Explanatory Notes to Legislative Proposals Relating to the Income Tax Act and Regulations

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Preface

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

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

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Income Tax Act and Income Tax Regulations

Amendments to the *Income Tax Act* (the “Act” or “ITA”) and the *Income Tax Regulations* (the “Regulations” or “ITR”)

Canadian Entrepreneurs’ Incentive

Clause 1

ITA
110.63

The Act is amended to add new section 110.63. It provides the new Canadian entrepreneurs’ incentive (CEI). The CEI is a deduction from taxable income that generally reduces the inclusion rate on certain qualifying capital gains by half. It applies to taxation years that begin after 2024.

Definitions

ITA
110.63(1)

New subsection 110.63(1) sets out a number of definitions for the purposes of section 110.63.

“excluded business”

The definition “excluded business” sets out a list of businesses that are not eligible for the new Canadian entrepreneurs’ incentive deduction. An excluded business means:

- the professional practice of an accountant, lawyer, notary, physician, mental health practitioner, health care practitioner, veterinarian, optometrist, dentist, chiropractor, engineer or architect;
- a business whose principal asset is the reputation, knowledge or skill of one or more employees;
- the provision of consulting services;
- the provision of financial services;
- the provision of services or instruments relating to insurance;
- the provision of services relating to property;
- the purchase, sale and rental of real property;
- the provision of services or sale of goods relating to providing short-term lodging and complementary services to travellers, vacationers and others;
- the provision of services or sale of goods relating to preparing meals, snacks and beverages, for immediate consumption on or off the premises; and
- operating facilities or providing services relating to cultural, entertainment and recreational interests.

"qualifying Canadian entrepreneur incentive property"

The definition "qualifying Canadian entrepreneur incentive property" sets out the conditions for property to eligible for the new Canadian entrepreneur incentive deduction in respect of taxable capital gains on the disposition of the property. Qualifying Canadian entrepreneur incentive property can be either qualified farm or fishing property (as defined in subsection 110.6(1)), or a share that meets certain conditions.

If the property is a share, it must be a share that would be a qualified small business corporation share (as defined in subsection 110.6(1)), if the words "used principally in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it" in paragraph (a) of the definition "small business corporation" in subsection 248(1) were read as: "used principally in an active business (other than an excluded business, as defined in subsection 110.63(1)) carried on primarily in Canada by the particular corporation or by a corporation related to it". This means that, when determining whether all or substantially all of a corporation's value is derived from assets used in an active business (as set out in the definition "small business corporation"), the test is narrowed so that assets used in an excluded business are effectively treated as bad assets. As such, dispositions of shares that derive material value from an excluded business will not be eligible for the Canadian entrepreneurs' incentive deduction.

In addition, throughout a period of at least 24 continuous months preceding the disposition time by an individual,

- if the property is a share, the individual owned not less than 5% of the issued and outstanding shares (having full voting rights under all circumstances) of the corporation,
- if the property is an interest in a partnership, the individual's specified proportion of the partnership for its most recent fiscal period is not less than 5%, and, and
- if the property is not described above, the fair market value of the individual's interest in the property was not less than 5% of the total fair market value of the property.

The individual must also have been actively engaged on a regular, continuous and substantial basis (within the meaning of paragraph 120.4(1.1)(a)) in the activities of the business for a total period of not less than three years.

Qualifying Canadian entrepreneur incentive property - deduction

ITA
110.63(2)

Subsection 110.63(2) provides a deduction in computing the taxable income of an individual (other than a trust) in respect of taxable capital gains from the disposition of qualifying Canadian entrepreneur incentive property. This deduction is similar to that available under the lifetime capital gains exemption under section 110.6, except, while section 110.6 provides for a deduction of the full amount of a taxable capital gain that qualifies under that section, the deduction available under new subsection 110.63(2) provides for a deduction of 1/2 of the taxable capital gain from the disposition of property that is qualifying Canadian entrepreneur incentive property.

This deduction is 1/2 of the least of three amounts.

The first amount is determined by the formula A – B.

The variable A represents the phased in upper limit of the Canadian entrepreneur incentive deduction. This limit is initially $266,667 (being the 2/3 taxable capital gain inclusion of a $400,000 capital gain) in 2025, and is increased by that amount in each of four subsequent years. As such, the maximum amount of any taxable capital gain that would be eligible for the CEI will be for:

- 2025, $266,667 (providing a maximum deduction of $133,333 on a capital gain of $400,000);
- 2026, $533,333 (providing a maximum deduction of $266,667 on a capital gain of $800,000);
- 2027, $800,000 (providing a maximum deduction of $400,000 on a capital gain of $1,200,000);
- 2028, $1,066,667 (providing a maximum deduction of $533,333 on a capital gain of $1,600,000); and
- 2029 or a subsequent year, $1,333,333 (providing a maximum deduction of $666,667 on a capital gain of $2,000,000).

The variable B reduces the available limit by twice the total amount deducted by the individual under this section for a previous year. This is because the caps in Variable A reflect lifetime limits (i.e. once fully phased in, the CEI provides a reduction on a lifetime $2,000,000 of capital gains).

The second limiting amount is determined by the formula C – D.

The variable C incorporates the computation provided under section 110.6. The amount determined for C is the total amount that would be deductible in respect of the individual for the year under section 110.6 in respect of capital gains and losses, if the only capital gains and losses of the individual were for properties that, at the time they were disposed of, were qualifying Canadian entrepreneur incentive property and the amount determined under paragraph 110.6(2.02)(a) was the total of the amount that would otherwise be determined under that paragraph and the first amount set out above. Paragraphs 110.6(2.02)(b), (c) and (d) would also compute separate, limiting amounts determined as if the only capital gains and losses of the individual were for properties that, at the time they were disposed of, were qualifying Canadian entrepreneur incentive property. For example, the individual’s annual gains limit for the year would be determined as if the only gains and losses of the individual for the year were from the disposition of qualifying Canadian entrepreneur incentive property.

Variable D is the total amount deducted by the individual for the year under section 110.6, in respect of properties that were, at the time they were disposed of, qualifying Canadian entrepreneur incentive property. As such, the deduction threshold for the Canadian entrepreneur incentive deduction is reduced by any amount deducted under the lifetime capital gains exemption for dispositions of qualifying Canadian entrepreneur incentive property.

For example, assume that in 2025 an individual disposed of shares that qualified as qualifying Canadian entrepreneur incentive property. The individual had a capital gain of $1,800,000 on the disposition, resulting in a taxable capital gain of $1,200,000. The individual’s annual gains limit for the year from the disposition of qualifying Canadian entrepreneur incentive property is $1,200,000. Assume that the individual had the full amount of the lifetime capital gains exemption available to them, allowing a deduction of $833,333.

Under variable C, paragraph 110.6(2.02)(a) would be the total of $833,333 (the amount that would otherwise be determined under that paragraph) plus $266,667 (the amount determined in paragraph (2)(a)). As such, the amount that would be determined for paragraph 110.6(2.02)(a) would be $1,100,000. This is less than the annual gains limit of $1,200,000. As such, the amount of $1,100,000 would be determined for variable C.

Assuming that the individual takes the full deduction available under the lifetime capital gains exemption, variable D would be $833,333 for the year.

As such, the second amount would be $1,100,000 - $833,333 = $266,667.

The third limiting amount is the individual’s net taxable capital gains for the year from the disposition of qualifying Canadian entrepreneur incentive property.

Failure to report capital gain

ITA
110.63(3)

New subsection 110.63(3) applies where an individual has realized a capital gain on a disposition of qualifying Canadian entrepreneur incentive property in a taxation year and knowingly or under circumstances amounting to gross negligence fails to report the disposition in their return of income for that taxation year or fails to file a return for that taxation year within one year following the taxpayer’s filing-due-date for the taxation year and the Minister of National Revenue establishes the facts justifying the denial. Subsection 110.63(3) applies notwithstanding that an amount could have been claimed as a capital gains deduction under subsection 110.63(2).

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(6)).

Deduction not permitted

ITA
110.63(4)

New subsection 110.63(4) is an anti-avoidance rule to prevent the conversion of taxable capital gains of corporations into exempt capital gains of individuals. Any such gain will be denied the capital gains deduction otherwise provided under subsection 110.63(2).

There are a number of provisions in the Act which permit property to be transferred between corporations on a tax-deferred basis. This subsection is not intended to restrict the operation of these provisions. However, this provision is necessary to ensure that these provisions are not utilized to effect a sale of corporate property in such a manner that a capital gain on corporate property is transmogrified into a capital gain of an individual shareholder in order to qualify for the deduction under subsection (2).

For example, where a corporation disposes of a property by first transferring the property to another corporation for consideration that is less than the fair market value of the property and an individual realizes a capital gain on the sale of the shares of either corporation as part of that series of transactions, they will not be permitted to claim the deduction under subsection (2) with respect to that gain. Similarly, an individual will be denied a deduction under subsection (2) with respect to a capital gain realized as part of a so-called butterfly transaction or series of transactions where corporate property is disposed of in an arm’s length transaction, either directly or indirectly, on a tax-free or tax deferred basis.

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(7)).

This amendment applies to taxation years that begin after 2024.

Deduction not permitted

ITA
110.63(5)

New subsections 110.63(5) and (6) are anti-avoidance rules to prevent the conversion of dividend income into partially exempt capital gains of individuals. These rules are intended to prevent corporations from issuing shares that have attributes designed to facilitate the realization of the yield by way of a capital gain rather than by way of dividends. These rules would apply, for example, to preferred shares that do not pay dividends or pay relatively low dividends but that are retractable or redeemable at a substantial premium. An individual will be denied the deduction under subsection (2) with respect to capital gains realized on a disposition of those types of shares. This rule will not apply, however, in the case of prescribed shares (within the meaning of subsection 110.6(8)).

New subsection 110.63(5) provides that an individual may not claim the deduction under subsection (2) with respect to a capital gain realized on a disposition of property where it is reasonable to conclude that a significant portion of the capital gain is attributable to the fact that dividend payments on a share (other than a prescribed share within the meaning of subsection 110.6(8)) have either not been made or have been deferred. For this purpose, dividend payments will be considered to have been deferred where the dividends actually paid on the share in a year are less than 90% of the average annual rate of return on the share for the year (as defined in subsection (6)).

Similar provisions apply in respect of the lifetime capital gains deductions (see subsections 110.6(8) and (9)).

This amendment applies to taxation years that begin after 2024.

Average annual rate of return

ITA
110.63(6)

New subsection 110.63(6) defines the average annual rate of return on a share (other than a prescribed share within the meaning of subsection 110.6(8)) for the year. The average annual rate of return on a share for a year is based on an objective standard, that is, the rate of return that a knowledgeable and prudent investor would expect to receive based on certain assumptions. By virtue of these assumptions, any delay, postponement or variation in the amount of dividends is generally ignored. Also ignored are any proceeds the investor might expect on the redemption or disposition of the share that differs from the original issue price.

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(9)).

This amendment applies to taxation years that begin after 2024.

Related persons, etc.

ITA
110.63(7)

New subsection 110.63(7) provides certain interpretation rules that apply to section 110.63.

Ordering rule

New paragraph 110.63(7)(a) provides an ordering rule for the disposition of shares that are identical properties for the purpose of determining whether a share satisfies the holding period test under the definition “qualifying Canadian entrepreneur incentive property” in subsection 110.63(1). Where a taxpayer disposes of shares only some of which meet the holding requirements of the definition “qualifying Canadian entrepreneur incentive property” in subsection 110.63(1), new paragraph 110.63(7)(a) deems the taxpayer to have disposed of the shares in the order in which they were acquired by the taxpayer.

Personal trusts

Under new subparagraph 110.63(7)(b)(i) a beneficiary of a personal trust is deemed to be related to the trust while they are a beneficiary.

New subparagraph 110.63(7)(b)(ii) provides that a personal trust will also be treated as being related, in respect of the subject shares, to any person from whom it acquired those shares where, at the time the trust disposes of the shares, all beneficiaries (other than registered charities) of the trust are related to the person from whom the trust acquired the shares (or would be related to that person if he or she were living at that time).

For the purposes of the capital gains deduction for qualifying Canadian entrepreneur incentive property, this paragraph provides that the period of time during which subject shares were held by a personal trust of which the individual was a beneficiary will be included in determining whether the holding period requirement for the subject shares set out in the definition “qualifying Canadian entrepreneur incentive property” in subsection 110.63(1) have been met.

Partnerships

New paragraph 110.63(7)(c) provides that a partnership shall be deemed to be related to a person for any period throughout which the person was a member of the partnership. For the purposes of the capital gains deduction for qualifying Canadian entrepreneur incentive property, the period of time during which property was held by a partnership of which the individual was a member will be included in determining whether the holding period requirements for the subject property set out in the definition “qualifying Canadian entrepreneur incentive property” in subsection 110.63(1) have been met.

New paragraph 110.63(7)(d) deems a person who is a member of a partnership that is a member of another partnership (a lower-tiered partnership) to be a member of the lower-tiered partnership. This paragraph will permit such a taxpayer to have access to the capital gains deduction arising on the disposition of qualifying Canadian entrepreneur incentive property by the lower-tiered partnership.

Holding corporations

New paragraph 110.63(7)(e) provides that a holding corporation will be deemed to be related to any of its shareholders from whom it acquired shares in another corporation in respect of the acquired shares where all or substantially all of the consideration received by a shareholder from the corporation in respect of the acquisition was common shares of the corporation. Paragraph (e) is a relieving provision which ensures that shareholders who held shares that are qualifying Canadian entrepreneur incentive property (within the meaning of subsection 110.63(1)) will not disentitle themselves to the capital gains deduction for dispositions of qualifying Canadian entrepreneur incentive property by reason only of the interposition of a holding company between themselves and the property.

Issued shares

Paragraph 110.63(7)(f) deems shares issued by a corporation to a particular person or partnership, except in certain circumstances, as having been owned immediately before their issue to the particular person or partnership by a person who was not related to the particular person or partnership.

Shares that are not subject to this rule are described in subparagraphs (i) to (iii). More specifically, subparagraph (i) provides that shares issued as consideration for other shares will not be subject to this rule.

Subparagraph (ii) provides that shares issued as part of a transaction or series of transactions in which the person or partnership disposed of all or substantially all of the assets used in an active business carried on by that person or the members of the partnership or disposed of an interest in a partnership where all or substantially all of the partnership's assets were used in an active business carried on by the members of that partnership are not subject to this rule.

Subparagraph (iii) provides that shares issued by the corporation as stock dividends on other shares of the capital stock of the corporation will not be subject to this rule. Paragraph 248(5)(b) provides that a share received in payment of a stock dividend on a particular share of the capital stock of a corporation is deemed to be property substituted for that particular share. Therefore, the holding period in the definition "qualifying Canadian entrepreneur incentive property" in subsection 110.63(1) operates effectively where shares are received as stock dividends on other shares of the capital stock of a corporation.

The effect of the rule in paragraph 110.63(7)(f) is to require shares, other than those issued in circumstances provided for in the exceptions in subparagraphs (i), (ii) and (iii), to be owned for the full 24 month holding period by the taxpayer or persons or partnerships related to the taxpayer to qualify for the capital gains deduction for qualifying Canadian entrepreneur incentive property. This rule ensures that the holding period requirement provided under the definition "qualifying Canadian entrepreneur incentive property" in subsection 110.63(1) cannot be circumvented through the issuance of shares of a corporation from treasury.

Similar interpretation rules apply in respect of the lifetime capital gains deduction for dispositions of qualified small business corporation shares (see subsection 110.6(14)).

Disability Supports Deduction

Clause 1

Disability supports deduction

ITA
64

Section 64 permits the deduction of disability supports expenses incurred to enable the taxpayer to work, to attend secondary school or to attend a designated educational institution, unless they have been reimbursed by a non-taxable payment.

Section 64 is amended to expand the list of expenses eligible for the disability supports deduction by adding amounts paid for:

- the cost of an ergonomic work chair (prescribed by a medical practitioner) for an individual who has a severe and prolonged impairment in physical functions, including amounts paid for an ergonomic assessment (to a person engaged in the business of providing such services);
- the cost of a bed positioning device (prescribed by a medical practitioner) for an individual who has a severe and prolonged impairment in physical functions, including related amounts paid for an ergonomic assessment (to a person engaged in the business of providing such services);
- the cost of a mobile computer cart (prescribed by a medical practitioner) for an individual who has a severe and prolonged impairment in physical functions;
- the cost of an alternative input device (prescribed by a medical practitioner) for an individual who has an impairment in physical or mental functions to allow them to use a computer;
- the cost of a digital pen device (prescribed by a medical practitioner) for an individual who has an impairment in physical or mental functions to allow them to use a computer;
- the cost of a navigation device for low vision (prescribed by a medical practitioner) for an individual who has a vision impairment;
- the cost of memory or organizational aids (prescribed by a medical practitioner) for an individual who has an impairment in mental functions; and
- the cost of a specially trained service animal (prescribed by a medical practitioner), including certain related costs, for an individual who suffers from one or more specified disabilities.

This amendment applies to the 2024 and subsequent taxation years.

Clause 2

Medical expense tax credit

ITR
5700

Section 5700 provides a list of medical devices and equipment the cost of which is eligible for inclusion in the calculation of the medical expense tax credit under paragraph 118.2(1)(m) of the Act.

Section 5700 is amended to add a navigation device for low vision for an individual who has a vision impairment to the list of medical devices the cost of which is eligible for the credit.

This amendment applies to the 2024 and subsequent taxation years.

Employee Ownership Trust Tax Exemption

Clause 1

General rules

ITA
39(9)(b)(i)

Pursuant to subsection 39(9), in computing a business investment loss of a taxpayer that is an individual (other than a trust), the taxpayer is required to deduct, from the amount of the business investment loss otherwise determined, the lesser of the amount of the business investment loss and the taxpayer's capital gains in respect of which a deduction was claimed under section 110.6, to the extent that such gains have not been used to reduce other business investment losses.

Subparagraph 39(9)(b)(i) is amended to add a reference to new sections 110.61 and 110.62, which provide capital gain exemptions for dispositions of shares pursuant to a qualifying business transfer and a qualifying cooperative conversion, respectively. For more information, see the commentary to subsections 110.61 and 110.62.

This amendment applies in respect of transactions that occur on or after January 1, 2024.

Clause 2

Reserve – dispositions to employee ownership trusts

ITA
40(1.3)

Subsection 40(1.3) provides an extension of the 5-year capital gains reserve under subparagraph 40(1)(a)(iii) to 10 years for dispositions of shares pursuant to a qualifying business transfer. In computing the taxpayer's gain from the disposition of shares, the taxpayer may claim a reserve over up to ten years whereby a minimum of ten per cent of the gain is included in the taxpayer's income each year.

Subsection (1.3) is amended to clarify that the extended reserve is available to the taxpayer from the time of the disposition of the shares pursuant to a qualifying business transfer.

This amendment applies in respect of transactions that occur on or after January 1, 2024.

Clause 3

ITA
74.2(2)

Subsection 74.2(2) provides that taxable capital gains and allowable capital losses attributed to an individual in a taxation year under certain provisions of the Act will be treated, for the purposes of the lifetime capital gains exemption, as having arisen on a disposition in the year of property by the individual.

Paragraphs 74.2(2)(a) and (b) are amended, effective for the 2024 and subsequent taxation years, to add references to the capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or a qualifying cooperative conversion under new sections 110.61 and 110.62, respectively.

This amendment applies to the 2024 and subsequent taxation years.

Clause 4

Definitions

ITA
110.6(1)

"annual gains limit"

The annual gains limit of an individual is one of the factors applicable in determining the individual's entitlement to the lifetime capital gains exemption for a year, determined by the formula A - B. The definition "annual gains limit" in subsection 110.6(1) is amended consequential on the introduction of the capital gain exemptions available on the disposition of shares pursuant to a qualifying business transfer or a qualifying cooperative conversion under new sections 110.61 and 110.62, respectively.

<u>Description of A</u>
The description of A is equal to the lesser of paragraphs (a) and (b). This formula functions to reduce the annual gains limit for the individual's allowable capital losses to the extent it exceeds their net taxable capital gains from sources unrelated to the disposition of properties eligible for the lifetime capital gains exemption. More specifically, paragraph (a) is equal to the individual's net taxable capital gains, which includes any allowable capital losses. If this amount is less than the net taxable capital gains from the disposition of properties eligible for the lifetime capital gains exemption (paragraph (b)), the description of A is equal to the individual's net taxable capital gains for the year.

Paragraph (a) is amended to exclude any portion of the net taxable capital gains that relate to deductions claimed by the individual for the year under new subsections 110.61(2) and 110.62(2). This amendment ensures that a capital gain that has effectively been exempted through a deduction under section 110.61 or 110.62 is excluded from the total net taxable capital gains in this paragraph.

<u>Description of B</u>

The description of B reduces the annual gains limit for the total of paragraphs (a) the individual's net capital losses (to the extent it exceeds their net taxable capital gains from sources unrelated to the disposition of properties eligible for the lifetime capital gains exemption) and (b) the individual's allowable business investment losses (ABILs) for the year.

Subparagraph (a)(ii) is amended to exclude any portion of the net taxable capital gains that relate to deductions claimed by the individual for the year under new subsections 110.61(2) and 110.62(2). This amendment ensures that a capital gain that has effectively been exempted through a deduction under section 110.61 or 110.62 is excluded from the total net taxable capital in this paragraph.

Paragraph (b) is amended to exclude any portion of the ABILs that have reduced the amount otherwise deductible by the individual for the year under new subsection 110.61(2) or 110.62(2). This amendment ensures that ABILs that have already reduced another deduction under section 110.61 or 110.62 are not reducing the annual gains limit for the lifetime capital gains exemption.

These amendments are deemed to have come into force on Announcement Date.

"cumulative net investment loss"

An individual's cumulative net investment loss at the end of a taxation year may limit the individual's access to the capital gains exemption provided under section 110.6 by reducing their cumulative gains limit at the end of the year. The cumulative net investment loss of an individual at the end of a year is defined as the amount by which the aggregate of their investment expenses for the year and prior years ending after 1987 exceeds the aggregate of their investment income for such years.

The definition "cumulative net investment loss" is amended consequential on the introduction of the capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or a qualifying cooperative conversion under new sections 110.61 and 110.62, respectively.

Under subparagraph (ii) of the description of H used in the formulas in paragraphs 110.61(2)(b) and 110.62(2)(b), the amount by which an individual's "investment expense" exceeds their "investment income" for the year (referred to, here, as "net investment losses") may reduce the amount of the deduction that the individual may claim under subsections 110.61(2) or 110.62(2). To ensure the reduction caused by the individual's net investment losses to the amount of the deduction available under subsections 110.61(2) or 110.62(2) is only accounted for once, the definition of "cumulative net investment loss" is amended to exclude that amount of the individual's net investment losses which reduced the deduction available under subsections 110.61(2) and 110.62(2). This amendment ensures that the amount of the individual's net investment losses which reduced the deduction available under subsections 110.61(2) and 110.62(2) does not reduce the individual's cumulative gains limit in the same amount.

This amendment is deemed to have come into force on Announcement Date.

Clause 5

Capital gains deduction – qualifying business transfers

ITA
110.61(2)

Subsection 110.61(2) sets out the rules for calculating an individual's entitlement to the capital gains deduction on qualifying business transfers. If the conditions provided under subsection (1) have been met and the individual is eligible for a deduction under subsection (2), then in computing the taxable income for a taxation year of the individual, the individual may deduct such amount as they may claim not exceeding the least of the amounts provided under paragraphs (a) and (b).

This subsection is amended and reorganized in order to incorporate limitations equivalent to those currently applicable to the lifetime capital gains exemption (i.e., limitations equivalent to the "annual gains limit" and similar to the "cumulative net investment loss", both defined in section 110.6). These restrictions prevent multiple deductions from being claimed against the same amount.

$10 million gains limit

New paragraph 110.61(2)(a) provides that the deduction cannot exceed the amount that would be determined under the formula: A × B × C – D.

Variable A is the elected amount included in the joint election referred to in paragraph 110.61(1)(e) (i.e., the total amount of capital gains that the parties agree may be eligible for a deduction under subsection (2) with respect to the qualifying business transfer, not exceeding $10,000,000).

Variable B is 1, unless more than one individual is entitled to a deduction under this subsection in respect of the qualifying business transfer. If more than one individual is entitled to the deduction, then variable B is the percentage assigned to the individual in the joint election referred to in paragraph (1)(e), if a percentage is assigned to the individual in accordance with clause (1)(e)(ii)(B). In any other case, variable B is nil.

Variable C is the fraction of the taxpayer's capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year.

Variable D recognizes that an individual may use the reserve provided under subparagraph 40(1)(a)(iii) to report the capital gain from a qualifying business transfer over multiple taxation years. Variable D is the total of each amount claimed by the taxpayer under subsection (2) in a prior taxation year in respect of the disposition of the subject shares multiplied by the amount determined by the formula E ÷ F (which adjust past deductions claimed to compensate for any difference between the capital gains inclusion rates in the current and past taxation years).

Variable E is the fraction of a capital gain that is a taxable capital gain under paragraph 38(a) in the current year.

Variable F is the fraction of a capital gain that is a taxable capital gain under paragraph 38(a) in the prior year in respect of the disposition of the subject shares.

Reduction of capital gains deduction

New paragraph (2)(b) requires that certain other deductions, if claimed, are first applied against the relevant taxable capital gain realized on the subject shares before the deduction under section 110.61 can be claimed. This limit ensures that, in computing net income, the exemption is reduced to the extent the taxpayer has also claimed allowable capital losses under paragraph 3(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying business transfer or a previous qualifying business transfer) or allowable business investment losses (ABILs), and to the extent that the taxpayer's investment expense exceeds their investment income (referred to, here, as "net investment losses"). This limit also ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has also claimed net capital loss carryovers under paragraph 111(1)(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying business transfer or a previous qualifying business transfer).

More specifically, this paragraph provides that the deduction available under section 110.61 cannot exceed the amount that would be determined under the formula: G – H.

<u>Variable G</u>
Variable G is the lesser of subparagraph (i), the individual's net taxable capital gains for the year (except any portion that relate to a deduction of another qualifying business transfer previously claimed by the individual for the year under this subsection), and subparagraph (ii), their net taxable capital gains from the disposition of the subject shares.

This formula functions to reduce the capital gains deduction for the individual's allowable capital losses to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying business transfer, or a previous qualifying business transfer. More specifically, subparagraph (i) is equal to the individual's net taxable capital gains for the year, which includes any allowable capital losses. If this amount is less than subparagraph (ii), their net taxable capital gains from the subject shares, variable G is equal to the individual's net taxable capital gains for the year.

<u>Variable H</u>
Variable H is the total of subparagraphs (i) to (iii).

Subparagraph (i) is the individual's ABILs for the year (except any portion that previously reduced the amount otherwise deductible by the individual for the year under this subsection).

Subparagraph (ii) is the individual's net investment losses for the year (except any portion that previously reduced the amount otherwise deductible by the individual for the year under this subsection).

Subparagraph (iii) is the individual's net capital losses for other taxation years deducted under paragraph 111(1)(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying business transfer or a previous qualifying business transfer).

For the purposes of subparagraph (ii) of variable H, an "investment expense" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "paragraph (a) of the description of B in the definition annual gains limit" in paragraph (f) of that definition is to be read as "subparagraph (iii) of the description of H in subsection 110.61(2)".

For the purposes of subparagraph (ii) of variable H, "investment income" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "A in the definition annual gains limit" in paragraph (f) of that definition is to be read as "G in subsection 110.61(2)".

The limit under paragraph (2)(b) is intended to ensure that the new exemption is not used to shelter other unrelated income. Similar limits apply in respect of the lifetime capital gains deductions (see the definitions "annual gains limit" and "cumulative net investment loss" in subsection 110.6(1)).

Example

This example assumes that the proposed changes to raise the capital gains inclusion rate to 2/3 have been implemented.

Imene owns shares of two unrelated operating corporations (22.5% of the fair market value of all shares of Opco1 and 15% of Opco2). In September 2025, Imene and the other Opco1 shareholders sold all of their Opco1 shares to an employee ownership trust (EOT1) pursuant to a qualifying business transfer. Similarly, in October 2025, Imene and all the other Opco2 shareholders sold all of their Opco2 shares to another employee ownership trust (EOT2). All of the Opco1 and Opco2 shares are "qualified small business corporation shares" (QSBC shares), as defined under subsection 110.6(1). Imene's sale of Opco1 shares resulted in a capital gain of $3,000,000 (taxable capital gain of $2,000,000) and Opco2 shares resulted in a capital gain of $750,000 (taxable capital gain of $500,000). Under the joint election for the capital gains deduction for selling to an employee ownership trust (EOTCGE) provided under subsection 110.61(1)(e), EOT1 effectively allocates $2,250,000 and EOT2 effectively allocates $1,500,000 of their respective $10,000,000 EOTCGE to Imene. Imene has never used her lifetime capital gains exemption (LCGE) prior to this transaction.

Imene has also realized $100,000 of allowable business investment losses (ABILs) in November 2025.

In December 2025, Imene disposed of portfolio shares resulting in a capital gain of $150,000 ($100,000 taxable capital gain). The portfolio shares do not qualify for the LCGE. Lastly, Imene has $75,000 of net capital losses carried forward from her 2023 taxation year (i.e., the portion of a $150,000 capital loss realized in 2023 that is an allowable capital loss, when the inclusion rate was 1/2) that she will use to fully shelter the capital gain realized on the portfolio shares in December 2025 (by virtue of the adjustment to net capital losses in subsection 111(1.1)).

Imene does not have any other relevant income for the year, or any other years.

What amounts can Imene claim under the EOTCGE and LCGE to reduce her taxable income from the sale of the Opco shares?

Pursuant to section 111.1, Imene calculates the amount she can claim under section 110.61 prior to section 110.6.

Under new subsection 110.61(2.1), since Imene is claiming more than one EOTCGE in the year, she must designate the order in which the deductions are claimed. Imene designates the deduction for Opco1 shares to be claimed before Opco2 shares.

Step 1a – Calculate EOTCGE amount for Opco1 shares

Applying the formula provided under paragraph 110.61(2)(a), this amount is $1,500,000 (i.e., $2.25 million of the $10 million EOT exemption limit was allocated to Imene multiplied by the fraction of her capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year (2/3)).

Paragraph 110.61(2)(b) requires the application of the formula: G – H.

In this case, variable G is the lesser of Imene's net taxable capital gains for the year (i.e., $2,600,000) and Imene's net taxable capital gains from the Opco1 shares sold to EOT1 (i.e., $2,000,000). Therefore, variable G is $2,000,000.

Variable H is the total of Imene's (i) ABILs for the year (i.e., $100,000), (ii) net investment losses for the year (i.e., $100,000 - $600,000 = nil), and (iii) net capital losses deducted in the year that exceeds the amount, if any, by which her net taxable capital gains exceeds the amount determined for G (i.e., $100,000 – (2,600,000 – 2,000,000) = nil). Therefore, variable H is $100,000 (from the ABILs).

The amount calculated under the formula "G – H" under paragraph (b) is $1,900,000 (i.e., $2,000,000 – $100,000).

The maximum amount that Imene may claim for her Opco1 shares under subsection 110.61(2) is the lesser of the amounts under paragraphs (a) (i.e., $1,500,000) and (b) (i.e., $1,900,000). Imene may therefore claim the EOTCGE for her Opco1 shares in the amount of $1,500,000 in computing her taxable income for her 2025 taxation year.

Since Imene's EOTCGE in respect of Opco1 shares is limited to her allocated EOT exemption limit in paragraph (a), no portion of the ABILs have reduced the amount otherwise deductible (in paragraph (b)). This is a relevant factor for determining the EOTCGE in respect of Opco2 shares (see below).

<u>Step 1b – Calculate EOTCGE amount for Opco2 shares</u>

Applying the formula provided under paragraph 110.61(2)(a), this amount is $1,000,000 (i.e., $1.5 million of the $10 million EOT exemption limit was allocated to Imene multiplied by the fraction of her capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year (2/3)).

Paragraph 110.61(2)(b) requires the application of the formula: G – H.

In this case, variable G is the lesser of Imene's net taxable capital gains for the year (except any portion related to a previous EOTCGE) (i.e., $2,600,000 - $1,500,000 (Opco1) = $1,100,000) and Imene's net taxable capital gains from the Opco2 shares sold to EOT2 (i.e., $500,000). Therefore, variable G is $500,000.

Variable H is the total of Imene's (i) ABILs for the year except any portion that previously reduced the amount otherwise deductible under this subsection (as mentioned above, no portion of the $100,000 ABILs have reduced the amount otherwise deductible), (ii) net investment losses for the year (i.e., $100,000 - $2,100,000 = nil), and (iii) net capital losses deducted in the year ($100,000) that exceeds the amount, if any, by which her net taxable capital gains (except any portion related to a previous EOTCGE) ($2,600,000 – $1,500,000 = 600,000) exceeds the amount determined for G (i.e., $100,000 – ($600,000 – $500,000) = nil). Therefore, variable H is $100,000 (from the ABILs).

The amount calculated under the formula "G – H" under paragraph (b) is $400,000 (i.e., $500,000 – $100,000).

The maximum amount that Imene may claim for her Opco2 shares under subsection 110.61(2) is the lesser of the amounts under paragraph (a) (i.e., $1,000,000) and (b) (i.e., $400,000). Imene may therefore claim the EOTCGE for her Opco2 shares in the amount of $400,000 in computing her taxable income for her 2025 taxation year.

Since the amount otherwise deductible under subsection 110.61(2) has been reduced by the $100,000 ABILs, it is a relevant factor in determining the LCGE (see below).

<u>Step 2 – Calculate LCGE amount</u>

Under subsection 110.6(2.1), Imene may claim the LCGE on her net taxable capital gain resulting from the sale of QSBC shares (including her Opco1 and Opco2 shares), not exceeding the least of the amounts determined under paragraphs (a) through (d).

Paragraph (a):

For the 2025 taxation year, the LCGE limit is $1,250,000, it follows that the amount corresponding to paragraph (a) is $833,333.

Paragraph (b):
The cumulative gains limit at the end of 2025 is $500,000 (from variable A of the annual gains limit – see below).

Paragraph (c):
Imene's annual gains limit (as amended in the definition in subsection 110.6(1)) for the year is determined by the formula A – B:

Variable A – is the lesser of paragraphs (a) and (b):

(a) Imene's net taxable capital gains ($2,600,000) except any portion related to an EOTCGE ($1,500,000 (Opco1) + $500,000 (Opco2) = $2,000,000). Thus, the amount under paragraph (a) is $600,000 ($2,600,000 - $2,000,000); and

(b) Imene's net taxable capital gains from the disposition of Opco1 and Opco2 shares ($2,500,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the EOTCGE. Thus, the amount under paragraph (b) is $500,000 ($2,500,000 - $2,000,000).

Consequently, variable A is the lesser of paragraph (a) (i.e., 600,000) and paragraph (b) (i.e., 500,000) equal to $500,000.

Variable B – is the total of paragraphs (a) and (b):

(a) the amount, if any, by which Imene's net capital losses deducted in the year ($100,000) exceeds the amount, if any, by which the amount of net taxable capital gains (except any portion related to an EOTCGE) ($2,600,000 – $2,000,000 = $600,000) exceeds the amount determined for A in respect of the individual for the year ($500,000). Therefore, paragraph (a) is nil ($100,000 – ($600,000 – 500,000)); and

(b) Imene's ABILs for the year except any portion that reduced Imene's EOTCGE. Therefore, paragraph (b) is nil ($100,000 – $100,000). Since the $100,000 ABILs have already reduced the EOTCGE in respect of Opco2 shares, it should not also reduce the LCGE.

Variable B is the total of paragraphs (a) and (b) equal to nil.

Consequently, the annual gains limit (paragraph (c)) is $500,000 ($500,000 – nil).

Paragraph (d):
Paragraph (d) is the net taxable capital gains under paragraph 3(b), if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were the QSBC shares ($2,500,000). However, under new subsection 111.1(2), no amount may be claimed under

the LCGE in respect of a taxable capital gain that has been deducted under the EOTCGE. Consequently, paragraph (d) is $500,000 ($2,500,000 - $2,000,000).

In computing Imene's taxable income for the 2025 taxation year, she may claim the LCGE under subsection 110.6(2.1) on her taxable capital gain, resulting from the sale of the Opco1 and Opco2 shares, an amount not exceeding the least of paragraphs (a) ($833,333), (b) (500,000), (c) ($500,000) and (d) (500,000), equal to $500,000.

Step 3 – Conclusion

Imene's taxable capital gains for the 2025 taxation year from the sale of Opco1 shares is $2,000,000 and Opco2 shares is $500,000, for a total of $2,500,000. The total deductions claimed for these shares under the EOTCGE is $1,900,000 ($1,500,000 + $400,000) and under the LCGE is $500,000, for a total of $2,400,000. The $100,000 reduction in these exemptions reflect the ABILs incurred in the year that offset the remaining taxable capital gains from these share dispositions. However, the $100,000 net capital losses do not reduce the exemptions because they do not exceed the taxable capital gains from sources unrelated to the disposition of the relevant properties (i.e., the net capital losses deducted does not exceed the taxable capital gains from portfolio shares). As a result of these exemptions, Imene's taxable income for her 2025 taxation year is nil. (Note that this example does not take into account any taxable income from alternative minimum tax.)

ITA
110.61(2.1)

New subsection 110.61(2.1) is relevant in a taxation year if an individual claims more than one deduction under subsection 110.61(2). In that case, the individual must designate the order in which each deduction is claimed, so that the formula in paragraph 110.61(2)(b) may apply to exclude certain amounts from a previous subsection 110.61(2) deduction. See subsection 110.61(2) for more information. If the individual does not designate the order of the deductions, the Minister may designate the order.

This amendment is deemed to have come into force on Announcement Date.

Clause 6

ITA
111(2)(b)

Subsection 111(2) permits the deduction of an individual's net capital losses claimed under paragraph 111(1)(b) in the year of death and in the immediately preceding taxation year against all sources of income. Subsection 111(1.1) determines the amount in respect of net capital losses which is deductible under paragraph 111(1)(b), and in so doing it also provides for the adjustment in net capital losses for carryover to another year to reflect differences in the inclusion rate for capital gains and losses in the loss year from the rate for the year in which the loss is claimed.

In the circumstances specific to the taxpayer's year of death and the immediately preceding taxation year, paragraph (2)(b) provides an adjusted rule respecting the application of paragraph (1.1)(b), which takes into account the lifetime capital gains exemption provided under section 110.6.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, paragraph (2)(b) is amended to include the capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion under sections 110.61 and 110.62, respectively.

This amendment is deemed to have come into force on January 1, 2024.

ITA
111(8)

"non-capital loss"

The definition "non-capital loss" determines a taxpayer's non-capital loss for a taxation year using a formula. Variable E of this formula lists certain amounts to be included in a taxpayer's non-capital loss.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, paragraph (b) of the description of E is amended to include, in determining a taxpayer's non-capital loss for a taxation year, an amount deducted under new sections 110.61 and 110.62 in computing the taxpayer's taxable income for the year.

This amendment is deemed to have come into force on January 1, 2024.

Clause 7

ITA
126(1)(b)(ii)(A)(III)

Subsection 126(1) sets out rules with respect to the foreign tax credit for non-business income.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subclause 126(1)(b)(ii)(A)(III) is amended to include references to these sections.

This amendment is deemed to have come into force on January 1, 2024.

ITA
126(2.1)(a)(ii)(A)(III)

Subsection 126(2.1) sets out rules with respect to the foreign tax credit for business income. In particular, subsection 126(2.1) sets out a limit for the amount of a taxpayer's deduction under subsection 126(2) in respect of businesses carried on by the taxpayer in a country other than Canada.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subclause 126(2.1)(a)(ii)(A)(III) is amended to include references to these sections.

This amendment is deemed to have come into force on January 1, 2024.

ITA
126(3)(b)(iii)

Subsection 126(3) set out rules with respect to the foreign tax credit for Canadian-resident employees of certain international organizations. The credit that may be claimed under subsection 126(3) is determined by multiplying the employee's Part I tax otherwise payable for a taxation year by a fraction. The numerator of that fraction, determined under paragraph 126(3)(a), consists of the employee's income for the year (or, where section 114 applies, for the period or periods in the year throughout which the employee is resident in Canada) from employment with the organization; the denominator of the fraction, determined under paragraph 126(3)(b), consists generally of the amount by which the employee's income for the year (or, where section 114 applies, for the period or periods in the year throughout which the employee is resident in Canada) exceeds the deductions listed in subparagraph 126(3)(b)(iii).

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subparagraph 126(3)(b)(iii) is amended to include references to these sections.

This amendment is deemed to have come into force on January 1, 2024.

ITA
126(5.1)

Subsection 126(5.1) provides a special rule for determining a foreign tax credit where an individual has claimed a capital gains exemption during a taxation year. The individual will be deemed to have claimed the exemption in a year in respect of those taxable capital gains specified by him in his tax return for the year. If the taxpayer does not specify the order, the Minister may do so. A related amendment to the definition of non-business income tax excludes any foreign tax on capital gains in respect of which an exemption has been claimed.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subsection 126(5.1) is amended to include references to these sections.

This amendment is deemed to have come into force on January 1, 2024.

ITA
126(7)

“non-business-income tax”

The definition “non-business-income tax” in subsection 126(7) defines the “non-business-income tax” paid by a taxpayer for a taxation year to the government of a country other than Canada, for the purpose of determining the taxpayer’s foreign tax credit. Paragraph (g) of the definition reduces a taxpayer’s non-business-income tax by the amount of any foreign tax that may reasonably be regarded as attributable to a taxable capital gain or portion thereof in respect of which the taxpayer has claimed a capital gains exemption.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, paragraph (g) of the definition “non-business-income tax” in subsection 126(7) is amended to include references to these sections.

This amendment is deemed to have come into force on January 1, 2024.

ITA
126(9)(a)(ii)

Subsection 126(1) sets out the rules for claiming a credit in respect of foreign taxes on non-business income (that is, the foreign taxes imposed on investment income and other categories of foreign source non-business income). A credit in respect of foreign taxes on business income is provided under subsection 126(2). Neither credit may exceed the Canadian tax otherwise payable in respect of the foreign source income. Canadian tax otherwise payable on foreign source income is generally determined by reference to the ratio of the net income from sources in a foreign country to total income. The net foreign source income is the amount, if any, by which “qualifying incomes” (as defined in subsection 126(7)) from those sources exceeds “qualifying losses” (as defined in the same subsection) from those sources.

Pursuant to paragraph 126(9)(a)(ii), the qualifying incomes and qualifying losses for a taxation year of a taxpayer from sources in a country are determined without reference to, for the purpose of subparagraph 126(1)(b)(i), any portion of the income in respect of which an amount was deducted under the lifetime capital gains exemption in section 110.6 in computing the taxpayer’s income for the year.

Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subparagraph 126(9)(a)(ii) is amended to include references to these new sections.

This amendment is deemed to have come into force on January 1, 2024.

Clause 8

ITA
128(2)(e)(ii)(A)

Paragraph 128(2)(e) provides rules applicable where an individual has become bankrupt and requires the trustee in bankruptcy, on behalf of the individual, to file a return of the individual's income computed as if the individual were not entitled to any deduction in the computation of taxable income other than certain losses carried over from other years.

Clause 128(2)(e)(ii)(A) is amended to include references to sections 110.61 and 110.62, consequential on the introduction of these new sections, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively. This ensures that, in computing the individual's taxable income for the year, there may be deducted amounts claimed under sections 110.61 and 110.62 to the extent that the amounts claimed are in respect of an amount included in income under subparagraph (e)(i).

This amendment is deemed to have come into force on January 1, 2024.

ITA
128(2)(f)(iii)

Paragraph 128(2)(f) requires an individual who is bankrupt at any time in a taxation year to file an income tax return for the year, in addition to the return required under paragraph 128(2)(e) to be filed by the trustee in bankruptcy. For this purpose, the individual's income is to be determined as if certain listed deductions were not available.

Subparagraph 128(2)(f)(iii) is amended to include in the list of deductions that are not available a deduction under new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively.

This amendment is deemed to have come into force on January 1, 2024.

Clause 9

ITA
183.1(7)

Where s. 110.6(8) does not apply

Subsection 183.1(7) ensures that subsection 110.6(8) will not apply to deny the capital gains exemption with respect to a capital gain realized on a share where section 183.1 has applied to a portion of the proceeds of disposition that were used in calculating the capital gain.

New subsections 110.61(8) and 110.62(8) provide a similar rule to that provided under subsection 110.6(8). Consequential on the introduction of new sections 110.61 and 110.62, which provide for capital gain exemptions available on the dispositions of shares pursuant to a qualifying business transfer or qualifying cooperative conversion, respectively, subsection 183.1(7) is amended to include references to subsections 110.61(8) and 110.62(8).

This amendment is deemed to have come into force on January 1, 2024.

Clause 10

ITA
251(1)(b)

Subject to certain exceptions, paragraph 251(1)(b) generally provides that a trust and a taxpayer do not deal at arm's length if the taxpayer, or any person not dealing at arm's length with the taxpayer, would be beneficially interested in the trust if subsection 248(25) were read without reference to subclauses 248(25)(b)(iii)(A)(II) to (IV).

Paragraph 251(1)(b) is amended to include a reference to paragraph (h) of the definition "trust" in subsection 108(1), which refers to employee ownership trusts (EOT) as an exception to the general rule in this paragraph. This amendment is intended to ensure that where a minority shareholder of a corporation that is sold to a trust pursuant to a qualifying business transfer (as defined in subsection 248(1)) and a beneficiary of the new employee ownership trust are related, the selling minority shareholder will not be deemed not to deal at arm's length with the EOT solely due to that relationship. Consequently, the selling minority shareholder could satisfy the requirement to deal with the EOT at arm's length at all times from the disposition time and onwards (as provided under subparagraphs (b)(i) and (c)(i) of the definition "qualifying business transfer" (QBT) in subsection 248(1)).

Example

An EOT acquired 100% of the shares of an operating corporation (Opco) from Mr. X and Mr. Z under a QBT. Immediately prior to the disposition of the shares under the QBT, Mr. X owned 20% of the shares of Opco and Mr. Z owned the remaining 80% of the shares. Opco has no debt.

Opco has 30 employees that would become beneficiaries of the EOT following the QBT. Two of the employees (Employee 1 and Employee 2) are related to Mr. X.

Subparagraph (b)(iv) of the definition “employee ownership trust” in subsection 248(1) requires that immediately before the time of a QBT to the trust, the beneficiary did not own, directly or indirectly, together with any person or partnership that is related to or affiliated with the individual, shares of the capital stock or indebtedness of the qualifying business, the value of which is equal to or greater than 50% of the fair market value of the shares of the capital stock and indebtedness of the qualifying business. Employee 1 and Employee 2 meet this requirement because, although they are related to Mr. X, Mr. X only owned a total of 20% of the shares of Opco immediately before the disposition time. On this basis, Employee 1 and Employee 2 can be beneficiaries of EOT.

In order for a seller to claim the deduction available under subsection 110.61(2) for a disposition of shares under a QBT, the seller must deal at arm’s length with the EOT at the disposition time and at all times after the disposition. This requirement is provided under subparagraphs (b)(i) and (c)(i) of the definition “QBT” in subsection 248(1).

Paragraph 251(1)(b) generally provides that a trust and a taxpayer do not deal at arm’s length if the taxpayer, or any person not dealing at arm’s length with the taxpayer, would be beneficially interested in the trust if subsection 248(25) were read without reference to subclauses 248(25)(b)(iii)(A)(II) to (IV). As a result of the amendment to paragraph 251(1)(b), employee ownership trusts are excluded from this deeming rule.

Because of the amendment to paragraph 251(1)(b), the deeming rule does not apply in respect of Employee 1 and Employee 2. Thus, absent other relevant facts, Mr. X would not be deemed by paragraph 251(1)(b) not to deal with the EOT at arm’s length due to the beneficial interests of his relatives, Employee 1 and Employee 2, in the EOT. Thus, absent other relevant facts, Mr. X would be able to satisfy the requirements under subparagraphs (b)(i) and (c)(i) of the QBT definition to deal with the EOT at arm’s length at the disposition time and at all times after the disposition. Thus, Mr. X may be eligible to claim a deduction under subsection 110.61(2).

This amendment is deemed to have come into force on January 1, 2024.

Clause 11

ITR
600(c)

Section 600 prescribes provisions of the Act for the purposes of obtaining permission to amend, revoke or extend the time to file an election, for which ministerial discretion may be exercised under paragraphs 220(3.2)(a) and (b) of the Act.

Paragraph 600(c) is amended to add references to paragraphs 110.61(1)(e) (i.e., in respect of the election for qualifying business transfers) and 110.62(1)(e) (i.e., in respect of the election for qualifying cooperative conversions). This amendment is intended to permit, at the Minister’s discretion, the parties to a qualifying business transfer and qualifying cooperative conversion to amend, revoke or late file the applicable election.

This amendment is deemed to have come into force on January 1, 2024.

Workers Cooperatives

Clause 1

General rules

ITA
40(1)(a)(iii)

Subparagraph 40(1)(a)(iii) is amended to add a reference to new subsection (1.4), which extends the general five-year period for capital gains reserve claims to 10 years for dispositions of shares pursuant to a qualifying cooperative conversion. For more information, see the commentary to new subsection (1.4) of the Act.

This amendment is deemed to have come into force on January 1, 2024.

Reserve – dispositions to worker cooperatives

ITA
40(1.4)

Where a taxpayer disposes of capital property in a taxation year, the gain otherwise determined may be reduced under subparagraph 40(1)(a)(iii) by a reasonable reserve in respect of proceeds of disposition that are not due to the taxpayer until after the end of the year. However, the gain from the disposition is fully recognized over the first five (or, in some cases, ten) taxation years of the taxpayer ending after the time of disposition.

New subsection (1.4) provides an extension of the application of subparagraph 40(1)(a)(iii) for dispositions of shares pursuant to a qualifying cooperative conversion. In computing the taxpayer's gain from the disposition of shares, the taxpayer may claim a reserve over up to ten years whereby a minimum of ten per cent of the gain is included in the taxpayer's income each year.

The extension of the ten-year capital gains reserve to qualifying cooperative conversions is intended to facilitate the sale of businesses to worker cooperatives.

For more information, see the commentary on subparagraph 40(1)(a)(iii) and the definitions "worker cooperative" and "qualifying cooperative conversion" in subsection 248(1).

These amendments apply in respect of transactions that occur on or after January 1, 2024.

Clause 2

Continuing corporation

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) provides continuity rules for the purposes of a number of provisions of the Act. Specifically, it provides, for certain enumerated purposes, the corporation formed as the result of an amalgamation is considered to be the same corporation as, and a continuation of, each predecessor corporation. Because of paragraph 88(1)(e.2), these continuity rules also apply in the context of a winding-up to which subsection 88(1) applies.

Paragraph 87(2)(j.6) is amended to add references to the definition "qualifying cooperative conversion" in subsection 248(1) and to new section 110.62, which provides the conditions for the application of the capital gains deduction for qualifying cooperative conversions.

This amendment is consequential upon the introduction of new section 110.62. This amendment ensures that an amalgamation (as defined in subsection 87(1)) of a subject corporation and a purchaser corporation (as defined under the definition "qualifying cooperative conversion" in subsection 248(1)) and a winding-up under subsection 88(1) of a subject corporation into a purchaser corporation, are permitted under new section 110.62, which will continue to apply to the reorganized corporate group. For more information, see the commentary on section 110.62.

This amendment is deemed to have come into force on January 1, 2024.

Clause 3

Capital gains deduction for qualifying cooperative conversion – conditions

ITA
110.62(1)

New subsection 110.62(1) provides the conditions for the application of the capital gains deduction under subsection (2) available upon a qualifying cooperative conversion (as defined in subsection 248(1)) to a worker cooperative. The conditions in subsection (1) are summarized and discussed in further detail below.

Claimant is an individual (other than a trust)

New subsection 110.62(1) requires that a person claiming the deduction under subsection (2) must be an individual (other than a trust).

Disposition occurs between 2024 and 2026

New subsection 110.62(1) further provides that for subsection (2) to apply, the disposition of the subject shares must occur after 2023 and before 2027.

Disposition occurs under a qualifying cooperative conversion

New subsection 110.62(1) also provides that subsection (2) applies if, at the time of a disposition (referred to as the "disposition time") of shares (referred to as "subject shares") of the capital stock of a corporation (referred to as the "subject corporation") to another corporation (referred to as the "purchaser corporation"), the disposition satisfied the conditions for a qualifying cooperative conversion (as defined in subsection 248(1)).

Deduction has not previously been sought in respect of the same business

New paragraph 110.62(1)(a) provides that for subsection (2) to apply, no individual may have, prior to the disposition time, claimed a deduction under subsection (2) in respect of another disposition of shares that, at the time of that disposition, derived their value from an active business that is also relevant to the determination of whether the disposition of the subject shares satisfies the condition set out in paragraph (a) of the definition qualifying cooperative conversion in subsection 248(1). This condition is intended to ensure that an interest in a business is effectively transferred only once pursuant to a qualifying cooperative conversion for which the capital gains deduction in subsection (2) is available, preventing multiplication of the deduction under subsection (2) in respect of the same business.

24-month holding period

New paragraph 110.62(1)(b) provides the conditions that the subject shares must meet throughout the 24 months immediately prior to the disposition time under the qualifying cooperative conversion. Subparagraph (i) requires that, during this period, the subject shares were not owned by anyone other than the individual or a person or partnership related to the individual. For more information on the interpretation of related persons for the purposes of this section, see the commentary on subsection (11).

Active business requirement

New subparagraph (b)(ii) requires that, during the 24-month period immediately prior to the disposition time, more than 50% of the fair market value of the subject shares was derived from assets which were used principally in an active business.

Subject corporation is not a professional corporation

New paragraph 110.62(1)(c) provides the conditions that the purchaser corporation and the subject corporation must meet immediately before the disposition time. Subparagraph (c)(i) ensures the deduction in subsection (2) is not available on a qualifying cooperative conversion if the subject corporation, or any corporation affiliated with the subject corporation in which the subject corporation owns (directly or indirectly) shares, is a professional corporation (as defined in subsection 248(1)).

Purchaser corporation's members are not its employees immediately before the disposition time

New subparagraph (c)(ii) provides that the purchaser corporation acquiring the subject shares under the qualifying cooperative conversion must not already be established for the purposes of providing employment to its members who are its employees at that time (excluding any officer or director of the purchaser corporation), or the employees of another corporation controlled by the purchaser corporation. Consequently, if a sale of a business is made to a pre-existing worker cooperative, such a transfer would not qualify for the deduction under subsection (2).

This condition is intended to improve neutrality by ensuring that an established worker cooperative does not hold a tax advantage (in the form of a deduction under subsection 110.62(2)) over its non-worker cooperative competitors when acquiring a new business. Similarly, this condition mitigates the advantage held by an established worker cooperative (due to greater access to financing) bidding against a newly formed worker cooperative for the benefit of workers of a target business who wish to form their own worker cooperative. The deduction under subsection (2) is intended to reduce the disincentive of selling a business to a newly created worker cooperative that may not have the financial resources of a third-party buyer.

Claimant is an adult

New paragraph 110.62(1)(d) provides the conditions that the individual and the individual's spouse or common-law partner, and the members of the worker cooperative must meet at the disposition time. Subparagraph (d)(i) requires that the individual claiming the deduction under subsection (2) must be at least 18 years of age at the disposition time.

Claimant (or spouse or common-law partner) was actively engaged in the underlying business

New subparagraph 110.62(1)(d)(ii) requires that throughout any 24-month period ending before the disposition time, the individual claimant, or a spouse or common-law partner of the individual, was actively engaged on a regular and continuous basis in the business that is relevant to the determination of whether the subject shares satisfy the condition set out in paragraph (a) of the definition "qualifying cooperative conversion" in subsection 248(1). This requirement restricts the deduction under subsection (2) to owner-managers and their spouses or common-law partners.

Example

In 2015, Daniella started a business in which she was engaged on a full-time basis throughout the following six years. In 2021, she began to transition most of her management and employment duties to her current employees and has been relatively uninvolved in the day-to-day operations of the business ever since. In 2024, Daniella decided to sell her business to her employees through a worker cooperative under a qualifying cooperative conversion.

Because Daniella was actively engaged in the business on a full-time basis for six years prior to the disposition time, she satisfies the condition in subparagraph 110.62(1)(d)(ii).

Residency of members of the purchaser corporation at disposition time

New subparagraph (d)(iii) requires that, at the disposition time, the purchaser corporation is a worker cooperative (as defined in subsection 248(1)) and provides two threshold requirements regarding the composition and residency of its members. These residency requirements are intended to ensure that the deduction under subsection (2) predominantly benefits Canadian workers.

Residency requirement #1 – 75% of qualifying cooperative workers reside in Canada

New clause (d)(iii)(A) requires that at least 75% of the purchaser corporation's qualifying cooperative workers described in paragraph (d) of the definition "worker cooperative" in subsection 248(1) are resident in Canada at the disposition time. The definition "qualifying cooperative worker" is provided in subsection 248(1) and, subject to certain conditions, generally includes most employee members of a cooperative. The requirement in clause (d)(iii)(A) generally means that at least 75% of the members of the worker cooperative who are also employed by the worker cooperative are resident in Canada at the disposition time.

Residency requirement #2 – 75% of employee members reside in Canada

New clause (d)(iii)(B) requires that at least 75% of the individual employee members of the purchaser corporation who are described in paragraph (e) of the definition "worker cooperative" in subsection 248(1) are resident in Canada. Paragraph (e) of the definition "worker cooperative" provides that at least 75% of all individuals employed by the corporation and all qualifying cooperative businesses controlled by the corporation (other than an employee who has not completed an applicable probationary period, which may not exceed 12 months) are holders of a membership share of the corporation.

Joint election

New paragraph 110.62(1)(e) recognizes that the deduction under subsection (2) may be shared among multiple individuals disposing of subject shares under a qualifying cooperative conversion. This paragraph also recognizes that the actions of the purchaser corporation could potentially cause a disqualifying event, as described under subsection (3), and trigger the relevant consequences described under subsection (4).

New subparagraph (i) requires that the purchaser corporation, the individual and any other individual entitled to a deduction under subsection (2) in respect of the qualifying cooperative conversion must jointly elect, in prescribed form, for the deduction provided under subsection (2) to apply in respect of the disposition of the subject shares.

Under new clause (ii)(A), the election must provide the elected amount (i.e., the total amount of capital gains that the parties agree may be eligible for a deduction under subsection (2) with respect to the qualifying cooperative conversion), not exceeding $10,000,000. If multiple individuals are eligible for a deduction in respect of the qualifying cooperative conversion, new clause (ii)(B) requires that the election include the percentage of the elected amount that is assigned to each eligible individual. The total percentages assigned to all individuals must not exceed 100%.

The election must be filed with the Minister of National Revenue on or before the earlier of the individual's or the worker cooperative's filing-due date for the taxation year that includes the disposition time.

See the commentary to new subsections 110.62(3) and (4) for more information regarding disqualifying events, and the commentary to new subsection 160(1.7) for information regarding joint and several liability of the parties to an election under paragraph 110.62(1)(e) if the deduction under subsection (2) is denied.

Capital gains deduction — qualifying cooperative conversions

ITA
110.62(2)

New subsection 110.62(2) sets out the rules for calculating an individual's entitlement to the capital gains deduction on qualifying cooperative conversions. If the conditions provided under subsection (1) have been met and the individual is eligible for a deduction under subsection (2), then in computing the taxable income for a taxation year of the individual, the individual may deduct such amount as they may claim not exceeding the least of the amounts provided under paragraphs (a) and (b).

New paragraph 110.62(2)(a) provides that the deduction cannot exceed the amount that would be determined under the formula: $A \times B \times C - D$.

Variable A is the elected amount included in the joint election referred to in paragraph 110.62(1)(e) (i.e., the total amount of capital gains that the parties agree may be eligible for a deduction under subsection (2) with respect to the qualifying cooperative conversion, not exceeding $10,000,000).

Variable B is 1, unless more than one individual is entitled to a deduction under this subsection in respect of the qualifying cooperative conversion. If more than one individual is entitled to the deduction, then variable B is the percentage assigned to the individual in the joint election referred to in paragraph (1)(e), if a percentage is assigned to the individual in accordance with clause (1)(e)(ii)(B). In any other case, variable B is nil.

Variable C is the fraction of the taxpayer's capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year.

Variable D recognizes that an individual may use the reserve provided under subparagraph 40(1)(a)(iii) to report the capital gain from a qualifying business transfer over multiple taxation years. Variable D is the total of each amount claimed by the taxpayer under subsection (2) in a prior taxation year in respect of the disposition of the subject shares multiplied by the amount determined by the formula $E \div F$ (which adjust past deductions claimed to compensate for any difference between the capital gains inclusion rates in the current and past taxation years).

Variable E is the fraction of a capital gain that is a taxable capital gain under paragraph 38(a) in the current year.

New paragraph (b) provides that the deduction cannot exceed the amount that would be determined in respect of the individual for the year under paragraph 3(b) in respect of capital gains and capital losses if the only properties referred to in paragraph 3(b) were subject shares. Paragraph (b) also provides that, in making that determination, there is not to be included any amounts already included in the amount determined under paragraph 3(b) for the purposes of paragraphs 110.6(2)(d) and 110.6(2.1)(d) (i.e., the lifetime capital gains deductions for dispositions of qualified farm property and qualified small business corporation shares) in respect of the individual.

This version of paragraph (b) applies on a temporary basis for the portion of 2024 prior to Announcement Date. It is replaced as of Announcement Date with a version that includes additional limits (discussed below).

Disqualifying event

ITA
110.62(3)

New subsection 110.62(3) provides the meaning of a disqualifying event in respect of a qualifying cooperative conversion. A disqualifying event occurs at the earliest of the times in which the events described in paragraphs (a) and (b) occur.

New paragraph (a) provides that a disqualifying event could occur when the worker cooperative that participated in the qualifying cooperative conversion ceases to be a worker cooperative. A worker cooperative would cease to be a worker cooperative if it no longer met any of the requirements in the definition "worker cooperative" in subsection 248(1).

Under new paragraph (b), a disqualifying event could occur at the time that is the beginning of the taxation year of a qualifying business of the worker cooperative in which less than 50% of the fair market value of the shares of the worker cooperative is attributable to assets used principally in an active business carried on by the worker cooperative (or by a qualifying cooperative business controlled by the worker cooperative) at both that time and at the beginning of the preceding taxation year of the worker cooperative.

<u>Example 1 – Asset lease to an arm's length party</u>

In 2024, a purchaser corporation (Purchaseco) acquired 100% of the shares of a subject corporation (Subco) that employed the members of Purchaseco and carries on an active business of manufacturing widgets. Upon the acquisition, Purchaseco and Subco amalgamated, forming a worker cooperative (WC). When Purchaseco acquired Subco, Subco owned two manufacturing facilities: Facility 1 and Facility 2. Sixty per cent of the fair market value of the Subco shares was attributable to Facility 2, an asset used principally in Subco's active business. WC has a December 31 taxation year-end.

In December 2027, WC ceased using Facility 2 for manufacturing and instead rented Facility 2 to an arm's length tenant under a 3-year lease. WC continued to carry on its active business using Facility 1. However, during this period, less than 50% of the fair market value of the WC shares was attributable to assets used principally in WC's active business.

As a result of having leased Facility 2, at the beginning of two of WC's consecutive taxation years (i.e., January 1, 2028 and January 1, 2029), more than 50% of the fair market value of WC's shares was not attributable to assets used principally in an active business carried on by WC. Consequently, a disqualifying event within the meaning of paragraph 110.62(3)(b) occurred on January 1, 2029, and paragraph 110.62(4)(b) applies to WC at that time.

Example 2 – Asset lease to a qualified cooperative business controlled by the worker cooperative

In 2024, a worker cooperative (WC) acquired 100 per cent of the shares of a qualifying cooperative business (Holdco), which controls and wholly-owns a subsidiary corporation (Opco). Opco carries on an active business in which the members of WC are employed. Holdco also owns equipment that it leases to Opco. Holdco and Opco have December 31 taxation year ends. For the following several years, Opco uses the equipment principally to carry on its active business and over 50% of the fair market value of the Holdco shares is attributable to the leased equipment.

A disqualifying event under paragraph 110.62(3)(b) occurs if less than 50% of the fair market value of the shares of a qualifying business is attributable to assets used principally in an active business carried on by WC at both the beginning of the taxation year of the qualifying cooperative business and at the beginning of the preceding taxation year of the qualifying cooperative business. In this case, the conditions for paragraph 110.62(3)(b) to apply are not met by virtue of Holdco leasing its equipment to Opco because at least 50% of the fair market value of the Holdco shares was attributable to assets (the leased equipment) used principally in an active business carried on by WC.

See the commentary to subsection 110.62(4) for information regarding the consequences of a disqualifying event.

Consequences of a disqualifying event

ITA
110.62(4)

New subsection 110.62(4) provides the consequences of a disqualifying event.

If the disqualifying event occurs within 24 months of the disposition time for the qualifying cooperative conversion, new paragraph (a) deems the capital gains deduction provided under subsection (2) to have never applied in respect of the subject shares disposed of under the qualifying cooperative conversion. See the commentary to paragraph 152(4)(b.941) for information regarding the 3-year extension of the normal reassessment period for an individual in respect of a deduction claimed under subsection (2), and subsection 160(1.7) regarding joint and several liability of the parties to an election under paragraph 110.62(1)(e) if the deduction under subsection (2) is denied.

If the disqualifying event occurs any time after the day that is 24 months after the disposition time for the qualifying cooperative conversion, new paragraph (b) deems the worker cooperative to have realized a capital gain equal to the elected amount (within the meaning of clause (1)(e)(ii)(A)) included in the joint election referred to in paragraph (1)(e), for the year in which the disqualifying event occurs.

Example

In Year 1, WC is a “worker cooperative” as defined in subsection 248(1). WC became a worker cooperative immediately following its acquisition pursuant to a qualifying cooperative conversion of all the common shares of a corporation (EmployerCo) that employs the members of WC. The individual that sold the EmployerCo shares to WC claimed the capital gains deduction under subsection 110.62(2) in respect of the sale. The only property owned by WC is the common shares of EmployerCo. EmployerCo is a “qualifying cooperative business”, as defined under subsection 248(1).

In Year 5, WC sells all of its common shares in EmployerCo to an arm’s length third-party purchaser in exchange for cash.

WC’s sale of the EmployerCo shares in Year 5 is a disqualifying event within the meaning of paragraph 110.62(3)(a). This result occurs because WC would no longer satisfy the conditions in the definition “worker cooperative” in subsection 248(1) (for example, paragraph (d) of the definition would not be satisfied because none of WC’s shareholders would be “qualifying cooperative workers” since those individuals are no longer employed by WC or any qualifying cooperative business controlled by WC).

As a result of the disqualifying event, paragraph 110.62(4)(b) would apply to deem the WC to have realized a capital gain (equal to the elected amount of capital gains eligible for a deduction under subsection (2)) at the time of the disqualifying event.

Anti-avoidance

ITA
110.62(5)

New subsection 110.62(5) is an anti-avoidance rule, which applies despite any other provision in section 110.62. This subsection provides that the deduction provided under subsection (2) does not apply in respect of a qualifying cooperative conversion if it is reasonable to consider that one of the purposes of any transaction (as defined in subsection 245(1)), or series of transactions, is to:

a) involve the subject corporation (or the purchaser corporation) in the qualifying cooperative conversion to accommodate the direct or indirect acquisition of subject shares (or the acquisition of all or substantially all of the risk of loss and opportunity for gain or profit in respect of the subject shares) by another person or partnership (other than the subject corporation or the purchaser corporation) in a manner that permits an individual to claim a deduction under subsection (2) that would otherwise not be available; or
b) organize or reorganize a subject corporation or any other corporation, partnership or trust in a manner that allows a deduction to be claimed under subsection (2) in respect of more than one qualifying cooperative conversion of a business that is relevant to the determination of whether subject shares satisfied the condition set out in paragraph (a) of the definition "qualifying cooperative conversion" in subsection 248(1).

This subsection is intended to ensure worker cooperatives are not used as accommodating intermediaries to facilitate the avoidance of tax that would otherwise be payable on a direct sale of shares to a third party. This provision is also intended to address planning that seeks to multiply the deduction under subsection (2) by selling a business in separate parts.

Failure to report capital gain

ITA
110.62(6)

New subsection 110.62(6) applies where an individual has realized a capital gain on a disposition of subject shares under a qualifying cooperative conversion in a taxation year and knowingly or under circumstances amounting to gross negligence fails to report the disposition in their return of income for that taxation year or fails to file a return for that taxation year within one year following the taxpayer's filing-due-date for the taxation year and the Minister of National Revenue establishes the facts justifying the denial. Subsection 110.62(6) applies notwithstanding that an amount could have been claimed as a capital gains deduction under subsection 110.62(2).

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(6)).

Deduction not permitted

ITA
110.62(7)

New subsection 110.62(7) is an anti-avoidance rule to prevent the conversion of taxable capital gains of corporations into exempt capital gains of individuals. Any such gain will be denied the capital gains deduction otherwise provided under subsection 110.62(2).

There are a number of provisions in the Act which permit property to be transferred between corporations on a tax-deferred basis. This subsection is not intended to restrict the operation of these provisions. However, this provision is necessary to ensure that these provisions are not utilized to effect a sale of corporate property in such a manner that a capital gain on corporate property is transmogrified into a capital gain of an individual shareholder in order to qualify for the deduction under subsection (2).

For example, where a corporation disposes of a property by first transferring the property to another corporation for consideration that is less than the fair market value of the property and an individual realizes a capital gain on the sale of the shares of either corporation as part of that series of transactions, they will not be permitted to claim the deduction under subsection (2) with respect to that gain. Similarly, an individual will be denied a deduction under subsection (2) with respect to a capital gain realized as part of a so-called butterfly transaction or series of transactions where corporate property is disposed of in an arm's length transaction, either directly or indirectly, on a tax-free or tax deferred basis.

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(7)).

Deduction not permitted

ITA
110.62(8)

New subsections 110.62(8) and (9) are anti-avoidance rules to prevent the conversion of dividend income into exempt capital gains of individuals. These rules are intended to prevent corporations from issuing shares that have attributes designed to facilitate the realization of the yield by way of a capital gain rather than by way of dividends. These rules would apply, for example, to preferred shares that do not pay dividends or pay relatively low dividends but that are retractable or redeemable at a substantial premium. An individual will be denied the deduction under subsection (2) with respect to capital gains realized on a disposition of those types of shares. This rule will not apply, however, in the case of prescribed shares (within the meaning of subsection 110.6(8)).

New subsection 110.62(8) provides that an individual may not claim the deduction under subsection (2) with respect to a capital gain realized on a disposition of property where it is reasonable to conclude that a significant portion of the capital gain is attributable to the fact that dividend payments on a share (other than a prescribed share within the meaning of subsection 110.6(8)) have either not been made or have been deferred. For this purpose, dividend payments will be considered to have been deferred where the dividends actually paid on the share in a year are less than 90% of the average annual rate of return on the share for the year (as defined in subsection (9)).

Similar provisions apply in respect of the lifetime capital gains deductions (see subsections 110.6(8) and (9)).

Average annual rate of return

ITA

110.62(9)

New subsection 110.62(9) defines the average annual rate of return on a share (other than a prescribed share within the meaning of subsection 110.6(8)) for the year. The average annual rate of return on a share for a year is based on an objective standard, that is, the rate of return that a knowledgeable and prudent investor would expect to receive based on certain assumptions. By virtue of these assumptions, any delay, postponement or variation in the amount of dividends is generally ignored. Also ignored are any proceeds the investor might expect on the redemption or disposition of the share that differs from the original issue price.

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(9)).

Deduction not permitted

ITA
110.62(10)

New subsection 110.62(10) is an anti-avoidance rule that prevents individuals from claiming disproportionate amounts received from or allocated by a partnership or trust (other than a personal trust), as being eligible for the capital gains deduction under subsection 110.62(2). This new subsection will deny a deduction under subsection (2) in circumstances where it is reasonable to consider that one of the main reasons that an individual acquires, holds or has an interest in a partnership or trust (other than a personal trust) or that one of the main reasons for the attributes of such interest is to enable the individual to receive a disproportionate percentage of any capital gain or taxable capital gain of the partnership or trust.

A similar provision applies in respect of the lifetime capital gains deductions (see subsection 110.6(11)).

Related persons, etc.

ITA
110.62(11)

New subsection 110.62(11) provides certain interpretation rules that apply to section 110.62.

Ordering rule

New paragraph 110.62(11)(a) provides an ordering rule for the disposition of shares that are identical properties for the purpose of determining whether a share satisfies the holding period test under subparagraph 110.62(1)(b)(i). Where a taxpayer disposes of shares only some of which meet the holding requirements of the subject shares under subparagraph 110.62(1)(b)(i), new paragraph 110.62(11)(a) deems the taxpayer to have disposed of the shares in the order in which they were acquired by the taxpayer.

Personal trusts

Under new subparagraph 110.62(11)(b)(i) a beneficiary of a personal trust is deemed to be related to the trust while they are a beneficiary.

New subparagraph 110.62(11)(b)(ii) provides that a personal trust will also be treated as being related, in respect of the subject shares, to any person from whom it acquired those shares where, at the time the trust disposes of the shares, all beneficiaries (other than registered charities) of the trust are related to the person from whom the trust acquired the shares (or would be related to that person if he or she were living at that time).

For the purposes of the capital gains deduction for qualifying cooperative conversions, this paragraph provides that the period of time during which subject shares were held by a personal trust of which the individual was a beneficiary will be included in determining whether the holding period requirement for the subject shares set out in paragraph 110.62(1)(b) have been met.

Partnerships

New paragraph 110.62(11)(c) provides that a partnership shall be deemed to be related to a person for any period throughout which the person was a member of the partnership. For the purposes of the capital gains deduction for qualifying cooperative conversions, the period of time during which shares were held by a partnership of which the individual was a member will be included in determining whether the holding period requirements for the subject shares set out in paragraph 110.62(1)(b) have been met.

New paragraph 110.62(11)(d) deems a person who is a member of a partnership that is a member of another partnership (a lower-tiered partnership) to be a member of the lower-tiered partnership. This paragraph will permit such a taxpayer to have access to the capital gains deduction arising on the disposition of subject shares under a qualifying cooperative conversion by the lower-tiered partnership.

Holding corporations

New paragraph 110.62(11)(e) provides that a holding corporation will be deemed to be related to any of its shareholders from whom it acquired shares in another corporation in respect of the acquired shares where all or substantially all of the consideration received by a shareholder from the corporation in respect of the acquisition was common shares of the corporation. Paragraph (e) is a relieving provision which ensures that shareholders who held subject shares (within the meaning of subsection 110.62(1)) will not disentitle themselves to the capital gains deduction for qualifying cooperative conversions by reason only of the interposition of a holding company between themselves and the subject corporation (within the meaning of subsection 110.62(1)).

Issued shares

Paragraph 110.62(11)(f) deems shares issued by a corporation to a particular person or partnership, except in certain circumstances, as having been owned immediately before their issue to the particular person or partnership by a person who was not related to the particular person or partnership.

Shares that are not subject to this rule are described in subparagraphs (i) to (iii). More specifically, subparagraph (i) provides that shares issued as consideration for other shares will not be subject to this rule.

Subparagraph (ii) provides that shares issued as part of a transaction or series of transactions in which the person or partnership disposed of all or substantially all of the assets used in an active business carried on by that person or the members of the partnership or disposed of an interest in a partnership where all or substantially all of the partnership's assets were used in an active business carried on by the members of that partnership are not subject to this rule.

Subparagraph (iii) provides that shares issued by the corporation as stock dividends on other shares of the capital stock of the corporation will not be subject to this rule. Paragraph 248(5)(b) provides that a share received in payment of a stock dividend on a particular share of the capital stock of a corporation is deemed to be property substituted for that particular share. Therefore, the holding period in paragraph 110.62(1)(b) operates effectively where shares are received as stock dividends on other shares of the capital stock of a corporation.

The effect of the rule in paragraph 110.62(11)(f) is to require shares, other than those issued in circumstances provided for in the exceptions in subparagraphs (i), (ii) and (iii), to be owned for the full 24 month holding period by the taxpayer or persons or partnerships related to the taxpayer to qualify for the capital gains deduction for a qualifying cooperative conversion. This rule ensures that the holding period requirement provided under paragraph 110.62(1)(b) in respect of the subject shares cannot be circumvented through the issuance of shares of a corporation from treasury.

Similar interpretation rules apply in respect of the lifetime capital gains deduction for dispositions of qualified small business corporation shares (see subsection 110.6(14)).

These amendments are deemed to have come into force on January 1, 2024.

Capital gains deduction — qualifying cooperative conversions

ITA
110.62(2)

Subsection 110.62(2) is amended to replace its existing paragraph (b) with a new one. New paragraph (b) incorporates limitations equivalent to those currently applicable to the lifetime capital gains exemption (i.e., limitations equivalent to the "annual gains limit" and similar to the "cumulative net investment loss", both defined in section 110.6). These restrictions prevent multiple deductions from being claimed against the same amount.

Paragraph (b) requires that certain other deductions, if claimed, are first applied against the relevant taxable capital gain realized on the subject shares before the deduction under section 110.62 can be claimed. This limit ensures that, in computing net income, the exemption is reduced to the extent the taxpayer has also claimed allowable capital losses under paragraph 3(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying cooperative conversion, a previous qualifying cooperative conversion or a previous qualifying business transfer (the previous conversions or transfers referred to, here, as "previous exemption sources")) or allowable business investment losses (ABILs), and to the extent that the taxpayer's investment expense exceeds their investment income (referred to, here, as "net investment losses"). This limit also ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has also claimed net capital loss carryovers under paragraph 111(1)(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying cooperative conversion or previous exemption sources).

More specifically, this paragraph provides that the deduction available under section 110.62 cannot exceed the amount that would be determined under the formula: G – H.

Variable G

Variable G is the lesser of subparagraph (i), the individual's net taxable capital gains for the year (except any portion that relate to previous exemption sources), and subparagraph (ii), their net taxable capital gains from the disposition of the subject shares.

This formula functions to reduce the capital gains deduction for the individual's allowable capital losses to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying cooperative conversion or previous exemption sources. More specifically, subparagraph (i) is equal to the individual's net taxable capital gains for the year, which includes any allowable capital losses. If this amount is less than subparagraph (ii), their net taxable capital gains from the subject shares, variable G is equal to the individual's net taxable capital gains for the year.

Variable H

Variable H is the total of subparagraphs (i) to (iii).

Subparagraph (i) is the individual's ABILs for the year (except any portion that previously reduced the amount otherwise deductible by the individual for the year under this subsection or subsection 110.61(2)).

Subparagraph (ii) is the individual's net investment losses for the year (except any portion that previously reduced the amount otherwise deductible by the individual for the year under this subsection or subsection 110.61(2)).

Subparagraph (iii) is the individual's net capital losses for other taxation years deducted under paragraph 111(1)(b) (to the extent it exceeds their net taxable capital gains from sources unrelated to the qualifying cooperative conversion or previous exemption sources).

For the purposes of subparagraph (ii) of variable H, an "investment expense" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "paragraph (a) of the description of B in the definition annual gains limit" in paragraph (f) of that definition is to be read as "subparagraph (iii) of the description of H in subsection 110.62(2)".

For the purposes of subparagraph (ii) of variable H, "investment income" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "A in the definition annual gains limit in paragraph (f)" of that definition is to be read as "G in subsection 110.62(2)".

The limit under paragraph (2)(b) is intended to ensure that the new exemptions are not used to shelter other unrelated income. Similar limits apply in respect of the lifetime capital gains deductions (see the definitions "annual gains limit" and "cumulative net investment loss" in subsection 110.6(1)).

Example

This example assumes that the proposed changes to raise the capital gains inclusion rate to 2/3 have been implemented.

Adam owns 15% of the fair market value of all shares of an operating corporation (Opco). In September 2025, Adam and the other Opco shareholders sold all of the Opco shares to a worker cooperative (WC) pursuant to a qualifying cooperative conversion. All of the Opco shares are "qualified small business corporation shares" (QSBC shares), as defined under subsection 110.6(1). Adam's sale of Opco shares results in a capital gain of $2,250,000 (taxable capital gain of $1,500,000). Under the joint election for the capital gains deduction for selling to a worker cooperative (WCCGE) provided under subsection 110.62(1)(e), Adam is allocated $1,500,000 of the total shared $10,000,000 WCCGE. Adam has never used his lifetime capital gains exemption (LCGE) prior to this transaction.

In 2025, Adam also disposed of some portfolio shares in January, resulting in a capital gain of $150,000 ($100,000 taxable capital gain) and in February, resulting in a capital loss of $300,000 ($200,000 allowable capital loss). None of the portfolio shares qualify for the LCGE.

Adam does not have any other relevant income for the year, or any other years.

What amounts can Adam claim under the WCCGE and LCGE to reduce his taxable income from the sale of the Opco shares?

Pursuant to section 111.1, Adam calculates the amount he can claim under section 110.62 prior to section 110.6.

Step 1 – Calculate WCCGE amount

Applying the formula provided under paragraph 110.62(2)(a), this amount is $1,000,000 (i.e., $1.5 million of the $10 million WC exemption limit was allocated to Adam multiplied by the fraction of the taxpayer's capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year (2/3).

Paragraph 110.62(2)(b) requires the application of the formula: G – H.

Variable G functions to reduce the capital gains deduction for the individual's allowable capital losses ($200,000 from portfolio shares) to the extent it exceeds their taxable capital gains from sources unrelated to the qualifying cooperative conversion ($100,000 from portfolio shares). Consequently, the capital gains deduction should be reduced by the excess of $100,000 ($200,000 - $100,000). More specifically, variable G is the lesser of Adam's net taxable capital gains for the year (i.e., $1,400,000) and Adam's net taxable capital gains from the Opco shares sold to the WC for the year (i.e., $1,500,000). Therefore, variable G is $1,400,000.

Variable H is the total of Adam's (i) ABILs for the year (i.e., none), (ii) net investment losses for the year (i.e., none), and (iii) net capital losses deducted in the year that exceeds the amount, if any, by which his net taxable capital gains exceeds the amount determined for G (i.e., none). Therefore, variable H is nil.

The amount calculated under the formula "G – H" under paragraph (b) is $1,400,000 (i.e., $1,400,000 – nil).

The maximum amount that Adam may claim for his Opco shares under subsection 110.62(2) is the lesser of the amounts under paragraph (a) (i.e., $1,000,000) and (b) (i.e., $1,400,000). Adam may therefore claim the WCCGE for his Opco shares in the amount of $1,000,000 in computing his taxable income for his 2025 taxation year.

Since Adam's WCCGE in respect of Opco shares is limited to his allocated WC exemption limit in paragraph (a), no portion of the allowable capital losses have reduced the amount otherwise deductible (in paragraph (b)).

<u>Step 2 – Calculate LCGE amount</u>

Under subsection 110.6(2.1), Adam may claim the LCGE on his taxable capital gain resulting from the sale of the Opco shares, not exceeding the least of the amounts determined under paragraphs (a) through (d).

Paragraph (a):
For the 2025 taxation year, the LCGE limit is $1,250,000. It follows that the amount corresponding to paragraph (a) is $833,333.

Paragraph (b):
The cumulative gains limit at the end of 2025 is $400,000 (from variable A of the annual gains limit – see below).

Paragraph (c):
Adam’s annual gains limit (as amended in the definition in subsection 110.6(1)) for the year is determined by the formula A – B:

Variable A – is the lesser of paragraphs (a) and (b):

(a) Adam’s net taxable capital gains (except any portion related to a WCCGE). Thus, the amount under paragraph (a) is $400,000 ($1,400,000 - $1,000,000); and

(b) Adam’s net taxable capital gains from the disposition of Opco shares ($1,500,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the WCCGE. Thus, the amount under paragraph (b) is $500,000 ($1,500,000 - $1,000,000).

Consequently, variable A is the lesser of paragraph (a) (i.e., 400,000) and paragraph (b) (i.e., 500,000) equal to $400,000.

Variable B – is the total of paragraphs (a) and (b):

(a) the amount of Adam’s net capital losses deducted in the year that exceeds the excess of his net taxable capital gains over the amount determined for A. Since Adam has not deducted any net capital losses in the year, paragraph (a) is nil; and

(b) Adam’s ABILs for the year, which is also nil.

Therefore, variable B is nil.

Consequently, the annual gains limit is $400,000 ($400,000 – nil).

Paragraph (d):
Paragraph (d) is the net taxable capital gains under paragraph 3(b), if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were the QSBC shares ($1,500,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the WCCGE. Consequently, paragraph (d) is $500,000 ($1,500,000 - $1,000,000).

In computing Adam’s taxable income for the 2025 taxation year, he may claim the LCGE under subsection 110.6(2.1) on his taxable capital gain resulting from the sale of the Opco shares an amount not exceeding the least of paragraphs (a) (i.e., $833,333), (b) (i.e., 400,000), (c) (i.e., $400,000) and (d) (i.e., 500,000), equal to $400,000.

Step 3 – Conclusion

Adam’s taxable capital gains for the year from the sale of Opco shares is $1,500,000. He also has taxable capital gains from the sale of portfolio shares of $100,000 and allowable capital losses from the sale of other portfolio shares of $200,000. The total deductions claimed for the Opco shares is $1,400,000 ($1,000,000 under the WCCGE and $400,000 under the LCGE). The $100,000 reduction in these exemptions reflect the allowable capital losses incurred in the year, that exceeds taxable capital gains from sources unrelated to the QSBC shares (i.e., $200,000 - $100,000), that offset the remaining taxable capital gains from these share dispositions.

See the commentary to the definitions “annual gains limit” and “cumulative gains limit” in subsection 110.6(1) for more information regarding the interaction of the annual gains limit under paragraph (b) and the equivalent limits under the lifetime capital gains deduction. See also, the commentary to new subsections 110.62(3) and (4) for more information regarding disqualifying events that could deny the deduction under subsection (2), and the commentary to paragraph 152(4)(b.941) for information regarding the 3-year extension of the normal reassessment period for an individual in respect of a deduction claimed under subsection (2).

This amendment replaces paragraph 110.62(2)(b) as enacted by subsection (1). This amendment is deemed to come into force on Announcement Date.

ITA
110.62(2.1)

New subsection 110.62(2.1) is relevant in a taxation year if an individual claims more than one deduction under subsection 110.62(2). In that case, the individual must designate the order in which each deduction is claimed, so that the formula in paragraph 110.62(2)(b) may apply to exclude certain amounts from a previous subsection 110.62(2) deduction. See subsection 110.62(2) for more information. If the individual does not designate the order of the deductions, the Minister may designate the order.

This amendment is deemed to have come into force on Announcement Date.

Clause 4

ITA
136(1)

Section 136 provides rules that apply to certain cooperative corporations. For the purposes of the Act, these cooperatives corporations are generally considered not to be private corporations, except for purposes of certain provisions that are listed in subsection 136(1).

Subsection 136(1) is amended to add the definition “qualifying cooperative conversion” in subsection 248(1) as another instance in which these cooperative corporations are treated as a private corporations. This means that a cooperative corporation (as described under section 136) will be treated as a private corporation for the purposes of the definition “qualifying cooperative conversion” in subsection 248(1), which is referenced in the new 10-year capital gains reserve under subparagraph 40(1)(a)(iii) and subsection 40(1.4), the new capital gains deduction under section 110.62 for qualifying cooperative conversions.

For more information, see the commentary to new subparagraph 40(1)(a)(iii) and subsection 40(1.4), section 110.62 and the definition “qualifying cooperative conversion” in subsection 248(1).

This amendment is deemed to have come into force on January 1, 2024.

Clause 5

ITA
152(4)(b.941)

Subsection 152(4) generally provides that the Minister of National Revenue may at any time assess tax and other amounts payable by a taxpayer for a taxation year but may not assess after the normal reassessment period for the year. An individual taxpayer’s normal reassessment period for a year is generally three years from the date of the initial notice of assessment.

New paragraph 152(4)(b.941) is introduced to support the Minister of National Revenue in verifying and reassessing a taxpayer who does not satisfy the conditions required for the application of the capital gains deduction for qualifying cooperative conversions under section 110.62.

Specifically, paragraph 152(4)(b.941) provides an additional three year reassessment period after the end of the normal reassessment period for the taxpayer in respect of the year of a disposition for which the taxpayer claimed a deduction under subsection 110.62(2). Because a disqualifying event (as described in paragraph 110.62(3)(a)) in respect of the capital gains deduction may occur up to a maximum period of 24 months after the disposition, an extended reassessment period is required to afford the Minister of National Revenue the ability to verify compliance.

For more information, see the commentary to new section 110.62.

This amendment is deemed to have come into force on January 1, 2024.

Clause 6

Joint liability — qualifying cooperative conversion capital gains deduction

ITA
160(1.7)

New subsection 160(1.7) is added consequential on the introduction of the joint election provided by new paragraph 110.62(1)(e) to satisfy the conditions listed in new subsection 110.62(1) for the application of the capital gains deduction for qualifying cooperative conversions in subsection 110.62(2).

For subsection 110.62(2) to apply, new paragraph 110.62(1)(e) requires an individual who wishes to claim a deduction under subsection 110.62(2) in respect of a qualifying cooperative conversion to a purchaser corporation to jointly elect, in prescribed form, with the purchaser corporation and any other individuals sharing the capital gains deduction from the qualifying cooperative conversion.

The joint election, and the joint and several liability imposed by this new subsection, recognize that the actions of the purchaser corporation could potentially cause a disqualifying event (as described in subsection 110.62(3)) to occur, causing the denial of the deduction under subsection 110.62(2) to the individual pursuant to paragraph 110.62(4)(a).

Consequently, a purchaser corporation that jointly elects under paragraph 110.62(1)(e) for subsection 110.62(2) to apply is, in the event paragraph 110.62(4)(a) subsequently applies, jointly and severally, or solidarily, liable for tax payable by the individual under Part I of the Act, to the extent that the tax payable by the individual is greater than it would have been had the conditions for the application of subsection 110.62(2) been satisfied. Any other individual who is a party to the joint election to share the capital gains deduction under 110.62(2) would not be joint and severally, or solidarily, liable for the additional tax payable by the taxpayer due to the application of paragraph 110.62(4)(a).

For more information, see the commentary on paragraph 110.62(1)(e), subsections 110.62(2) to (4) and paragraph 152(4)(b.941).

This amendment is deemed to have come into force on January 1, 2024.

Clause 7

ITA
248(1)

“qualifying cooperative business”

The new definition “qualifying cooperative business” in subsection 248(1) is relevant for the definitions “qualifying cooperative worker” and “worker cooperative” in subsection 248(1). A qualifying cooperative business is defined as a corporation controlled by a WC that satisfies the conditions in paragraphs (a) to (c).

Canadian-controlled Private Corporation

Paragraph (a) requires that the corporation be a Canadian-controlled private corporation (note that a cooperative corporation described under section 136 is a private corporation for purposes of the definition of qualifying cooperative business).

Governance and Board Representation

Paragraph (b) provides a restriction on the governance of the qualifying cooperative business. Specifically, not more than 40% of the directors of the qualifying cooperative business can be individuals that, immediately before the time that the WC acquired control of the corporation, owned, directly or indirectly in any manner whatever, together with any person or partnership that is related to or affiliated with the director, 50% or more of the fair market value of the shares of the capital stock or indebtedness of the corporation.

Paragraph (c) requires that the qualifying cooperative business deals at arm's length and is not affiliated with any person or partnership that owned 50% or more of the fair market value of the shares of the capital stock or indebtedness of the corporation immediately before the time the WC acquired control of the corporation.

This amendment is deemed to come into force on January 1, 2024.

"qualifying cooperative conversion"

The new definition "qualifying cooperative conversion" in subsection 248(1) is relevant to apply the new capital gain deduction under subsection 110.62(2) and the new 10-year capital gain reserve under subparagraph 40(1)(a)(iii) and subsection 40(1.4). The requirements of this new definition are intended to ensure that only genuine business transfers to worker cooperatives (WCs) on arm's length terms can benefit from these new tax benefits. A "qualifying cooperative conversion" means a disposition by a taxpayer of shares of the capital stock of a corporation ("subject corporation") to another corporation ("purchaser corporation") provided that certain conditions are met. These conditions are provided in paragraphs (a) through (c).

Paragraph (a) provides requirements for the subject corporation being disposed of. Specifically, immediately before the disposition, all or substantially all the fair market value of the assets of the subject corporation must be attributable to assets (other than an interest in a partnership) that are used principally in an active business carried on by the subject corporation or by a corporation that is controlled and wholly-owned by the subject corporation.

Paragraph (b) provides requirements applicable to the time of the disposition of the shares of the subject corporation described in paragraph (a). Specifically, at the time of the disposition, the taxpayer must deal at arm's length with the purchaser corporation, the purchaser corporation must acquire control of the subject corporation, and the purchaser corporation must be a WC.

Paragraph (c) provides requirements following the disposition described in paragraph (b). First, at all times after the disposition, the taxpayer must deal at arm's length with the purchaser corporation and subject corporation. Second, at all times after the disposition, the taxpayer must not retain any right or influence that, if exercised, would allow the taxpayer (whether alone or together with any person or partnership that is related to or affiliated with the taxpayer) to control, directly or indirectly in any manner whatever, the purchaser corporation or subject corporation. Relevant facts in determining arm's length dealing could include, for example, that the WC conducted its own due diligence with respect to the acquisition and obtained independent legal, tax and financial advice, including an independent valuation from a qualified professional.

This amendment is deemed to come into force on January 1, 2024.

"qualifying cooperative worker"

The new definition “qualifying cooperative worker” in subsection 248(1) is relevant for purposes of the definition “worker cooperative” in subsection 248(1). It means an individual that meets the conditions provided in paragraphs (a) through (e).

Paragraph (a) requires that the individual is a member of a cooperative corporation, which has been established or continued under the provisions of a law, of Canada or of a province, that provide for the establishment of the corporation as a cooperative corporation or that provide for the establishment of cooperative corporations.

Paragraph (b) requires that the individual is an employee of the cooperative or a qualifying cooperative business (as defined under subsection 248(1)) controlled by the cooperative.

Paragraphs (c) through (e) provide the instances in which an individual would be excluded from the definition “qualifying cooperative worker”.

More specifically, paragraph (c) excludes as “qualifying cooperative workers” individuals that represent together with any person or partnership that is related or affiliated with the individual, more than 50% of the members of the worker cooperative.

Paragraph (d) excludes as “qualifying cooperative workers” individuals who immediately before the time of a qualifying cooperative conversion to the cooperative, owned, directly or indirectly, together with any person or partnership that is related to or affiliated with the individual, shares of the capital stock or indebtedness of the cooperative or a qualifying cooperative business controlled by the cooperative, the value of which is equal to or greater than 50% of the fair market value of the shares of the capital stock and indebtedness of the cooperative or the qualifying cooperative business controlled by the corporation.

Paragraph (e) excludes as “qualifying cooperative workers” individuals who claimed, or are related to an individual who claimed, a deduction under subsection 110.62(2) in respect of a disposition of shares of the cooperative or a qualifying cooperative business controlled by the cooperative.

This definition is relevant to making a determination of whether a corporation is a “worker cooperative” (as defined under subsection 248(1)) and is referenced in various conditions in that definition. For more information, see the commentary to the definition “worker cooperative” in subsection 248(1).

This amendment is deemed to come into force on January 1, 2024.

“worker cooperative”

The new definition “worker cooperative” (WC) in subsection 248(1) is relevant to apply the new capital gain deduction under subsection 110.62(2) and the new 10-year capital gain reserve under subparagraph 40(1)(a)(iii) and subsection 40(1.4) for qualifying cooperative conversions (also defined in subsection 248(1)). A WC is a corporation, which at all relevant times, satisfies all of the conditions provided under paragraphs (a) through (i) of the definition.

Residence

New paragraph (a) requires that the corporation is resident in Canada.

Incorporation or continuance under a law governing cooperative corporations

New paragraph (b) requires that the corporation was incorporated or continued by or under the provisions of a law, of Canada or of a province, that provide for the establishment of the corporation as a cooperative corporation or that provide for the establishment of cooperative corporations.

Purpose of the cooperative

New paragraph (c) requires that the corporation is established for the purpose of providing employment to its members.

Control by worker members

New paragraph (d) requires that if the membership of all qualifying cooperative workers (as defined in subsection 248(1)) of the corporation were notionally attributed to one hypothetical person, that person would control the corporation. Paragraph (d) is intended to ensure that control of the cooperative rests with its qualifying cooperative worker members that are employed by the cooperative or a qualifying cooperative business controlled by the cooperative.

The hypothetical person test in paragraph (d) addresses the concern that a corporation, the voting shares (in the case of a cooperative corporation, the membership shares) of which are distributed among a large number of persons, is usually not considered to be controlled by any group of its shareholders (or members), provided the shareholders (or members) do not act together to exercise control. As a result, it could be argued that a cooperative that is owned by a number of members (including non-worker members, if the cooperative is a multi-stakeholder cooperative) is not controlled by its qualifying cooperative workers. New paragraph (d) clarifies that this is not considered to be the case for purposes of the definition of “worker cooperative”.

For more information, see the commentary to the definition “qualifying cooperative worker” in subsection 248(1).

At least 75% of employees are members of the cooperative

New paragraph (e) provides that at least 75% of the of all individuals employed by the corporation and all qualifying cooperative businesses controlled by the corporation (other than an employee who has not completed an applicable probationary period, which may not exceed 12 months) are members of the cooperative. This requirement originates from the worker cooperative requirements provided under the *Canada Cooperatives Act*.

Membership

New paragraph (f) requires that each initial membership share provided to an employee of the corporation and any qualifying cooperative business controlled by the corporation is issued in exchange for a payment of a nominal amount determined in the same manner for all members described under the definition “qualifying cooperative worker” (as defined in subsection 248(1)), and offered to each employee following their completion of an applicable probationary period, which may not exceed 12 months. This requirement is intended to ensure membership in the WC is accessible to employees that meet the requirements provided under definition “qualifying cooperative worker”.

Governance

New paragraphs (g) and (h) provide conditions for the governance of the WC, including the composition of the directors of the WC. These conditions are intended to balance the interests of the selling shareholders of a subject corporation with the interests of the purchasing cooperative and its members, to ensure that a qualifying cooperative conversion occurs on arm’s length terms, and to ensure that the qualifying cooperative members (as an aggregated group) acquire control of the subject corporation upon the qualifying cooperative conversion.

Paragraph (g) provides at least one-third of the directors of the corporation are “qualifying cooperative workers” (as defined under subsection 248(1)) of the cooperative.

Paragraph (h) prohibits more than 40% of the directors of the cooperative from consisting of individuals each of whom, immediately before the time of a qualifying cooperative conversion that involved the cooperative, owned, directly or indirectly, together with any person or partnership that is related to or affiliated with the director, 50% or more of the fair market value of the shares of the capital stock or indebtedness of the cooperative or a qualifying cooperative business (as defined under subsection 248(1)) controlled by the cooperative.

Distribution of surplus earnings

New paragraph (i) requires that the by-laws of the cooperative provide a procedure for allocating, crediting or distributing any surplus earnings of the corporation, including that not less than 50% of those earnings must be paid on the basis of the remuneration earned by the qualifying cooperative workers from the corporation or the labour contributed by those members to the cooperative.

For more information, see the commentary to the definitions “qualifying cooperative business” and “qualifying cooperative worker” in subsection 248(1).

This amendment is deemed to have come into force on January 1, 2024.

Charities and Qualified Donees

Clause 1

Qualified Donees

This clause makes a number of amendments to section 149.1 related to the administrative rules for qualified donees. Unless otherwise noted, these changes generally come into force on royal assent.

ITA
149.1(1) “registered foreign charity”

The new definition “registered foreign charity” refers to a foreign charity that has been registered by the Minister pursuant to subsection 149.1(26).

This amendment is consequential to amendments to subsection 149.1(14.2), paragraph 168(1)(c), and subsections 188.1(6) and 188.2(2.1) and applies to taxation years that begin after April 16, 2024.

ITA
149.1(6.3)

Subsection 149.1(6.3) authorizes the Minister to designate a charity as a charitable organization, private foundation or public foundation.

Currently, to make such a designation, the Minister must send a notice to the charity by registered mail.

Subsection 149.1(6.3) is amended to allow the Minister to send the notice electronically if the charity has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

ITA
149.1(14.2)

New subsection 149.1(14.2) requires that each “registered foreign charity” file a public information return for the year in prescribed form and containing prescribed information. Information contained in a public information return will be disclosed to the public by the Minister pursuant to subsection 149.1(15).

The return must be filed within six months from the end of the organization’s taxation year. This change applies to taxations years that begin after April 16, 2024.

ITA
149.1(15)

Subsection 149.1(15) authorizes the Minister to communicate certain information in respect of charities.

Paragraph 149.1(15)(a) provides that, notwithstanding section 241, the Minister may share prescribed information that is required to be contained in the public information return under subsections 149.1(14) and (14.1).

Paragraph 149.1(15)(a) is amended to also refer to a public information return under new subsection 149.1(14.2).

ITA
149.1(22)

Subsection 149.1(22) provides that the Minister may send a notice to a person of the decision to refuse the application of the person for registration as a registered charity, registered Canadian amateur athletic association, registered journalism organization or qualified donee.

Currently, if the Minister sends such a notice to a person, the Minister must do so by registered mail.

Subsection 149.1(22) is amended to allow the Minister to send the notice by regular mail or electronically if the person has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

Subsection 149.1(22) is also shortened by replacing the reference to "a registered charity, registered Canadian amateur athletic association, registered journalism organization or qualified donee referred to in subparagraph (a)(i) or (iii) of the definition *qualified donee* in subsection (1)" by a reference to "a qualified donee referred to in subparagraph (a)(i) or (iii) or any of paragraphs (b) to (c) of the definition *qualified donee* in subsection (1)". This does not change its substance.

ITA
149.1(23)

Subsection 149.1(23) provides for notification that the registration of the person as a charity is annulled. The Minister may annul the registration of a charity if the person was registered in error or the person was a charity but has ceased to be a charity solely because of a change in law.

Currently, to make such a notification, the Minister must send a notice to the person by registered mail.

Subsection 149.1(23) is amended to allow the Minister to send the notice electronically if the person has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

ITA
149.1(26)

Subsection 149.1(26) provides the criteria for the registration of a foreign organization for the purposes of the definition *qualified donee* in subsection 149.1(1).

Currently, the period for which a foreign charity may be registered is 24 months.

Subsection 149.1(26) is amended to increase that period to 36 months, applicable to foreign charities registered after April 16, 2024.

Clause 2

Revocation of Registration of Certain Organizations and Associations

ITA
168(1)

Subsection 168(1) describes the circumstances under which the Minister may give notice of the Minister's intention to revoke the registration of certain qualified donees.

Currently, if the Minister gives such a notice, the Minister must do so by registered mail. Further, in respect of a failure to file an information return, the Minister may only give this notice to a qualified donee that is a registered charity, a registered Canadian amateur athletic association or registered journalism organization.

Subsection 168(1) is amended to allow the Minister to send the notice electronically if the person has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

Also, paragraph 168(1)(c) is amended to permit the Minister to give notice to a registered foreign charity (as defined in amended subsection 149.1(1)) if it fails to file an information return.

ITA
168(2)

Where the Minister has notified a registered charity, Canadian amateur athletic association or registered journalism organization that the Minister proposes to revoke its registration, subsection 168(2) requires the Minister to publish a copy of the notice of revocation in the *Canada Gazette*.

Subsection 168(2) is amended to require that such publication now be made on an internet webpage of the Government of Canada and, consequential to the amendment of subsection 168(1), to also refer to the time of sending of the notice for the purpose of determining when the notice must be published.

Also, new paragraph 168(2)(c) requires that the Minister maintain a permanent record of the notice and make the notice available to the public.

ITA
168(4)

Subsection 168(4) provides that the objection process in respect of assessments under Part I also applies to certain notices of decisions of the Minister regarding certain qualified donees.

Consequential to the amendment to subsection 168(1), subsection 168(4) is amended to also refer to the day on which the notice was sent for the purpose of determining the deadline by which a person may serve on the Minister a written notice of objection.

Clause 3

Failure to file information returns

ITA
188.1(6)

Subsection 188.1(6) provides that a registered charity, registered Canadian amateur athletic association, or registered journalism organization is liable to a penalty equal to $500 if it fails to file a return for a taxation year as and when required by subsection 149.1(14) or (14.1).

Consequential to the enactment of new subsection 149.1(14.2), subsection 188.1(6) is amended to make liable to the penalty a registered foreign charity if it fails to file a return for a taxation year as and when required by new subsection 149.1(14.2).

Clause 4

Notice of suspension with assessment

ITA
188.2(1)

Subsection 188.2(1) provides for the suspension of a registered charity, registered Canadian amateur athletic association or registered journalism organization’s tax-receipting privileges under certain circumstances for one year from the time that is seven days after the day of mailing of the notice of suspension by registered mail by the Minister.

Subsection 188.2(1) is amended to allow the Minister to send the notice electronically if the person has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the date the notice is sent.

Consequently, subsection 188.2(1) is also amended to refer to the day of sending of the notice for the purpose of determining the time from which the suspension takes effect.

ITA
188.2(2)

Subsection 188.2(2) provides for the suspension of certain qualified donees' tax-receipting privileges under certain circumstances for one year from the time that is seven days after the day of mailing of the notice of suspension by registered mail by the Minister.

Subsection 188.2(2) is amended to allow the Minister to send the notice electronically if the qualified donee has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

Consequently, subsection 188.2(2) is also amended to refer to the day of sending of the notice for the purpose of determining the time from which the suspension takes effect.

ITA
188.2(2.1)

Subsection 188.2(2.1) provides for the suspension of certain qualified donees' tax-receipting privileges for one year from the time that is seven days after the day of mailing of the notice of suspension by registered mail by the Minister if the qualified donee fails to report information that is required to be filed annually under subsection 149.1(14) or (14.1).

Subsection 188.2(2.1) is amended to allow the Minister to send the notice electronically if the qualified donee has given the Minister the authorization to do so in accordance with new subsection 244(14.3) and has not revoked the authorization at least 30 days before the notice is sent.

Consequently, subsection 188.2(2.1) is also amended to refer to the day of sending of the notice for the purpose of determining the time from which the suspension takes effect.

Further, subsection 188.2(2.1) is amended so that it also applies in respect of a registered foreign charity (as defined by amended subsection 149.1(1)) if it fails to report information that is required to be filed annually under new subsection 149.1(14.2).

ITA
188.2(3)

Subsection 188.2(3) sets out the consequences of a suspension under subsection 188.2(1), (2) or (2.1). One of those consequences is that the qualified donee is deemed not to be a qualified donee for the purposes of the Act and no charitable donations deduction or tax credit may be claimed by any person who makes a gift to the donee during that period.

Currently, this deeming rule takes effect seven days after the day on which the relevant notice is mailed.

Consequential to the amendment of subsections 188.2(1), (2), and (2.1), paragraph 188.2(3)(a) is amended to also refer to the date on which the notice is sent for the purpose of determining the time from which the deeming rule takes effect.

Clause 5

Tax regarding non-qualified investment

ITA
189(8)

Subsection 189(8) provides that certain provisions of Part I relating to returns, assessments, payments and appeals are applicable in respect of amounts assessed under Part V and to a notice of suspension issued under subsection 188.2(1), (2) or (2.1).

Paragraphs 189(8)(a) and (b) provide some qualifications to the application by reference of those Part I provisions, including a qualification that a notice or application sent or served under certain provisions be addressed to the “Assistant Commissioner, Appeals Branch”.

Paragraph 189(8)(b) is amended to replace the reference to “Assistant Commissioner, Appeals Branch” with a reference to “Appeals Branch”. This is being done to provide more flexibility.

New paragraph 189(8)(c) similarly qualifies the application by reference of those Part I provisions by providing that a person may serve a notice of objection or make an application for an extension of time to file such a notice in any manner authorized by the Minister.

Clause 6

Electronic notice — qualified donees

ITA
244(14.3)

New subsection 244(14.3) provides an alternative to the default method of delivering certain notices to qualified donees (or to a person who has been refused registration as a qualified donee) who use the CRA’s My Business Account or My Trust Account services.

New subsection 244(14.3) provides that certain notices that refer to the business number, trust account number or registration number of a person are presumed to be sent and received by the person on the date that they are posted in the secure electronic account (e.g., My Business Account or My Trust Account) in respect of the number.

This presumption only applies to the extent that the person has authorized that these notices be made available in that manner and has not revoked that authorization at least 30 days prior to the date the notice is posted in the account.

Clause 7

Definitions

ITA
248(1) “registered foreign charity”

Subsection 248(1) is amended to add the definition “registered foreign charity”, so that the definition of that term in amended subsection 149.1(1) applies for the purposes of the Act.

Clause 8

Contents of Receipts

ITR
3501(1)

Subsection 3501(1) sets out the requirements regarding the information that must be contained in an official receipt issued by a registered organization to enable a taxpayer to claim a credit under section 118.1 of the Act or a deduction under section 110.1 of the Act.

Subsection 3501(1) is amended to remove some of these information requirements by repealing paragraph 3501(1)(d) and subparagraph 3501(1)(e.1)(iii) and by amending paragraph 3501(1)(g) to remove the necessity to indicate an individual’s initial on a receipt.

Also, consequential to the enactment of new subsection 3501(3.2), paragraph 3501(1)(i) is amended to include a reference to that new subsection.

Finally, paragraph 3501(1)(j) is amended by replacing the reference to “website” with a reference to “webpage”.

ITR
3501(1.1)

Subsection 3501(1.1) sets out the requirements regarding the information that must be contained in an official receipt issued by a recipient other than a registered organization to enable a taxpayer to claim a credit under section 118.1 of the Act or a deduction under section 110.1 of the Act.

Subsection 3501(1.1) is amended to remove some of these information requirements by repealing paragraph 3501(1.1)(c) and subparagraph 3501(1.1)(e)(iii) and by amending paragraph 3501(1.1)(g) to remove the necessity to indicate an individual’s initial on a receipt.

Also, consequential to the enactment of new subsection 3501(3.2), paragraph 3501(1.1)(i) is amended to include a reference to that new subsection.

Finally, paragraph 3501(1.1)(j) is amended by replacing the reference to “website” with a reference to “webpage”.

ITR
3501(2)

Subsection 3501(2) provides that official receipts must be personally signed by certain individuals except as provided in subsections (3) and (3.1).

Consequential to the enactment of new subsection 3501(3.2), subsection 3501(2) is amended to include a reference to that new subsection.

ITR
3501(3.2)

New subsection 3501(3.2) sets out the circumstances under which an official receipt may be signed electronically.

ITR
3501(5)

Subsection 3501(5) requires a “spoiled official receipt form” to be marked “cancelled”.

Subsection 3501(5) is amended so that it applies to a “spoiled official receipt”.

Also, subsection 3501(5) is amended to provide that a spoiled official receipt may alternatively be marked “void”.

Registered Education Savings Plans

ITA
146.1

Section 146.1 contains the core tax rules, including registration conditions, that apply to registered education savings plans (RESPs).

Budget 2024 announced the government’s intention to amend the *Canada Education Savings Act* to introduce automatic enrolment in the Canada Learning Bond for eligible children who do not have an RESP opened for them before age 4.

Section 146.1 is being amended to provide modified conditions applicable to RESPs for which the subscriber is the Minister designated for purposes of the *Canada Education Savings Act.*

Clause 1

Definitions

ITA
146.1(1)

Subsection 146.1(1) defines a number of terms that apply for the purposes of the rules in section 146.1 that apply to RESPs.

A new definition of "designated subscriber" is added to subsection 146.1(1). A designated subscriber in respect of an education savings plan means the Minister that is designated for the purposes of the *Canada Education Savings Act* and that enters into the plan with a promoter.

The definitions of "education savings plan" and "subscriber" are each amended to include a reference to a "designated subscriber".

Clause 2

Social Insurance Number not required

ITA
146.1(2.3)

Subsection 146.1(2.3) provides exceptions to the requirement that a beneficiary's Social Insurance Number must be provided to the promoter of the education savings plan.

New paragraph 146.1(2.3)(c) provides an additional exception where the subscriber of an RESP is a designated subscriber. See the additional commentary on the new definition of "designated subscriber" in subsection 146.1(1).

Clause 3

Special rules

ITA
146.1(8)

New subsection 146.1(8) introduces modifications to registration conditions (in section 146.1) that will apply to education savings plans entered into between a designated subscriber and a promoter. See the additional commentary on the new definition of "designated subscriber" in subsection 146.1(1).

Paragraph 146.1(8)(a) applies in the case that an RESP had been opened on behalf of a beneficiary by a designated subscriber and then another subscriber subsequently acquires the rights of the designated subscriber under the plan. In that case, the Social Insurance Number of the beneficiary must be provided to the promoter before an educational assistance payment may be made to or for the beneficiary.

Paragraph 146.1(8)(b) applies throughout a period during which the subscriber of an RESP is a designated subscriber. It modifies two registration conditions and adds two new conditions that apply throughout that period:

- The conditions in paragraph 146.1(2)(d.1) that normally apply to accumulated income payments will not apply to accumulated income payments to a designated subscriber. That is, those conditions do not apply to the earnings and gains (on Canada Learning Bonds) that are paid to the designated subscriber to facilitate the closure of automatically opened plans, as needed.
- The condition in paragraph 146.1(2)(l) does not apply. Accordingly, the promoter of the RESP need not inform the beneficiary, parent or primary caregiver that a plan has been opened on behalf of the beneficiary. It is contemplated that the designated subscriber will inform the necessary parties that the plan has been established.
- The plan may not accept contributions on behalf of the beneficiary. For this purpose, note that Canada Learning Bond payments into an RESP are not a "contribution".
- The plan may not make educational assistance payments to or on behalf of the beneficiary.

Clause 4

Tax in respect to overpayments to RESP

ITA
204.94

Section 204.94 generally charges a 20% tax on "accumulated income payments" from RESPs.

Amendments to subsection 204.94(1) and the preamble of subsection 204.94(2) will ensure that the tax will not apply to accumulated income payments made to a designated subscriber of an RESP.

See the additional commentary on amendments to section 146.1 that correspond to a Budget 2024 announcement to introduce changes to the *Canada Education Savings Act* to provide automatic enrolment in the Canada Learning Bond for eligible children.

Clause 5

Definitions

ITA
207.01(1) "controlling individual"

The definition “controlling individual” provides a common term for the holder, annuitant or subscriber of various registered savings plans, for the purpose of the application of taxes under Part XI.01 of the Act.

Paragraph (c) of that definition is amended to exempt an RESP subscriber that is a “designated subscriber”. Accordingly, the tax provisions of Part XI.01 will not apply (neither to the promoter nor the subscriber) in respect of an RESP for which the subscriber is a designated subscriber. See the additional commentary on amendments to section 146.1 of the Act regarding modified registration conditions that apply to RESPs entered into between a designated subscriber and a promoter.

Clause 6

T4A information return

ITR
200(2)(j)

Paragraph 200(2)(j) of the Regulations generally requires the promoter of an RESP to issue a T4A information return to the recipient of a payment out of an RESP and to file a copy with the Canada Revenue Agency. That paragraph is amended to remove that reporting obligation in the case of a payment made to a designated subscriber.

See the additional commentary on amendments to section 146.1 of the Act regarding modified registration conditions that apply to RESPs entered into between a designated subscriber and a promoter.

Non-Compliance with Information Requests

Clause 1

Information gathering

ITA
231.1(1)

Subsection 231.1(1) grants authorized persons, for any purpose related to the administration or enforcement of the Act, certain enumerated powers. This subsection is amended to confirm that these enumerated powers extend to listed international agreements or, for greater certainty, tax treaties with another country.

A “listed international agreement” is defined in subsection 248(1) to mean the *Convention on Mutual Administrative Assistance in Tax Matters*, concluded at Strasbourg on January 25, 1988, as amended from time to time by a protocol or other international instrument as ratified by

Canada and a comprehensive tax information exchange agreement that Canada has entered into, and that has effect, in respect of another country or jurisdiction.

A "tax treaty" with a country is defined in subsection 248(1) to mean a comprehensive agreement or convention for the elimination of double taxation on income, between the Government of Canada and the government of the country, which has the force of law in Canada at that time.

This subsection is further amended to make clear that any purpose related to the administration or enforcement of the Act includes the collection of any amount payable under the Act by any person.

Information or document

ITA
231.1(1)(f)

Subsection 231.1(1) is also amended to add new paragraph (f) to the powers granted to authorized persons. New paragraph (f) confirms that an authorized person may require a taxpayer or any other person to provide and deliver any information or additional information including a return of income or a supplementary return, or any document. The authorized person may require a taxpayer or any other person to provide this additional information in a reasonable manner and within a reasonable period of time. This amendment further confirms that the additional information must be provided and delivered without cost to His Majesty in right of Canada.

New paragraph 231.1(1)(f) is subject to new subsection 231.1(4), which limits the applicability of new paragraph 231.1(1)(f). This limitation arises in situations where information or documents relate to unnamed persons.

Not applicable to unnamed persons

ITA
231.1(4)

New subsection 231.1(4) limits the application of new paragraph 231.1(1)(f) if the information or document relates to one or more unnamed persons and an application under subsection 231.2(3) would have been required if the information or document had been sought under section 231.2. In this case, paragraph 231.1(1)(f) is inapplicable and the information or document would need to be sought under section 231.2.

This amendment comes into force on royal assent.

Clause 2

Requirement to provide documents or information

ITA
231.2(1)

Subsection 231.2(1) provides that, notwithstanding any other provision of the Act, the Minister of National Revenue may by notice require that any person provide information or any document for any purpose relating to the administration or enforcement of the Act, of a listed international agreement or, for greater certainty, of a tax treaty with another country. An exception applies if the information or document relates to an unnamed person or persons, in which case the procedure set out in subsections 231.1(2) to (6) must be followed.

Subsection 231.2(1) is amended to confirm that the Minister may by notice require that any person provide information or documents within such reasonable time and in such reasonable manner as is stipulated in the notice, without cost to His Majesty in right of Canada.

Judicial authorization

ITA
231.2(3)(b)

Subsection 231.2(3) provides that a judge, on an *ex parte* application, may authorize the Minister to impose a requirement on a third party subject to such conditions that the judge considers appropriate if the judge is satisfied that the unnamed person or group of persons is ascertainable and that the requirement is made to verify compliance with the Act.

Paragraphs 231.2(3) (b) to (d) are replaced by new paragraph (b), which confirms that a judge of the Federal Court may authorize the Minister to impose on a third party a requirement under subsection (1) relating to an unnamed person or more than one unnamed person if the judge is satisfied by information on oath that the requirement is made to verify compliance by the person or the persons with any duty or obligation under this Act, a listed international agreement or, for greater certainty, a tax treaty with another country. The terms “listed international agreement” and “tax treaty” are defined in subsection 248(1).

This amendment comes into force on royal assent.

Clause 3

Documents and information – oath or affirmation

ITA
231.41

New section 231.41 is added to provide that a requirement or notice sent or served on a person under sections 231.1, 231.2 or 231.6 may require that the person provide any answers to questions, information or documents sought by the Minister orally under oath or affirmation, or by affidavit.

New section 231.41 applies in conjunction with existing subsection 220(5) of the Act, which provides that any officer or servant employed in connection with the administration or enforcement of the Act, who is designated by the Minister, may administer oaths and take and receive affidavits, declarations and affirmations for the purposes of or incidental to the administration or enforcement of the Act or any regulations made under the Act. Every officer or servant designated by the Minister has for those purposes all the powers of a commissioner for administering oaths or taking affidavits.

This amendment comes into force on royal assent.

Clause 4

Copies

ITA
231.5

Subsection 231.5(1) permits the making of copies of documents obtained in certain circumstances, and states that the copy made has the same probative force as the original document. This subsection also enables the making of a print-out of an electronic document and sets out that the print-out has the same probative force as the original document.

Subsections 231.5(1) and (2) deal with unrelated subject matter and are therefore being reorganized into two separate sections. Existing subsection 231.5(1) is renumbered as section 231.5.

The text of subsection 231.5(1), as set out in new section 231.5, is amended to refer to a document that is seized, inspected, audited, examined or provided under section 231.6. Other than these changes, the text of subsection 231.5(1), as set out in new section 231.5, is unaltered.

This amendment comes into force on royal assent.

Clause 5

Compliance

ITA
231.51

Subsection 231.5(2) prohibits a person from hindering, molesting or interfering with, or attempting to hinder, molest or interfere with, an official who is performing any act that the official is authorized under the Act to perform.

Existing subsection 231.5(2) is renumbered as section 231.51.

The text of former subsection 231.5(2), as set out in new section 231.51, is amended to provide that every person shall, unless the person is unable to do so, do everything that the person is required to do by sections 231.1 to 231.6. This amendment ensures that this provision applies to new section 231.41, newly renumbered section 231.5 and section 231.6.

This amendment comes into force on royal assent.

Clause 6

Definition of foreign-based information or document

ITA
231.6(1)

Section 231.6 provides rules which enable the Minister to obtain foreign-based information or documentation that is necessary to permit a proper assessment for Canadian tax purposes. Subsection 231.6(1) sets out a definition of "foreign-based information or document" that applies for the purposes of this section as a whole.

Subsection 231.6(1) is amended to confirm that this definition of foreign-based information extends to any information or document that is available or located outside Canada and that may be relevant to the administration or enforcement of the Act, of a listed international agreement or, for greater certainty, of a tax treaty with another country. The terms "listed international agreement" and "tax treaty" are defined in subsection 248(1).

Requirement to provide foreign-based information

ITA
231.6(2)

Under subsection 231.6(2) a person resident in Canada or a non-resident person carrying on business in Canada must provide, when required by notice of the Minister, any foreign-based information or document.

Subsection 231.6(2) is amended to provide that an authorized person may require a taxpayer or any other person to provide this additional information in such reasonable manner and within such reasonable period of time as is stipulated in the notice. This amendment further confirms that the additional information must be provided and delivered without cost to His Majesty in right of Canada.

Notice

ITA
231.6(3)(a)

Subsection 231.6(3) stipulates what must be set out in a notice referred to in subsection 231.6(2). Paragraph 231.6(3)(a) specifies that a reasonable period of time of not less than 90 days must be provided for the production of the information or document. This paragraph is amended to clarify that this reasonable period of time must be not less than 90 days after the notice is sent or served.

Powers on review

ITA
231.6(5)

Subsection 231.6(5) specifies the determinations that may be made by a judge on hearing an application under subsection 231.6(4) in respect of a requirement.

Subsection 231.6(5) is amended to provide that a judge may either confirm the requirement under paragraph (a) or, pursuant to new paragraph (b), vary or set aside the requirement if they determine that the requirement was not reasonable.

New paragraph (b) replaces existing paragraphs (b) and (c).

ITA
231.6(7)

Subsection 231.6(7) provides that the period of time that elapses between the application for review and its final disposition does not count toward the six-year statutory limit for making tax assessments relating to foreign transactions between non-arm's length taxpayers under subparagraph 152(4)(b)(iii), nor in the time permitted for the production of the information or document.

Consequential on the addition of new paragraph 231.8(1)(c), which brings section 231.6 within the ambit of section 231.8, subsection 231.6(7) is repealed.

Consequence of failure

ITA
231.6(8)

Subsection 231.6(8) sets out the consequences to a person of failing to comply with a notice sent or served under section 231.6. Failure to provide substantially all information or documents required may result in a prohibition on the introduction into evidence of any such information or document in a civil proceeding relating to the administration or enforcement of the Act.

This subsection is amended to confirm that the prohibition on the introduction into evidence of any such information or document applies to a civil proceeding which relates to the administration or enforcement of the Act, a listed international agreement or, for greater certainty, a tax treaty with another country. The terms “listed international agreement” and “tax treaty” are defined in subsection 248(1).

This amendment comes into force on royal assent.

Clause 7

Compliance order

ITA
231.7(1)

Section 231.7 provides a means of enforcing compliance with sections 231.1 and 231.2. If a person has failed to comply, subsection 231.7(1) allows the Minister of National Revenue to seek, by way of summary application, a court order requiring the person to provide the access, assistance, information or document sought under section 231.1 or 231.2.

The preamble of subsection 231.7(1) is amended to provide that a court order may be sought in order to obtain any access, information or document sought by the Minister under section 231.6, in addition to under sections 231.1 and 231.2. This subsection is further amended to confirm that a court may order a person to answer all questions either orally or in writing as required by paragraph 231.1(1)(d).

Paragraph 231.7(1)(a) is amended to add two new subparagraphs:

- New subparagraph (a)(i) includes language from current paragraph (a), except that it now includes a reference to section 231.6. In order for a court order to be issued under this section, a judge must be satisfied that a person was required under section 231.1, 231.2 or 231.6 to provide the access, assistance, information or document and did not do so; and
- New subparagraph (a)(ii) is added to confirm the court’s authority to order a person to answer all questions either orally or in writing as required by paragraph 231.1(1)(d). In order for a court order to be issued under this section, a judge must be satisfied that a person was required under paragraph 231.1(1)(d) to answer questions either orally or in writing. and did not do so.

Paragraph 231.7(1)(b) is amended to refer to “an answer to a question”. A judge must be satisfied, in the case of information, a document, or *an answer to a question*, that the information, document or answer is not protected from disclosure by solicitor-client privilege. As this paragraph no longer includes a reference to section 232, the scope of solicitor-client privilege is to be determined in accordance with case law.

Penalties

ITA
231.7(6)

New subsection 231.7(6) is added to provide that if an order has been issued by a judge under subsection (1) with respect to a taxpayer's failure to comply, the taxpayer is liable to a penalty of 10% of the aggregate amount of tax payable by the taxpayer under this Act for each taxation year of the taxpayer in respect of which the order relates.

New subsection 231.7(6) only applies if the order relates to a taxation year of the taxpayer. As such, the penalty does not apply if an order is obtained against a person that has failed to provide access, assistance, information or a document in respect of another taxpayer's taxation year.

This penalty applies in addition to any penalty otherwise provided, such as a penalty under new section 231.9.

Threshold amount of tax

ITA
231.7(7)

New subsection 231.7(7) is added to provide that a penalty under subsection (6) may not be imposed if the amount of tax payable by the taxpayer under the Act for each taxation year in respect of which the order under subsection (1) relates is less than $50,000.

Make application at any time

ITA
231.7(8)

New subsection 231.7(8) is added to make clear that the Minister may apply for a compliance order under subsection 231.7(1) before or after sending a notice described under subsection 231.9(1).

Assessment

ITA
231.7(9)

New subsection 231.7(9) permits the Minister of National Revenue to assess the penalty provided for under subsection (6) and provides that the administrative provisions of Division I and J will apply, with such modifications as the circumstances require, in respect of the assessment as though it had been made under section 152.

This amendment comes into force on royal assent.

Clause 8

Time period not to count

ITA
231.8(1)

Section 231.8 provides that the period of time that elapses between the filing of the application for review of a requirement for information, or the filing of a notice of appearance (or otherwise challenging the application for a compliance order), and the time either the application for judicial review or the application to obtain the compliance order is finally disposed of, as the case may be, does not count toward the statutory limit for making tax assessments.

Section 231.8 is renumbered as subsection 231.8(1), and is amended:

- to add new paragraph (a) to expand its application to section 231.1. This paragraph provides that if a taxpayer, or a person that does not deal at arm's length with the taxpayer, is sent or served with a requirement under subsection 231.1(1) in respect of the taxation year of the taxpayer, the period of time between the day on which an application for judicial review in respect of the requirement is made and the day on which the application is finally disposed of is not to be counted in the computation of the period of time within which an assessment may be made for a taxation year of a taxpayer under subsection 152(4);
- to renumber paragraph (a) as new paragraph (b). The text of new paragraph (b) is also amended to expand its application to a person that does not deal at arm's length with the taxpayer. New paragraph (b) provides that if a taxpayer, or a person that does not deal at arm's length with the taxpayer, is sent or served with a notice of a requirement under subsection 231.2(1) in respect of the taxation year of the taxpayer, the period of time between the day on which an application for judicial review is made and the day on which the application is finally disposed of is not to be counted in the computation of the period of time within which an assessment may be made for a taxation year of the taxpayer under subsection 152(4);
- to add new paragraph (c), to expand its application to section 231.6. This new paragraph provides that if a taxpayer, or a person that does not deal at arm's length with the taxpayer, is sent or served with a notice of requirement under subsection 231.6(2) in respect of the taxation year of the taxpayer, the period of time between the day on which the taxpayer or the non-arm's length person applies to a judge for review under subsection 231.6(4) in respect of the requirement and the day on which the application is finally disposed of is not to be counted in the computation of the period of time within which an assessment may be made for a taxation year of a taxpayer under subsection 152(4);
- to renumber paragraph (b) as new paragraph (d). The text of new paragraph (d) is also amended to expand its application to a person that does not deal at arm's length with the taxpayer. The text of new paragraph (d) is amended to provide that if an application is commenced by the Minister under subsection 231.7(1) to order the taxpayer or a person that does not deal at arm's length with the taxpayer to provide any access, assistance, information or document in respect of the taxation year of the taxpayer, the period of time between the day on which the taxpayer or non-arm's length person files a notice of appearance, or otherwise opposes the application, and the day on which the application is finally disposed of is not to be counted in the computation of the period of time within

which an assessment may be made for a taxation year of a taxpayer under subsection 152(4);

- to add new paragraph (e), to expand its application to new section 231.9. This new paragraph provides that if the taxpayer or a person that does not deal at arm's length with the taxpayer, is sent or served with a notice of non-compliance under subsection 231.9(1) in respect of the taxation year of the taxpayer, the period of time that the notice of non-compliance is outstanding is not to be counted in the computation of the period of time within which an assessment may be made for a taxation year of a taxpayer under subsection 152(4). New subsection 231.9(11) provides that, for the purposes of this paragraph and subsection 231.9(1), a notice of non-compliance is outstanding from the day that it is sent to, or served on, the person until the day that the person has complied, or has done everything reasonably required to comply, with each requirement or notice in respect of which the notice of noncompliance was issued. However, subsection 231.9(11) is subject to subsection 231.9(10), which provides that if a notice of non-compliance is vacated (by the Minister under subsection 231.9(5) or by a judge under subsection 231.9(9)), it is deemed to have never been issued; and
- to add new paragraph (f), which applies if a judge has, pursuant to subsection 231.9(9), vacated a notice of non-compliance sent to, or served on, the taxpayer or a person that does not deal at arm's length with the taxpayer in respect of the taxation year of the taxpayer. In such situations, the period of time between the day on which the taxpayer or the non-arm's length person applies to a judge for review under subsection 231.9(8) and the day on which the application is finally disposed of is not to be counted in the computation of the period of time within which an assessment may be made for a taxation year of a taxpayer under subsection 152(4).

When finally disposed of

ITA
231.8(2)

Each of paragraphs 231.8(1)(a) to (d) and (f) refer to "the day on which the application is finally disposed of". New subsection 231.8(2) provides that, for the purposes of subsection (1), an application is finally disposed of when the application is disposed of and the time to appeal the application has expired and, in case of an appeal, when the appeal and any further appeal is disposed of or the time for filing any further appeal has expired.

This amendment comes into force on royal assent.

Clause 9

Overview

ITA
231.9

New section 231.9, which provides an alternative means of enforcing compliance with sections 231.1, 231.2 and 231.6, permits the Minister to issue a notice of non-compliance to any person who has failed to meet their obligations under these sections.

Notice of non-compliance

ITA
231.9(1)

New subsection 231.9(1) enables the Minister to send to or serve a person with a notice of non-compliance, at any time, if the Minister determines that they have not met their obligations with respect to a requirement or notice to provide information, foreign-based information, returns, documents or reasonable assistance under section 231.1, 231.2 or 231.6.

Contents of notice of non-compliance

ITA
231.9(2)

New subsection 231.9(2) provides that a notice of non-compliance issued under subsection (1) must set out, in respect of each taxation year of the taxpayer under review, the manner in which the person that has been sent or served with the notice of non-compliance has failed to comply with a requirement or notice under section 231.1, 231.2 or 231.6.

Notice

ITA
231.9(3)

New subsection 231.9(3) specifies that a notice of non-compliance may be served personally, by registered or certified mail, or sent electronically to a bank or credit union that has provided written consent to receive notices of non-compliance electronically.

Request for review

ITA
231.9(4)

New subsection 231.9(4) provides that a person sent or served with a notice of non-compliance may, within 90 days after the day on which the notice of non-compliance is sent or served, request, in writing to the Minister, that the notice of non-compliance be reviewed and make a representation or submission to the Minister in that regard.

Minister’s review

ITA

231.9(5)

New subsection 231.9(5) provides that within 180 days from the date of receipt by the Minister of a request for review under subsection 231.9(4), the Minister shall confirm, vary or vacate the notice of non-compliance, and notify the person in writing of the Minister's decision.

When required to set aside

ITA
231.9(6)

New subsection 231.9(6) provides that a notice of non-compliance must be vacated by the Minister under subsection 231.9(5) if the Minister determines that it was unreasonable to issue the notice of non-compliance, or that the person had, prior to the issuance of the notice, done everything reasonably necessary to comply with each requirement or notice in respect of which the notice of non-compliance was issued.

Notice deemed vacated

ITA
231.9(7)

New subsection 231.9(7) provides that a notice of non-compliance is deemed to be vacated under subsection (5) if the Minister does not confirm, vary or vacate the notice of non-compliance (and notify the person in writing of the Minister's decision) within 180 days of receipt by the Minister of a request for review under subsection 231.9(4).

Application for review of decision

ITA
231.9(8)

New subsection 231.9(8) provides that a person may, within 90 days after the day on which the person is notified of the Minister's decision under subsection (5), apply to a judge for a review of that decision.

Powers on review

ITA
231.9(9)

New subsection 231.9(9) provides that on hearing an application for review of a decision submitted under subsection 231.9(8), a judge may confirm the decision, or vary or vacate the decision, if they determine that the Minister's decision was not reasonable.

When notice vacated

ITA
231.9(10)

New subsection 231.9(10) provides that if a notice of non-compliance is vacated by the Minister under subsection (5), or a judge under subsection (9), the notice is deemed to have never been sent or served. This means that no penalty would be applicable under subsection (12), and the limitation period would not be stopped under paragraph 231.8(1)(e), where a notice of non-compliance is ultimately vacated.

When notice outstanding

ITA
231.9(11)

New subsection 231.9(11) sets out a rule that determines when a notice of non-compliance will be outstanding for the purposes of the application of subsection (12) and paragraph 231.8(1)(e). In these situations, a notice of non-compliance is considered to be outstanding from the day that it is sent to, or served on, a person until the day on which the person has, to the satisfaction of the Minister, complied or demonstrated that they have done everything reasonably necessary to comply, with each requirement or notice in respect of which the notice of noncompliance was issued. However, this rule is subject to subsection (10) which provides that if a notice of non-compliance is vacated by the Minister under subsection (5), or a judge under subsection (9), the notice is deemed to have never been issued.

Penalty

ITA
231.9(12)

New subsection 231.9(12) provides that a person sent or served with a notice of non-compliance is liable to a penalty of $50 for each day the notice of non-compliance is outstanding, to a maximum of $25,000.

Assessment

ITA
231.9(13)

New subsection 231.9(13) empowers the Minister of National Revenue to assess the penalty provided for under subsection (12) and provides that the administrative provisions of Division I and J will apply, with such modifications as the circumstances require, in respect of the assessment as though it had been made under section 152.

This amendment comes into force on royal assent.

Avoidance of Tax Debts

Clause 1

Tax Debt Avoidance

ITA
160(5)

The amount that a taxpayer is liable to pay in respect of the transfer of property from a non-arm's length tax debtor is determined under subsection 160(1). The Minister may assess the taxpayer for such a liability under subsection 160(2).

Subsection 160(1) applies in situations where

- there has been a non-arm's length transfer of property, and
- the transferor had a pre-existing tax liability or a tax liability that arose in the year of the transfer.

If these conditions are met, the transferee is jointly and severally, or solidarily, liable in respect of amounts payable by the transferor under the Act, to the extent that the fair market value of the property transferred exceeded the value of the consideration given for the property at the time of the transfer.

Subsection 160(5) provides anti-avoidance rules to prevent planning which seeks to circumvent the application of section 160.

Paragraph 160(5)(a) addresses planning that attempts to circumvent the application of section 160 by avoiding the requirement that property be transferred between persons that do not deal at arm's length. Paragraph 160(5)(b) addresses planning that attempts to circumvent the application of section 160 by avoiding the requirement that the transferor have an existing tax debt owing in or in respect of the taxation year in which the property is transferred, or any preceding taxation year. Paragraph 160(5)(c) addresses planning that attempts to effectively avoid section 160 through a transaction or series of transactions that reduce the fair market value of consideration given for the property transferred in order to render all or a portion of a tax debt of the transferor uncollectible. The anti-avoidance rules in subsection 160(5) currently apply for the purposes of subsections 160(1) to (4).

Consequential on the introduction of the supplementary anti-avoidance rules in new subsections 160(6), (7) and (8), subsection 160(5) is amended to provide that it applies for the purposes of section 160.

This amendment applies in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160(6)

New subsections 160(6) to (8) introduce supplementary anti-avoidance rules to strengthen the tax debt anti-avoidance rules of section 160. New subsection 160(6) provides the test for the application of the deemed transfer anti-avoidance rules in new subsection 160(7). The deemed transfer rules address circumstances where a tax debt avoidance planner acts as an intermediary or facilitator to enable the indirect transfer of property from a tax debtor to a non-arm's length party while attempting to avoid the operative requirement of section 160 that there be a transfer of property from a transferor to a non-arm's length transferee in order for section 160 to apply.

Subsection 160(6) provides that subsection 160(7) will apply in the following circumstances:

- a person (the "planner") has transferred property, either directly or indirectly, by means of a trust or by any other means whatever, to a person (the "transferee") or a person not dealing at arm's length with the transferee, pursuant to the direction of, or with the concurrence of the transferee;
- another person (the "transferor") has transferred a property (the "particular property"), either directly or indirectly, by means of a trust or by any other means whatever, to the planner or any other person; and
- it is reasonable to conclude that one of the purposes for undertaking or arranging the transaction or series of transactions is to avoid joint and several, or solidary, liability of the transferee and transferor for an amount payable under the Act.

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160(7)

New subsection 160(7) applies if the conditions set out in new subsection 160(6) are met. Where these conditions are met, the transferor will be deemed to have transferred the particular property to the transferee for the purposes of the tax debt avoidance rule in section 160. This will ensure that the tax debt avoidance rule applies in situations where property has been transferred from a tax debtor to a person and, as part of the same transaction or series, property has been received by a person that does not deal at arm's length with the tax debtor.

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160(8)

New subsection 160(8)

As noted above, in many cases tax debt avoidance planning is facilitated by a planner who receives a significant fee that is effectively funded by a portion of the avoided tax debt. The courts have held that a taxpayer who engages in tax debt avoidance planning is normally not jointly and severally, or solidarily, liable for the portion of the tax debt that has effectively been retained by the planner as a fee. This remains the case even where the amount retained by the planner is moved offshore and out of the reach of the Canada Revenue Agency.

To further enhance the effectiveness of the tax debt anti-avoidance rule, new subsection 160(8) will provide that taxpayers who participate in tax debt avoidance planning will be jointly and severally, or solidarily, liable for the full amount of the avoided tax debt, including any portion that has effectively been retained by the planner. New subsection 160(8) provides that, for the purposes of determining joint and several or solidary liability for a tax debt, the consideration provided by a transferee is deemed to be nil if the conditions set out in subsection 160(8) are met.

Subsection 160(8) will apply to a transaction or series of transactions that is a "section 160 avoidance transaction" (as defined in subsection 160.01(1)) if

- the transaction or series of transactions is described in paragraph (a) or new paragraph (c) of the definition "section 160 avoidance transaction" (each of which includes purpose tests), or
- it is reasonable to conclude that one of the purposes for undertaking or arranging the transaction or series of transactions is to avoid joint or several, or solidary, liability of the transferee and transferor for an amount payable under the Act.

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160.01(1)

Subsection 160.01(1) provides definitions that apply for the purpose of section 160.01.

The definition "section 160 avoidance transaction" is relevant for the definition "section 160 avoidance planning". The definition "section 160 avoidance transaction" is also relevant for the enhanced joint and several or solidary liability rule in new subsection 160(8).

A "section 160 avoidance transaction" is a transaction or series of transactions, in respect of which the condition in paragraph (a) or (b) of the definition is met.

Paragraph (a) refers to the conditions in paragraphs (5)(a) and (b). For more information see the commentary on those paragraphs. Paragraph (b) is relevant where subsection (5) applied to the transaction. In that case, it looks to whether the amount determined under subparagraph 160(5)(c)(ii) exceeds the amount determined under subparagraph 160(5)(c)(i).

Consequential on the introduction of the supplementary section 160 anti-avoidance rules in new subsections 160(6), (7) and (8), the definition "section 160 avoidance transaction" is amended by adding new paragraph (c), which provides that a section 160 avoidance transaction will include a transaction or series of transactions in respect of which subsection 160(7) applies. This expanded definition will be relevant for the purposes of the enhanced joint and several and solidary liability rule in new subsection 160(8).

The amendment will also be relevant for determining whether a taxpayer has engaged in section 160 avoidance planning. Subsection 160.01(2) provides for a penalty for a person who engages in, participates in, assents to or acquiesces in planning activity that they know is section 160 avoidance planning, or would reasonably be expected to know is section 160 avoidance planning, but for circumstances amounting to gross negligence.

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160.01(1)

The definition “transferee” in subsection 160.01(1) refers to a “transferee” as used in subsections 160(1) and (5). Consequential on the introduction of new subsection 160(7), the definition “transferee” in subsection 160.01(1) is amended to include a reference to subsection 160(7).

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

ITA
160.01(1)

The definition “transferor” in subsection 160.01(1) refers to a “transferor” as used in subsections 160(1) and (5). Consequential on the introduction of new subsection 160(7), the definition “transferor” in subsection 160.01(1) is amended to include a reference to subsection 160(7).

This amendment will apply in respect of a transaction or series of transactions that occurs on or after April 16, 2024.

Mutual Fund Corporations

Clause 1

ITA
131

Section 131 sets out rules relating to the taxation of mutual fund corporations and their shareholders, including the rules in subsection 131(8) that define the expression “mutual fund corporation”. Section 131 is amended by adding a limitation to preclude a corporation from being a mutual fund corporation even if it would otherwise qualify under subsection 131(8) (for more information, see the commentary on new subsections 131(8.2) and (8.3)).

Meaning of *mutual fund corporation*

ITA
131(8)

Subsection 131(8) defines the expression “mutual fund corporation”. In general, a corporation is a mutual fund corporation if it is a Canadian public corporation (as defined in subsection 89(1)), its only undertaking is the investment of its funds and its issued shares are redeemable on demand and their fair market value is no less than 95% of the fair market value of all the corporation’s issued shares.

Consequential on the introduction of new subsections 131(8.2) and (8.3), this subsection is amended to add a reference to those provisions. As a result, even if a corporation qualifies as a mutual fund corporation under this subsection, it will not be a mutual fund corporation for purposes of the Act if it is described in subsection (8.2) and not subject to the exception in subsection (8.3). For more information, see the commentary on subsections (8.2) and (8.3).

This amendment applies to taxation years that begin on or after January 1, 2025.

Substantial interest

ITA
131(8.2)

New subsection 131(8.2) introduces a restriction deeming a corporation not to be a mutual fund corporation even if that corporation otherwise qualifies under subsection 131(8). This subsection does not apply to corporations which are “prescribed labour-sponsored venture capital corporations” as defined in section 6701 of the Regulations.

Paragraphs (a) and (b) provide two requirements each of which must be met in order for this subsection to apply to preclude a corporation from being a mutual fund corporation.

The requirement in paragraph (a) is met if “specified persons” have a “substantial interest” in the corporation. For purposes of this subsection, “specified persons” are defined as a person (including a trust) or partnership, or any combination of persons or partnerships that do not deal with each other at arm’s length. A “substantial interest” in a corporation is defined as a fair market value interest in the corporation of over ten per cent.

The requirement in paragraph (b) is met if the corporation is controlled by, or for the benefit of, the “specified persons” referred to in paragraph (a) who hold a substantial interest in the corporation.

This subsection applies to taxation years that begin on or after January 1, 2025.

Exception

ITA

131(8.3)

New subsection 131(8.3) provides an exception from the application of subsection 131(8.2) for a corporation during the first two years of its existence, provided that the aggregate fair market value of the shares of the corporation owned by the “specified persons” (as described in subsection (8.2)) does not exceed 5 million dollars. This exception recognizes that a start-up mutual fund corporation may exceed the ten per cent fair market value threshold during its initial capital-raising stage as a result of a specified person with a controlling interest providing an initial capital investment.

This subsection applies to taxation years that begin on or after January 1, 2025.

Synthetic Equity Arrangements

Clause 1

Dividend rental arrangements – exception

ITA
112(2.31) to (2.34)

Section 112 is one of the principal provisions dealing with the treatment of dividends received by a corporation resident in Canada from another corporation. Section 112 is amended to repeal subsections 112(2.31) to (2.34).

Subsection 112(2.3) denies an inter-corporate dividend deduction in respect of dividends received by a corporation in circumstances where a corporation has entered into a “dividend rental arrangement” (as defined in subsection 248(1)).

However, subsection 112(2.31) may provide an exception to the denial in subsection 112(2.3) for a dividend received on a DRA share (as defined in subsection 248(1)) in respect of which there is a dividend rental arrangement because of paragraph (c) of the definition “dividend rental arrangement” (*i.e.*, the dividend rental arrangement is a synthetic equity arrangement as defined in subsection 248(1)). Specifically, under paragraph 112(2.31)(b), a dividend received on a share in respect of which there is a synthetic equity arrangement will not be subject to subsection 112(2.3) if the taxpayer establishes that, throughout the particular period, no tax-indifferent investor or group of tax-indifferent investors, each member of which is affiliated with every other member, has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share.

Subsection 112(2.32) sets out rules under which a taxpayer is able to satisfy the condition in paragraph 112(2.31)(b) by obtaining certain specified representations in writing from the counterparty or counterparties to the synthetic equity arrangement.

Subsection 112(2.33) is intended to ensure that the exception in subsection (2.31) is only available for the period during which the representations have been provided remain accurate.

Subsection 112(2.34) provides interpretive rules for the purpose of subsection 112(2.32).

Subsection 112(2.31) is repealed to eliminate the exception to subsection 112(2.3) for synthetic equity arrangements in respect of which the taxpayer has established that no tax-indifferent investor has all or substantially all of the risk of loss and opportunity for gain or profit in respect of the share. Consequential on the repeal of subsection 112(2.31), subsections 112(2.32) to (2.34) are also repealed.

These amendments apply in respect of dividends received after 2024.

Clause 2

Definitions

ITA
248(1)

Subsection 248(1) defines various terms that apply for the purposes of the Act. Subsection 248(1) is amended to remove the exception to the synthetic equity arrangement rules where no tax-indifferent investor has all or substantially all the economic exposure in respect of the share and the associated exception where the synthetic equity arrangement is traded on a recognized derivatives exchange. Specifically, the definitions “derivative forward agreement”, “dividend rental arrangement” and “synthetic equity arrangement” are amended and the definitions “recognized derivative exchange”, “specified mutual fund trust”, “specified synthetic equity arrangement”, “synthetic equity arrangement chain”, and “tax-indifferent investor” are repealed.

These amendments apply in respect of dividends received after 2024.

“derivative forward agreement”

A derivative forward agreement essentially combines a derivative financial instrument with the purchase or sale of a capital property. Income from a derivative financial investment is generally fully taxable as ordinary income. Derivative forward agreements are typically used in an attempt to convert this fully taxable derivative income to a capital gain, only half of which is included in income. A derivative forward agreement therefore involves the purchase or sale of a capital property.

Paragraph (b) of the definition deals with agreements to purchase a capital property. In order for a purchase agreement to be a derivative forward agreement, the economic return on the agreement (*i.e.*, the difference between the price paid for the property and the fair market value of the property when delivered) must have a derivative component. For the purposes of determining whether the return has a derivative component, the return must be attributable, in whole or in part, to an underlying interest other than an interest described in subparagraphs (b)(i) to (iii).

Subparagraph (b)(i) of the definition essentially provides that, where the return on the purchase is based on the economic performance of the property being purchased, the purchase agreement will not be a derivative forward agreement. This exception is intended to exclude certain commercial transactions from the scope of the derivative forward agreement rules.

Clauses (b)(i)(A) to (C) of the definition contain conditions under which the exception is not available. Clause (b)(i)(B) contains the conditions that the purchase agreement is an agreement to acquire property from a tax-indifferent investor or a financial institution, as defined in subsection 142.2(1).

Subclause (b)(i)(B)(I) of the definition is amended, consequential on the repeal of the definition "tax-indifferent investor" in subsection 248(1), to replace the reference to the definition "tax-indifferent investor" with a "tax-indifferent" as defined in subsection 18.2(1).

For more information, see the commentary on the definitions "tax-indifferent" in subsection 18.2(1) and "tax-indifferent investor" in subsection 248(1).

"dividend rental arrangement"

A dividend rental arrangement is an arrangement under which one person receives a dividend on a share that has been borrowed from another person who retains the risk of loss or opportunity for gain from fluctuations in the share value. Paragraph (d) of the definition is an anti-avoidance rule intended to prevent parties that otherwise deal at arm's length with each other from colluding with one another to circumvent the definition "synthetic equity arrangement" in subsection 248(1).

Paragraph (d) is repealed consequential to the amendment to subparagraph (a)(ii) of the definition "synthetic equity arrangement". Paragraph (d) is no longer relevant as an agreement or arrangement described in this paragraph would be captured by the expanded "synthetic equity arrangement" definition.

"recognized derivatives exchange"

The definition "recognized derivatives exchange" in subsection 248(1), which is relevant for the purposes of subparagraph (b)(i) of the definition "synthetic equity arrangement" in the same subsection, is repealed consequential on the repeal of that subparagraph.

For more information, see the commentary on the repeal of subparagraph (b)(i) of the definition of "synthetic equity arrangement" in subsection 248(1).

"specified mutual fund trust"

The definition "specified mutual fund trust" in subsection 248(1), which is relevant for the purposes of the definition "tax-indifferent investor" in the same subsection, is repealed consequential on the repeal of the "tax-indifferent investor" definition.

For more information, see the commentary on the repeal of the definition “tax-indifferent investor” in subsection 248(1).

“specified synthetic equity arrangement”

The definition “specified synthetic equity arrangement” in subsection 248(1), which is relevant for the purposes of subsection 112(2.32) and the definitions “synthetic equity arrangement chain” and “tax-indifferent investor”, is repealed consequential on the repeal of that subsection and those definitions.

For more information, see the commentary on the repeal of subsections 112(2.31) to (2.34).

“synthetic equity arrangement”

A synthetic equity arrangement in respect of a DRA share of a person or partnership (the “particular person”) means one or more agreements or other arrangements that satisfy the criteria in paragraph (a) of the definition but does not include any agreements or arrangements described in any of the subparagraphs (b)(i), (ii) or (iii) of the definition. Synthetic equity arrangements include agreements that provide all or substantially all the risk of loss and opportunity for gain or profit in respect of the share to another person. Under subsection 112(2.3), the dividend received deduction may be denied for a dividend received by a person on a share in respect of which there is a synthetic equity arrangement. This is to prevent the tax loss that would result if the person could claim a tax deduction for both the dividend received in respect of the share and for the amount paid to compensate the counterparty who has been provided the risk under the synthetic equity arrangement.

The “synthetic equity arrangement” definition is amended as part of the removal of the exception where no tax-indifferent investor has all or substantially all the economic exposure in respect of the share (in subsection 112(2.31)) and the removal of the associated exception for derivatives traded on a recognized derivatives exchange.

Subparagraph (a)(i) of the definition provides that a synthetic equity arrangement must be entered into by the particular person or by a person or partnership that does not deal at arm’s length with the particular person. Subparagraph (a)(i) is amended to remove the reference to a “counterparty” and “an affiliate counterparty” in subsection 112(2.32), consequential on the repeal of that subsection.

Subparagraph (a)(ii) of the definition provides that a synthetic equity arrangement must have the effect of providing all or substantially all of both the risk of loss and opportunity for gain or profit in respect of the share of the particular person to a counterparty or a group of counterparties.

Subparagraph (a)(ii) is amended to replace the reference to “providing all or substantially all of the risk” with “eliminating all or substantially all of the risk”. This recognizes that the risk status of a counterparty to the synthetic equity arrangement (i.e., determining whether all or substantially all of the risk of loss and opportunity for gain or profit in respect of a share has been "provided" to a tax-indifferent investor) is no longer relevant. Instead, this amended subparagraph would apply where the agreements or arrangements in respect of a share of a particular person have the effect of eliminating all or substantially all of the risk of loss or opportunity for gain or profit in the share of that particular person.

Subparagraph (b)(i) of the definition excludes from the "synthetic equity arrangement" definition certain agreements that are traded on a recognized derivatives exchange. Subparagraph (b)(i) is repealed to remove this exception.

For more information, see the commentary on the repeals of subsections 112(2.31) to (2.34) and the definition "tax-indifferent investor" in subsection 248(1).

"synthetic equity arrangement chain"

The definition "synthetic equity arrangement chain" in subsection 248(1), which is relevant for the purposes of subsection 112(2.32), is repealed, consequential on the repeal of that subsection.

For more information, see the commentary on the repeal of subsections 112(2.31) to (2.34).

"tax-indifferent investor"

A tax-indifferent investor is generally defined in subsection 248(1) as meaning a person or partnership that is:

- a person exempt from tax under section 149;
- a non-resident person, other than a person to which all amounts paid or credited under a synthetic equity arrangement or a specified synthetic equity arrangement may be attributed to the business carried on by the person in Canada through a permanent establishment;
- a trust resident in Canada (other than a specified mutual fund trust) if any of the interests as a beneficiary under the trust is not a fixed interest in the trust; or
- in certain cases, a trust or partnership of which persons in the first three bullets are, directly or indirectly, beneficiaries or members.

Under subsection 112(2.31), the notion of a tax-indifferent investor essentially limits the application of subsection 112(2.3) to dividends received on DRA shares for which there is a synthetic equity arrangement entered into with certain counterparties that do not pay any Canadian income tax.

This definition is repealed as part of the removal of the exception that applies under subsection 112(2.31) when the counterparty to the synthetic equity arrangement is not a tax-indifferent investor.

Synthetic equity arrangements — disaggregation

ITA

248(42)

Subsection 248(42) provides that an arrangement that reflects the fair market value of more than one type of identical share is considered to be a separate arrangement in respect of each type of identical share the value of which the arrangement reflects. Subsection 248(42) is relevant for the purposes of the definition “synthetic equity arrangement” in subsection 248(1), paragraphs (c) and (d) of the definition “dividend rental arrangement” in that subsection and subsections 112(2.31), (2.32) and (10). Consequential on the repeals of subsections 112(2.31) and (2.32) and paragraph (d) of the definition “dividend rental arrangement” in subsection 248(1), subsection 248(42) is amended to remove the references to those provisions.

Clause 3

Definitions

ITR
8201

Section 8201 of the Regulations provides a definition of the term “permanent establishment” for the purposes of various provisions in the Act. The section is amended to remove the reference to “tax-indifferent investor” in subsection 248(1) of the Act consequential on the repeal of that subsection.

This amendment applies in respect of dividends received after 2024.

Manipulation of Bankrupt Status

Clause 1

ITA
80(1)

“forgiven amount”

Losses and other tax attributes that arise from expenditures for which a taxpayer did not ultimately bear the cost are generally not recognized under the Act. To this end, sections 80 to 80.04 of the Act provide rules that apply when a commercial debt obligation is (or is deemed to be) settled or extinguished for less than its principal amount or the amount for which it was issued. These rules are generally referred to as the “debt forgiveness rules”. When a commercial obligation is settled or extinguished, it gives rise to a “forgiven amount” as defined in subsection 80(1). A forgiven amount in respect of a commercial obligation issued by a debtor is required to be applied against certain tax attributes of the debtor, in a specified order, as provided in subsections 80(3) to (12).

In general, subsection 80(13) currently requires that one half (or where the debtor is a partnership or trust, the full amount) of any remaining unapplied portion of the forgiven amount be included in computing the debtor's income, unless it can be transferred to another taxpayer under section 80.04. (The one-half rate is proposed to be increased to two thirds consequential on proposed amendments to the capital gains rate.) Section 61.3 provides insolvent corporations (including corporate members of insolvent partnerships) with a deduction against certain amounts included in income due to the application of subsection 80(13). Section 61.4 provides corporations, trusts and non-resident persons that carry on business through a fixed place of business in Canada with a discretionary reserve against certain amounts included in income due to the application of subsection 80(13).

Subparagraph (i) of element B of the definition "forgiven amount" provides that a forgiven amount is nullified if the debtor is a bankrupt at that time. Consequently, section 80 does not apply to the settlement or extinguishment of commercial obligations of a bankrupt debtor. However, the deductibility of losses of a bankrupt corporation are restricted by paragraph 128(1)(g). The term "bankrupt" is defined in subsection 248(1) as having the meaning assigned by the *Bankruptcy and Insolvency Act*.

Some corporate taxpayers are entering into arrangements in which they are temporarily assigned into bankruptcy prior to settling or extinguishing a commercial obligation with a view to avoiding the application of both the debt forgiveness rules in section 80 and the loss restriction rule in paragraph 128(1)(g). As a result, there is no reduction in the taxpayer's tax attributes and no income inclusion even though the bankruptcy is subsequently annulled. Similar arrangements are being entered into using partnerships. Although these arrangements can be challenged by the government based on existing rules in the Act, these challenges can be both time-consuming and costly. Accordingly, the Government is introducing this specific legislative measure.

Subparagraph (i) of element B of the definition "forgiven amount" is amended to restrict its application to an individual (other than a partnership or trust) who is a bankrupt at that time. Consequently, a bankrupt corporation, partnership or trust is no longer exempt from the debt forgiveness rules. However, relief from the debt forgiveness income inclusion rule is available to qualifying bankrupt corporations under sections 61.3 (including insolvent corporations that are members of partnerships subject to the debt forgiveness income inclusion rule) and 61.4. For more information, see the commentary to paragraph 128(1)(g).

This amendment applies in respect of bankruptcy proceedings of corporations that are commenced on or after April 16, 2024.

This amendment applies in respect of bankruptcy proceedings of partnerships and trusts that are commenced on or after Announcement Date.

Clause 2

ITA
128(1)(g)

Subsection 128(1) provides rules applicable to corporations that have become bankrupt. Paragraph 128(1)(g) applies to the taxation year that the corporation was granted the absolute order of discharge from bankruptcy and any subsequent year by denying the deductibility of losses under section 111 that the corporation incurred prior to or during a period in which it was bankrupt. Outside the bankruptcy context, the settlement or extinguishment of commercial debt for less than its issuance or principal amount subjects the debtor to a reduction of their tax attributes (and a potential income inclusion) under sections 80 to 80.04, known as the “debt forgiveness rules”.

Some corporate taxpayers are entering into arrangements in which they are temporarily assigned into bankruptcy prior to settling or extinguishing a commercial obligation with a view to avoiding the application of both the debt forgiveness rules in section 80 and the loss restriction rule in paragraph 128(1)(g). As a result, there is no reduction in the taxpayer’s tax attributes and no income inclusion even though the bankruptcy is subsequently annulled. Although these arrangements can be challenged by the government based on existing rules in the Act, these challenges can be both time-consuming and costly. Accordingly, the Government is proposing this specific legislative measure.

Paragraph 128(1)(g) is repealed consequential upon the amendment of subparagraph (i) of element B of the definition “forgiven amount” in subsection 80(1) to subject a bankrupt corporation to the debt forgiveness rules. Together with the new definition of “forgiven amount” in subsection 80(1), bankrupt corporations will be subject to a reduction of their non-capital loss and net capital loss carry forward balances (as well as other tax attributes) upon settlement or forgiveness of their debts. Relief from the application of the debt forgiveness income inclusion rule in subsection 80(13) remains available to qualifying bankrupt corporations under section 61.3. For more information, see the commentary to the definition “forgiven amount” in subsection 80(1).

This amendment applies in respect of bankruptcy proceedings that are commenced on or after April 16, 2024.

Accelerated Capital Cost Allowance for Productivity-Enhancing Assets

Clause 1

Property Acquired in the Year

ITR
1100(2)

Subsection 1100(2) provides rules for computing the capital cost allowance (CCA) deduction in respect of a property for the year in which the property first becomes available for use.

Subsection 1100(2) has two main parts. The first part, as expressed by elements A and B, relates to the enhanced first-year CCA in respect of “accelerated investment incentive property” (AII property) of a taxpayer, as defined in subsection 1104(4), and property included in Classes 54 to 56. The second part, as expressed by element C, is the “half-year rule”, which applies to any other depreciable property and limits a taxpayer's CCA claim to one-half of the otherwise applicable amount, for the year in which the property first becomes available for use.

Element A provides the relevant factors for determining the first-year accelerated CCA for a class.

Element A is amended to provide immediate expensing (as an additional enhanced first-year allowance at an effective CCA rate of 100%) for AII property included in Class 44 (patents or the rights to use patented information for a limited or unlimited period), Class 46 (data network infrastructure equipment and related systems software) and Class 50 (general-purpose electronic data-processing equipment and systems software).

Subparagraph (a)(ii) of element A is amended so that the factor of nil that would have applied to property in Classes 44, 46 or 50 that becomes available for use after 2023 does not apply to property referred to in new paragraphs (c.1) to (c.3).

New paragraphs (c.1) to (c.3) of element A provide the following factors for AII property that is acquired and becomes available for use after April 15, 2024 and before 2027:

- 3, in respect of property in Class 44,
- 2 1/3, in respect of property in Class 46, and
- 9/11, in respect of property in Class 50.

The applicable factors revert to nil for AII property in Classes 44, 46 and 50 acquired after 2026.

These amendments apply to property that is acquired and becomes available for use after April 15, 2024.

Accelerated Capital Cost Allowance for Purpose-Built Rental Housing

Clause 1

ITR
1100(1)(a.4)

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

New paragraph 1100(1)(a.4) provides a 6% additional allowance for property that is a "new purpose-built residential rental" (as defined in subsection 1104(2) of the Regulations) throughout the year. As such, the total capital cost allowance rate for buildings that are new purpose-built residential rentals will be 10%

This amendment applies as of April 16, 2024.

Clause 2

ITR
1101(1ac.1)

Section 1101 provides separate classes in respect of certain properties described in Schedule II to the Regulations and used to earn income.

New subsection 1101(1ac.1) provides that each property of a taxpayer that is a new purpose-built residential rental is prescribed to be a separate class of property.

This amendment applies as of April 16, 2024.

Clause 3

ITR
1104(2)

Section 1104 sets out various definitions and interpretation rules that apply for the purpose of determining the capital cost allowance for a taxation year in respect of a depreciable property of a taxpayer.

Subsection 1104(2) is amended by adding the definitions “purpose-built residential rental”, “new purpose-built residential rental” and “residential rental unit”. These definitions are relevant for the 6% additional allowance provided for in new paragraph 1100(1)(a.4) for new purpose-built residential rentals.

A “purpose-built residential rental” is a building situated in Canada, or a part of a building situated in Canada, that meets both the conditions in paragraphs (a) and (b) of this definition.

Paragraph (a) provides that the property contains at least four “residential rental units” or 10 private rooms or suites. A residential rental unit means a housing unit used or intended for use as a rented residential premises that is not provided to the travelling or vacationing public.

Paragraph (b) provides that all or substantially all of the residential rental units of the property are rented, or offered for rent, for continuous periods of not less than 28 consecutive days.

A “new purpose-built residential rental” is a “purpose-built residential rental”, that meets either of the following conditions:

- It was built for use as a purpose-built residential rental if construction began after April 15, 2024 and before 2031.
- It was previously a building, or part of a building, used as a commercial property that was substantially renovated for use as a purpose-built residential rental if the renovations began after April 15, 2024 and before 2031.

In addition, the property must become available for use before 2036.

This amendment applies as of April 16, 2024.

Interest Deductibility Limits

Clause 1

ITA
18.2

Section 18.2, together with section 18.21 and paragraph 12(1)(l.2), is the core rule of the excessive interest and financing expense limitation ("EIFEL") regime.

Definitions

ITA
18.2(1)

Subsection 18.2(1) defines a number of terms that apply for the purposes of sections 18.2 and 18.21 in determining the application of the excessive interest and financing expense limitation. Subsection 18.2(1) is amended to introduce two new exemptions to the EIFEL rules for certain interest incurred in respect of purpose-built residential rentals and regulated energy utilities businesses. This involves amending the "exempt interest and financing expenses" definition and adding the definitions "purpose-built residential rental", "regulated energy utility business" and "residential rental unit" to this subsection.

"exempt interest and financing expenses"

The definition of "exempt interest and financing expenses" is relevant for purposes of providing an exemption from the EIFEL rules for interest and financing expenses incurred in respect of the financing of typical Canadian public-private partnership (P3) infrastructure projects.

Pursuant to variable A of the definition "interest and financing expenses," exempt interest and financing expenses are not included in a taxpayer's interest and financing expenses. Accordingly, they are not subject to a deduction denial under subsection 18.2(2) or an income inclusion under paragraph 12(1)(l.2).

Income or losses derived from borrowings that give rise to exempt interest and financing expenses are similarly excluded from the calculation of adjusted taxable income, ensuring that activities that are funded by borrowings that give rise to exempt interest and financing expenses do not generate adjusted taxable income that could be used to shelter additional (non-exempt) interest and financing expenses and do not generate losses that would reduce a taxpayer's ability to deduct interest and financing expenses in respect of its other businesses or activities.

The definition of "exempt interest and financing expenses" is amended to add two new exemptions to the EIFEL rules. This involves making the P3 exemption paragraph (a) of this definition and adding new paragraphs (b) and (c).

- Paragraph (b) adds an elective exemption for certain interest and financing expenses incurred before January 1, 2036, in respect of arm's length financings used to build or acquire a purpose-built residential rental or to convert a property into a purpose-built residential rental.
- Paragraph (c) adds an elective exemption for certain interest and financing expenses incurred in respect of arm's length financings to carry on a regulated energy utility business.

New paragraph (b) of this definition introduces the purpose-built residential rental exemption. Specifically, under paragraph (b), expenses that would otherwise be interest and financing expenses of a taxpayer will be exempt interest and financing expenses in respect of a borrowing or other financing where each of the following conditions are satisfied:

- The expenses were paid or payable, before 2036, to either (i) a person who deals at arm's length with the taxpayer or who deals at arm's length with a partnership of which the taxpayer is a member or (ii) to a particular person who does not deal at arm's length if it may reasonably be considered that all or substantially all the amounts paid to this particular person were paid to one or more persons who deal at arm's length with the taxpayer or who deal at arm's length with the partnership (subparagraph (b)(i)).
- The expenses are reasonably attributable to the portion of the borrowing used by the taxpayer or a partnership of which the taxpayer is a member to acquire or build a purpose-built residential rental or convert a property into a purpose-built residential rental (subparagraph (b)(ii)). For more information on the new definition "purpose-built residential rental", please see the commentary for that definition in this subsection.
- At the time that the expenses were paid or payable, the property that is acquired, or that is in the process of being built or converted, is owned by the taxpayer or the partnership, and is a purpose-built residential rental or is being built or converted to become one. This condition ensures, for instance, that a taxpayer cannot continue to claim exempt interest and financing expenses on a borrowing that was used to build, acquire or convert a property held in a preceding taxation year that has since been disposed of by the taxpayer (subparagraph (b)(iii)).
- The taxpayer or the partnership must file an election in respect of the borrowing for the year, by the filing due date of the taxpayer for the year, to have this paragraph apply. This election is made annually (subparagraph (b)(iv)).

New paragraph (c) implements a regulated energy utility business exemption. Specifically, expenses that would otherwise be interest and financing expenses of a taxpayer will be exempt interest and financing expenses in respect of a borrowing or other financing where each of the following conditions are satisfied:

- The expenses were paid or payable to either (i) a person who deals at arm's length with the taxpayer or who deals at arm's length with a partnership of which the taxpayer is a member or (ii) a particular person who does not deal at arm's length if it may reasonably be considered that all or substantially all the amounts paid to the particular person were then paid to one or more persons who deal at arm's length with the taxpayer or who deal at arm's length with the partnership (subparagraph (c)(i)).

- The amount is reasonably attributable to the portion of the borrowing that is used for the purpose of gaining or producing income from a regulated energy utility business carried on by the taxpayer or the partnership (subparagraph (c)(ii)). For more information on the new definition "regulated energy utility business", see the commentary on that definition in this subsection.
- All or substantially all of the property of the taxpayer or the partnership is both used or held for the purpose of gaining or producing income from a regulated energy utility business and situated in Canada (subparagraph (c)(iii)).
- The taxpayer or the partnership elects on or before the filing-due date of the taxpayer for the taxation year, or has already elected in a preceding taxation year, to have this paragraph apply. Under this condition, once the taxpayer has made an election for a particular taxation year, this condition has been satisfied for that particular taxation year and any subsequent taxation year (subparagraph (c)(iv)).

"purpose-built residential rental"

The definition "purpose-built residential rental" is relevant for new paragraph (b) of the definition of "exempt interest and financing expenses", which provides, under certain circumstances, an elective exemption for interest and financing expenses of a taxpayer in respect of borrowings used to acquire or build purpose-built residential rentals or used to convert property into a purpose-built residential rental.

A purpose-built residential rental is a building situated in Canada, or a part of a building situated in Canada, that meets both the conditions in paragraphs (a) and (b) of this definition.

Paragraph (a) provides that the property contains at least four residential rental units or 10 private rooms or suites. Paragraph (b) provides that all or substantially all of the residential rental units of the property are rented, or offered for rent, for continuous periods of not less than 28 consecutive days.

For more information, see the commentary in paragraph (b) on the definition "exempt interest and financing expenses" and on the new definition "residential rental unit".

"regulated energy utility business"

The definition "regulated energy utility business" is relevant for new paragraph (c) of the "exempt interest and financing expenses" definition that provides an elective exemption for certain interest and financing expenses that are in respect of the portion of the borrowing used for a regulated energy utility business. Specifically, this definition is relevant to the condition in subparagraph (c)(ii) and clause (c)(iii)(A) of the "exempt interest and financing expenses" definition.

A regulated energy utility business is defined as a business carried on by a person or partnership in Canada that also meets the following two conditions:

- The business is the production, generation, storage, transmission, distribution, sale, delivery or provision of any input used for the production of light, heat, cold or energy. Inputs include electricity, natural gas and steam.
- The prices of products and services in respect of the business are established or approved by a "government entity" (as defined in subsection 241(10)).

"residential rental unit"

The definition "residential rental unit" is relevant in determining whether a property is a purpose-built residential rental for purposes of paragraph (b) of the "exempt interest and financing expenses" definition. Under this definition, a residential rental unit means a housing unit used or intended for use as a rented residential premises that is not provided to the travelling or vacationing public.

Deeming rule

ITA
18.2(20)

Income or losses derived from borrowings that give rise to exempt interest and financing expenses are excluded from the calculation of "adjusted taxable income" (as defined in subsection 18.2(1)).

New subsection 18.2(20) introduces a deeming rule where a taxpayer, or a partnership in which the taxpayer is a member, elects in the taxation year, or in any preceding taxation year, under subparagraph (c)(iv) of the definition "exempt interest and financing expenses". In that case, any income or loss of the taxpayer or the partnership for that year from a regulated energy utility business (as defined in subsection 18.2(1)) will be deemed to be derived from borrowings that give rise to exempt interest and financing expenses. In other words, where such an election has been made in a year, any income or loss from the taxpayer's or partnership's regulated energy utility business for the year will be excluded from the taxpayer's adjusted taxable income for the year and for all subsequent years.

Consistent with the broader EIFEL rules, the amendments to section 18.2 would apply to taxation years that begin on or after October 1, 2023.

Clause 2

Borrowed Money

ITA
20(3)

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

Subsection 20(3) ensures continuity of purpose in respect of money borrowed to repay money previously borrowed. Subsection 20(3) is amended to add a reference to paragraph (b) of the definition "exempt interest and financing expenses" in subsection 18.2(1), under which certain amounts may be exempt interest and financing expenses to the extent such amounts are reasonably attributable to the portion of the borrowing in respect of purpose-built residential rentals. This amendment provides that amounts incurred in respect of refinancings of borrowings may still be exempt interest and financing expenses if the initial borrowing met the conditions under paragraph (b) of the "exempt interest and financing expenses" definition.

This amendment would apply to taxation years that begin on or after October 1, 2023.

Clean Electricity Investment Tax Credit

Clause 1

Section 127.491 provides a fully refundable investment tax credit for clean electricity property acquired by qualifying entities. Key differences between this investment tax credit and the clean technology investment tax credit include the credit rate, eligible properties and eligible credit recipients; in many other respects, the clean electricity investment tax credit rules are similar to the rules for the clean technology investment tax credit from a technical perspective.

Section 127.491 is effective as of April 16, 2024, in respect of property that is not part of a project the construction of which began before March 28, 2023. Special rules apply in relation to investment made by designated provincial Crown corporations. For more detail regarding how the effective date applies in relation to acquisitions of property, see the commentary below on the definitions "designated provincial Crown corporation" and "specified percentage" in subsection 127.491(1) and on subsections 127.491(4) to (6) and (8).

Definitions

ITA
127.491(1)

Subsection 127.491(1) provides various definitions relevant for the purpose of the clean electricity investment tax credit.

"actual emission intensity"

The definition "actual emission intensity" is relevant for the purpose of subsection 127.491(19) which provides for a recovery tax in respect of a "specified natural gas energy system" (as defined in subsection 127.491(1)) – see explanatory notes on that subsection and definition for more information.

"Actual emission intensity" in the context of the clean electricity investment tax credit means the actual quantity of carbon dioxide (measured in tonnes) that is released into the atmosphere for each gigawatt hour of electrical energy produced by a specified natural gas energy system, as determined by the formula in the definition "emission intensity" which is also defined in subsection 127.491(1).

Actual emission intensity is a key component of the compliance report that is required to be filed with the Minister of National Revenue and the Minister of Natural Resources under subsection 127.491(20) for each operating year (cumulative 365 days of operations of the system) during the compliance period of the system. It is also a key component of the "average actual emission intensity" of a "specified natural gas energy system", which is relevant for the purpose of the recovery rule in subsection 127.491(19).

"average actual emission intensity"

The "average actual emission intensity" of a qualified natural gas energy system means the average of the reported actual emission intensity for each operating year of the system's compliance period, weighted by the quantity of electrical energy produced each year.
The average actual emission intensity is determined by the formula $((A \times B) + (C \times D) + (E \times F) + (G \times H) + (I \times J)) \div K$.

Variables A, C, E, G and I each represent the actual emission intensity of electrical energy produced by the system for each operating year of the compliance period.

Variables B, D, F, H and J each represent the quantity, in gigawatt hours, of electrical energy produced by the system in an operating year of the compliance period.

Variable K represents the total quantity, in gigawatt hours, of electrical energy produced by the system over the compliance period.

The average actual emission intensity is used to determine the amount of any recovery amount for the system at the end of its compliance period, under subsection 127.491(19).

For more information, see the commentary on the definitions "actual emission intensity", "operating year" and "compliance period" in subsection 127.491(1) and on subsection 127.491(19).

"clean electricity investment tax credit"

The definition "clean electricity investment tax credit" is relevant primarily for the purpose of computing the amount of a qualifying entity's tax credit that may be claimed under subsection 127.491(2).

The definition includes the total of two elements.

The first element – paragraph (a) – is the specified percentage of the capital cost to a qualifying entity of clean electricity property that is acquired in the year.

The second element – paragraph (b) – applies where the entity is a member of a partnership that acquired clean electricity property, and is the amount required by subsection 127.491(13) to be added in computing the entity's clean electricity investment tax credit at the end of the year.

"clean electricity property"

The definition "clean electricity property" is added to describe the property for which the clean electricity investment tax credit may be available for a qualifying entity. The definition contains five general requirements, which are set out in paragraphs (a) to (e).

Paragraph (a) requires the property not to be part of a project for which construction commenced before March 28, 2023. The parenthetical text explicitly excludes some pre-construction activities from being considered "construction" for this purpose. If a major project is undertaken in discrete phases for bona fide business or engineering reasons, the Minister may determine that each phase is a separate project for the purposes of applying this paragraph under subsection 127.491(36).

Subparagraph (b)(i) requires that the property be situated in Canada and be intended for use exclusively in Canada. Paragraph (b) also ensures that certain wind and water energy properties (more fully described in subparagraphs (d)(v) and (d)(xiv) of Class 43.1 in Schedule II to the Regulations) are included if they are installed in Canada's exclusive economic zone. Subparagraph (b)(ii) is a special rule that applies only to "designated provincial Crown corporations". In order for a designated provincial Crown corporation to have clean electricity property, the property must be located in an "eligible jurisdiction". For more information, see the commentary on those defined terms.

Paragraph (c) requires that the property not have been used or acquired for use or lease before it was acquired by the entity, to ensure that the credit is available only for new equipment.

Paragraph (d) requires that, if the property is leased by the taxpayer to another person, that person must be a "qualifying entity". Alternatively, it also permits the property to be leased to a partnership all the members of which are qualifying entities. Paragraph (d) also requires that the leased property be leased in the ordinary course of carrying on a business in Canada by the taxpayer whose principal business is one of the specified activities, or any combination thereof.

Paragraph (e) requires that the property be described in one of subparagraphs (i) to (x), which describe specific types of equipment. The types of qualifying equipment are as follows:

- Hydro-electric installations described in subparagraph (d)(ii) of Class 43.1 in Schedule II to the Regulations, if that subparagraph were read without reference to the 50 megawatt rated-capacity at the hydro-electric installation site (subparagraph (i)).

- Equipment used to generate electricity from solar, wind, or water energy that is described in subparagraphs (d)(v), (vi) or (xiv) of Class 43.1 in Schedule II to the Regulations (subparagraph (ii)).
- "Concentrated solar energy equipment", as defined in subsection 127.45(1), that is part of a system used solely for the purpose of generating electrical energy, exclusively from concentrated sunlight (subparagraph (iii)).
- Nuclear energy equipment – see definition in subsection 127.491(1) for more information (subparagraph (iv)).
- Geothermal equipment that is described in subparagraph (d)(vii) of Class 43.1 in Schedule II to the Regulations that is used exclusively for the purpose of generating electrical or heat energy (or both) solely from geothermal energy, if the property is part of a system that meets certain conditions. The system has to export more electrical energy than heat energy on a net annual basis and must not extract fossil fuels for sale (subparagraph (v)).
- Waste biomass electricity generation equipment, as defined in subsection 127.45(1), that is part of a system that exports more electrical energy than heat energy on a net annual basis (subparagraph (vi)).
- Fixed location energy storage property or pumped hydroelectric energy storage property that is described in subparagraphs (d)(xviii) or (xix) of Class 43.1 in Schedule II to the Regulations, excluding equipment that uses any fossil fuel in operation (subparagraph (vii)).
- Qualified natural gas energy equipment (subparagraph (viii)) – see definition in subsection 127.491(1).
- Qualified interprovincial transmission equipment (subparagraph (ix)) – see definition in subsection 127.491(1).
- Property that is incorporated into another property as part of a "refurbishment" of the other property, where the other property is described in any of subparagraphs (i) to (ix) and continues to be so described after the refurbishment is completed (subparagraph (x)) – see "refurbishment" definition in subsection 127.491.

"compliance period"

The definition "compliance period" is relevant primarily for the purposes of subsection 127.491(19), which provides for the potential recovery of previously deducted clean electricity investment tax credit, and subsection 127.491(20), which provides for annual information reporting requirements.

The "compliance period" in respect of a specified natural gas energy system (as defined in subsection 127.491(1)) of a taxpayer means the period of time beginning on the "start-up date" of the system and ending on the last day of the fifth "operating year" (as defined in subsection 127.491(1)) of the system. This period may be longer than five years if the system experiences any shutdown time. For more information, see the commentary on the definitions "operating year", "qualified natural gas energy system" and "specified natural gas energy system" in this subsection.

“dedicated geological storage”

The definition “dedicated geological storage” is relevant for the definition “emission intensity”, and has the same meaning as in subsection 127.44(1), which is the definitions subsection for carbon capture utilization and storage tax credit rules. In general terms, “dedicated geological storage” means a geological formation that is located in a designated jurisdiction; is capable of permanently storing captured carbon; is authorized and regulated for the storage of captured carbon under the laws of the designated jurisdiction (which is defined in subsection 127.44(1)); and is a formation in which no captured carbon is used for enhanced oil recovery.

“designated provincial Crown corporation”

The definition “designated provincial Crown corporation” is relevant for special rules in section 127.491 that apply to such a corporation (see commentary on “clean electricity property” definition and subsection 127.491(4)).

A corporation is such a corporation if

- under paragraph (a) of the definition, not less than 90% of the shares (except directors’ qualifying shares) or of the capital of which is owned by one or more persons each of which is His Majesty in right of a province,
- under paragraph (b) of the definition, it is one of the listed territorial Crown corporations, or
- under paragraph (c) of the definition, all of the shares (except directors’ qualifying shares) or of the capital of which is owned by one or more persons each of which is a corporation described in paragraph (a) or (b).

“eligible jurisdiction”

“Eligible jurisdiction” means a jurisdiction designated by the Minister of Finance in accordance with subsection 127.491(6).

In general terms, a designated provincial Crown corporation is eligible to obtain a refundable clean electricity investment tax credit in respect of the capital cost of a clean electricity property. Among the conditions for a property to be a clean electricity property for such a corporation, the property must be located in a province that has been designated by the Minister of Finance to be an eligible jurisdiction.

A province or territory is an eligible jurisdiction for the purposes of section 127.491(6) if the Minister of Finance determines that the province meets the conditions published on a website maintained by the Government of Canada. The designation will be published on a website maintained by the Government of Canada.

For greater clarity, the reference to a province includes Yukon, the Northwest Territories and Nunavut as provided under subsection 35(1) of the *Interpretation Act*.

For more information, see the commentary on the definitions “clean electricity property” and “designated provincial Crown corporation” in subsection 127.491(1) and on subsection 127.491(6).

“emission intensity”

The definition "emission intensity" is relevant for the purpose of the definitions “actual emission intensity” and “average actual emission intensity” in subsection 127.491(1) and subsection 127.491(19), which provides for a recovery amount payable in respect of a “specified natural gas energy system” (as defined in subsection 127.491(1)). See explanatory notes on those definitions and that subsection for more information.

“Emission intensity” in the context of the clean electricity investment tax credit means the tonnes of carbon dioxide emissions that are released into the atmosphere for each gigawatt hour of electrical energy produced by a specified natural gas energy system, as determined by the formula A divided by B in the definition.

In general terms, variable A in the formula is total emissions in tonnes of carbon dioxide released during an operating year of the system. It is equivalent to total carbon dioxide emissions from the combustion of fuel less emissions attributed to the production of useful thermal energy and the tonnes of carbon dioxide captured and stored in dedicated geological storage.

Variable B in the formula is the total electrical energy in gigawatt hours generated during the operating year of the system.

All measurements must be determined in a manner that is acceptable to the Minister of Natural Resources.

“government assistance”

“Government assistance” has the same meaning as in subsection 127(9). That definition in subsection 127(9) is amended to exclude the clean electricity investment tax credit – see explanatory notes on the amendment to that definition.

The capital cost of property that is eligible for the clean electricity investment tax credit is reduced by the amount of any government assistance or non-government assistance pursuant to paragraph 127.491(10)(c). Those amounts could become eligible for the clean electricity investment tax credit if they are subsequently repaid, pursuant to subsection 127.491(12). For more information, see the commentary on those subsections.

“ineligible use”

The definition “ineligible use” describes two of the circumstances where a previous clean electricity property could become subject to the recapture rules in subsections 127.491(17) and (18).

The first circumstance applies a point-in-time test: if, after its acquisition by a qualifying entity, the property no longer meets the criteria for being a clean electricity property (other than the requirement that it was not previously used), it will be treated as having been converted to an ineligible use.

The second circumstance is in respect of "qualified natural gas energy equipment" that is part of a qualified natural gas energy system. An ineligible use of that property occurs, under subparagraph (b)(ii), if the actual emission intensity (as defined in subsection 127.491(1)) of the electrical energy produced by the system in an operating year (as defined in subsection 127.491(1)) is greater than 65 tonnes of carbon dioxide per gigawatt hour of electrical energy, in the sixth to twentieth operating year of the system. An average actual emission intensity that exceeds this limit during the compliance period of the system (the period beginning on the "start-up date" of the system and ending on the last day of the fifth operating year) would trigger a recovery amount as determined under subsection 127.491(19) – see explanatory notes on the definition "compliance period" and that subsection.

Subsection 127.491(35) provides temporary relief in certain circumstances where waste biomass electricity generation equipment or qualified natural gas energy equipment is part of a system that is temporarily operated in a manner that is an "ineligible use" as defined in subsection 127.491(1) – see explanatory notes on subsection 127.491(35).

"non-government assistance"

"Non-government assistance" has the same meaning as in subsection 127(9).

The capital cost of property that is eligible for the clean electricity investment tax credit is reduced by the amount of any government assistance or non-government assistance pursuant to paragraph 127.491(10)(c). Those amounts could become eligible for the clean electricity investment tax credit if they are subsequently repaid, pursuant to subsection 127.491(12). For more information, see the commentary on those subsections.

"nuclear energy equipment"

The definition "nuclear energy equipment" is relevant for the purposes of subparagraph (e)(iv) of the definition "clean electricity property" in subsection 127.491(1).

"Nuclear energy equipment" means equipment (including reactors, reactor vessels, reactor control rods, moderators, cooling systems, control systems, nuclear fission fuel handling equipment, containment structures, electrical generating equipment and equipment for the distribution of heat energy) that is used all or substantially all to generate electrical energy, or a combination of electrical energy and heat energy, from nuclear fission as determined on an annual basis and that meets the following conditions:

- the equipment is part of a system that exports more electrical energy than heat energy on a net annual basis;

- the equipment is not one of the following: nuclear fission fuel, equipment for nuclear waste disposal and nuclear waste disposal sites, transmission equipment, distribution equipment, property included in Class 10 in Schedule II to the Regulations, equipment used to export heat energy from the system, or property that would be included in Class 17 in Schedule II to the Regulations if that Class were read without reference to its paragraph (a.1).

“operating year”

The definition “operating year” is relevant in respect of a “specified natural gas energy system” (as defined in subsection 127.491(1)) and the recovery tax provided in subsection 127.491(19) – see commentary below on the related definition and subsection for more information.

An “operating year” in the context of a specified natural gas energy system means each cumulative 365-day period during which the system operates (i.e., produces any amount of electrical energy). As a result, any period during which the system is not operating is disregarded in the calculation of a system’s operating year.

The first operating year of a system begins on its “start-up date” and ends on the day the system achieves 365 days of operations – see the commentary below on the definition “start-up date” in subsection 127.491(1). The next operating year would begin on the day after the first operating year ends and run for the next cumulative 365-day period.

For example, if the first day of the compliance period of a qualified natural gas energy system is on January 1, 2025, and it has 30 days of shutdown time before accumulating 365 days of operations, the system’s first operating year would end on January 30, 2026.

“preliminary work activity”

Expenditures in respect of a “preliminary work activity” cannot be included in the capital cost of clean technology property for purposes of computing a taxpayer’s clean technology investment tax credit because of subparagraph 127.491(10)(a)(v).

This expression has the meaning assigned in subsection 127.45(1) – see proposed definition in subsection 127.45(1). In general terms, a preliminary work activity is an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of eligible property, including (but not limited to) the activities described in paragraphs (a) to (e) of that definition.

“qualified interprovincial transmission equipment”

The definition “qualified interprovincial transmission equipment” is relevant for subparagraph (e)(ix) of the definition “clean electricity property” in subsection 127.491(1).

A property is qualified interprovincial transmission equipment if it is primarily used to transmit or manage electrical energy that originates in, or is destined for, a province other than the province in which the property is located.

It must also be one of the following types of property:

- equipment for the transmission of electrical energy, including cables and switches, that is rated for voltages of at least 69 kilovolts;
- electrical transmission structures, including towers and lattices; or
- related equipment used to manage electrical energy, including transformers, electric power conditioning equipment and control equipment, that is directly connected to equipment described above.

Property that is a building or "distribution equipment" (defined in subsection 248(1)) is not eligible.

"qualified natural gas energy equipment"

The definition "qualified natural gas energy equipment" is relevant for the purposes of paragraph (e) of the definition "clean electricity property" in subsection 127.491(1), which includes such equipment in subparagraph (viii) in the list of equipment that can be eligible for the clean electricity investment tax credit, to the extent that all of the other conditions in the latter definition are met.

The definition "qualified natural gas energy equipment" lists the conditions that must be met for a property to be such equipment in paragraphs (a) to (d).

Paragraph (a) requires that the property be part of a system that meets the conditions listed in subparagraphs (i) to (vii):

(i) the system is fuelled all or substantially all by natural gas (as determined on an annual basis) and is not fuelled by anything other than gaseous fuels,

(ii) the system is used solely for the purpose of generating electrical energy, or a combination of electrical energy and heat energy (capturing carbon dioxide associated with fuel combustion is permitted)),

(iii) the system exports more electrical energy than heat energy on a net basis as determined on an annual basis,

(iv) the system is physically and functionally integrated with equipment that captures and compresses carbon dioxide for transportation,

(v) less than 50% of the gross electrical energy generated by the system is used to power the equipment referred to in subparagraph (iv), as determined on an annual basis,

(vi) the system is not expected to exceed an emission intensity of 65 tonnes of carbon dioxide per gigawatt hour of gross electrical energy generated, and

(vii) a system evaluation has been issued for the system by the Minister of Natural Resources, in the form and manner determined by the Minister of Natural Resources.

Paragraph (b) provides that the property must be equipment listed in any of subparagraphs (i) to (vi), including ancillary equipment that is physically and functionally integrated with and used solely to support the functioning of other qualified natural gas energy equipment. Ancillary equipment includes feedwater, condensate and emissions monitoring systems.

Paragraph (c) provides that the Minister of Natural Resources must have verified that the particular equipment is equipment described in paragraph (b), if the equipment is acquired before the "start-up date" (as defined in subsection 127.491(1)) of the system. See the commentary on the definition "start-up date" for more information.

Paragraph (d) provides that the equipment must not be a property listed in paragraph (d).

"qualified natural gas energy system"

The definition "qualified natural gas energy system" is relevant for the purposes of subsection 127.491(19) which is a recovery rule where the "average actual emission intensity" (as defined in subsection 127.491(1)) of the electricity produced by a "specified natural gas energy system" (which is defined in subsection 127.491(1) as a system that has, at any time, been a qualified natural gas energy system) is greater than 65 tonnes of carbon dioxide per gigawatt hour of electrical energy. The definition is also relevant for the definition "ineligible use" in subsection 127.491(1) which is relevant for the recapture rules in subsections 127.491(17) and (18).

A system is a qualified natural gas energy system if it meets the conditions provided in paragraph (a) of the definition "qualified natural gas energy equipment" in subsection 127.491(1) – see explanatory notes on that definition for more information.

See the commentary on the definition "specified natural gas energy system" below for more information.

"qualified verification firm"

The definition "qualified verification firm" is relevant for the purposes of the compliance report to be filed by a qualifying entity under paragraph 127.491(20) in respect of the fifth "operating year" of a "qualified natural gas energy system" (both expressions are defined in subsection 127.491(1)). The compliance report must include a verification report prepared by a "qualified verification firm" in respect of the actual emission intensity of the system during each operating year of the compliance period as required under paragraph (d). This definition is also relevant for the purposes of preparing a "system plan" (which is defined in the same subsection) that may be required by the Minister of Natural Resources as part of a system evaluation under paragraph 127.491(9).

A “qualified verification firm” means, in respect of a “specified natural gas energy system” of a taxpayer (which means under the definition of that term a system that has, at any time, been a qualified natural gas energy system), an engineer or engineering firm that meets the requirements in paragraphs (a) to (d). These include requirements to have appropriate professional status and insurance coverage, to be independent of, and to deal at arm’s length with and not to be an employee of the taxpayer, to have expertise in auditing continuous emissions monitoring systems to demonstrate compliance with *Regulations Limiting Carbon Dioxide Emissions from Natural Gas-fired Generation of Electricity*, and to meet requirements described in guidelines of the Minister of Natural Resources.

“qualifying corporation”

The definition “qualifying corporation” lists through paragraphs (a) to (f) the corporations that are eligible for the clean electricity investment tax credit as a “qualifying entity” as defined in subsection 127.491(1):

a) a taxable Canadian corporation (within the meaning of subsection 89(1) of the Act);
b) a designated provincial Crown corporation – see the commentary on the proposed definition above;
c) a corporation described in paragraph 149(1)(d.5) of which not less than 90% of the shares, or the capital, is owned by one or more entities each of which is either:
    - a municipality in Canada;
    - an Aboriginal government (as defined in subsection 241(10)) — or similar Indigenous governing bodies — described in paragraph 149(1)(c);
d) a corporation described in paragraph 149(1)(d.6) of which all of the shares (except directors’ qualifying shares), or the capital, is owned by one or more of
    - a municipality in Canada;
    - an Aboriginal government (as defined in subsection 241(10)) — or similar Indigenous governing bodies — described in paragraph 149(1)(c);
e) a corporation of which all of the shares (except directors’ qualifying shares) or of the capital is owned by one or more persons described in paragraphs (b) to (d);
f) a corporation to which paragraph 149(1)(o.2) applies.

“qualifying entity”

The definition “qualifying entity” is relevant in determining whether an entity is eligible for the clean electricity investment tax credit.

A qualifying entity means a qualifying corporation or a qualifying trust, as defined for the purposes of section 127.491.

This definition ensures that only qualifying corporations or qualifying trusts are eligible for the clean electricity investment tax credit. Qualifying entities that are members of a partnership that acquires clean electricity property may also be eligible for this investment tax credit because of subsection 127.491(13).

“qualifying trust”

The definition “qualifying trust” ensures that only a trust that meets the conditions provided in the definition are eligible for the clean electricity investment tax credit.

A trust is a qualifying trust if, at all relevant times, the trust meets the following conditions:

- The beneficiaries of the trust are solely corporations described in paragraph 149(1)(o.2).
- The trust is a limited partner of a partnership.
- The sole undertaking of the trust is the holding of its interest in the partnership.

See commentary on subsection 127.491(14) which provides a rule regarding assistance in the context of trusts.

“refurbishment”

The definition “refurbishment” is relevant for the purposes of subparagraph (e)(x) of the definition “clean electricity property” in subsection 127.491(1).

In general terms, a qualifying entity may claim the clean electricity investment tax credit on the capital cost of a property that the entity has acquired and that is described in any of subparagraphs (e)(i) to (ix) of the definition “clean electricity property” if the property has not been used, or acquired for use or lease, for any purpose whatever before it was acquired by the entity.

In general terms, subparagraph (e)(x) of the definition “clean electricity property” provides that property that is incorporated into another property as part of the refurbishment of the other property, that is described in any of subparagraphs (e)(i) to (ix), is “clean electricity property”. Such property is subject to the other conditions set out in paragraphs (a) to (d), including that the property has not been used, or acquired for use or lease, for any purpose before it was acquired by the entity.

“Refurbishment” means significant alterations, renovations, improvements or additions to a property to substantially extend its useful life, increase its capacity or improve its efficiency.

“specified natural gas energy system”

This term means a system that was, at any time, a qualified natural gas energy system.

This term is relevant for the recovery rule in subsection 127.491(19) that may apply if the average actual emission intensity of the electricity produced by the system is greater than 65 tonnes of carbon dioxide per gigawatt hour of electrical energy for the “compliance period” of a system that was a “qualified natural gas energy system” at any time during the period. See commentary on those definitions in subsection 127.491(1) and on subsection 127.491(19) for more information.

“specified percentage”

The definition “specified percentage” sets out the rates for determining the amount of the clean electricity investment tax credit.

Under paragraph (a), the rate is nil for property that is acquired before April 16, 2024. Paragraph (a) applies without reference to subsection 127.491(8), which otherwise deems property not to have been acquired until it is available for use. Accordingly, property that is acquired before April 16, 2024, but becomes available for use on or after that day, is ineligible for the clean electricity investment tax credit.

Under paragraph (b), the rate is 15 per cent for property acquired on or after April 16, 2024 and before January 1, 2035.

Under paragraph (c), the rate is nil for property acquired after December 31, 2034. Subsection 127.491(8) would deem property that was acquired in 2034 or earlier, but became available for use in 2035, to be acquired in 2035 so that it would be subject to the nil rate.

However, the above-noted rates could be reduced by ten percentage points if the claimant does not elect to meet the labour requirements set out in section 127.46. See the explanatory notes to the proposed amendments to that section for more information.

“start-up date”

The definition “start-up date” is relevant for the definitions “compliance period” and “operating year”, and these definitions are relevant for the purposes of the definition “specified natural gas energy system” and the recovery rule provided in subsection 127.491(19).

The “start-up date” of an operating year marks the start of the first operating year of a specified natural gas energy system and thus the start of the “compliance period” of the system. The start-up date means the first day on which the system generates electrical energy for sale.

“**system plan”**

The definition “system plan” is relevant for the purposes of the definition “qualified natural gas energy system” in subsection 127.491(1) and subsection 127.491(9), under which the Minister of Natural Resources may request certain information and documentation including a system plan and, to the extent that it is not provided, may refuse to complete an evaluation of the system.
A “system plan” means a plan for a qualified natural gas energy system of a qualifying entity that includes the information described in paragraphs (a) to (d) and that is filed with the Minister of Natural Resources in accordance with paragraph (e).

The plan must be prepared by a qualified verification firm (as defined in subsection 127.491(1)), must include a front-end engineering design study (or an equivalent study as determined by the Minister of Natural Resources) for the system, set out expected emission intensity and other ratios relevant to determining whether the system is a qualified natural gas energy system, any information required in guidelines published by the Minister of Natural Resources, and be filed by the entity with the Minister of Natural Resources, in the form and manner determined by the Minister of Natural Resources.

Clean electricity investment tax credit

ITA
127.491(2)

Subsection 127.491(2) provides rules under which the amount of the amount of the clean electricity investment tax credit is to be paid or credited to a qualifying entity for a year where the entity has filed with a prescribed form containing prescribed information on or before the entity’s filing-due date (within the meaning assigned by subsection 248(1)).

In the case of a qualifying entity that is a taxable Canadian corporation (paragraph (a) of the definition “qualifying corporation”) or a qualifying trust, paragraph 127.491(2)(a) deems the amount of the clean electricity investment tax credit to have been paid on account of tax payable by the entity for the year, where the entity has filed with its return of income for the year a prescribed form containing prescribed information. The deemed payment will effectively reduce the entity’s tax payable for the year, if any, and result in a refund to the extent the clean electricity investment tax credit exceeds its amount otherwise owing under the Act.

In the case of an entity that is described in any of paragraphs (c) to (f) of the definition “qualifying corporation”, the Minister shall, with all due dispatch, pay to the entity an amount equal to its clean electricity investment tax credit for the period, if the entity satisfies the conditions set forth in subsection 127.491(3).

In the case of an entity that is described in paragraph (b) of the definition “qualifying corporation”, the Minister shall, with all due dispatch, pay to the entity an amount equal to its clean electricity investment tax credit for the period, if the entity satisfies the conditions set forth in subsection 127.491(4).

References in paragraphs (2)(b) and (c) to “the period” are intended to refer to the relevant accounting or taxation year for the entity, having regard to the terms of the agreements referred to in those paragraphs.

Section 149 entities

ITA
127.491(3)

Subsection 127.491(3) provides conditions that a qualifying corporation described in any of paragraphs (c) to (f) of that definition must satisfy to be entitled to a clean electricity investment tax credit under subsection 127.491(2).

As provided under subsection (3), such corporation must agree in writing with the Minister to be subject to the provisions of this Act in respect of their entitlement to the clean electricity investment tax credit, including for greater certainty, this section, subsection 150(2) and (3), sections 152, 158, 159 and 161 to 167, Division J of Part I , and Part XV of this Act, with any modifications that the circumstances require. Otherwise, they are not entitled to the clean electricity investment tax credit.

Written agreement – designated provincial Crown corporations

ITA
127.491(4)

Subsection 127.491(4) provides conditions that a designated provincial Crown corporation (as defined in subsection 127.491(1)) must satisfy to be entitled to a clean electricity investment tax credit under subsection 127.491(2).

As provided under subsection (4), such a corporation must enter into a written agreement with the federal government ("His Majesty in right of Canada") to be subject to the provisions of this Act in respect of their entitlement to the clean electricity investment tax credit, including for greater certainty, this section, subsection 150(2) and (3), sections 152, 158 to 167, Division J of Part I , and Part XV of this Act, with any modifications that the circumstances require. Otherwise, they are not entitled to the clean electricity investment tax credit.

Amount payable

ITA
127.491(5)

Subsection 127.491(5) provides that any amount payable by a qualifying entity under this section is deemed to be payable as a tax or as a payment in lieu of tax, as the case may be.

This subsection reflects that taxable Canadian corporations and qualifying trusts, as well as corporations that do not have to pay tax under Part I of the Act on their income, are eligible to obtain a clean electricity investment tax credit and may be subject to the recovery and recapture rules in section 127.491.

Eligible jurisdiction

ITA
127.491(6)

Subsection 127.491(6) is relevant for the purposes of subparagraph (b)(ii) of the definition "clean electricity property" in respect of a corporation that is a "designated provincial Crown corporation", as defined in subsection 127.491(1).

In general terms, a designated provincial Crown corporation is eligible to obtain a refundable clean electricity investment tax credit in respect of the capital cost of a clean electricity property. Among the conditions for a property to be a clean electricity property for such a corporation, the property must be located in a province that has been designated by the Minister of Finance to be an eligible jurisdiction. See commentary on the definitions “clean electricity property” and “designated provincial Crown corporation” in subsection 127.491(1).

A province is an eligible jurisdiction for the purposes of section 127.491 if the Minister of Finance determines that the province meets the conditions published on a website maintained by the Government of Canada. The designation will specify the time at and after which it is in effect. The designation may have retroactive effect. It will be published on a website maintained by the Government of Canada. For greater clarity, the reference to a province includes Yukon, the Northwest Territories and Nunavut as provided under subsection 35(1) of the *Interpretation Act*.

Time limit for application

ITA
127.491(7)

Subsection 127.491(7) places a time limit on filing the form necessary to be eligible for the clean electricity investment tax credit.

The prescribed form claiming this tax credit must be filed on or before the day that is one year after the qualifying entity’s filing-due date for the year. A consequential change to subsection 220(2.2) removes the Minister’s discretion to waive this requirement.

If the form is filed after the taxpayer’s filing-due date but within the one-year period, the deemed payment under subsection (2) is deemed not to arise under that subsection until the prescribed form and information have been filed with the Minister.

Time of acquisition

ITA
127.491(8)

Subsection 127.491(8) deems clean electricity property not to have been acquired until it has become available for use by a qualifying entity. Accordingly, the clean electricity investment tax credit cannot be claimed before the year the property is available for use, even if expenditures to acquire the property are incurred in an earlier year. This could also impact the specified percentage applicable during the phase-out period – see the commentary above on the definition “specified percentage” in subsection 127.491(1) for more information.

Qualified natural gas energy system evaluation

ITA
127.491(9)

Subsection 127.491(9) provides that the Minister of Natural Resources may request from a qualifying entity all documentation and information necessary for the Minister of Natural Resources to complete a qualified natural gas energy system evaluation, including a system plan, and may refuse to complete the evaluation if such documentation or information is not provided by the entity.

Special rules — adjustments

ITA
127.491(10)

Subsection 127.491(10) sets out various rules to determine the capital cost of clean electricity property. By excluding amounts from the capital cost of property in the context of the clean electricity investment tax credit, these rules operate to in effect deny support under this tax credit to the extent described.

Under paragraph (a), the clean electricity investment tax credit is not available for any property for which any “clean economy tax credit” (as defined in subsection 127.47(1)) was deducted. Note that, in the context of property of a partnership, this rule applies at the partnership level because of the operation of subsection 127.491(13) which in effect directs the partnership to apply these rules as if the partnership were a taxable Canadian corporation, and then allocate out the members’ reasonable shares. For more information on the interaction of the subparagraph (a)(ii) “one investment tax credit per property” rule and partnerships, see the commentary on subsections 127.491(13) and subsection 127.47(4.1).

In addition, amounts added to the cost of property by virtue of section 21 do not form part of the capital cost of a clean electricity property for the purposes of the clean electricity investment tax credit. Also, expenditures incurred in respect of a “preliminary work activity” cannot be included in the capital cost of a clean electricity property. “Preliminary work activity” has the same definition for the purposes of both section 127.491 and for the clean technology investment tax credit rules in section 127.45. See the commentary on subsection 127.45(1) with regard to that defined term for more information.

In the case of a property that is part of a qualified natural gas energy system, under subparagraph (a)(iv), the capital cost of the property cannot include any amount if a CCUS tax credit was deducted by any person in respect of any property that is part of the system. This rule is intended to effectively require taxpayers to choose between CCUS tax credits and clean electricity investment tax credits for the system.

Further, under subparagraph (a)(vi), the capital cost of a clean electricity property cannot include any amount on which either a CCUS tax credit under section 127.44 of the Act or a clean hydrogen tax credit under section 127.48 of the Act was deducted in respect of any part of the capital cost of the property by any person. This rule is intended to apply specifically in the context of dual-use equipment (CCUS) and dual-use equipment described in subparagraphs (c)(iii)(B), (c)(iii)(D), or (c)(iv) to (vi) of the definition "eligible clean hydrogen property" in subsection 127.48(1) of the Act to prevent any portion of property that is benefitting from support under those investment tax credits from receiving support under the clean electricity investment tax credit. For example:

- A taxpayer has acquired a piece of dual-use electricity generation equipment for $1,000,000 that is expected to support a qualified CCUS project and a qualified clean hydrogen project, with 50 per cent of the power generated by the equipment to be used for the CCUS project with another 30 per cent for the clean hydrogen project. The CCUS tax credit and clean hydrogen tax credit would be available on the portion of the capital cost of the equipment in the respective usage proportions, applying to 80 per cent of the capital cost of the property in total (i.e., $500,000 plus $300,000).
- The taxpayer sells the remaining 20 per cent of power generated by the equipment to the grid.
- If the equipment meets the definition "clean electricity property", the taxpayer would be prevented from obtaining the clean electricity investment tax credit on the remaining capital cost of the equipment ($200,000) because of subparagraph (a)(vi) if it has obtained either, or in this case both, the CCUS tax credit or the clean hydrogen tax credit on the electricity generation equipment.

Under paragraph (b), the cost of the taxpayer's clean electricity property is determined without reference to subsections 13(7.1) and (7.4) of the Act. Among other things, this allows clean electricity investment tax credits to be disregarded in determining the cost of clean electricity property for these purposes.

Under paragraph (c), the capital cost of clean electricity property is reduced by amounts relating to "government assistance" and "non-government assistance" (as those terms are defined in subsection 127(9)) that can reasonably be considered to be in respect of the property. Subparagraph (c)(i) reduces the capital cost of clean electricity property by assistance received in or before the taxation year in which the property was acquired (or was deemed to be acquired). Subparagraph (c)(ii) reduces the capital cost of clean electricity property in circumstances where an amount has not yet been received during the year, but the qualifying entity is nevertheless entitled to receive the amount in the year, or can be reasonably be expected to receive the amount in the year or a subsequent year, and that amount would be government assistance or non-government assistance to the entity if it were received by the entity. Amounts that are repaid or that, having reduced the capital cost of property under paragraph (10)(c), are no longer expected to be received may be eligible for the clean electricity investment tax credit under subsection 127.491(12).

Under paragraph (d), adjustments in subsections 127(11.6) to 127(11.8) may apply to the cost of property transferred between non-arm's length parties for the purposes of the clean electricity investment tax credit. Those rules are imported for the purpose of the clean electricity investment tax credit, subject to certain necessary adjustments.

Deemed deduction

ITA
127.491(11)

Subsection 127.491(11) ensures that any amount determined under subsection 127.491(2) is also deemed to have been deducted from the taxpayer's tax otherwise payable under Part I. This deeming rule applies for the purpose of various provisions of the Act. It causes these rules to operate in the same manner whether the clean electricity investment tax credit is received as a refund or is actually deducted against tax otherwise payable.

Repayment of assistance

ITA
127.491(12)

The capital cost of clean electricity property may be reduced under paragraph 127.491(10)(c) by the amount of "government assistance" and "non-government assistance" that is received, is receivable or is reasonably expected to be received, in respect of the property. If such assistance is subsequently repaid or can no longer reasonably be expected to be received, those amounts may once again be eligible for the clean electricity investment tax credit because of subsection 127.491(12). Because a property must be acquired in the year to obtain an investment tax credit under section 127.491 (see the definition "clean electricity investment tax credit" in subsection 127.491(1)), a separate property is deemed to have been acquired to enable the investment tax credit to be claimed in respect of the later year.

Partnerships

ITA
127.491(13)

Subsection 127.491(13) applies if a qualifying entity in a particular taxation year is a member of a partnership, and a clean electricity investment tax credit would be determined in respect of the partnership if it were a taxable Canadian corporation. The clean electricity investment tax credit rules are generally intended to apply to partnerships and their partners that are qualifying entities in a manner similar to the partnership rules for the investment tax credits under section 127 of the Act, subject to important modifications to the partnership rules made for the clean economy investment tax credits described in section 127.47 of the Act which will include the clean electricity investment tax credit, to which subsection 127.45(13) is subject - see the commentary on section 127.47, including new proposed amendments to that section, for more information.

Trust - assistance received by beneficiary

ITA
127.491(14)

Subsection 127.491(14) provides for a reduction of the expenditures incurred by a partnership and on which a partnership may calculate a clean electricity investment tax credit where a qualifying trust is a member of the partnership, and a beneficiary of the trust or the trust has received, is entitled to receive or can reasonably be expected to receive government assistance or non-government assistance. In such a case, the amount of the assistance that may reasonably be considered to be in respect of a clean electricity property for which a clean electricity investment tax credit has been allocated by a partnership to the trust is deemed to have been received by the partnership as government assistance or non-government assistance, as the case may be, in respect of the property.

This provision essentially mirrors subsection 127.47(5), with adjustments made to be applicable in respect of a qualifying trust that is a member of a partnership.

Unpaid amounts

ITA
127.491(15)

Subsection 127.491(15) ensures that if any part of the capital cost of a particular clean electricity property of a qualifying entity is unpaid on the day that is 180 days after the end of the taxation year of a taxpayer in which the clean electricity property was acquired, that part of the cost is added to the capital cost of a separate clean electricity property that is deemed to be acquired at the time that the unpaid amount is paid, unless the particular property has been converted to an ineligible use, disposed of or exported from Canada (i.e. subject to a recapture event).

Tax shelter investment

ITA
127.491(16)

Subsection 127.491(16) provides that the clean electricity investment tax credit is unavailable if a clean electricity property (or an interest in a person or partnership with a direct or indirect interest in such property) is a tax shelter investment under section 143.2. This approach is consistent with that taken for the other clean economy investment tax credits.

Recapture — conditions for application

ITA
127.491(17)

Subsection 127.491(17) sets out three conditions that trigger the application of recapture of all or part of the clean electricity investment tax credit under subsection (18).

The first condition in paragraph (a) is that a taxpayer acquired a clean electricity property within a particular period. More specifically, paragraph (a) requires, in the case of a clean electricity

property other than qualified natural gas energy equipment, that the taxpayer acquired the property in the particular year or in any of the preceding ten calendar years.
Subsection 127.491(8) deems clean electricity property not to have been acquired until it has become available for use by a qualifying entity. This means that the recapture rules could apply based on actions that occur during the ten calendar years after a property becomes available for use. In the case of a qualified natural gas energy equipment, the period is 20 calendar years, so recapture could apply based on actions that occur during the 20 calendar years after a property becomes available for use.

Paragraph (b) requires that the taxpayer became entitled to a clean electricity investment tax credit in respect of all or a portion of the capital cost of the clean electricity property referred to in paragraph (a).

Paragraph (c) requires that the property be converted to an ineligible use (see proposed definition in subsection 127.491(1) and related explanatory notes), be exported from Canada or be disposed of. Paragraph (c) does not apply if the property was previously converted to an ineligible use or exported from Canada, which ensures that recapture is not triggered twice for the same property. In cases where the property has been disposed of without having previously been converted to an ineligible use or exported from Canada, recapture may be deferred in some cases by virtue of subsections 127.491(24) and (25).

Recapture

ITA
127.491(18)

Where recapture applies in respect of a clean electricity property, the recapture amount is effectively calculated based on the proportion of the value of the property that has been used by the taxpayer prior to its conversion to an ineligible use, its export or its disposition.
For example, if a clean electricity property is sold to an arm's length party for 80% of the original capital cost of the property to the taxpayer, 80% of the clean electricity investment tax credit associated with that property will be recaptured. Similarly, if a clean electricity property is converted to an ineligible use at a time when its fair market value is 50% of its original capital cost, 50% of the clean electricity investment tax credit associated with that property will be recaptured. Recapture of the clean electricity investment tax credit will in no case exceed the taxpayer's clean electricity investment tax credit associated with the particular property (variable A). Variable B is the amount of any previous recapture paid by the taxpayer in respect of the property.

Where a clean electricity property is disposed of to a person that deals at arm's length with the taxpayer, variable C of the formula in subsection 127.491(18) is the proceeds of disposition of the particular property. In other cases (being the disposition to a non-arm's length party, conversion to an ineligible use or export), variable C of the formula in subsection 127.491(18) is the fair market value of the particular property. Variable D is the capital cost of the property that applied for the purposes of the clean electricity investment tax credit. There is an exception to the recapture rules if the property is disposed of to certain related persons, in which case recapture may be deferred pursuant to subsections 127.491(24) and (25).

Recovery — qualified natural gas energy systems

ITA
127.491(19)

Subsection 127.491(19) may require a qualifying entity to pay a recovery amount if, at the end of the compliance period of its qualified natural gas energy system, the average actual emission intensity of the electricity produced is greater than 65 tonnes of carbon dioxide per gigawatt hour of electrical energy.

The amount payable is determined by the formula A – B, applied to each qualified natural gas energy system.

Variable A is the total amount of clean electricity investment tax credits, each of which is based on the specified percentage that was applied to the capital cost of qualified natural gas energy equipment that was part of a system in determining a clean electricity investment tax credit of the taxpayer.

Variable B is the total of all amounts each of which can reasonably be considered to be the portion of any amount previously paid by the taxpayer because of subsection (18) in respect of the equipment, which would be in circumstances warranting a recapture of a clean electricity investment tax credit previously allowed in respect of the equipment.

The recovery tax is subject to a de minimis exception under subsection 127.491(23) if the average actual emission intensity of the qualifying entity's qualified natural gas energy system over the compliance period is 68.5 tonnes of carbon dioxide per gigawatt hour of electrical energy produced or less.

Compliance — emission intensity

ITA
127.491(20) and (21)

Subsection 127.491(20) sets out the requirement for a taxpayer that has deducted a clean electricity investment tax credit in respect of a qualified natural gas energy system to file with both the Minister of National Revenue and the Minister of Natural Resources, within 180 days after the end of each of the first twenty operating years, a compliance report containing certain information in respect of that operating year.

For the compliance report in respect of the system's fifth operating year, the taxpayer is required to include a report prepared by a "qualified verification firm" that verifies the "actual emission intensity" for each "operating year" in the compliance period. Each of those terms is defined in subsection 127.491(1).

Among other things, this information is relevant for the determination of the system’s average actual emission intensity at the end of the compliance period, which will be used to determine the amount of any recovery tax payable under subsection 127.491(19).

Under subsection 127.491(21), the Minister of Natural Resources will review each of a qualifying entity’s compliance reports and the Minister of National Revenue may, in consultation with the Minister of Natural Resources, make a determination or redetermination of the actual emission intensity of the electrical energy produced.

Failure to report

ITA
127.491(22)

Subsection 127.491(22) sets out a penalty that applies if a taxpayer fails to file a compliance report for a qualified natural gas energy system as required by subsection 127.491(20). There is a separate penalty for each compliance report that the taxpayer fails to file as required.

In general terms the penalty is 4% of the amount of the clean electricity investment, prorated to provide a daily amount in respect of the failure to file, but not exceeding the total clean electricity investment tax credit deducted by the qualifying entity in respect of the project.

Variable A is the total clean electricity investment tax credits deducted by the taxpayer in respect of the system before the applicable deadline set out in subsection (20), while variable B is the number of days during which the failure continues.

***De minimis* exception**

ITA
127.491(23)

Subsection 127.491(23) provides an exception to the recovery amount under subsection 127.491(19) if the average actual emission intensity of the qualifying entity’s qualified natural gas energy system over the compliance period is 68.5 tonnes of carbon dioxide per gigawatt hour of electrical energy produced or less.

This exception is intended to provide some tolerance and flexibility for variations in a system’s emission intensity that are unanticipated or outside of the qualified entity’s control.

Certain related party transfers

ITA
127.491(24) and (25)

Subsection 127.491(24) sets out conditions for the deferral of recapture under subsection 127.491(25).

Under subsection 127.491(24), recapture of the clean electricity investment tax credit will be deferred where clean electricity property is disposed of by a qualifying entity to a related qualifying entity in circumstances where the property would be clean electricity property to the purchaser (but for the requirement that the property not have been previously used under paragraph (c) of the definition of clean electricity property). This relieving provision is intended to facilitate bona fide transfers of clean electricity property within corporate groups. It is similar to subsection 127(33), which provides for deferral of the recapture of certain other investment tax credits where property is transferred to a non-arm's length party.

Subsection 127.491(25) provides for the deferred recapture. It generally causes the transferee to be treated as if it had claimed investment tax credits of the transferor in respect of the property, ensuring that the transferee is subject to recapture if it changes the use of the property to an ineligible use, or disposes of or exports the property. To achieve this result, subsection 127.491(25) makes subsection 127(34) applicable, with such modifications as the circumstances require.

Recapture event reporting requirement

ITA
127.491(26) and (27)

Where a recapture event described in subsection 127.491(17) occurs, or a deferral of recapture occurs because a qualifying entity has transferred clean electricity property to a related qualifying entity under subsections 127.491(24) and (25), the qualifying entity is required to notify the Minister in prescribed form and manner on or before the entity's filing-due date for that year. Consequential amendments to subsections 152(4) and (4.01) will extend the assessment period in respect of clean electricity investment tax credit recapture assessments where the notification has not been filed in prescribed form and manner.

Subsection (27) provides a similar reporting requirement for partnerships.

Recapture and recovery– partnerships

ITA
127.491(28) and (29)

Subsection 127.491(28) provides a mechanism for the recapture or recovery of a clean electricity investment tax credit received through a partnership. This mechanism in general terms directs a partnership to apply the rules in subsections (17) to (19) and (23) to (24) as if the partnership were itself a taxable Canadian corporation. Subsection (29) then directs the partnership to reasonably allocate the tax determined because of subsection (28) among the members of the partnership unless subsection 127.491(30) applies.

All members of the partnership, regardless of when they acquired their partnership interest, would generally be liable to pay a share of an amount payable because of this rule.

Election by member to pay tax

ITA
127.491(30)

Subsection 127.491(30) provides an election enabling a member of a partnership to elect to pay the total amount of recapture or recovery tax determined under subsection (28) that would otherwise have to be allocated out to members of the partnership for payment.

Joint and several, or solidary, liability

ITA
127.491(31) and (32)

Subsection 127.491(31) creates joint and several liability (common law) or solidary liability (civil law) for partnership members for any amount determined because of subsection 127.491(28) in respect of the partnership. Paragraphs 127.491(31)(a) and (b) provide exceptions to this joint, several and solidary liability. Under paragraph (a), the joint, several and solidary liability does not apply in relation to amount of tax that has been allocated to certain qualifying entities under subsection 127.491(29). For this purpose, allocation to any qualifying entity, other than one that is exempt from tax under Part I of the Act and that has not entered into an agreement under subsection 127.491(3) or (4) to be effectively subject to such tax, is effective to remove the joint and several or solidary liability. Under paragraph (b), an amount that has been paid by a taxable Canadian corporation that elected under subsection 127.491(30) is also not subject to joint, several or solidary liability.

Subsection 127.491(32) limits the liability of a former member of the partnership to the total amount of clean electricity investment tax credit obtained by the member as a result of their membership in the partnership.

Interest on recovery tax

ITA
127.491(33)

Subsection 127.491(33) provides that, when applying subsection 161(1) to an amount of recovery tax payable under subsection 127.491(19), the balance-due day of a qualifying entity for the taxation year is deemed to be the balance-due day of the taxation year for the related clean electricity investment tax credit under subsection 127.491(2). This has the potential effect of creating a liability for interest from the taxation year in which the tax credit was originally claimed.

Environmental compliance

ITA
127.491(34)

Subsection 127.491(34) prevents a qualifying entity from obtaining a clean electricity investment tax credit if there is substantial non-compliance of the entity with the requirements of any environmental laws, by-laws and regulations that are applicable to the property at the time the property become available for use. The general purpose of this rule is to prevent the provision of incentives to support environmental objectives through the tax system in circumstances where laws for the protection of the environment are being disregarded or violated in significant ways.

The significance of the particular infraction would have to be assessed based on the facts and circumstances and the objectives and purposes of the applicable laws, by-laws and regulations.

Compliance — reasonable efforts

ITA
127.491(35)

Subsection 127.491(35) provides temporary relief in certain circumstances where waste biomass electricity generation equipment or qualified natural gas energy equipment is part of a system that is temporarily operated in a manner that is an "ineligible use" as defined in subsection 127.491(1). Property that previously qualified for the clean electricity investment tax credit that is operated in manner that is an "ineligible use" would ordinarily become subject to the recapture rules in subsections 127.491(17) and (18). Subsection (35) is generally similar to existing sections 1104(14) and (15) of the Regulations, which provide similar relief in the context of Classes 43.1 and 43.2.

Paragraph (a) provides that equipment that is part of a system mentioned above can be considered to be operated in the required manner at a particular time during a period of deficiency, failing or shutdown of the system that is beyond the control of the qualifying entity, if the entity makes all reasonable efforts to rectify the difficulty causing the deficiency, failing or shutdown within a reasonable period of time.

Paragraph (b) is intended to accommodate situations of ownership of property by other persons as part of the same system. It provides that, for the purposes of paragraph (a), a system described in paragraph (a) may include property of another person or partnership if the following conditions are met:

- The property, if it were owned by the entity, would reasonably be considered to be part of the entity's system.
- The property uses electrical energy or heat energy obtained from the system, or transports or stores carbon dioxide obtained from the system.
- The operation of the property is necessary for the entity's system to operate in the required manner.

- At the time that the entity's system first became operational, the deficiency, failing or shutdown in the operation of the property could not reasonably have been anticipated by the entity to occur within the next five years.

Project

ITA
127.491(36)

Property that is part of a project that began construction before March 28, 2023 is generally not eligible for the clean electricity investment tax credit (see discussion above on paragraph (a) of the definition of "clean electricity property" in subsection 127.491(1)). Some pre-construction activities are excluded from being considered "construction" for this purpose.

Subsection 127.491(36) provides that if a major project is undertaken in discrete phases for bona fide business or engineering reasons, the Minister may determine that each phase is a separate project for this purpose.

Authority of the Minister of Natural Resources

ITA
127.491(37)

Subsection 127.491(37) gives the Department of Natural Resources the authority to publish technical guidance that will apply conclusively with respect to engineering and scientific matters, for the purpose of determining whether a property is a clean electricity property. The Department of Natural Resources already publishes such a technical guide for property in Classes 43.1 and 43.2 of Schedule II to the Regulations and for Canadian renewable and conservation expense purposes, and similar income tax rules to 127.491(37) specify that such guidance is conclusive with regard to engineering and scientific matters (see for example the definition "Canadian renewable and conservation expense" in subsection 66.1(6) of the Act).

Clean electricity investment tax credit — purpose

ITA
127.491(38)

Subsection 127.491(38) is an interpretative provision that describes the intended purpose of the clean electricity investment tax credit: to encourage the investment of capital in the deployment of clean electricity property in Canada.

Clean Technology Investment Tax Credit

Clause 1

Section 127.45 provides a refundable investment tax credit for certain investments in clean technology. Several amendments are being made to this section, including to extend the availability of the clean technology investment tax credit to certain equipment that supports the generation of electricity and/or heat from waste biomass.

Definitions

ITA
127.45(1)

“specified percentage”

The definition “specified percentage” is amended to clarify the interaction of former paragraphs (a) to (c) by ensuring that former paragraphs (b) and (c) (now renumbered as subparagraphs (b)(i) and (ii)) are explicitly subject to paragraph (a). This amendment clarifies the original intention of paragraph (a), which is to ensure that property acquired before March 28, 2023 is ineligible for the clean technology investment tax credit, even if it becomes available for use on or after March 28, 2023.

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

“clean technology property”

Subparagraphs (d)(i) to (iv) of the definition “clean technology property” are amended to remove language that already appears in the capital cost allowance classes of Schedule II to the Regulations to which those subparagraphs refer.

Subparagraph (d)(i) is also amended to clarify that test wind turbines (within the meaning assigned by subsection 1219(3) of the Regulations) are excluded.

Finally, subparagraph (d)(viii) is added consequential to the addition of “waste biomass electricity generation equipment” and “waste biomass heat generation equipment” to the categories of property eligible for the clean technology investment tax credit.

The amendments to subparagraphs (d)(i) to (iv) are deemed to have come into force on March 28, 2023. New subparagraph (d)(viii) is deemed to have come into force on November 21, 2023.

“non-clean technology use”

The definition non-clean technology use is amended to replace the words “ceasing to be” with “not being” before the words “a clean technology property”.

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

“preliminary work activity”

Expenditures in respect of a “preliminary work activity” cannot be included in the capital cost of clean technology property for purposes of computing a taxpayer’s clean technology investment tax credit because of subparagraph 127.45(5)(a)(iv).

A preliminary work activity is an activity that is preliminary to the acquisition, construction, fabrication or installation by or on behalf of a taxpayer of eligible clean technology property. Generally, a preliminary work activity includes (but is not limited to) the activities described in paragraphs (a) to (e).

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

“eligible bioenergy fuel”

The definition “eligible bioenergy fuel” is added to subsection 127.45(1) to describe fuel derived from specified waste material that is used by a system to produce electricity or both electricity and heat.

“gaseous biofuel”, “liquid biofuel”, “solid biofuel”, “specified waste material”, “spent pulping liquor”

These definitions are added to subsection 127.45(1) to describe certain feedstock and fuels relevant to the determination of whether systems, and consequently property, satisfy the requirements in the definitions of waste biomass electricity generation equipment and waste biomass heat generation equipment.

These definitions have the same meaning as in subsection 1104(13) of the Regulations.

The definition “specified waste material” describes eligible feedstock for waste biomass electricity generation equipment and waste biomass heat generation equipment.

The definition “spent pulping liquor” describes an eligible feedstock for waste biomass electricity generation equipment. However, spent pulping liquor would not be an eligible feedstock for waste biomass heat generation equipment.

The definitions “gaseous biofuel”, “liquid biofuel” and “solid biofuel” describe the types of fuels that could be produced from specified waste material and subsequently used to generate electricity, heat, or both electricity and heat, with either waste biomass electricity generation equipment or waste biomass heat generation equipment.

“waste biomass electricity generation equipment”

The definition “waste biomass electricity generation equipment” is added to subsection 127.45(1) to establish eligibility criteria for property that uses specified waste material to generate electricity, or both electricity and heat.

Paragraph (a) sets out system-level requirements for the eligibility of property within a system that generates electricity, or both electricity and heat:

- The system must be used solely to generate electricity, or both electricity and heat. While part of the system could be used to produce biofuel from specified waste material or upgrade the combustibility of specified waste material (see subparagraphs (b)(v) and (vi)), in either case any resulting fuel must be for use within the system. Property that is part of a system that produces any chemicals or fuel for sale would not be eligible.
- The material consumed by the system to produce electrical energy, or both electrical energy and heat energy, must derive all or substantially all of its energy content from specified waste material on an annual basis.
- The system must be located on a single site, or on contiguous or adjacent sites that function as a single integrated site, at which the activities described above are carried out. For example, property would not be considered part of an eligible system if it were located on a separate site that is not contiguous or adjacent to the site on which the activities described above are carried out.
- The system must not exceed a heat rate of 11,000 BTU per kilowatt-hour, as described by the formula in subparagraph (a)(v).

Paragraph (b) describes property that could qualify as waste biomass electricity generation equipment, provided it is part of a system that meets the requirements in paragraph (a):

- Electrical generating equipment.
- Heat generating equipment that is used primarily to produce heat energy to operate electrical generating equipment.
- Equipment that generates both electrical and heat energy.
- Certain heat recovery equipment.
- Equipment used to produce solid biofuel, liquid biofuel, or gaseous biofuel, all or substantially all from specified waste material (as measured by energy content), if that fuel is used solely to operate equipment described above. Equipment in this category must be described in any of subparagraphs (d)(xi), (xiii), (xvi) or (xx) of Class 43.1 in Schedule II to the Regulations.
- Equipment used to upgrade the combustibility of specified waste material that is used solely to operate the equipment described above.
- Ancillary equipment that is physically and functionally integrated with, and used solely to support the functioning of, equipment described above. This includes control, feedwater, and condensate systems.

Paragraph (c) describes certain property that would not be eligible for the clean technology investment tax credit as waste biomass electricity generation equipment.

“waste biomass heat generation equipment”

The definition “waste biomass heat generation equipment” is added to subsection 127.45(1) to establish eligibility criteria for property that uses specified waste material to generate heat.

Paragraph (a) sets out system-level requirements for the eligibility of property within a system that generates heat:

- The system must be used solely to generate heat energy. While part of the system could be used to produce biofuel from specified waste material (other than spent pulping liquor) or upgrade the combustibility of specified waste material (see subparagraphs (b)(ii) and (iii)), in either case any resulting fuel must be for use within the system. Property that is part of a system that produces any chemicals or fuel for sale would not be eligible.
- The material consumed by the system to produce heat energy must derive all or substantially all of its energy content from specified waste material, other than spent pulping liquor, on an annual basis.
- The system must be on a single site, or on contiguous or adjacent sites that function as a single integrated site, at which the activities described above are carried out. For example, property would not be considered part of an eligible system if it were located on a separate site that is not contiguous or adjacent to the site on which the activities described above are carried out.

Paragraph (b) describes certain property that could qualify as waste biomass heat generation equipment, provided it is part of a system that meets the requirements in paragraph (a):

- Heat generating equipment.
- Equipment used to produce solid biofuel, liquid biofuel, or gaseous biofuel, all or substantially all from specified waste material (as measured by energy content), other than spent pulping liquor, if that fuel is used solely to operate equipment described above. Equipment in this category must be described in any of subparagraphs (d)(xi), (xiii), (xvi) or (xx) of Class 43.1 in Schedule II to the Regulations.
- Equipment used to upgrade the combustibility of specified waste material, other than spent pulping liquor, that is used solely to operate the equipment described above.
- Ancillary equipment that is physically and functionally integrated with, and used solely to support the functioning of, equipment described above. This includes control, feedwater, and condensate systems.

Paragraph (c) describes certain property that would not be eligible for the clean technology investment tax credit as waste biomass heat generation equipment.

These definitions are deemed to have come into force on November 21, 2023.

Special rules – adjustments

ITA
127.45(5)(a)

The introductory language of paragraph 127.45(5)(a) is amended to remove the reference to a capital property. This amendment is intended to facilitate the other changes described below.

Subparagraph 127.45(5)(a)(i) is amended to clarify that the clean technology investment tax credit will not be denied in respect of a property where an earlier clean technology investment tax credit amount was claimed in respect of the same property. This amendment is intended to facilitate additional claims under amended subsections (7) and (9) in a subsequent tax year, once amounts of assistance have been repaid or unpaid amounts in respect of the property are ultimately paid. However, subparagraph 127.45(5)(a)(i) continues to ensure that a clean technology investment tax credit cannot be deducted twice on the same amount.

Subparagraph 127.45(5)(a)(ii) is amended to make reference to any "clean economy tax credit" as defined in subsection 127.47(1). This ensures that a clean technology investment tax credit cannot be claimed if another clean economy tax credit is deducted on the same amount.

Subparagraph 127.45(5)(a)(ii.1) further clarifies that no clean technology investment tax credit is available in respect of a property on which either the CCUS tax credit or the clean hydrogen investment tax credit has been claimed on any part of the capital cost of that property. This amendment ensures that the clean technology investment tax credit cannot be claimed on any property where the CCUS tax credit or the clean hydrogen investment tax credit was deducted in respect of the same property.

Subparagraph 127.45(5)(a)(iv) is added to exclude amounts in respect of an expenditure incurred for a preliminary work activity from the cost of clean technology property.

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

Environmental compliance

ITA
127.45(5.1)

Subsection 127.45(5.1) prevents a qualifying taxpayer from obtaining a clean technology investment tax credit if there is substantial non-compliance by the taxpayer with the requirements of any environmental laws, by-laws and regulations that are applicable to the property at the time the property become available for use. The general purpose of this rule is to prevent the provision of incentives to support environmental objectives through the tax system in circumstances where laws for the protection of the environment are being disregarded or violated in significant ways.

The significance of the infraction would have to be assessed based on the facts and circumstances and the objectives and purposes of the applicable laws, by-laws and regulations.

This amendment is deemed to have come into force on November 21, 2023.

Compliance — reasonable efforts
ITA
127.45(5.2)

Subsection 127.45(5.2) provides temporary relief in certain circumstances where waste biomass electricity generation equipment or waste biomass heat generation equipment is part of a system that is temporarily operated in a manner that is a “non-clean technology use” as defined in subsection 127.45(1). Property that previously qualified for the clean technology investment tax credit that is operated in manner that is a “non-clean technology use” would ordinarily become subject to the recapture rules in subsections 127.45(11) to (18). Subsection (5.2) is generally similar to existing subsections 1104(14) et (15) of the Regulations, which provide similar temporary relief in the context of Classes 43.1 and 43.2.

Paragraph (a) provides that property that is part of a system mentioned above can be considered to be operated in the required manner at a particular time during a period of deficiency, failing or shutdown of the system that is beyond the control of the qualifying taxpayer, if the taxpayer makes all reasonable efforts to rectify the difficulty causing the deficiency, failing or shutdown within a reasonable period of time.

Paragraph (b) is intended to accommodate situations of ownership of property by other persons as part of the same system. It provides that, for the purposes of paragraph (a), a system described in paragraph (a) may include property of another person or partnership if the following conditions are met:

- The property, if it were owned by the taxpayer, would reasonably be considered to be part of the taxpayer’s system.
- The property utilizes electrical energy or heat energy obtained from the system.
- The operation of the property is necessary for the taxpayer’s system to operate in the required manner.
- At the time that the taxpayer’s system first became operational, the deficiency, failing or shutdown in the operation of the property could not reasonably have been anticipated by the taxpayer to occur within five years after that time.

This amendment is deemed to have come into force on November 21, 2023.

Deemed deduction

ITA
127.45(6)

Consequential on the enactment of the clean electricity investment tax credit, subsection 127.45(6) is amended to deem a deduction of the clean technology investment tax credit for the purpose of section 127.491.

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

Repayment of assistance

ITA
127.45(7)

Subsection 127.45(7) is amended to clarify that a clean technology investment tax credit may be available in respect of amounts of government or non-government assistance that have been repaid, where that assistance previously reduced the capital cost of clean technology property under paragraph 127.45(5)(b.1).

This amendment deems a separate clean technology property to be acquired in the year of repayment, provided that a recapture event described in paragraph 127.45(11)(c) has not occurred in respect of the property on which an assistance amount has been repaid.

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

Unpaid amounts

ITA
127.45(9)

Where an amount in respect of a clean technology property is unpaid on the day that is 180 days after the end of a taxation year in which a deduction in respect of a clean technology investment tax credit would otherwise be available, that amount is excluded from the capital cost of the particular property for the purpose of computing the taxpayer's clean technology investment tax credit under paragraph 127.45(9)(a).

Subsection 127.45(9) is amended to clarify that a clean technology investment tax credit may be available for amounts in respect of a clean technology property that are paid more than 180 days after the end of a taxation year in which a deduction in respect of a clean technology investment tax credit would otherwise be available.

In order to facilitate claims for such amounts, paragraph 127.45(9)(b) is amended to deem a separate clean technology property to be acquired in the year of payment, provided that a recapture event described in paragraph 127.45(11)(c) has not occurred in respect of the property for which the amount has ultimately been paid.

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

Election by member to pay tax

ITA
127.45(18.1)

Subsection 127.45(18.1) enables a qualifying taxpayer that is a member of a partnership during the partnership's fiscal period to elect to pay the entire amount determined in respect of the partnership under subsections 127.45(16) and (17).

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

Joint and several liability

ITA
127.45(18.2)

Subsection 127.45(18.2) creates joint and several liability (or, for civil law, solidary liability) for partnership members for any tax determined because of subsections 127.45(16) and (17) in respect of the partnership, except to the extent that the tax has been paid by a qualifying taxpayer that elected under subsection 127.45(18.1) or has been allocated to a member of the partnership and added to its tax payable under subsection 127.45(17). Both current and former members of the partnership are subject to this rule.

This amendment is deemed to have come into force on March 27, 2023.

Former member liability

ITA
127.45(18.3)

Under subsection 127.45(18.2), a taxpayer who was formerly a member of a partnership and had claimed a clean technology investment tax credit in respect of the partnership may be jointly and severally, or solidarily, liable for recapture tax. Subsection 127.45(18.3) limits this liability to the total of all amounts that the former member received as a clean technology investment tax credit because of its membership in the partnership.

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

Clean Hydrogen Investment Tax Credit

Clause 1

ITA
127.48

Several changes are proposed for the legislation that implements the clean hydrogen tax credit. The amendments generally apply as of March 28, 2023, consistent with the effective date for the clean hydrogen tax credit, except as otherwise provided.

Definitions

ITA
127.48(1)

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

“dual-use hydrogen and ammonia equipment”

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

“ineligible use”

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

“Fuel LCA Model”

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

This definition is amended to ensure that taxpayers use a version of the Fuel LCA Model that is listed in the latest *Clean Hydrogen Investment Tax Credit – Carbon Intensity Modelling Guidance Document*, and do not use any version of the Fuel LCA Model containing errors that have been corrected in a subsequent version.

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

“non-hydrogen or ammonia use”

The definition “non-hydrogen or ammonia use” describes one of the circumstances where property that was previously an eligible clean hydrogen property could become subject to the recapture rules in subsections 127.48(21) and (22).

This definition is amended to clarify that, in applying the point-in-time test, the use in question results in the property not being an eligible clean hydrogen property, rather than “ceasing” to be eligible.

“dual-use electricity and heat equipment”

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

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

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

“eligible clean hydrogen property”

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

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

Subparagraphs (c)(i) and (ii) are amended to clarify that the property described in these two subparagraphs must be used to produce all or substantially all hydrogen. For example, certain equipment would be ineligible if it is used to produce oxygen that contributes to a substantial portion (e.g., more than 10%) of the project’s total revenues.

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

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

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

“eligible power purchase agreement”

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

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

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

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

“oxygen and nitrogen production equipment”

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

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

Deemed deduction

ITA
127.48(3)

Subsection 127.48(3) ensures that any amount deemed to have been paid on account of tax payable under subsection 127.48(2) is also deemed to have been deducted from the taxpayer’s tax otherwise payable under Part I.

Subsection 127.48(3) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

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

Calculation of carbon intensity

ITA
127.48(6)

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

Paragraph (6)(b) requires a “cradle-to-gate” approach in determining carbon intensity by requiring an assessment of the emissions from the production of hydrogen by the project, together with upstream emissions from the production of inputs to the hydrogen-production process, in applying the Fuel LCA Model.

Paragraph (b) is amended to exclude the items listed in new paragraph (6)(j) from the general “cradle-to-gate” carbon intensity calculation.

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

Paragraph (d) is amended to provide that, for the purposes of calculating the carbon intensity of a clean hydrogen project, any captured carbon that is subject to an “eligible use” (also defined in subsection 127.44(1)) is deemed to be permanently stored.

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

The preamble of paragraph (e) is amended to clarify that the relevant electricity generated or purchased to be taken into account in calculating carbon intensity under this subsection is the electricity used in connection with the hydrogen production of the project.

Clause (e)(i)(B) is also amended to clarify that the inputs used in eligible on-site generation must be any or a combination of hydrogen, an eligible heat source described in new subparagraphs (i)(i) or (ii) or eligible hydrocarbons (with carbon dioxide captured using a CCUS process).

Subsection 127.48(6) is also amended by adding new paragraphs (6)(i) to (n) to implement additional rules with respect to the calculation of carbon intensity.

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

If the heat source is not described in one of the categories listed in subparagraph (i)(i) or (ii), then the carbon intensity of the project is deemed to be greater than 4.5 (and the project would not be eligible for the clean hydrogen tax credit). This is to ensure that clean hydrogen projects do not use heat produced from an ineligible source (e.g., heat produced from burning diesel or coal).

New paragraph (6)(j) provides that the contribution to carbon intensity of delivering, collecting, recovering, treating or recirculating water, and energy used in compressing hydrogen beyond 30 bar, may be disregarded in the calculation of carbon intensity.

New paragraph (6)(k) provides that the emissions related to certain by-products of the hydrogen production process (off-gas, oxygen, certain nitrogen and heat) are to be attributed to the production of hydrogen.

New paragraphs (6)(l) and (m) provide that the emissions related to certain heat produced indirectly from hydrogen production and energy used in hydrogen purification are also to be attributed to hydrogen production.

New paragraph (6)(n) replaces and modifies the previous paragraph (6)(i), which provides that the *Clean Hydrogen Investment Tax Credit – Carbon Intensity Modelling Guidance Document* is to apply conclusively with respect to the calculation of carbon intensity, except as otherwise provided in section 127.48. The modification removes the reference to the timing of the applicable version to allow for more recent versions of the modelling guidance to apply.

Clean hydrogen project determination and rules

ITA
127.48(9)

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

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

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

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

Capital cost of clean hydrogen property

ITA
127.48(10)

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

Under paragraph (10)(a), the capital cost of eligible clean hydrogen property cannot include any amounts in respect of which a clean hydrogen tax credit was previously deducted by any person, or for which any other clean economy tax credits (as defined in subsection 127.47(1)) are deducted by any person.

The introductory language of paragraph (a) is amended to remove the reference to a capital property. This amendment is intended to facilitate other changes described below.

Subparagraph (a)(i) is amended to clarify that the clean hydrogen tax credit will not be denied in respect of a property where an earlier clean hydrogen tax credit amount was claimed in respect of the same property. This amendment is intended to facilitate additional claims for the clean hydrogen tax credit in respect of a property under subsections 127.48(11) and (13) in a subsequent tax year, once amounts of assistance have been repaid or unpaid amounts in respect of the property are ultimately paid. However, subparagraph 127.48(10)(a)(i) continues to ensure that a clean hydrogen tax credit cannot be deducted twice on the same amount.

This amendment also clarifies that certain eligible clean hydrogen property that also qualifies as "dual-use equipment" (as defined in subsection 127.44(1)) is not precluded from being eligible for both the CCUS tax credit and the clean hydrogen tax credit, provided that different portions of the property's capital cost are used to claim each credit.

Subparagraph (10)(a)(ii) is amended to make reference to any "clean economy tax credit" as defined in subsection 127.47(1). This ensures that a clean hydrogen tax credit cannot be claimed if another clean economy tax credit is deducted on the same amount.

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

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

Repayment of assistance

ITA
127.48(11)

Subsection 127.48(11) applies if a taxpayer has repaid (or has not received and can no longer reasonably be expected to receive), in a particular taxation year, an amount of government assistance or non-government assistance that was applied to reduce the capital cost of eligible clean hydrogen property under paragraph 127.48(10)(c) for a preceding year.

Subsection 127.48(11) is amended to clarify that a clean hydrogen tax credit may be available in respect of amounts of the repaid assistance, by deeming a separate eligible clean hydrogen property to be acquired in the year of repayment, provided that a recapture event described in paragraph 127.48(21)(c) has not occurred in respect of the property on which an assistance amount has been repaid.

Unpaid amounts

ITA
127.48(13)

Subsection 127.48(13) provides that if any part of the capital cost of a taxpayer’s eligible clean hydrogen property is unpaid on the day that is 180 days after the end of the taxation year in which the property was acquired, that part of the cost is excluded from the capital cost of the property for the purpose of computing the taxpayer’s clean hydrogen tax credit under paragraph 127.48(13)(a).

Subsection 127.48(13) is amended to clarify that a clean hydrogen tax credit may be available for amounts in respect of an eligible clean hydrogen property that are paid more than 180 days after the end of the taxation year in which a deduction in respect of the clean hydrogen tax credit would otherwise be available.

In order to facilitate claims for such amounts, paragraph 127.48(13)(b) is amended to deem a separate eligible clean hydrogen property to be acquired in the year of late payment, provided that a recapture event described in paragraph 127.48(21)(c) has not occurred in respect of the property for which the amount has ultimately been paid.

Property deemed in respect of qualified project

ITA
127.48(13.1)

Subsection 127.48(13.1) is added to prevent certain property from being excluded from eligibility for the clean hydrogen tax credit due to taxpayers’ inability to provide clean hydrogen project plans to the Minister of Natural Resources because the Minister of Natural Resources was not yet accepting them. In these circumstances, provided the project becomes a qualified clean hydrogen project in due course, subsection (13.1) deems the otherwise-ineligible property to have been acquired in respect of a qualified clean hydrogen project.

Recovery and recapture – partnerships

ITA
127.48(25)

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

Subsection 127.48(25) is amended to clarify that the rules in section 127.47 take precedence, and that this subsection applies regardless of whether the relevant clean hydrogen tax credit was claimed by a current or former member of the partnership.

Joint, several and solidary liability

ITA
127.48(28)

Subsection 127.48(28) creates joint and several liability (or, for civil law, solidary liability) for partnership members for any tax determined because of subsection 127.48(25) in respect of the partnership, except to the extent that the tax has been paid by a taxable Canadian corporation that elected under subsection 127.48(27) or has been allocated to a member of the partnership and added to its tax payable under subsection 127.48(26).

Subsection 127.48(28) is amended to specify that both current and former members of the partnership are subject to this rule, and that, in order for the limitation of liability provision under paragraph 127.48(28)(a) to apply, the corresponding amount must be added to the tax payable of a qualifying taxpayer under subsection 127.48(26).

This amendment seeks to ensure that recovery and recapture taxes applicable in the partnership context are payable by and collectable from taxable entities.

Former member liability

ITA
127.48(28.1)

Under amended subsection 127.48(28), a taxpayer who was formerly a member of a partnership and had claimed a clean hydrogen tax credit in respect of the partnership may be jointly and severally, or solidarily, liable for recovery and recapture tax. New subsection 127.48(28.1) limits this liability to the total of all amounts that the former member received as a clean hydrogen tax credit because of its membership in the partnership.

Clean Technology Manufacturing Investment Tax Credit

Clause 1

Section 127.49 provides a refundable investment tax credit for certain investments in clean technology manufacturing (the “CTM investment tax credit”). Several amendments are being made to the CTM investment tax credit, primarily to deal with polymetallic mining, as well as to address certain other technical points. Unless otherwise indicated, these amendments are deemed to have come into force on January 1, 2024.

Definitions

ITA
127.49(1)

“CTM use”

To be eligible for the CTM investment tax credit, a taxpayer must acquire the relevant property for a CTM use. If the taxpayer does not use the property for a CTM use (i.e., the taxpayer uses it for a "non-CTM use"), it may be subject to recapture in respect of the related credit.

Under the previous definition, all property used in a "qualifying mineral activity" had to produce *all of substantially all* "qualifying materials" in order to qualify as a CTM use. Amendments to the definition CTM use are intended to permit a property used in connection with certain such activities to produce a lesser proportion of "qualifying materials" (i.e., *primarily* qualifying materials) and still qualify as a CTM use.

The activities that will qualify for the new "primarily" test are described in paragraph (a) of the definition "qualifying mineral activity" (i.e., the extraction of resources from a mineral deposit or a tailing pond) and paragraph (b) of that definition (i.e., a "specified mineral processing activity" that is performed at a mine site or well site). The determination of whether the use of a particular property meets this test must be made in accordance with the value of all commercial outputs as set out in subsection 127.49(2.2). Mine sites or well sites can include tailing ponds and mills located at these sites.

CTM property must still be used all or substantially to produce qualifying materials if the specified mineral processing activity occurs at a location other than a mine site or well site. The determination of whether the use of a particular property meets the "all or substantially all" test must also be made in accordance with the value of all commercial outputs as set out in subsection 127.49(2.2).

See the explanatory notes to the definition "safe harbour price", and subsections 127.49(2.1) to (2.3), for further details on the use of values as the appropriate output metric when assessing the extent to which property is used (or is expected to be used) for qualifying mineral activities producing qualifying materials.

"qualifying mineral activity"

The definition "qualifying mineral activity" is amended:

- first, to simplify the definition by incorporating some elements into a new definition ("specified mineral processing activity");
- second, to distinguish specified mineral processing activities that occur at a mine or well site from those that occur at other locations; and
- finally, to renumber former paragraphs (c) to (e) (now contained in paragraphs (d) to (f)) and make minor related changes.

For more information on the first change, see the explanatory notes to "specified mineral processing activity".

The second change facilitates the operation of the "primarily" and "all or substantially all" tests set out in paragraphs (b) and (c) of the definition "CTM use". For more information, see the explanatory notes to the definition "CTM use".

“specified percentage”

The definition “specified percentage” is amended to clarify the interaction of former paragraphs (a) to (e) by ensuring that former paragraphs (b) to (e) (now renumbered as subparagraphs (b)(i) to (iv)) are explicitly subject to paragraph (a). This amendment clarifies the original intention of paragraph (a), which is to ensure that property acquired before January 1, 2024 is ineligible for the CTM investment tax credit, even if it becomes available for use on or after January 1, 2024.

“independent engineer or geoscientist”

The definition “independent engineer or geoscientist” is added to subsection 127.49(1). This definition establishes the requirements for individuals who can make the certification required by subsection 127.49(2.1). That certification is required to be filed in respect of a CTM investment tax credit where the property that is the subject of the claim is, or will be, used either in the extraction of resources from a mineral deposit or tailing pond, or in a specified mineral processing activity that is performed at a mine site or well site.

In addition to meeting the requirements of the definition “qualified professional engineer or professional geoscientist” in subsection 127(9), an independent engineer or geoscientist for the purposes of section 127.49 must also be at arm’s length with, independent of, and not employed by each taxpayer claiming a related CTM investment tax credit. In the context where a partnership acquires a CTM property and its partners will each claim their reasonable share of the resulting CTM investment tax credit, a related CTM investment tax credit may refer to the credits claimed by the other partners on their shares of the capital cost of the same CTM property.

For example, if A, B and C are all taxable Canadian corporations that are partners in a partnership that will each claim their share of a CTM investment tax credit on CTM property acquired by the partnership, and subsection (2.1) applies to require a certification by an independent engineer or geoscientist, that independent engineer or geoscientist must be at all times at arm’s length with, independent of, and not employed by each of A, B and C.

“safe harbour price”

The definition “safe harbour price” is added to subsection 127.49(1). A safe harbour price may be used by a taxpayer to determine the value of commercial outputs relevant to a CTM investment tax credit under subsection 127.49(2).

The safe harbour price must in all cases be computed using a five-year historical average spot price of the relevant material (whether a qualifying material or other output of a mining or processing facility).

The default method of calculating a historical average, under paragraph (a) of the definition “safe harbour price”, is to use prices from a recognized commodities exchange. If spot market prices are not available in respect of a particular material (examples may include mixed-metal concentrates with uncommon mineral compositions, certain rare earth element oxides, or materials with significant geographic price variation such as certain aggregates), a taxpayer may use normal and accepted commercial practices in the industry under paragraph (b) of the definition to calculate a five-year historical average spot price of a material.

See the explanatory notes to the definition "CTM use", and subsections 127.49(2.2) and (2.3), for further details on the use of safe harbour price in claiming the CTM investment tax credit.

"specified mineral processing activity"

The definition "specified mineral processing activity" is added to subsection 127.49(1). This definition contains activities formerly described in paragraph (b) of "qualifying mineral activity". The definition "qualifying mineral activity", in turn, is amended by cross-referencing "specified mineral processing activity".

Certification requirement

ITA
127.49(2.1)

For certain qualifying mineral activities (in particular, extraction or processing activities performed at a mine or well site), the availability of the CTM investment tax credit will be based on a "primarily" test, rather than an "all or substantially all" test, with respect to the production of qualifying materials (see the discussion above on the amendments to the definition "CTM use"). Accordingly, to support those claims for the CTM investment tax credit, taxpayers are required, under subsection 127.49(2.1), to submit a certification in the prescribed form from an independent engineer or geoscientist.

As part of the certification, the independent engineer or geoscientist must attest that property is being used, or will be used, at a particular mine or well site of the taxpayer, and in accordance with a plan that primarily targets qualifying materials. Whether the "primarily" test is met is to be determined using the value of all commercial outputs expected to be produced, in accordance with subsection (2.2).

The certification must be submitted with the claim form required under existing subsection 127.49(2).

Valuation of commercial outputs

ITA
127.49(2.2)

In computing the expected and actual values of outputs produced from the relevant property, the taxpayer may choose to use either the fair market value of those outputs (paragraph 127.49(2.2)(a)) or the applicable "safe harbour price" of the outputs (paragraph 127.49(2.2)(b)).

In particular, taxpayers may elect under paragraph (2.2)(a) to use the fair market value of commercial production to determine whether property will meet the “primarily” or “all or substantially all” tests. In that case, if the taxpayer is in pre-commercial production at the time a claim for the CTM investment tax credit is made, subparagraph (2.2)(a)(i) applies to permit the use of the fair market value of the expected outputs to determine eligibility for the credit. In subsequent years, when the taxpayer is in commercial production, the fair market value of the actual outputs from the property under subparagraph (2.2)(a)(ii) must be used to determine whether recapture applies.

Alternatively, in order to prevent the future recapture of the CTM investment tax credit from applying to CTM property solely due to a fluctuation in the market prices of outputs produced by a taxpayer, paragraph 127.49(2.2)(b) provides an election to use the applicable “safe harbour price” . In that case, a taxpayer may elect to use this price, computed at the time the CTM investment tax credit is claimed, to determine whether property is expected to meet (and continues to meet) either the “primarily” or “all or substantially all” tests throughout the 10-year recapture period for CTM property.

An election made under subsection (2.2) is binding on the taxpayer with respect to the property to which the election applies for any subsequent taxation year as a result of subsection 127.49(2.3).

Binding nature of election

ITA
127.49(2.3)

Subsection 127.49(2.3) ensures that an election under subsection (2.2) (i.e., an election to use either the fair market value of commercial production or safe harbour prices as the applicable method to value the output from a particular property) is binding for any taxation year subsequent to the year in which a CTM investment tax credit is claimed, with respect to a particular property of a taxpayer.

Special rules – adjustments

ITA
127.49(5)(a)

The introductory language of paragraph 127.49(5)(a) is amended to remove the reference to a capital property. This amendment is intended to facilitate the other changes described below.

Subparagraph 127.49(5)(a)(i) is amended to clarify that the CTM investment tax credit will not be denied in respect of a property where an earlier CTM investment tax credit amount was claimed in respect of the same property. This amendment is intended to facilitate additional claims for the CTM investment tax credit in respect of a property under subsections (7) and (9) in a subsequent tax year, once amounts of assistance have been repaid or unpaid amounts in respect of the property are ultimately paid. However, subparagraph 127.49(5)(a)(i) continues to ensure that a CTM investment tax credit cannot be deducted twice on the same amount.

Subparagraph 127.49(5)(a)(ii) is amended to make reference to any "clean economy tax credit" as defined in subsection 127.47(1). This ensures that a CTM investment tax credit cannot be claimed if another clean economy tax credit is deducted on the same amount.

Subparagraph 127.45(5)(a)(ii.1) further clarifies that no CTM investment tax credit is available in respect of a property on which either the CCUS tax credit or the clean hydrogen investment tax credit has been claimed on any part of the capital cost of that property. This amendment ensures that the CTM investment tax credit cannot be claimed on any property where either the CCUS tax credit or the clean hydrogen investment tax credit was deducted in respect of the same property.

Deemed deduction

ITA
127.49(6)

Consequential on the enactment of the clean electricity investment tax credit, subsection 127.49(6) is amended to deem a deduction of the CTM investment tax credit for the purpose of section 127.491.

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

Repayment of assistance

ITA
127.49(7)

Subsection 127.49(7) is amended to clarify that a CTM investment tax credit may be available in respect of amounts of government or non-government assistance that have been repaid, where that assistance previously reduced the capital cost of CTM property under paragraph 127.49(5)(c).

This amendment deems a separate CTM property to be acquired in the year of repayment, provided that a recapture event described in paragraph 127.49(11)(c) has not occurred in respect of the property on which an assistance amount has been repaid.

Unpaid amounts

ITA
127.49(9)

Where an amount in respect of a CTM property is unpaid on the day that is 180 days after the end of a taxation year in which a deduction in respect of a CTM investment tax credit would otherwise be available, that amount is excluded from the capital cost of the particular property for the purpose of computing the taxpayer's CTM investment tax credit under paragraph 127.49(9)(a).

Subsection 127.49(9) is amended to clarify that a CTM investment tax credit may be available for amounts in respect of a CTM property that are paid more than 180 days after the end of the taxation year in which a deduction in respect of a CTM investment tax credit would otherwise be available.

In order to facilitate claims for such amounts, paragraph 127.49(9)(b) is amended to deem a separate CTM property to be acquired in the year of payment, provided that a recapture event described in paragraph 127.49(11)(c) has not occurred in respect of the property for which the amount has ultimately been paid.

Election by member to pay tax

ITA
127.49(18.1)

Subsection 127.49(18.1) enables a qualifying taxpayer that is a member of a partnership during the partnership's fiscal period to elect to pay the entire amount determined in respect of the partnership under subsections 127.49(16) and (17).

Joint and several liability

ITA
127.49(18.2)

Subsection 127.49(18.2) creates joint and several liability (or, for civil law, solidary liability) for partnership members for any tax determined because of subsections 127.49(16) and (17) in respect of the partnership, except to the extent that the tax has been paid by a qualifying taxpayer that elected under subsection 127.49(18.1) or has been allocated to a member of the partnership and added to its tax payable under subsection 127.49(17). Both current and former members of the partnership are subject to this rule.

Former member liability

ITA
127.49(18.3)

Under subsection 127.49(18.2), a taxpayer who was formerly a member of a partnership and had claimed a CTM investment tax credit in respect of the partnership may be jointly and severally, or solidarily, liable for recapture tax. Subsection 127.49(18.3) limits this liability to the total of all amounts that the former member received as a CTM investment tax credit because of its membership in the partnership.

Proposals relating to various Clean Economy Tax Credits

Clause 1

ITA
127.44(1)

“dual-use equipment”

A portion of expenditures for “dual-use equipment” may qualify for CCUS tax credits under certain circumstances. To be included as dual use equipment, equipment must be described in any of paragraphs (a) to (d) of the definition. In addition, in the case of property acquired before the first day of commercial operations of the CCUS project, the equipment must be verified by the Minister of Natural Resources as being dual-use equipment.

Subparagraphs (a)(i) the definition describes certain energy generation equipment and water supply equipment respectively. Under subparagraph (a)(i), in order to for energy generation equipment to qualify as dual-use equipment in the category, it must be equipment that is part of a CCUS project of a taxpayer. It must not be used for natural gas processing or acid gas injection.

It must generate electrical energy, heat energy or a combination of electrical or heat energy, if more than 50% of either the electrical energy or heat energy that is expected to be produced over the total CCUS project review period, based on the most recent project plan, is expected to directly support a qualified CCUS project or hydrogen production from electrolysis or natural gas. Subparagraph (a)(i) is amended to clarify that the 50% test may be met through a combination of direct support of a qualified CCUS project and direct support of a qualified clean hydrogen project as described in clause (a)(i)(B). The energy generation equipment continues to be subject to a requirement that it cannot use fossil fuels and emit carbon dioxide that is not subject to capture by a qualified CCUS project.

This amendment applies on or after March 28, 2023.

“qualified carbon capture expenditure”

The definition “qualified carbon capture expenditure” is relevant to determining the amount of the taxpayer’s CCUS development tax credit under subsection (4) and CCUS refurbishment tax credit under subsection (5). In general terms, it represents a portion of the taxpayer’s capital expenditures incurred in the year to acquire property that is used for the capture aspect of a CCUS project (in contrast to property used in other parts of a CCUS project, such as for transportation, storage or use).

In general terms, Variable A includes the capital cost to the taxpayer of the property acquired by the taxpayer in the year that is used for, or related to, the capture aspect of a CCUS project. Variable A, in its paragraph (b), also includes a portion of the capital cost of “dual-use equipment”. The included portion as a qualified carbon capture expenditure is the proportion that the output from the dual-use equipment that is expected to be used in a CCUS project is of total output over the period of the project's "total CCUS project review period". The description of the portion of included water equipment in subparagraph (b)(ii) of variable A is amended slightly to correct the calculation of the portion of such dual-use equipment that is a qualified carbon capture expenditure. In particular, the word "returned from" are replaced by the words "supplied to" and the later phrase "returned to" is replaced by the words "processed by". This change ensures that the calculation is consistent with a similar calculation in the context of the clean hydrogen investment tax credit in section 127.48 and is mathematically correct.

This amendment applies on or after March 28, 2023.

Deemed deduction

ITA
127.44(3)

Subsection 127.44(3) of the Act deems the amount that is deemed to have been paid on account of tax payable under subsection (2) to have been deducted from the taxpayer's tax otherwise payable under Part I for the purposes of section 127.44 and various rules, causing those rules to operate in the same manner whether a CCUS tax credit (as defined in subsection 127.44(1)) is obtained as a refund or deducted against tax otherwise payable.

Subsection 127.44(3) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Special rules — adjustments

ITA
127.44(9)(b)(ii)(C)

Paragraph 127.44(9)(b) causes certain amounts to be excluded from a taxpayer's qualified CCUS expenditures. This includes, for instance, an expenditure to acquire property for which an investment tax credit is claimed under section 127 or under clean economy provisions. Paragraph (b) is amended consequential on the introduction of section 127.491 to exclude an expenditure to acquire property for which a clean electricity investment tax credit is claimed.

This amendment applies on or after April 16, 2024.

Clause 2

Definitions

ITA
127.46(1)

“regular tax credit rate”

This term means the “specified percentage” as defined in subsections 127.44(1),127.45(1) and 127.48(1), as the case may be, and is the tax credit rate available for taxpayers who meet the labour requirements in respect of certain clean economy tax credits.

The definition “regular tax credit rate” in subsection 127.46(1) is amended to add a reference to new subsection 127.491(1), consequential on the introduction of the clean electricity investment tax credit.

“specified tax credit”

For the purposes of the labour requirements in section 127.46, this term means a CCUS tax credit under section 127.44, a clean technology investment tax credit under section 127.45, and a clean hydrogen investment tax credit under section 127.48.

The definition “specified tax credit” in subsection 127.46(1) is amended to add a reference to the clean electricity investment tax credit under new section 127.491.

These amendments apply on or after April 16, 2024.

Reduced or regular rate

ITA
127.46(2)

Subsection 127.46(2) specifies that, in order to qualify for the “regular tax credit rate”, an incentive claimant must elect in prescribed form and manner to meet the labour requirements. An incentive claimant that does not elect under subsection (2) is limited to claiming the CCUS tax credit, the clean technology investment tax credit or the clean hydrogen tax credit at the “reduced tax credit rate”, which is ten percentage points less than the rate that would otherwise be available in respect of those credits under section 127.44, 127.45 or 127.48, as applicable.

Where an incentive claimant elects to meet the labour requirements but fails to do so, the incentive claimant generally maintains its entitlement to the tax credit at the regular tax credit rate but will be required to take corrective measures or pay related penalties. An incentive claimant loses its entitlement to a tax credit at the regular tax credit rate if it fails to meet the labour requirements knowingly or in circumstances amounting to gross negligence. Subsections 127.46(6) and (7) specify the ordinary consequences of failing to meet the prevailing wage and apprenticeship requirements, respectively, in the absence of intentional conduct or gross negligence. Subsection 127.46(9) sets out the consequences of intentional conduct or gross negligence.

Subsection 127.46(2) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Exception

ITA
127.46(15)

Subsection 127.46(15) specifies that the labour requirements do not apply to a specified tax credit claimed for the acquisition of off-road zero emission vehicles or to the acquisition and installation of low carbon heating equipment. Subsection (15) is amended to provide more specific descriptions of the type of property that is not subject to the labour requirements.

This amendment applies in respect of specified property prepared or installed on or after November 28, 2023.

Clause 3

Definitions

ITA
127.47(1)

Section 127.47 provides rules that apply where a "clean economy tax credit" (as defined in subsection 127.47(1)) is determined at a partnership level before allocation to its members.

These amendments would extend these partnership rules to the clean electricity investment tax credit.

These amendments apply on or after April 16, 2024.

"clean economy allocation provision"

For the purposes of new section 127.47, "clean economy allocation provision" means any of the following specific partnership allocation rules:

- subsection 127.44(11) (CCUS tax credit),
- subsection 127.45(8) (clean technology investment tax credit),
- subsection 127.48(12) (clean hydrogen tax credit), and
- subsection 127.49(8) (CTM investment tax credit).

The definition of "clean economy allocation provision" is amended to add a reference to new subsection 127.491(13), consequential on the introduction of the clean electricity investment tax credit.

"clean economy expenditure"

The definition “clean economy expenditure” serves to consolidate expenditures that qualify for the clean economy tax credits.

A “clean economy expenditure” means a qualified CCUS expenditure (as defined in and determined under section 127.44), as well as the capital cost of a clean technology property (as defined and determined under section 127.45), of an eligible clean hydrogen property (as defined and determined under section 127.48) or of a CTM property (as defined and determined under section 127.49).

The definition “clean economy expenditure” is amended to add a reference to the capital cost of a “clean electricity property” as defined and determined under new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

“clean economy provision”

A “clean economy provision” means any of sections 127.44, 127.45, 127.46, 127.48 and 127.49 and Part XII.7.

This definition allows the tiered partnership rule in new subsection 127.47(7) to apply for the purposes of all clean economy provisions.

The definition “clean economy provision” is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

“clean economy tax credit”

A “clean economy tax credit” means any of the following investment tax credits:

- a CCUS tax credit, as defined in subsection 127.44(1),
- a clean technology investment tax credit, as defined in subsection 127.45(1),
- a clean hydrogen tax credit, as defined in subsection 127.48(1), and
- a CTM investment tax credit, as defined in subsection 127.49(1).

This definition serves to consolidate the clean economy tax credits for the purposes of limiting the total clean economy tax credit amount based on reasonableness under subsection 127.47(2) and, for limited partners, based on the partner’s at-risk amount under subsection 127.47(3). It is also relevant for the purpose of apportioning any aggregate credit amounts back to each clean economy tax credit under subsection 127.47(4).

The definition “clean economy tax credit” is amended to add a reference to the “clean electricity investment tax credit”, as defined in new subsection 127.491(1).

Multiple tax credits

ITA
127.47(4.1)

In general terms, subsection 127.47(4.1) provides a rule clarifying the amount that a taxpayer that is a member of a partnership is deemed to have paid on account of its tax payable under Part I of the Act under each of the clean economy tax credits.

Each clean economy tax credit provides that where a qualifying taxpayer files a prescribed form containing prescribed information on or before its filing-due date for a taxation year, the taxpayer is deemed to have paid on its balance-due date for the year an amount on account of its tax payable equal to the taxpayer's clean economy tax credit – as defined in subsection 127.47(1).

In general terms, a clean economy tax credit of a qualifying taxpayer is the total of the following amounts:

- The total of all amounts each of which is the specified percentage of an amount that qualifies for the particular credit.
- Where the taxpayer is a member of a partnership, the total of all amounts that is required by the applicable clean economy allocation provision – as defined in subsection 127.47(1) – is to be added to the taxpayer's clean economy tax credit.

Where a property is eligible property for more than one clean economy tax credit, a qualifying taxpayer is generally limited to claiming only one of the tax credits on the cost of the property. In such circumstances, proposed subsection 127.47(4.1) ensures that where property is owned at the partnership level, each member of the partnership may generally claim any one – but not more than one - credit that they have been allocated by a partnership under the partnership allocation rules. An exception ensures that the dual-use equipment rules in the CCUS and clean hydrogen context still allow each portion of the property to support a credit claim.

The following illustrates the application of proposed subsection 127.47(4.1).

Example – Allocation of Clean Economy Tax Credits

Partner A and Partner B are limited partners of a limited partnership, and Partner C is the general partner. All three partners are taxable Canadian corporations.

The partners make the following contributions: Partner A, $10,000; Partner B, $10,000; Partner C, a nominal amount.

The taxation year of Partner A, Partner B and Partner C is the calendar year. The fiscal period of the partnership is also the calendar year.

In year 1, partnership acquires a property that qualifies as clean technology property (as defined under subsection 127.45(1)) and clean electricity property (see definition in proposed subsection 127.491(1)) for $20,000. The property becomes available for use in year 2 (see subsection 127.45(4) and proposed subsection 127.491(4)). The capital cost of the property at the end of year 2 is $20,000.

The following illustrates how the computation rule in proposed subsection 127.47(4.1) is intended to apply to Partner A and Partner B as limited partners of the partnership.

Partner A

The amount that Partner A may obtain under subsection 127.45(2) is equal to Partner A's clean technology investment tax credit for year 2, which is the total of all amounts required under subsection 127.45(8) to be added in computing its clean technology investment tax credit at the end of the year. Under this allocation provision, the clean technology investment tax credit is computed at the partnership level as if the partnership were a taxable Canadian corporation and its fiscal period were its taxation year, and the portion of the tax credit amount that can reasonably be considered to be Partner A's share thereof is added in computing its tax credit at the end of year 2.

Assuming that the specified percentage is 30%, the notional tax credit at the partnership level (using the fiction that the partnership is a taxable Canadian corporation) would be $6,000. The capital cost of the property to the partnership at the end of year 2 is $20,000. The special capital cost adjustment rules in subsection 127.45(5) do not apply in computing the capital cost of the property to the partnership. More specifically, the partnership is neither deducting the clean technology investment tax credit nor the clean electricity investment tax credit, no other person has deducted any clean economy tax credit in respect of the property, and Partner A does not have a capital cost in the property.

Partner A's share of the partnership's clean technology investment tax credit is $3,000 (which is 50 % of $6,000), regardless of Partner B.

The share of Partner A's clean electricity investment tax credit of the partnership that it may obtain under subsection 127.491(2) would be determined in a similar manner under subsection 127.491(13). With a specified percentage of 15%, the clean electricity investment tax credit at the partnership level would be $3,000, and Partner A's share of it would be $1,500.

Partner A can decide which of the $3,000 clean technology investment tax credit or the $1,500 clean electricity investment tax credit it wants to claim, regardless of which investment tax credit Partner B decides to claim. Partner A would choose the higher amount, unless Partner A is in fact ineligible for the clean technology investment tax credit.

Under subsection 127.47(6), the partnership will be deemed to have received the amount of the investment tax credit claimed by Partner A at the end of fiscal period 2 for the purposes of subsection 13(7.1).

Partner B

Similarly, the amount that Partner B may obtain under subsection 127.45(2) or under subsection 127.491(2) for year 2 is $3,000 and $1,500 respectively.

Depending on Partner B's eligibility for each credit, Partner B can claim the $3,000 clean technology investment tax credit or the $1,500 clean electricity investment tax credit, regardless of which investment tax credit Partner A claims.

Under subsection 127.47(6), the partnership will be deemed to have received the amount of the investment tax credit claimed by Partner B at the end of fiscal period 2 for the purposes of subsection 13(7.1).

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

Clause 4

Partnerships

ITA
211.92(12)

When a member of a partnership has claimed CCUS investment tax credits in respect of a project allocated to it by the partnership applying subsection 127.44(11), subsection 211.92(12) provides, in general terms, that amounts under Part XII.7 are to be determined in respect of the partnership as if it were a taxable Canadian corporation (with a taxation year rather than a fiscal period) and as if the deemed corporation had claimed all the CCUS investment tax credits that were claimed by any member of the partnership. Subsection (12) is amended, for greater certainty, to clarify that it applies if a current or former member of the partnership has ever claimed a CCUS investment tax credit.

This amendment applies on or after January 1, 2022.

Joint, several and solidary liability

ITA
211.92(15) and (16)

Subsection 211.92(15) creates joint and several liability (common law concept) and solidary liability (civil law concept) for partnership members for any tax determined because of subsection 211.92(12) in respect of the partnership, except to the extent that the tax has been paid by a taxable Canadian corporation that elected under subsection 211.92(14), or has been allocated to a member of the partnership and added to their tax payable under subsection 211.92(13). Subsection 211.92(15) is amended to refer to both current and former members of the partnership.

New subsection 211.92(16) limits any liability of a former partner to the former's partner's total CCUS investment tax credit determined because of their membership in the partnership.

This amendment applies on or after January 1, 2022.

Clause 5

Clean economy tax credits

ITA
241(3.41)

Section 241 prohibits the use or communication of taxpayer information by any official or other representative of the government, except as authorized. Subsection 241(3.41) provides authority to the Minister of National Revenue and the Minister of Finance to publish certain taxpayer information that reasonably relates to the claimants or recipients of a “clean economy tax credit” (as defined in subsection 127.47(1)). The information includes:

- the name of any corporation or trust that claimed or received a clean economy tax credit, as well as the name of any partnership in respect of which the corporation or trust claimed or received the tax credit as a member of the partnership or as a deemed member thereof under subsection 127.47(7),
- the specific clean economy tax credit, and
- the period for which the clean economy tax credit pertains to.

Subsection 241(3.41) is amended to also allow the disclosure of the amount of the tax credit claimed or received and the province where the relevant property is located.

This amendment comes into force on royal assent.

Where taxpayer information may be disclosed

ITA
241(4)(d)(vi.1)

Subparagraph 241(4)(d)(vi.1) permits the communication of taxpayer information to the Department of Natural Resources solely for the purpose of determining whether property is prescribed energy conservation property or whether an outlay or expense is a Canadian renewable and conservation expense.

Subparagraph 241(4)(d)(vi.1) is amended to allow the communication of taxpayer information solely for the purposes of determining whether a property is a “clean electricity property” or a “qualified natural gas energy equipment”, or whether a system is a “qualified natural gas energy system”, as those expressions are defined in subsection 127.491(1).

The sharing of this information, and the technical advice of the Department of Natural Resources, will assist the Minister of National Revenue in administering the above-noted benefit programs.

This amendment applies on or after April 16, 2024.

ITA
241(4)(d)(vi.2)

Paragraph 241(4)(d) authorizes the communication of information obtained under the Act to specific persons for specific purposes.

Subparagraph 241(4)(d)(vi.2) permits the communication of taxpayer information to a person employed or engaged in the service of an office or agency of the Government of Canada (e.g., Canada Revenue Agency, Natural Resources Canada and Environment and Climate Change Canada) solely for the purpose of administering or enforcing the clean economy tax credits or the evaluation or formulation of related policies or guidelines.

This subparagraph is amended to add a reference to new section 127.491, consequential to the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 6

ITR
1104(15)

Generally, subsection 1104(14) provides that certain property (which is part of a system that was operated at a time within the parameters set out in paragraph (c) of Class 43.1 (30% CCA rate)) will continue to be considered to operate during a period of a deficiency, failing or shutdown of the system that is beyond the control of the taxpayer. In such circumstances, the taxpayer is required to make all reasonable efforts to rectify the difficulty causing the deficiency, failing or shutdown within a reasonable period of time.

Subsection 1104(15) was introduced to address cases where a taxpayer’s system is not operating in the manner required under Class 43.1 because of a deficiency, failing or shutdown of the property of another person or partnership. Pursuant to paragraph (b), the subsection only applies to property of another person or partnership if the property utilizes steam obtained from the taxpayer’s system primarily in an industrial process (other than the generation of electrical energy).

Paragraph (b) is amended to apply to property of another person or partnership that utilizes heat obtained from the taxpayer’s system, broadening the application of subsection 1104(15). In addition to steam, paragraph (b) will apply to property that utilizes other methods of transferring heat. Paragraph (b) will also no longer be restricted to cases where the heat is used in industrial processes.

This amendment applies on or after November 21, 2023.

ITR
1104(17)

Subsection 1104(17) requires environmental compliance in respect of certain properties before those properties can be included in Class 43.1 or 43.2 in Schedule II in the Regulations. The subsection applies to property that would otherwise be included in subparagraph (c)(i) of Class 43.1 and to property that is described in any of subparagraphs (d)(vii) to (ix), (xi), (xiii), (xiv), (xvi), (xvii), and (xix) to (xxii) of Class 43.1 or paragraph (a) of Class 43.2. Property is not in compliance unless, at the time the property becomes available for use by the taxpayer, the taxpayer has satisfied the requirements of all environmental laws, by-laws and regulations of Canada, a province or a municipality in Canada, or of a municipal or public body performing a function of government in Canada, applicable in respect of the property.

Subsection 1104(17) is amended to apply to all properties described in Class 43.1 or 43.2 and to apply only where there is substantial non-compliance with the requirements of any environmental laws, by-laws and regulations at the time the property become available for use. The general purpose of this amendment is to prevent the provision of incentives to support environmental objectives through the tax system in circumstances where laws for the protection of the environment are being disregarded or violated in significant ways and is aligned with similar requirements in respect of the clean technology and clean electricity investment tax credits (see related subsections 127.45(5.1) and 127.491(34)).

The significance of the infraction would have to be assessed based on the facts and circumstances and the objectives and purposes of the applicable laws, by-laws and regulations.

This amendment applies on or after November 21, 2023.

Other consequential amendments related to the Clean Electricity Investment Tax Credit

Clause 1

Investment tax credit

ITA
12(1)(t)

The amount deducted from tax in respect of an investment tax credit may reduce the tax basis of a related expenditure — that is, the undepreciated capital cost of depreciable property, the adjusted cost base of certain interests in a partnership or a trust, the amount of deductible scientific research expenditures, or the amount of Canadian exploration expenses. To the extent that such reductions in tax basis do not take place, paragraph 12(1)(t) requires the amount of any credit claimed to be included in the taxpayer’s income.

Paragraph 12(1)(t) is amended to reflect the introduction of the new clean electricity investment tax credit by adding a reference to new section 127.491 under which the new investment tax credit is provided. References are also added to new subparagraph 53(2)(c)(vi.5), which applies cost base reductions to partners claiming the new tax credit.

This amendment applies on or after April 16, 2024.

Clause 2

Deemed capital cost of certain property

ITA
13(7.1)

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

Subsection 13(7.1) provides for reductions in the capital cost of a depreciable property equal to the amounts of deducted investment tax credits and certain other assistance from government in respect of the property, but does not apply to amounts described in paragraph (a), (b) or (b.1).

Subsection (7.1) is amended by adding a reference to new section 127.491 in the preamble and in paragraph (e). These amendments are consequential to the introduction of the new clean electricity investment tax credit under section 127.491.

This amendment applies on or after April 16, 2024.

Definitions

ITA
13(21)

"undepreciated capital cost"

Element I of the definition "undepreciated capital cost" (UCC) reduces the UCC of the depreciable property of a class by the amount of any investment tax credit claimed in respect of a property which was in the class in the year where that tax credit was claimed subsequent to the disposition of the property. Because an investment tax credit claim reduces the balance of the class and may cause it to become negative, thereby giving rise to an income inclusion for a year which, in turn, may affect the amount of the investment tax credit which can be claimed, this calculation can become circular where the credit reduces UCC in the same year as that in which the tax credit is claimed. Accordingly, a reduction of the UCC of the class is required only for taxation years following the year in which a related investment tax credit is claimed.

Element I of the definition is amended by adding a reference to new subsection 127.491(11) consequential to the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Loss restriction event

ITA
13(24)(a)

Subsection 13(24) is a special rule that applies where a corporation or partnership of which a corporation is a majority interest partner has acquired a depreciable property within the 12-month period ending immediately before a change of control of the corporation and the property was not used, or acquired for use, in a business carried on before that period. Under this rule, the capital cost of property acquired in the 12-month period is not included in computing undepreciated capital cost until after the change of control. Also, for the purposes of the investment tax credit and refundable investment tax credit rules in sections 127, 127.1, 127.44, 127.45, 127.48 and 127.49, the property will be considered not to have been acquired until after the change of control.

Where the property was disposed of and not reacquired before the change of control, the property is treated for capital cost allowance purposes as having been acquired immediately before the disposition. The purpose of this special rule is to prevent the transfer of depreciable property in contemplation of a change of control in order to reduce taxable income where the person acquiring control would not themselves be in a position to use the capital cost allowance or investment tax credit on the property.

Paragraph 13(24)(a) is amended to add a reference to new section 127.491 consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 3

Definitions

ITA
18.2(1)

“adjusted taxable income”

A taxpayer’s adjusted taxable income is a measure of its earnings before interest, taxes, depreciation and amortization and is determined based on tax, rather than accounting, concepts. It is relevant to the excessive interest and financing expense limitation rules.

Paragraph (l) of Variable B includes in adjusted taxable income an amount deducted under subsection 127(5) or (6), 127.44(3), 127.45(6), 127.48(3) and 127.49(6) that was not included in income under paragraph 12(1)(t) and was not included in calculating adjusted taxable income for a preceding year, to the extent that the amount is included in an amount determined under paragraph 13(7.1)(e), subparagraphs 53(2)(c)(vi) to (c)(vi.4) or (h)(ii), or for I in the definition “undepreciated capital cost” in subsection 13(21).

Paragraph (l) of Variable B is amended to add a reference to subsection 127.491(11) and subparagraph 53(2)(c)(vi.5), consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 4

Adjustment to cost base

ITA
53(1)(e)(xiii)

Subparagraph 53(1)(e)(xiii) provides additions to the adjusted cost base of a taxpayer's partnership interest where investment tax credits have been recaptured (added to the taxpayer's tax otherwise payable) as required by subsection 127(30) or 127.45(17), section 127.48, subsection 127.49(17) or section 211.92. Where an investment tax credit is recaptured, the adjusted cost base of a partnership interest is increased to reflect the amount recaptured.

Subparagraph 53(1)(e)(xiii) is amended to add a reference to section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Amounts to be deducted

ITA
53(2)(c)

Paragraph 53(2)(c) provides for certain amounts that must be deducted in computing the adjusted cost base to a taxpayer of a partnership interest.

New subparagraph 53(2)(c)(vi.5) is added to the paragraph to require that a deduction be made for that part of a clean electricity investment tax credit claimed by a taxpayer pursuant to subsection 127.491(11) which can reasonably be attributed to the taxpayer's share of a partnership's clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 5

Resource expenses of limited partner

ITA
66.8(1)(a)(ii)(B)(I)

Subsection 66.8(1) provides for the reduction of a taxpayer's share of a partnership's resource expenditures incurred in a fiscal period in certain cases where the taxpayer's share of such resource expenditures exceeds the taxpayer's "at-risk amount" at the end of the fiscal period in respect of the partnership.

Subclause 66.8(1)(a)(ii)(B)(I) provides a further adjustment in respect of the amount required by subsection 127(8), 127.44(11), 127.45(8), 127.48(12) and 127.49(8) in respect of the partnership to be added in computing the investment tax credit of the taxpayer in respect of the fiscal period. The result is that investment tax credits are subtracted from the "at-risk amount" in making the determination in subsection 66.8(1).

This subclause is amended to adjust for amounts required by subsection 127.491(13) in respect of the partnership to be added in computing the clean electricity investment tax credit of the taxpayer in respect of the fiscal period.

This amendment applies on or after April 16, 2024.

Clause 6

Certain investment tax credits

ITA
87(2)(qq.1)

Paragraph 87(2)(qq.1) treats the corporation formed on an amalgamation as the same corporation as, and a continuation of, each of its predecessors, for the purposes of computing the corporation's clean economy investment tax credits.

This paragraph is amended to provide the same treatment for the purposes of new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 7

Winding-up

ITA
88(1)(e.31)

Subsection 88(1)(e.3) allows the flow-through of investment tax credits for the purposes of sections 127.44, 127.45, 127.48 and 127.49 and Part XII.7 to a parent corporation on a wind-up of the subsidiary. A parent corporation could be subject to recapture or recovery of these investment tax credits.

Paragraph 88(1)(e.31) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Winding-up of Canadian corporation

ITA
88(2)(c)

Subsection 88(2) applies to a winding-up of a Canadian corporation to which subsection 88(1) does not apply.

Paragraph 88(2)(c) provides that paragraph 12(1)(t), which generally requires investment tax credits claimed in a preceding taxation year to be included in computing a taxpayer's income to the extent that they have not been applied to reduce certain related expenditures or amounts, may also apply in respect of investment tax credits claimed by the corporation in the year in which all or substantially all of its property is distributed on a winding-up.

Paragraph 88(2)(c) is amended to reflect the introduction of the new clean electricity investment tax credit by adding a reference to new subsection 127.491(11). References are also added to new subparagraph 53(2)(c)(vi.5), which apply cost base reductions to partners claiming the new investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 8

Limited partnership losses

ITA
96(2.1)(b)(ii)

Subsection 96(2.1) deals with the losses of limited partnerships. This subsection generally limits the deduction by a limited partner of losses to the extent of the limited partner's "at-risk amount" in respect of a partnership at the end of the fiscal period of the partnership ending in that year.

Subparagraph 96(2.1)(b)(ii) further limits the deduction of limited partner losses, beyond the "at-risk amount" limitation, by the amount of investment tax credits required to be added by subsection 127(8), the amount of CCUS tax credits required to be added by subsection 127.44(11), the amount of clean technology investment tax credits required to be added by subsection 127.45(8), the amount of clean hydrogen tax credits required to be added by subsection 127.48(12) and the amount of CTM investment tax credits required to be added by subsection 127.49(8).

This subparagraph is amended to reduce limited partnership losses by the amount required to be added by new subsection 127.491(13) in respect of the new clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

At-risk amount

ITA
96(2.2)

Subsection 96(2.2) defines the “at-risk amount” of a limited partner for the purposes of determining deductible losses and tax credits allocated to the partner.

Subsection 96(2.2) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Limited partner

ITA
96(2.4)

Subsection 96(2.4) provides an extended definition of “limited partner” for the purpose of applying the limited partnership at-risk rules in subsection 96(2.2).

Subsection 96(2.4) is amended to add a reference to new section 127.491, consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 9

Losses deductible

ITA
111(1)(e)(ii)(A)

Paragraph 111(1)(e) contains rules for carryforwards of limited partnership losses.

In general, limited partnership losses may not exceed a limited partner’s at-risk amount, and the amounts that are required to be included in computing the tax credits of the taxpayer for the taxation year under the following rules:

- subsection 127(8) (investment tax credit of a partnership),

- subsection 127.44(11) (CCUS tax credit of a partnership),
- subsection 127.45(8) (clean technology investment tax credit of a partnership),
- subsection 127.48(12) (clean hydrogen tax credit of a partnership), and
- subsection 127.49(8) (CTM investment tax credit of a partnership).

Clause 111(1)(e)(ii)(A) is amended to add a reference to new subsection 127.491(13), consequential on the introduction of the clean electricity investment tax credit. The effect of this amendment is to reduce losses available to a limited partner by the limited partner's share of a clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 10

Definitions

ITA
127(9)

"government assistance"

The definition "government assistance" in subsection 127(9) is relevant for various provisions in section 127 that require the investment tax credit to be calculated by reference to the cost of property or the amount of an expenditure made net of any grant, inducement or other assistance received in respect of the cost of the property or the expenditure. The definition is also relevant for the purposes of the clean economy tax credits in sections 127.44, 127.45, 127.48 and 127.49.

The definition is amended to exclude the clean electricity investment tax credit in section 127.491. This amendment is intended to ensure that the investment tax credits under section 127 (such as the Atlantic investment tax credit) and the clean electricity investment tax credit are not reduced by amounts received under the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 11

Assessment

ITA
152(1)(b)

Section 152 contains rules relating to assessments and reassessments of tax, interest and penalties payable by a taxpayer. Subsection 152(1) lists certain refunds and deemed payments on account of tax that are to be determined in the course of assessment of tax.

Paragraph 152(1)(b) is amended to add a reference to new subsection 127.491(2), consequential on the introduction of the new refundable clean electricity investment tax credit under section 127.491. In general terms, subsection 127.491(2) deems an amount equal to the clean electricity investment tax credit to have been paid on account of tax payable by a qualifying entity.

This amendment applies on or after April 16, 2024.

Assessment and reassessment

ITA
152(4)(b.95)

New subsection 127.491(26) and (27) require taxpayers and partnerships that could trigger transactions or events described in subsections 127.491(17) and (18), (24) and (25) or (28) to (32), to notify the Minister in prescribed form and manner.

- Notice must be filed by a qualifying entity for a recapture event that occurred in the year, on or before the entity's filing-due date for the year.
- Notice must be filed by a partnership, for a recapture event that occurred during its fiscal period, on or before the day when a return is required by section 229 of the Regulations to be filed in respect of the period.

Subsection 152(4) is amended to add new paragraph 152(4)(b.95), which allows the Minister to reassess a taxpayer outside the normal reassessment period when either the qualifying entity has failed to notify the Minister in prescribed form and manner, or a partnership of which the entity is a member has failed to notify the Minister in prescribed form and manner, of a transaction or event described in the subsections mentioned above.

When this new paragraph applies, the Minister may reassess the qualifying entity within four years (in the case of a corporation other than a Canadian-controlled private corporation) or three years (in any other case) from the date the form is filed. The Minister's ability to reassess under this paragraph is limited to reassessments related to the application of the recapture rules of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Extended period of assessment

ITA
152(4.01)(b)

Subsection 152(4.01) limits the matters in respect of which the Minister can reassess when a reassessment to which paragraph 152(4)(a), (b), (b.1) or (b.5) to (c) applies is made beyond the normal reassessment period for a taxpayer in respect of a taxation year.

Consequential on the addition of paragraph 152(4)(b.95), subparagraph 152(4.01)(b)(xv) is added with a reference to that paragraph. As such, a reassessment for a taxation year, made by the Minister after the normal reassessment period as a result of paragraph 152(4)(b.95), is limited to the recapture of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 12

Reduced instalments

ITA
157(3)(e)

Section 157 requires a corporation to pay instalments of its total tax payable under Parts I, I.3, VI, VI.1 and XIII.1 of the Act. Paragraph 157(3)(e) allows a corporation to reduce its monthly installments by certain refundable amounts under the Act.

Paragraph 157(3)(e) is amended to add a reference to new subsection 127.491(2), consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Amount of payment — three-month period

ITA
157(3.1)(c)

Subsection 157(1.1) allows small Canadian-controlled private corporations that meet certain conditions to pay their annual tax liability by quarterly instalments instead of monthly.

Subsection 157(3.1) allows these corporations to reduce each quarterly instalment by 1/4 of the amount of certain tax refunds. Paragraphs 157(3.1)(b) and (c) list these tax refunds.

Paragraph 157(3.1)(c) is amended to add a reference to new subsection 127.491(2), consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Clause 13

False statements or omissions

ITA
163(2)(d.1)

Subsection 163(2) imposes a penalty where a taxpayer knowingly, or in circumstances amounting to gross negligence, participates in or makes a false statement or omission for the purposes of the Act.

Paragraph 163(2)(d.1) is amended to apply where false information is provided in respect of an amount claimed under new subsection 127.491(2) (the clean electricity investment tax credit).

This amendment applies on or after April 16, 2024.

Clause 14

Exception

ITA

220(2.2)

Subsection 220(2.2) provides that the Minister's discretion to waive a requirement to file a prescribed form, receipt or other document, or to provide prescribed information, does not extend to such items filed on or after the day specified for the purposes of subsection 37(11), paragraph (m) of the definition "investment tax credit" in subsection 127(9), or subsection 127.44(17), 127.45(3), 127.48(4) or 127.49(3).

Subsection 220(2.2) is amended to extend the restriction on Ministerial discretion to waive filing requirements by adding a reference to new subsection 127.491(7), consequential on the introduction of the clean electricity investment tax credit.

This amendment applies on or after April 16, 2024.

Withholding for Non-Resident Service Providers

Clause 1

ITA
153(8)

Paragraph 153(1)(g) of the Act, together with subsections 105(1) and (2) of the Regulations, requires a person who pays a non-resident for services provided in Canada to withhold 15 per cent of the payment and remit it to the Canada Revenue Agency (CRA). This acts as a pre-payment of any Canadian tax that the non-resident may ultimately owe.

Non-residents that carry on a business in Canada are generally subject to Canadian tax on the income they earn from the business. However, many non-resident service providers do not ultimately owe Canadian tax either because a treaty exemption applies (e.g. they do not have a permanent establishment in Canada) or because the service is international shipping or operating an aircraft in international traffic, both of which are generally exempt from Canadian income tax. Although subsection 153(1.1) allows the CRA to waive the withholding requirement in advance if the non-resident can demonstrate that the amount to be withheld would exceed their ultimate Canadian tax liability, these waivers are only granted on a transaction-by-transaction basis, which can be inefficient.

To improve efficiency, new subsection 153(8) is added. It will allow the CRA to waive the withholding requirement, over a specified period, for payments to a non-resident service provider if either of the following conditions are met (as well as any other conditions that the Minister of National Revenue may specify):

- the payments are income of a treaty-protected business of the non-resident, (meaning that the non-resident would not be subject to Canadian income tax in respect of the payments because of a treaty between its country of residence and Canada); or
- the income from providing the services is exempt under paragraph 81(1)(c)(i.e., it is income from international shipping or from operating an aircraft in international traffic).

New subsection 153(8) comes into force on royal assent.

Substantive CCPCs

Clause 1

Definitions

ITA
89(1)

“capital dividend account”

The “capital dividend account” (CDA) is a mechanism intended to achieve integration by generally allowing amounts that have borne a sufficient level of tax at the corporate level to flow through a private corporation without attracting an extra level of tax. To the extent that a private corporation has a CDA balance, it may generally elect to treat dividends that it pays as capital dividends. Capital dividends may be received tax-free by the corporation’s shareholders. Consequential to changes to the definition of “relevant tax factor” (RTF), new paragraph (h) is added to the definition of CDA to address the integration of certain earnings of foreign affiliates as they are repatriated to and distributed by Canadian-controlled private corporations (CCPCs) and substantive CCPCs to their individual shareholders.

Under the current rules, amounts repatriated from foreign affiliates to CCPCs and distributed to individual shareholders are generally integrated through the system of deductions available for dividends received from foreign affiliates in section 113 and through the “general rate income pool” (defined in subsection 89(1), and from which CCPCs may distribute eligible dividends).

However, due to the new RTF for CCPCs and substantive CCPCs, the current rules would not effectively integrate such amounts.

To address integration, new paragraph (h) provides additions to the CDA of a CCPC or a substantive CCPC. The amount added to CDA approximates the portion of certain after-tax earnings repatriated to the corporation from its foreign affiliate to the extent such earnings had been subject to a notional tax rate of 52.63 per cent (represented by the new "relevant tax factor" of 1.9 applicable to such corporations). This addition to the CDA represents after-tax income that was subject to tax at a rate approximating the highest combined federal and provincial personal income tax rate and therefore, to achieve integration, should not be subject to additional Canadian income tax upon its distribution to the corporation's Canadian resident individual shareholders.

More specifically, new paragraph (h) provides additions to the CDA equal to the total of all amounts each of which is, if the corporation was a CCPC throughout the year or a substantive CCPC at any time in the year,

(i) an amount deductible under paragraph 113(1)(a.1) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate less the amount determined under sub-subclause 113(1)(a.1)(ii)(A)(II)1. in respect of the dividend (i.e. the non-taxable portion of hybrid surplus plus the after-tax amount of the taxable portion of hybrid surplus that was subject to sufficient foreign tax, as determined based on the RTF of 1.9, less any foreign withholding tax paid in respect of the dividend prescribed to have been paid out of hybrid surplus), and

(ii) the total of the amounts deductible under paragraphs 113(1)(b) and (c) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate if

- no election was made by the corporation for the particular taxation year under subsection 93.4(3) with respect to that amount, or
- an election was made under subsection 93.4(3), to the extent that the amount was determined under paragraph 93.4(3)(b) less the amount determined under clause 113(1)(c)(i)(A) in respect of the dividend (i.e. the after-tax amount of the taxable surplus that was subject to sufficient foreign tax, as determined based on the RTF of 1.9, plus the after-tax amount of withholding tax-sheltered amounts).

For amounts deductible under paragraphs 113(1)(b) and (c) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate where an election under subsection 93.4(3) has been made, the amounts determined under paragraph 93.4(3)(a) would have been subject to the higher RTF of 4 and would not have borne a sufficient level of tax at the corporate level to justify being included in a corporations' CDA; such amounts would thus instead be added to the corporation's general rate income pool.

These amendments apply to taxation years that begin on or after April 7, 2022.

For more information, see the commentary on the definition of "general rate income pool" in subsection 89(1), section 93.4 and the definition "relevant tax factor" in subsection 95(1).

Subparagraph (h)(i) of the definition is also amended to ensure the same treatment applies to repatriations of a foreign affiliate's successor hybrid surplus (representing certain capital gains realized post-June 24, 2024) by adding a reference to new paragraph 113(1)(a.2).

This amendment applies to dividends received after June 24, 2024.

"general rate income pool"

The definition "general rate income pool" (GRIP) in subsection 89(1) of the Act is relevant for determining the extent to which a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation can pay eligible dividends in any given taxation year. Generally, a corporation's GRIP reflects the amount of its after-tax income that was subject to tax at the general corporate tax rate.

Existing paragraph (b) of variable E of the definition adds to GRIP all amounts in respect of dividends received from foreign affiliates of the taxpayer to the extent those amounts are deductible under any provision of section 113. A number of amendments are made in respect to this paragraph.

First, paragraph (b) of variable E is amended consequential to the amendment to the definition "relevant tax factor" (RTF) in subsection 95(1) and the resulting adjustment to the determination of the deduction for inter-corporate dividends paid to a CCPC or a substantive CCPC from the hybrid surplus or taxable surplus of a foreign affiliate under subsection 113(1). More specifically, paragraph (b) of variable E is amended to remove from the GRIP of a CCPC an amount equal to the deductions claimed in respect of amounts deductible under paragraphs:

- 113(1)(a.1) (i.e. repatriations of a foreign affiliate's hybrid surplus (representing certain capital gains)),
- 113(1)(b) (i.e. repatriations of a foreign affiliate's taxable surplus), unless an election was filed with respect to the amount under subsection 93.4(3) and to the extent that the amount was determined under paragraph 93.4(3)(a) (in other words, the portion of an amount deductible under paragraph 113(1)(b) that was calculated using the RTF of 4 will remain in GRIP),
- 113(1)(c) (in respect of the payment of withholding tax to a foreign government on inter-corporate dividends received from a foreign affiliate prescribed to be paid out of taxable surplus) (unless an election was filed with respect to the amount under subsection 93.4(3) and to the extent that the amount was determined under paragraph 93.4(3)(a) (in other words, the portion of an amount deductible under 113(1)(c) that was calculated using the RTF of 4 will remain in GRIP)).

The integration of these amounts will now be addressed through the capital dividend account. For more information, see the commentary on the definition "capital dividend account" in subsection 89(1), section 93.4, and the definition "relevant tax factor" in subsection 95(1).

Second, the amount that can be added to a deposit insurance corporation's GRIP with respect to amounts deductible under section 113 is modified to better represent the amount of the after-tax earnings repatriated to the corporation from a foreign affiliate. This is accomplished by removing the amount of foreign withholding tax paid with respect to the dividend from the amount that is added to GRIP under variable E of the definition. This amendment more accurately reflects the after-tax amount determined under the general corporate rate and that remains on hand for distribution.

These amendments apply to taxation years that begin on or after April 7, 2022.

Third, paragraph (b) of variable E is amended to exclude amounts deductible under paragraph 113(1)(d) or subsection 113(2), both of which represent *de facto* returns of capital rather than true dividends.

This amendment applies to taxation years that begin on or after August 9, 2022.

Lastly, clause (b)(ii)(B) of variable E is amended to ensure that amounts deducted under paragraph 113(1)(a.2) (representing repatriations of a foreign affiliate's successor hybrid surplus, which includes certain capital gains realized post-June 24, 2024) are also excluded from GRIP. Similar to amounts deducted under paragraph 113(1)(a.1), the integration of these amounts will now be addressed through the capital dividend account.

For more information, see the commentary on the definition "capital dividend account" in subsection 89(1).

This amendment applies to dividends received after June 24, 2024.

Clause 2

Specified provisions for subsection (1)

ITA
93.1(1.1)

Where a Canadian-resident corporation owns shares of a non-resident corporation through a partnership, subsection 93.1(1) applies in determining whether the non-resident corporation is a foreign affiliate of the Canadian-resident corporation for the purposes of certain provisions of the Act and Regulations. In those circumstances, subsection 93.1(1) provides a look-through rule that deems the Canadian corporation to own its proportionate number of the non-resident corporation's shares based on the relative fair market value of its interest in the partnership. The rule also applies where a foreign affiliate of the Canadian corporation owns shares of another non-resident corporation through a partnership.

Subsection 93.1(1.1) lists the purposes for which the look-through rule in subsection 93.1(1) applies. Paragraph 93.1(1.1)(a) is amended by adding a reference to section

93.4 (other than subsection 93.4(2)) to ensure that foreign affiliate status can flow through a partnership for the purposes of the new elective relieving regime with respect to foreign accrual business income earned by an affiliate.

This amendment generally applies to taxation years that begin after 2024. However, as section 93.4 applies to earlier taxation years where an election is filed under subsection 93.4(4) or (5), the amendments to subsection 93.1(1.1) apply to earlier taxation years where an election is filed under subsection 93.4(4) or (5) . For more information, see the commentary on those subsections.

Clause 3

Foreign accrual business income

ITA
93.4

Overview

Neutrality is a fundamental principle of Canadian tax policy. The Canadian income tax system aims to achieve neutrality by ensuring that income earned through a corporation is taxed at roughly the same rate as income that is earned directly by a Canadian resident individual. This objective is commonly referred to as integration.

To encourage business investment and growth, the business income of a corporation is subject to a low rate of tax in the corporation and is integrated only once dividends are paid out to shareholders. In contrast, the “aggregate investment income” (AII) of Canadian-controlled private corporations (CCPCs) and substantive CCPCs (SCCPCs) is subject to additional refundable tax that approximates the highest marginal tax rate payable by Canadian resident individuals. This ensures no tax deferral advantage can be obtained by Canadian resident individuals earning their investment income through a holding corporation rather than directly. This refundable tax forms part of a system of rules that link the taxation of income earned by corporations and their individual shareholders to achieve integration. The foreign accrual property income (FAPI) rules are a component of the system of integration.

Very generally, the FAPI rules aim to prevent Canadian taxpayers from gaining a tax deferral advantage from earning investment income and certain other types of highly-mobile income through controlled foreign affiliates (i.e., generally, a non-resident corporation in which the taxpayer has a controlling interest). The rules do this by requiring a Canadian shareholder to include in its income for a taxation year its participating share of any controlled foreign affiliate’s FAPI for the year on an accrual basis under subsection 91(1), regardless of whether such amounts are distributed to the Canadian shareholder. If the Canadian shareholder is a CCPC or SCCPC, any FAPI amounts included under subsection 91(1) minus any deductions claimed under subsection 91(4) for the year are included in AII and subject to the same additional refundable tax described above.

To prevent double taxation, a “foreign accrual tax” (FAT) deduction is available under subsection 91(4) in respect of foreign taxes paid on FAPI that is included in a Canadian shareholder’s income under subsection 91(1). The deductible amount is determined by grossing up the foreign taxes paid by the “relevant tax factor” (RTF), which is defined in subsection 95(1). The RTF definition is being amended to subject CCPCs, SCCPCs and certain partnerships to an RTF of 1.9, instead of the RTF of 4 that previously applied, in order to more accurately reflect the corporate tax rate (approximating the highest personal income tax bracket) that would otherwise apply to investment income earned directly by a CCPC or a SCCPC. Prior to the amendment, FAT of $25 on FAPI of $100 was sufficient to eliminate any FAPI inclusion. With the new RTF of 1.9, each dollar of FAT now provides CCPCs, SCCPCs and certain partnerships with approximately half of the tax shelter it previously provided.

To account for the fact that FAPI, as defined in subsection 95(1), includes certain types of income that are not included in AII when earned directly by a CCPC or SCCPC in Canada, section 93.4 is introduced to provide an elective relieving regime that allows CCPCs and substantive CCPCs to preserve the higher RTF of 4 on amounts included under the new definitions “foreign accrual business income” (FABI) and “FABI surplus” contained in subsection 93.4(1). This elective regime is intended to improve integration by aligning the treatment of these amounts under the domestic and foreign anti-deferral regimes.

FABI and FABI surplus

Very generally, the FABI of a foreign affiliate for a taxation year consists of:

- Income that is recharacterized as “income from a business other than an active business” of the affiliate under subparagraph 95(2)(b)(i), where certain conditions are met; and
- Income from an investment business of the affiliate that is the development of real property or immovables for sale, or the leasing of real property or immovables, where there are more than five full time employees employed by the affiliate or another member of the corporate group in the active conduct of the business.

A foreign affiliate’s FABI surplus is the amount that would be the affiliate’s taxable surplus if it was limited to:

- The foreign affiliate’s FABI;
- Dividends received out of another affiliate’s FABI surplus, less dividends paid out of the affiliate’s own FABI surplus; and
- The active business earnings of the affiliate that are not FAPI but are included in its taxable surplus.

For more information, see the commentary on those definitions in subsection 93.4(1).

New elections

New section 93.4 provides CCPCs, SCCPCs and partnerships all the member of which (other than non-resident persons) are corporations in the year with two new relieving elections:

- An election under subsection 93.4(2) to use the RTF of 4 in calculating a deduction under subsection 91(4) in respect of FAT that can reasonably be regarded as attributable to the FABI of a controlled foreign affiliate; and
- An election under subsection 93.4(3) to use the RTF of 4 in calculating a deduction under paragraphs 113(1)(b) and (c) on the portion of any dividend that is considered to be paid out of a foreign affiliate's FABI surplus.

The new election under subsection 93.4(2) ensures that any FAPI income inclusion under subsection 91(1) that may reasonably be regarded as attributable to FABI will be completely offset by a deduction under subsection 91(4) where the tax rate of the foreign tax that may reasonably be regarded as attributable to FABI is equal to or exceeds 25 per cent. Similarly, the election under subsection 93.4(3) results in a deduction under subsection 113(1) that completely offsets a dividend received from an affiliate where the rate of foreign taxes imposed on the underlying income included in the FABI surplus is equal to or exceeds 25%. Each of these relieving elections allows Canadian shareholders to apply the RTF of 4, which more accurately reflects the combined federal and provincial corporate tax rate that would have applied had the FABI or the income included in FABI surplus been earned by the Canadian shareholder directly.

Consequential amendments are also made to the definitions "capital dividend account" and "general rate income pool" in subsection 89(1) to ensure proper treatment of FABI and non-FABI amounts when they are earned by a foreign affiliate and repatriated to the Canadian corporation, and to the definition "income" or "loss" in subsection 129(4) to ensure that the portion of an amount included in a corporation's income under subsection 91(1) (or deducted under subsection 91(4)) that can reasonably be considered to be attributable to the FABI of a controlled foreign affiliate is disregarded in determining the AII of a CCPC or SCCPC. For more information, see the commentary on the definitions "capital dividend account" and "general rate income pool" in subsection 89(1) and the definition "income" or "loss" in subsection 129(4).

Pre-2025 taxation years

New subsections 93.4(4) and (5) generally aim to extend the same treatment as described above with respect to amounts that would be included in FABI or FABI surplus, as the case may be, where such amounts arise in a taxation year that ends before the taxpayer's first taxation year beginning after 2024 and an election is made on or before the filing-due date for the taxpayer's first taxation year beginning after 2024.

Other amendments

To facilitate the application of certain deeming rules applicable in respect of partnerships that hold shares in a foreign affiliate, references to certain provisions in section 93.4 are added to paragraph 93.1(1.1)(a). Further, to allow late-filed elections under subsections 93.4(2) and (3) in certain circumstances, paragraph 600(b) of the Regulations is also amended to add references to those subsections. For more information, see the commentary on subsection 93.1(1.1) and on section 600 of the Regulations.

Effective date

Section 93.4 generally applies to taxation years that begin after 2024. However, section 93.4 also applies to earlier taxation years where an election is filed under subsection 93.4(4) or (5). For more information, see the commentary on those subsections.

Definitions

ITA
93.4(1)

“FABI surplus”

The definition “FABI surplus” in new subsection 93.4(1) is relevant where a taxpayer elects under new subsection 93.4(3), in determining the deductions available to a corporation resident in Canada under paragraphs 113(1)(b) and (c) in respect of foreign taxes paid on the earnings of a foreign affiliate when distributed to the corporation out of the affiliate’s taxable surplus.

This definition draws on the existing definition “taxable surplus” but adapts the amounts included in that definition to limit it to the following items:

- the subject affiliate’s FABI;
- dividends received out of another affiliate’s FABI surplus, less dividends paid out of the affiliate’s own FABI surplus; and
- the subject affiliate’s net earnings or net loss from an active business carried on by it in a country.

Paragraph (a) of the definition includes in the subject affiliate’s FABI surplus any inter-affiliate dividends received by the subject affiliate that are paid out of the payor affiliate’s FABI surplus. Specifically, it includes the lesser of:

- the portion of any dividend included in the subject affiliate’s taxable surplus under subparagraph (iii) of the description of A of the definition “taxable surplus” in subsection 5907(1) of the Regulations; and
- the proportion of the payer affiliate’s FABI surplus at the time the dividend was paid that the dividend received is of the whole dividend referred to in paragraph 5900(1)(b) of the Regulations.

Paragraph (b) of the definition reduces the subject affiliate’s FABI surplus for any dividends paid by the subject affiliate out of its FAPI surplus and determines such amounts to be the lesser of:

- the portion of the whole dividend deemed under paragraph 5901(1)(b) of the Regulations to be paid out of the subject affiliate’s taxable surplus; and
- the subject affiliate’s FABI surplus at that time.

Paragraphs (a) and (b), in effect, each provide an ordering rule which treats amounts paid out of a foreign affiliate's taxable surplus as being paid out of its FABI surplus ahead of any taxable surplus other than FABI surplus.

Subparagraph (c)(i) of the definition provides that the computation of the subject affiliate's FABI surplus takes into consideration only two other categories of amounts. The first is amounts taken into consideration in computing its taxable surplus in respect of FAPI that can reasonably be considered to be attributable to its FABI in respect of which an election has been made under subsection 93.4(2). By referencing amounts "in respect of FAPI" that are taken into consideration in computing taxable surplus, this ensures a foreign affiliate's FABI surplus is reduced for income or profits tax applicable to such income and increased for any income or profits tax refunds that can be reasonably be regarded as tax refunded in respect of such a loss. In other words, it is necessary to re-determine the amounts under paragraph (b) of the definitions "net earnings" and "net loss", and under subparagraph (b)(ii) of the definitions "taxable earnings" and "taxable loss", in subsection 5907(1) of the Regulations on the basis that each of those paragraphs and subparagraphs referred only to the affiliate's FABI for the year.

Subparagraph (c)(ii) of the definition provides that the subject affiliate's FABI surplus includes its net earnings or net loss from an active business carried on by it in a country that are included in its taxable surplus. Notably, this ensures the FABI surplus of the subject affiliate is reduced for any income or profits tax paid in respect of such income and increased for any income or profits tax refunded to the affiliate that can be reasonably be regarded as tax refunded in respect of such a loss.

In certain situations, it is necessary to reset or establish (depending on the provision) the amount of a foreign affiliate's taxable surplus or taxable deficit under section 5905. The preamble of the definition "FABI surplus" requires a determination of the taxable surplus or deficit of the subject affiliate, which in turn requires a determination of the subject affiliate's opening taxable surplus or opening taxable deficit – factoring in only the items in paragraphs (a) to (c) of the "FABI surplus" definition. The opening taxable surplus or taxable deficit is then included under subparagraph (i) of the description of A or B, respectively, which feeds into the subject affiliate's FABI surplus. Similarly, any adjustments included in subparagraphs (iv) and (iv.1) of the description of A, and subparagraphs (v) and (vi) of the description of B, of the definition "taxable surplus" must be reasonably allocated between the affiliate's FABI surplus and taxable surplus amounts other than its FABI surplus. Paragraphs (a) to (c) of the "taxable surplus" definition remain unaltered for the purposes of the "FABI surplus" definition, meaning that the start and end dates for the period in respect of which a foreign affiliate's taxable surplus is being determined are the same as the dates applicable for determining its taxable surplus.

"foreign accrual business income"

The definition "foreign accrual business income" (or "FABI") in new subsection 93.4(1) is relevant when an election is made under new subsection 93.4(2). That relieving election provides an enhanced deduction under subsection 91(4) to a taxpayer that is CCPC, SCCPC or partnership, in respect of foreign taxes paid on the foreign accrual property income (FAPI) of a foreign affiliate of the taxpayer that is included in the taxpayer's income pursuant to subsection 91(1).

The FABI definition draws on the existing FAPI definition in subsection 95(1) but is limited to certain amounts included in FAPI that would not be AII if those amounts had instead been earned by a CCPC or SCCPC.

Paragraph (a) provides that any income from the provision of services or an undertaking to provide services that is deemed under subparagraph 95(2)(b)(i) to be from a separate business, other than an active business, carried on by the affiliate is included in computing the affiliate's FABI, provided the consideration paid or payable in consideration for those services (or that undertaking) is deductible in computing the income from an active business carried on in Canada by a taxpayer resident in Canada or the FABI of another affiliate. This requirement concerning the deductibility of the consideration ensures that these income amounts are excluded from AII only where they are not deductible against amounts that would otherwise have been included in AII.

Paragraph (b) provides that any income or loss from an investment business that is the development of real property or immovables for sale, or the leasing of real property or immovables, is included in computing the affiliate's FABI if the "more than five full time employee" test in the definition "investment business" in subsection 95(1) would otherwise be satisfied if that test were broadened to include employees performing services in Canada. This aims to better align the employee test in the definition "investment business" within the FAPI regime with the definition "specified investment business" in subsection 125(7) used for the domestic anti-deferral rules.

Just as a foreign affiliate's FAPI is relevant in computing its taxable surplus, a foreign affiliate's FABI is relevant in determining its FABI surplus. The inclusion of a foreign affiliate's FABI in its FABI surplus is provided in subparagraph (c)(i) of the definition "FABI surplus". For more information, see the commentary to that definition.

"underlying FABI surplus tax"

The definition "underlying FABI surplus tax" in new subsection 93.4(1) is relevant (along with the definition "FABI surplus") where a taxpayer elects under new subsection 93.4(3), in determining the deductions available to a corporation resident in Canada under paragraphs 113(1)(b) and (c) in respect of foreign taxes paid on the earnings of a foreign affiliate when distributed to the corporation out of the affiliate's taxable surplus.

This definition draws on the existing definition "underlying foreign tax" in subsection 5907(1) of the Regulations but includes only amounts that would be included in a foreign affiliate's underlying foreign tax if it were limited to amounts that can reasonably be regarded as applicable in respect of the affiliate's FABI surplus. Accordingly, in determining an affiliate's underlying FABI surplus tax for the purpose of determining the amount deductible under paragraph 113(1)(b), it is necessary to identify the income or profits tax paid to a government of a country by the affiliate that can reasonably be regarded as having been paid in respect of its FABI surplus and that was included in computing its underlying foreign tax. This could include, for example, the income or profits taxes paid on the affiliate's income earned in connection with the provision of services or its real estate development business, as well as withholding taxes paid by the affiliate on any FABI surplus dividends received by it from another foreign affiliate. Similarly, it is necessary to identify the income or profits tax refunded by a government of a country to the affiliate that can reasonably be regarded as having been refunded in respect of its FABI surplus. Further it is necessary to identify underlying foreign taxes applicable to dividends paid by the affiliate that can reasonably be regarded as underlying FABI surplus tax applicable in respect of dividends paid out of the subject affiliate's FABI surplus.

Where an election was previously made to disproportionately allocate underlying foreign tax to a taxable surplus dividend to increase the amount deductible in respect of the dividend under paragraph (b) of the definition "underlying foreign tax applicable" in subsection 5907(1) of the Regulations, it will be necessary to evaluate what portion of the underlying foreign tax applicable relates to underlying FABI surplus tax and determine the remaining underlying FABI surplus tax, if any, available for distributions after the disproportionate UFT election.

Example

Facts

1. *Canco is a Canadian-resident corporation that holds all of the issued and outstanding shares of CFA, a controlled foreign affiliate of Canco.*

2. *Canco elected in 2025 under subsection 93.4(4), with the result it is deemed to have timely made the election under subsection 93.4(2) for each of its taxation years that begin before April 7, 2022.*

3. *A portion of CFA's FAPI in some taxation years before 2020 can reasonably be considered to be attributable to FABI.*

4. *In 2020, CFA paid a dividend of $180, which was deemed to be paid out of its taxable surplus under paragraph 5901(1)(b) of the Regulations. At the time of the dividend payment, CFA's taxable surplus balance was $270 ($220 of which was reasonably considered to be in respect of FABI surplus and $50 of which was amounts other than its FABI surplus) and its underlying foreign tax was $30 ($23 of which was reasonably considered to be underlying FABI surplus tax while $7 was amounts other than its underlying FABI surplus tax).*

5. *Canco made an election to disproportionately allocate underlying foreign tax to the taxable surplus dividend to increase the amount deductible in respect of the dividend under paragraph (b) of the definition "underlying foreign tax applicable" in subsection 5907(1) of the Regulations. The elected amount was $25.*

Analysis

Under paragraph (b) of the definition "FABI surplus" in subsection 93.4(1), the dividend of $180 deemed to be paid out of CFA's taxable surplus is treated as having been paid entirely out of its FABI surplus.

Absent a disproportionate underlying foreign tax election, the underlying foreign tax applicable to the dividend in 2020 would be $20 and thus the underlying FABI surplus tax applicable to the dividend would also be $20. The disproportionate underlying foreign tax election resulted in an additional $5 of underlying foreign tax being applicable in respect of the dividend in 2020, and 100% of the dividend is considered to be paid out of the affiliate's FABI surplus. Thus, $3 of that additional $5 of underlying foreign tax applicable is considered underlying FABI surplus tax applicable.

Assuming there were no further increases or decreases to the affiliate's underlying foreign tax and underlying FABI surplus tax from 2020 to 2023, the affiliate's underlying foreign tax at the start of 2024 is $5, $0 of which is considered to be underlying FABI surplus tax.

Amounts deductible under subsection 91(4)

ITA
93.4(2)

New subsection 93.4(2) provides taxpayers with an election to use the RTF of 4 in calculating a deduction in respect of FAT under subsection 91(4) for a taxation year, to the extent that the FAT can reasonably be regarded as being attributable to the FABI of a controlled foreign affiliate. If a taxpayer so elects, any FAPI inclusion under subsection 91(1) for the taxation year that may reasonably be regarded as attributable to FABI will be completely offset by a deduction under subsection 91(4) where the tax rate of the foreign tax that may reasonably be regarded as attributable to FABI equals or exceeds 25 per cent.

Paragraph (a) sets out a requirement to compute two separate deductions under subsection 91(4) – one deduction for any portion of the "income amount" (as defined in subsection 91(4)) that may reasonably be regarded as attributable to the FABI of any controlled foreign affiliate (referred to as the "FABI amount"), and the other deduction for any portion of the income amount other than the FABI amount (referred to as the "excess amount"). The FABI amount reflects FABI of controlled foreign affiliates whose shares are owned by the taxpayer either directly or indirectly through other controlled foreign affiliates.

Paragraph (b) provides that in determining the amount deductible under subsection 91(4) in respect of any FABI amount, each reference to "income amount" in subsection 91(4) is to be read as a reference to the "FABI amount" and the RTF of 4 applies in determining that deduction. This more accurately reflects the combined federal and provincial corporate tax rate that would have applied to this type of income had the FABI been earned by the Canadian shareholder directly.

Paragraph (c) provides that in determining the amount deductible under subsection 91(4) for any excess amount, each reference to "income amount" in subsection 91(4) is to be read as a reference to the “excess amount”. The default RTF of 1.9 is used in determining the deduction under subsection 91(4) for any excess amount.

Consequential amendments are made to the definition “income” or “loss” in subsection 129(4) to ensure that the portion of an amount included in a taxpayer’s income under subsection 91(1) (or deducted under subsection 91(4)) that can reasonably be considered to be attributable to the FABI of a controlled foreign affiliate is disregarded in determining the AII of a CCPC or SCCPC.

As this election is made on an annual basis, in circumstances where a taxpayer has a FABI amount for the year that forms part of the FAPI imputed under subsection 91(1) but no deduction is being claimed under subsection 91(4) (e.g., where the foreign tax has not yet been paid), the taxpayer can nonetheless make an election in the year of the FAPI inclusion so that the FABI amount for the year is excluded from the AII of the CCPC or SCCPC. For more information, see the commentary to the definition “income” or “loss” in subsection 129(4).

Dividends received from foreign affiliates

ITA
93.4(3)

New subsection 93.4(3) provides taxpayers with an election to use the RTF of 4 in calculating a deduction under paragraphs 113(1)(b) or (c) in respect of the portion of any dividend paid out of the taxable surplus of a foreign affiliate that is considered to be paid out of the affiliate’s FABI surplus. If a taxpayer so elects, specific rules in paragraphs 93.4(3)(a) to (c) apply in determining the deductions under paragraphs 113(1)(b) and (c).

Paragraph (a) determines the portion, of the dividend prescribed to be paid out of a foreign affiliate’s taxable surplus, that is paid out of the affiliate’s FABI surplus (referred to as the “FABI surplus dividend”). This paragraph, in effect, provides an ordering rule ensuring that a foreign affiliate’s FABI surplus is distributed first, before taxable surplus amounts other than FABI surplus. For more information, see the commentary to the definition “FABI surplus” in subsection 93.4(1).

The overall aim of paragraph (b) is to allow for the RTF of 4 to be used to determine the deductions under paragraphs 113(1)(b) and (c) in respect of a FABI surplus dividend. It does so by modifying paragraphs 113(1)(b) and (c) and the RTF definition, as follows:

- Subparagraph (i) modifies the references in paragraphs 113(1)(b) and (c) to the taxable surplus portion of the dividend to refer solely to the FABI surplus dividend. This ensures that the limitations under subparagraphs 113(1)(b)(ii) and (c)(ii) are capped at the amount of the FABI surplus dividend. It also ensures that a deduction under paragraph 113(1)(c) in respect of the FABI surplus dividend is to be determined using only the non-business-income tax applicable to that portion of the dividend.
- Subparagraph (ii) provides that, in determining a deduction under paragraph 113(1)(b) in respect of a FABI surplus dividend, the amount prescribed to be the foreign tax

applicable (as set out in paragraph 5900(1)(b) of the Regulations) consists only of the affiliate's underlying FABI surplus tax.
- Subparagraph (iii) modifies to the reading of the RTF definition in subsection 95(1), to allow the RTF of 4 to apply for deductions under paragraphs 113(1)(b) and (c) in respect of FABI surplus dividends.

Under paragraph (c), the RTF of 1.9 is to be used for the portion of the taxable surplus dividend other than the affiliate's FABI surplus dividend. This is achieved by modifying paragraphs 113(1)(b) and (c), as follows:

- Subparagraph (i) modifies the references in paragraphs 113(1)(b) and (c) to the taxable surplus portion of the dividend to refer solely to the portion of the taxable surplus dividend other than the FABI surplus dividend. This ensures that the limitations under subparagraphs 113(1)(b)(ii) and (c)(ii) are capped at the portion of the taxable surplus dividend other than the FABI surplus dividend. It also provides that a deduction under paragraph 113(1)(c) in respect of the portion of the taxable surplus dividend other than the FABI surplus dividend is to be determined using only the non-business-income tax applicable to that portion of the dividend.
- Subparagraph (ii) provides that, in determining a deduction under paragraph 113(1)(b) in respect of the portion of the taxable surplus dividend other than the FABI surplus dividend, the amount prescribed to be the foreign tax applicable (as set out in paragraph 5900(1)(b) of the Regulations) consists only of underlying foreign tax amounts other than the affiliate's underlying FABI surplus tax.

Applying the RTF of 4 in determining the deductions under paragraphs 113(1)(b) and (c) for distributions of FABI surplus, and the RTF of 1.9 for the deductions in respect of distributions of taxable surplus amounts other than FABI surplus, more accurately reflects the combined federal and provincial corporate tax rate that would have applied to the earnings underlying each type of distribution had they been earned by the Canadian shareholder directly.

Consequential amendments are also made to the definitions of "capital dividend account" and "general rate income pool" to improve the integration of a foreign affiliate's earnings as they are distributed through a corporate chain to the ultimate Canadian individual shareholder. For more information, see the commentary on the definitions "capital dividend account" and "general rate income pool" in subsection 89(1) and the definition "relevant tax factor" in subsection 95(1).

Pre-2023 taxation years

ITA
93.4(4)

While new section 93.4 generally applies for taxation years beginning after 2024, there are circumstances where a taxpayer may wish to elect under subsection 93.4(2) for each of its taxation years that begin before April 7, 2022 (referred to as "pre-2023 taxation years"). A taxpayer will be deemed to have timely made elections for the pre-2023 taxation years if the taxpayer makes an election under subsection 93.4(4) in prescribed form and manner by the filing-due date for its first taxation year or fiscal period that begins after 2024.

This deemed election for pre-2023 taxation years is intended to deal with two circumstances. First, it addresses situations where a taxpayer included in computing its income its participating share of a controlled foreign affiliate's FAPI under subsection 91(1) for a taxation year beginning before April 7, 2022, and the FAPI may reasonably be regarded as attributable to FABI of the taxpayer's controlled foreign affiliates, but the FAT is paid in a taxation year that begins on or after that date. In that case, this election allows the taxpayer to be deemed to elect under subsection 93.4(2) in order to use the RTF of 4 in determining the amount deductible under subsection 91(4) in the taxation year when it paid the FAT for the portion of the FAPI that may reasonably be regarded as attributable to FABI included under subsection 91(1) for its taxation year beginning before April 7, 2022.

Second, this election also addresses situations where a foreign affiliate pays a dividend out of taxable surplus in a taxation year beginning on or after April 7, 2022, to a corporation that is a CCPC or a SCCPC, and the corporation wishes to apply the RTF of 4 in determining the amounts deductible under paragraphs 113(1)(b) and (c) in respect of the portion of the dividend that would be considered to be paid out of the affiliate's FABI surplus if the affiliate were able to earn FABI for taxation years beginning before April 7, 2022. This election causes the taxpayer to be deemed to elect under subsection 93.4(2) for the taxation years beginning before April 7, 2022, in order to satisfy the requirement under subparagraph (c)(i) of the definition "FABI surplus" in subsection 93.4(1). This results in the taxpayer being considered to earn FABI for those taxation years and thus accumulating FABI surplus, in respect of which the taxpayer can apply the RTF of 4 on distributions in taxation years beginning on or after April 7, 2024.

Pre-2025 taxation years

ITA
93.4(5)

Similar to the election in subsection 93.4(4), a taxpayer can elect under subsection 93.4(5) to have an election under subsection 93.4(2), and subsection (3) as applicable, deemed to have been timely made for each of its taxation years that begins after April 6, 2022 and before 2025. This election is required to be filed by the taxpayer in prescribed form and manner by its filing-due date for its first taxation year or fiscal period that begins after 2024.

The expression "as applicable" in the preamble of this subsection acknowledges that an election under subsection 93.4(3) is not relevant for a taxpayer that is a partnership given the deeming rule in subsection 93.1(2), which deems each member of a partnership to receive its proportionate share of a dividend received by the partnership from a foreign affiliate of the member. Therefore, an election under subsection 93.4(2) will be applicable for a taxpayer that is a CCPC, SCCPC or partnership all the members of which (other than non-resident persons) are corporations, whereas an election under subsection 93.4(3) will be applicable only for a taxpayer that is a CCPC or a SCCPC.

The election under in 93.4(5) is separate from the one in subsection 93.4(4), which applies to taxation years that begin before April 7, 2022, in recognition that taxpayers may wish to be deemed to make elections under subsections 93.4(2) for taxation years that begin before April 7, 2022, but not for taxation years beginning after that date and before 2025. For example, a taxpayer that is a CCPC or SCCPC may prefer not to make an election under subsection 93.4(5) if the amounts deducted by the taxpayer under paragraphs 113(1)(b) and (c) in respect of a dividend received from a foreign affiliate have already been included in computing its CDA and the taxpayer has paid a capital dividend in respect of such amounts. To avoid having to recalculate its CDA and the potential Part III tax applying in respect of excess capital dividend amounts, the taxpayer may in those cases decide not to make an election under subsection 93.4(5).

Clause 4

Definitions

ITA
95(1)

The definition "relevant tax factor" (RTF) in subsection 95(1) is used in determining the Canadian tax relief provided in respect of foreign taxes imposed on the earnings of a foreign affiliate of a taxpayer.

Relief for foreign tax paid, based on the taxpayer's RTF, is provided

- under subsection 91(4), in respect of foreign tax paid on FAPI of a controlled foreign affiliate that is included in the taxpayer's income pursuant to subsection 91(1), or
- under section 113, in respect of foreign tax paid on earnings of a foreign affiliate that are repatriated to a corporation resident in Canada.

The RTF can also indirectly affect the taxation of distributions paid to the ultimate Canadian resident individual shareholder of a corporation, since amounts deductible under section 113 are added to certain corporations' "general rate income pool" (which is relevant for determining the extent to which a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation can pay eligible dividends in any given taxation year).

The existing definition provides that the RTF for a corporation (or a partnership all the resident members of which are corporations) is the reciprocal of the basic corporate tax rate less the general rate reduction (i.e., 1/(0.38-0.13), or 4). The RTF for individuals and for other partnerships is 1.9.

The RTF definition is amended to generally subject CCPCs, substantive CCPCs and partnerships one or more members of which are CCPCs or substantive CCPCs to the RTF of 1.9. The RTF of 1.9 more accurately reflects the corporate tax rate (approximating the highest personal income tax bracket) that would otherwise apply to investment income earned by a CCPC or a substantive CCPC.

An elective relieving regime is also introduced in section 93.4 to allow CCPCs and substantive CCPCs to preserve the high RTF of 4 on certain types of income that are included in FAPI and/or taxable surplus and that would generally not have been subject to the high tax rate on investment income had they been earned domestically rather than through a foreign affiliate. For more information, see the commentary on new section 93.4 and the amended definition of “income” or “loss” in subsection 129(4).

Consequential amendments are also made to the definitions of “capital dividend account” and “general rate income pool” to improve the integration of a foreign affiliate’s earnings as they are distributed through a corporate chain to the ultimate Canadian individual shareholder.

The purpose of these amendments is to improve neutrality by further aligning the domestic and international anti-deferral regimes.

For more information, see the commentary on the definitions “capital dividend account” and “general rate income pool” in subsection 89(1), section 93.4 and the definition “income” or “loss” and “non-eligible refundable dividend tax on hand” in subsection 129(4).

These amendments apply to taxation years that begin on or after April 7, 2022.

Clause 5

Definitions

ITA
129(4)

The definitions “income” or “loss” in subsection 129(4) determine what income or loss from a source that is a property means for the purposes of determining a corporation’s “aggregate investment income” (AII) for a taxation year. AII is relevant in establishing the corporation’s surtax liability under section 123.3, the availability of the general rate reduction under section 123.4, and the “non-eligible refundable dividend tax on hand” balance.

Paragraph (b) of the definition “income” or “loss” provides that no account is to be taken of income or loss from a property that is incident to or pertains to an active business carried on by the corporation, or that is used or held by the corporation principally to gain or produce income from an active business.

Pursuant to the introduction of the new elective relief mechanism with respect to “foreign accrual business income” (FABI) earned by a controlled foreign affiliate of a Canadian corporation in section 93.4, paragraph (b) is amended and reorganized to ensure that, where an election under subsection 93.4(2) has been filed by the corporation or by a partnership of which the corporation is a member (or of which the corporation is deemed to be a member under subsection 93.1(3), which provides a look-through rule for tiered partnership structures), no account is to be taken of the portion of an amount included in a corporation’s income under subsection 91(1) (or deducted under subsection 91(4)) to the extent that it can reasonably be considered to be attributable to the FABI of a controlled foreign affiliate.

More specifically, new clause (b)(iii)(A) is meant to ensure that, where an election under subsection 93.4(2) has been made, the amount added to the "FABI amount" for the year under that subsection (*i.e.* the portion of the amount, if any, included in computing the taxpayer's income for the year under subsection 91(1) that may reasonably be regarded as attributable to the FABI of any controlled foreign affiliate) – which would generally not be included in AII had they been earned directly by the Canadian corporation – is not indirectly included in the corporation's AII through the foreign accrual property income (FAPI) regime. Similarly, new clause (iii)(B) aims to ensure that deductions claimed under subsection 91(4) in computing the corporation's income do not unduly reduce the corporation's AII if the deduction can reasonably be considered to be attributable to foreign accrual tax paid in respect of FABI.

In general terms, new subparagraph (b)(iii) seeks to disregard the portion of any income inclusion under subsection 91(1), or deduction under subsection 91(4), that can reasonably be considered to be attributable to the FABI of any controlled foreign affiliate of a corporation in computing a corporation's AII.

Example

<u>Facts</u>

Canco is a Canadian corporation which holds all of the issued and outstanding shares of CFA, a controlled foreign affiliate of Canco.

CFA earns income that is included in FAPI, a portion of which can (in some years) reasonably be considered to be attributable to FABI.

Over years 1 through 4, the situation can be summarized as follows:

	Year 1	*Year 2*	*Year 3*	*Year 4*
FAPI (other than FABI)	*100*	*-*	*-*	*30*
FABI	*(50)*	*50*	*20*	*20*
Total 91(1) inclusion	*50*	*50*	*20*	*50*
Foreign Accrual Tax	*(10)*	*(10)*	*(4)*	*-*
Relevant Tax Factor	*1.9*	*1.9*	*4*	*4*
Total 91(4) deduction	*(19)*	*(19)*	*(16)*	*-*

<u>Analysis</u>

Determining Canco's AII without the amendment to paragraph (b) of the "income" or "loss" definition

Without the amendment to paragraph (b) of the definition "income" or "loss", the following amounts – representing the difference between the amount included in computing Canco's income for the year under subsection 91(1) and the amount deducted in computing Canco's income for the year under subsection 91(4) – would be included in Canco's AII for each year pursuant to the new relevant tax factor rules:

Year 1: $31

Year 2: $31

Year 3: $4

Year 4: $50

Determining Canco's AII with the amendment to paragraph (b) of the "income" or "loss" definition

By virtue of new subparagraph (b)(iii) of the definition "income" or "loss" in subsection 129(4), the following amounts are included in Canco's AII for each year:

Year 1: $31

In Year 1, Canco earned FAPI (other than FABI) and generated a foreign accrual business loss (FABL). Thus, no portion of the amounts included and deducted in computing Canco's income under subsections 91(1) and (4) can reasonably be considered to be attributable to CFA's FABI. Consequently, subparagraph (b)(iii) does not apply and the amount included in Canco's AII for the year is unchanged.

Year 2: $31

In Year 2, CFA earned $50 of FABI, which is included in computing Canco's income for the year under subsection 91(1). However, since CFA had realized an equivalent foreign accrual business loss in Year 1, its net FABI over the period is nil. It would thus be reasonable to consider that no portion of CFA's tax liability is attributable to FABI, such that no election under 93.4(2) could be made (hence the relevant tax factor of 1.9). Consequently, new subparagraph (b)(iii) would not apply and an amount of $31 – representing the difference between the amount included in Canco's income for the year under subsection 91(1) and the amount deducted in computing Canco's income for the year under subsection 91(4) – would be included in Canco's AII for the year.

Year 3: $0

In Year 3, Canco filed an election under 93.4(2) and it is reasonable to consider that the entirety of the amounts included and deducted in computing Canco's income for the year under subsections 91(1) and (4) are attributable to CFA's FABI. As such, both amounts will be disregarded in determining Canco's AII for the year (in other words, the amount of $20 included *in Canco's income under subsection 91(1) will not be included in Canco's AII and the amount of $16 deducted in computing Canco's income under subsection 91(4) cannot be used to reduce Canco's AII for the year (if, for example, Canco had other sources of AII in the year, the $16 91(4) deduction could not be applied against it)).*

Year 4: $30

In Year 4, Canco earns $20 of FABI and $30 of FAPI (other than FABI) and pays no tax. While the FABI amount (i.e. the portion of an amount in respect of a share that has been included in computing the income of Canco under subsection 91(1) for a taxation year or for any of the 5 immediately preceding taxation years that can reasonably be regarded as attributable to the FABI of CFA) at the end of Year 4 would be $24, clause (iii)(A) only applies to disregard amounts added to the FABI amount for the year, or in this case, $20. Therefore, although no foreign tax was paid in the year, Canco could file an election under 93.4(2) in order to ensure that an amount of $20 be disregarded in calculating its AII for the year, resulting in an addition of $30 to its AII for the year.

For more information, see the commentary on new section 93.4.

In the French version of the Act, the definitions "income" and "revenue" are also reorganized in order to better align with the English definitions.

This amendment applies to taxation years that begin on or after April 7, 2022.

Clause 6

Prescribed provisions for late elections

ITR
600

Section 600 prescribes provisions of the Act for the purposes of obtaining permission to amend, revoke or extend the time to file an election, for which ministerial discretion may be exercised under paragraphs 220(3.2)(a) and (b) of the Act.

Paragraph 600(b) is amended to add a reference to subsection 93.4(2) and (3). For more information, see the commentary on new section 93.4.

This amendment applies to taxation years that begin after 2024.