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Special Report: Canada Federal Budget 2015

This annual publication is produced by the Tax Group at Dentons Canada LLP together with Wolters Kluwer CCH. This edition contains editorial comments regarding the tax proposals announced in the 2015 Federal Budget.

Editorial Comment on Budget Resolutions

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

Resolution 1: Tax-Free Savings Account

1. The definition "TFSA dollar limit" in subsection 207.01(1) of the *Income Tax Act* is replaced by the following:

"TFSA dollar limit" for a calendar year means,

(*a*) for 2009, $5,000;

(*b*) for each year after 2009 and before 2015, the amount (rounded to the nearest multiple of $500, or if that amount is equidistant from two such consecutive multiples, to the higher multiple) that is equal to $5,000 adjusted for each year after 2009 in the manner set out in section 117.1; and

(*c*) for each year after 2014, $10,000.

Dentons Canada LLP Commentary: A tax-free savings account ("TFSA") allows individuals to earn investment income, including interest, dividends, and capital gains, on a tax-free basis. Although contributions to a TFSA are not tax-deductible, the income earned in a TFSA is not subject to Part I tax, while in the account or when such income is distributed to the account holder. However, there are certain circumstances in which a TFSA may be subject to Part I tax, such as if the TFSA holds a "non-qualified investment" or carries on one or more businesses (see subsection 146.2(6)).

In 2009 the annual contribution limit for a TFSA ("TFSA dollar limit") was $5,000. For the 2013 and 2014 taxation years, the TFSA dollar limit was increased to $5,500 with proposed $500 annual increases indexed for inflation. Unused TFSA room can be carried forward indefinitely. Furthermore, distributions from the account add to the TFSA contribution room in the year after the distribution.

The 2015 budget proposes to increase the TFSA dollar limit from $5,500 to $10,000, effective as of January 1, 2015. In addition, the TFSA dollar limit will no longer be indexed for inflation.

Resolutions 2 to 4: Home Accessibility Tax Credit

2. (1) Subsection 108(1.1) of the Act is replaced by the following:

(1.1) For the purpose of the definition "testamentary trust" in subsection (1), a contribution to a trust does not include a qualifying expenditure (within the meaning of sections 118.04 or 118.041) of a beneficiary under the trust.

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

3. (1) The Act is amended by adding the following after section 118.04:

118.041. (1) The following definitions apply in this section.

"eligible dwelling" of an individual, at any time in a taxation year, means a housing unit (including the land subjacent to the housing unit and the immediately contiguous land, but not including the portion of that land that exceeds the greater of 1/2 hectare and the portion of that land that the individual establishes is necessary for the use and enjoyment of the housing unit as a residence) located in Canada if

(*a*) the individual (or a trust under which the individual is a beneficiary) owns — whether jointly with another person or otherwise — at that time, the housing unit or a share of the capital stock of a co-operative housing corporation acquired for the sole purpose of acquiring the right to inhabit the housing unit owned by the corporation; and

(*b*) the housing unit is ordinarily inhabited, or is reasonably expected to be ordinarily inhabited, at any time in the taxation year

(i) by the individual, if the individual is a qualifying individual, or

(ii) by the individual and a qualifying individual, if

(A) the individual is an eligible individual in respect of the qualifying individual, and

(B) the qualifying individual does not, throughout the taxation year, own — whether jointly with another person or otherwise — and ordinarily inhabit another housing unit in Canada.

"eligible individual", in respect of a qualifying individual for a taxation year, means

(*a*) an individual who is the qualifying individual's spouse or common-law partner in the year;

(*b*) except if paragraph (*c*) of this definition applies, an individual who is entitled to deduct an amount under subsection 118.3(2) for the year in respect of the qualifying individual or would be if no amount was claimed for the year by the qualifying individual under subsection 118.3(1) or by the qualifying individual's spouse or common-law partner under section 118.8; or

(*c*) in the case of a qualifying individual who has attained the age of 65 before the end of the year, an individual who

(i) claimed for the year a deduction under subsection 118(1) in respect of the qualifying individual because of

(A) paragraph (*b*) of the description of B in that subsection, or

(B) paragraph (*c.1*) or (*d*) of that description where the qualifying individual is a parent, grandparent, child, grandchild, brother, sister, aunt, uncle, nephew or niece of the individual, or of the individual's spouse or common-law partner, or

(ii) could have claimed for the year a deduction referred to in subparagraph (i) in respect of the qualifying individual if

(A) the qualifying individual had no income for the year,

(B) in the case of a deduction referred to in clause (i)(A), the individual were not married and not in a common-law partnership, and

(C) in the case of a deduction under subsection 118(1) because of paragraph (*d*) of the description of B in that subsection in respect of a qualifying individual who is a dependant (within the meaning of subsection 118(6)) of the individual, the qualifying individual were dependent on the individual because of mental or physical infirmity.

"individual" does not include a trust.

"qualifying expenditure" of an individual means an outlay or expense that is made or incurred, during a taxation year, that is directly attributable to a qualifying renovation — of an eligible dwelling of a qualifying individual or an eligible individual in respect of a qualifying individual — and that is the cost of goods acquired or services received during the year and includes an outlay or expense for permits required for, or for the rental of equipment used in the course of, the qualifying renovation, but does not include an outlay or expense

(*a*) to acquire a property that can be used independently of the qualifying renovation;

(*b*) that is the cost of annual, recurring or routine repair or maintenance;

(*c*) to acquire a household appliance;

(*d*) to acquire an electronic home-entertainment device;

(*e*) that is the cost of housekeeping, security monitoring, gardening, outdoor maintenance or similar services;

(*f*) for financing costs in respect of the qualifying renovation;

(*g*) made or incurred primarily for the purpose of increasing or maintaining the value of the eligible dwelling;

(*h*) made or incurred for the purpose of gaining or producing income from a business or property;

(*i*) in respect of goods or services provided by a person not dealing at arm's length with the qualifying individual or the eligible individual, unless the person is registered for the purposes of Part IX of the*Excise Tax Act*; or

(*j*) to the extent that the outlay or expense can reasonably be considered to be have been reimbursed, otherwise than as assistance from the federal or a provincial government including a grant, subsidy, forgivable loan or a deduction from tax.

"qualifying individual", in respect of a taxation year, means an individual

(*a*) who has attained the age of 65 years before the end of the taxation year; or

(*b*) in respect of whom an amount is deductible, or would be deductible if this Act were read without reference to paragraph 118.3(1)(*c*), under section 118.3 in computing a taxpayer's tax payable under this Part for the taxation year.

"qualifying renovation" means a renovation or alteration of an eligible dwelling of a qualifying individual or an eligible individual in respect of a qualifying individual that

(*a*) is of an enduring nature and integral to the eligible dwelling; and

(*b*) is undertaken to

(i) enable the qualifying individual to gain access to, or to be mobile or functional within, the eligible dwelling, or

(ii) reduce the risk of harm to the qualifying individual within the eligible dwelling or in gaining access to the dwelling.

(2) For the purpose of this section,

(*a*) a qualifying expenditure in respect of an eligible dwelling of a particular individual — who is a qualifying individual or an eligible individual in respect of a qualifying individual — includes an outlay or expense made or incurred by a co-operative housing corporation, a condominium corporation (or, for civil law, a syndicate of co-owners) or a similar entity (in this paragraph referred to as the "corporation"), in respect of a property that is owned, administered or managed by that corporation and that includes the eligible dwelling, to the extent of the share of that outlay or expense that is reasonably attributable to the eligible dwelling, if

(i) the outlay or expense would be a qualifying expenditure of the corporation if the corporation were an individual and the property were an eligible dwelling of that individual, and

(ii) the corporation has notified, in writing, either the particular individual or, if the particular individual is an eligible individual in respect of a qualifying individual, the qualifying individual, of the share of the outlay or expense that is attributable to the eligible dwelling; and

(*b*) a qualifying expenditure in respect of an eligible dwelling of a particular individual — who is a qualifying individual or an eligible individual in respect of a qualifying individual — includes an outlay or expense made or incurred by a trust, in respect of a property owned by the trust that includes the eligible dwelling, to the extent of the share of that outlay or expense that is reasonably attributable to the eligible dwelling, having regard to the amount of the outlays or expenses made or incurred in respect of the eligible dwelling (including, for this purpose, common areas relevant to more than one eligible dwelling), if

(i) the outlay or expense would be a qualifying expenditure of the trust if the trust were an individual and the property were an eligible dwelling of that individual, and

(ii) the trust has notified, in writing, either the particular individual or, if the particular individual is an eligible individual in respect of a qualifying individual, the qualifying individual, of the share of the outlay or expense that is attributable to the eligible dwelling.

(3) For the purpose of computing the tax payable under this Part by a qualifying individual or an eligible individual, in respect of an eligible dwelling for a taxation year, there may be deducted the amount determined by the formula

$$A \times B$$

where

A is the appropriate percentage for the taxation year; and

B is the lesser of

(*a*) $10,000, and

(*b*) the total of all amounts, each of which is a qualifying expenditure of the individual in respect of the eligible dwelling for the taxation year.

(4) Despite paragraph 248(28)(*b*), an amount may be included in determining both an amount under subsection (3) and under section 118.2 if those amounts otherwise qualify to be included for the purposes of those provisions.

(5) For the purpose of this section,

(*a*) a maximum of $10,000 of qualifying expenditures for a taxation year in respect of a qualifying individual can be claimed under subsection (3) by the qualifying individual and all eligible individuals in respect of the qualifying individual;

(*b*) if there is more one qualifying individual in respect of an eligible dwelling, a maximum of $10,000 of qualifying expenditures for a taxation year in respect of the eligible dwelling can be claimed under subsection (3) by the qualifying individuals and all eligible individuals in respect of the qualifying individuals; and

(*c*) if more than one individual is entitled to a deduction under subsection (3) for a taxation year in respect of the same qualifying individual or the same eligible dwelling and the individuals cannot agree as to what portion of the amount each can so deduct, the Minister may fix the portions.

(6) For the purpose subsection (5), if an individual becomes bankrupt in a particular calendar year, despite subsection 128(2), any reference to the taxation year of the individual is deemed to be a reference to the particular calendar year.

(7) For the purpose of this section,

(*a*) if an individual dies during a calendar year and would have attained 65 years of age if the individual were alive at the end of the year, the individual is deemed to have attained 65 years of age at the beginning of the year;

(*b*) if an individual becomes a qualifying individual during a calendar year and becomes bankrupt in that year, the individual is deemed to be a qualifying individual at the beginning of that year; and

(*c*) if an individual becomes a qualifying individual during a calendar year and an eligible individual in respect of the qualifying individual becomes bankrupt in that year, the individual is deemed to be a qualifying individual at the beginning of the year.

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

4. (1) Section 118.92 of the Act is replaced by the following:

118.92. In computing an individual's tax payable under this Part, the following provisions shall be applied in the following order: subsections 118(1) and (2), section 118.7, subsections 118(3) and (10) and sections 118.01, 118.02, 118.031, 118.04, 118.041, 118.05, 118.06, 118.07, 118.3, 118.61, 118.5, 118.6, 118.9, 118.8, 118.2, 118.1, 118.62, 119.1 and 121.

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: Budget 2015 introduces a new federal "Home Accessibility Tax Credit" with respect to certain home renovation expenditures for "qualifying individuals" or "eligible individuals". The tax credit equals 15% of "qualifying expenditures" incurred in a taxation year in respect of an "eligible dwelling" up to a maximum expenditure of $10,000 and is effective for 2016 and subsequent taxation years.

In general, "qualifying individuals" include seniors who are 65 years or older, and persons with disabilities who are eligible for the Disability Tax Credit at any time in a taxation year.

The credit may also be claimed by an "eligible individual", which includes an individual that has claimed the spouse or common-law partner amount, the eligible dependent amount, the caregiver amount or the infirm dependent amount for the qualifying individual in the taxation year, or an individual who could have claimed such amounts if:

- in the case of the spouse or common-law partner amount or, if the eligible individual was not married or in a common-law partnership in the case of the eligible dependent amount, the qualifying individual had no income in the taxation year; and

- in the case of the infirm dependent and caregiver amounts, the qualifying individual was over the age of 18 and had no income in the taxation year.

An "eligible dwelling" is the principal residence owned by the qualifying individual. In order to qualify, the dwelling must be ordinarily inhabited by the qualifying individual or, alternatively, the individual must be reasonably expected to ordinarily inhabit the dwelling in the year. The dwelling may be owned by the individual solely, or jointly with a spouse or common-law partner. Similar to the principal residence rules, a qualifying individual may only have one "eligible dwelling" at any time.

An "eligible dwelling" will also include a dwelling owned by an "eligible individual" if the dwelling is the principal residence of the "eligible individual" and the qualifying individual ordinarily inhabits the dwelling with the eligible individual.

The Budget clarifies that if part of the dwelling is used to earn business or rental income, the qualifying or eligible individual may only claim the credit for the full amount of eligible expenditures made with respect to any personal areas in the dwelling.

If the qualifying individual's principal residence is a condominium or a co-operative housing corporation, the credit is available for eligible expenditures to renovate the unit and the qualifying individual's share of the cost of eligible expenditures with respect to common areas.

For the purposes of this tax credit, a qualified expenditure is an outlay or expense made in the year directly attributable to a "qualifying renovation" of the dwelling which includes any renovation that (a) is of an enduring nature and integral to the dwelling; **and** (b) is undertaken either to (i) enable accessibility, mobility or functionality for a qualifying individual within the eligible dwelling, or (ii) reduce the risk of harm in the dwelling or in obtaining access to the dwelling.

The Budget clarifies that the following expenditures would not qualify for the credit:

- expenditures made with the primary intent of improving or maintaining the value of a dwelling;
- the cost of routine repairs and maintenance normally performed on an annual or more frequent basis;
- expenditures for household appliances and devices (e.g., audio-visual electronics);
- payments for services (e.g., outdoor maintenance and gardening, housekeeping or security); and
- the costs of financing a renovation (e.g., mortgage interest costs).

Expenditures are not eligible for the credit if they are for goods or services provided by a person related to the qualifying or eligible individual unless that related person is registered for Goods and Services Tax/Harmonized Sales Tax.

If the credit can be claimed by both a qualifying individual and an eligible individual, the maximum eligible amount must be claimed by one of the individuals or shared among the individuals.

Interestingly, where a qualifying expenditure is eligible for both the new home accessibility tax credit and the medical expense tax credit, the individual is permitted to claim both credits.

Resolutions 5 to 9: Minimum Withdrawal Factors for Registered Retirement Income Funds

5. The Act is amended by adding the following after section 60.021:

60.022 (1) In determining the amount that may be deducted because of paragraph 60(l) in computing a taxpayer's income for the 2015 taxation year, clause 60(*l*)(v)(B.2) is to be read as follows:

(B.2) the total of all amounts each of which is

(I) the taxpayer's eligible amount (within the meaning of subsection 146.3(6.11)) for the year in respect of a registered retirement income fund,

(II) the taxpayer's eligible RRIF withdrawal amount (within the meaning of subsection 60.022(2)) for the year in respect of a RRIF,

(III) the taxpayer's eligible variable benefit withdrawal amount (within the meaning of subsection 60.022(3)) for the year in respect of an account of the taxpayer under a money purchase provision of a registered pension plan, or

(IV) the taxpayer's eligible PRPP withdrawal amount (within the meaning of subsection 60.022(4)) for the year in respect of an account of the taxpayer under a PRPP,

(2) A taxpayer's eligible RRIF withdrawal amount for the taxation year in respect of a RRIF under which the taxpayer is the annuitant at the beginning of the taxation year is the amount determined by the formula

$$A - B$$

where

A is the lesser of

(*a*) the total of all amounts included, because of subsection 146.3(5), in computing the taxpayer's income for the taxation year in respect of amounts received out of or under the fund (other than an amount paid by direct transfer from the fund to another fund or to a registered retirement savings plan), and

(*b*) the amount that would be the minimum amount under the fund for the 2015 taxation year if it were determined using the prescribed factors under subsections 7308(3) or (4), as the case may be, of the *Income Tax Regulations* as they read on December 31, 2014; and

B is the minimum amount under the fund for the taxation year.

(3) A taxpayer's eligible variable benefit withdrawal amount for a taxation year in respect of an account of the taxpayer under a money purchase provision of a registered pension plan is the amount determined by the formula

$$A - B - C$$

where

A is the lesser of

(*a*) the total of all amounts each of which is the amount of a retirement benefit (other than a retirement benefit permissible under any of paragraphs 8506(1)(*a*) to (*e*) of the *Income Tax Regulations*) paid from the plan in the taxation year in respect of the account and included, because of paragraph 56(1)(*a*), in computing the taxpayer's income for the taxation year, and

(*b*) the amount that would be the minimum amount for the account for the 2015 taxation year if it were determined using the factor designated under subsection 7308(4) of the *Income Tax Regulations* as they read on December 31, 2014;

B is the minimum amount for the account for the taxation year; and

C is the total of all contributions made by the taxpayer under the provision and designated for the purposes of subsection 8506(12) of the *Income Tax Regulations*.

(4) A taxpayer's eligible PRPP withdrawal amount for a taxation year in respect of an account of the taxpayer under a PRPP is the amount determined by the formula

$$A - B$$

where

A is the lesser of

(*a*) the total of all amounts each of which is the amount of a distribution made from the account in the taxation year and included, because of subsection 147.5(13), in computing the taxpayer's income for the taxation year, and

(*b*) the amount that would be the minimum amount for the account for the 2015 taxation year if it were determined using the factor designated under subsection 7308(4) of the *Income Tax Regulations* as they read on December 31, 2014, and

B is the minimum amount for the account for the taxation year.

(5) For the purposes of this section,

(*a*) "money purchase provision" has the same meaning as in subsection 147.1(1);

(*b*) "retirement benefits" has the meaning as in subsection 8500(1) of the *Income Tax Regulations*;

(*c*) the minimum amount for an account of a taxpayer under a money purchase provision of a registered pension plan is the amount determined under subsection 8506(5) of the *Income Tax Regulations*; and

(*d*) the minimum amount for an account of a taxpayer under a PRPP is the amount that would be the minimum amount for the calendar year under subsection 8506(5) of the *Income Tax Regulations* if the taxpayer's account were an account under a money purchase provision of a registered pension plan.

6. Section 146.3 of the Act is amended by adding the following after subsection (1.2):

(1.3) For the purposes of subsections (5.1) and 153(1) and the definition "periodic pension payment" in section 5 of the*Income Tax Conventions Interpretation Act*, the minimum amount under a retirement income fund for 2015 is the amount that would be the minimum amount under the fund for the year if it were determined using the prescribed factors under subsections 7308(3) or (4), as the case may be, of the *Income Tax Regulations* as they read on December 31, 2014.

7. Paragraph 147.5(3)(*b*) of the Act is replaced by the following:

(*b*) a contribution is made to the plan in respect of a member after the calendar year in which the member attains 71 years of age, other than an amount

(i) described in subparagraph (*a*)(iii), or

(ii) if subsection 60.022(1) applies, described in any of subclauses 60(*l*)(v)(B.2)(II) to (IV);

8. (1) The table to subsection 7308(3) of the *Income Tax Regulations* is replaced by the following:

X	Factor
Under 72	1/(90 – X)
72	0.0540
73	0.0553
74	0.0567
75	0.0582
76	0.0598
77	0.0617
78	0.0636
79	0.0658
80	0.0682

X	Factor
81	0.0708
82	0.0738
83	0.0771
84	0.0808
85	0.0851
86	0.0899
87	0.0955
88	0.1021
89	0.1099
90	0.1192
91	0.1306
92	0.1449
93	0.1634
94	0.1879
95 or older	0.2000

(2) The table to subsection 7308(4) of the *Income Tax Regulations* is replaced by the following:

Y	Factor
Under 71	1/(90 – Y)
71	0.0528
72	0.0540
73	0.0553
74	0.0567
75	0.0582
76	0.0598
77	0.0617
78	0.0636
79	0.0658
80	0.0682
81	0.0708
82	0.0738
83	0.0771
84	0.0808
85	0.0851
86	0.0899
87	0.0955
88	0.1021
89	0.1099
90	0.1192
91	0.1306
92	0.1449
93	0.1634

Y	Factor
94	0.1879
95 or older	0.2000

(3) Subsections (1) and (2) apply to the 2015 and subsequent taxation years.

9. Section 8506 of the *Income Tax Regulations* is amended by adding the following after subsection (10):

(11) *Recontribution for 2015.* If a contribution made by a member of a registered pension plan and credited to the member's account under a money purchase provision of the plan complies with the conditions in subsection (12), the contribution

(*a*) is deemed to have been made in accordance with the plan as registered;

(*b*) is to be disregarded for the purposes of paragraph (2)(*c.1*); and

(*c*) is deemed to be an excluded contribution for the purposes of paragraph 8301(4)(*a*).

(12) *Conditions Referred to in Subsection (11).* The conditions referred to in subsection (11) are as follows:

(*a*) the contribution is made after December 31, 2014 and before March 1, 2016;

(*b*) the contribution is designated for the purposes of this subsection in a manner acceptable to the Minister; and

(*c*) he amount of the contribution does not exceed the amount determined by the formula

$$A - B - C$$

where

A is the lesser of

(i) the total of all amounts each of which is the amount of a retirement benefit (other than a retirement benefit permissible under any of paragraphs (1)(*a*) to (*e*)) paid from the plan in 2015 in respect of the account and included, because of paragraph 56(1)(*a*) of the Act, in computing the taxpayer's income for the taxation year, and

(ii) the amount that would be the minimum amount for the account for 2015 if it were determined using the factor designated under subsection 7308(4) as it read on December 31, 2014,

B is the minimum amount for the account for 2015, and

C is the total of all other contributions made by the member under the money purchase provision at or before the time of the contribution and designated for the purposes of this subsection.

Dentons Canada LLP Commentary: Minimum Withdrawal Factors for Registered Retirement Income Funds

A Registered Retirement Savings Plan ("RRSP") must be converted to a Registered Retirement Income Fund ("RRIF") or be used to purchase a qualifying annuity in the year that the taxpayer turns 71 years of age. Following conversion, contributions are no longer permitted and minimum amounts must be withdrawn from the plan commencing in the year after conversion. The minimum withdrawal amount is determined by applying a percentage factor as set out in subsection 7308(3) of the *Income Tax Regulations* and is based on the account holder's age.

Budget 2015 proposes to reduce this required minimum withdrawal amount to better reflect long-term historical real rates of return and expected inflation. Withdrawal amounts will be based on a 5% nominal rate of return and 2% rate of inflation indexing.

New Section 60.022 will be added to reflect the change in rules effective for the 2015 tax year. The prescribed factors will be amended as detailed in the following table which will replace the table in subsection 7308(3) of the *Income Tax Regulations:*

Existing and New RRIF Factors

Age

(at start of year)

	Existing Factor %	**New Factor** %
71	7.38	5.28
72	7.48	5.40
73	7.59	5.53
74	7.71	5.67
75	7.85	5.82
76	7.99	5.98
77	8.15	6.17
78	8.33	6.36
79	8.53	6.58
80	8.75	6.82
81	8.99	7.08
82	9.27	7.38
83	9.58	7.71
84	9.93	8.08
85	10.33	8.51
86	10.79	8.99
87	11.33	9.55
88	11.96	10.21
89	12.71	10.99
90	13.62	11.92
91	14.73	13.06
92	16.12	14.49
93	17.92	16.34
94	20.00	18.79
95 & over	20.00	20.00

Factors will remain unchanged for conversion of a RRIF of an annuitant prior to age 71 and older than 95.

Since the new factors come into effect effective for 2015, a RRIF holder who may have withdrawn more than the new minimum amount in 2015 will have until February 29, 2016, to re-contribute any excess withdrawn.

These new factors will also be used to determine what must be withdrawn annually, from a Registered Pension Plan as well as a Pooled Registered Pension Plan, starting at age 71.

Resolutions 10 and 11: Lifetime Capital Gains Exemption for Qualified Farm or Fishing Property

10. (1) Section 104 of the Act is amended by adding the following after subsection (21.2):

(21.21) If clause (21.2)(*b*)(ii)(A) applies to deem, for the purposes of section 110.6, the beneficiary under a trust to have a taxable capital gain (referred to in this subsection as the "QFFP taxable capital gain") from a disposition of capital property that is qualified farm or fishing property of the beneficiary, for the beneficiary's taxation year that ends on or after April 21, 2015, and in which the designation year of the trust ends, for the purposes of subsection 110.6(2.2), the beneficiary is, if the trust complies with the requirements of subsection (21.22), deemed to have a taxable capital gain from the disposition of qualified farm or fishing property of the beneficiary on or after April 21, 2015 equal to the amount determined by the formula

$$A \times B/C$$

where

A is the amount of the QFFP taxable capital gain;

B is, if the designation year of the trust ends on or after April 21, 2015, the amount that would be determined in respect of the trust for the designation year under paragraph 3(*b*) in respect of capital gains and capital losses if the only properties referred to in paragraph 3(*b*) were qualified farm or fishing properties of the trust that were disposed of by the trust on or after April 21, 2015; and

C is, if the designation year of the trust ends on or after April 21, 2015, the amount that would be determined in respect of the trust for the designation year under paragraph 3(*b*) in respect of capital gains and capital losses if the only properties referred to in paragraph 3(*b*) were qualified farm or fishing properties.

(21.22) A trust shall determine and designate, in its return of income under this Part for a designation year of the trust, the amount that is determined under subsection (21.21) to be the beneficiary's taxable capital gain from the disposition on or after April 21, 2015 of qualified farm or fishing property of the beneficiary.

(2) Subsection (1) applies in respect of taxation years that end after April 20, 2015.

11. (1) Section 110.6 of the Act is amended by adding the following after subsection (2.1):

(2.2) In computing the taxable income for a taxation year of an individual (other than a trust) who was resident in Canada throughout the year and who disposed of qualified farm or fishing property in the year or a preceding taxation year and after April 20, 2015, there may be deducted an amount claimed by the individual that does not exceed the least of

(*a*) the amount, if any, by which $500,000 exceeds the total of

(i) $400,000 adjusted for each year after 2014 in the manner set out by section 117.1, and

(ii) the total of all amounts each of which is an amount deducted under this subsection in computing the individual's taxable income for a preceding taxation year that ended after 2014,

(*b*) the amount, if any, by which the individual's cumulative gains limit at the end of the year exceeds the total of all amounts each of which is an amount deducted by the individual under subsection (2) or (2.1) in computing the individual's taxable income for the year,

(*c*) the amount, if any, by which the individual's annual gains limit for the year exceeds the total of all amounts each of which is an amount deducted by the individual under subsection (2) or (2.1) in computing the individual's taxable income for the year, and

(*d*) the amount that would be determined in respect of the individual for the year under paragraph 3(*b*) in respect of capital gains and capital losses if the only properties referred to in that paragraph were qualified farm or fishing properties disposed of by the individual after April 20, 2015.

(2.3) Subsection (2.2) does not apply in computing the taxable income for a taxation year of an individual unless the individual has claimed the maximum amount that could be claimed under subsections (2) and (2.1) for the taxation year.

(2) Subsection 110.6(4) of the Act is replaced by the following:

(4) Notwithstanding subsections (2) and (2.1), the total amount that may be deducted under this section in computing an individual's income for a taxation year shall not exceed the amount determined by the formula in paragraph (2)(*a*) and the amount that may be deducted under subsection (2.2) in respect of the individual for the year.

(3) The portion of subsection 110.6(5) of the Act before paragraph (*a*) is replaced by the following:

(5) For the purposes of subsections (2) to (2.2), an individual is deemed to have been resident in Canada throughout a particular taxation year if

(4) The portion of subsection 110.6(6) of the Act before paragraph (*a*) is replaced by the following:

(6) Notwithstanding subsections (2) to (2.2), no amount may be deducted under this section in respect of a capital gain of an individual for a particular taxation year in computing the individual's taxable income for the particular taxation year or any subsequent year, if

(5) The portion of subsection 110.6(7) of the Act before paragraph (*a*) is replaced by the following:

(7) Notwithstanding subsections (2) to (2.2), no amount may be deducted under this section in computing an individual's taxable income for a taxation year in respect of a capital gain of the individual for the taxation year if the capital gain is from a disposition of property which disposition is part of a series of transactions or events

(6) Subsection 110.6(8) of the Act is replaced by the following:

(8) Notwithstanding subsections (2) to (2.2), if an individual has a capital gain for a taxation year from the disposition of a property and it can reasonably be concluded, having regard to all the circumstances, that a significant part of the capital gain is attributable to the fact that dividends were not paid on a share (other than a prescribed share) or that dividends paid on such a share in the taxation year or in any preceding taxation year were less than 90% of the average annual rate of return on that share for that year, no amount in respect of that capital gain shall be deducted under this section in computing the individual's taxable income for the year.

(7) Subsections (1) to (6) apply to taxation years that end after April 20, 2015.

Dentons Canada LLP Commentary: Since 1985, section 110.6 of the *Income Tax Act* has provided individuals with an exemption from tax payable in respect of certain capital gains realized on the disposition of qualified small business corporation shares and qualified farm or fishing property. The amount of the Lifetime Capital Gains Deduction ("LCGD") is $813,600 in 2015, and is indexed to inflation thereafter.

Budget 2015 proposes to increase the LCGD on the dispositions of qualified farm or fishing property that occur after April 20, 2015 to the greater of $1 million; and the indexed LCGD applicable to capital gains realized on the disposition of qualified small business corporation shares. In essence, the additional LCGD applicable to qualified farm or fishing property will be eliminated over time unless further revisions are made in future.

Budget 2015 also proposes to add new subsections 104(21.21) and 104(21.22) to the *Income Tax Act* providing a formula prorating gains arising on or after April 21, 2015 where a trust designates a capital gain in respect of qualified farm or fishing property in a designation year ending on or after April 21, 2015.

Resolution 12: Registered Disability Savings Plan — Legal Representation

12. Clause (*a*)(ii)(B.1) of the definition "disability savings plan" in subsection 146.4(1) of the Act is replaced by the following:

(B.1) if the arrangement is entered into before 2019, a qualifying family member in relation to the beneficiary who, at the time the arrangement is entered into, is a qualifying person in relation to the beneficiary,

Dentons Canada LLP Commentary: Registered Disability Savings Plans ("RDSP") have existed since 2008 and are trust arrangements that permit parents and others to contribute and save for the long-term financial security of a person qualifying for the disability tax credit. An RDSP can invest and earn income tax-free for the purpose of making future payments to the beneficiary. Budget 2012 introduced a temporary measure to allow a qualifying family member (i.e., a beneficiary's parent, spouse or common-law partner) to become the plan holder of an RDSP where the adult beneficiary may lack the capacity to enter into a contract.

This temporary measure was intended to apply until the end of 2016. However not all provinces and territories have had sufficient opportunity to introduce streamlined processes that permit a trusted person legally to manage the resources on behalf of the RDSP beneficiary. Budget 2015 proposes to extend the measure until the end of 2018 to give the provinces and territories the opportunity to address the RDSP legal representation issue described above.

Resolution 13: Repeated Failure to Report Income Penalty

13. (1) Subsection 163(1) of the Act is replaced by the following:

163. (1) Every person is liable to a penalty who

(*a*) fails to report an amount, equal to or greater than $500, required to be included in computing the person's income in a return filed under section 150 for a taxation year (in this subsection and subsection (1.1) referred to as the "unreported amount");

(*b*) had failed to report an amount, equal to or greater than $500, required to be included in computing the person's income in any return filed under section 150 for any of the three preceding taxation years; and

(*c*) is not liable to a penalty under subsection (2) in respect of the unreported amount.

(1.1) The amount of the penalty to which the person is liable under subsection (1) is equal to the lesser of

(*a*) 10% of the unreported amount, and

(*b*) the amount determined by the formula

$$0.5(A - B)$$

where

A is the total of the amounts that would be determined under paragraphs (2)(*a*) to (*g*) if subsection (2) applied in respect of the unreported amount, and

B is any amount deducted or withheld under subsection 153(1) that may reasonably be considered to be in respect of the unreported amount.

(2) Subsection (1) applies to taxation years that begin after 2014.

Dentons Canada LLP Commentary: Budget 2015 provides a relieving measure with respect to the penalty levied for repeated failures to report income. Generally, under subsection 163(1) of the Act, where a taxpayer fails to report an amount of income in a particular taxation year and in any of the three preceding taxation years, a penalty equal to (10%) of the unreported income of the particular year is levied (often referred to as the "repeated failure to report" penalty).

Another penalty may be levied equal to (50%) of the tax payable on the unreported income in situations where the taxpayer knew or, under circumstances amounting to gross negligence, ought to have known that the income should have been reported (often referred to as the "gross negligence" penalty). The gross negligence penalty will not apply if the repeated failure to file penalty is levied.

It has been recognized that in certain situations, including those of lower income earning individuals, the repeated failure to file penalty can be disproportionate to the income in question. Furthermore, the repeated failure to file penalty can also be in excess of the gross negligence penalty in certain situations.

The Tax Court has repeatedly described the penalty in subsection 163(1) as a "harsh provision" (see, for example, *Galachiuk v. The Queen*, 2014 DTC 1153 (TCC).

Accordingly, subsection 163(1) is proposed to be amended such that the repeated failure to report penalty only applies if the taxpayer fails to report at least $500 of income in the particular year and any of the three preceding years.

The amount of the penalty will equal the lesser of: (i) 10% of the unreported income and (ii) an amount equal to 50% of the difference between the amount of tax that was understated (computed as if the gross negligence penalty provisions applied) and the actual tax paid with respect to the unreported amount (*i.e.*, by way of employer withholding).

These changes will apply for taxation years that commence after 2014.

Resolution 14: Alternative Arguments in Support of Assessments

14. The Act is modified in accordance with the proposals relating to Alternative Arguments in Support of Assessments described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: Generally, the purpose of an income tax assessment is to determine the income tax liability of a taxpayer for a particular year. If a taxpayer disagrees with the assessment, the taxpayer may file an objection and, if necessary, an appeal in the Tax Court.

The appeal process cannot result in an increased tax liability for the taxpayer. However, the Minister's arguments in support of the correctness of the assessment may change during the course of the appeal. In this regard, subsection 152(9) was added to the Act after the Supreme Court of Canada in *The Queen v. Continental Bank of Canada* (98 DTC 6501) held that the Minister could not raise an alternate reason to support the assessment after the expiry of the normal reassessment period.

Subsection 152(9) allows alternative arguments to be advanced in support of an assessment, but attempts by the Minister to reassess outside of the normal reassessment period by introducing a new basis for liability should still not be allowed. The Minister is also limited in this regard if the taxpayer would not be able to adduce evidence to deal with the alternative basis of assessment without leave of the court and the court granting leave would be inappropriate.

In *Walsh v. The Queen* (2007 DTC 5441), the Federal Court of Appeal stated that the following conditions apply when the Minister seeks to rely on subsection 152(9) of the Act: (i) the Minister cannot include transactions which did not form the basis of the taxpayer's reassessment, (ii) the right of the Minister to present an alternative argument in support of an assessment is subject to paragraphs 152(9)(*a*) and (*b*), which speak to the prejudice to the taxpayer; and (iii) the Minister cannot use subsection 152(9) to reassess outside the time limitations in subsection 152(4) of the Act, or to collect tax exceeding the amount in the assessment under appeal.

In the recent decision of *Last v. The Queen* (2014 DTC 5077, affirming 2012 DTC 1290 (TCC)), the Federal Court of Appeal held that while the basis for an assessment can be changed after the expiry of the normal reassessment period, each source of income is to be considered separately such that the amount of the assessment in connection with any one particular source cannot increase.

Budget 2015 proposes to clarify that, pursuant to subsection 152(9), all amounts in an assessment may be increased or adjusted, provided that the total amount of the assessment does not increase.

These measures will apply in respect of appeals instituted after Royal Assent to the enacting legislation.

Budget 2015 also proposes to amend the *Excise Tax Act* and the *Excise Act, 2001* to include similar provisions for GST/HST and excise duties for tobacco and alcohol products.

Resolution 15: Information Sharing for the Collection of Non-Tax Debts

15. Paragraph 241(4)(*d*) of the Act is amended by striking out "or" at the end of subparagraph (xvi), by adding "or" at the end of subparagraph (xvii) and by adding the following after subparagraph (xvii):

(xviii) to an official of the Canada Revenue Agency solely for the purpose of the collection of amounts owing to Her Majesty in right of Canada or of a province under the *Government Employees Compensation Act*, the *Canada Labour Code*, the*Merchant Seamen Compensation Act*, the*Canada Student Loans Act*, the *Canada Student Financial Assistance Act*, the *Postal Services Continuation Act, 1997*, the *Wage Earner Protection Program Act*, the*Apprentice Loans Act* or a law of a province governing the granting of financial assistance to students at the post-secondary school level;

Dentons Canada LLP Commentary: Information about taxpayers obtained in the administration and enforcement of the *Income Tax Act* is generally confidential. However, subsection 241(4) provides an exception that allows an official to provide tax information for certain specified purposes.

Budget 2015 proposes to amend and extend the application of paragraph 241(4)(*d*), to permit the sharing of taxpayer information within the CRA in respect of non-tax debts under certain federal and provincial government programs (listed in proposed new subparagraph 241(4)(*d*)(xviii). The proposal will apply on Royal Assent. Similar amendments with respect to the sharing of taxpayer information in respect of non-tax debts are proposed in respect of the *Excise Tax Act* and the *Excise Act, 2001*.

Resolution 16: Transfer of Education Credits — Effect on the Family Tax Cut

16. Section 119.1 of the Act, as proposed by the *Support for Families Act* (Bill C-57), is modified in accordance with the proposals relating to the Transfer of Education Credits — Effect on the Family Tax Cut described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: The Family Tax Cut ("FTC") was first introduced in October 2014 and is applicable to couples with children under the age of 18. The FTC allows the higher-income spouse or common-law partner to transfer notionally up to $50,000 of taxable income to a spouse or partner in a lower income tax bracket up to a maximum non-refundable federal tax credit of $2,000. The purpose of the FTC is to reduce or eliminate the federal tax differential between one-income families in relation to two-income families.

The previously announced FTC rules prevented the transfer of education-related credits from being taken into account in the calculation of the FTC, thereby potentially reducing the value of the transfer. Budget 2015 proposes to revise the calculation of the FTC to ensure that couples claiming the FTC and transferring education-related credits receive the appropriate value of the FTC.

The proposed FTC rules are intended to apply for 2014 and subsequent taxation years. Taxpayers that have already filed their individual income tax returns for 2014 will automatically be reassessed by the CRA once the provisions receive Royal Assent to receive any additional benefit that they are entitled to.

Resolution 17: Donations Involving Private Corporation Shares or Real Estate

17. The Act is modified to give effect to the proposals relating to Donations Involving Private Corporation Shares or Real Estate described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: Currently, donations to registered charities of public company securities, ecologically sensitive land and property that qualifies under the criteria set out in the *Cultural Property Export and Import Act* qualify for enhanced tax benefits. The donor's capital gain arising upon the donation is equal to zero but the donor is eligible to receive a charitable donation receipt for the full fair market value of the donated property and can claim the resulting tax benefits.

With respect to public company shares and ecologically sensitive land, this treatment is relatively new, and results from changes to the Act between 2000 and 2008 (see paragraphs 38(*a*.1) and 38(*a*.2)). In contrast, the donation of private company shares or real estate results in "normal" capital gains being realized based on proceeds of disposition equal to the amount of the charitable receipt, although the donor can elect to choose an amount that is less than the fair value of the property (see subsections 118.1(6), 110.1(2.1) and 110.1(3)).

Budget 2015 now provides for enhanced tax treatment with respect to private company shares and real estate ("Private Assets"). The cash proceeds derived from the sale of Private Assets can be donated, which will result in the capital gain otherwise realized being exempt from tax. The gift must be made within 30 days of the disposition and the Private Assets must be sold to a purchaser who deals with the donor and the registered charity at arm's length. If all of the cash derived from the sale of the Private Assets is donated, the entire capital gain realized on the sale will be exempt; otherwise the exempt portion of the capital gain will be pro-rated based on the portion of the cash donated to the total proceeds.

Anti-avoidance rules will be enacted to ensure that the exemption from tax on the capital gain is not abused. Budget 2015 states that the exemption will not be available if, within five years of the disposition (i) the donor or any non-arm's length person acquires the Private Assets directly or indirectly, after they are sold, (ii) in the case of shares, the donor acquires shares which are substituted for the shares that had been sold, or (iii) in the case of shares, the shares that have been sold are redeemed and the corporation does not deal at arm's length with the donor at the time of redemption. Where these rules apply, the reversal of the exemption from gain will be taxed in the year of the reacquisition or redemption.

These rules will apply to donations made in respect of dispositions occurring after 2016.

Resolutions 18 and 19: Investments in Limited Partnerships by Registered Charities

18. (1) Section 149.1 of the Act is amended by adding the following after subsection (10):

(11) For the purposes of this section and sections 149.2 and 188.1, each member of a partnership at any time is deemed at that time to own the portion of each property of the partnership equal to the proportion that the fair market value of the member's interest in the partnership at that time is of the fair market value of all interests in the partnership at that time.

(2) Subsection (1) is deemed to have come into force on April 21, 2015.

19. (1) Section 253.1 of the Act is renumbered as subsection 253.1(1) and is amended by adding the following:

(2) For the purposes of section 149.1 and subsections 188.1(1) and (2), if a registered charity or a registered Canadian amateur athletic association holds an interest as a member of a partnership, the member shall not, solely because of its acquisition and holding of that interest, be considered to carry on any business of the partnership if

(*a*) by operation of any law governing the arrangement in respect of the partnership, the liability of the member as a member of the partnership is limited;

(*b*) the member deals at arm's length with each general partner of the partnership; and

(*c*) the member, or the member together with persons and partnerships with which it does not deal at arm's length, holds interests in the partnership that have a fair market value of not more than 20% of the fair market value of the interests of all members in the partnership.

(2) Subsection (1) applies in respect of investments in limited partnerships that are made or acquired after April 20, 2015.

Dentons Canada LLP Commentary: The ability of a charitable organization or public foundation to carry on business is limited to activities which are considered to be related to its charitable purposes. Furthermore, a private foundation is not entitled to carry on any business activities.

As under general legal principles, each partner of a partnership is considered to be carrying on the business of the partnership (with a view to making a profit), the foregoing restrictions greatly reduce, if not eliminate, the ability of a charity to own an interest in partnership.

Section 253.1 was added to the *Income Tax Act* in 2001 with effect for years ending after 2002, to override the conclusion that a partner is always carrying on the business of the partnership, but only for certain purposes of the Act, and only where the underlying partnership was a limited partnership under law. This provision arose specifically as a result of the decision in *Robinson Trust v. HMTQ*, 98 DTC 6065. In *Robinson*, the Court held that where a partnership carries on an active business, the limited partners of the partnership are consid-

ered to carry on that active business themselves, even though they may have limited liability and take no part in the management of the business. Without section 253.1, certain entities would have been precluded from investing in limited partnerships, most notably being pension funds, REITs and income trusts.

Section 253.1 will now be amended to extend its application specifically to registered charities and registered Canadian amateur athletic associations (each referred to as a "Charity"). The relief contained in new subsection 253.1(2) provides that the Charity will not be considered to be carrying on the business of the partnership when it owns a partnership interest if (i) the partnership is a limited partnership at law, (ii) the Charity deals at arm's length with each general partner of the partnership, and (iii) the Charity, together with all non-arm's length entities, does not own interests in the partnership having a value of more than 20% of the fair market value of all interests in the partnership.

As a result of these proposals, certain related provisions applicable to charities will also be amended. In particular, the excess corporate holdings rules which limit a charity's ownership percentage in a corporation, will be amended to look through a limited partnership to treat the charity as directly owning its proportion of shares owned by the limited partnership (see ¶21,972 of the Canadian Tax Reporter Commentary). Furthermore, the non-qualifying security rules and the loanback rules will be amended to also apply to donations of interests in limited partnerships (see ¶6400a and ¶18,369m of the Canadian Tax Reporter Commentary).

These measures apply in respect of investments in limited partnerships that are made or acquired on or after Budget Day.

Resolution 20: Gifts to Foreign Charitable Foundations

20. (1) Subparagraph (*a*)(v) of the definition "qualified donee" in subsection 149.1(1) of the Act is replaced by the following:

(v) a foreign charity that has applied to the Minister for registration under subsection (26),

(2) The portion of subsection 149.1(26) of the Act before subparagraph (*b*)(i) is replaced by the following:

(26) For the purposes of subparagraph (*a*)(v) of the definition "qualified donee" in subsection (1), the Minister may register, in consultation with the Minister of Finance, a foreign charity for a 24-month period that includes the time at which Her Majesty in right of Canada has made a gift to the foreign charity, if

(*a*) the foreign charity is not resident in Canada; and

(*b*) the Minister is satisfied that the foreign charity is

(3) Subsections (1) and (2) apply to applications made on or after the day on which the enacting legislation receives royal assent.

Dentons Canada LLP Commentary: Budget 2015 proposes to allow foreign charitable foundations to be registered as qualified donees if (i) they receive a gift from the Government of Canada and (ii) they are pursuing activities related to disaster relief or urgent humanitarian aid or are carrying on activities in the national interest of Canada. If the Minister agrees that these conditions are met, at the Minister's discretion, a foreign foundation will be treated as a qualified donee for the purposes of the Act for a 24-month period, generally commencing on the date that the foreign foundation received the gift.

Currently, subsection 149.1(26) and the definition of "qualified donee" in subsection 149.1(1) provide that only to a foreign organization that is a "charitable organization" can be treated as a qualified donee — i.e. only a foreign charity carrying on its own activities

is eligible and a foreign foundation is not. Accordingly, these amendments will broaden the types of foreign entities that are able to become "qualified donees".

This measure will apply on Royal Assent to the enacting legislation.

Resolutions 21 to 24: Small Business Tax Rate

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

(i) the product of the amount determined under paragraph (*a*) in respect of the taxpayer for the taxation year multiplied by

(A) for the 2016 and 2017 taxation years, 17%,

(B) for the 2018 taxation year, 16%, and

(C) for taxation years after 2018, 15%, and

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

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

(*a*) the product 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 multiplied by

(i) for the 2016 taxation year, 21/29,

(ii) for the 2017 and 2018 taxation years, 20/29, and

(iii) for taxation years after 2018, 9/13; and

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: Income earned by a corporation and paid to an individual as a dividend is required to be included in the individual's income and is subject to tax in the taxation year received. Under Canadian tax rules the amount of dividend is subject to a gross-up factor such that the amount of income reported by the individual is approximately equivalent to the pre-tax income of the corporation. A dividend tax credit ("DTC") is provided to the individual to compensate for the corporate taxes assumed to have been paid. In theory, the rules attempt to ensure that individuals will report the same income and be subject to the same tax as they would be if the income had been earned directly.

As a consequence of the proposed changes to the small business tax rate, the existing gross-up and DTC do not produce appropriate tax results. Accordingly, Budget 2015 proposes that the gross-up factor and the DTC (expressed as a percentage of the grossed-up dividend) will be revised approximately as follows:

Year	2015	2016	2017	2018	2019 onwards
Small business tax rate %	11	10.5	10	9.5	9
Gross-up %	18	17	17	16	15
DTC %	11	10.5	10	9.5	9

The reduced gross-up and reduced DTC are appropriate to dividends from income that is subject to the small business deduction. Since these provisions are to apply to all dividends other than eligible dividends, they will apply to dividends from investment income. It does not appear to be appropriate to have these reductions apply to dividends from investment income. The concept of integration of investment income earned by a Canadian-controlled private corporation seems to be eroded further.

23. (1) Paragraphs 125(1.1)(*a*) and (*b*) of the Act are replaced by the following:

(*a*) that proportion of 17% that the number of days in the taxation year that are in 2015 is of the number of days in the taxation year,

(*b*) that proportion of 17.5% that the number of days in the taxation year that are in 2016 is of the number of days in the taxation year,

(*c*) that proportion of 18% that the number of days in the taxation year that are in 2017 is of the number of days in the taxation year,

(*d*) that proportion of 18.5% that the number of days in the taxation year that are in 2018 is of the number of days in the taxation year, and

(*e*) that proportion of 19% that the number of days in the taxation year that are after 2018 is of the number of days in the taxation year.

(2) Subsection (1) applies to the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: Canadian-controlled private corporations currently enjoy a small business deduction ("SBD") that reduces federal income tax on up to $500,000 of active business income annually to a small business tax rate of 11%. The $500,000 threshold is shared among associated corporations and begins to be phased-out where taxable capital in Canada exceeds $10 million and is eliminated at $15 million or greater.

Budget 2015 proposes to increase the SBD so that the small business tax rate is reduced to 9% by 2019 as follows:

January 1, 2016 10.5%

January 1, 2017 10.0%

January 1, 2018 9.5%

January 1, 2019 9.0%

Taxation years that straddle the calendar year will be pro-rated accordingly.

24. (1) Paragraph 137(4.3)(*a*) of the Act is replaced by the following:

(*a*) the preferred-rate amount of a corporation at the end of a taxation year is determined by the formula

$$A + B/C$$

where

A is its preferred-rate amount at the end of its immediately preceding taxation year,

B is the amount deductible under section 125 from the tax for the taxation year otherwise payable by it under this Part, and

C is its small business deduction rate for the taxation year within the meaning of subsection 125(1.1);

(2) Subsection (1) applies for the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: The "preferred-rate amount" of a corporation that is a credit union at the end of a taxation year includes income qualifying for the SBD. To determine the preferred-rate amount, the amount deducted as a SBD is multiplied by a factor that reflects the SBD rate.

Budget 2015 proposes a reduction to the small business tax rate. As a consequence, a transitional rule is provided to determine the preferred-rate amount of a credit union at the end of its taxation year. Under the transitional rule, the preferred-rate amount of a credit union at the end of such taxation year will be prorated based upon the number of days in each calendar year where the small business tax rate is declining.

Resolutions 25 to 28: Manufacturing and Processing Machinery and Equipment: Accelerated Capital Cost Allowance

25. Paragraph 1100(1)(a) of the *Income Tax Regulations* is amended by striking out "and" at the end of subparagraph (xxxvii), by adding "and" at the end of subparagraph (xxxviii) and by adding the following after subparagraph (xxxviii):

(xxxix) of Class 53, 50 per cent,

26. Paragraph 4600(2)(k) of the *Income Tax Regulations* is replaced by the following:

(*k*) a property included in Class 21, 24, 27, 29, 34, 39, 40, 43, 45, 46, 50, 52 or 53 in Schedule II;

27. Paragraph (*a*) of Class 43 of Schedule II to the *Income Tax Regulations* is replaced by the following:

(*a*) is not included in Class 29 or 53, but that would otherwise be included in Class 29 if that Class were read without reference to its subparagraphs (*b*)(iii) and (v) and paragraph (*c*); or

28. Schedule II to the *Income Tax Regulations* is amended by adding the following after Class 52:

CLASS 53

Property acquired after 2015 and before 2026 that is not included in Class 29, but that would otherwise be included in that Class if

(*a*) subparagraph (a)(ii) of that Class were read without reference to "in Canadian field processing carried on by the lessee or"; and

(*b*) that Class were read without reference to its subparagraphs (b)(iv) to (vi) and paragraph (c).

Dentons Canada LLP Commentary: Since March 19, 2007, class 29 of the capital cost allowance ("CCA") rules has provided an accelerated depreciation rate of 50 percent calculated on a straight-line basis for machinery and equipment used in manufacturing or processing of goods for sale or lease — previously, these assets were eligible for a CCA rate of 30% on a declining basis under Class 43. The accelerated treatment was originally announced in the 2007 federal Budget for property acquired before 2009, but the deadline was extended in subsequent budgets to the current deadline applying to property acquired before 2016.

For property acquired after 2015 and before 2026, Budget 2015 effectively moves machinery and equipment used in manufacturing or processing of goods for sale or lease to new Class 53. The CCA rate will be 50% on a declining-balance basis. The one-half year rule will apply to Class 53. The property will be considered "qualified property" under subsection 127(9) for the purposes of the Atlantic Investment Tax Credit. Beginning in 2026, these properties will be subject to the former 30% rate under Class 43.

Resolution 29: Agricultural Cooperatives: Deferral of Tax on Patronage Dividends Paid in Shares

29. Paragraph (*a*) of the definition "tax deferred cooperative share" in subsection 135.1(1) of the Act is replaced by the following:

(*a*) issued, after 2005 and before 2021, by an agricultural cooperative corporation to a person or partnership that is at the time the share is issued an eligible member of the agricultural cooperative corporation, pursuant to an allocation in proportion to patronage;

Dentons Canada LLP Commentary: Under subsection 135(7), a payment by an agricultural cooperative corporation made pursuant to "an allocation in proportion to patronage" (sometimes called a patronage dividend) is included in the income of the recipient in the year of receipt. However, an exception was announced in Budget 2005 for the payment of patronage stock dividends to eligible members of an agricultural cooperative by way of the issuance of "tax-deferred cooperative shares". The amendment allows the recipient (by way of optional election) to defer the inclusion of some or all the dividend until the year in which the shares are sold, effective for shares issued after 2005 and before 2016. Furthermore, the normal 15% rate of withholding tax that normally applies to patronage dividends is not imposed when the share is issued; instead, withholding is imposed when the share is redeemed.

Budget 2015 proposes to extend this deferral treatment for shares issued by an agricultural cooperative corporation before 2021.

Resolution 30: Quarterly Remitter Category for New Employers

30. (1) Subsection 108(1) of the *Income Tax Regulations* is replaced by the following:

108. (1) Subject to subsections (1.1) to (1.13), amounts deducted or withheld in a month under subsection 153(1) of the Act shall be remitted to the Receiver General on or before the 15th day of the following month.

(2) Section 108 of the *Income Tax Regulations* is amended by adding the following after subsection (1.12):

(1.13) If an employer is a new employer throughout a particular month in a particular calendar year, all amounts deducted or withheld from payments described in the definition "remuneration" in subsection 100(1) that are made by the employer in the month may be remitted to the Receiver General

(*a*) in respect of such payments made in January, February and March of the particular calendar year, on or before the 15th day of April of the particular calendar year;

(*b*) in respect of such payments made in April, May and June of the particular calendar year, on or before the 15th day of July of the particular calendar year;

(*c*) in respect of such payments made in July, August and September of the particular calendar year, on or before the 15th day of October of the particular calendar year; and

(*d*) in respect of such payments made in October, November and December of the particular calendar year, on or before the 15th day of January of the year following the particular calendar year.

(3) Section 108 of the *Income Tax Regulations* is amended by adding the following after subsection (1.2):

(1.21) For the purposes of subsection (1.4), the monthly withholding amount, in respect of an employer for a month, is the total of all amounts each of which is an amount required to be

remitted with respect to the month by the employer or, if the employer is a corporation, by each corporation associated with the corporation, under

(*a*) subsection 153(1) of the Act and a similar provision of a law of a province which imposes a tax upon the income of individuals, if the province has entered into an agreement with the Minister of Finance for the collection of taxes payable to the province, in respect of payments described in the definition "remuneration" in subsection 100(1);

(*b*) subsection 21(1) of the *Canada Pension Plan*; or

(*c*) subsection 82(1) of the *Employment Insurance Act*.

(4) Section 108 of the *Income Tax Regulations* is amended by adding the following after subsection (1.3):

(1.4) For the purposes of subsection (1.13) an employer

(*a*) becomes a new employer at the beginning of any month after 2015 in which the employer first becomes an employer; and

(*b*) ceases to be a new employer at a specified time in a particular year, if in a particular month the employer does not meet any of the following conditions:

(i) the monthly withholding amount in respect of the employer for the particular month is less than $1,000,

(ii) throughout the 12–month period before that time, the employer has remitted, on or before the day on or before which the amounts were required to be remitted, all amounts each of which was required to be remitted under subsection 153(1) of the Act, subsection 21(1) of the*Canada Pension Plan*, subsection 82(1) of the*Employment Insurance Act* or Part IX of the *Excise Tax Act*, and

(iii) throughout the 12–month period before that time, the employer has filed all returns each of which was required to be filed under the Act or Part IX of the Excise Tax Act on or before the day on or before which those returns were required to be filed under those Acts.

(1.41) For the purposes of subsection (1.4), the specified time is the end of

(a) March of the particular year, if the particular month is January, February or March of that year;

(b) June of the particular year, if the particular month is April, May or June of that year;

(c) September of the particular year, if the particular month is July, August or September of that year; and

(d) December of the particular year, if the particular month is October, November or December of that year.

(5) Subsections (1) to (4) apply in respect of amounts deducted or withheld after 2015.

Dentons Canada LLP Commentary: Employers are required to remit various payroll and income tax source deductions. The frequency with which such source deductions are required to be remitted is based on the average monthly withholding amount in prior calendar years — remittance may be on a weekly, twice-monthly, monthly or quarterly basis.

Currently, new employers must remit source deductions on a monthly basis for at least a year and are only eligible to remit on a quarterly basis if they have an average monthly withholding amount that does not exceed $3,000 and a perfect remittance record for the preceding twelve months.

Budget 2015 proposes to amend section 108 and subsection 108(1) of the *Income Tax Regulations* to allow new employers to remit on a quarterly basis if the monthly withholding amount is less than $1,000. This corresponds to the source deductions required for one employee at a salary of up to $43,500. If the withholding amount exceeds $1,000 per month, the employer will become a weekly, twice-monthly, monthly or quarterly remitter under the existing remittance rules.

Resolutions 31 and 32: Synthetic Equity Arrangements

31. (1) Section 112 of the Act is amended by replacing subsection (2.3) with the following:

(2.3) No deduction may be made under subsection (1) or (2) or 138(6) in computing the taxable income of a particular corporation in respect of a dividend received on a share of the capital stock of a corporation as part of a dividend rental arrangement of the particular corporation or a partnership of which the particular corporation is directly or indirectly a member.

(2.31) Subsection (2.3) does not apply to a dividend received on a share as part of a dividend rental arrangement of a person or partnership (referred to in this subsection and subsection (2.32) as the "taxpayer") throughout a particular period during which the synthetic equity arrangement referred to in paragraph (c) of the definition "dividend rental arrangement" is in effect if

(*a*) the dividend rental arrangement is a dividend rental arrangement because of paragraph (*c*) of the definition "dividend rental arrangement" in subsection 248(1); and

(*b*) the taxpayer establishes that, throughout the particular period, no tax-indifferent investor or group of tax-indifferent investors, each member of which is affiliated with every other member, has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share because of the synthetic equity arrangement or a specified synthetic equity arrangement.

(2.32) A taxpayer is considered to have satisfied the condition described in paragraph (2.31)(*b*) in respect of a share if

(*a*) where the taxpayer or the non-arm's length person referred to in paragraph (*a*) of the definition "synthetic equity arrangement" in subsection 248(1) (either of which is referred to in this subsection as the "synthetic equity arrangement party") obtains accurate representations in writing from its counterparty, or from each member of a group comprised of all its counterparties each of which is affiliated with every other member (each member of this group of counterparties is referred to in this subsection as an "affiliated counterparty"), with respect to the synthetic equity arrangement, as appropriate, that

(i) it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period referred to in subsection (2.31), and

(ii) it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period referred to in subsection (2.31);

(*b*) where the synthetic equity arrangement party obtains accurate representations in writing from its counterparty, or from each affiliated counterparty, with respect to the synthetic equity arrangement that the counterparty, or each affiliated counterparty, as appropriate

(i) is not a tax-indifferent investor and does not reasonably expect to become a tax-indifferent investor during the particular period referred to in subsection (2.31),

(ii) has entered into one or more specified synthetic equity arrangements that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit, in respect of the share, in one of the following circumstances:

(A) in the case of a counterparty, that counterparty

(I) has entered into a specified synthetic equity arrangement with its own counterparty (a counterparty of a counterparty or of an affiliated counterparty is referred to in this subsection as a “specified counterparty”), or

(II) has entered into a specified synthetic equity arrangement with each member of a group of its own counterparties every member of which is affiliated with each other member (each member of this group of counterparties is referred to in this subsection as an “affiliated specified counterparty”), or

(B) in the case of an affiliated counterparty, each affiliated counterparty

(I) has entered into a specified synthetic equity arrangement with the same specified counterparty, or

(II) has entered into a specified synthetic equity arrangement with an affiliated specified counterparty that is part of the same group of affiliated specified counterparties, and

(iii) has obtained accurate representations in writing from each of its specified counterparties, or from each member of the group of affiliated specified counterparties referred to in subclause (A)(II) or (B)(II), as appropriate, that

(A) it is not a tax-indifferent investor and it does not reasonably expect to become a tax-indifferent investor during the particular period referred to in subsection (2.31), and

(B) it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period referred to in subsection (2.31);

(c) where the synthetic equity arrangement party obtains accurate representations in writing from its counterparty, or from each affiliated counterparty, with respect to the synthetic equity arrangement that the counterparty, or each affiliated counterparty, as appropriate

(i) is not a tax-indifferent investor and does not reasonably expect to become a tax-indifferent investor during the particular period referred to in subsection (2.31),

(ii) has entered into specified synthetic equity arrangements

(A) that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share,

(B) where no single specified counterparty or group of affiliated specified counterparties has been provided with all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share, and

(C) where each specified counterparty or affiliated specified counterparty deals at arm’s length with each other (other than in the case of affiliated specified counterparties, within the same group, of affiliated specified counterparties), and

(iii) has obtained accurate representations in writing from each of its specified counterparties, or from each of its affiliated specified counterparties, that

(A) it is a person resident in Canada and it does not reasonably expect to cease to be resident in Canada during the particular period referred to in subsection (2.31), and

(B) it has not eliminated and it does not reasonably expect to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share during the particular period referred to in subsection (2.31); or

(*d*) where a person or partnership is a party to a synthetic equity arrangement chain in respect of the share, the person or partnership

(i) has obtained all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share under the synthetic equity arrangement chain,

(ii) has entered into one or more specified synthetic equity arrangements that have the effect of eliminating all or substantially all of its risk of loss and opportunity for gain or profit in respect of the share, and

(iii) obtains accurate representations in writing of the type described in paragraph (*a*), (*b*) or (*c*), as if it were a synthetic equity arrangement party, from each of its counterparties where each such counterparty deals at arm's length with that person or partnership.

(2.33) If, at a time during a particular period referred to in subsection (2.31), a counterparty, specified counterparty, affiliated counterparty or affiliated specified counterparty reasonably expects to become a tax-indifferent investor or to eliminate all or substantially all of its risk of loss and opportunity for gain or profit in respect of a share, the particular period for which it has provided a representation in respect of the share is deemed to end at that time.

(2.34) For greater certainty, each reference in subsection (2.32) to a "counterparty", a "specified counterparty", an "affiliated counterparty" or an "affiliated specified counterparty" shall be read as referring only to a person or partnership that obtains all or any portion of the risk of loss or opportunity for gain or profit in respect of the share referred to in that subsection.

(2) Section 112 of the Act is amended by adding the following after subsection (9):

(10) For the purposes of subsections (3), (3.1), (4), (4.1) and (5.2), if a synthetic equity arrangement is in respect of a number of shares that are identical properties (referred to in this subsection as "identical shares") that is less than the total number of such identical shares owned by the taxpayer at that time and in respect of which there is no other synthetic equity arrangement, the synthetic equity arrangement is deemed to be in respect of those identical shares in the order in which the taxpayer acquired them.

(3) Subsection (1) applies to dividends that are paid or become payable after October 2015.

(4) Subsection (2) comes into force on November 1, 2015.

32. (1) The definition "dividend rental arrangement" in subsection 248(1) of the Act is amended by striking out "and" at the end of paragraph (*a*) and by adding the following after paragraph (*b*):

(*c*) includes any synthetic equity arrangement, in respect of a share owned by the person, and

(*d*) includes one or more agreements or arrangements (other than agreements or arrangements described in paragraph (*c*)) entered into by the person, or the non-arm's length person referred to in paragraph (a) of the definition "synthetic equity arrangement", if

(i) the agreements or arrangements have the effect, or would have the effect if entered into by the person instead of the non-arm's length person, of eliminating all or substantially all of the person's risk of loss and opportunity for gain or profit in respect of a share owned by the person,

(ii) as part of a series of transactions that includes these agreements or arrangements, a tax-indifferent investor, or a group of tax-indifferent investors each member of which is affiliated with every other member, obtains all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share, and

(iii) it is reasonable to conclude that one of the purposes of the series of transactions is to obtain the result described in subparagraph (ii);

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

"recognized derivatives exchange" means a person or partnership recognized or registered under the securities laws of a province to carry on the business of providing the facilities necessary for the trading of options, swaps, futures contracts or other financial contracts or instruments whose market price, value, delivery obligations, payment obligations or settlement obligations are derived from, referenced to or based on an underlying interest;

"specified mutual fund trust", at any time, means a mutual fund trust other than a mutual fund trust for which it can reasonably be considered, having regard to all the circumstances, including the terms and conditions of the units of the trust, that the total of all amounts each of which is the fair market value, at that time, of a unit issued by the trust and held by a person exempt from tax under section 149 is all or substantially all of the total of all amounts each of which is the fair market value, at that time, of a unit issued by the trust;

"specified synthetic equity arrangement", in respect of a share owned by a person or partnership, means one or more agreements or other arrangements that

(*a*) have the effect of providing to a person or partnership all or any portion of the risk of loss or opportunity for gain or profit in respect of the share, and

(*b*) can reasonably be considered to have been entered into in connection with a synthetic equity arrangement, in respect of the share, or in connection with another specified synthetic equity arrangement, in respect of the share;

"synthetic equity arrangement", in respect of a share owned by a person or a partnership (referred to in this definition as the "particular person"),

(*a*) means one or more agreements or other arrangements that

(i) are entered into by the particular person, or by a person or partnership that does not deal at arm's length with the particular person (referred to in this definition as a "non-arm's length person"), with one or more persons or partnerships (referred to in this definition as a "counterparty" and in subsection 112(2.32) as a "counterparty" or an "affiliated counterparty" as appropriate),

(ii) have the effect, or would have the effect, if entered into by the particular person instead of the non-arm's length person, of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share to a counterparty or a group of counterparties each member of which is affiliated with every other member and, for greater certainty, opportunity for gain or profit includes rights to, benefits from and distributions on a share, and

(iii) if entered into by a non-arm's length person, can reasonably be considered to have been entered into with the knowledge, or where there ought to have been the knowledge, that the effect described in subparagraph (ii) would result, and

(*b*) does not include

(i) an agreement that is traded on a recognized derivatives exchange unless it can reasonably be considered that, at the time the agreement is executed, the particular person or the non-arm's length person, as the case may be, knows or ought to know the identity of its counterparty,

(ii) one or more agreements or other arrangements that, but for this subparagraph, would be a synthetic equity arrangement, in respect of a share owned by the particular person (in this subparagraph referred to as the "synthetic short position"), if

(A) the particular person has entered into one or more other agreements or other arrangements (other than, for greater certainty, an agreement under which the share

is acquired or a securities lending arrangement) that have the effect of providing all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share to the particular person (in this subparagraph referred to as the "synthetic long position"),

(B) the synthetic short position has the effect of offsetting all amounts included or deducted in computing the income of the particular person with respect to the synthetic long position, and

(C) the synthetic short position was entered into for the purpose of obtaining the effect referred to in clause (B), and

(iii) an agreement whose payment or settlement obligations are derived from, or referenced to, an index

(A) that reflects the value of 75 or more types of identical shares,

(B) that references only long positions with respect to its underlying components,

(C) that is created and maintained by persons or partnerships that deal at arm's length with the particular person and the value of which is published and publicly available, and

(D) where the total fair market value of the shares of the capital stock of Canadian corporations reflected in the index is not, at any time during the term of the agreement or arrangement, greater than 5% of the total fair market value of all shares reflected in the index;

"synthetic equity arrangement chain", in respect of a share owned by a person or partnership, means a synthetic equity arrangement — or a synthetic equity arrangement in combination with one or more specified synthetic equity arrangements — where

(*a*) no party to the synthetic equity arrangement or a specified synthetic equity arrangement, if any, is a non-resident person or a partnership other than a Canadian partnership, and

(*b*) each other party to these agreements or arrangements is affiliated with the person or partnership;

"tax-indifferent investor" means

(*a*) a person exempt from tax under section 149,

(*b*) a non-resident person, other than a person to which amounts paid or credited under a synthetic equity arrangement or a specified synthetic equity arrangement may reasonably be attributed to the business carried on by the person in Canada through a permanent establishment (as defined by regulation) in Canada,

(*c*) a trust resident in Canada (other than a specified mutual fund trust) if any of the interests as a beneficiary under the trust is not a fixed interest (as defined in subsection 251.2(1)) in the trust (in this definition referred to as a "discretionary trust"),

(*d*) a partnership if more than 10% of the fair market value of all interests in the partnership can reasonably be considered to be held, directly or indirectly through one or more trusts or partnerships, by any combination of persons described in paragraphs (*a*) to (*c*), and

(*e*) a trust resident in Canada (other than a specified mutual fund trust or a discretionary trust) if more than 10% of the fair market value of all interests as beneficiaries under the trust can reasonably be considered to be held, directly or indirectly through one or more trusts or partnerships, by any combination of persons described in paragraphs (*a*) or (*c*);

(3) Section 248 of the Act is amended by adding the following after subsection (41):

(42) For the purposes of subsections 112(2.31), (2.32) and (10), the definition "synthetic equity arrangement" in subsection (1) and paragraph (c) of the definition "dividend rental arrangement" in subsection (1), a synthetic equity arrangement that reflects the fair market value of more than one type of identical shares (as defined in subsection 112(8.1)) is considered to be a separate arrangement with respect to each type of identical shares the value of which the arrangement reflects.

(4) Subsection (1) applies to dividends that are paid or become payable after October 2015.

(5) Subsections (2) and (3) come into force on November 1, 2015.

Dentons Canada LLP Commentary: Taxable dividends received by one corporation from another are, subject to certain exceptions, deductible in determining the recipient corporation's taxable income. The purpose of this inter-corporate dividend deduction is to avoid multiple levels of taxation on corporate distributions.

The *Income Tax Act* currently contains rules that deny the inter-corporate dividend deduction where the dividend is received as part of an arrangement (a dividend rental arrangement) the main reason of which is to allow a person to receive a dividend on a share in circumstances where another person has the economic benefit or exposure in respect of the share. An example of a dividend rental arrangement would be where a corporate taxpayer borrows a share from a tax-exempt entity for the purpose of receiving a dividend on the share. But for the denial of the inter-corporate dividend, the corporate taxpayer may be able to receive the dividend, claim the inter-corporate dividend deduction, and also claim a deduction for a fee paid to the tax-exempt counterparty for the use of the share.

There was some concern on the part of the Department of Finance that the existing dividend rental arrangement rules were not broad enough to cover arrangements where legal title to a share is retained and all or substantially all of the risk of loss and opportunity for gain or profit is transferred to another taxpayer through the use of an equity derivative (a synthetic equity arrangement). The party that retains legal title would receive the dividends on the share, claim the inter-corporate dividend deduction, and also claim a deduction for a dividend-equivalent fee that would be paid to the counterparty. The counterparty is frequently a "tax indifferent" entity that does not pay Canadian tax, such as a tax-exempt entity or a non-resident person, and therefore has no preference to earning a "fee" as opposed to a dividend.

Budget 2015 documents state that the Canadian government believes that it can successfully challenge synthetic equity arrangements under existing rules – but that this is a time-consuming and expensive process. Budget 2015 proposes to eliminate the above advantage by amending the dividend rental arrangement rules to deny the inter-corporate dividend deduction for dividends received by a taxpayer where the taxpayer (or a person that does not deal at arm's length with the taxpayer) enters into a synthetic equity arrangement in respect of a Canadian share.

An exception to the denial of the inter-corporate dividend deduction will be provided where it can be established that a tax-indifferent investor is not a counterparty to the synthetic equity arrangement. A taxpayer will qualify for this exception if it obtains accurate representations in writing from the counterparty that the counterparty is not a tax-indifferent investor and either:

i. does not reasonably expect to eliminate all or substantially all of the risk of loss and opportunity for gain or profit; or

ii. has transferred all or substantially all of the risk of loss and opportunity for gain or profit to its own counterparty and has obtained the appropriate representations from that counterparty.

If the representations are later determined to be inaccurate, the arrangement will be treated as a dividend rental arrangement.

These measures are not applicable to arrangements traded on a recognized derivatives exchange unless the taxpayer knows, or ought to know, the counterparty to the arrangement.

A new anti-avoidance measure will deem certain agreements to fall within the definition of synthetic equity arrangements where it can be established that the agreement eliminated all or substantially all of the risk of loss and opportunity for gain or profit if one of the purposes of the transaction or series of transactions is to avoid the measure.

These measures are applicable to dividends paid or payable after October 2015.

An alternate measure may also be considered that would deny the dividend deduction where a synthetic equity arrangement exists regardless of the identity of the counterparty. Budget 2015 documents state that this would result in broader application of the proposed measures but would simplify the rules. Taxpayers will have until August 31, 2015 to submit comments to the Minister of Finance.

Resolutions 33 to 36: Tax Avoidance of Corporate Capital Gains (Section 55)

33. (1) Paragraph 52(3)(*a*) of the Act is replaced by the following:

(*a*) where the stock dividend is a dividend,

(i) in the case of a shareholder that is an individual, the amount of the stock dividend, and

(ii) in any other case, the total of all amounts each of which is

(A) the lesser of the amount of the stock dividend and its fair market value, and

(B) the amount determined by the formula

$$A + B - C$$

where

A is the amount of the reduction under paragraph 55(2.3)(*b*) in respect of that stock dividend,

B is the amount of the deemed gain under paragraph 55(2)(*b*) in respect of that stock dividend, and

C is the amount included in the total because of clause (A);

(2) Subsection (1) applies to stock dividends received after April 20, 2015.

34. (1) Subparagraph 53(1)(*b*)(ii) of the Act is replaced by the following:

(ii) the portion of the total determined under subparagraph (i) that relates to dividends in respect of which the taxpayer was permitted a deduction under subsection 112(1) in computing the taxpayer's taxable income, except any portion of the dividend that, if paid as a separate dividend, would not be subject to subsection 55(2) because the amount of the separate dividend would not exceed the amount of the income earned or realized by any corporation — after 1971 and before the safe-income determination time for the transaction, event or series — that could reasonably be considered to

contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received;

(2) Subsection (1) applies to dividends received after April 20, 2015.

35. (1) Subsection 55(2) of the Act is replaced by the following:

(2) If this subsection applies to a taxable dividend received by a dividend recipient, notwithstanding any other provision of this Act, the amount of the dividend (other than the portion of it, if any, subject to tax under Part IV that is not refunded as a consequence of the payment of a dividend by a corporation where the payment is part of the series referred to in subsection (2.1))

(*a*) is deemed not to be a dividend received by the dividend recipient; and

(*b*) is deemed to be a gain of the dividend recipient, for the year in which the dividend was received, from the disposition of a capital property.

(2.1) Subsection (2) applies to a taxable dividend received by a corporation resident in Canada (in subsections (2) to (2.2) and (2.4) referred to as the "dividend recipient") as part of a transaction or event or a series of transactions or events if

(*a*) the dividend recipient is entitled to a deduction in respect of the dividend under subsection 112(1) or (2) or 138(6);

(*b*) it is the case that

(i) one of the purposes of the payment or receipt of the dividend (or, in the case of a dividend under subsection 84(3), one of the results of which) is to effect a significant reduction in the portion of the capital gain that, but for the dividend, would have been realized on a disposition at fair market value of any share of capital stock immediately before the dividend, or

(ii) the dividend is received on a share that is held as capital property by the dividend recipient and one of the purposes of the payment or receipt of the dividend (other than a dividend under subsection 84(3)) is to effect

(A) a significant reduction in the fair market value of any share, or

(B) a significant increase in the cost of property, such that the amount that is the total of the cost amounts of all properties of the dividend recipient immediately after the dividend is significantly greater than the amount that is the total of the cost amounts of all properties of the dividend recipient immediately before the dividend; and

(*c*) the amount of the dividend exceeds the amount of the income earned or realized by any corporation — after 1971 and before the safe-income determination time for the transaction, event or series — that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received.

(2.2) For the purpose of applying subsections (2) to (2.4) , the amount of a stock dividend and the dividend recipient's entitlement to a deduction under subsection 112(1) or (2) or 138(6) in respect of the amount of that dividend is to be determined as if paragraph (b) of the definition "amount" in subsection 248(1) read as follows:

"(b) in the case of a stock dividend paid by a corporation, the greater of

(i) the amount by which the paid-up capital of the corporation that paid the dividend is increased by reason of the payment of the dividend, and

(ii) the fair market value of the share or shares issued as a stock dividend at the time of payment,".

(2.3) If this subsection applies

(*a*) the amount of the stock dividend is deemed for the purpose of subsection (2) to be a separate dividend to the extent of the portion of the amount that does not exceed the amount of the income earned or realized by any corporation — after 1971 and before the safe-income determination time for the transaction, event or series — that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received; and

(*b*) the amount of the separate dividend referred to in paragraph (a) is deemed to reduce the amount of the income earned or realized by any corporation — after 1971 and before the safe-income determination time for the transaction, event or series — that could reasonably be considered to contribute to the capital gain that could be realized on a disposition at fair market value, immediately before the dividend, of the share on which the dividend is received.

(2.4) Subsection (2.3) applies in respect of a stock dividend if

(a) a dividend recipient holds a share upon which it receives the stock dividend;

(b) the fair market value of the stock dividend referred to in paragraph (*a*) exceeds the amount by which the paid-up capital of the corporation that paid the stock dividend is increased because of the dividend; and

(c) subsection (2) would apply to the dividend if subsection (2.1) were read without reference to its paragraph (*c*).

(2.5) For the purpose of applying clause (2.1)(*b*)(ii)(A), whether a dividend causes a significant reduction in the fair market value of any share is to be determined as if the fair market value of the share, immediately before the dividend, was increased by an amount equal to the fair market value of the dividend received on the share.

(2) The portion of paragraph 55(3)(*a*) of the Act that is before subparagraph (i) is replaced by the following:

(*a*) in the case of a dividend under subsection 84(3), if, as part of a transaction or event or a series of transactions or events as a part of which the dividend is received, there was not at any particular time

(3) Subsections (1) and (2) apply to dividends received after April 20, 2015.

36. The Act is further amended by making other consequential amendments as a result of sections 33 to 35.

Dentons Canada LLP Commentary: Section 55(2) and its related provisions (referred as the "Butterfly Rules") operate to recharacterize intercorporate dividends, which would otherwise be tax-free, as capital gains. The Butterfly Rules are complex and detailed anti-avoidance provisions and have become increasingly onerous for practitioners to navigate since their introduction in 1979. However, in spite of an almost forty-year lifespan, application of the Butterfly Rules still require heavy reliance on administrative positions and statements by the Canada Revenue Agency, which has proved problematic for the Minister when debating these sections during tax litigation.

This Budget attempts to reorganize and expand the Butterfly Rules in a detailed manner and to deal with a specific abusive situation noted in the Budget Documents. However, as with all complex legislation, it is likely that the proposed amendments will affect situations other than the specific one mentioned in the Budget Documents.

The type of transaction that prompted the changes is set out clearly in the Budget Documents. A corporation should be prevented from creating a scenario where the fair market

value of a subsidiary is "artificially" reduced by means of paying an intercorporate dividend, which in turn creates an accrued capital loss in the shares of that subsidiary.

There is reference in the Budget to a recent Tax Court case in which the government was unsuccessful using 55(2) to prevent what in its view was an inappropriate outcome using stock dividends; it is believed that the case referred to is *D&D Livestock Ltd. v. HMTQ*, 2013 DTC 1251.

Budget 2015 notes in the context of the specific amendments to the Butterfly Rules regarding stock dividends that "[s]uch transactions may be challenged by the Government under the existing general anti-avoidance rule. However, as any such challenge could be both time-consuming and costly, the Government is introducing specific legislative measures to ensure that the appropriate tax consequences apply." We note that this language has now become standard fare whenever the government introduces a new (or overhauls an existing) anti-avoidance rule. Presumably, this is done to prevent prejudicing any existing litigation before the courts.

Specifically, the situation addressed by Budget 2015 is as follows:

1. Corporation A is the sole shareholder of Corporation B. Assume that the adjusted cost base to Corporation A of Corporation B's shares is $4.0MM. The fair market value of Corporation B's shares is $4.0MM.

2. Corporation A contributes $1.0MM to Corporation B for additional shares of the same class it already owns. Accordingly, Corporation A now has shares in Corporation B with an adjusted cost base and fair market value equal to $5.0MM.

3. If Corporation B then pays a dividend to Corporation A of $1.0MM, the fair market value of its shares will decline to $4.0MM and the cash recently contributed for additional shares will have been returned to Corporation A. However, the adjusted cost base to Corporation A of its shares in Corporation B will remain equal to $5.0MM. Existing subsection 55(2) would not "catch" this dividend since the purpose of this dividend was not to reduce the capital gain on the Corporation B shares.

4. Assume Corporation A also has an asset with a nominal adjusted cost base and a value of $1.0MM, meaning the asset has an accrued but unrealized capital gain of $1.0MM. If that asset was transferred by Corporation A to Corporation B pursuant to section 85, the shares in Corporation B held by Corporation A would then have an adjusted cost base of $5.0MM and a fair market value of $5.0MM.

5. If Corporation A then sells the shares of Corporation B for $5.0MM, it would realize no gain or loss. However, if the asset was sold directly instead, a capital gain of $1.0MM would have been realized by Corporation A. Accordingly, these steps enabled Corporation A to avoid realizing a capital gain of $1.0MM.

Budget 2015 rewrites subsection 55(2) and introduces new subsections 55(2.1) to (2.4) to track transactions which ultimately reduce the value of any share or increase the cost of property to deal with the transactions described above.

Specifically, new subsection 55(2.1) deems subsection 55(2) to apply to a dividend (thereby recharacterizing the dividend as a capital gain) where three conditions are met. First, the dividend is deductible to the recipient under any of subsections 112(1), 112(2), or 138(6).

Second, either: (i) one of the purposes of the dividend (or, for a deemed dividend under subsection 84(3), one of the results of the dividend) is to effect a significant reduction in the portion of the capital gain that but for the dividend would arise on the disposition of the share (this is effectively the existing rule in 55(2)); or (ii), the dividend is paid on a share that is capital property to the shareholder and one of the purposes (or, where the dividend is a deemed dividend, the effect) of the payment is to cause either "a significant reduction in the fair market value of any share" or "a significant increase in the cost of property, such that the amount that is the total of the cost amounts of all properties of the dividend recipient immediately after the dividend is significantly greater than the amount that is the total of the cost amounts of all properties of the dividend recipient immediately before the dividend".

Third, the existing exemption for dividends out of so-called "safe income" (i.e., tax-paid corporate retained earnings), is maintained. However, it remains to be seen whether new paragraph 55(2)(*c*), the safe income exemption, will be interpreted in a manner consistent with the existing safe income carve out in 55(2). In particular, the new safe income rule deems a dividend to be a capital gain to the extent that the dividend exceeds the income earned or realized by any corporation — after 1971 and before the safe income determination time for the transaction, event, or series — that could reasonably be considered to contribute to the capital gain that could be realized on a fair market value disposition *of the share on which the dividend is received*. This language appears to differ from the existing safe income exemption.

New subsection 55(2.2) provides a modified valuation methodology for determining the amount of a stock dividend in the context of the Butterfly Rules. For the purpose of applying 55(2.1), the stock dividend will be considered to have an "amount" equal to *the greater of* the amount by which the paying corporation's paid up capital has been increased and the fair market value of the stock dividend shares. Prior to these proposals, the amount of a stock dividend was typically considered to be equal to the increase in the paid up capital of the class of shares in respect of the stock dividend, and the fair market value was not a relevant factor (other than in certain very limited instances).

New subsection 55(2.3) will apply where certain conditions provided in proposed subsection 55(2.4) apply. These rules apply if: (i) a dividend recipient holds a share upon which it receives the stock dividend; (ii) the fair market value of the stock dividend exceeds the amount by which the paying corporation's paid up capital was increased because of the stock dividend; and (iii) subsection 55(2) would apply without regard to the safe income of the paying corporation and the resulting reduction in the capital gain because of the dividend.

Where these conditions are met, subsection 55(2.3) provides that the amount of the stock dividend will be a dividend for the purposes of subsection 55(2) and, to the extent that such dividend exceeds the corporation's safe income, the dividend will be deemed to have reduced a capital gain on a share disposed, thereby causing the dividend to be a capital gain. Paragraph 55(2.3)(*b*) further provides that the amount of this deemed capital gain will reduce the safe income otherwise available with respect to other dividends.

In addition to the significant changes noted above, Budget 2015 changes the Butterfly Rules in the context of "related party" transactions (for example, in the context of a family-owned business controlled by a parent). Currently, the "saving provisions" contained in paragraph 55(3)(*a*) prevent subsection 55(2) from applying in the case of all dividends, whether deemed or actual, so long as certain criteria are met. Budget 2015 proposes to amend paragraph 55(3)(*a*) so that it will apply only "in the case of a dividend under subsection 84(3)". This means only deemed dividends arising upon a share redemption, repurchase, or cancellation can be "protected" from subsection 55(2) by virtue of the paragraph 55(3)(*a*) exemption. Presumably, this means that the "purpose" test, which has been retained in new subparagraph 55(2)(*b*)(i), will have to be examined when paying dividends within a related corporate group. This may require a safe income calculation to be completed (or updated) in the case of

each intercorporate dividend, an undoubtedly costly and time-consuming process for taxpayers and their advisors.

The changes described above are to apply to dividends received after Budget Date.

Resolutions 37 to 40: Withholding for Non-Resident Employers

37. (1) Paragraph 153(1)(*a*) of the Act is replaced by the following:

(*a*) salary, wages or other remuneration, other than

(i) amounts described in subsection 212(5.1), and

(ii) amounts paid at any time by an employer to an employee if, at that time, the employer is a qualifying non-resident employer and the employee is a qualifying non-resident employee,

(2) Subsection 153(6) of the Act is replaced by the following:

(6) The following definitions apply in this section.

"designated financial institution" means a corporation that

(*a*) is a bank, other than an authorized foreign bank that is subject to the restrictions and requirements referred to in subsection 524(2) of the *Bank Act*;

(*b*) is authorized under the laws of Canada or a province to carry on the business of offering its services as a trustee to the public; or

(*c*) is authorized under the laws of Canada or a province to accept deposits from the public and carries on the business of lending money on the security of real property or immovables or investing in indebtedness on the security of mortgages on real property or of hypothecs on immovables.

"qualifying non-resident employee", at any time in respect of a payment referred to in paragraph (1)(*a*), means an employee who

(*a*) is, at that time, resident in a country with which Canada has a tax treaty;

(*b*) is not liable to tax under this Part in respect of the payment because of that treaty; and

(*c*) is not present in Canada for 90 days or more in any 12–month period that includes that time.

"qualifying non-resident employer" at any time means an employer

(*a*) that is at that time

(i) in the case of an employer that is not a partnership, resident in a country with which Canada has a tax treaty, and

(ii) in the case of an employer that is a partnership, a partnership in respect of which the total of all amounts, each of which is a share of the partnership's income or loss for the fiscal period that includes that time of a member that is, at that time, resident in a country with which Canada has a tax treaty, is not less than 90% of the income or loss of the partnership for the period, and, where the income and loss of the partnership are nil for the period, the income of the partnership for the period is deemed to be $1,000,000 for the purpose of determining a member's share of the partnership's income for the purposes of this subparagraph;

(*b*) that does not, in its taxation year or fiscal period that includes that time, carry on business through a permanent establishment (as defined by regulation) in Canada; and

(*c*) that is at that time certified by the Minister under subsection (7).

(7) The Minister may

(*a*) certify an employer for a specified period of time if the employer has applied in prescribed form containing prescribed information and the Minister is satisfied that the employer

(i) meets the conditions in paragraph (*a*) of the definition "qualifying non-resident employer",

(ii) does not carry on business through a permanent establishment (as defined by regulation) in Canada, and

(iii) meets the conditions established by the Minister; and

(*b*) revoke an employer's certification if the employer fails to comply with any of the conditions referred to in subparagraphs (*a*)(i) to (iii).

(3) Subsections (1) and (2) apply in respect of payments made after 2015.

38. (1) Section 227 of the Act is amended by adding the following after subsection (8.5):

(8.6) Subsection (8) does not apply to a qualifying non-resident employer (as defined in subsection 153(6)) in respect of a payment made to an employee if, after reasonable inquiry, the employer had no reason to believe at the time of the payment that the employee was not a qualifying non-resident employee (as defined in subsection 153(6)).

(2) Subsection (1) applies in respect of payments made after 2015.

39. (1) The portion of section 8201 of the Income Tax Regulations before paragraph (*a*) is replaced by the following:

8201. For the purposes of subsection 16.1(1), the definition "outstanding debts to specified non-residents" in subsection 18(5), subsections 100(1.3) and 112(2), the definition "qualified Canadian transit organization" in subsection 118.02(1), subsections 125.4(1) and 125.5(1), the definition "taxable supplier" in subsection 127(9), subparagraph 128.1(4)(*b*)(ii), subsections 153(6) and (7), paragraphs 181.3(5)(a) and 190.14(2)(*b*), the definitions "Canadian banking business" and "tax-indifferent investor" in subsection 248(1) and paragraph 260(5)(*a*) of the Act, a "permanent establishment" of a person or partnership (either of whom is referred to in this section as the "person") means a fixed place of business of the person, including an office, a branch, a mine, an oil well, a farm, a timberland, a factory, a workshop or a warehouse if the person has a fixed place of business and, where the person does not have any fixed place of business, the principal place at which the person's business is conducted, and

(2) Subsection (1) comes into force on November 1, 2015, except that in its application before 2016, the portion of subsection 8201 before its paragraph (a), as enacted by subsection (1), is to be read without reference to subsections 153(6) and (7).

40. The Act and the *Income Tax Regulations* are further amended by making other consequential amendments as a result of sections 37 to 39.

Dentons Canada LLP Commentary: A non-resident employee who earns employment income in Canada is subject to Canadian income tax on that income, even if the employee's remuneration is paid by a non-resident employer. Furthermore, the withholding tax requirements of subsection 153(1) normally apply to the payment of such remuneration.

Under some of Canada's income tax treaties, a non-resident's employment income in Canada may be exempt from tax in Canada. For example, under the Canada-U.S. Tax Treaty, a U.S. resident is exempt from tax in Canada on remuneration from employment in Canada if the remuneration does not exceed C$10,000, or if the U.S. resident is present in Canada for 183 days or less in any 12-month period commencing or ending in the relevant fiscal year, the remuneration is not paid directly or indirectly by an employer who is resident in Canada, and

is not borne by a permanent establishment in Canada of the employer. Despite the treaty exemption, the employer is liable to withhold tax under the Income Tax Act. The CRA may grant waivers from withholding in individual cases, but as the Budget papers state, "the existing employee waiver system has been criticized as inefficient because each waiver is granted only in respect of a specific employee and for a specific time period".

Budget 2015 proposes a blanket exemption from withholding under paragraph 153(1) (a) (i.e., a waiver is not needed) for remuneration paid by a "qualifying non-resident employer" to a "qualifying non-resident employee".

An employee is a "qualifying non-resident employee" if the employee: is resident in a country with which Canada has a tax treaty, is exempt from Part I tax in respect of the payment because of that tax treaty, and is not present in Canada for 90 or more days in any 12-month period that includes the time of the payment. Note that the 90 day limit is more restrictive than the 183 day limit in the Canada-U.S. Tax Treaty.

An employer is a "qualifying non-resident employer" if it is resident in a country with which Canada has a tax treaty. In the case of an employer that is a partnership, generally, members of the partnership who are resident in a treaty country must have an aggregate share of at least 90% of the partnership's income for the fiscal period that includes the time of the remuneration payment. In either case, the employer cannot carry on business through a permanent establishment (as defined in section 8201 of the Regulations) in the taxation year or fiscal period in which the remuneration payment is made. Lastly, the employer must be certified by the CRA.

A qualifying non-resident employer who fails to withhold tax as required on a payment to an employee (that is, where the above-noted conditions are not met) will not be subject to the penalties of subsection 227(8) provided that "after reasonable inquiry, the employer had no reason to believe at the time of the payment that the employee was not a qualifying non-resident employee" (proposed subsection 227(8.6)).

These provisions will apply in respect of payments made after 2015.

Resolution 41: Captive Insurance

41. (1) Paragraphs 95(2)(*a.2*) and (*a.21*) of the Act are replaced by the following:

(*a.2*) in computing the income from a business other than an active business for a taxation year of a foreign affiliate of a taxpayer

(i) there shall be included the income of the affiliate for the year from the insurance of specified Canadian risks (which, for the purposes of this paragraph, includes income for the year from the reinsurance of specified Canadian risks), unless more than 90% of the gross premium revenue of the affiliate for the year from the insurance of risks (net of reinsurance ceded) was in respect of the insurance of risks (other than specified Canadian risks) of persons with whom the affiliate deals at arm's length,

(ii) if subparagraph (i) applies to include income of the affiliate from the insurance of specified Canadian risks in computing the income of the affiliate from a business other than an active business,

(A) the insurance of those risks is deemed to be a separate business, other than an active business, carried on by the affiliate, and

(B) any income of the affiliate that pertains to or is incident to that business is deemed to be income from a business other than an active business,

(iii) except to the extent that the income is included in computing the income of the affiliate from a business other than an active business because of subparagraph (i) or (ii), there

shall be included the income of the affiliate for the year in respect of the ceding of specified Canadian risks which, for the purposes of this paragraph, includes

(A) income of the affiliate from services in respect of the ceding of specified Canadian risks, and

(B) except to the extent that the amount is included under clause (A), an amount equal to the difference between the fair market value of the consideration provided in respect of the ceding of the specified Canadian risks and the affiliate's cost in respect of those specified Canadian risks, and

(iv) if subparagraph (iii) applies to include income of the affiliate in respect of the ceding of specified Canadian risks in computing the income of the affiliate from a business other than an active business,

(A) the ceding of those risks is deemed to be a separate business, other than an active business, carried on by the affiliate, and

(B) any income of the affiliate that pertains to or is incident to that business is deemed to be income from a business other than an active business;

(*a.21*) for the purposes of paragraph (*a.2*), one or more risks insured by a foreign affiliate of a taxpayer that, if this Act were read without reference to this paragraph, would not be specified Canadian risks (in this paragraph referred to as the "foreign policy pool") are deemed to be specified Canadian risks if

(i) the affiliate, or a person or partnership that does not deal at arm's length with the affiliate, enters into one or more agreements or arrangements in respect of the foreign policy pool,

(ii) the affiliate's risk of loss or opportunity for gain or profit in respect of the foreign policy pool, in combination with its risk of loss or opportunity for gain in respect of the agreements or arrangements, can reasonably be considered to be — or could reasonably be considered to be if the affiliate had entered into the agreements or arrangements entered into by the person or partnership — determined, in whole or in part, by reference to one or more criteria in respect of one or more risks insured by another person or partnership (in this paragraph referred to as the "tracked policy pool"), which criteria are

(A) the fair market value of the tracked policy pool,

(B) the revenue, income, loss or cash flow from the tracked policy pool, or

(C) any other similar criteria, and

(iii) 10% or more of the tracked policy pool consists of specified Canadian risks;

(2) Subsection 95(2) of the Act is amended by adding the following after paragraph (*a.22*):

(*a.23*) for the purposes of paragraphs (*a.*2) and (*a.*21), "specified Canadian risk" means a risk in respect of

(i) a person resident in Canada,

(ii) a property situated in Canada, or

(iii) a business carried on in Canada;

(3) Subsections (1) and (2) apply to taxation years of a taxpayer that begin after April 20, 2015.

Dentons Canada LLP Commentary: Paragraph 95(2)(*a*.2) deems certain income earned by a foreign affiliate of a Canadian-resident taxpayer from the insurance and reinsurance of Canadian-source risks (“specified Canadian risks”, as described below) to be income from a separate business other than an active business. As such, if the foreign affiliate is a controlled foreign affiliate (“CFA”) of the Canadian resident, the income will be subject to the foreign accrual income property (“FAPI”) rules and included in the income of the Canadian resident. The provision is an anti-avoidance rule, meant to prevent Canadian residents from shifting income from insuring specified Canadian risks (those in respect of persons resident in Canada, property situated in Canada or businesses carried on in Canada) to a controlled foreign affiliate resident in a low-tax country.

The 2014 federal Budget introduced an anti-avoidance rule to ensure that the provision could not be circumvented through the use of certain “insurance swaps”. In general terms, this new rule can apply where a foreign affiliate of a taxpayer enters into an agreement in respect of foreign risks, the profit or loss from which is determined in whole or part by reference to a pool of insurance that insures specified Canadian risks.

The Department of Finance felt that the new insurance swap rules were being avoided through the use of alternative arrangements under which a foreign affiliate cedes its specified Canadian risks for consideration that includes an embedded profit element based upon the expected return on the pool of Canadian risks. Budget 2015 thus provides a further anti-avoidance rule that applies in these circumstances. More specifically, paragraph 95(2)(*a*.2) is amended such that if the affiliate cedes specified Canadian risks, it will include in income from a business that is not an active business (and therefore FAPI) (a) the affiliate’s income from services in respect of the ceding of the specified Canadian risks, and (b) an amount equal to the difference between the fair market value of the specified Canadian risks ceded and the affiliate’s costs in respect of those specified Canadian risks.

Budget 2015 includes the proposed definition of “specified Canadian risk” (as described above). Previously, the components of the specified Canadian risk were described separately as risks in respect of a person resident in Canada, a property situated in Canada, or a business carried on in Canada.

The new anti-avoidance rule applies to taxation years that begin after April 20, 2015. However, the Budget papers state that the Government “invites interested stakeholders to submit comments on this measure by June 30, 2015. Please send your comments to legislation-taxation@fin.gc.ca.”

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