Preface

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

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Minister of Finance

These notes are intended for information purposes only and should not be construed as an official interpretation of the provisions they describe.

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Private Corporations – Amendments to the Income Tax Act

Income Sprinkling

Clause 1

Definitions concerning the tax on split income

ITA
120.4(1)

The following definitions apply for the purpose of the tax on split income (TOSI) rules in section 120.4 of the *Income Tax Act (the "Act")*.

"excluded amount"

The definition "excluded amount" in subsection 120.4(1) describes income that is excluded from split income of an individual. The definition "excluded amount" currently includes two types of income. The first is income from property inherited by the individual from a parent of the individual. The second is income from property inherited by the individual from anyone, if the individual is, in the year in which the income is required to be reported, either a full time student enrolled at a post-secondary institution as defined in subsection 146.1(1) or eligible for the disability tax credit.

The definition "excluded amount" is amended in three respects. First, the definition is amended so that it also applies in respect of income that is from gains from the disposition of property. This change reflects a separate amendment (new paragraph (e) of the definition "split income") that would include certain gains in split income. Second, it is amended so that the existing types of income that are excluded amounts are also excluded in respect of property inherited by individuals who have not attained the age of 24 years. Third, the definition "excluded amount" is amended to include all amounts included in the income of individuals who have attained the age of 17 years before the year, other than a "split portion" of an amount.

For additional information, see the commentary on the definitions "split income" and "split portion" and the commentary on new paragraph (1.1)(e).

"specified individual"

A "specified individual" describes a taxpayer that is subject to tax on their "split income".

The definition "specified individual" in subsection 120.4(1) is repealed and replaced with a new definition. Under the new definition, an individual (other than a trust) is a specified individual in relation to a taxation year if three conditions are met:

1. the individual is a resident of Canada at the end of the taxation year or, if the individual died during the taxation year, the individual was a resident of Canada immediately before their death;

2. the individual is related (determined in accordance with new paragraph 120.4(1.1)(a)) to another individual (other than a trust) who is resident in Canada (referred to as the "other individual"); and

3. the individual has either (a) not attained the age of 17 years before the year and the other individual is a parent of the individual, or (b) the individual's income for the year includes an amount derived from a business that is, or was, sufficiently linked to the other individual. The rule applies to all types of income that are described in the split income definition, including income on reinvested split income (within the meaning of paragraph (g) of the split income definition) and amounts that are included in computing the individual's income as a result of section 15 or 246.

"split income"

"Split income" describes the types of income that are subject to the TOSI under subsection 120.4(2).

The definition "split income" is amended and expanded in several respects.

Subparagraphs (b)(ii) and (c)(ii) are amended by replacing part of their contents with a reference to amounts that can reasonably be considered to be income derived, directly or indirectly, from one or more related sources in respect of the individual. For the most part, much of the previous contents of those subparagraphs is preserved in the new definition "related source". For more information, see the explanatory notes for the new definition "related source".

New paragraph (d) extends the split income definition to apply in respect of income from indebtedness (*e.g.*, interest). In general terms, this type of income received by a specified individual from a debtor corporation, partnership or trust will be split income if other amounts (*e.g.*, dividends) received by the specified individual from the debtor would be split income.

Specifically, an amount will be split income pursuant to paragraph (d) of the definition when two conditions are met.

- First, the amount must be in respect of a debt obligation of a corporation (other than a publicly listed corporation or a mutual fund corporation), partnership or trust (other than a mutual fund trust). The following debt obligations are excluded:

    - certain debts of, or guaranteed by, governments, that are described in paragraph (a) of the definition "fully exempt interest" in subsection 212(3);

    - publicly-listed or traded debt; and

- a deposit standing to the individual's credit at a bank or credit union.

- Second, it must be reasonable to consider that one of two conditions are met:

  - where the debtor is a partnership or trust, the income is derived from a related source (as defined in subsection (1)) or any other amount that would be split income if received by the individual; or

  - where the debtor is a corporation, a person related to the individual is a "specified shareholder" (as defined in subsection 248(1)) of the corporation or a "connected individual" (as defined in subsection (1)) in respect of the corporation.

New paragraph (e) extends the split income definition to include taxable capital gains and income from the disposition of property, that is not otherwise included in the definition of split income, in situations where income from the property would be split income in the hands of the specified individual.

Specifically, an amount will be split income pursuant to paragraph (e) of the definition when two conditions are met.

- First, the amount must either be a gain realized by the individual from the disposition of property or income derived by the individual through a trust that is attributable to the disposition of a property by any person or partnership.

- Second, the property referred to in the first condition must generally be property the income from which would be split income if received by the specified individual. This would be the case for shares of a corporation (other than a publicly-traded share or a share of a mutual fund corporation). It could also be the case where the property is a debt obligation or an interest in a partnership or trust (other than a mutual fund trust or a trust that is deemed to arise under section 143, which relates to certain communal organizations). For property other than shares of a corporation, the property must also be a property in respect of which

  - an amount was included in the individual's split income for the year or a previous year, or

  - all of part of its fair market value immediately before the disposition was attributable to a share of a corporation (other than a publicly-traded share of a corporation or a share of a mutual fund corporation).

This type of income will be split income for dispositions of property that occur after 2017.

New paragraph (f) extends the split income definition to include certain amounts that are required to be included in a specified individual's income because of the application of section

246. In that respect, it is similar to existing subparagraph (a)(ii) of the definition, which applies in respect of shareholder benefits included in income because of section 15. In general terms, section 246 provides that where a person confers a benefit, directly or indirectly, on a taxpayer (that is not otherwise included in the taxpayer's income, but that would have been included if it had been made directly to the taxpayer), the amount of the benefit is included in the taxpayer's income for the year in which the benefit has been conferred. Amounts included in a specified individual's income as a result of section 246 will be split income to the extent that the amount would be split income if paid directly by the person to the specified individual.

New paragraph (g) extends the split income definition to include income from reinvested split income (or income subject to the tax attribution rules) of individuals under the age of 25 years. Paragraphs (a) to (f) of the definition are intended to prevent a higher-income taxpayer from splitting income with a lower-income taxpayer. The intent of paragraph (g) is that income derived from the investment of the after-tax amount of split income received by a specified individual will continue to be characterized as split income. As a result, a higher-income taxpayer will not be able to "seed" income-earning investment capital the income from which will be taxed in the hands of a lower-income related person without the TOSI rules applying to the income. For example, paragraph (g) would deem gains realized by a specified individual from the sale of publicly-listed shares to be split income if the specified individual purchased the shares using amounts that were previously included in their split income.

In terms of the technical requirements, paragraph (g) applies in respect of income from (or from the disposition of) certain properties that is included in the income of a specified individual who has not turned 24 years of age before the year. To be within the rule, a property must reasonably be considered to be derived from an amount that is or was split income of the individual (or income of the individual to which the attribution rules applied), or that would be derived from such income if certain conditions were met. This condition can be met in one of two ways. The first way (in clause (iii)(A)) deals with income earned directly or through a partnership. Clause (iii)(A) will be satisfied if the property can reasonably be considered to be attributable to an amount that is or was

- included in computing the individual's split income (determined as though new paragraph (e) included in computing split income the full amount of the proceeds from a disposition of property to which that paragraph applies and new paragraph (1.1)(e) was read without reference to its subparagraph (i));

- deemed, by certain attribution rules in the Act to be an amount in respect of another person; or

- a capital dividend received by the individual that would, if it were a taxable dividend received by the individual, be included in computing the individual's split income.

The second way (in clause (iii)(B)) that property can be included in paragraph (g) relates to income earned by an individual that can reasonably be considered to be attributable to an amount

received by a trust. Clause (iii)(B) will be satisfied if the conditions in subclauses (I) to (IV) are met:

- the trust receives the amount in a taxation year of the trust that ends after 2017 (referred to as the "trust year" in this clause);
- the trust is not one of the listed types of trust (*e.g.*, a graduated rate estate or a mutual fund trust);
- generally, the trust earns income of the type (described in clause (iii)(A)) that would be included in paragraph (g) if earned directly by the individual; and
- the trust would have split income in respect of the year, based upon the following assumptions:
    - the trust were related to every person with which the individual is related,
    - the trust were a specified individual who had not attained the age of 17 years,
    - the definition "excluded amount" did not apply,
    - each capital dividend received by the trust in the taxation year were a taxable dividend received by the trust, and
    - the trust's split income for the year included each amount received, or receivable, by the trust in the year that is deemed by certain attribution rules in the Act to be an amount in respect of another person.

"beneficiary"

"Beneficiary" under a trust has the meaning assigned by subsection 108(1), which defines a beneficiary to include a person beneficially interested in a trust.

"business revenue"

"Business revenue" means, in respect of a person for a taxation year, all amounts received or receivable by the person in the year in respect of a business or the rental of property of the person. The method regularly followed by the person in computing the person's income is to be used for the purpose of determining whether amounts are received or receivable from a business or the rental of property. "Business revenue" does not include amounts received or receivable by the person as or on account of capital.

"connected individual"

"Connected individual" sets out the requisite degree of connection between an individual (other than a trust) and a corporation for certain purposes of the TOSI rules. In particular, an individual who is resident in Canada will be a connected individual in respect of a corporation at any time where any of the following conditions (in paragraphs (a) to (d)) are met:

- the corporation is controlled, directly or indirectly, in any manner whatever by the individual or a related group (within the meaning of subsection 251(4) determined as though new paragraph (1.1)(a) applied) of which the individual is a member;

- the individual owns property that directly or indirectly represents ten per cent or more of the equity value of the corporation;

- the individual (or a person related to the individual) owns equity, directly or indirectly, in the corporation and the corporation carries on a services business, where either the services or business revenue are primarily attributable to the individual or the services are regulated under the laws of Canada or a province (*e.g.*, certain professional services) and are performed all or in part by the individual; and

- the individual (or a person related to the individual) owns equity, directly or indirectly, in the corporation and ten per cent or more of the value of the corporation's property is attributable to property that is (or that is substitute for) property that was acquired from the individual (or from another corporation in respect of which the individual is a connected individual at any time after 2017 and before the time) in exchange for less than fair market consideration, debt or shares any part of which remains outstanding, or any property acquired as a return on these types of properties.

"organization"

"Organization" includes an association, body, college, institute, society and any similar arrangement recognized under the laws of Canada or a province (*e.g.*, a law society). This definition is relevant to paragraph (c) of the definition "connected individual".

"related source"

Paragraphs (b) and (c) of the definition "split income" currently contain rules relating to income received by an individual through an interest in a partnership or trust. Some of these rules are incorporated (as modified) into the new "related source" definition.

A "related source" in respect of an individual can be one of two sources of income. The first source, in paragraph (a), is the provision of property or services by a person or partnership to, or in support of, a business carried on by either a person that is related to the individual at any time

in the year, or by a corporation in respect of which a person related to the individual is at any time in the year a specified shareholder (as defined in subsection 248(1)) or a connected individual.

The second source that qualifies as a "related source" in respect of an individual, in paragraph (b), is a business of, or the rental of property by, a particular partnership or trust. Such a source will be a related source if a person related to the individual at any time in the year either

- is actively engaged on a regular basis in the activities of the particular partnership or trust related to earning income from a business or the rental of property, or

- in the case of a particular partnership, has an interest – including directly or indirectly through one or more partnerships – in the particular partnership.

"split portion"

The amendments to the TOSI rules extend the application of the rules to amounts received by individuals over the age of 17 years (for more information, see the commentary on the definitions "specified individual" and "excluded amount"). Generally, individuals over the age of 17 years will be subject to TOSI on income described in paragraphs (a) to (g) of the split income definition, unless the income is an excluded amount. For these individuals, the key concept in determining whether split income is an excluded amount is the definition "split portion". Effectively, the TOSI will apply to split income of individuals over the age of 17 years to the extent that the amounts received are a split portion of the split income.

Generally, the split portion definition is intended to include amounts received by a specified individual which are not commensurate with the amounts that the individual would receive if they were dealing with the payor of the amounts at arm's length. It is intended that property income received by individuals from a family business be included in split income where the income they earn is not commensurate with their contributions to the business.

The test for determining whether an amount is a split portion of what would otherwise be split income depends on the type of split income being tested. Paragraph (a) of the split portion definition deals with amounts that are split income by virtue of paragraph (g) of the split income definition (generally, income from reinvested split income), paragraph (c) deals with amounts that are split income by virtue paragraph (e) of the split income definition (generally, income from dispositions of property) and paragraph (b) deals with all other amounts that constitute split income.

In order to prevent circularity in the split portion definition (*i.e.*, whether an amount is included in split income depends upon whether it is an excluded amount, which depends upon whether it is a split portion, which refers to whether the amount is included in split income), the definition refers to amounts that would be split income of the individual if the definition "excluded amount" were read without reference to its paragraph (b).

Reinvested split income

Pursuant to paragraph (a) of the split portion definition, if paragraph (g) of the definition "split income" causes an amount to be split income of a specified individual, then the amount is deemed to be included in the split portion of the specified individual. As discussed above, paragraph (g) extends the split income definition to include income from reinvested split income. See the commentary on "split income" in subsection 120.4(1) for more information.

Reasonableness test

Pursuant to paragraph (b) of the split portion definition, in general an amount will be included in the split portion of a specified individual to the extent that it is reasonable to conclude that the amount received by the specified individual (including amounts deemed received by section 15 or 246) in respect of property exceeds a reasonable, arm's length return on the property.

This standard is intended to ensure that, for an amount to be included in the split portion of a particular amount of split income in respect of an individual, the amount must be derived from a source in which a related individual is sufficiently involved. Specifically, the particular amount must be paid or payable by a person or partnership (the "operating entity") that is sufficiently connected to the individual or be derived directly or indirectly from such an amount (called a "reference amount"). For these purposes, a sufficient connection exists where the operating entity is:

- in the case of income in respect of shares of a corporation (*e.g.*, income included in "split income" under paragraph (a) of that definition), a corporation in respect of which another individual related to the individual is a connected individual; and

- for other types of amounts included in split income,

    - a person related to the individual,

    - a corporation in respect of which another individual related to the individual is a specified shareholder or connected individual,

    - a partnership or trust, if another individual related to the individual is actively engaged on a regular basis in the activities of the partnership or trust related to earning income from a business or the rental of property,

    - a partnership in which a person referred to in this list has an interest (including through multiple tiers of partnerships), or

    - a trust under which a person or partnership described in this list is a beneficiary.

The particular amount must also have been paid or payable in respect of a business of, or the rental of property by, the operating entity.

For an amount to be included in the "split portion" of an amount under this reasonableness test, it must also be reasonable to consider that it exceeds what would have been paid or payable by the operating entity to the individual if the operating entity and the individual were dealing at arm's length. In making this determination, the following factors are relevant:

- the extent of the individual's labour contributions to the source business prior to the amount being paid or becoming payable (*e.g.*, looking at the quantity of work performed and arm's length comparables for similar work);
- the assets contributed by the individual, directly or indirectly, in support of the source business;
- the risks assumed by the individual in respect of the source business; and
- the total of all amounts that were previously paid or that became payable, directly or indirectly, by any person or partnership to or for the benefit of the individual in respect of the business.

Subparagraphs 120.4(1.1)(e)(ii) and (iii) contain rules for applying the reasonableness test above. In particular, subparagraph (iii) contains special rules that limit what is considered reasonable for an individual who is between the ages of 18 and 24. For more information, see the commentary on subparagraph 120.4(1.1)(e)(ii) and (iii).

Example #1

Pat works in the mailroom of a business owned by other members of Pat's immediate family. Pat contributes no capital and assumes no risk in respect of the business. Pat is paid a salary of $40,000, but a salary of up to $50,000 would be reasonable given what comparable mailroom workers earn in the same industry. Pat receives a dividend of $10,000 at the end of the year from the business. Taking into account Pat's labour contributions and the amounts previously received, the dividend of $10,000 would be considered reasonable.

Example #2

Rasmin is not actively involved in the business carried on by Rasmin's sibling, but has invested $100,000 to be used in the business and has taken back preferred shares that pay 5% annual dividends. Given the assets of the business, its liabilities and the terms of the preferred shares, an arm's length investor acquiring the preferred shares would be expected to require a return in the range of 4-6%. The annual dividends would therefore be considered reasonable.

Dispositions of property

Paragraph (c) of the split portion definition generally includes gains from the disposition of property the income of which would be included in the split portion of the individual's split income due to the reasonableness test described above. Mechanically, an amount will be included because of paragraph (c) if two conditions are met.

- The first condition is that it is reasonable to consider that the amount would be included in paragraph (e) of the split income definition (*i.e.*, income from the disposition of property).

- The second condition is that, if the individual received an amount in respect of the property disposed of, such amount would be included in the individual's split income pursuant to subparagraph (a)(i) (dividends), subparagraph (b)(ii) (in respect of partnerships), clause (c)(ii)(C) (in respect of trusts) or paragraph (d) (in respect of debt) of the split income definition.

Additional rules with respect to tax on split income

ITA
120.4(1.1)

New subsection 120.4(1.1) of the Act contains interpretative rules for the purpose of applying the TOSI rules in respect of a specified individual.

ITA
120.4(1.1)(a)

Subsection 251(2) of the Act defines "related persons" for purposes of the Act. For purposes of the TOSI rules, new paragraph 120.4(1.1)(a) expands the meaning of related persons to include an aunt, uncle, niece or nephew of an individual. In addition, a person and a trust are deemed to be related to each other if they are deemed by paragraph 251(1)(b) not to deal at arm's length with each other.

ITA
120.4(1.1)(b)

New paragraph 120.4(1.1)(b) of the Act clarifies the meaning of references in the TOSI rules to "services performed by an individual in respect of a business of a person or partnership". This reflects differences in how the operation of professional services corporations is described under the laws of different jurisdictions (*i.e.*, it is described as a corporation providing services through an individual or as services performed by an individual on behalf of or through a corporation).

ITA
120.4(1.1)(c)

New paragraph 120.4(1.1)(c) of the Act deems a reference to a taxation year of a partnership in the TOSI rules to be the same as its fiscal year.

ITA
120.4(1.1)(d)

New paragraph 120.4(1.1)(d) of the Act is an anti-avoidance rule intended to prevent planning that seeks to avoid the imposition of the TOSI by acquiring certain properties that are specifically excluded from the application of the TOSI rules in substitution for properties the income from which would be subject to the TOSI rules.

This anti-avoidance rule applies if it can reasonably be considered that one of the reasons that any person or partnership holds a property is to avoid an individual being assessed additional TOSI, either in respect of the particular taxation year of the individual or an earlier taxation year of the individual. If this rule applies, then paragraph (b) of the definition "excluded amount" will not apply in respect of the property and the property will no longer be of a category of property the income from which, or the taxable capital gain or profit from the disposition of, would otherwise be excluded from the definition "split income".

ITA
120.4(1.1)(e)

New paragraph 120.4(1)(e) of the Act contains rules that modify the application of the definitions in subsection 120.4(1) in certain circumstances.

Subparagraph (i) deems an individual's split income to be nil to the extent that the individual's taxable income (calculated without regard to split income) would exceed the amount at which the highest marginal income tax bracket applies. Because the TOSI taxes split income at the highest marginal income tax rate, it is not necessary in respect of split income that is already taxed at the highest marginal income tax rate. However, this exception does not apply for certain purposes, including in determining whether income is included in split income under paragraph (g) of the definition "split income".

Subparagraph (ii) contains various rules that apply for the purposes of determining whether amounts received by individuals (including amounts that are split income by virtue of paragraph (e) of the definition) are reasonable within the meaning of paragraph (b) of the split portion definition in subsection 120.4(1).

Clauses (A) and (B) are specific anti-avoidance rules that apply to exclude certain labour and capital contributions from the reasonableness test. While the measures in clauses (A) and (B) refer to specific circumstances, it is expected that the general anti-avoidance rule in section 245

could apply to deny tax benefits that arise in other circumstances not specifically contemplated by the provision.

The first anti-avoidance rule (in clause (A)) provides that an individual is deemed not to have performed functions in respect of a source business in a taxation year if the principal purpose of the business in that year was to derive income from property, or at least 50 per cent of the income of the business for the year was from property or taxable capital gains from the disposition of property.

The second anti-avoidance rule (in clause (B)) provides that an individual is deemed not to have contributed assets in support of a source business to the extent that the individual received the assets as split income or acquired the assets in connection with a related person providing financial assistance to the individual (*e.g.*, by guaranteeing debt of the individual).

Clause (C) applies for the purpose of determining whether the reasonableness test is satisfied in respect of inherited property. Where property in respect of a source business is acquired by or for the benefit of an individual as a consequence of the death of a person, that individual may not have made any contributions to the business prior to the inheritance. In order to provide continuity and ensure that the reasonableness test applies appropriately to the individual inheriting the property, that individual will be deemed to have made the same contributions to the source business as the deceased individual.

Subparagraph (iii) contains rules for applying the reasonableness test in paragraph (b) of the split portion definition to individuals who have attained the age of 17 years before a year but who have not attained the age of 24 years before the year that an amount is included in the individual's income.

Pursuant to clause (A), the amount of their return that will be considered reasonable based on their labour contributions to the source business (*i.e.*, the factor set out in clause (b)(iii)(A) of the split portion definition) will be determined based on the extent to which the individual is actively engaged on a regular, continuous and substantial basis in the activities of the source business. Therefore, if a specified individual between the ages 17 and 25 was not actively engaged in a source business on a regular, continuous and substantial basis for a year, then the specified individual will be considered not to have performed functions in respect of the source business for the purposes of clause (A) of the reasonableness test.

Pursuant to clause (B), the amount of their return that will be considered reasonable based upon their capital contributions to and risks assumed in respect of the source business (*i.e.*, the factors set out in clauses (b)(iii)(B) and (C) of the split portion definition)) will be limited to a prescribed rate of return. The rate used for this purpose is set out in paragraph 4301(c) of the *Income Tax Regulations*.

Tax on split income with respect to taxable capital gains

ITA
120.4(4)

Subsection 120.4(4) of the Act generally provides that a capital gain of a specified individual from a disposition of certain shares, that are transferred to a person that does not deal at arm's length with the individual, is subject to the TOSI. Twice the amount that would otherwise have been the individual's taxable capital gain in respect of the disposition is deemed to be a taxable dividend received by the taxpayer in the year and included in the individual's split income.

Subsection 120.4(4) is amended consequential on other changes to the TOSI rules. The amendments ensure that subsection 120.4(4) will not apply to capital gains from a disposition of shares of a corporation that would be excluded from the split income of an individual. Consequential on the extension of the TOSI rules to individuals who are 18 and older for the 2018 and subsequent taxation years, subparagraph (c)(i) provides that dispositions before 2018 by individuals who have attained the age of 17 years before the year are excluded.

ITA 120.4(5)

Subsection 120.4(5) of the Act generally applies in a manner similar to subsection 120.4(4) in respect of certain amounts if a specified individual would otherwise be required under paragraph 104(13)(a) or subsection 105(2) to include the amount in computing their income for a taxation year. Under subsection 120.4(5), if a particular amount otherwise required to be included in the income of a specified individual under paragraph 104(13)(a) or subsection 105(2) can reasonably be considered to be attributable to a taxable capital gain of any trust from the disposition of shares that are transferred to a person with whom the specified individual does not deal at arm's length, paragraph 104(13)(a) and subsection 105(2) are deemed not to apply and twice the amount is deemed to be a taxable dividend received by the specified individual in the year.

Subsection 120.4(5) is amended in a manner similar to the amendments made to subsection 120.4(4).

Clause 2

Joint and several, or solidary, liability – tax on split income

ITA
160(1.2)

Subsection 160(1.2) of the Act, which applies in respect of tax owing on split income, is amended as a consequence of changes to the TOSI rules in section 120.4.

New paragraph 160(1.2)(a) applies when a specified individual is liable to tax on split income under subsection 120.4(2) for a taxation year and the individual did not turn 24 before the

beginning of the year. If this condition is met, a particular individual is, subject to certain exceptions, jointly and severally, or solidarily, liable with the specified individual for the tax arising on the split income if the particular individual and the specified individual are related to each other (for the purpose of applying the TOSI rules) during the year and the relationships between a business, the particular individual and the specified individual set out in the definition “specified individual” in subsection 120.4(1) exist.

For specified individuals who have not attained the age of 17 before the taxation year in which the liability arises, only parents of the specified individuals may be jointly and severally, or solidarily, liable with the specified individual for the tax arising on the split income.

Paragraph 160(1.2)(b) limits a particular individual’s liability under this subsection to amounts included in a specified individual’s split income in respect of the particular individual.

Paragraph 160(1.2)(c) clarifies that this subsection does not limit a specified individual’s liability under other sections of the Act or for interest payable by a particular person as a result of tax assessed under this subsection.

Clause 3

Age credit

ITA
118(2)

Subsection 118(2) of the Act provides an age tax credit for individuals who are over 65 years of age or who reach age 65 in the year. The credit is calculated as a percentage (15 per cent for 2017) of an indexed base amount ($7,225 for 2017). The base amount upon which an individual’s age tax credit is calculated is reduced by 15 per cent of the amount by which the individual’s income for the year exceeds an indexed income base amount ($36,430 for 2017).

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer’s income for a taxation year, of an amount equal to the taxpayer’s split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

Subsection 118(2) is amended to exclude amounts deductible under paragraph 20(1)(ww) from the income base upon which the reduction in the age tax credit is calculated. This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.,* income is computed without reference to the deduction on account of split income) is used for purposes of this provision.

Limitations re subsec. (1)

ITA
118(4)

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

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer's income for a taxation year, of an amount equal to the taxpayer's split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

New paragraph 118(4)(a.2) provides that, for the purpose of calculating the age tax credit in subsection 118(2), references to income for the year are to be read as references to income determined as if no amount were deductible under paragraph 20(1)(ww). This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.*, income is computed without reference to the deduction on account of split income) is used for purposes of this provision.

Clause 4

GST/HST credit – definitions

ITA
122.5(1)

Subsection 122.5(1) of the Act defines a number of terms for the purpose of the goods and services tax credit (GSTC).

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer's income for a taxation year, of an amount equal to the taxpayer's split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

The definition "adjusted income" in subsection 122.5(1) is amended to exclude amounts that are deductible in calculating a taxpayer's income under paragraph 20(1)(ww) from the income base upon which the GSTC is calculated. This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.*, income is computed without reference to the deduction on account of split income) is used for purposes of this provision.

Clause 5

Canada Child Benefit – definitions

ITA
122.6(1)

Section 122.6 of the Act defines a number of terms for the purpose of the Canada Child Benefit (CCB).

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer's income for a taxation year, of an amount equal to the taxpayer's split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

The definition "adjusted income" in section 122.6 is amended to exclude amounts that are deductible in calculating a taxpayer's income under paragraph 20(1)(ww) from the income base upon which the CCB is calculated. This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.*, income is computed without reference to the deduction on account of split income) is used for purposes of this provision.

Clause 6

Working Income Tax Benefit – definitions

ITA
122.7(1)

Subsection 122.7(1) of the Act defines a number of terms for the purpose of the Working Income Tax Benefit (WITB).

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer's income for a taxation year, of an amount equal to the taxpayer's split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

The definition "adjusted net income" in subsection 122.7(1) is amended to exclude amounts that are deductible in calculating a taxpayer's income under paragraph 20(1)(ww) from the income base upon which the WITB is calculated. This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.*, income is computed without reference to the deduction on account of split income) is used for purposes of this provision.

Clause 7

Tax on Old Age Security Benefits – definitions

ITA
180.2(1)

Subsection 180.2(1) of the Act defines a number of terms for the purpose of the special recovery tax on old age security (OAS) benefits.

Paragraph 20(1)(ww) provides for the deduction, in computing a taxpayer’s income for a taxation year, of an amount equal to the taxpayer’s split income for the year. Paragraph 20(1)(ww) ensures that income that is taxed as split income is not also taxed as regular income.

The definition “adjusted income” in subsection 180.2(1) is amended to exclude amounts that are deductible in calculating a taxpayer’s income under paragraph 20(1)(ww) from the income base upon which the tax on OAS benefits is calculated. This amendment is consequential on the expansion of the TOSI rules to individuals over the age of 17 years. It ensures that the ordinary rule for computing income (*i.e.*, income computed without reference to the deduction on account of split income) is used for purposes of this provision.

Clause 8

Failure to provide identification number

ITA
162(6)

Subsection 162(6) of the Act provides a penalty for failure by any person or partnership to provide their Social Insurance Number, their business number or their U.S. federal taxpayer identification number as required under the Act or a regulation.

Subsection 162(6) is amended to add a reference to trust account numbers to the information subject to a penalty if not provided in accordance with the Act or a regulation. This amendment is consequential on the introduction of the “trust account number” definition.

Clause 9

Regulations respecting information returns

ITA
221(1)(d.1)

Paragraph 221(1)(d.1) of the Act enables the Governor in Council to make regulations requiring any person or partnership to provide certain information to any class of persons who are required to make an information return containing that information.

Paragraph 221(1)(d.1) is amended to extend this regulatory power to require a trust to provide its trust account number to any class of persons required to make an information return containing that information. This amendment is consequential on the introduction of the “trust account number” definition.

Clause 10

Production of Number

ITA
237(1.1)

Subsection 237(1.1) of the Act provides that an individual’s Social Insurance Number or a person’s or partnership’s business number (as applicable) must be provided in any return filed under the Act or at the request of any person required to make an information return in which either number is required.

Subsection 237(1.1) is amended so that the obligation to provide information applies to any “designated number”, as defined in new subsection 237(1.2). Subsection (1.1) is also amended so that the obligation to provide a designated number extends to requests by partnerships that are required to make a return in which a designated number is required. This amendment is consequential on the introduction of the “trust account number” definition.

“designated number”

ITA
237(1.2)

New subsection 237(1.2) of the Act defines designated number for the purpose of subsection 237(1.1) as:

- in the case of an individual, their Social Insurance Number;
- in the case of a trust, its trust account number; and
- in any other case, the person’s or partnership’s business number.

This amendment is consequential on the introduction of the "trust account number" definition.

Number required in information returns

ITA
237(2)

Subsection 237(2) of the Act provides that any person making an information return must make a reasonable effort to obtain the Social Insurance Number or business number of the person or partnership to which the return relates, and cannot release this information, except as set out in the subsection.

Subsection 237(2) is amended in two respects. First, subsection 237(2) is amended to add a reference to partnerships required to make an information return. Second, subsection 237(2) is amended to apply to situations where a person or partnership is required to make an information return requiring a trust account number. This amendment is consequential on the introduction of the "trust account number" definition.

Authority to communicate number

ITA
237(3)

Subsection 237(3) of the Act permits a person to release information set out in subsection 237(2) to a related person, where the related person is required to make an information return that requires this information. This subsection is of significance in the context of demutualization, as it permits an insurance corporation to release this information to its holding corporation in connection with the holding corporation's responsibility to report dividends and other amounts payable to persons who were policyholders in respect of the insurance corporation.

Subsection 237(3) is amended to add a trust account number to the types of information that can be released to a related person. This amendment is consequential on the introduction of the "trust account number" definition.

Authority to communicate number

ITA
237(4)

Subsection 237(4) of the Act provides further circumstance in which information set out in subsection 237(2) may be released to another person in the context of a demutualization of an insurance corporation.

Subsection 237(4) is amended to add a trust account number to the types of information that can be released under this provision. This amendment is consequential on the introduction of the “trust account number” definition.

Clause 11

Information return

ITA
237.1(7)

Subsection 237.1(7) of the Act imposes an obligation on promoters to make an information return in respect of tax shelters.

Paragraph 237.1(7)(a) is amended to add a reference to the trust account numbers of investors to the information that must be included in the tax shelter information return. This amendment is consequential on the introduction of the “trust account number” definition.

Clause 12

Offence with respect to an identification number

ITA
239(2.3)

Subsection 239(2.3) of the Act provides that it is a criminal offence for a person who has been provided with an individual’s Social Insurance Number or a taxpayer’s or partnership’s business number pursuant to the Act or regulations to use or communicate the number for other purposes.

Subsection 239(2.3) is amended to add the trust account number to the type of information the improper use of which will constitute a criminal offence. It is also amended so that a person is permitted to use the trust account number of a trust for a purpose for which the person has been authorized in writing by the particular trust. These amendments are consequential on the introduction of the “trust account number” definition.

Clause 13

Definitions

ITA
248

“business number”

The definition “business number” is amended to explicitly exclude a trust account number.

"trust account number"

A "trust account number" means the number (other than a business number) used by the Minister to identify a trust, and of which the Minister has notified the trust.

Clause 14

Investment income

Income Tax Regulations (ITR)
201(1)

Subsection 201(1) of the ITR imposes a requirement on certain persons to provide annual information returns to the Minister of National Revenue and taxpayers in respect of interest and dividend payments. Subparagraph 201(1)(b)(ii) requires a person who makes a payment on account of interest in respect of money on loan to, money on deposit with, or property of any kind deposited or placed with a corporation, association, organization or institution to make an information return.

Subparagraph 201(1)(b)(ii) is amended so that information returns must also be made in respect of interest payments on account of money on loan to, money on deposit with, or property of any kind deposited or placed with a trust. This amendment also clarifies that a partnership is subject to the rule.

Clause 15

Partnership returns

ITR
229(1)

Subsection 229(1) of the ITR requires that every member of a partnership that carries on business in Canada, or that is a Canadian partnership or SIFT partnership, file a partnership return. This return must contain certain prescribed information including, for certain individuals who are members of the partnership, their Social Insurance Numbers. This subsection is amended so that the partnership return must also include the business number or trust account number of a partner, as the case may be. This amendment is consequential on the introduction of the "trust account number" definition.

Clause 16

Adjustments to cost base – partnership

ITA
53(1)(e)(xii)

Paragraph 53(1)(e) of the Act requires certain amounts to be added in computing the adjusted cost base to a taxpayer of a partnership interest. Subparagraph 53(1)(e)(xii) references the addition required by paragraph 110.6(23)(a).

Subparagraph 53(1)(e)(xii) is amended consequential on the 2018 deemed disposition election in subsection 110.6(18) to add a reference to the addition required by subparagraph 110.6(18.1)(c)(i). For more information, see the commentary under subsections 110.6(18) and (18.1).

Adjustments to cost base – partnership

ITA
53(2)(c)(xi)

Paragraph 53(2)(c) of the Act requires certain amounts to be deducted in computing the adjusted cost base to a taxpayer of a partnership interest. Subparagraph 53(2)(c)(xi) references the deduction required by paragraph 110.6(23)(b).

Subparagraph 53(2)(c)(xi) is amended consequential on the 2018 deemed disposition election in subsection 110.6(18) to add a reference to the deduction required by subparagraph 110.6(18.1)(c)(ii). For more information, see the commentary under subsections 110.6(18) and (18.1).

Adjustments to cost base

ITA
53(2)(v)

Paragraph 53(2)(v) of the Act requires a taxpayer to deduct an amount in computing the adjusted cost base to the taxpayer, at any time after February 22, 1994, of a property in respect of which an election was made under subsection 110.6(19). The amount to be deducted is computed under subsection 110.6(22).

Paragraph 53(2)(v) is amended consequential on the 2018 deemed disposition election in subsection 110.6(18) to add a reference to a property in respect of which an election was made under subsection 110.6(18), as well as a reference to the deduction computed under paragraph

110.6(18.1)(h). For more information, see the commentary under subsections 110.6(18) and (18.1).

Clause 17

Designated taxable capital gains

ITA
104(21.2)

Subsection 104(21.2) of the Act sets out rules for establishing the eligible taxable capital gains of a trust that, for the purposes of section 110.6, can be attributed to the beneficiaries of a trust and to specific types of properties disposed of by the trust. This attribution permits beneficiaries to claim the lifetime capital gains exemption under section 110.6 for dispositions by the trust of qualified farm or fishing property or qualified small business corporation shares.

Subsection 104(21.2) is amended consequential on changes to the lifetime capital gains exemption rules in section 110.6. Subsection 104(21.2) will now apply only if the trust is an "eligible LCGE trust" (as defined in subsection 110.6(1)) in the year in which it makes a designation in respect of the trust's net taxable capital gains under subsection 104(21).

These amendments generally apply to the 2018 and subsequent taxation years.

Clause 18

Definitions concerning the lifetime capital gains exemption

ITA
110.6(1)

Subsection 110.6(1) of the Act contains definitions that are relevant for the lifetime capital gains exemption rules in section 110.6 of the Act. Subsection (1) is amended by adding the new definitions "eligible employee beneficiary" and "eligible LCGE trust".

"eligible employee beneficiary"

An "eligible employee beneficiary" is defined in respect of a corporation and a trust. It means an individual (other than a trust) who at any time is a beneficiary under the trust, where the following conditions are satisfied:

- the individual acquired their beneficial interest in the trust because of his or her employment with the corporation (or another corporation with which the corporation does not deal at arm's length) and in connection with an agreement referred to in subsection 7(1) in respect of shares of the corporation (or a non-arm's length corporation);

- at or before that time, the individual was not a specified employee or a connected individual (as defined in subsection 120.4(1)) in respect of the corporation (or a non-arm's length corporation); and

- at or before that time, the individual was not related (within the expanded meaning of section 120.4) to a specified employee, a connected individual or a specified shareholder of the corporation (or a non-arm's length corporation)).

The definition "eligible employee beneficiary" is relevant to the definition "eligible LCGE trust".

"eligible LCGE trust"

An "eligible LCGE trust" is generally a trust that is a qualifying beneficiary trust or an employee share ownership trust referred to in subsection 7(2) that holds shares of a corporation for the benefit of employees who deal at arm's length with the corporation.

In the former case, a trust will be an eligible LCGE trust for a taxation year if all of the following conditions are met:

- the trust is, throughout the year, a personal trust for which a day is to be determined under paragraph 104(4)(a), (a.1) or (a.4) by reference to the death, that has not occurred before the beginning of the year, of an individual (referred to as a "qualifying beneficiary"),

- no amount is distributed from the capital of the trust to any beneficiary during the year, other than a qualifying beneficiary, and

- no amount of the net taxable capital gains of the trust for the year is designated in respect of any beneficiary under subsection 104(21), other than in respect of a qualifying beneficiary.

In the latter case, a trust will be an eligible LCGE trust for a taxation year if all of the following conditions are met:

- the trust is, throughout the year, an employee share ownership trust referred to in subsection 7(2) that holds shares of a corporation (referred to as the "issuer corporation");

- no amount is distributed, in circumstances to which subsection 107(2) applies, from the capital of the trust to any beneficiary during the year, other than shares of the issuer corporation that are distributed to "eligible employee beneficiaries" (as defined in subsection (1)) of the corporation; and

- no amount of the net taxable capital gains of the trust for the year is designated in respect of any beneficiary under subsection 104(21), other than in respect of an eligible employee beneficiary of the issuer corporation and the trust.

For more information, see the commentary on subsection (12).

Ineligible capital gains – dispositions after 2017

ITA
110.6(12) and (12.1)

Subsection 110.6(2) of the Act provides a deduction in computing the taxable income of a taxpayer in respect of taxable capital gains from the disposition of qualified farm or fishing property. Subsection (2.1) provides a similar deduction from the disposition of qualified small business corporation shares and subsection (2.2) provides an additional deduction from the disposition of qualified farm or fishing property (subsections (2) to (2.2) are referred to collectively as the "lifetime capital gains exemption" or "LCGE").

New subsections (12) and (12.1) are introduced to limit the amounts that may be deducted under the LCGE for dispositions of qualified farm or fishing property or qualified small business corporation shares that occur after 2017. Subsection (12) specifies the limitation on the amount that may be deducted under the LCGE and subsection (12.1) contains conditions that must be met for certain of these limitations to apply.

Generally, subsections (12) and (12.1) are intended to constrain access to the LCGE by individuals who have not effectively invested in the business in respect of which the LCGE is being claimed. They are intended to prevent the multiplication of the LCGE through tax planning strategies where eligible taxable capital gains are realized by family members of a business principal in situations where the family members have not effectively contributed to the business.

Subsections (12) and (12.1) reduce the amount that an individual may deduct under the LCGE in respect of the individual's capital gain for a year from the disposition of property in the following circumstances and by the following amounts:

1. *Individuals under the age of 18 years*. No amount is deductible under the LCGE if the individual has not attained the age of 17 years before the year.

2. *Allocations under subsection 144(4).* No amount is deductible under the LCGE to the extent that the capital gain is deemed to be a capital gain of the individual because of an allocation under subsection 144(4) by a trust governed by an employees profit sharing plan. Note, however, that this provision does not prohibit individuals from claiming the LCGE in respect of capital gains that are allocated under subsection 104(21.2) from a trust governed by an employees profit sharing plan that is an eligible LCGE trust as defined in subsection 110.6(1). Capital gains that are allocated in this manner to an individual under subsection 104(21) by a trust governed by an employees profit sharing

plan could qualify for the LCGE, provided that all the other conditions for claiming the LCGE are satisfied.

3. *Gains accruing before the age of 18 years*. An individual cannot claim the LCGE in respect of a gain that arose from the disposition of property (whether held by the individual or another person or partnership) to the extent that the gain accrued before the beginning of the year that the individual turned 18 years of age. This rule does not impact the ability of an individual to claim the LCGE in respect of the portion of a gain that accrued after the beginning of the year in which the individual turns 18. This rule is intended to prevent an individual from claiming the LCGE in respect of gains that accrued on property before the individual attained the age of 18 years.

4. *Split income*. If a taxable capital gain from the disposition of a property is included in computing an individual's split income pursuant to paragraph (e) of the "split income" definition (in subsection 120.4(1), which generally relates to gains from the disposition of property), then the amount that the individual can deduct under the LCGE in computing the individual's taxable capital gain for the year is reduced by twice the amount of the taxable capital gain included in computing the individual's split income. This rule effectively prevents an individual from claiming the LCGE in respect of an unreasonable portion of a capital gain as determined using the reasonableness tests that apply in determining the individual's split income. For the purpose of this rule, the amount included in computing an individual's split income is to be determined as if paragraph 120.4(1.1)(e) were read without reference to its subparagraph (i), which generally precludes the application of the tax on split income to the extent that an individual is already taxed at the top marginal rate.

5. *Gains accruing prior to rollout from trust*. An individual cannot claim the LCGE in respect of a gain that arose from the disposition of property or property for which it is a substitute (whether held by the individual or another person or partnership) to the extent that the gain accrued on the property prior to the property being distributed from the capital of a trust to a beneficiary of the trust on a rollover basis. This rule does not apply to property that is distributed from an "eligible LCGE trust" (as defined in subsection (1)). This rule is intended to prevent an individual from claiming the LCGE in respect of gains that accrued on property held by a trust, other than an eligible LCGE trust where the individual is a beneficiary under the trust.

6. *Property transferred from a trust*. The previous reduction applies where the property disposed of (the "disposition property") is acquired from a trust on a tax-deferred basis, while this reduction applies in similar circumstances except that, in general terms, part of the gain on the disposition property is indirectly attributable to property acquired from a trust on a tax-deferred basis. Specifically, an individual's deduction under the LCGE will be reduced if it can reasonably be considered that the fair market value of the disposition property, or property for which it is a substitute, increased as a result of (i) another property (the "distributed property") being acquired by a person or partnership after 2017 as a result of a rollout from a trust to which paragraph 107(2)(b) applied, or (ii) the fair

market value of a person or partnership's interest as a beneficiary in a discretionary trust increasing after 2017 as a result of a decision made in respect of the distribution of income or capital of the trust in respect of an interest in the trust. This reduction in the LCGE deduction will only apply if the disposition of the disposition property and the acquisition or decision referred to above are part of the same series of transactions or events.

If the reduction applies as a result of an acquisition of property by a person or partnership, then the amount that the individual may deduct under the LCGE will be reduced to the extent that the accrued gain on the distributed property is reflected in the gain on the disposition property. This is determined by the formula A x (B – C)/B, where

A is the amount of the increase in the fair market value of the disposition property that occurs as a result of the acquisition of the distributed property by the person or partnership,

B is the fair market value of the distributed property at the time it is acquired by the person or partnership, and

C is the cost of the distributed property to the person or partnership as determined under paragraph 107(2)(b).

If the reduction applies as a result of a decision affecting the person or partnership's rights as a beneficiary under a discretionary trust, then the LCGE deduction claimed by the individual will be reduced by the amount by which the fair market value of the disposition property increased as a result of the decision.

This rule is intended to prevent the LCGE from being claimed in respect of property the value of which is derived from other property that is distributed from a trust, or from a non-taxable transfer of value to a beneficial interest in a trust.

Subsection (12) contains rules to prevent amounts that are described in more than one of the limitations from being double-counted in reducing the amount of the LCGE that can be claimed by an individual in a year.

Personal trust – QSBC shares

ITA
110.6(16)

To be a "qualified small business corporation share" of an individual, the share cannot be owned by an unrelated person in the 24-month period ending immediately before the disposition of the share. For this purpose, paragraph 110.6(14)(c) of the Act treats a personal trust as being related to an individual for any period throughout which the individual was a beneficiary of the trust. The expression "personal trust" is defined in subsection 248(1).

Subsection (16) extends this definition of personal trust to include employee share ownership trusts referred to in subsection 7(2) for the purpose of subsections (1) and (14).

Subsection (16) is amended to replace the reference to employee share ownership trusts with trusts that are eligible LCGE trusts under paragraph (b) of that definition. This amendment is consequential on the amendments to the LCGE implemented through new subsections (12) and (12.1).

Definitions – 2018 election

ITA
110.6(17.1)

The following definitions apply to the new 2018 deemed disposition election provisions found in subsections 110.6(18), (18.1) and (24) to (30) of the Act. For more information, see the commentary under those provisions.

"***disposition day***"

The disposition day of a taxpayer means the day in 2018 that is identified in the election made by the taxpayer under subsection (18).

"***disposition time***"

The disposition time means the beginning of a disposition day.

"***election year***"

The election year of a taxpayer means the taxpayer's taxation year that includes the taxpayer's disposition day.

"***eligible property***"

The definition "eligible property" describes the type of property that may be eligible for the 2018 deemed disposition election in subsection (18). Eligible property of a taxpayer must be owned by the taxpayer continuously from the end of 2017 until the end of the taxpayer's disposition day. At the disposition time, the property must be capital property of the taxpayer and must be a "qualified farm or fishing property" or a "qualified small business corporation share", as defined in subsection (1). For these purposes, the 24-month holding period tests in those definitions only need to be satisfied for a period of 12 months before the disposition time. This modification to the definitions of qualified farm or fishing property and qualified small business corporation share is intended to give taxpayers sufficient time to take steps to utilize the LCGE under the existing rules through use of the deemed disposition election.

In addition to the above requirements, in order to meet the definition "eligible property" the property must be identified in the election made by the taxpayer under subsection (18) and must not be property in respect of which section 74.2, 74.3, 75 or 75.1 apply.

"***eligible taxpayer***"

An "eligible taxpayer" for a taxation year can be either an individual (other than a trust) or a trust that is, throughout the year, a personal trust or an employee share ownership trust referred to in subsection 7(2).

Election – deemed disposition in 2018

ITA
110.6(18) and (18.1)

New subsections 110.6(18) and (18.1) of the Act provide a mechanism for individuals and certain trusts (referred to as "eligible taxpayers") to recognize capital gains accrued to a particular day in 2018 chosen by the eligible taxpayers (referred to as the "disposition day") on certain property (referred to as "eligible property") in order that those gains may be sheltered by the LCGE in accordance with the rules that apply prior to the amendments that apply to dispositions after 2017. For more information, see the commentary under subsection (12).

In order for subsection (18.1) to apply to recognize an accrued gain in respect of eligible property owned by a taxpayer in 2018, the following conditions in subsection (18) must be met:

- the taxpayer must be an eligible taxpayer (as defined in subsection (17.1)) for the taxpayer's election year;

- the taxpayer must elect to have subsection (18.1) apply (the requirements for making the election are set out in subsection (24));

- where the taxpayer is not a trust, it must be reasonable to conclude that the application of subsection (18.1) in respect of the property would result in an increase in the amount deductible under subsections (2), (2.1) or (2.2), as the case may be, in computing the taxpayer's taxable income for the taxpayer's election year and, if the taxpayer is under the age of 18 years, the property must not be a share of a corporation; and

- where the taxpayer is a trust,

    - it must be reasonable to assume that the amount of any taxable capital gain that would result from the application of subsection (18.1) from the disposition of the property will be included in an amount deemed by subsection 104(21.2) to be a taxable capital gain of one or more beneficiaries who are individuals (other than trusts);

- each of the beneficiaries referred to above must be a beneficiary under the trust continuously from the end of 2017 until the end of the trust's disposition day and must be resident in Canada throughout the beneficiary's taxation year in which the trust's election year ends;

- if the beneficiary is under the age of 18 years, the property cannot be a share of a corporation; and

- if the trust is governed by an employees profit sharing plan, the trust cannot make an election under subsection 144(4.2) in respect of the property for the trust's election year.

Subparagraph (18.1)(a)(i) provides that the property will be considered to have been disposed of by the eligible taxpayer at the disposition time for proceeds of disposition equal to the amount designated in the election. The election cannot be used to trigger a capital loss because the subparagraph provides that the proceeds of disposition cannot be less than the adjusted cost base of the property.

Subparagraph (18.1)(a)(ii) provides that the property will be considered to have been reacquired by the eligible taxpayer immediately after the deemed disposition at a cost equal to the eligible taxpayer's proceeds of disposition determined under subparagraph (i). Notwithstanding this rule, if the designated amount in respect of a property is greater than its fair market value at the disposition time, the eligible taxpayer's cost of the property on the reacquisition will be what it would have been had the designated amount been equal to that fair market value less the amount by which the designated amount exceeds 11/10 of that fair market value. The purpose of this cost base reduction is to discourage taxpayers from designating amounts in excess of fair market value in order to realize gains in excess of the gains accrued to the disposition time.

Where an eligible taxpayer elects under subsection 110.6(18) in respect of eligible property and the disposition of the property would result in an income inclusion under section 7 or 35, certain rules apply. Under subparagraph (18.1)(b)(i), there is no deemed disposition of the eligible property for the purposes of section 7 and 35, and therefore no income inclusion under those sections as a result of the deemed disposition. Under subparagraph (18.1)(b)(ii), the proceeds of disposition determined under paragraph (a) are reduced by the amount, if any, that would be included under section 7 or 35 as a result of the disposition of the property in computing the income of the taxpayer (except to the extent that the amount is included in computing the adjusted cost base of the property under paragraph 53(1)(j)).

Where an eligible taxpayer elects under subsection 110.6(18) in respect of an interest in a partnership, certain adjustments to the taxpayer's adjusted cost base of the interest are required for the purpose of computing the taxpayer's capital gain resulting from the election (which will be reflected in the individual's exempt capital gains balance in respect of the partnership). Paragraph (18.1)(c) requires an addition to the adjusted cost base of the interest equal to the total of

- the taxpayer's share of the partnership's income for the election year before the disposition day; and
- the taxpayer's share of the partnership's net capital gains that arose from dispositions before the disposition day.

For this purpose, the income of the partnership for the election year is prorated on a daily basis.

Where the partnership has net losses for the election year and the prorated portion of the net loss is greater than the pre-disposition day net taxable capital gains, the excess is required to be deducted in computing the taxpayer's adjusted cost base immediately before the deemed disposition.

These adjustments ensure that the income or loss of the partnership for the period prior to the disposition day that is reflected in the value of the partnership interest on that day (but that would otherwise not be reflected in the adjusted cost base of its members' interests until the end of the fiscal period) will be reflected in the adjusted cost base of those interests for the purpose of determining the member's gains accrued to the disposition day that can be recognized by means of the capital gains election mechanism in subsection (18.1). For more information, see the commentary under paragraphs 53(1)(e) and 53(2)(c).

Where an eligible taxpayer, other than a trust, elects under subsection (18) in respect of eligible property, paragraph (18.1)(d) ensures than new subsection (12) will not apply to limit the availability of the LCGE in respect of the capital gain that arises on the deemed disposition of the property. In addition, the capital gain will not be subject to the tax on split income ("TOSI") rules, which would otherwise apply in respect of dispositions after 2017. The purpose of this provision is to provide taxpayers with the benefit of the old LCGE and TOSI regimes for capital gains that arise as a result of the election.

Where an eligible taxpayer that is a trust elects under subsection (18.1) in respect of eligible property, paragraph (18.1)(e) also ensures that new subsection (12) will not apply to limit the availability of the LCGE in respect of the capital gain that arises on the deemed disposition of the property and that can reasonably be considered to be deemed by subsection 104(21.2) to be a taxable capital gain of an individual beneficiary from that disposition. In addition, the capital gain will not be subject to the TOSI rules, which would otherwise apply in respect of dispositions after 2017. The purpose of this provision is to allow beneficiaries of trusts to obtain the benefit of the old LCGE and TOSI regimes for capital gains of the trust that arise as a result of the election.

Where an eligible taxpayer elects under subsection (18) in respect of property, paragraph (18.1)(f) applies such that, for the purpose of determining whether the property is a qualified small business corporation share of a taxpayer at the disposition time, the 24-month tests in the definition are to be read as 12-month tests. This rule is intended to give eligible taxpayers

sufficient time to undertake any necessary steps for shares to meet the definition of qualified small business corporation shares prior to the disposition time.

Where an eligible taxpayer elects under subsection (18) in respect of property, paragraph (18.1)(g) applies such that, for the purpose of determining whether property is qualified farming or fishing property of a taxpayer at the disposition time, the tests that need to be satisfied for a period of 24 months in the definition instead only need to be satisfied for a period of 12 months before the disposition time. This rule is intended to give eligible taxpayers sufficient time to undertake any necessary steps for property to meet the definition of qualified farming or fishing property prior to the disposition time.

Paragraph (18.1)(h) provides a deduction in determining the adjusted cost base to an eligible taxpayer of eligible property at any time after the property is deemed to have been reacquired in accordance with subparagraph (18.1)(a)(ii). Where the taxpayer makes an excess designation under paragraph (18), paragraph (18.1)(h) will cause the eligible property to have a negative adjusted cost base after the property is deemed to have been reacquired if the adjusted cost base reduction provided under subparagraph (18.1)(a)(ii) is insufficient to account for the amount of the excess designation.

Pursuant to subparagraph (18.1)(a)(ii), where the amount designated in the election under subparagraph (18.1)(a)(i) in respect of the eligible property exceeds 11/10 of the property's fair market value at the disposition time, the cost at which the eligible taxpayer is deemed to have reacquired the property will be reduced by the amount by which the designated amount exceeds 11/10 of the fair market value of the eligible property (the "excess amount"). Paragraph (18.1)(h) provides that, where the excess amount is greater than the fair market value of the eligible property at the disposition time, the amount by which it exceeds the fair market value will be deducted in computing the adjusted cost base of the eligible property to the eligible taxpayer at any time after the property is deemed to have been reacquired in accordance with subparagraph (18.1)(a)(ii).

For more information, see the commentary under paragraph 53(2)(v).

2018 election

Subsections 110.6(24) to (30) of the Act deal with the timing of capital gains elections in respect of eligible capital property owned on February 22, 1994, the revocation of elections, the filing of late and amended elections and the penalties payable in respect of late-filed and amended elections.

Subsections (24) to (30) are repealed and replaced consequential on the enactment of the 2018 capital gains election under subsection (18). New subsections (24) to (30) deal with the filing and revocation of elections under new subsection (18), the filing of late and amended elections and the penalties payable in respect of late-filed and amended elections.

Filing of 2018 election

ITA
110.6(24)

New subsection 110.6(24) of the Act sets out the requirements for filing elections made under subsection 110.6(18) in respect of eligible property.

An election must: be made by an eligible taxpayer in the form and manner prescribed by the Minister of National Revenue; be filed on or before the balance-due day of the taxpayer's election year; identify the taxpayer's disposition day; and include a description of the property. An individual's balance-due day for a taxation year coincides with the normal filing deadline for the individual's tax return for the year. For most individuals, this will be April 30th of the following year. For deceased individuals, the filing deadline for the terminal return is April 30th of the following year unless the death occurred in the last two months of the year or before April 30th of the following year, in which case the filing deadline is six months after the date of death.

If the election is made by a trust, the election must also include the name, address, business number, Social Insurance Number or trust account number, as applicable, of each beneficiary under the trust who was allocated an amount of a capital gain of the trust for its election year.

Revocation of election

ITA
110.6(25)

Subject to subsections 110.6(28) and (28.1) of the Act, new subsection (25) permits an election made under subsection (18) in respect of eligible property to be revoked by filing a notice before 2021 in the form and manner prescribed by the Minister of National Revenue.

Late election

ITA
110.6(26)

Subject to subsection 110.6(28.1) of the Act, new subsection (26) permits an election under subsection (18) in respect of eligible property to be filed with the Minister of National Revenue after the filing deadline in subsection (24) if the election is filed before 2021 and an estimate of the penalty in respect of the late filing is paid when the election is filed.

Amended election

ITA
110.6(27)

Subject to subsections 110.6(28) and (28.1) of the Act, new subsection (27) permits an election under subsection (18) in respect of eligible property to be amended if the amended election is filed with the Minister of National Revenue before 2021 and an estimate of the penalty in respect of the amended election is paid when the amended election is filed.

Excess designated amount in election

ITA
110.6(28)

New subsection 110.6(28) of the Act prohibits the revocation or amendment of an election where the amount designated in the election in respect of the eligible property is greater than 11/10 of its fair market value at the disposition time.

Where the election was made in respect of eligible property that is a partnership interest, then the election cannot be revoked or amended if the designated amount in respect of the partnership interest exceeds the greater of $1 and the fair market value of the partnership interest at the disposition time. The purpose of this rule in respect of partnership interests is to accommodate situations where the fair market value of the partnership interest is nil or is negative.

Trusts – late, amended, revoked election

ITA
110.6(28.1)

New subsection 110.6(28.1) of the Act stipulates that an eligible taxpayer that is a trust may only late-file, amend or revoke an election in accordance with subsections (25) to (27) if the trust files the election, amendment or revocation with a prescribed form amending the trust’s tax return for its election year. In addition, the election for subsection (25), (26) or (27) to apply must be made jointly with the beneficiaries of the trust who will be affected by the late filing, amendment or revocation of the election.

For the purposes of subsection (28.1), affected beneficiaries are those for whom an amount was allocated from the net taxable capital gains of the trust under subsection 104(21) prior to the filing, as well as those for whom an amount will be allocated under subsection 104(21) as a result of the filing.

Trusts – late, amended, revoked election

ITA
110.6(28.2)

New subsection 110.6(28.2) of the Act ensures that beneficiaries of a trust will be able to benefit from the 2018 deemed disposition election in subsection (18) if the trust late-files, amends or revokes an election in accordance with subsection (25), (26) or (27). Subsection (28.2) stipulates that, notwithstanding subsection 104(24), an amount is deemed for the purposes of subsections 104(6) and (13) to have become payable by a trust to a beneficiary in the trust's election year (and not at any other time) if

- an election was late-filed, amended or revoked in accordance with the relevant provisions,

- it is reasonable to conclude that the amount is the taxable capital gain that resulted from the deemed disposition of property under paragraph (18.1)(a) as a result of the late-filed, amended or revoked election, and

- prior to the trust making the late-filed, amended or revoked election, the trust made the amount payable to the beneficiary after the trust's election year.

Penalty – election

ITA
110.6(29)

Subsection 110.6(29) of the Act provides for a penalty in respect of subsection (18) elections that are filed late in accordance with subsection (26) or that are amended in accordance with subsection (27). The penalty in respect of late-filed or amended elections is 1/3 of one per cent of the taxable capital gain on the eligible property resulting from the election multiplied by the number of months that begins on the day after the balance-due day for the taxpayer's election year (in most cases, this will be May 2019) and ends on the day that the election or amended election is filed with the Minister of National Revenue.

The penalty in respect of a late-filed or amended elections applies on a property-by-property basis. As a result, the penalty in respect of an increase in the designated amount in respect of one property will not be offset by a revocation or another election or a decrease in the designated amount in respect of another property.

Unpaid balance of penalty

ITA
110.6(30)

Subsection 110.6(30) of the Act provides for the assessment of penalties in respect of late-filed and amended elections and the requirement for the eligible taxpayer to pay the penalties so assessed.

2018 – disposition by minor

ITA
110.6(30.1)

New subsection 110.6(30.1) of the Act provides transitional rules for the eligibility of minors to claim the LCGE in respect of shares of a corporation held by the minor at the end of 2018. Minors do not qualify for relief under the deemed disposition election mechanism in subsection (18) in respect of capital gains arising from the deemed disposition of shares. However, subsection (12) will not apply to minors where the share is disposed of by the minor (or by a personal trust under which the minor is a beneficiary) in 2018, provided that the minor (or the trust) held the share continuously from the end of 2017 until the disposition. In addition, the capital gain will not be subject to the TOSI rules, which would otherwise apply in respect of dispositions after 2017.

For the purposes of determining whether the minor can claim the LCGE in respect of the capital gain on the disposition of the share, the definitions qualified small business corporation share, interest in a family farm or fishing partnership, and share of the capital stock of a family farm or fishing corporation are generally to be read as if the references to 24-month periods instead read as references to 12-month periods. This rule is intended to provide sufficient time to undertake any necessary steps for the shares to satisfy the relevant definitions prior to the disposition.

Clause 19

Allocated capital gains and losses

ITA
144(4)

A trust that is governed by an employees profit sharing plan is required to allocate all of its income and losses each year to employees who are beneficiaries under the plan. Subsection 144(4) of the Act provides that capital gains and capital losses that are so allocated to the beneficiaries retain their character as capital gains and capital losses in the hands of the beneficiaries to whom they are allocated.

Subsection 144(4) is amended so that it no longer states that capital gains so allocated are treated as capital gains in the hands of employees for the purposes of the lifetime capital gains exemption. This amendment is consequential on the changes to the lifetime capital gains exemption, which limit the ability of trust beneficiaries to claim the lifetime capital gains exemption to gains allocated from eligible LCGE trusts (which may include an employees profit sharing plan that satisfies the conditions for an eligible LCGE trust). It is intended that an eligible LCGE trust allocate capital gains to beneficiaries that are eligible for the lifetime capital gains exemption under subsections 104(21) and (21.2).

Converting Income into Capital Gains

Clause 20

Anti-avoidance – dividend stripping by individuals

ITA
84.1

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

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

Section 84.1 applies to a sale of shares of a corporation (a "subject corporation") by a taxpayer to a non-arm's-length corporation (including a related corporation) only if the two corporations are "connected" with each other. In general terms, if the two corporations are not connected, the related corporation would, if it is a private corporation, be subject to a special dividend tax under Part IV of the Act on a dividend from the subject corporation that approximates the highest federal-provincial personal income tax rate on a taxable dividend; in general, the Part IV tax is refunded when the dividend is distributed as a taxable dividend to individual shareholders subject to personal income tax. In contrast, Part IV tax may not be payable on a dividend paid by a corporation to a connected corporation, which would typically be the case if the dividend payer is a private corporation that does not earn income from property.

In the case of the purchaser corporation that issues a share of its capital stock as consideration for acquiring the subject share, subsection 84.1(1)(a) can apply to reduce the purchaser corporation's paid-up capital (PUC)). In general, this PUC reduction equals the amount by which the increase in the purchaser corporation's PUC (as otherwise determined) exceeds the greater of two amounts:

i. the PUC in respect of the subject shares; and

ii. the adjusted cost base (ACB) of the subject shares.

In addition, and in general terms, paragraph (1)(b) may also apply to treat as a dividend all or a portion of the fair market value of any non-share consideration paid for the subject shares by the purchaser corporation and received by the taxpayer.

Tax policy concerns have arisen with respect to the application of section 84.1 in the context of the conversion of surplus into capital gains. Section 84.1 is amended to prevent its avoidance and an anti-stripping rule in respect of non-arm's length transactions for the benefit of individuals is added in new section 246.1 of the Act. For more information, see the commentary under new section 246.1.

The amendments to section 84.1 apply in respect of dispositions that occur on or after Announcement Date. New section 246.1 applies in respect of amounts that are received or become receivable on or after Announcement Date.

Rules applicable when applying s. 84.1

ITA
84.1(2)(a.1)

Paragraph 84.1(2)(a.1) of the Act provides a rule for determining a taxpayer's adjusted cost base (ACB) of a share for the purposes of section 84.1. It applies to a share acquired by a taxpayer after 1971 from a person with whom the taxpayer was not dealing at arm's length, to a share substituted for such a share, and to a share substituted for a share owned by the taxpayer at the end of 1971. If applicable, paragraph 84.1(2)(a.1) reduces – for the purpose of applying section 84.1 – the ACB of a taxpayer's share as otherwise determined by two amounts described in subparagraphs (i) and (ii).

- Subparagraph (i) reduces the ACB of the taxpayer's share by the excess, if any, of the share's fair market value on "Valuation Day" (January 1, 1972) over the cost of the share to the taxpayer on January 1, 1972.
- Subparagraph (ii) reduces the ACB of the taxpayer's share, in general, by the total of all amounts deducted — as a lifetime capital gains exemption (LCGE) under section 110.6 – in respect of a previous disposition of the share, or a share for which the share was substituted, by the taxpayer or an individual with whom the taxpayer did not deal at arm's length.

In general terms, the effect of the above reductions to the ACB of a taxpayer's share is that they prevent the amount by which the ACB is reduced from being used to extract corporate surplus as a capital amount.

Paragraph 84.1(2)(a.1) is amended in two respects. The first amendment deletes the requirement, in the opening words of the paragraph, that a share disposed of by a taxpayer be acquired "from a person with whom the taxpayer was not dealing at arm's length". This is illustrated as part of the first example below.

The second amendment concerns the amount by which the ACB of a taxpayer's share is to be reduced under subparagraph 84.1(2)(a.1)(ii). The current reduction in the ACB is, in general, the amount that is the total of all capital gains realized (and in respect of which the LCGE was deducted) from previous dispositions of the share, or a share for which it was substituted, by the taxpayer or an individual with whom the taxpayer did not deal at arm's length.

Under amended subparagraph 84.1(2)(a.1)(ii), the ACB of a taxpayer's share, or substituted share, is – for the purpose of section 84.1 – reduced by the total of all capital gains realized in respect of previous dispositions of the share, or a share for which it was substituted, by the taxpayer and any individual with whom the taxpayer did not deal at arm's length. This reduction is based on all capital gains realized by the taxpayer and non-arm's length individuals and not just those capital gains eligible for the LCGE. In general terms, the objective of the reduction in

the ACB of the taxpayer's share for the purposes of section 84.1 is to ensure that a taxpayer cannot extract corporate surplus as a return of paid-up capital or non-share consideration to the extent that the ACB relied upon results from previously realized non-arm's length capital gains.

Example 1

This example concerns a taxpayer who acquires a share of a private corporation (Opco) in circumstances where capital gains were realized on previous dispositions of the share by individuals with whom the individual did not deal at arm's length. In the example, the taxpayer is a daughter (D) whose father (F) and mother (M) are also the parents of D's brother (B). There are no other non-arm's length individuals.

D acquires a share of Opco for $700,000 from B (acquisition 5 below). To determine the amount of the ACB of her Opco share for the purpose of section 84.1, D refers to the cost of the share ($700,000) and computes the total amount of all capital gains realized from previous dispositions of the share after 1984 by D and by individuals with whom D did not deal at arm's length (i.e., F, M and B). All acquisitions and dispositions of the Opco share are for fair market value.

Previous acquisitions and dispositions of the Opco share in chronological order:

1. F acquires for $10,000 the Opco share from an arm's length person.
    - F's Opco share has a $10,000 cost and ACB.

2. F disposes of the Opco share to M for $100,000.
    - F realizes a $90,000 capital gain ($100,000 - $10,000).
    - M's Opco share has a $100,000 cost and ACB (before applying amended paragraph 84.1(2)(a.1)).

    Because of amended subparagraph 84.1(2)(a.1)(ii), the ACB of M's Opco share for the purposes of section 84.1 is reduced to

    $10,000, computed as follows: $100,000 (ACB otherwise determined) less F's $90,000 capital gain.

3. M disposes of the Opco share on an arm's length basis to X Corporation for $450,000.
    - M realizes a $350,000 capital gain ($450,000 - $100,000).
    - X Corporation's Opco share has a $450,000 cost and ACB.

4. X Corporation disposes of the Opco share on an arm's length basis to B for $600,000.
    - X Corporation realizes a $150,000 capital gain ($600,000 - $450,000).
    - B's Opco share has a $600,000 cost and ACB (before applying amended paragraph 84.1(2)(a.1)).

    Because of amended subparagraph 84.1(2)(a.1)(ii), the ACB of B's Opco share for the purposes of section 84.1 is reduced to:

    $160,000, computed as follows: $600,000 (ACB otherwise determined) less $440,000 (i.e., F's $90,000 capital gain + M's $350,000 capital gain).

5. B disposes of the Opco share to D for $700,000.
    - B realizes a $100,000 capital gain ($700,000 - $600,000).

- D's Opco share has a $700,000 cost and ACB (before applying amended paragraph 84.1(2)(a.1)).

  Under amended subparagraph 84.1(2)(a.1)(ii), the ACB of D's Opco share for the purposes of section 84.1 is reduced to:

  $160,000, computed as follows: $700,000 (ACB otherwise determined) less $540,000 (i.e., F's $90,000 capital gain + M's $350,000 capital gain + B's $100,000 capital gain).

Amended paragraph 84.1(2)(a.1) changes the results that can apply under subsection 84.1(1) in respect of a disposition of a subject share to a purchaser corporation. The following example describes these results.

Example 2

In this example, an individual (D) disposes of a share (the subject share) of a corporation resident in Canada (the subject corporation) to another corporation with which D does not deal at arm's length (the purchaser corporation). After the disposition, the purchaser corporation is connected to the subject corporation under subsection 186(4).

Before the disposition, D has a $700,000 cost and ACB in respect of the subject share and the PUC in respect of the subject share is Nil. However, the ACB of the subject share is reduced under subparagraph 84.1(2)(a.1)(ii) to $160,000 from $700,000 (see the prior example for an explanation of this reduction). The reductions to D's ACB concern previous capital gains realized by non-arm's length individuals. (In contrast, D's ACB would have been $700,000 under current paragraph (2)(a.1) assuming the individuals did not claim the LCGE.)

D intends to transfer her subject share to her purchaser corporation for $700,000 and wants to know the results under subsection 84.1(1) if she were to receive in return a share of the purchaser corporation with a PUC of $300,000 and $400,000 of non-share consideration.

A. *Application of paragraph 84.1(1)(a) – PUC reduction (Purchaser Corporation)*

Under amended paragraph 84.1(1)(a), the increase to the PUC of the class of shares of the purchaser corporation that includes the share issued to D ($300,000, determined without reference to section 84.1) is reduced by $300,000 to Nil. The $300,000 PUC reduction is determined by the formula (A – B) x C/A:

where

A is $300,000 (the increase in PUC of all shares of the purchaser corporation determined without reference to section 84.1 (assume there is only one class of shares and the increase is $300,000)).

B is Nil (the amount by which the greater of the PUC of the subject share (Nil) and their ACB ($160,000) exceeds the fair market value of the non-share consideration ($400,000).

C is $300,000 (the increase in the PUC of the particular class of shares determined without reference to section 84.1 as a result of the issuance of the share to D).

Note: There would have been no PUC reduction if current paragraph 84.1(2)(a.1) applied because the amount determined under the description B would have been $300,000 based on the $700,000 ACB exceeding by $300,000 the $400,000 of non-share consideration. Therefore, the result of A – B, which is the amount of the PUC reduction, would have been $300,000 - $300,000 = Nil.

B. Application of paragraph 84.1(1)(b) – deemed dividend treatment

Under amended paragraph 84.1(1)(b), D would be deemed to have received from the purchaser corporation a taxable dividend of $240,000 as determined under the formula (A + D) – (E + F):

where

A is $300,000 (the increase in PUC of all shares of the purchaser corporation determined without reference to section 84.1 (assume there is only one class of shares and the increase is $300,000)).

D is $400,000 (the non-share consideration).

E is $160,000 (the greater of the PUC (Nil) and the ACB ($160,000) of the subject share).

F is $300,000 (the purchaser corporation's PUC reduction under paragraph 84.1(1)(a)).

The result is that D is deemed to have received a dividend of $240,000, which is the amount by which the total of the purchaser corporation's $300,000 PUC (otherwise determined) and the $400,000 of non-share consideration she received ($700,000 in total) exceeds the total of D's "hard" ACB of $160,000 and the purchaser corporation's $300,000 PUC reduction under paragraph (1)(a) ($460,000 in total). There would have been no deemed dividend under paragraph (1)(b) if current paragraph 84.1(2)(a.1) applied because the total of $700,000 in the descriptions of A and D ($300,000 of PUC and $400,000 of non-share consideration) would not have exceeded the $700,000 "hard" ACB.

The objective of amended paragraph 84.1(2)(a.1), when read in the context of section 84.1 as a whole, is to ensure that an individual cannot use more than the greater of their so-called "hard" arm's length share cost and the PUC of their share to extract corporate surplus on a tax-free basis or as capital gains from a corporation.

Clause 21

Non-arm's length dividend stripping – individual

ITA
246.1

New section 246.1 of the Act is an anti-avoidance provision intended to prevent the distribution of corporate surplus (in general, unrealized corporate value less liabilities) to an individual shareholder resident in Canada, which would otherwise be distributed as a taxable dividend, on a tax-reduced or tax-free basis in a non-arm's length context (this is an example of what is generally called "surplus stripping").

New subsections 246.1(1) and (2) provide the circumstances in which an individual is treated as having received a taxable dividend.

New subsection 246.1(3) provides the circumstances under which the capital dividend account of a corporation that paid an amount to the individual as a capital dividend is to be reduced, and the amount of the reduction.

New section 246.1 applies in respect of amounts that are received or become receivable on or after Announcement Date.

Deemed taxable dividend

ITA
246.1(1)

In general terms, new subsection 246.1(1) of the Act provides that an individual is deemed to have received a taxable dividend in a taxation year equal to the portion of an amount received or receivable by the individual in the year in the circumstances indicated in new subsection 246.1(2). The amount that is received or receivable by an individual that could be subject to new subsection (1) can be received or receivable by the individual directly or indirectly through a partnership or a trust.

Application of ss. 246.1(1)

ITA
246.1(2)

New subsection 246.1(2) of the Act contains the circumstances in which the portion of an amount that is received or receivable by an individual in a taxation year is deemed to be a taxable dividend under new subsection 246.1(1).

Subsection 246.1(2) provides that subsection (1) applies to the portion of the amount received or receivable, directly or indirectly, by an individual in a taxation year, as part of a transaction or event, or series of transactions or events, if the following conditions are met:

(a) the individual is resident in Canada in the taxation year;
(b) the amount was received or receivable, directly or indirectly in any manner whatever, from a person with whom the individual was not dealing at arm's length (including in situations where an accommodating third party that purportedly deals at arm's length with the individual is used as an intermediary to avoid subsection (1));
(c) as part of the transaction, event or series, there is a disposition of property or an increase or reduction in the paid-up capital in the capital stock of a corporation; and
(d) it can reasonably be considered that one of the purpose of the transaction, event or series was to effect a significant reduction or disappearance of assets of a private corporation (including assets that the private corporation acquires or holds an interest in, directly or indirectly) at any time in a manner such that any part of tax otherwise payable under the Act by the individual with respect to the portion, and in consequence of any distribution of property of the corporation, is avoided.

In general terms, an individual is to be considered to be avoiding any part of tax otherwise payable with respect to the amount received or receivable if the amount of tax payable by the individual is less than the amount of tax that the individual would have had to pay in respect of the receipt or receivable had the corporation instead paid a taxable dividend immediately before the transaction.

A "significant reduction or disappearance of assets" of a corporation may result from several amounts received or receivable by the individual as part of a series of transactions, in which case each amount would be recharacterized as a taxable dividend. The assets that could be reduced or

disappear include assets acquired directly or indirectly in the series (*e.g.*, cash received under a loan).

Reduction – capital dividend account

ITA
246.1(3)

New subsection 246.1(3) of the Act provides certain tax consequences that apply where a private corporation pays a capital dividend to an individual to which subsection 246.1(1) applies. When a capital dividend received or receivable by an individual is recharacterized under new subsection 246.1(1) as a taxable dividend, subsection (3) provides for a reduction in the payer corporation's capital dividend account. The capital dividend account of the payer corporation is reduced by the amount determined by the formula A – B. That represents the untaxed portions of any capital gains that a dividend payer realizes as part of the series referred to in subsection (2) before the capital dividend became payable to the individual.