2013 does not concede that existing arrangements of this sort actually provide the recharacterization treatment sought — however, it is stated that to avoid "time-consuming and costly" challenges, new legislation is required.

A "derivative forward agreement" (a new definition contained in subsection 248(1)) means an agreement entered into by a taxpayer to buy or sell a capital property where:

(a) the term exceeds 180 days or is part of a series of agreements which exceed 180 days,

(b) in the case of a purchase agreement, the amount of the property to be delivered to the taxpayer upon the settlement is determined in whole or part by reference to an underlying interest (including a value, price, rate, variable, index, event, probability or thing) other than (i) the value of the property, (ii) income or capital gains in respect of the property or (iii) if the property is an interest in a partnership, trust or corporation, a return or distribution of capital by such entity, and

(c) in the case of a sale agreement, the sale price of the property is determined using the same criteria as referred to in (b) above.

If a "derivative forward agreement" is found to exist, new paragraphs 12(1)(*z*.7) and , 20(1)(*xx*) will apply to cause the income or loss derived from the arrangement to be included as ordinary income or loss with respect to the property acquired or disposed. Income or loss will be computed based on the difference between the fair market value of the property and its cost — with recognition of such income or loss being at the time of acquisition, in the case of a derivative forward purchase agreement, or at the time of disposition, in the case of a derivative forward sale agreement.

To avoid double tax, appropriate adjustments will be made to the cost of such properties under new paragraphs 53(1)(*s*), 53(1)(*t*), 53(2)(*w*) and 53(2)(*x*) by increasing (or decreasing) the cost of such properties by the income inclusion (or deduction).

These new rules will apply to agreements and arrangements entered into on or after Budget Day. They will also apply to pre-Budget Day arrangements which are extended after Budget Day and such extended agreements will be treated as if they were entered into on the date of the extension.

The obvious purpose of resolution 23-26 is to prevent transactions involving the sale of property that would give rise to ordinary income from becoming sales that give rise to capital gains. Evidently section 245 is not considered adequate for this purpose.

Resolution 27: Trust Loss Trading

27. (1) The Act is amended by adding the following after section 251.1:

251.2.

(1) The definitions in this subsection apply in this section.

"beneficiary" has the same meaning as in subsection 251.1(3).

"equity" has the same meaning as in subsection 122.1(1) read without reference to paragraph (*e*) of the definition "equity" in that subsection.

"equity value" has the same meaning as in subsection 122.1(1).

"majority-interest beneficiary" has the same meaning as in subsection 251.1(3).

"majority-interest group of beneficiaries" has the same meaning as in subsection 251.1(3).

"person" includes a partnership.

"specified right", held at any time by a person in respect of a trust, means a right under a contract, in equity or otherwise, to acquire, either immediately or in the future and either absolutely or contingently, equity of the trust, or to cause the trust to redeem or cancel equity of the trust, unless the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual.

"subsidiary", of a particular person at any time, means a corporation, partnership or trust (in this definition referred to as the "subject entity") where

(*a*) the particular person holds at that time property

(i) that is equity of the subject entity, or

(ii) all or part of the fair market value of which is derived directly or indirectly from equity of the subject entity; and

(*b*) the total of the following amounts is at that time equal to more than 50% of the equity value of the subject entity:

(i) the total of all amounts each of which is the fair market value at that time of a property described in subparagraph (*a*)(i), and

(ii) the total of all amounts each of which is the portion of the fair market value at that time, of a property described in subparagraph (*a*)(ii), that is derived directly or indirectly from equity of the subject entity.

(2) For the purposes of this Act, a trust is at any time subject to a loss restriction event if

(*a*) that time is on or after Budget Day and after the time at which the trust is created; and

(*b*) at that time a person becomes a majority-interest beneficiary, or a group of persons becomes a majority-interest group of beneficiaries, of the trust.

(3) For the purposes of subsection (2), a person is deemed not to become a majority-interest beneficiary, and a group of persons is deemed not to become a majority-interest group of beneficiaries, as the case may be, of a particular trust solely because of

(*a*) the acquisition of equity of the particular trust by

(i) a particular person from another person with whom the particular person was affiliated immediately before the acquisition,

(ii) a particular person who was affiliated with the particular trust immediately before the acquisition,

(iii) an estate from an individual, if the estate arose on and as a consequence of the death of the individual and the individual contributed the equity to the estate as a consequence of the death, or

(iv) a particular person from an estate that arose on and as a consequence of the death of an individual, if the individual contributed the equity to the estate as a consequence of the death and was affiliated with the particular person immediately before the death;

(*b*) a variation in the terms of the particular trust, the satisfaction of or failure to satisfy a condition under the terms of the particular trust, the exercise by any person of or the failure by any person to exercise a power, or (without limiting the generality of the foregoing) the redemption, surrender or termination of equity of the particular trust at any time, if each majority-interest beneficiary, and each member of a majority-interest group of beneficiaries, of the particular trust immediately after that time was affiliated with the particular trust immediately before

(i) that time, or

(ii) in the case of the redemption or surrender of equity of the particular trust that was held, immediately before that time, by an estate and that was acquired by the estate from an individual as described in subparagraph (*a*)(iii), the individual's death;

(*c*) the transfer at any time of all the equity of the particular trust to a corporation, partnership or another trust (in this paragraph referred to as the "acquirer"), if

(i) the only consideration for the transfer is equity (determined without reference to paragraph (*d*) of the definition "equity" in subsection 122.1(1)) of the acquirer,

(ii) at all times before that time the acquirer

(A) never held property, or

(B) held only property having a nominal value, and

(iii) immediately after that time the acquirer is neither

(A) a subsidiary of any person, nor

(B) if the acquirer is a corporation, controlled, directly or indirectly in any manner whatever, by a person or group of persons; and

(*d*) the transfer at any time of equity of the particular trust to a corporation, partnership or another trust (in this paragraph referred to as the "acquirer"), if

(i) immediately before that time a person was a majority-interest beneficiary, or a group of persons was a majority-interest group of beneficiaries, of the particular trust,

(ii) immediately after that time the person, or group of persons, as the case may be, described in subparagraph (i) in respect of the particular trust, and no other person or group of persons, is

(A) if the acquirer is a corporation, a person by whom, or a group of persons by which, the corporation is controlled, directly or indirectly in any manner whatever,

(B) if the acquirer is a partnership, a majority-interest partner, or a majority-interest group of partners, of the partnership, and

(C) if the acquirer is a trust, a majority-interest beneficiary, or a majority-interest group of beneficiaries, of the trust, and

(iii) at no time during a series of transactions or events that includes the transfer does the person or group of persons, as the case may be, described in subparagraph (i) in respect of the particular trust, cease to be a person or group of persons described in any of clauses (ii)(A) to (C) in respect of the acquirer.

(4) For the purposes of subsection (2), and subject to subsection (3), a person is deemed to become at a particular time a majority-interest beneficiary of a particular trust if

(*a*) a particular person is at and immediately before the particular time a majority-interest beneficiary, or a member of a majority-interest group of beneficiaries, of the particular trust, and the particular person is at the particular time, but is not immediately before the particular time, a subsidiary of another person (in this paragraph referred to as the "acquirer"), unless

(i) the acquirer is immediately before the particular time affiliated with the particular trust, or

(ii) this paragraph previously applied to deem a person to become a majority-interest beneficiary of the particular trust because of the particular person becoming, as part of a series of transactions or events that includes the particular person becoming at the particular time a subsidiary of the acquirer, a subsidiary of another person that is at the particular time a subsidiary of the acquirer; and

(*b*) at the particular time, as part of a series of transactions or events, two or more persons acquire equity of the particular trust in exchange for or upon a redemption or surrender of equity of a corporation, partnership or another trust, unless

(i) a person affiliated with the corporation, partnership or other trust was immediately before the particular time a majority-interest beneficiary of the particular trust,

(ii) if all the equity of the particular trust that was acquired at or before the particular time as part of the series were acquired by one person, the person would not at the particular time be a majority-interest beneficiary of the particular trust, or

(iii) this paragraph previously applied to deem a person to become a majority-interest beneficiary of the particular trust because of an acquisition of equity of the particular trust that was part of the series.

(5) In applying this section,

(*a*) in determining whether persons are affiliated with each other

(i) section 251.1 is to be read without reference to the definition "controlled" in subsection 251.1(3),

(ii) in determining whether an individual (other than a trust) is affiliated with another individual (other than a trust), individuals connected by blood relationship, marriage or common-law partnership or adoption are deemed to be affiliated with one another, and

(iii) if, at any time as part of a series of transactions or events a person acquires equity of a corporation, partnership or trust, and it can reasonably be concluded that one of the reasons for the acquisition, or for making any agreement or undertaking in respect of the acquisition, is to cause a condition in subsection (3) or (4) regarding affiliation to be satisfied at a particular time, the condition is deemed not to be satisfied at the particular time; and

(*b*) in determining whether a particular person becomes at any time a majority-interest beneficiary, or a particular group of persons becomes at any time a majority-interest group of beneficiaries, of a trust, the fair market value of each person's equity of the trust is to be determined at and immediately before that time

(i) without reference to the portion of that fair market value that is attributable to property acquired, if it can reasonably be considered that one of the reasons for the acquisition is to cause subsection (2) not to apply,

(ii) without reference to the portion of that fair market value that is attributable to a change in the fair market value of all or part of any equity of the trust, if it can reasonably be considered that one of the reasons for the change is to cause subsection (2) not to apply, and

(iii) as if each specified right held immediately before that time by the particular person or by a member of the particular group in respect of the trust is at that time exercised, if it can reasonably be considered that one of the reasons for the acquisition of the right is to cause subsection (2) not to apply.

(6) For the purposes of this Act, if a trust is subject to a loss restriction event at a particular time on a day, the trust is deemed to be subject to the loss restriction event at the beginning of that day and not at the particular time unless the trust elects in its return of income under Part I filed for its taxation year that ends immediately before the loss restriction event not to have this subsection apply.

(2) The Act and the *Income Tax Regulations* are further modified to make such amendments as are necessary to give effect to the proposals relating to trust loss trading described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day, including amendments, to account for a trust becoming subject to a loss restriction event, to subsections 10(10) and (11) and 12(10.4), paragraph 13(7)(*f*), clause 13(21.2)(*e*)(iii)(D), subsections 13(24) and (25), paragraph 14(12)(*f*), subparagraphs 18(15)(*b*)(iii) and 18.1(10)(*b*)(ii), paragraph 37(1)(*h*), subsection 37(6.1), subparagraph 40(3.4)(*b*)(iii), paragraph 53(2)(*b.2*), paragraph (*f*) of the definition "superficial loss" in section 54, sections 66 and 80, paragraphs 80.04(4)(*h*) and 87(2.1)(*b*), subsections 111(4) to (5.5) and (12), paragraph (*c*) of the description of C in the definition "net capital loss" in subsection 111(8), paragraphs (*j*) and (*k*) of the definition "investment tax credit" in subsection 127(9), subsections 127(9.1) and (9.2), section 132.2, subsection 249(4) and section 256 of the Act and section 600 of the *Income Tax Regulations*.

(3) Subsections 27(1) and (2) apply to transactions that occur on or after Budget Day, other than transactions that the parties are obligated to complete pursuant to the terms of an agreement in writing between the parties entered into before Budget Day. Parties will be considered not to be obligated to complete a transaction if one or more of those parties may be excused from completing the transaction as a result of changes to the Act.

Editorial Comment: Various loss restriction rules under the Act prevent loss trading between persons who are not related. For example, upon the acquisition of control of a corporation, many provisions deny or restrict the utilization of certain pre-acquisition-of-control losses, credits, deductions and similar amounts in the period after the acquisition of control. The taxation year of the corporation will be deemed to have ended immediately before the acquisition of control. The denied or restricted amounts include pools such as net capital and non-capital losses, eligible capital expenditures, resource-related exploration and development expenditures, scientific research and experimental development expenditures, and investment tax credits. Certain streaming rules allow some amounts such as non-capital losses to be utilized after the acquisition of control, as long as the corporation continues to carry on the same or similar business.

Until this amendment whereby section 251.2 is to be added, there were no such rules in the Act dealing with the acquisition of control of a trust. The Budget introduces new rules for trusts that will be similar to the corporate acquisition of control rules. In essence, the amendments have as their purpose the same restrictions on trading in losses by trusts as currently exist for corporations. Evidently, the Department of Finance does not see section 245 as sufficient to prevent loss trading by trusts.

Basically, under new section 251.2, a trust will be subject to various acquisition of control provisions, including the loss streaming provisions, that currently apply to corporations (amendments will be made to those provisions to account for the new trust rules). The triggering event for the application of the provisions, termed a "loss restriction event" of the trust, will occur at any time at which a person becomes a majority-interest beneficiary or a group of persons becomes a majority-interest group of beneficiaries of the trust. The "majority-interest" condition is generally met if the person or group has an interest or interests in the income of the trust whose value is more than 50% of the value of all the interests in the income of the trust, or an interest or interests in the trust whose value is more than 50% of all of the interests in the capital of the trust.

Proposed subsection 251.2(3) provides various exceptions to the loss restriction event rules, similar in nature to the exceptions to the acquisition of corporate control rules found in subsection 256(7). The new rules, for example, will not apply solely by reason of a person acquiring an interest in the trust from an affiliated person, from a person who was affiliated with the trust, or from an estate that arose on the death of another person with whom the particular person was affiliated. As another example, the new rules will not apply solely by reason of a variation in the terms of the trust, the satisfaction or failure to satisfy a condition under the trust, or the exercise of a discretionary power at any time (among other actions), generally if each majority-interest partner or each majority-interest member of a majority-interest group immediately after the time was affiliated with the trust immediately before the time.

Proposed subsection 251.2(4) provides a rule that deems a person to become a majority-interest beneficiary of a trust (thus triggering the loss restriction event rules), generally if a person is a majority-interest beneficiary (or a member of a majority-interest group) of the particular trust, and the particular person is at the particular time, but is not immediately before the particular time, a "subsidiary" of another person ("acquirer"). Generally, this will occur if the acquirer acquires more than 50% of the equity value of the person (e.g., more than 50% of the value of the shares or interests in a particular person that is a corporation, trust, or partnership). The deeming rule does not apply if the acquirer was, immediately before the particular time, affiliated with the trust.

Where the loss restriction event occurs for a trust on a day, it is deemed to subject to the loss restriction event rule at the beginning of the day, unless the trust elects otherwise in its tax return for its taxation year that ends immediately before the loss restriction event (like the corporate rules, there will be a deemed taxation year end for the trust immediately before the loss restriction event).

The new trust rules apply to transactions that occur on or after Budget Day, other than transactions that the parties are obligated to complete pursuant to the terms of an agreement in writing between the parties entered into before Budget Day. For these purposes, parties will be considered not to be obligated to complete a transaction if one or more of those parties may be excused from completing the transaction as a result of changes to the Act.

Resolutions 28 to 30: Non-Resident Trusts

28. (1) The portion of subsection 75(2) of the Act before paragraph (*a*) is replaced by the following:

(2) If a trust, that is resident in Canada and that was created in any manner whatever since 1934, holds property on condition

(2) Paragraphs 75(3)(*c*) to (*c.3*) of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), are replaced with the following:

(*c*) by a qualifying environmental trust; or

(3) Subsections 28(1) and (2) apply to taxation years that end on or after Budget Day.

29. (1) Paragraph 94(4)(*h*) of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), is replaced by the following:

(*h*) determining whether subsection 75(2) applies in respect of the trust.

(2) Section 94 of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), is amended by adding the following after subsection (8):

(8.1) Subsection (8.2) applies at any time to a particular person, and to a particular property, in respect of a trust, if at that time

(*a*) the particular person is resident in Canada; and

(*b*) the trust holds the particular property on condition that the particular property or property substituted for the particular property

(i) may

(A) revert to the particular person, or

(B) pass to one or more persons or partnerships to be determined by the particular person, or

(ii) shall not be disposed of by the trust during the existence of the particular person, except with the person's consent or in accordance with the person's direction.

(8.2) If this subsection applies at any time to a particular person, and to a particular property, in respect of a trust, in applying this section in respect of the trust for a taxation year of the trust that includes that time

(*a*) every transfer or loan made at or before that time by the particular person (or by a trust or partnership of which the particular person was a beneficiary or member, as the case may be) of the particular property, of another property for which the particular property is a substitute, or of property from which the particular property derives, or the other property derived, its value in whole or in part, directly or indirectly, is deemed to be a transfer or loan, as the case may be, by the particular person of restricted property; and (*b*) paragraph (2)(*c*) is to be read without reference to subparagraph (2)(*c*)(iii) in its application to each transfer and loan described in paragraph (*a*).

(3) Subsections 29(1) and (2) apply to taxation years that end on or after Budget Day.

30. (1) The portion of paragraph 107(4.1)(*b*) of the Act, as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48), before subparagraph (i) is replaced by the following:

(*b*) subsection 75(2) or 94(8.2) was applicable, or subsection 75(2) would have been applicable if it were read without reference to "while the person is resident in Canada" and if subsection 75(3) as it read immediately before Budget Day were read without reference to its paragraph (*c.2*), at a particular time in respect of any property of

(2) Subsection 30(1) applies to taxation years that end on or after Budget Day.

Editorial Comment: Subsection 75(2) of the Act is an attribution rule that can apply where property of a trust is held on condition that it, or property substituted therefor, may revert to the person ("transferor") from whom was received, or pass to persons to be determined by the transferor after the creation of the trust. It can also apply if the property shall not be disposed of except with the transferor's consent or in accordance with the transferor's direction. Where the rule applies, the income from the property or a taxable capital gain from the disposition of the property are deemed to be income or taxable capital gain of the transferor.

Resolutions 28 and 29 introduce a similar rule that will apply to non-resident trusts where the transferor is resident in Canada. The rule addresses the Department's concerns relating to the recent *Sommerer* decision (2012 DTC 5126), in which the Federal Court of Appeal held that subsection 75(2) did not apply to a Canadian resident beneficiary of a non-resident trust who sold property to the trust for fair market value proceeds, despite the fact that the beneficiary could, under the terms of the trust, receive the property or property substituted for it in his capacity as beneficiary under the trust. The Court held that subsection 75(2) generally applies only to the settlor of the trust.

Proposed amendments to the non-resident trust rules in section 94 of the Act, currently found in Bill C-48, will be amended to add new subsections 94(8.1) and (9.2). Basically, the provisions will apply in circumstances similar to subsection 75(2): They will apply at a time if a person is resident in Canada, and a trust holds property on condition that the property or property substituted for it (i) may revert to the person or pass to one or more persons to be determined by the person, or (ii) shall not be disposed of by the trust except with the person's consent or in accordance with the person's direction.

Where the new provisions apply, new subsection 94(8.2) will provide that every loan or transfer at or before the time by the person of the property, of another property for which the property is a substitute, or of property from which the property derives its value, will be treated as a transfer or loan to the trust by the person of restricted property. As such, it will be treated as a contribution and the person will be a contributor for the purposes of the deemed resident trust rules of section 94, which may result in the trust, if non-resident, being deemed a trust resident in Canada and generally taxable on its worldwide income. Furthermore, since the contribution is deemed to be one of restricted property, the arm's length transfer exception to the definition of "contribution" will not apply.

To clarify that the new provisions (rather than subsection 75(2)) apply to non-resident trusts, subsection 75(2) is amended so that it applies only to trusts resident in Canada.

In addition, subsection 107(4.1) will be amended to apply to a distribution from a trust to a beneficiary or a spouse of the beneficiary who has not transferred the property to the trust where the trust was subject to subsection 75(2) or new subsection 94(8.2). Subsection 107(4.1) denies the tax-free rollover of trust property to a beneficiary, and deems the distributed property to be disposed of at fair market value. It currently applies only where subsection 75(2) formerly applied.

These amendments relating to non-resident trusts have apparently much more far reaching effects than subsection 75(2).

The above amendments apply to taxation years that end after Budget Day.

Resolution 31: Scientific Research and Experimental Development Program

31. The Act is modified to introduce a penalty of $1,000 in respect of each scientific research and experimental development program claim made by a taxpayer for which prescribed information about tax preparation is missing, incomplete or inaccurate. If a tax preparer participates in the preparation of the claim, the tax preparer will be jointly and severally, or solidarily, liable with the taxpayer for the penalty. The penalty applies in respect of claims filed on or after the later of January 1, 2014 and the day on which the enacting legislation receives royal assent.

Editorial Comment: The Budget provides $15 million in new funding to the CRA so that it can focus more resources on reviews of Scientific Research and Experimental Development ("SR&ED") program claims where the risk of non-compliance is perceived to be high and eligibility for the SR&ED program unlikely. To that end, taxpayers making claims will be required to provide more detailed information on their SR&ED program claim forms about SR&ED program tax preparers and billing arrangements. The Budget states that where one or more third parties have assisted with the preparation of a claim, the business number of each third party will be required, along with details about the billing arrangements including whether contingency fees were used and the amount of the fees payable. In instances where no third party was involved, the claimant will be required to certify that no third party assisted in any aspect of the preparation of the SR&ED program claim.

In conjunction with the new reporting requirements, Resolution 31 proposes a penalty of $1,000 in respect of each SR&ED claim made by a taxpayer for which prescribed information about tax preparation or billing arrangements is missing, incomplete or inaccurate. If a third party participates in the preparation of the claim, the third party will be jointly and severally, or solidarily, liable with the taxpayer for the penalty. The penalty applies in respect of claims filed on or after the later of January 1, 2014 and the day on which the enacting legislation receives Royal Assent.

Resolution 32: Mining Expenses Pre-Production Mine Development Expenses

32. (1) Paragraph (*g*) of the definition "Canadian exploration expense" in subsection 66.1(6) of the Act is replaced by the following:

(*g*) any expense incurred by the taxpayer after November 16, 1978 and before Budget Day for the purpose of bringing a new mine in a mineral resource in Canada, other than a bituminous sands deposit or an oil shale deposit, into production, in reasonable commercial quantities and incurred before the new mine comes into production in such quantities, including an expense for clearing, removing overburden, stripping, sinking a mine shaft or constructing an adit or other underground entry, but not including any expense that results in revenue or can reasonably be expected to result in revenue earned before the new mine comes into production in reasonable commercial quantities, except to the extent that the total of all such expenses exceeds the total of those revenues,

(2) The definition "Canadian exploration expense" in subsection 66.1(6) of the Act is amended by adding the following after paragraph (*g*.2):

(*g*.3) any expense incurred by the taxpayer that would be described in paragraph (*g*) if the reference to "Budget Day" in that paragraph were "2017" and that is incurred

(i) under an agreement in writing entered into by the taxpayer before Budget Day, or

(ii) as part of the development of a new mine, if

(A) the construction of the new mine was started by, or on behalf of, the taxpayer before Budget Day (and for this purpose construction does not include obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities), or

(B) the engineering and design work for the construction of the new mine, as evidenced in writing, was started by, or on behalf of, the taxpayer before Budget Day (and for this purpose engineering and design work does not include obtaining permits or regulatory approvals, conducting environmental assessments, community consultations or impact benefit studies, and similar activities),

(*g*.4) any expense, or portion of any expense, incurred by the taxpayer and determined by the formula

$$A \times B$$

where

A is an expense that would be described in paragraph (*g*) if the reference to "Budget Day" in that paragraph were "2018" and that is not described in paragraph (*g*.3), and

B is

(*i*) 100% if the expense is incurred before 2015,

(*ii*) 80% if the expense is incurred in 2015,

(*iii*) 60% if the expense is incurred in 2016, and

(*iv*) 30% if the expense is incurred in 2017;

(3) The description of A in the definition "eligible oil sands mine development expense" in subsection 66.1(6) of the Act is replaced by the following:

A is an expense that would be a Canadian exploration expense of the taxpayer described in paragraph (*g*) of the definition "Canadian exploration expense" if that paragraph were read without reference to "and before Budget Day" and "other than a bituminous sands deposit or an oil shale deposit", but does not include an expense that is a specified oil sands mine development expense, and

(4) Paragraph (*a*) of the definition "specified oil sands mine development expense" in subsection 66.1(6) of the Act is replaced by the following:

(*a*) would be a Canadian exploration expense described in paragraph (*g*) of the definition "Canadian exploration expense" if that paragraph were read without reference to "and before Budget Day" and "other than a bituminous sands deposit or an oil shale deposit",

(5) Subsections 32(1) to (4) are deemed to have come into force on Budget Day.

33. (1) The definition "Canadian development expense" in subsection 66.2(5) of the Act is amended by adding the following after paragraph (*c*.1):

(*c*.2) any expense, or portion of any expense, that is not a Canadian exploration expense incurred by the taxpayer on or after Budget Day for the purpose of bringing a new mine in a mineral resource in Canada, other than a bituminous sands deposit or an oil shale deposit, into production, in reasonable commercial quantities and incurred before the new mine comes into production in such quantities, including an expense for clearing, removing overburden, stripping, sinking a mine shaft or constructing an adit or other underground entry,

(2) Subsection 33(1) is deemed to have come into force on Budget Day.

Editorial Comment: Budget 2013 proposes changes to better align the deductions available for expenses in the mining sector with those available in the oil and gas sector. Pre- and post-production development expenses in the oil and gas sector are both treated as "Canadian development expenses" (CDE) and are deductible at a rate of 30 per cent per year on a declining balance basis. In contrast, in the mining sector, a pre-production mine development expense incurred for the purpose of bringing a new mine in a mineral resource in Canada into production in reasonable commercial quantities is currently characterized as a "Canadian exploration expense" (CEE) and may be deductible in full in the year incurred or carried forward indefinitely for use in future years. Budget 2013 proposes that pre-production mine development expenses described in paragraph (*g*) of the definition of CEE will be treated as CDE.

The transition from CEE to CDE will be phased in with these expenses being allocated proportionately to CEE and CDE based on the calendar year in which the expense is incurred. This measure will generally apply to expenses incurred on or after March 21, 2013 but the actual phase-in period starts in 2015 with 20% being allocated to CDE in 2015, 40% being allocated in 2016, 70% in 2017 and 100% after 2017. The existing CEE treatment will be maintained for expenses incurred before March 21, 2013 and will also apply for expenses incurred before 2017 either under a written agreement entered into by the taxpayer before March 21, 2013 or as part of the development of a mine where either the construction or the engineering and design work, as evidenced in writing, was started by the taxpayer before March 21, 2013. Budget 2013 also proposes consequential amendments to the definitions of "eligible oil sands mine development expense" and "specified oil sands mine development expense" in subsection 66.1(6) and the definition of "Canadian development expense" in subsection 66.2(5).

Budget 2013 also proposes to phase-out the accelerated capital cost allowance (CCA) for certain assets acquired for use in new mines or eligible mine expansions. This phase-out is consistent with the phase-out of accelerated CCA in the oil and gas sector that was announced in Budget 2007. The current rules permit a taxpayer to deduct up to 100 per cent of the remaining cost of eligible assets acquired for use in a new mine or eligible mine expansion, not exceeding the taxpayer's income for the year from the mining project (which is calculated after deducting regular CCA). Budget 2013 proposes to phase-out the accelerated CCA for mining (other than for bituminous sands and oil shale, for which the phase-out will be complete in 2015) over the 2017 to 2020 calendar years. This measure will generally apply to assets acquired on or after March 21, 2013. The accelerated CCA will be maintained for eligible assets acquired before March 21, 2013 and for certain assets acquired before 2018 for a new mine or a mine expansion either under a written agreement entered into by the taxpayer before March 21, 2013 or as part of the development of a new mine or as part of a mine expansion where either the construction or the engineering and design work, as evidenced in writing, was started by the taxpayer before March 21, 2013.

Resolution 34: Reserve for Future Services

34. (1) Subsection 20(7) of the Act is amended by striking out "or" at the end of paragraph (*b*), by adding "or" at the end of paragraph (*c*) and by adding the following after paragraph (*c*):

(*d*) as a reserve in respect of a reclamation obligation.

(2) Subsection 34(1) applies in respect of amounts received on or after Budget Day. However, that subsection does not apply in respect of an amount received that is directly attributable to a reclamation obligation, that was authorized by a government or regulatory authority before Budget Day and that is received

(a) under a written agreement between the taxpayer and another party (other than a government or regulatory authority) that was entered into before Budget Day and not extended or renewed on or after Budget Day; or

(b) before 2018.

Editorial Comment: Paragraph 20(1)(*m*) of the Act allows a deduction for amounts received in a year on account of goods to be delivered or services to be rendered after the end of the year. The reserve can offset the inclusion of the amount under paragraph 12(1)(*a*) or (*e*) of the Act. The reserve can generally be claimed up until the year in which the goods are delivered or the services are rendered, thus effectively deferring inclusion until the subsequent year in which the related income is earned.

There was concern that taxpayers with future reclamation obligations were claiming these reserves on the grounds that the current amounts they were receiving would be used to fund those future reclamation services, such that those amounts could be considered to be in respect of services to be rendered in a future year. In one decision involving those circumstances (*Deputy Minister of Revenue for Quebec v. La Compagnie Meloche Inc.*, 2002 DTC 7169), the Quebec Court of Appeal allowed the taxpayer to claim a reserve in respect of future reclamation of waste disposal sites for provincial tax purposes.

Although taxpayers can utilize the existing Qualifying Environmental Trust (QET) rules to set up trusts to fund future reclamation activities, the income earned in those trusts is subject to tax. On the other hand, by employing the paragraph 20(1)(*m*) reserve up until the reclamation is carried out, and thereby deferring the inclusion of the initial income used to fund the reclamation, a taxpayer could effectively earn investment income by investing initial income to fund the reclamation on a tax-free basis (see “The Case for “Reverse Depreciation” of Reclamation Costs”, 2004 *Canadian Tax Journal*, No. 1).

In order to ensure that the paragraph 20(1)(*m*) reserve does not provide relief for taxpayers who have rendered services to customers but who have future reclamation obligations (other than to the customer) arising from providing such services, an amendment is proposed to subsection 20(7) of the Act. As a result, the reserve will no longer apply in respect of reclamation obligations.

This amendment measure will apply to amounts received on or after Budget Day.

A grandfathering provision ensures that the change does not apply to amounts received that are directly attributable to future reclamation costs, that were authorized by a government or regulatory authority before Budget Day, and that are received (i) under a written agreement between the taxpayer and another party (other than a government or regulatory authority) that was entered into before Budget Day and not extended or renewed on or after Budget Day, or (ii) before 2018.

Resolution 35: Additional Deduction for Credit Unions

35. (1) Subsection 137(3) of the Act is replaced by the following:

(3) There may be deducted from the tax otherwise payable under this Part for a taxation year by a corporation that was, throughout the year, a credit union, an amount equal to the amount determined by the formula

$$A \times B \times C$$

where

A is the rate that would, if subsection 125(1.1) applied to the corporation for the year, be its small business deduction rate for the year within the meaning assigned by that subsection,

B is the amount, if any, determined by the formula

D - E

where

D is the lesser of

(*a*) the corporation's taxable income for the year, and

(*b*) the amount, if any, by which 4/3 of the corporation's maximum cumulative reserve at the end of the year exceeds the corporation's preferred-rate amount at the end of the immediately preceding taxation year,

E is the least of the amounts determined under paragraphs 125(1)(*a*) to (*c*) in respect of the corporation for the year, and

C is the percentage that is the total of

(*a*) the proportion of 100% that the number of days in the year that are before Budget Day is of the number of days in the year,

(*b*) the proportion of 80% that the number of days in the year that are on or after Budget Day and before 2014 is of the number of days in the year,

(*c*) the proportion of 60% that the number of days in the year that are in 2014 is of the number of days in he year,

(*d*) the proportion of 40% that the number of days in the year in 2015 is of the number of days in the year,

(*e*) the proportion of 20% that the number of days in the year in 2016 is of the number of days in the year, and

(*f*) if one or more days in the year are after 2016, 0%.

(2) The Act is further modified to make such amendments as are necessary to give effect to the proposals relating to the additional deduction for credit unions described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

(3) Subsections 35(1) and (2) apply to taxation years that end on or after Budget Day.

Editorial Comment: Credits unions can normally claim the small business deduction that applies to Canadian-controlled private corporations ("CCPCs"). The 17% tax deduction, applicable to the first $500,000 of active business income, results in a federal small business tax rate of 11% in respect of that income.

Furthermore, credit unions are eligible for an additional tax deduction in respect of income that is not eligible for the small business deduction. An additional deduction of 17% can apply in respect of the amount by which the lesser of (a) the corporation's taxable income for the year, and (b) the amount, if any, by which 4/3 of the corporation's maximum cumulative reserve at the end of the year (in general terms, representing certain debts owing by the credit union to its members, including deposits, and the amount of any share of any member) exceeds the corporation's preferred-rate amount at the end of the immediately preceding taxation year, exceeds (c) the corporation's active business income that was subject to the regular small business deduction.

As noted, this additional tax deduction is in addition to the regular small business deduction.

The Budget states that the additional deduction for credit unions was originally implemented to provide credit unions with access to the small business deduction similar to that for CCPCs. Since that time, the design of the small business deduction has changed significantly. As a result of those changes, the additional deduction for credit unions now provides access by credit unions to a preferential income tax rate that is not available to CCPCs. Accordingly, the Budget proposes to phase out and eliminate the additional tax deduction for credit unions.

For 2013, the additional tax deduction will be reduced to 80% of the amount otherwise calculated (as described above); for 2014 through 2016, the reduction will be reduced to 60%, 40% and 20%, for each year respectively, of the amount otherwise calculated. After 2017, the percentage will be zero such that the additional tax deduction will no longer apply. The above percentages will be pro-rated for taxation years that straddle the beginning of an affected year.

Resolutions 36 to 42: Leveraged Life Insurance Arrangements

36. (1) The portion of subparagraph 20(1)(*e.2*)(i) of the Act before clause (A) is replaced by the following:

(i) the premiums payable by the taxpayer under a life insurance policy (other than an annuity contract or LIA policy) in respect of the year, if

(2) Subparagraph 20(1)(*e.2*)(ii) of the Act is replaced by the following:

(ii) the net cost of pure insurance in respect of the year (other than in respect of a period after 2013 if the policy is a 10/8 policy), as determined in accordance with the regulations, in respect of the interest in the policy referred to in clause (i)(A),

(3) Section 20 of the Act is amended by adding the following after subsection (2):

(2.01) For the purposes of paragraphs (1)(*c*) and (*d*), interest does not include an amount that is paid or payable on or after Budget Day in respect of a period after 2013 and that is described in paragraph (*a*) of the definition "10/8 policy" in subsection 248(1).

(4) Subsections 36(1) to (3) apply to taxation years that end on or after Budget Day.

37. (1) Section 70 of the Act is amended by adding the following after subsection (5.3):

(5.31) For the purposes of subsections (5) and 104(4), the fair market value at any time of any property deemed to have been disposed of at that time as a consequence of a particular individual's death is to be determined as though the fair market value at that time of any annuity contract were the total of all amounts each of which is the amount of a premium paid on or before that time under the contract if

(*a*) the contract is, in respect of an LIA policy, a contract referred to in subparagraph (*b*)(ii) of the definition "LIA policy" in subsection 248(1); and

(*b*) the particular individual is the individual, in respect of the LIA policy, referred to in that subparagraph.

(2) Subsection 37(1) applies to taxation years that end on or after Budget Day.

38. (1) The portion of paragraph (*d*) of the definition "capital dividend account" in subsection 89(1) of the Act after subparagraph (i) is replaced by the following:

(ii) all amounts each of which is the proceeds of a life insurance policy (other than an LIA policy) of which the corporation was not a beneficiary on or before June 28, 1982 received by the corporation in the period and after May 23, 1985 in consequence of the death of any person exceeds the total of all amounts each of which is

(iii) the adjusted cost basis (within the meaning assigned by subsection 148(9)) of a policy referred to in subparagraph (i) or (ii) to the corporation immediately before the death, or

(iv) if the policy is a 10/8 policy and the death occurs after 2013, the amount outstanding, immediately before the death, of the borrowing or the policy loan, as the case may be, that is described in paragraph (*a*) of the definition "10/8 policy" in subsection 248(1) in respect of the policy,

(2) Subsection 38(1) applies to taxation years that end on or after Budget Day.

39. (1) Section 148 of the Act is amended by adding the following after subsection (4):

(5) If a policyholder has on or after Budget Day and before 2014 disposed of an interest in a 10/8 policy because of a partial or complete surrender of the policy, the policyholder may deduct in computing the policyholder's income for the taxation year in which the disposition occurs an amount that does not exceed the least of

(*a*) the amount included under subsection (1) in computing the policyholder's income for the year in respect of the disposition,

(*b*) the total of all amounts each of which is an amount, to the extent that the amount has not otherwise been included in determining an amount under this paragraph, of a payment made on or after Budget Day and before 2014 that reduces the amount outstanding of a borrowing or policy loan, as the case may be, described in paragraph (*a*) of the definition "10/8 policy" in subsection 248(1) in respect of the policy, and

(*c*) the total of all amounts each of which is an amount, to the extent that the amount has not otherwise been included in determining an amount under this paragraph, that the policyholder is entitled to receive as a result of the disposition and that is paid after Budget Day and before 2014 out of an investment account described in paragraph (*b*) of the definition "10/8 policy" in subsection 248(1) in respect of the policy.

(2) Subsection 39(1) applies to taxation years that end on or after Budget Day.

40. (1) Subsection 248(1) of the Act is amended by adding the following definitions in alphabetical order:

"LIA policy"means a life insurance policy (other than an annuity) where

(*a*) a particular person or partnership becomes obligated on or after Budget Day to repay an amount to another person or partnership (in this definition referred to as the "lender") at a time determined by reference to the death of a particular individual whose life is insured under the policy, and

(*b*) the lender is assigned an interest in

(i) the policy, and

(ii) an annuity contract the terms of which provide that payments are to continue for a period that ends no earlier than the death of the particular individual;

"10/8 policy" means a life insurance policy (other than an annuity) where

(*a*) an amount is or may become

(i) payable, under the terms of a borrowing, to a person or partnership that has been assigned an interest in the policy or in an investment account in respect of the policy, or

(ii) payable (within the meaning assigned by the definition "amount payable" in subsection 138(12)) under a policy loan (as defined in subsection 148(9)) made in accordance with the terms and conditions of the policy, and

(*b*) either

(i) the rate of interest payable on an obligation held in an investment account in respect of the policy is determined by reference to the rate of interest payable on the borrowing or policy loan, as the case may be, described in paragraph (*a*), or

(ii) the maximum amount of an investment account in respect of the policy is determined by reference to the amount of the borrowing or policy loan, as the case may be, described in paragraph (*a*);

(2) Subsection 40(1) applies to taxation years that end on or after Budget Day.

41. (1) Section 201 of the *Income Tax Regulations* is amended by adding the following after subsection (5):

(5.1) Subsection (5) applies to an insurer in respect of an LIA policy in respect of a calendar year only if

(*a*) the insurer is notified in writing — before the end of the calendar year and by, or on behalf, of the policyholder — that the policy is an LIA policy; or

(*b*) it is reasonable to conclude that the insurer knew, or ought to have known, before the end of the calendar year, that the policy is an LIA policy.

(2) Subsection 41(1) applies to taxation years that end on or after Budget Day.

42. (1) The portion of subsection 306(1) of the *Income Tax Regulations* before paragraph (*a*) is replaced by the following:

306.

(1) For the purposes of this Part and subsection 12.2(11) of the Act, "exempt policy" at any time means a life insurance policy (other than an annuity contract, LIA policy or a deposit administration fund policy) in respect of which the following conditions are met at that time:

(2) Subsection 42(1) applies to taxation years that end on or after Budget Day.

Editorial Comment: Two significant changes are proposed with respect to planning using insurance — namely, the effective elimination of "leveraged insured annuities" ("LIAs") and "10/8 arrangements" ("10/8s"). Both of these arrangements have been used extensively in the closely-held private company ("Opco") context for many years. These arrangements were typically marketed and sold on the basis that the combined current and future tax savings derived from the arrangements would substantially offset the annual expense of acquiring the insurance.

The tax savings derived from these arrangements generally depended on three key elements: (i) the deductibility of interest expense on money borrowed in connection with the arrangements, (ii) no immediate taxation of investment income earned within certain life insurance policies and annuities, and (iii) the rules which exclude the value of insurance when determining the fair market value of shares of Opco held by a shareholder (the "Shareholder") but allow for the addition of the insurance (net of certain adjustments) to Opco's capital dividend account. Additional tax savings could also be obtained in certain cases by way of a deduction of a portion of the annual insurance premium paid.

Simply put, Budget 2013 eliminates all of these tax benefits, subject to grandfathering for LIAs where all amounts were borrowed before Budget Day. Otherwise, *all* of the provisions described below are effective for taxation years which end on or after Budget Day. As a minor relieving measure, there exists a tax-neutral "unwind" provision for 10/8s (in Resolution 39) which is described in more detail below.

LIAs

LIAs were typically created using the following steps. An operating company ("Opco") would obtain a life insurance policy (the "Policy") on the life of an individual who was a shareholder of a private corporation (the "Shareholder") (or on a combination of lives, for example, jointly with the spouse of the Shareholder). Opco would also buy an annuity ("Annuity") which would provide for an annual payment to Opco during the life of the Shareholder (or other relevant lives, consistent with the Policy). The amount paid under the annuity would be sufficient to cover the insurance premium costs under the Policy. Opco would then borrow money from a financial institution (the "Lender") on an interest-bearing basis (the "Loan"). The amount of the Loan would be used to fund business operations of Opco (or investment purposes) and would be approximately equal to the initial cash outlay required to purchase the Annuity. The Policy and the Annuity would be assigned by Opco to the Lender as collateral for the obligations under the Loan.

On an annual basis, (i) Opco would deduct the interest expense paid in respect of the Loan, assuming that the borrowed funds were in fact used for the purpose of gaining or producing income; (ii) with respect to the annual payment received by Opco pursuant to the Annuity, only a certain portion would be subject to tax, based on the rules pertaining to annuities (which recognize some or all of the payment as a tax-free return of capital); and (iii) the net cost of pure insurance paid with respect to the insurance premium on the Policy would be deductible under paragraph 20(1)(*e*.2), since the Policy was assigned as collateral to the Lender. The aggregate effect of these provisions would significantly reduce the cash requirements to Opco of the arrangement.

Upon the death of the Shareholder, (i) the value of Shareholder's shares in Opco would not include the amount paid (or to be paid) under the Policy to Opco pursuant to subsection 70(5.3) in excess of the cash surrender value of the Policy and (ii) there would be added to the capital dividend account of Opco the amount paid under the Policy in excess of its "adjusted cost base" (essentially the cash surrender value of the Policy). Accordingly, the capital gain otherwise realized on the death of the Shareholder could be significantly reduced using the capital dividend account, subject to the "stop-loss" rules. Therefore, these benefits, when combined with the annual tax savings, created an attractive result.

The Budget proposes to do away with essentially all of the above by first creating a new definition of "LIA policy" which means a policy where (a) a person becomes obligated **on or after Budget Day** to repay a loan at a time determined by reference to the death of an individual whose life is insured under the policy, and (b) the lender is assigned an interest in the policy and an annuity contract which provides for payments under the annuity to continue for a period that ends no earlier than the death of the particular individual.

If an "LIA policy" exists, then (i) amended subparagraph 20(1)(*e*.2)(i) will result in no deduction with respect to the premium paid, (ii) new subsection 70(5.31) will provide that the amounts paid to acquire the annuity will be included in computing the fair market value of shares deemed to have been disposed of on the particular individual's death, (iii) amended paragraph (*b*) of the definition of "capital dividend account" will apply to ensure that no amount is added to the capital dividend account with respect to the LIA policy, and (iv) amendments to subsection 306(1) of the *Income Tax Regulations* will apply so that the LIA policy will not be an "exempt policy", so that income accruing on an annual basis will be subject to taxation. (Also, certain reporting requirements will be imposed on insurers with respect to LIA policies.)

It is interesting to note that there is no specific new provision dealing with the deductibility of interest incurred within LIA policy arrangements — which is in contrast to the changes for 10/8s discussed below.

10/8s

This arrangement created many, if not all, of the tax benefits described above for LIAs and was designed using the same principles.

Generally, the taxpayer would acquire a life insurance policy and borrow from a lender using the policy as collateral. Alternatively, the policy itself would provide for the ability to receive a "policy loan". The borrowed funds would be invested so as to ensure that the interest expense would be deductible pursuant to paragraph 20(1)(*c*). The net rate of interest on the borrowed funds would typically be set at 10%.

The policy would have an investment account associated with it and an amount approximating the amount of the borrowed funds would be deposited into it — the amount of the allowable deposit would be net determined by reference to the regulations pertaining to the insurance policy itself. The net rate of return paid on the funds in the investment account would typically be 8%.

As a result, the 10% interest expense on the borrowed funds would be deductible, while the 8% income earned within the policy would not be taxable since the policy was an "exempt policy". In certain cases, it was also possible to obtain a deduction for the net cost of pure insurance under paragraph 20(1)(*e*.2). A further result of this arrangement would be to effectively create a larger capital dividend account upon the death of the insured due to the amount borrowed which was effectively added to the insurance proceeds payable on the death of the insured.

Perhaps to reduce the need for CRA to pursue costly and time-consuming challenges to these arrangements, new rules are being introduced to prevent these arrangements from providing the intended tax results in the future. The changes will generally be effective for taxation years that end on or after Budget Day, thereby putting an end to the intended tax benefits associated with 10/8s.

A policy will be a "10/8 policy" (a definition to be added to subsection 248(1)) where (a) an amount is (i) payable under the terms of a borrowing to a person or partnership that has been assigned an interest in the policy or the investment account in respect of the policy, or (ii) payable under a policy loan, and (b) either (i) the rate of interest paid on the amount in the investment account is determined by reference to the rate payable on the borrowing or policy loan, or (ii) the maximum amount of the investment account in respect of the policy is determined by reference to the amount of the borrowing or policy loan described in (a).

Where a "10/8 policy" exists, the following results occur: (i) new paragraph 20(1)(*e*.2)(ii) will deny any deduction on account of the net cost of pure insurance with respect to a period after 2013, (ii) new subsection 20(2.01) will provide that for the purposes of paragraphs 20(1)(*c*) and (*d*), the amount paid on account of the borrowing or policy loan for a period after 2013 is not considered to be interest, and (iii) the addition to the capital dividend account as a result of the death of the individual after 2013 will be reduced by the amount of borrowing or policy loan in respect to the policy outstanding at such time (pursuant to the amended paragraph (*d*) of the definition of "capital dividend account").

A relieving provision is included to allow for some relief where a 10/8 is wound up on or after Budget Day and before 2014. Generally, where a policy is surrendered, an income inclusion is triggered pursuant to subsection 148(1). New subsection 148(5) will allow for a special deduction to offset this income inclusion with respect to a 10/8 policy equal to the least of: (a) the entire amount included in subsection 148(1) as a result of the disposition of the 10/8 policy, (b) the total of all amounts paid to reduce a borrowing or a policy loan outstanding and (c) the total of the amount that the policyholder is entitled to receive as a result of the disposition that has been paid out of the investment account on or after Budget Day and before 2014.

Resolution 43: Restricted Farm Losses

(1) The portion of subsection 31(1) of the Act before paragraph (*a*) is replaced by the following:

31.

(1) If a taxpayer's chief source of income for a taxation year is neither farming nor a combination of farming and some other source of income that is a subordinate source of income for the taxpayer, then for the purposes of sections 3 and 111 the taxpayer's loss, if any, for the year from all farming businesses carried on by the taxpayer shall be deemed to be the total of

(2) Clause 31(1)(*a*)(ii)(B) of the Act is replaced by the following:

(B) $15,000, and

(3) Subsections 43(1) and (2) apply to taxation years that end on or after Budget Day.

Editorial Comment: Restricted farm loss (RFL) provisions apply in situations where a taxpayer incurs a loss from farming, unless his/her chief source of income is from farming or a combination of farming and some other form of income. Losses so applied are limited to $8,750 ($2,500 plus 1/2 of the next $12,500). This provision was dealt with by the Supreme Court of Canada in *Moldowan v. the Queen* (1978) 1 SCR 480 (77 DTC 5213). Farm losses incurred in one year in excess of these amounts can be carried forward for 20 years and offset against farming income.

In 2012, the Supreme Court of Canada decided in *The Queen v. Craig* 2012 SCC 43 (2012 DTC 5115), that farm losses would not be subject to the RFL provisions in situations where farming meets the chief source of income test even though another source of income is greater than income from farming. As a result of the *Craig* decision, amendments are proposed to ensure that the RFL provisions will apply in situations where another source of income is greater than income from farming.

These provisions will apply to taxation years that end on or after Budget Day. As well, the maximum amount of a loss that can be claimed in any one year is being increased to $17,500 (being $2,500 plus 1/2 of the next $30,000).

Resolutions 44 to 46: Corporate Loss Trading

44. (1) Paragraph 87(2)(*g*.1) of the Act is replaced by the following:

(*g.1*) for the purposes of sections 12.4 and 26, subsection 97(3) and section 256.1, the new corporation is deemed to be the same corporation as, and a continuation of, each predecessor corporation;

(2) Subsection 44(1) is deemed to have come into force on Budget Day.

45. (1) The portion of subsection 256(8) of the Act after paragraph (*e*) is replaced by the following:

the taxpayer is deemed to be in the same position in relation to the control of the corporation as if the right were immediate and absolute and as if the taxpayer had exercised the right at that time for the purpose of determining whether control of a corporation has been acquired for the purposes of subsections 10(10) and 13(24), section 37, subsections 55(2), 66(11), (11.4) and (11.5), 66.5(3), 66.7(10) and (11), section 80, paragraph 80.04(4)(*h*), subparagraph 88(1)(*c*)(vi), paragraph 88(1)(*c.3*), subsections 88(1.1) and (1.2), sections 111 and 127 and subsections 181.1(7), 190.1(6) and 249(4), and in determining for the purpose of section 251.1 whether a corporation is controlled by any other person or group of persons.

(2) Subsection 45(1) is deemed to have come into force on Budget Day.

46. (1) The Act is amended by adding the following after section 256:

256.1.

(1) The definitions in this subsection apply in this section.

"attribute trading restriction" means a restriction on the use of a tax attribute arising on the application, either alone or in combination with other provisions, of any of this section, subsections 10(10), 13(21.2) and (24) and 14(12), section 37, subsections 40(3.4), 66(11.4) and (11.5), 66.7(10) and (11), 69(11) and 88(1.1) and (1.2), sections 111 and 127 and subsections 181.1(7), 190.1(6), 249(4) and 256(7).

"person" includes a partnership.

"specified provision" means any of subsections 10(10) and 13(24), paragraph 37(1)(*h*), subsections 66(11.4) and (11.5), subsections 66.7(10) and (11) and 111(4), (5), (5.1), (5.2) and (5.3), paragraphs (*j*) and (*k*) of the definition "investment tax credit" in subsection 127(9), subsections 181.1(7) and 190.1(6) and any provision of similar effect.

(2) Subsection (3) applies at a particular time in respect of a corporation if

(*a*) shares of the capital stock of the corporation held by a person, or the total of all shares of the capital stock of the corporation held by members of a group of persons, as the case may be, have at the particular time a fair market value that exceeds 75% of the fair market value of all the shares of the capital stock of the corporation;

(*b*) shares, if any, of the capital stock of the corporation held by the person, or the total of all shares of the capital stock of the corporation held by members of the group, have immediately before the particular time a fair market value equal to or less than 75% of the fair market value of all the shares of the capital stock of the corporation;

(*c*) the person or group does not control the corporation at the particular time; and

(*d*) it is reasonable to conclude that one of the main reasons that the person or group does not control the corporation is to avoid the application of one or more specified provisions.

(3) If this subsection applies at a particular time in respect of a corporation, then for the purposes of the attribute trading restrictions,

(*a*) the person or group referred to in subsection (2) is deemed to acquire control of the corporation, and each corporation controlled by the corporation, at the particular time and not at any time after the particular time solely because this paragraph applied at the particular time; and (*b*) during the period that the condition in paragraph (2)(*a*) is satisfied, each corporation referred to in paragraph (*a*) — and any corporation incorporated or otherwise formed subsequent to that time and controlled by that corporation — is deemed not to be related to, or affiliated with, any person to which it was related to, or affiliated with, immediately before paragraph (*a*) applies.

(4) For the purposes of applying paragraph (2)(*a*) in respect of a person or a group of persons,

(*a*) if it is reasonable to conclude that one of the reasons that one or more transactions or events occur is to cause a person, or a group of persons, not to hold shares having a fair market value that exceed 75% of the fair market value of all the shares of the capital stock of a corporation, the paragraph is to be applied without reference to those transactions or events; and

(*b*) the person, or each member of the group, is deemed to have exercised each right that is held by the person or a member of the group and that is referred to in paragraph 251(5)(*b*) in respect of a share of the corporation referred to in paragraph (2)(*a*).

(5) For the purposes of subsections (2) to (4), if the fair market value of the shares of the capital stock of a corporation is nil at any time, then for the purpose of determining the fair market value of those shares, the corporation is deemed, at that time, to have assets net of liabilities equal to $100,000 and to have $100,000 of income for the taxation year that includes that time.

(6) If, at any time as part of a transaction or event or series of transactions or events control of a particular corporation is acquired by a person, or a group of persons, and it can reasonably be concluded that one of the main reasons for the acquisition of control is so that a specified provision does not apply to one or more corporations, the attribute trading restrictions are deemed to apply to each of those corporations as if control of each such corporation is acquired at that time.

(2) Subsection 46(1) is deemed to have come into force on Budget Day.

(3) Notwithstanding subsection 46(2), subsection 46(1) does not apply to an event or transaction that occurs on or after Budget Day pursuant to an obligation created by the terms of an agreement in writing entered into between parties before Budget Day. For the purposes of this subsection, parties will be considered not to be obligated if one or more of those parties may be excused from fulfilling the obligation as a result of changes to the Act.

Editorial Comment: Various loss restriction rules under the Act apply where control of a corporation is acquired. The aim of the rules is to prevent loss trading between non-related parties.

Upon the acquisition of control of a corporation, most of the rules either deny or restrict the utilization of certain pre-acquisition-of-control losses, credits, deductions and similar amounts in the period after the acquisition of control. The denied or restricted amounts include pools such as net capital and non-capital losses, eligible capital expenditures, resource-related exploration and development expenditures, scientific research and experimental development expenditures, and investment tax credits, among others.

Control of a corporation generally means ownership of such number of shares as carry the right to a majority of votes in the election of the board of directors.

In the Budget, concern is expressed about over transactions that have avoided the loss restriction rules by avoiding an acquisition of control through the acquisition of a significant amount of non-voting shares. The Budget provides one example: “Under one such transaction, a profitable corporation (Profitco) transfers, directly or indirectly, income-producing property to an unrelated corporation with loss pools (Lossco) in return for shares of Lossco. Profitco seeks to avoid acquiring control of Lossco because that would result in restrictions being imposed on the subsequent use of those loss pools. Profitco acquires shares of Lossco that represent more than 75 per cent (often greater than 90 per cent) of the fair market value of all Lossco's shares, but that — in order to avoid an acquisition of control and the attendant tax consequences do not give Profitco voting control of Lossco. Lossco uses its loss pools to shelter from tax all or part of the income derived from the property. Lossco then pays Profitco tax-free inter-corporate dividends."

As a result, new subsections 256.1(2) and (3) of the Act deem control of a corporation (acquired corporation) to be acquired at a particular time when shares in the corporation are acquired by a person or group of persons and the acquisition results in the person or group owning shares with a combined value of more than 75% of the fair market value of all of the acquired corporation's shares (if they owned less than 75% immediately before the particular time). The deemed acquisition of control will be relevant in the application of various "attribute trading restrictions", defined in new subsection 256.1(1) as restrictions on the use of a tax attribute (such as a loss, credit, etc.) under various loss restriction provisions in the Act (which are listed in the definition). Basically, this means that going over the 75% threshold has the same effect as an actual acquisition of control.

The new provisions will apply only if the person or group did not otherwise control the acquired corporation at the particular time. Furthermore, the rule will apply only if it is reasonable to conclude that one of the main reasons the person or group did not acquire control of the corporation was to avoid the application of one or more "specified provisions" (the various listed loss restriction provisions).

Where the rule applies, the person or group will also be deemed to acquire control of each corporation controlled by the acquired corporation. Furthermore, once the 75% ownership threshold is met, each of these corporations, and any future corporation controlled by these corporations, is deemed not to be related to or affiliated with any person to which it was related or affiliated immediately before the 75% threshold was met. Presumably, one of the reasons for this is to prevent the application of the related party exceptions to the regular acquisition of control rules under subsection 256(7).

An anti-avoidance rule provides that if it is reasonable to conclude that one of the reasons that one or more transactions or events occur is to cause a person, or a group of persons, not to hold shares having a fair market value that exceed 75% of the fair market value of all the shares of the capital stock of a corporation, those transactions or events are to be ignored in determining whether the 75% threshold has been met. Another rule provides that, for the purposes of the 75% threshold, each person owning options to acquire shares in the corporation is deemed to own those shares.

The new rules come into force on Budget Day. However, they do not apply to an event or transaction that occurs on or after Budget Day pursuant to an obligation created by the terms of an agreement in writing entered into between parties before Budget Day. For these purposes, parties will be considered not to be obligated if one or more of those parties may be excused from fulfilling the obligation as a result of changes to the Act.

Resolution 47: International Electronic Funds Transfers

47. The *Income Tax Act, Excise Act, 2001* and *Excise Tax Act* are modified in accordance with the proposals relating to the reporting of international electronic funds transfers described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Editorial Comment: The Budget contains several provisions to enable the CRA to be more aggressive in tackling issues of international tax avoidance.

Beginning in 2015, all banks, credit unions, caisses populaires, trust and loan companies, money service businesses and casinos are required to report all international electronic funds transfers of $10,000 or more. These institutions will be required to report to the CRA within five working days of the transfer and include the amount of the transfer, the transferor, the transferee, the facility acting as intermediary and the details of the transaction itself.

Corresponding changes will be made to the *Income Tax Act*, the *Excise Tax Act* as well as the *Excise Act 2001.*

Resolution 48: Information Requirements Regarding Unnamed Persons

48. (1) The portion of subsection 231.2(3) of the Act before paragraph (*a*) is replaced by the following:

> (3) A judge of the Federal Court may, on application by the Minister and subject to such conditions as the judge considers appropriate, authorize the Minister to impose on a third party a requirement under subsection (1) relating to an unnamed person or more than one unnamed person (in this section referred to as the "group") where the judge is satisfied by information on oath that

(2) Subsections 231.2(4) to (6) of the Act are repealed.

(3) Subsections 48(1) and (2) apply to applications made by the Minister of National Revenue after royal assent to the enacting legislation.

Editorial Comment: As part of its International tax avoidance measures, the CRA will be required to give notice to third parties at the time it initially seeks a court order from a Federal Court Judge, so as to streamline the court order process. This will eliminate the ability of the third party to seek a review of the issuance of a court order on an *ex parte* basis. To challenge a court order, the third party will now be required to make representation at the original hearing of the application for the order, thus eliminating the need for a review.

This measure will apply once the legislation receives Royal Assent.

Resolution 49: Stop International Tax Evasion Program

49. The Act is modified in accordance with the proposals relating to the Stop International Tax Evasion Program described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Editorial Comment: The CRA is introducing an incentive to individuals who provide them with information on major international tax non-compliance that results in the collection of taxes due. This will not apply to individuals who have been convicted of tax evasion in the case that they are reporting, or do not meet other criteria of the program. All incentives paid under this program must be reported as income for tax purposes. Individuals will be required to enter into a contract with the CRA to provide them with information and this information must result in a minimum federal tax recovery of $100,000 of additional assessments or reassessments. Incentives will be paid at the rate of 15% of the federal tax collected. Only transactions conducted outside Canada or partially outside Canada and involving foreign property are eligible for the program.

Further details regarding this program will be forthcoming in the near future.

Resolutions 50 to 51: Thin Capitalization Rules

50. (1) Section 12 of the Act is amended by adding the following after subsection (2.01), as proposed by the *Technical Tax Amendments Act, 2012* (Bill C-48):

(2.02) For the purposes of this Act, if an amount is included in computing the income of a taxpayer for a taxation year because of paragraph (1)(*l*.1) in respect of interest that is deductible by a partnership in computing its income from a particular source or from sources in a particular place, the amount is deemed to be from the particular source or from sources in the particular place, as the case may be.

(2) Subsection 50(1) applies to taxation years that begin after 2013.

51. (1) Subsection 18(4) of the Act is replaced by the following:

(4) Notwithstanding any other provision of this Act (other than subsection (8)), in computing the income for a taxation year of a corporation or a trust from a business (other than the Canadian banking business of an authorized foreign bank) or property, no deduction shall be made in respect of that proportion of any amount otherwise deductible in computing its income for the year in respect of interest paid or payable by it on outstanding debts to specifiednon-residents that

(*a*) the amount, if any, by which

(i) the average of all amounts each of which is, in respect of a calendar month that ends in the year, the greatest total amount at any time in the month of the outstanding debts to specified non-residents of the corporation or trust,

exceeds

(ii) 1.5 times the equity amount of the corporation or trust for the year,

is of

(*a*) the amount determined under subparagraph (*a*)(i) in respect of the corporation or trust for the year.

(2) Paragraph (*a*) of the definition "outstanding debts to specified non-residents" in subsection 18(5) of the Act and the portion of that definition before paragraph (*a*) are replaced by the following:

"outstanding debts to specified non-residents", of a corporation or trust at any particular time in a taxation year, means

(*a*) the total of all amounts each of which is an amount outstanding at that time as or on account of a debt or other obligation to pay an amount

(i) that was payable by the corporation or trust to a person who was, at any time in the year,

(A) a specified non-resident shareholder of the corporation or a specified non-resident beneficiary of the trust, or

(B) a non-resident person who was not dealing at arm's length with a specified shareholder of the corporation or a specified beneficiary of the trust, as the case may be, and

(ii) on which any amount in respect of interest paid or payable by the corporation or trust is or would be, but for subsection (4), deductible in computing the income of the corporation or trust for the year,

(3) Subsection 18(5) of the Act is amended by adding the following in alphabetical order:

"beneficiary" has the same meaning as in subsection 108(1);

"equity amount", of a corporation or trust for a taxation year, means

(*a*) in the case of a corporation resident in Canada, the total of

(i) the retained earnings of the corporation at the beginning of the year, except to the extent that those earnings include retained earnings of any other corporation,

(ii) the average of all amounts each of which is the corporation's contributed surplus (other than any portion of that contributed surplus that arose in connection with an investment, as defined in subsection 212.3(10), to which subsection 212.3(2) applies) at the beginning of a calendar month that ends in the year, to the extent that it was contributed by a specified non-resident shareholder of the corporation, and

(iii) the average of all amounts each of which is the corporation's paid-up capital at the beginning of a calendar month that ends in the year, excluding the paid-up capital in respect of shares of any class of the capital stock of the corporation owned by a person other than a specified non-resident shareholder of the corporation,

(*b*) in the case of a trust resident in Canada, the amount, if any, by which

(i) the total of

(A) the average of all amounts each of which is the total amount of all equity contributions to the trust made before the beginning of a calendar month that ends in the year, to the extent that the contributions were made by a specified non-resident beneficiary of the trust, and

(B) the tax-paid earnings of the trust for the year,

exceeds

(ii) the average of all amounts each of which is the total of all amounts that were paid or became payable by the trust to a beneficiary of the trust in respect of the beneficiary's interest under the trust before the beginning of a calendar month that ends in the year except to the extent that the amount is

(A) included in the beneficiary's income for a taxation year because of subsection 104(13),

(B) an amount from which tax was deducted under Part XIII because of paragraph 212(1)(*c*), or

(C) paid or payable to a person other than a specified non-resident beneficiary of the trust, and

(*c*) in the case of a corporation or trust that is not resident in Canada, 40% of the amount, if any, by which

(i) the average of all amounts each of which is the cost of a property, other than an interest as a member of a partnership, owned by the corporation or trust at the beginning of a calendar month that ends in the year that is,

(A) in the case of a corporation or trust that carries on business in Canada, used by it in the year in, or held by it in the year in the course of, carrying on business in Canada, and

(B) in the case of a corporation or trust that files a return under this Part in accordance with subsection 216(1) in respect of the year, an interest in real property, or a real right in immovables, in Canada, or an interest in, or for civil law a right in, timber resource properties and timber limits, in Canada,

exceeds

(ii) the average of all amounts each of which is the total of all amounts outstanding at the beginning of a calendar month that ends in the year as, or on account of, a debt or other obligation to pay an amount that was payable by the corporation or trust other than a debt or obligation that is included in the outstanding debts to specified non-residents of the corporation or trust;

"equity contribution", to a trust, means a transfer of property to the trust that is made

(*a*) in exchange for an interest as a beneficiary under the trust,

(*b*) in exchange for a right to acquire an interest as a beneficiary under the trust, or

(*c*) for no consideration by a person beneficially interested in the trust;

"specified beneficiary", of a trust at any time, means a person who at that time, either alone or together with persons with whom that person does not deal at arm's length, has an interest as a beneficiary under the trust with a fair market value that is not less than 25% of the fair market value of all interests as a beneficiary under the trust and for the purpose of determining whether a particular person is a specified beneficiary of a trust,

(*a*) if the particular person, or a person with whom the particular person does not deal at arm's length, has at that time a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently to, or to acquire, an interest as a beneficiary under the trust, the person is deemed at that time to own the interest,

(*b*) if the particular person, or a person with whom the particular person does not deal at arm's length, has at that time a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently to cause a trust to redeem, acquire or terminate any interest in it as a beneficiary (other than an interest held by the particular person or a person with whom the particular person does not deal at arm's length), the trust is deemed at that time to have redeemed, acquired or terminated the interest, unless the right is not exercisable at that time because the exercise of the right is contingent on the death, bankruptcy or permanent disability of an individual, and

(*c*) if the amount of income or capital of the trust that the particular person, or a person with whom the particular person does not deal at arm's length, may receive as a beneficiary of the trust depends on the exercise by any person of, or the failure by any person to exercise, a discretionary power, that person is deemed to have fully exercised, or to have failed to exercise, the power, as the case may be;

"specified non-resident beneficiary", of a trust at any time, means a specified beneficiary of the trust who at that time is a non-resident person;

"tax-paid earnings", of a trust resident in Canada for a taxation year, means the total of all amounts each of which is the amount, if any, in respect of a particular taxation year of the trust that ended before the year determined by the formula

$$A - B$$

where

A is the taxable income of the trust under this Part for the particular year, and

B is the total of tax payable under this Part by the trust, and all income taxes payable by the trust under the laws of a province, for the particular year;

(4) Subsections 18(5.1) and (6) of the Act are replaced by the following:

(5.1) For the purposes of subsections (4) to (6), if

(*a*) a particular person would, but for this subsection, be a specified shareholder of a corporation or a specified beneficiary of a trust at any time,

(*b*) there was in effect at that time an agreement or arrangement under which, on the satisfaction of a condition or the occurrence of an event that it is reasonable to expect will be satisfied or will occur, the particular person will cease to be a specified shareholder of the corporation or a specified beneficiary of the trust, and

(*c*) the purpose for which the particular person became a specified shareholder or specified beneficiary was the safeguarding of rights or interests of the particular person or a person with whom the particular person is not dealing at arm's length in respect of any indebtedness owing at any time to the particular person or a person with whom the particular person is not dealing at arm's length,

the particular person is deemed not to be a specified shareholder of the corporation or a specified beneficiary of the trust, as the case may be, at that time.

(5.2) For the purposes of subsections (4) to (6), a non-resident corporation is deemed to be a specified shareholder of itself and a non-resident trust is deemed to be a specified beneficiary of itself.

(5.3) For the purposes of subparagraph (*c*)(i) of the definition "equity amount" in subsection (5),

(*a*) if a property is partly used or held by a taxpayer in a taxation year in the course of carrying on business in Canada, the cost of the property to the taxpayer is deemed for the year to be equal to the same proportion of the cost to the taxpayer of the property (determined without reference to this subsection) that the proportion of the use or holding made of the property in the course of carrying on business in Canada in the year is of the whole use or holding made of the property in the year, and

(*b*) if a corporation or a trust is deemed to own a portion of a property of a partnership because of subsection (7), at any time,

(i) the property is deemed to have, at that time, a cost to the corporation or trust equal to the same proportion of the cost of the property to the partnership as the proportion of the debts and other obligations to pay an amount of the partnership allocated to it under subsection (7) is of the total amount of all debts and other obligations to pay an amount of the partnership, and

(ii) in the case of a partnership that carries on business in Canada, the corporation or trust is deemed to use or hold the property in the course of carrying on business in Canada to the extent the partnership uses or holds the property in the course of carrying on business in Canada for the fiscal period of the partnership that includes that time.

(5.4) For the purposes of this Act, a trust resident in Canada may designate in its return of income under this Part for a taxation year that all or any portion of an amount paid or credited as interest by the trust, or by a partnership, in the year to a non-resident person is deemed to be income of the trust that has been paid to the non-resident person as a beneficiary of the trust, and not to have been paid or credited by the trust or the partnership as interest, to the extent that an amount in respect of the interest (*a*) is included in computing the income of the trust for the year under paragraph 12(1)(*l*.1); or

(*b*) is not deductible in computing the income of the trust for the year because of subsection (4).

(6) If any loan (in this subsection referred to as the “first loan”) has been made

(*a*) by a specified non-resident shareholder of a corporation or a specified non-resident beneficiary of a trust, or

(*b*) by a non-resident person who was not dealing at arm’s length with a specified shareholder of a corporation or a specified non-resident beneficiary of a trust,

to another person on condition that a loan (in this subsection referred to as the “second loan”) be made by any person to a particular corporation or trust, for the purposes of subsections (4) and (5), the lesser of

(*c*) the amount of the first loan, and

(*d*) the amount of the second loan

is deemed to be a debt incurred by the particular corporation or trust to the person who made the first loan.

(5) The portion of paragraph 18(7)(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) to owe the portion (in this subsection and paragraph 12(1)(*l*.1) referred to as the “debt amount”) of each debt or other obligation to pay an amount of the partnership and to own the portion of each property of the partnership that is equal to

(6) Subsections 51(1) to (5) apply to taxation years that begin after 2013 except that if a trust that is resident in Canada on Budget Day elects in writing and files the election with the Minister of National Revenue on or before the trust’s filing-due date for its first taxation year that begins after 2013,

(a) for the purpose of determining the trust’s equity amount, as defined in subsection 18(5) of the Act, as enacted by subsection 51(3), the trust is deemed

(i) to not have received any equity contributions, as defined in subsection 18(5) of the Act, as enacted by subsection 51(3), before Budget Day,

(ii) to not have paid or made payable any amount to a beneficiary of the trust before Budget Day, and

(iiii) to have tax-paid earnings, as defined in subsection 18(5) of the Act, as enacted by subsection 51(3), of nil for each taxation year that ends before Budget Day, and

(b) each beneficiary of the trust at the beginning of Budget Day is deemed to have made an equity contribution at that time to the trust equal to the amount determined by the formula

$$A/B \times (C - D)$$

where

A is the fair market value of the beneficiary’s interest as a beneficiary under the trust at that time,

B is the fair market value of all the beneficial interests under the trust at that time,

C is the total fair market value of all the properties of the trust at that time, and

D is the total amount of the trust's liabilities at that time.

Editorial Comment: Budget 2013 proposes to extend Canada's "thin capitalization rules" to trusts that are resident in Canada and non-resident corporations or trusts that carry on business in Canada. Under current legislation, the thin capitalization rules apply only to corporations resident in Canada or a partnership of which a corporation resident in Canada is a member.

Background

In general, subsection 18(4) of the Act limits the deductibility of interest paid to certain related non-residents by a corporation resident in Canada or a partnership of which such a corporation is a member where the interest bearing debt of that corporation (including a pro rata amount of the debt of a partnership) exceeds 1.5 times the corporation's "equity" as defined for these purposes. Resolution 51 will repeal existing subsection 18(4).

The New Thin Capitalization Regime

New subsection 18(4) will provide that, in computing the income of a corporation or a trust from a business (excluding the Canadian banking business of an authorized foreign bank) or property, a pro rata denial of the interest deductibility is required in respect of otherwise deductible interest paid or payable by it on "outstanding debts to specified non-residents" where the average of all amounts each of which is, in respect of a calendar month that ends in the year, the greatest total amount at any time in the month of the outstanding debts to specified non-residents exceeds 1.5 times the "equity amount" of the corporation or trust for the year.

New subsection 18(4) includes a number of changes. First, the rules now apply to trusts. Second, the residence of the corporation (or trust) seeking to claim an interest deduction is no longer relevant — non-resident trusts and corporations with Canadian operations will now be subject to Canadian thin capitalization rules effective for tax years beginning after 2013 (subject to elective rules applicable to a Canadian-resident trusts, discussed below).

A modified definition of "outstanding debts to specified non-residents" for purposes of subsection 18(5) is introduced in order to include amounts owed by a trust. Under the modified definition, "outstanding debts to specified non-residents" of a corporation or trust will include amounts on account of a debt or other obligation to a pay an amount to a person who was a specified non-resident shareholder of the corporation or a specified non-resident beneficiary of the trust, or any non-resident person not dealing at arm's length with a specified non-resident shareholder of the corporation or specified non-resident beneficiary of the trust, as the case may be.

A number of new definitions will be added to subsection 18(4) in order to extend the thin capitalization rule to trusts.

Beneficiary

The existing definition of beneficiary in subsection 108(1) of the Act will be incorporated by reference to subsection 18(5).

Equity Amount

"Equity amount" is a new defined term, effectively replacing existing clauses 18(4)(*a*)(ii)(A)–(C) in defining the "equity" element of the thin capitalization ratio. Pursuant to paragraph (a) of the new definition, the old rules in clauses 18(4)(*a*)(ii)(A)–(C) will apply in determining the equity amount of a corporation.

In determining the equity amount of a trust resident in Canada, paragraph (b) of the definition is applicable. That paragraph provides that it is the amount if any, by which (i) the total of (A) the average of all amounts each of which is the total amount of all "equity contributions" (see below) to the trust made before the beginning of a calendar month that ends in the year, and (B) the "tax-paid earnings" (see below) of the trust for the year, exceeds (ii) the average of all amounts each of which is the total of all amounts that were paid or became payable by the trust to a beneficiary of the trust in respect of the beneficiary's interest under the trust before the beginning of a calendar month that ends in the year, except to the extent the amount is (A) included in the beneficiary's income for a taxation year under subsection 104(13), (B) an amount for which Part XIII tax was deducted due to the application of paragraph 212(1)(*c*), or (C) paid or payable to a person other than a specified non-resident beneficiary of the trust. In effect, a Canadian-resident trust's equity amount will be increased by contributions made by a specified non-resident beneficiary and the tax-paid income of the trust (that is not paid or made payable to a beneficiary). The equity amount of a trust resident in Canada will be reduced by capital distributions made to specified non-resident beneficiaries.

A third set of rules apply to determine the "equity amount" of a non-resident corporation or trust under paragraph (*c*) of the definition. The equity amount of a non-resident corporation or trust is computed as 40% of the average of all the corporation or trust's cost of a property (other than an interest as a member of a partnership) owned at the beginning of a calendar month that ends in the year that is used in (or held in the course of) a business carried on in Canada by the corporation or trust less the corporation or trust's debts payable by the corporation or trust, other than "outstanding debts to specified non-residents" of the corporation or trust. Effectively, 2⁄5 of the corporation or trust's property used in a business carried on in Canada, net of arm's length debt or debt owing to a non-arm's length resident of Canada, will be the "equity amount" of a corporation or trust.

For a non-resident corporation or trust that has made a section 216 election to be taxed as a resident of Canada on certain rents, 40% of the cost (computed as a monthly average) of the non-resident's real property interests (or timber resource properties and timber interests, as the case may be), less outstanding debts to specified non-residents, will be the corporation's equity amount.

Equity Contribution

As noted above, an "equity contribution" by a specified non-resident beneficiary of a Canadian-resident trust will increase that trust's "equity amount" for purposes of the thin capitalization rules. The new definition of "equity contribution" in subsection 18(5) of the Act provides that an equity contribution is a transfer of property to a trust that is made: (a) in exchange for an interest as a beneficiary under the trust; (b) in exchange for a right to acquire an interest as a beneficiary under a trust; or (c) for no consideration by a person beneficially interested in the trust. These rules effectively provide that a transfer of property to a Canadian-resident trust by a person who is a beneficiary of the trust, or who acquires a beneficial interest in the trust (or a right to acquire such beneficial interest) in exchange for the property is an "equity contribution".

Specified Beneficiary

Under the existing rules, a shareholder of a Canadian corporation must own, together with persons with whom it does not deal at arm's length, at least 25% of the shares of the borrower (votes or value) in order to be a "specified shareholder" A specified shareholder who is a non-resident is a "specified non-resident shareholder" and an interest bearing amount owing to such shareholder by a Canadian resident corporation is generally included in the definition of "outstanding debts to specified non-residents" of the corporation. As Budget

2013 proposes to extend the rule to Canadian-resident trusts, the definition of specified beneficiary is being introduced.

Generally, a person will be a specified beneficiary of a trust where that person, together with persons with whom the person does not deal at arm's length, has an interest as a beneficiary under the trust with a fair market value of at least 25% of the fair market value of all interests as a beneficiary under the trust. The definition includes a number of interpretative provisions. First, under paragraph (*a*) of the definition, if a particular person, or a person with whom the particular person does not deal at arm's length, has a right under a contract in equity or otherwise, either immediately or in the future and either absolutely or contingently to, or to acquire an interest in the trust, the person will be deemed to have so acquired the interest. This is similar to the existing rule in paragraph (*c*) of the definition of specified shareholder.

Under paragraph (*b*) of the definition of "specified beneficiary", where a particular person or a person with whom the particular person does not deal at arm's length, has a right under a contract in equity or otherwise, either immediately or in the future and either absolutely or contingently to cause a trust to redeem, acquire or terminate a beneficial interest in the trust held by a person other than the particular person (or any person not dealing at arm's length with the particular person) the trust is deemed to have redeemed, acquired or terminated such interest. An exclusion applies where the right is not exercisable at that time because its exercise is contingent on the death, bankruptcy or permanent disability of an individual. This is similar to the existing rule in paragraph (*d*) of the definition of specified shareholder.

Paragraph (*c*) of the definition of "specified beneficiary" deals with discretionary trusts. It provides that if the amount of income that a person may receive as a beneficiary of the trust depends on the exercise by any person of, or the failure to exercise, a discretionary power, that person is deemed to have fully exercised, or to have failed to exercise, such power, as the case may be. This rule effectively provides that each beneficiary under a discretionary trust will be deemed to own 100% of the fair market value of the beneficial interests in the trust for purposes of these rules. (A similar rule in respect of "associated corporations" is exists in paragraph 256(1.2)(*f*).)

Specified Non-Resident Beneficiary

A "specified non-resident beneficiary" of a trust at any time is a "specified beneficiary" of the trust who is at that time a non-resident person. This rule parallels the definition of "specified non-resident shareholder".

Tax-Paid Earnings

The new definition of "tax-paid earnings" is relevant in determining a Canadian-resident trust's "equity amount" for thin capitalization purposes. Tax-paid earnings increase a trust's equity amount, thereby increasing the amount of interest-bearing debt of the trust without having the thin capitalization rules limit the trust's ability to deduct the interest.

Tax-paid earnings of a trust resident in Canada for a taxation year means the amount, if any, in respect of a particular taxation year of the trust that ended before the year, of the trust's taxable income as computed under Part I of the Act for the year, less: (i) the tax payable by the trust under the Act for the particular year, and (ii) all income taxes payable by the trust under provincial law for the particular year. This rule effectively allows a trust to add tax-paid income to its capital for thin capitalization purposes.

Additional Provisions

Budget 2013 will repeal existing subsections 18(5.1) and (6) and replace them with new subsections 18(5.1), (5.2), (5.3), (5.4) and (6).

Existing subsection 18(5.1) provides a rule that deems a person who would otherwise be a specified shareholder of a corporation not to be a specified shareholder where certain conditions are met. Generally, the rule applies where the person became a specified shareholder to safeguard rights in respect of indebtedness owing to the person or a non-arm's length person, and the person will cease to be a specified shareholder once conditions of the agreement or arrangement have been met. The existing rule will be repealed and replaced with an identical rule applying to both specified beneficiaries as well as specified shareholders.

New subsection 18(5.2) provides that for the purposes of the thin capitalization rules in subsection 18(4)–(6), a non-resident corporation is deemed to be a specified shareholder of itself and a non-resident trust is deemed to be a specified beneficiary of itself.

New subsection 18(5.3) provides several deeming rules applicable to the definition of "equity amount" in subsection 18(5) as it applies to non-resident corporations and trusts. Paragraph 18(5.3)(*a*) provides a rule prorating the cost of property used by the non-resident in a business carried on in Canada where that property is only partly used in the Canadian business. Paragraph 18(5.3)(*b*) provides rules for determining the cost of property of a partnership to a non-resident corporation or trust where the non-resident corporation or trust is deemed to own such property pursuant to subsection 18(7) of the Act (as proposed to be amended by Resolution 51(5)).

Under subsection 18(5.4), a Canadian-resident trust will be able to treat an amount that it (or a partnership of which it was a member) paid or credited as interest to a non-resident person that is either included in the trust's income under paragraph 12(1)(*l*.1) (i.e. was paid by a partnership of which the trust is a member), or is not deductible due to the application of subsection 18(4) as a distribution of trust income to the person as a beneficiary of the trust. This is a similar to the rule in subsection 214(16) deeming interest of a corporation that is not deductible due to the application of the thin capitalization provisions to be a dividend paid by the corporation to the specified shareholder. Under new subsection 18(5.4), the ability to designate the amount is elective and must be made in the trust's T3 return for the year in which the interest deduction was denied or the interest required to be included in income. This would enable the trust to deduct the amount in computing its income under subsection 104(6) of the Act. Any amount so designated would be subject to Part XIII withholding tax at a rate of 25% (subject to treaty relief) under paragraph 212(1)(*c*), and potentially Part XII.2 tax as well. As an *inter vivos* trust is subject to tax at the highest rate applicable to an individual, withholding tax may lead to a lower overall tax impact when compared to an income inclusion or non-deductible interest.

Under new subsection 18(6), the rule regarding back-to-back loans is extended to trusts.

Partnerships

In the 2012 Budget, the thin capitalization rules were extended to partnerships by deeming each member of a partnership to owe a pro rata proportion of the partnership's debt for purposes of the thin capitalization rules. This rule is being extended to deem each partner to own a pro rata proportion of the partnership's property as well. This amendment is necessary in light of the extension of the thin capitalization rules to non-residents who carry on business in Canada. The cost amount of the property used in Canada generally excludes the cost of partnership property and instead will look through to the underlying partnership property, and use the partnership's cost amount in property to determine the non-resident's cost amount under new subparagraph 18(5.3)(*c*)(i).

Coming Into Force

Generally, the new thin capitalization rules will be effective for taxation years beginning after 2013, giving taxpayers some time to reorganize their affairs (if necessary) in light of the new rules.

A trust that is resident in Canada on March 21, 2013, can elect in writing with the Minister of National Revenue on or before the date that is the trust's filing due date for the first taxation year of the trust that begins after 2013 to have certain rules apply to determine the trust's equity amount and to determine the beneficiary's equity contributions.

Where the trust has made an election, for the purposes of determining the trust's equity amount, the trust will be deemed: (i) not to have received any equity contributions before March 21, 2013, (ii) not to have paid or made payable any amount to a beneficiary of the trust prior to March 21, 2013, and (iii) to have tax-paid earnings of nil for each taxation year that ends before March 21, 2013. Each beneficiary will be deemed to have made an equity contribution to the trust at the beginning of March 21, 2013 equal to their pro-rata interest as a beneficiary under the trust of the trust's assets net of liabilities. Effectively, this rule enables a trust to have the net value of its property on March 21, 2013 to be treated as its equity amount on a going forward basis.

Resolution 50 introduces new subsection 12(2.02) of the Act. This is a tracing provision that provides that where an amount is required to be included under paragraph 12(1)(*l*.1), the income is deemed to be from the particular source or sources in respect of which the interest is deductible by the partnership. This provision may result in the application of Part XII.2 to certain trust designations made under new subsection 18(5.4).

Resolution 52: International Banking Centres

52. (1) The Act is amended by repealing section 33.1 and by making such other amendments as are consequential to that repeal.

(2) Subsection 52(1) applies to taxation years that begin on or after Budget Day.

Editorial Comment: The International Banking Centre (IBC) rules were enacted in 1987 in order to compete with certain foreign jurisdictions which had enacted tax legislation favourable to international bankers. In an effort to retain international banking business in Canada, and to attract more such business, the IBC rules were introduced to exempt prescribed financial institutions from tax on certain income earned through a branch or office in Montreal or Vancouver.

The policy rationale of attracting banking activity normally conducted abroad no longer applies, because of changes to the structures of financial institutions. Consequently, there has been virtually no use of these rules in recent years.

In an effort to simplify Canada's tax system, and ensure tax fairness and impartiality across business sectors and regions, Budget 2013 proposes to repeal the IBC rules. This measure will apply to taxation years that begin on or after March 21, 2013.