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Special Report: Canada Federal Budget 2016

This annual publication is produced by the Tax Group at Dentons Canada LLP together with Wolters Kluwer CCH. This edition contains editorial comments regarding the tax proposals announced in the 2016 Federal Budget.

Editorial Comment on Budget Resolutions

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

Resolutions 1 to 5: Canada Child Benefit

1. The heading "*Canada Child Tax Benefit*" before section 122.6 of the Act is replaced by the following:

Canada Child Benefit

2. (1) Paragraph (*e*) of the definition *eligible individual* in section 122.6 of the Act is amended by striking out "or" at the end of subparagraph (ii), by adding "or" at the end of subparagraph (iv) and by adding the following after that subparagraph:

(*v*) is an Indian within the meaning of the *Indian Act*,

(2) Subsection (1) comes into force on July 1, 2016.

3. (1) Subsection 122.61(1) of the Act is replaced by the following:

122.61 *Deemed overpayment*. (1) If a person and, if the Minister so demands, the person's cohabiting spouse or common-law partner at the end of a taxation year have filed a return of income for the year, an overpayment on account of the person's liability under this Part for the year is deemed to have arisen during a month in relation to which the year is the base taxation year, equal to the amount determined by the formula

$$1/12(A + C + M)$$

where

A is the amount determined by the formula

$$E - Q - R$$

where

E is the total of

(*a*) the product obtained by multiplying $6,400 by the number of qualified dependants in respect of whom the person was an eligible individual at the beginning of the month who have not reached the age of six years at the beginning of the month, and

(*b*) the product obtained by multiplying $5,400 by the number of qualified dependants, other than those qualified dependants referred to in paragraph (a), in respect of whom the person was an eligible individual at the beginning of the month, and

Q is

(*a*) if the person's adjusted income for the year is less than or equal to $30,000, nil,

(*b*) if the person's adjusted income for the year is greater than $30,000 but less than or equal to $65,000, and if the person is, at the beginning of the month, an eligible individual in respect of

(i) only one qualified dependant, 7% of the person's adjusted income for the year in excess of $30,000,

(ii) only two qualified dependants, 13.5% of the person's adjusted income for the year in excess of $30,000,

(iii) only three qualified dependants, 19% of the person's adjusted income for the year in excess of $30,000, or

(iv) more than three qualified dependants, 23% of the person's adjusted income for the year in excess of $30,000, and

(*c*) if the person's adjusted income for the year is greater than $65,000, and if the person is, at the beginning of the month, an eligible individual in respect of

(i) only one qualified dependant, the total of $2,450 and 3.2% of the person's adjusted income for the year in excess of $65,000,

(ii) only two qualified dependants, the total of $4,725 and 5.7% of the person's adjusted income for the year in excess of $65,000,

(iii) only three qualified dependants, the total of $6,650 and 8% of the person's adjusted income for the year in excess of $65,000, or

(iv) more than three qualified dependants, the total of $8,050 and 9.5% of the person's adjusted income for the year in excess of $65,000;

R is the amount determined for the description of C;

C is the amount determined by the formula

$$F - (G \times H)$$

where

F is, if the person is, at the beginning of the month, an eligible individual in respect of

(*a*) only one qualified dependant, $2,308, and

(*b*) two or more qualified dependants, the total of

(i) $2,308 for the first qualified dependant,

(ii) $2,042 for the second qualified dependant, and

(iii) $1,943 for each of the third and subsequent qualified dependants,

G is the amount determined by the formula

$$J - [K - (L/0.122)]$$

where

J is the person's adjusted income for the year,

K is $45,282, and

L is the amount referred to in paragraph (a) of the description of F, and

H is

(*a*) if the person is an eligible individual in respect of only one qualified dependant, 12.2%, and

(*b*) if the person is an eligible individual in respect of two or more qualified dependants, the fraction (expressed as a percentage rounded to the nearest one-tenth of one per cent) of which

(i) the numerator is the total that would be determined under the description of F in respect of the eligible individual if that description were applied without reference to the fourth and subsequent qualified dependants in respect of whom the person is an eligible individual, and

(ii) the denominator is the amount referred to in paragraph (*a*) of the description of F, divided by 0.122;

and

M is the amount determined by the formula

$$N - O$$

where

N is the product obtained by multiplying $2,730 by the number of qualified dependants in respect of whom both

(*a*) an amount may be deducted under section 118.3 for the taxation year that includes the month, and

(*b*) the person is an eligible individual at the beginning of the month, and

O is

(*a*) if the person's adjusted income for the year is less than or equal to $65,000, nil, and

(*b*) if the person's adjusted income for the year is greater than $65,000,

(i) where the person is an eligible individual in respect of only one qualified dependant described in N, 3.2% of the person's adjusted income for the year in excess of $65,000, and

(ii) where the person is an eligible individual in respect of two or more qualified dependants described in N, 5.7% of the person's adjusted income for the year in excess of $65,000.

(2) The first formula in subsection 122.61(1) of the Act, as enacted by subsection (1), is replaced by the following:

$$1/12(A + M)$$

(3) The formula in the description of A in subsection 122.61(1) of the Act, as enacted by subsection (1), is replaced by the following:

$$E - Q$$

(4) The descriptions of R and C in subsection 122.61(1) of the Act, as enacted by subsection (1), are repealed.

(5) Subsection 122.61(5) of the Act is repealed.

(6) Subsection 122.61(7) of the Act is repealed.

(7) Subsections (1), (5) and (6) come into force on July 1, 2016.

(8) Subsections (2) to (4) come into force on July 1, 2017.

4. (1) Subsection 122.62(2) of the Act is replaced by the following

(2) *Extension for notices.* The Minister may, on or before the day that is 10 years after the beginning of the month referred to in subsection (1), extend the time for filing a notice under subsection (1).

(2) Subsection (1) comes into force on July 1, 2016.

5. (1) Section 122.63 of the Act is repealed.

(2) The Act is amended by adding the following after section 122.62:

122.63 *Agreement.* (1) The Minister of Finance may enter into an agreement with the government of a province whereby the amounts determined under the description of E in subsection 122.61(1) with respect to persons resident in the province shall, for the purpose of calculating overpayments deemed to arise under that subsection, be replaced by amounts determined in accordance with the agreement.

(2) *Agreement.* The amounts determined under the description of E in subsection 122.61(1) for a base taxation year because of any agreement entered into with a province and referred to in subsection (1) shall be based on the age of qualified dependants of eligible individuals, or on the number of such qualified dependants, or both, and shall result in an amount in respect of a qualified dependant that is not less, in respect of that qualified dependant, than 85% of the amount that would otherwise be determined under that paragraph in respect of that qualified dependant for that year.

(3) *Agreement.* Any agreement entered into with a province and referred to in subsection (1) shall provide that, where the operation of the agreement results in a total of all amounts, each of which is an amount deemed under subsection 122.61(1) to be an overpayment on account of the liability under this Part for a taxation year of a person subject to the agreement, that exceeds 101% of the total of such overpayments that would have otherwise been deemed to have arisen under subsection 122.61(1), the excess shall be reimbursed by the government of the province to the Government of Canada.

(3) Subsection (1) comes into force on July 1, 2016.

(4) Subsection (2) comes into force on July 1, 2017.

Dentons Canada LLP Commentary: Beginning July 2016, the new Canada Child Benefit ("CCB") will replace the Canada Child Tax Benefit ("CCTB") and the Universal Child Care benefit ("UCCB").

The CCTB is a non-taxable benefit that is paid monthly, based on adjusted family net income and the number of children in the family. The CCTB has three components (amounts shown are for the 2016-17 benefit year):

- a CCTB base benefit for low- and middle-income families, of up to $1,490 each for the first and second child and $1,594 for the third and each subsequent child;
- a national child benefit supplement for low-income families of up to $2,308 for a first child, $2,042 for a second child and $1,943 for each subsequent child; and
- a child disability benefit of up to $2,730, provided to families caring for a child under the age of 18 who is eligible for the disability tax credit.

The UCCB provides a taxable benefit of $160 per month for each child under the age of six and $60 per month for each child aged 6 through 17.

The components of the CCB base benefit are similar to the CCTB's except that they are based on the child's age ($6,400 per child under the age of 6 and $5,400 per child aged 6 through 17) and the phasing-out of the benefit depends on the number of children and on the level of family income. On the portion of adjusted family net income between $30,000 and $65,000, the benefits are phased out at a rate of 7 per cent for a one-child family, 13.5 per cent for a two child-family, 19 per cent for a three-child family, and 23 per cent for larger families. Where adjusted family net income exceeds $65,000, remaining benefits are phased out at rates of 3.2 per cent for a one-child family, 5.7 per cent for a two-child family, 8 per cent for a three-child family and 9.5 per cent for larger families, on the portion of income above $65,000.

The components of the CCB's national child benefit supplement are the same as those for the CCTB national child benefit supplement, except that the amount of component K is changed for a fixed amount of $45,282. The national child benefit supplement will be eliminated on July 1, 2017.

The components of the child disability benefit have not changed (the amount remains at $2,730 per eligible child), except for the phase-out of the benefit, which now is aligned with the CCB. The benefit will be phased out at a rate of 3.2 per cent for families with one eligible child and 5.7 per cent for families with more than one eligible child, on adjusted family net income in excess of $65,000.

The definition of the adjusted family income has not changed. The CCB will be calculated based on the 2015 adjusted family net income.

Contrary to the benefits paid under the CCTB, the CCB payments are not subject to indexation. Subsection 122.61(5) will be repealed, applicable July 1, 2016.

Amounts received under the new CCB are not taxable and do not reduce benefits paid under the goods and services tax credit. They are also not included in income for the purposes of federal income-tested programs delivered outside of the income tax system, such as the Guaranteed Income Supplement, the Canada education savings grant, the Canada learning bond, the Canada disability savings bond and the Canada disability savings grant.

Paragraph (*e*) of the definition of "eligible individual" in section 122.6 of the Act is amended to ensure that Indians under the *Indian Act* who are not entitled to the CCTB because they are not Canadian citizens or permanent residents under the Immigration and Refugee Protection Act are entitled to the new CCB. This amendment comes into force on July 1, 2016.

An individual may apply to receive payments of the CCTB and UCB for a particular month no more than 11 months after that particular month. The Minister may currently extend this deadline, provided that the individual would have been eligible to receive the benefits at the time. To be consistent with the delay that is usually allowed to make retroactive claims on other types of tax amounts like goods and services tax credit, working income tax benefit or disability tax credit, the deadline to make a claim for the new CCB in respect of a particular month is extended to 10 years after that month. This modification is effective for requests made after June 2016.

Subsection 122.63(1) of the Act allows individual provinces to modify, to an extent, the CCTB paid to residents of that province, by modifying the amounts paid on the basis of the age or number, or both, of qualified dependants, so long as the modified amount is at least 85% of the amount which would otherwise have been paid. Under the new rules, provinces and territories will be able to negotiate an agreement with similar parameters in order to reconfigure the CCB within the same fiscal envelope, if they wish to do so, starting for the 2017-18 benefit year.

Resolutions 6 to 9: Income Splitting Credit

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

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

(2) Subsection (1) applies to the 2016 taxation year.

7. (1) Section 119.1 of the Act is repealed.

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

8. (1) Clause 128(2)(*e*)(iii)(A) of the Act is replaced by the following:

(A) under any of sections 118 to 118.07, 118.2, 118.3, 118.5, 118.6, 118.8 and 118.9,

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

9. (1) Subsection 153(1.3) of the Act is replaced by the following:

(1.3) *Reduction not permitted.* A joint election made or expected to be made under section 60.03 is not to be considered a basis on which the Minister may determine a lesser amount under subsection (1.1).

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

Dentons Canada LLP Commentary: Budget 2016 proposes to eliminate family income splitting.

The income-splitting tax credit in s. 119.1 is a non-refundable tax credit that was introduced in 2014 for couples with at least one child under the age of 18. It allowed the higher-income spouse or common-law partner to notionally transfer up to $50,000 of taxable income to their spouse or common-law partner. The maximum credit amount was $2,000.

Several consequential amendments are proposed to eliminate references to this credit throughout the *Income Tax Act*.

Resolution 10 Northern Residents Deductions

10. (1) Clauses 110.7(1)(*b*)(ii)(A) and (B) of the Act are replaced by the following:

(A) $11.00 multiplied by the number of days in the year included in the qualifying period in which the taxpayer resided in the particular area, and

(B) $11.00 multiplied by the number of days in the year included in that portion of the qualifying period throughout which the taxpayer maintained and resided in a self-contained domestic establishment in the particular area (except any day included in computing a deduction claimed under this paragraph by another person who resided on that day in the establishment).

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

Dentons Canada LLP Commentary: The dollar amounts used in clauses 110.7(1)(*b*)(ii)(A) and (B) have been revised from $8.25 to $11.00. This modification is for the 2016 and subsequent taxation years. This will impact the calculation of the northern residents deduction an individual residing in a prescribed northern zone or a prescribed intermediate zone may claim on Form T2222. The dollar amounts are used to calculate the basic residency amount and the additional residency amount.

Resolutions 11 to 14: Labour-Sponsored Venture Capital Corporations Tax Credit

11. (1) Paragraph 127.4(5)(*a*) of the Act is replaced by the following:

(*a*) the amount determined by the formula

$$0.15 \times A + 0.05 \times B$$

where

A is the lesser of

(i) $5,000, and

(ii) the total of all amounts each of which is the net cost of the original acquisition of shares of a prescribed labour-sponsored venture capital corporation (other than a corporation that is a prescribed labour-sponsored venture capital corporation solely because it is a registered labour-sponsored venture capital corporation), and

B is the lesser of

(i) the amount if any by which $5,000 exceeds the amount determined for subparagraph (ii) in the description of A, and

(ii) the total of all amounts each of which is the net cost of the original acquisition of shares of a corporation that is a prescribed labour-sponsored venture capital corporation solely because it is a registered labour-sponsored venture capital corporation, and

(2) Paragraph 127.4(5)(*a*) of the Act, as enacted by subsection (1), is replaced by the following:

(*a*) $750, and

(3) Paragraphs 127.4(6)(*a*) and (*a*.1) of the Act are replaced by the following:

(*a*) 15% of the net cost to the individual (or to a qualifying trust for the individual in respect of the share) for the original acquisition of the share by the individual or by the trust, if the share is a share of a prescribed labour-sponsored venture capital corporation (other than a corporation that is a prescribed labour-sponsored venture capital corporation solely because it is a registered labour-sponsored venture capital corporation),

(*a*.1) 5% of the net cost to the individual (or to a qualifying trust for the individual in respect of the share) for the original acquisition of the share by the individual or by the trust, if

(i) the taxation year for which a claim is made under subsection (2) in respect of the original acquisition is 2016, and

(ii) the share is a share of a corporation that is a prescribed labour-sponsored venture capital corporation solely because it is a registered labour-sponsored venture capital corporation,

(*a*.2) nil, if

(i) the taxation year for which a claim is made under subsection (2) in respect of the original acquisition is after 2016, and

(ii) the share is a share of a corporation that is a prescribed labour-sponsored venture capital corporation solely because it is a registered labour-sponsored venture capital corporation,

(4) Subsection (1) applies to the 2016 taxation year.

(5) Subsection (2) applies to the 2017 and subsequent taxation years.

(6) Subsection (3) applies to the 2016 and subsequent taxation years.

12. (1) Paragraphs (*b*) and (*c*) of the definition labour-sponsored funds tax credit in subsection 211.7(1) of the Act are replaced by the following:

(*b*) in any other case, the amount that would be determined under subsection 127.4(6) in respect of the share if this Act were read without reference to its paragraphs (*b*) and (*d*).

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

13. Subsections 59(1), (4), (6) and (7) of *Economic Action Plan 2013 Act, No. 2.* are repealed.

14. (1) Section 6701.1 of the *Income Tax Regulations* is repealed.

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

Dentons Canada LLP Commentary: An individual other than a trust may claim a federal tax credit in respect of the acquisition of shares in a labour-sponsored venture capital corporation ("LSVCC") by the individual or the individual's registered retirement savings plan ("RRSP") or tax-free savings account ("TFSA"). Before 2015, the LSVCC tax credit was 15% of the cost of up to $5,000 of shares per year, for a maximum annual credit of $750 per year. The 2013 Budget proposed to phase out and eliminate the credit, by reducing it to 10% of up to $5,000 of acquisitions for 2015, 5% for 2016, and eliminating the credit for 2017 and subsequent years.

Resolutions 11 and 13 reinstate the 15% credit rate for acquisitions of shares in provincially-registered LSVCCs for 2016 and subsequent years. An individual's maximum federal credit will be $750 in respect of acquisitions by the individual or the individual's RRSP or TFSA, as was the case under the pre-2015 rules. Shares in new provincially-registered LSVCCs will be eligible for the credit, as the restriction on their registration under regulation 6701.1 of the *Income Tax Regulations* is proposed to be repealed as of Budget Day.

Notably, the 15% reinstatement does not apply to federally-registered LSVCCs, which remain subject to the phase out and elimination regime described above. The Budget papers note that "while significant funding to small and medium-sized businesses has been provided in a number of provinces through provincial LSVCC programs, the national LSVCC program has not had a similar impact." Thus, for 2016 the maximum credit for purchases of shares in federally-registered LSVCCs remains 5% of up to $5,000 of acquisitions, or $250. The credit for these shares will be eliminated in 2017.

Resolution 12 restores the provisions of the LSVCC tax credit related to individuals who do not hold the shares for the requisite time period.

Resolutions 15 to 18: Teacher and Early Childhood Educator School Supply Tax Credit

15. (1) The Act is amended by adding the following after section 122.8:

SUBDIVISION A.4 *School Supplies Tax Credit.*

122.9 (1) *Definitions.* The following definitions apply in this section.

eligible educator, in respect of a taxation year, means an individual who, at any time during the taxation year,

(*a*) is employed in Canada as a teacher or an early childhood educator at

(i) an elementary or secondary school, or

(ii) a regulated child care facility; and

(*b*) holds a valid and recognized (in the province or territory in which the individual is employed)

(i) teaching certificate, licence, permit or diploma, or

(ii) certificate or diploma in early childhood education.

eligible supplies expense, of an eligible educator for a taxation year, means an amount (other than any amount deducted in computing any person's income for any taxation year or any amount otherwise included in computing a deduction from any person's tax payable under this Act for any taxation year) paid by the eligible educator in the taxation year for teaching supplies to the extent that

(*a*) the teaching supplies were

(i) purchased by the eligible educator for the purpose of teaching or facilitating students' learning, and

(ii) directly consumed or used in an elementary or secondary school or in a regulated child care facility in the performance of the duties of the eligible educator's employment; and

(*b*) the eligible educator is not entitled to receive a reimbursement, allowance or any other form of assistance (other than an amount that is included in computing the income for any taxation year of the eligible educator and that is not deductible in computing the taxable income of the eligible educator) in respect of the amount paid.

return of income filed by an eligible educator for a taxation year means a return of income (other than a return of income filed under subsection 70(2) or 104(23), paragraph 128(2)(*e*) or subsection 150(4)) that is required to be filed for the year or that would be required to be filed if the individual had tax payable under this Part for the year.

teaching supplies means

(*a*) consumable supplies; and

(*b*) prescribed durable goods.

(2) *Deemed overpayment*. An eligible educator who files a return of income for a taxation year and who makes a claim under this subsection is deemed to have paid, at the end of the year, on account of tax payable under this Part for the year, an amount equal to the amount determined by the formula

$$A \times B$$

where

A is the appropriate percentage for the year; and

B is the least of

(*a*) $1,000;

(*b*) the total of all amounts each of which is an eligible supplies expense of the eligible educator for the year; and

(*c*) if the eligible educator fails to provide the certificate referred to in subsection (3) in respect of the year, as and when requested by the Minister, nil.

(3) *Certificate*. If the Minister so demands, an eligible educator making a claim under this section in respect of a taxation year shall provide to the Minister a written certificate from their

employer, or a delegated official of the employer, attesting to the eligible supplies expenses of the eligible educator for the year.

(4) *Effect of bankruptcy.* For the purposes of this subdivision, if an eligible educator becomes bankrupt in a particular calendar year, notwithstanding subsection 128(2), any reference to the taxation year of the eligible educator (other than in this subsection) is deemed to be a reference to the particular calendar year.

(5) *Part-year residents.* If an eligible educator is resident in Canada throughout part of a taxation year and is non-resident throughout another part of the year, the total of the amounts that are deemed to be paid by the eligible educator under subsection (2) for the year cannot exceed the lesser of

(*a*) the total of

(i) the amounts deemed to be paid under subsection (2) that can reasonably be considered as wholly applicable to the period or periods in the year throughout which the eligible educator is not resident in Canada, computed as though that period or those periods were the whole taxation year, and

(ii) the amounts deemed to be paid under subsection (2) that can reasonably be considered as wholly applicable to the period or periods in the year throughout which the eligible educator is resident in Canada, computed as though that period or those periods were the whole taxation year, and

(*b*) the total of the amounts that would have been deemed to have been paid under subsection (2) for the year had the eligible educator been resident in Canada throughout the year.

(6) *Non-residents.* Subsection (2) does not apply in respect of a taxation year of an eligible educator if the eligible educator is, at no time in the year, resident in Canada, unless all or substantially all the eligible educator's income for the year is included in computing the eligible educator's taxable income earned in Canada for the year.

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

16. (1) Paragraph 152(1)(*b*) of the Act is replaced by the following:

(*b*) the amount of tax, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 122.7(2) or (3), 122.8(2) or (3), 122.9(2), 125.4(3), 125.5(3), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year.

(2) Paragraph 152(4.2)(*b*) of the Act is replaced by the following:

(*b*) redetermine the amount, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 122.7(2) or (3), 122.8(2) or (3), 122.9(2), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year or deemed by subsection 122.61(1) to be an overpayment on account of the taxpayer's liability under this Part for the year.

(3) Subsections (1) and (2) apply to the 2016 taxation year.

17. (1) Subsection 163(2) of the Act is amended by adding the following after paragraph (*c*.4):

(*c*.5) the amount, if any, by which

(i) the total of all amounts each of which is an amount that would be deemed by subsection 122.9(2) to have been paid on account of the person's tax payable under this Part for the year if that amount were calculated by reference to the person's claim for the year under the subsection exceeds

(ii) the total of all amounts each of which is the amount that the person is entitled to claim for the year under subsection 122.9(2),

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

18. (1) The *Income Tax Regulations* are amended by adding the following after Part XCV:

PART XCVI *School Supplies Tax Credit.*

9600. *Prescribed durable goods.* For the purpose of the definition teaching supplies in subsection 122.9(1) of the Act, the following are prescribed durable goods:

(*a*) books;

(*b*) games and puzzles;

(*c*) containers (such as plastic boxes or banker boxes); and

(*d*) educational support software.

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

Dentons Canada LLP Commentary: Beginning with the 2016 taxation year, eligible educators will be able to claim a 15 percent refundable tax credit for eligible supplies expenses in the year, under new section 122.9 of the *Income Tax Act* ("the Act"). Maximum expenses of $1,000 are allowed, thus generating $150 in tax savings.

An "eligible educator" means an individual who holds a valid and recognized teaching certificate, licence, permit or diploma, or a certificate or diploma in early childhood education and who is employed as a teacher or early childhood educator at an elementary or secondary school or a regulated child care facility.

"Eligible supplies expense" means an amount paid for teaching supplies by the eligible educator for the purpose of teaching or facilitating students' learning, and directly consumed or used in an elementary or secondary school or in a regulated child care facility in the performance of the duties of the eligible educator's employment. "Teaching supplies" include consumable supplies such as construction paper for activities, items for science experiments, paper, glue, paint or other art supplies, and stationery items. It also includes the following prescribed durable goods: books, games, puzzles, containers (such as plastic boxes or banker boxes) and educational support software, as per new regulation 9600 of the *Income Tax Regulations*.

To be eligible, these expenses must not be otherwise deductible or included in computing a deduction. They must not give rise to a reimbursement, an allowance or any form of assistance for the benefit of the eligible educator. In addition, if the Minister so requests, the eligible educator must be able to provide a certificate issued by his or her employer attesting to the eligible supplies expenses for the year.

The credit must be claimed in the individual's tax return for the year. It cannot, however, be claimed in a rights or things return (subsection 70(2) of the Act), a separate return for graduated-rate estate income (subsection 104(23) of the Act), a bankruptcy trustee return (paragraph 128(2)(*e*) of the Act) or a separate return for short period business income (subsection 150(4) of the Act).

A non-resident educator is not eligible to claim the school supplies tax credit unless all or substantially all his or her income for the year is included in computing his or her taxable income earned in Canada for the year. In the case of a part-year resident educator, the same rule is applicable to eligible supplies expenses that can reasonably be considered wholly applicable to the period during which the eligible educator is not resident in Canada.

Resolution 19: Ontario Electricity Support Program

19. (1) Subsection 81(1) of the Act is amended by adding the following after paragraph (*g*.5):

> (*g*.6) *Ontario Electricity Support Program* . an amount of rate assistance received under section 79.2 of the *Ontario Energy Board Act 1998* , S.O. 1998, c.15, Sch B, as amended from time to time;

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

Dentons Canada LLP Commentary: Effective January 1, 2016, the Ontario government implemented the Ontario Electricity Support Program ("OESP"), which provides a monthly credit on a particular recipient's hydro bill. The amount of the credit varies from recipient to recipient depending upon their household income and the number of people in the household. Generally this type of credit is required to be included in a recipient's income for tax purposes and affects a recipient's entitlement to other income-related federal, provincial and territorial tax credits.

To ensure that amounts received by taxpayers from the OESP are not included in the income of a recipient so as to reduce their entitlement to other income-related credits, subsection 81(1) of the *Income Tax Act* is amended by adding paragraph (*g*.6), which specifically exempts amounts received from the OESP from inclusion in income.

Resolution 20: Mineral Exploration Tax Credit for Flow-Through Share Investors

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

> (*a*) that is a Canadian exploration expense incurred by a corporation after March 2016 and before 2018 (including, for greater certainty, an expense that is deemed by subsection 66(12.66) to be incurred before 2018) in conducting mining exploration activity from or above the surface of the earth for the purpose of determining the existence, location, extent or quality of a mineral resource described in paragraph (*a*) or (*d*) of the definition *mineral resource* in subsection 248(1),

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

> (*c*) an amount in respect of which is renounced in accordance with subsection 66(12.6) by the corporation to the taxpayer (or a partnership of which the taxpayer is a member) under an agreement described in that subsection and made after March 2016 and before April 2017, and
>
> (*d*) that is not an expense that was renounced under subsection 66(12.6) to the corporation (or a partnership of which the corporation is a member), unless that renunciation was under an agreement described in that subsection and made after March 2016 and before April 2017;

(3) Subsections (1) and (2) apply to expenses renounced under a flow-through share agreement entered into after March 2016.

Dentons Canada LLP Commentary: Budget 2016 proposes to again extend the availability of the mineral exploration tax credit for flow-through investors. Budget 2015 previously extended the credit to expenditures made on or before March 31, 2016. Budget 2016 further extends the credit to expenditures made after March 2016 and before 2018.

Resolutions 21 to 32: Education and Textbook Tax Credits

21. (1) Subparagraph 56(3)(*a*)(i) of the Act is replaced by the following:

(i) in an educational program in respect of which the taxpayer is a *qualifying student* (as defined in subsection 118.6(1)) in the taxation year, in the immediately preceding taxation year or in the following taxation year, or

(2) Paragraph 56(3.1)(*b*) of the Act is replaced by the following:

(*b*) if an award is received in connection with an educational program in respect of which the taxpayer is a qualifying student because of subparagraph (*a*)(ii) of the definition *qualifying student* in subsection 118.6(1) in the taxation year, in the immediately preceding taxation year or in the following taxation year (in this paragraph referred to as the "claim year"), the amount included under subparagraph (1)(*n*)(i) in computing the taxpayer's income for the taxation year in respect of the award may not exceed the amount that is the total of amounts, each of which is the cost of materials related to the program or a fee paid to a *designated educational institution* in respect of the program, as defined in subsection 118.6(1), in respect of the claim year.

(3) Subsection (1) applies to the 2017 and subsequent taxation years, and

(*a*) for the 2016 taxation year, a taxpayer will be considered to be entitled to deduct an amount under subsection 118.6(2) of the Act in respect of an educational program for the immediately following taxation year if the taxpayer is a qualifying student (as defined in subsection 118.6(1) of the Act) in respect of the educational program in that year; and

(*b*) for the 2017 taxation year, a taxpayer will be considered to be a qualifying student in respect of an educational program in the immediately preceding taxation year if the taxpayer was entitled to deduct an amount under subsection 118.6(2) of the Act in respect of the educational program for that year.

(4) Subsection (2) applies to the 2017 and subsequent taxation years, and

(*a*) for the 2016 taxation year, a taxpayer will be considered to be entitled to deduct an amount by reason of paragraph (*b*) of the description of B in subsection 118.6(2) of the Act in respect of an educational program for the immediately following taxation year if the taxpayer is a qualifying student in respect of the educational program because of subparagraph (*a*)(ii) of the definition *qualifying student* in subsection 118.6(1) of the Act for that year; and

(*b*) for the 2017 taxation year, a taxpayer will be considered to be a qualifying student in respect of an educational program because of subparagraph (*a*)(ii) of the definition *qualifying student* in subsection 118.6(1) of the Act in the immediately preceding taxation year if the taxpayer was entitled to deduct an amount by reason of paragraph (*b*) of the description of B in subsection 118.6(2) of the Act in respect of the educational program for that year.

22. (1) Subsection 118.6(1) of the Act is amended by adding the following in alphabetical order:

qualifying student, for a month in a taxation year, means an individual who,

(*a*) in the month,

(i) is enrolled in a qualifying educational program as a full-time student at a designated educational institution, or

(ii) is not described in subparagraph (i) and is enrolled at a designated educational institution in a specified educational program that provides that each student in the program spend not less than 12 hours in the month on courses in the program,

(*b*) if requested by the Minister, proves the enrolment by filing with the Minister a certificate in prescribed form issued by the designated educational institution and containing prescribed information, and

(*c*) in the case of an individual who is enrolled in a program at a designated educational institution described in subparagraph (*a*)(ii) of the definition ***designated educational institution***,

(i) has attained the age of 16 years before the end of the year, and

(ii) is enrolled in the program to obtain skills for, or improve the individual's skills in, an occupation;

(2) Subsections 118.6(2) and (2.1) of the Act are repealed.

(3) The portion of subsection 118.6(3) of the Act before paragraph (a) is replaced by the following:

(3) *Students eligible for the disability tax credit.* For the purposes of subparagraph (a)(i) of the definition *qualifying student* in subsection (1), the reference to "fulltime student" is to be read as "student" if

(4) Subsections (1) to (3) apply to the 2017 and subsequent taxation years.

23. (1) The description of B in subsection 118.61(1) of the Act is replaced by the following:

B is the total of all amounts each of which may be deducted under section 118.5 in computing the individual's tax payable under this Part for the year;

(2) The description of E in subsection 118.61(1) of the Act is replaced by the following:

E is the tuition tax credit transferred for the year by the individual to the individual's spouse, common-law partner, parent or grandparent.

(3) The portion of subsection 118.61(4) of the Act before the formula is replaced by the following:

(4) *Change of appropriate percentage*. For the purpose of determining the amount that may be deducted under subsection (2) in computing an individual's tax payable for a taxation year, in circumstances where the appropriate percentage for the taxation year is different from the appropriate percentage for the preceding taxation year, the individual's unused tuition, textbook and education tax credits at the end of the preceding taxation year is deemed to be the amount determined by the formula

(4) Subsections (1) to (3) apply to the 2017 and subsequent taxation years.

24. (1) The description of A in section 118.8 of the Act is replaced by the following:

A is the tuition tax credit transferred for the year by the spouse or common-law partner to the individual;

(2) Subparagraph (*b*)(i) of the description of C in section 118.8 of the Act is replaced by the following:

(i) the total of all amounts that may be deducted under section 118.5 in computing the spouse's or common-law partner's tax payable under this Part for the year, and

(3) Subsections (1) and (2) apply to the 2017 and subsequent taxation years.

25. (1) The portion of section 118.81 of the Act before paragraph (*a*) is replaced by the following:

118.81 *Tuition tax credit transferred.* In this subdivision, the tuition tax credit transferred for a taxation year by a person to an individual is the lesser of

(2) Subparagraph (i) of the description of A in paragraph 118.81(*a*) of the Act is replaced by the following:

(i) the total of all amounts that may be deducted under section 118.5 in computing the person's tax payable under this Part for the year, and

(3) Subsections (1) and (2) apply to the 2017 and subsequent taxation years.

26. (1) Section 118.9 of the Act is replaced by the following:

118.9 *Transfer to parent or grandparent.* If for a taxation year a parent or grandparent of an individual (other than an individual in respect of whom the individual's spouse or common-law partner deducts an amount under section 118 or 118.8 for the year) is the only person designated in writing by the individual for the year for the purpose of this section, there may be deducted in computing the tax payable under this Part for the year by the parent or grandparent, as the case may be, the tuition tax credit transferred for the year by the individual to the parent or grand-parent, as the case may be.

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

27. (1) Subparagraph 118.91(b)(i) of the Act is replaced by the following:

(i) such of the deductions permitted under subsections 118(3) and (10) and sections 118.01 to 118.2, 118.5, 118.62 and 118.7 as can reasonably be considered wholly applicable to the period or periods in the year throughout which the individual is resident in Canada, computed as though that period or those periods were the whole taxation year, and

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

28. (1) Section 118.94 of the Act is replaced by the following:

118.94 *Tax payable by non-residents (credits restricted)* . Sections 118 to 118.07 and 118.2, subsections 118.3(2) and (3) and sections 118.8 and 118.9 do not apply for the purpose of computing the tax payable under this Part for a taxation year by an individual who at no time in the year is resident in Canada unless all or substantially all the individual's income for the year is included in computing the individual's taxable income earned in Canada for the year.

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

29. (1) Paragraph 118.95(*a*) of the Act is replaced by the following:

(*a*) such of the deductions as the individual is entitled to under any of subsections 118(3) and (10) and sections 118.01 to 118.2, 118.5, 118.62 and 118.7, as can reasonably be considered wholly applicable to the taxation year, and

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

30. (1) Clause 128(2)(*e*)(iii)(A) of the Act is replaced by the following:

(A) under any of sections 118 to 118.07, 118.2, 118.3, 118.5, 118.8 and 118.9,

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

31. Subparagraphs (*a*)(i) to (iii) of the definition *repayment period* in subsection 146.02(1) of the Act are replaced by the following:

(i) at the beginning of the third calendar year within the participation period if, in each of the second and third calendar years within the participation period,

(A) for calendar years before 2017, the person would not be entitled to claim an amount under subsection 118.6(2) (as it read in the year) in respect of at least three months in the year, if that subsection were read without reference to paragraph (*b*) of the description of B in that subsection, and

(B) for calendar years after 2016, the person would not be a *qualifying student* (as defined in subsection 118.6(1)) in respect of at least three months in the year, if that definition were read without reference to its subparagraph (*a*)(ii),

(ii) at the beginning of the fourth calendar year within the participation period if, in each of the third and fourth calendar years within the participation period,

(A) for calendar years before 2017, the person would not be entitled to claim an amount under subsection 118.6(2) (as it read in the year) in respect of at least three months in the year, if that subsection were read without reference to paragraph (*b*) of the description of B in that subsection, and

(B) for calendar years after 2016, the person would not be a qualifying student (as defined in subsection 118.6(1)) in respect of at least three months in the year, if that definition were read without reference to its subparagraph (*a*)(ii),

(iii) at the beginning of the fifth calendar year within the participation period if, in each of the fourth and fifth calendar years within the participation period,

(A) for calendar years before 2017, the person would not be entitled to claim an amount under subsection 118.6(2) (as it read in the year) in respect of at least three months in the year, if that subsection were read without reference to paragraph (*b*) of the description of B in that subsection, and

(B) for calendar years after 2016, the person would not be a *qualifying student* (as defined in subsection 118.6(1)) in respect of at least three months in the year, if that definition were read without reference to its subparagraph (*a*)(ii), and

32. (1) Paragraph (*b*) of the definition *qualifying educational program* in subsection 118.6(1) of the Act is replaced by the following:

(*b*) a benefit, if any, received by the student because of a loan made to the student in accordance with the requirements of the *Canada Student Loans Act*, *Apprentice Loans Act* or *An Act respecting financial assistance for education expenses*, R.S.Q., c. A-13.3, or because of financial assistance given to the student in accordance with the requirements of the *Canada Student Financial Assistance Act*, or

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

Dentons Canada LLP Commentary: The Budget will eliminate the education and textbook portion of the education tax credits. It will not eliminate the tuition and examination fee tax credit.

This change will apply effective January 1, 2017. Unused education and textbook credit amounts carried forward from years prior to 2017 will remain available to be claimed in 2017 and subsequent years.

Resolutions 33 to 38: Children's Fitness and Arts Tax Credits

33. (1) The portion of the description of B in subsection 118.031(2) of the Act before the formula in that description is replaced by the following:

B is the total of all amounts each of which is, in respect of a qualifying child of the individual for the taxation year, the lesser of $250 and the amount determined by the formula

(2) Section 118.031 of the Act, as amended by subsection (1), is repealed.

(3) Subsection (1) applies to the 2016 taxation year.

(4) Subsection (2) comes into force on January 1, 2017.

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

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

(2) Subsection (1) applies to the 2017 and subsequent taxation years.

35. (1) The portion of the description of B in subsection 122.8(2) of the Act before the formula in that description is replaced by the following:

B is the total of all amounts each of which is, in respect of a qualifying child of the individual for the year, the lesser of $500 and the amount determined by the formula

(2) Subdivision a.3 of Division E of Part I of the Act, as amended by subsection (1), is repealed.

(3) Subsection (1) applies to the 2016 taxation year.

(4) Subsection (2) comes into force on January 1, 2017.

36. (1) Paragraph 152(1)(*b*) of the Act is replaced by the following:

(*b*) the amount of tax, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 122.7(2) or (3), 122.9(2), 125.4(3), 125.5(3), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year.

(2) Paragraph 152(4.2)(*b*) of the Act is replaced by the following:

(*b*) redetermine the amount, if any, deemed by subsection 120(2) or (2.2), 122.5(3), 122.51(2), 122.7(2) or (3), 122.9(2), 127.1(1), 127.41(3) or 210.2(3) or (4) to be paid on account of the taxpayer's tax payable under this Part for the year or deemed by subsection 122.61(1) to be an overpayment on account of the taxpayer's liability under this Part for the year.

(3) Subsections (1) and (2) apply to the 2017 and subsequent taxation years.

37. (1) Paragraph 163(2)(*c*.4) of the Act is repealed.

(2) Subsection (1) comes into force on January 1, 2017.

38. (1) Part XCIV of the *Income Tax Regulations* is repealed.

(2) Subsection (1) comes into force on January 1, 2017.

Dentons Canada LLP Commentary: The children's fitness tax credit was introduced in 2007. Originally a non-refundable credit, it became refundable in 2015. From 2007 to 2013, the eligible expenses were limited to $500, but this threshold was raised to $1,000 in 2014. An additional amount of $500 is applicable to children who are eligible for the disability amount and have at least $100 of eligible expenses.

Budget 2016 proposes to phase out the children's fitness tax credit. In the 2016 taxation year, the maximum eligible amount will be decreased to $500 (plus the supplemental amount of $500 for children eligible for the disability tax credit), while the credit remains refundable. In 2017, the credit will no longer be available.

The children's arts tax credit was introduced in 2011. The eligible expenses are limited to $500 plus an additional amount of $500 for children who are eligible for the disability amount and have at least $100 of eligible expenses. This credit is non-refundable.

Budget 2016 proposes to phase out the children arts tax credit as well. In the 2016 taxation year, the maximum eligible amount will be decreased to $250 (plus the supplemental amount of $500 for children eligible for the disability tax credit). In 2017, the credit will no longer be available.

Resolutions 39 to 46: Top Marginal Income Tax Rate — Consequential Amendments

39. (1) Paragraph (*b*) of the definition *relevant tax factor* in subsection 95(1) of the Act is replaced by the following:

(*b*) in any other case, 1.9;

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

Dentons Canada LLP Commentary: Budget 2016 proposes to modify paragraph (b) of the definition of "relevant tax factor" in subsection 95(1) for 2016 and years.

Under subsection 91(4), when an amount in respect of a share of a foreign affiliate has been included in computing the income of a taxpayer in the year or for any of the five previous tax years, there may be deducted in computing the taxpayer's income the lesser of (a) the product obtained by multiplying the "relevant tax factor" by the portion of the foreign accrual tax applicable to the income amount that was not deductible under this subsection in any previous year and (b) the amount, if any, by which the income amount exceeds the total of the amounts in respect of that share deductible in any of the five immediately preceding taxation years in respect of the income amount.

Budget 2016 proposes to reduce the "relevant tax factor" from 2.2 to 1.9, effectively reducing the amount that may be deducted by the taxpayer

40. (1) The descriptions of C and D in subsection 118.1(3) of the Act are replaced by the following:

C is the highest individual percentage for the year;

D is

(*a*) in the case of a trust (other than a graduated rate estate or a *qualified disability trust* as defined in subsection 122(3)), the amount, if any, by which its total gifts for the year exceeds $200, and

(*b*) in any other case, the lesser of

(i) the amount, if any, by which the individual's total gifts for the year exceeds $200, and

(ii) the amount, if any, by which the individual's amount taxable for the year for the purposes of subsection 117(2) exceeds the first dollar amount for the year referred to in paragraph 117(2)(*e*);

E is 29%; and

F is the amount, if any, by which the individual's total gifts for the year exceeds the total of $200 and the amount determined for D.

(2) Subsection (1) applies to the 2016 and subsequent taxation years and, for the purpose of calculating the amount determined for D, as enacted by subsection (1), an

individual's total gifts for the year are determined without reference to gifts made before the 2016 taxation year.

Dentons Canada LLP Commentary: Subsection 118.1(3) allows an individual to claim a tax credit for charitable gifts made to qualified donees during a taxation year or carried forward from a previous year. It also applies to Crown gifts, cultural gifts, and ecological gifts.

Budget 2016 proposes to amend the formula for determining the amount that may be claimed. Under the proposed revised formula, individuals and trusts that are subject to the 33% rate on all taxable income will be able to claim a 33% charitable donation tax credit for donations above $200.

41. (1) Subparagraph (i) of the description of A in paragraph 122(1)(*c*) of the Act is replaced by the following:

(i) the rate of tax payable under this Part by the trust for each taxation year referred to in the description of B were the highest individual percentage for the taxation year, and

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

Dentons Canada LLP Commentary: Budget 2016 proposes to modify the "recovery" tax amount under subsection 122(2) and paragraph 122(1)(*c*) for qualified disability trusts for 2016 and subsequent years. The recovery tax rate will be increased to 33% from 29% (reflecting the top personal rate).

42. (1) The Act is amended by adding the following after section 123.4:

123.5 *Tax on personal services business income* . There shall be added to the tax otherwise payable under this Part for each taxation year by a corporation an amount equal to 5% of the corporation's taxable income for the year from a personal services business.

(2) Subsection (1) applies to taxation years that end after 2015 except that, for taxation years that end after 2015 and begin before 2016, the reference to 5% in section 123.5 of the Act, as enacted by subsection (1), is to be read as a reference to the percentage determined by the formula

$$5\% \ (A/B)$$

where

A is the number of days in the taxation year that are after 2015; and

B is the total number of days in the taxation year.

Dentons Canada LLP Commentary: The Act provides certain rules, known as the personal services business ("PSB") rules, aimed at strongly discouraging the interposition of a corporation between two taxpayers where, absent the corporation, a relationship of employer-employee would exist. Where a corporation has PSB income, pursuant to the existing definition of "full rate taxable income" in subsection 123.4(1) of the Act, such income is not eligible for the "general rate reduction", and is therefore subject to a federal corporate tax rate of 28%. This amounts to an increase of 13% over the otherwise applicable federal corporate tax rate of 15%. See: *Tax Topics* No. 2072 (November 17, 2011) where the impact of this provision is more fully discussed.

To ensure that the tax on PSB income remains commensurate with the tax on income earned personally at the highest rate, Budget 2016 proposes to increase the federal income tax rate on PSB income by 5% for taxation years ending after 2015, through the introduction of proposed section 123.5. A prorated rate will apply for corporations having non-calendar year taxation years that begin in 2015 and end in 2016.

43. (1) Clauses 132(1)(*a*)(i)(A) and (B) of the Act are replaced by the following:

(A) 16.5% of the total of the trust's capital gains redemptions for the year, and

(B) the positive or negative amount, if any, that the Minister determines to be reasonable in the circumstances, after giving consideration to the percentages applicable in determining the trust's capital gains refunds for the year or any previous taxation year and the percentages applicable in determining the trust's refundable capital gains tax on hand at the end of the year, and

(2) The description of C in the definition *capital gains redemptions* in subsection 132(4) of the Act is replaced by the following:

C is 100/16.5 of the trust's refundable capital gains tax on hand at the end of the year,

(3) Paragraphs (*a*) and (*b*) of the description of A in the definition *refundable capital gains tax on hand* in subsection 132(4) of the Act are replaced by the following:

(*a*) the highest individual percentage for the year multiplied by its taxable income for the year,

(*b*) the highest individual percentage for the year multiplied by its taxed capital gains for the year, and

(4) Subsections (1) and (2) apply to the 2016 and subsequent taxation years.

(5) Subsection (3) applies to the 2016 and subsequent taxation years and, in respect of previous years prior to 2016, the references to "the highest individual percentage for the year" are to be read as "29%".

Dentons Canada LLP Commentary: Under section 132, the Minister may pay a capital gains refund to a mutual fund trust.

Budget 2016 proposes to amend several provisions of section 132 to reflect the change to the top personal tax rate from 29% to 33%. The top 33% personal rate is reflected in the formulas that are used in computing the refundable tax.

44. (1) Paragraph 143.1(3)(*c*) of the Act is replaced by the following:

(*c*) if the trust is liable to pay tax under Part XII.2 in respect of the particular year, 60% of the fair market value of all property held by it at that time, and

(2) Paragraph 143.1(4)(*a*) of the Act is replaced by the following:

(*a*) if the trust is liable to pay tax under Part XII.2 in respect of the year, 60% of the fair market value of all property held by it at that time; and

(3) Subsections (1) and (2) apply to the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: Budget 2016 proposes to modify the rules for amateur athlete trusts for 2016 and subsequent taxation years. Under subsections 143.1(3) and (4), where an amateur athlete trust is terminated or the beneficiary dies in the year, the trust is deemed to have distributed to the beneficiary a portion of the trust's property held at the time. Budget 2016 changes the percentage of property to be distributed from 64% to 60%.

45. (1) The description of A in subsection 207.8(2) of the Act is replaced by the following:

A is the highest individual percentage for the year;

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

Dentons Canada LLP Commentary: Under section 207.8, specified employees of a company (i.e., shareholders or non-arm's length individuals) may be taxable on excess employee profit sharing plan ("EPSP") amounts.

Budget 2016 proposes to modify the amount of tax payable by a specified employee in respect of an excess EPSP amount to 33% from 29%.

46. (1) The portion of subsection 210.2(1) of the Act before paragraph (*a*) is replaced by the following:

210.2 *Tax on income of trust.* (1) Subject to section 210.3, if a trust deducts an amount under paragraph 104(6)(*b*) in computing its income under Part I for a taxation year, the trust shall pay a tax under this Part in respect of the year equal to 40% of the least of

(2) Paragraph 210.2(1)(*c*) of the Act is replaced by the following:

(*c*) 100/60 of the amount deducted.

(3) The portion of subsection 210.2(2) of the Act before paragraph (*a*) is replaced by the following:

(2) *Amateur athlete trusts.* Notwithstanding subsection 210(2), a trust shall pay a tax under this Part in respect of a particular taxation year of the trust equal to 2/3 of the amount that is required by subsection 143.1(2) to be included in computing the income under Part I for a taxation year of a beneficiary under the trust, if

(4) Subsections (1) to (3) apply to the 2016 and subsequent taxation years.

Dentons Canada LLP Commentary: Under section 210.2, certain trusts are subject to an additional tax in respect of income designated to beneficiaries.

Budget 2016 proposes to modify the formulas for determining the amounts subject to tax and raises the tax rate from 36% to 40%, and for amateur athlete trusts raises the rate from 56.25% to 66.66%.

Resolution 47: Taxation of Switch Fund Shares

47. The Act is modified to give effect to the proposals relating to Taxation of Switch Fund Shares described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: Canadian mutual funds can be in the legal form of a trust or a corporation. While most mutual funds are structured as trusts, where a mutual fund is structured as a corporation it may be organized as a "switch fund". These mutual fund corporations use separate share classes in the same corporation to hold the assets for each fund. Investors are able to exchange shares of one class of the mutual fund corporation for shares of another class and rely on section 51 of the *Income Tax Act* to deem the switch not to be a disposition for income tax purposes.

Budget 2016 proposes to amend the *Income Tax Act* so that an exchange of shares of a mutual fund corporation (or investment corporation) that results in the investor switching between funds will be considered for tax purposes to be a disposition at fair market value. The proposed rules are not intended to apply to switches where the shares received only differ in respect of management fees or expenses and otherwise derive their value from the same portfolio.

Budget 2016 did not release the amendments to the *Income Tax Act* that would apply to bring this proposal into force. However, the proposed amendments will apply to dispositions of shares that occur after September 2016.

Resolutions 48 to 49: Sales of Linked Notes

48. (1) Section 20 of the Act is amended by adding the following after subsection (14.1):

(14.2) *Sales of linked notes.* For the purposes of subsection (14), the amount determined by the following formula is deemed to be interest that accrued on an assigned or otherwise transferred debt obligation — that is, at any time, described in paragraph 7000(1)(*d*) of the *Income Tax Regulations* — to which the transferee has become entitled to for a period commencing before the time of the transfer and ending at that particular time that is not payable until after that particular time:

$$A - (B + C)$$

where

A is the price for which the debt obligation was assigned or otherwise transferred at the particular time,

B is the amount by which the price (despite section 261, converted to Canadian currency using the exchange rate prevailing at the particular time, if the debt obligation is denominated in a foreign currency) for which the debt obligation was issued exceeds the portion, if any, of the principal amount of the debt obligation (despite section 261, converted to Canadian currency using the exchange rate prevailing at the particular time, if the debt obligation is denominated in a foreign currency) that was repaid by the issuer on or before the particular time, and

C is the portion of the amount, if any, by which the amount determined for A exceeds the amount determined for B, that is reasonably attributable to an increase in the value of fixed rate interest payments to be received under the debt obligation because of a decrease in market interest rates (for debt obligations denominated in the currency of the debt obligation) from the time of issue of the debt obligation to the particular time.

(2) Subsection (1) applies to transfers occurring after September 2016.

49. (1) The definition *security* in subsection 230(1) of the *Income Tax Regulations* is amended by adding the following after paragraph (*c*):

(*c*.1) a debt obligation that is, at any time, described in paragraph 7000(1)(*d*);

(2) Subsection (1) comes into force on October 1, 2016.

Dentons Canada LLP Commentary: A linked note is a debt obligation that typically pays "interest" based on some reference point such as the future value of a stock market index, commodity index, or similar index or asset. The interest is typically paid upon the maturity of the note. For example, a five-year note may pay the principal and all returns in five years upon maturity, with the "interest" being computed with reference to the value of a stock index at the time of maturity relative to its value at the time of the issuance of the note.

Linked notes are normally considered prescribed debt obligations ("PDOs") under regulation 7000(1)(*d*). Under the interest accrual rules that apply to this type of PDO, the amount of interest that is deemed to accrue in a particular year on the PDO is the "the maximum amount of interest thereon that could be payable thereunder in respect of that year". However, in any year prior to the year of maturity, it may be difficult or impossible to determine the maximum amount of interest that could be payable in respect of that year. As a result, the Canada Revenue Agency ("CRA") has allowed the interest on linked notes to be reported in the year of maturity rather than on an annual accrual basis (for example, see CRA document 2007-0237351R3, "Stock-link Notes", September 12, 2007).

For similar reasons, it has been difficult to apply the interest accrual rules of subsection 20(14) of the *Income Tax Act* to linked notes when they are transferred prior to maturity.

Those rules generally apply to include the pre-transfer accrued interest on a debt obligation in the transferor's income and to exclude the same amount from the transferee's income. Since the pre-transfer accrued interest on a transfer of a linked note is difficult (or impossible) to determine, some taxpayers have taken the position that any accrued gain on the transfer should be considered to be a capital gain (half of which is included as a taxable capital gain) rather than interest which is subject to full rate income inclusion.

Resolution 48 proposes new subsection 20(14.2). Under that provision, the pre-transfer accrued gain on a transfer of a linked note or similar PDO described in Regulation 7100(1)(*d*) will be deemed to be interest. The deemed interest will be subject to the accrual rules of subsection 20(14), which add the interest to the transferor's income and provide a deduction in computing the transferee's income. Generally, the deemed interest will equal the transfer price paid for the note minus the original issue price of the note, without regard to portion of the gain, if any, that results from foreign currency fluctuations. Any portion of the accrued gain that is attributable to an increase in the value of fixed-interest payments, if any, because of a decrease in market interest rates, will be excluded from the deemed interest rule under subsection 20(14.2).

Resolution 48 applies to transfers occurring after September 2016.

Resolution 49 provides that linked notes and other PDOs described in Regulation 7000(1)(*d*) will be subject to the reporting rules of regulation 230 that apply to traders and dealers in securities. Resolution 49 applies as of October 1, 2016.

Resolution 50: Emissions Trading Regimes

50. The Act is modified to give effect to the proposals relating to Emissions Trading Regimes described in the Budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: There are no specific income tax provisions dealing with emission trading transactions, and therefore tax consequences are determined using general income tax principles. Concern has been expressed that there is uncertainty regarding these transactions in addition to potential double-taxation relating to emissions allowances provided by government entities for no consideration.

Regulated emitters currently treat emissions allowances as eligible capital property ("ECP") for tax purposes. With the proposed repeal of the ECP rules in favour of a capital cost allowance system (discussed below) certain tax policy concerns have been raised respecting the appropriateness of treating emissions allowances as capital property. First, capital property is generally property of an enduring nature, but most emissions allowances are commonly viewed as one-time use property. Second, the treatment of emissions allowances as capital property could result in a mismatch of expenses where the obligation to remit allowances is deductible as current expenses.

Emissions allowances provided at no consideration by a government entity are generally required to be included in income as government assistance. There is no provision that allows the cost of the income inclusion to be increased for this income inclusion, raising the possibility of double taxation on disposition of the emissions allowance.

Budget 2016 proposes to introduce specific rules to treat emissions allowances as inventory. The lower of cost and market valuation method will not be available to be used due to the potential volatility in their value. Free allowances will not be required to be included in income.

Deductions in respect of accrued omissions allowances will be limited to the extent the accrued obligation exceeds the cost of any emissions allowances that the taxpayer has acquired and that can be used to settle the obligation.

Deductions will be treated like the current system for reserves. Each year a taxpayer claims a deduction in respect of an omissions obligation, it will quantify its deduction based on the cost of emissions allowances acquired plus the fair market value of any emissions allowances that it needs to acquire to fully satisfy its obligations. Deductions claimed in one year (say 2017) that will be satisfied in a future year (say 2018) will be required to be brought back into income in 2018, and the taxpayer will be required to evaluate the obligation each year until it is fully satisfied.

Emissions allowances that have been disposed of will be included in income to the extent the proceeds exceed the cost of the emissions allowance disposed of.

These proposals will apply to emissions allowances acquired in taxation years beginning after 2016 and on an elective basis in respect of emissions allowances in taxation years ending after 2012.

Resolutions 51 to 53: Small Business Tax Rate

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

(i) the product of the amount determined under paragraph (*a*) in respect of the taxpayer for the taxation year multiplied by 17%, and

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

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

(*a*) the product of the amount, if any, that is required by subparagraph 82(1)(*b*)(i) to be included in computing the individual's income for the year multiplied by 21/29; and

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

53. (1) Subsection 125(1.1) of the Act is amended by adding "and" at the end of paragraph (*a*) and by replacing paragraphs (*b*) to (*e*) with the following:

(*b*) that proportion of 17.5% that the number of days in the taxation year that are after 2015 is of the number of days in the taxation year.

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

Dentons Canada LLP Commentary: Budget 2016 proposes to reverse the phased-in increase of the small business deduction provided in subsection 125(1) of the Act. For Canadian-controlled private corporations ("CCPCs"), a deduction is available on the first $500,000 of the corporation's income earned in the year from an active business carried on in Canada. The general tax rate applicable to corporations in Canada is 28%. The small business deduction ("SBD") reduces this rate by 17.5% for 2016, providing for an overall federal corporate income tax rate on income eligible for the SBD of 10.5% (additional provincial tax will also apply). In the 2015 federal budget, the government had introduced a phased-in increase of the SBD from 11% (for 2015 and prior years), to 9%, by reducing the rate by 0.5% each year until 2019.

Budget 2016 preserves the reduction of the overall tax rate on small business income to 10.5% (i.e. a 17.5% reduction from the overall rate), but the previously-legislated reductions for 2017, 2018 and 2019 have been eliminated. As a result, the rate of tax on income eligible for the SBD will remain at 10.5% for 2016 and future years. A pro-rated rate will apply for corporations having non-calendar year taxation year ends.

In order to pay lip service to the concept of tax integration, corresponding changes to the "gross up and credit" rates for dividends other than eligible dividends received by and individual from a corporation resident in Canada. In general, a dividend (other than an "eligible dividend") received by an individual resident in Canada is "grossed up" under paragraph 82(1)(a) of the Act so that the amount brought into income of the individual more closely resembles the pre-tax earnings of the corporation that gave rise to the dividend. A credit is then available under section 121 of the Act to reflect the underlying corporate tax that has been paid by the corporation. As the system is intended to ensure that income earned through a corporation is, once distributed to an individual shareholder, subject to tax at the same overall rate as had the individual earned it directly, the amount of the gross up in paragraph 82(1)(a) and the credit paragraph 121(a) must be adjusted when there is a change to the underlying corporate tax rate.

As such, the previously-legislated changes to both the gross-up and credit rates have been eliminated for years after 2016. For 2016 and later years, the gross-up on dividends (other than eligible dividends) received from a corporation resident in Canada will remain at 17%, and the phased-in reduction to 15% is eliminated. As for the tax credit available on dividends (other than eligible dividends) received by an individual resident in Canada from a Canadian corporation, the previously-enacted change to 9/13 by 2019 is likewise eliminated; the credit rate will remain at 21/29ths for 2016 and future years.

Resolution 54: Multiplication of the Small Business Deduction

54. (1) Subparagraphs 125(1)(*a*)(i) and (ii) of the Act are replaced by the following:

(i) the total of all amounts each of which is the amount of income of the corporation for the year from an active business carried on in Canada, other than an amount that is

(A) described in paragraph (*a*) of the description of A in the definition *specified partnership income* in subsection (7) for the year,

(B) described in subparagraph (*a*)(i) of the definition *specified corporate income* in subsection (7) for the year, or

(C) paid or payable to the corporation by another corporation with which it is associated, that is deemed by subsection 129(6) to be income for the year from an active business carried on by the corporation in circumstances where the associated corporation is not a Canadian-controlled private corporation or is a Canadian-controlled private corporation that has made an election under subsection 256(2) in respect of its taxation year in which the amount was paid or payable,

(ii) the specified partnership income of the corporation for the year, and

(ii.1) the specified corporate income of the corporation for the year

(2) Section 125 of the Act is amended by adding the following after subsection (3):

(3.1) *Reduction — business limit.* The business limit for the year of a corporation under subsection (2) or (3) is reduced by the total of all amounts each of which is the portion, if any, of the business limit that the corporation assigns to another corporation under subsection (3.2).

(3.2) *Assignment.* For the purpose of this section, a Canadian-controlled private corporation (in this subsection referred to as the "first corporation") may assign all or any portion of its business limit under subsection (2) or (3) for a taxation year of the first corporation to another Canadian-controlled private corporation (in this subsection referred to as the "second corporation") for a taxation year of the second corporation if (*a*) the second corporation has income, for its taxation year, described in subparagraph (*a*)(i) of the definition *specified corporate income* in subsection (7) from the provision of services or property to the first corporation;

(*b*) the first corporation's taxation year ends in the second corporation's taxation year;

(*c*) the amount assigned does not exceed the amount of income referred to in paragraph (a); and

(*d*) a prescribed form is filed with the Minister by

(i) the first corporation in its return of income for its taxation year, and

(ii) the second corporation in its return of income for its taxation year.

(3) The description of A in the definition "specified partnership income" in subsection 125(7) is replaced by the following:

A is the total of all amounts each of which is an amount in respect of a partnership of which the corporation was a member, or a designated member, in the year equal to the lesser of

(*a*) the total of all amounts each of which is an amount in respect of an active business carried on in Canada by the corporation as a member, or a designated member, of the partnership determined by the formula

$$G - H$$

where

G is the total of all amounts each of which is

(i) the corporation's share of the income (determined in accordance with subdivision j of Division B) of the partnership for a fiscal period of the business that ends in the year,

(ii) income of the corporation for the year from the provision (directly or indirectly, in any manner whatever) of services or property to the partnership, or

(iii) an amount included in the corporation's income for the year in respect of the business under any of subsections 34.2(2), (3) and (12), and

H is the total of all amounts deducted in computing the corporation's income for the year from the business (other than amounts that were deducted in computing the income of the partnership from the business or the income of the corporation described under subparagraph (ii) of the description of G) or in respect of the business under subsection 34.2(4) or (11), and

(*b*) an amount equal to

(i) if the corporation was a member of the partnership, the corporation's specified partnership business limit for the year, and

(ii) if the corporation was a designated member of the partnership, the total of all amounts assigned to it under subsection (8) for the year and, where no such amounts have been assigned, nil, and

(4) Paragraph (*b*) of the description of B in the definition *specified partnership income* in subsection 125(7) of the Act is replaced by the following:

(*b*) the total of all amounts each of which is an amount in respect of a partnership of which the corporation was a member, or a designated member, in the year equal to the amount determined by the formula

$$N - O$$

where

N is the amount determined in respect of the partnership for the year under paragraph (*a*) of the description of A, and

O is the amount determined in respect of the partnership for the year

(i) if the corporation was a member of the partnership, under subparagraph (*b*)(i) of the description of A, and

(ii) if the corporation was a designated member of the partnership, under subparagraph (*b*)(ii) of the description of A;

(5) Subsection 125(7) of the Act is amended by adding the following in alphabetical order:

designated member, of a particular partnership in a taxation year, means a Canadian-controlled private corporation that provides (directly or indirectly, in any manner whatever) services or property to the particular partnership at any time in the corporation's taxation year where, at any time in the year,

(*a*) the corporation is not a member of the particular partnership; and

(*b*) either

(i) one of its shareholders holds a direct or indirect interest in the particular partnership, or

(ii) if subparagraph (i) does not apply,

(A) the corporation does not deal at arm's length with a person that holds a direct or indirect interest in the particular partnership, and

(B) it is not the case that all or substantially all of the corporation's income for the year from an active business is from providing services or property to

(I) persons with which the corporation deals at arm's length, or

(II) partnerships (other than the particular partnership) with which the corporation deals at arm's length, other than a partnership in which a person that does not deal at arm's length with the corporation holds a direct or indirect interest;

specified corporate income, of a corporation for a taxation year, means the lesser of

(*a*) the lesser of

(i) the total of all amounts each of which is income from an active business of the corporation for the year from the provision of services or property to a private corporation (directly or indirectly, in any manner whatever) if

(A) at any time in the year, the corporation (or one of its shareholders) or a person who does not deal at arm's length with the corporation (or one of its shareholders) holds a direct or indirect interest in the private corporation, and

(B) it is not the case that all or substantially all of the corporation's income for the year from an active business is from the provision of services or property to

(I) persons (other than the private corporation) with which the corporation deals at arm's length, or

(II) partnerships with which the corporation deals at arm's length, other than a partnership in which a person that does not deal at arm's length with the corporation holds a direct or indirect interest, and

(ii) the total of all amounts each of which is the portion, if any, of the business limit of a private corporation described in subparagraph (i) for a taxation year that the private corporation assigns to the corporation under subsection (3.2), and

(*b*) an amount that the Minister determines to be reasonable in the circumstances;

specified partnership business limit, of a person for a taxation year, at any particular time, means the amount determined by the formula

$$(K/L) \times M - T$$

where

K is the total of all amounts each of which is the person's share of the income (determined in accordance with subdivision j of Division B) of a partnership of which the person was a member for a fiscal period ending in the year from an active business carried on in Canada,

L is the total of all amounts each of which is the income of the partnership for a fiscal period referred to in paragraph (*a*) of the description of A in the definition *specified partnership income* in this subsection from an active business carried on in Canada, and

M is the lesser of

(*a*) the amount of the business limit indicated in subsection (2) for a corporation that is not associated in a taxation year with one or more other Canadian-controlled private corporations, and

(*b*) the product obtained by the formula

$$(Q/R) \times S$$

where

Q is the amount referred to in paragraph (*a*) of the description of M,

R is 365, and

S is the total of all amounts each of which is the number of days in the fiscal period of the partnership that ends in the year, and

T is the total of all amounts each of which is an amount, if any, that the person assigns under subsection (8);

(6) Section 125 of the Act is amended by adding the following after subsection (7):

(8) *Assignment — specified partnership business limit.* For the purpose of the definition *specified partnership income* in subsection (7), a person that is a member of a partnership in a taxation year may assign to a designated member of the partnership — for a taxation year of the designated member — all or any portion of the person's specified partnership business limit (determined without reference to this assignment) in respect of the person's taxation year if

(*a*) the person is described in paragraph (*b*) of the definition *designated member* in subsection (7) in respect of the designated member in the designated member's taxation year;

(*b*) the specified partnership business limit of the person is in respect of a fiscal period of the partnership that ends in the designated member's taxation year; and

(*c*) a prescribed form is filed with the Minister by

(i) the designated member in its return of income for the designated member's taxation year, and

(ii) the person in its return of income for the person's taxation year.

(9) *Anti-avoidance.* If a corporation provides services or property to a person or partnership that holds a direct or indirect interest in a particular partnership or corporation and one of the reasons for the provision of the services or property to the person or partnership, instead of to the particular partnership or corporation, is to avoid the application of subparagraph (1)(*a*)(ii) or (ii.1) in respect of the income from the provision of the services or property, no amount in respect of the corporation's income from the provision of the services or property is to be included in the total amount determined under paragraph (1)(*a*).

(7) Subsections (1) to (6) apply to taxation years that begin on or after Budget Day, except that a person who is entitled to make an assignment under subsection 125(3.2) of the Act, as enacted by subsection (2), or under subsection 125(8) of the Act, as enacted by subsection (6), can make such an assignment in respect of the person's taxation year that begins before and ends on or after Budget Day if the assignment is made to another person for their taxation year that begins on or after Budget Day.

Dentons Canada LLP Commentary: Budget 2016 proposes new measures aimed at eliminating the use of certain structures to "multiply" the availability of the small business deduction ("SBD") in certain situations that the government considers inappropriate. In general, the Act provides that the SBD is available only on the first $500,000 of income from an active business carried on in Canada in the year by a Canadian-controlled private corporation (a "CCPC"). This amount must be shared among CCPCs that are "associated" which each other, and is reduced on a straight line basis as the taxable capital employed in Canada of the CCPC (together with associated corporations) exceeds $10M, being fully eliminated once taxable capital employed in Canada totals $15M.

Where an active business is carried on through a partnership, the "specified partnership income" ("SPI") rules apply, such that only the first $500,000 of income of the partnership from the business is eligible for the SBD, and is allocated to each of the partners in accordance with their interest in the partnership. For a partner that is an eligible CCPC, SPI is eligible for the small business deduction, but will "count" towards the corporation's SBD limit of $500,000 for the year. To take a very simple example, if four corporations are equal members of a partnership that has $2,000,000 of income from an active business for the year, each corporation will have SPI of $125,000 (being 25% of the $500,000 limit) and non-SBD eligible income of $375,000. Had each corporation earned its proportionate share of the income directly (not through the partnership) each would presumably be able to claim the SBD on the full $500,000 of income.

As result of this limitation, various structures have emerged that seek to provide access to the $500,000 SBD limit where the SPI rules might otherwise apply. In an example of one such structure cited in the Budget documents, a professional partnership that provides accounting services to the public pays certain amounts as fees under a contract for services to a corporation that is controlled by a member of that partnership (although the corporation itself is not a member). Presumably, under existing legislation, the amount of the fee received by the corporation is not treated as SPI and the full $500,000 SBD limit is available. A variation on this structure also noted in the Budget documents is where the shareholder of the CCPC receiving fees is not a member of the partnership; provided that the amount received from the partnership is not a distribution of partnership income (which, since the corporation is not a partner in the partnership cannot be the case) the corporation has no SPI and the full $500,000 SBD limit is available.

Budget 2016 seeks to eliminate the so-called "multiplication" of the SBD using partnership structures. A new definition will be added to subsection 125(7) of the Act, "designated member" which will deem a CCPC to be a member of a partnership that the CCPC is not otherwise at law a member of where certain conditions are met. Specifically, the income of a CCPC will be SPI if: (i) the CCPC provides services or property to the particular partnership at any time in the CCPC's taxation year, (ii) the CCPC is not a member of the particular partnership, and (iii) either: (x) one of the shareholders of the CCPC holds a direct or indirect interest in the partnership, or (y) the CCPC does not deal at arm's length with a person that holds a direct or indirect interest in the partnership, and the CCPC does not derive all or substantially all (generally understood to be 90%) of its income from an active business from providing services or property to arm's length persons or partnerships (excluding any partnership in which a non-arm's length person to the CCPC holds a direct or indirect interest). This provision appears to provide a safe harbour for CCPCs that are actively providing services or property to various unrelated persons, notwithstanding that a person who is non-arm's length with the corporation is a direct or indirect member of the partnership.

The use of the phrase "direct or indirect" member suggests that Parliament intends a very broad interpretation of who is to be treated as a member of the partnership for these purposes. It is not clear whether this phrasing is meant, for example, to pierce the corporate veil and treat a shareholder of a corporation as an "indirect" member of a partnership. The case law stands for the proposition that a shareholder of a corporation is not considered to have an interest in the property of the corporation.

It appears that these provisions could apply as well to tiered structures, whereby a taxpayer has a holding corporation own the shares of the corporation that is a member of the partnership, and the corporation that is a member of the partnership pays fees to the holding corporation that are not currently considered SPI under existing rules.

The new concept of designated member is relevant in determining whether a CCPC must reduce the amount of its income that is eligible for the SBD. Existing subparagraph 125(1)(*a*)(i) of the Act will be repealed, and a new subparagraph 125(1)(*a*)(i) will replace it. This provision will reduce the amount available to an otherwise eligible CCPC in claiming the SBD by certain amounts. In respect of SPI, amounts described in revised element "A" of the definition of SPI will reduce the amount that can be claimed as eligible for the SBD. That provision will now capture the income of a "designated member" of the partnership. In addition, income of the corporation from providing services or property, directly or indirectly, in any manner whatever, to the partnership will now "count" towards the computation of the corporation's SPI.

Additional rules are also introduced to address the fact that a designated member of a partnership does not have any actual income from the partnership in determining the designated member's SBD income limit for the year. New paragraph 125(8) will allow a member of a partnership to assign any or all of the members "specified partnership business limit" (as defined in amended subsection 125(7)) where the following conditions are met: (a) the assignor is described in paragraph (b) of the definition of "designated member" (essentially a person who does not deal at arm's length with the designated member), (b) the fiscal period of the partnership giving rise to the SPI must end in the taxation year of the designated member, and (c) each of the assignor and assignee files a prescribed for with the CRA in its taxation year in which the assignment occurs.

Budget 2016 also introduces new measures to prevent taxpayers from using corporations to avoid inappropriately the SBD limitations. Although the Budget documents do not cite any specific examples, it appears to be targeting structures where a CCPC earns active business income from providing property or services to a private corporation in which the CCPC, a shareholder of the CCPC or a person who does not deal at arm's length with such shareholder has a direct or indirect interest in the private corporation. To address this perceived abuse, the Act will be amended to include a new concept of "specified corporate income" ("SCI"), which will be defined in subsection 125(7) of the Act.

That definition, which parallels the definition of designated member, essentially deems any income of a CCPC from the provision of services or goods to a private corporation to be SCI where certain conditions are met. First, the corporation, one or its shareholders, or a person who does not deal at arm's length with the corporation or one of its shareholders must hold a direct or indirect interest in the private corporation. It should be noted that this is an extremely broad concept which may end up inappropriately treating income as SCI. Second, the CCPC does not earn all or substantially all (90%) of its income from an active business for the year from the provision of services or goods to non-arm's length persons or partnership. Where these conditions are met, the CCPC will have SCI, subject to the assignment discussed below, the SBD cannot be claimed in respect of SCI.

New paragraph 125(3.2) will allow a CCPC to assign any or all of its business limit to another CCPC where certain conditions are met. To assign the business limit: (a) the assignee CCPC has income from the year that is SCI, (b) the assignor CCPC's taxation year ends in the assignee CCPC's taxation year, (c) the amount assigned cannot exceed the assignee CCPC's SCI for the year, and (d) each of the CCPCs files a prescribed form with the CRA in its tax return for the particular year. Pursuant to new subsection 125(3.1), the assignee CCPC's business limit is reduced by the amount of such assignment.

Additional related measures, including an anti-avoidance measure in new subsection 125(9), which applies where the provision of certain services or goods are made to a person or partnership instead of a particular partnership or corporation and one of the reasons is to avoid the application of the SPI or SCI rules, are also introduced.

These amendments will be effectively for taxation years that begin on or after March 22, 2016, provided that an assignment under either proposed subsection 125(3.2) or 125(8) can be made for taxation years beginning before March 22, 2016 and ending on or after that date if the taxation year of the assignee begins on or after March 22, 2016.

Resolution 55: Avoidance of the Business Limit and Taxable Capital Limit

55. (1) Subsection of the 256(2) of the Act is replaced by the following:

(2) *Corporations associated through a third corporation.* For the purposes of

(*a*) this Act, subject to paragraph (*b*), two corporations are deemed to be associated with each other at a particular time if

(i) they would, but for this subsection, not be associated with each other at the particular time, and

(ii) each corporation is associated with, or is deemed by this subsection to be associated with, the same corporation (in this subsection referred to as the "third corporation") at the particular time; and

(*b*) section 125,

(i) if the third corporation is not a Canadian-controlled private corporation at the particular time, the two corporations are deemed not to be associated with each other at the particular time, and

(ii) if the third corporation is a Canadian-controlled private corporation that elects in prescribed form to apply this subparagraph in its taxation year that includes the particular time, the two corporations are deemed not to be associated with each other at the particular time and the business limit of the third corporation for its taxation year that includes the particular time is deemed to be nil.

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

Dentons Canada LLP Commentary: The Budget contains additional anti-avoidance measures aimed at certain structures which seek to circumvent the rules (discussed above) which limit a CCPC's SBD to the first $500,000 of active business income earned in Canada, and which eliminate the availability of the SBD where taxable capital employed in Canada exceeds $15M. In general, these limits must be aggregated among corporations that are "associated" within the meaning of subsection 256(1) of the Act. The amendments seek particularly to address structures that utilize subsection 256(2) of the Act in a manner perceived by the government to be abusive.

Subsection 256(2) of the Act provides a "connective" rule – two corporations that are not otherwise associated are deemed to be associated where each is associated with the same third corporation. However, the post-amble to subsection 256(2) provides that for purposes of computing the SBD in section 125, if the third corporation is not a CCPC, or if it is a CCPC and it files an election, the third corporation is deemed not to be associated with the other two corporations (and its business limit is deemed to be nil). As a result of this exemption, the two corporations may each claim the $500,000 SBD limit, whereas absent the exemption, all three corporations would be required to aggregate a single $500,000 SBD limit.

However, this exemption applies solely for the purposes of determining the SBD of each corporation, and does not apply for other purposes in the Act, including subsection 129(6) which provides that certain income that would otherwise be income from property (interest or rent, for example) is treated as active business income when the income is paid by an associated corporation and is deductible in computing the associated corporation's income from an active business. Since ordinarily the corporations would be associated and have to share the SBD limit, this rule would not in itself result in any abuse. However, in the government's view, when inappropriately combined with the rule in subsection 256(2), it can result in a multiplication of the SBD income limit in a manner that is against the policy objectives of these rules.

To address this issue, Budget 2016 proposes replacing existing subsection 256(2) with a new rule having broader application. This rule provides that for purposes of the Act, two corporations not otherwise associated with each other will be deemed to be associated with each other where each is associated with, or is deemed by proposed subsection 256(2) of the Act to be associated with, a third corporation. For the purposes of section 125, the two corporations are automatically deemed not to be associated where the third corporation is a non-CCPC. Where the third corporation is a CCPC, an election can be made such that the two corporations will not be associated (and the third corporation will have a nil business limit. This is a change from the existing legislation which provides that each corporation is deemed not to be associated with the third corporation.

In addition, a corresponding amendment is being proposed to subparagraph 125(1)(*a*)(i) of the Act to provide that an amount paid or payable by one corporation to an associated CCPC that would otherwise benefit from the provision in subsection 129(6) of the Act is not eligible for the SBD in circumstances where the associated corporation is either: (i) not a CCPC, or (ii) is a CCPC that has made the election under subsection 256(2).

This amendment is effective for taxation years that begin on or after March 22, 2016.

Resolutions 56 to 59: Life Insurance Policies

56. The portion of subparagraph 53(1)(*e*)(iii) of the Act after clause (A) is replaced by the following:

exceeds the total of all amounts each of which is

(B) the *adjusted cost basis* (as defined in subsection 148(9)), immediately before the death, of

(I) if the death occurs before Budget Day, the policy to the partnership, and

(II) if the death occurs on or after Budget Day, a policyholder's interest in the policy, or

(C) the amount by which the fair market value of consideration given in respect of a disposition of an interest in the policy exceeds the amount determined under subparagraph 148(7)(*a*)(i) in respect of the disposition if

(I) the death occurs on or after Budget Day, and

(II) the disposition was before Budget Day,

57. (1) Subparagraph (*d*)(iii) of the definition *capital dividend account* in subsection 89(1) of the Act is replaced by the following:

(iii) the *adjusted cost basis* (as defined in subsection 148(9)), immediately before the death, of

(A) if the death occurs before Budget Day, the policy to the corporation, and

(B) if the death occurs on or after Budget Day, a policyholder's interest in the policy,

(2) Paragraph (*d*) of the definition *capital dividend account* in subsection 89(1) of the Act is amended by adding "or" at the end of subparagraph (iv) and by adding the following after that subparagraph:

(v) if the death occurs on or after Budget Day, an interest in the policy was disposed of before Budget Day and subsection 148(7) applied to the disposition, the total of

(A) the amount, if any, by which the fair market value of consideration given in respect of the disposition exceeds the total of

(I) the amount determined under subparagraph 148(7)(*a*)(i) in respect of the disposition, and

(II) the amount of any reduction in the paid-up capital of any class of the capital stock of a corporation because of the application of paragraphs 148(7)(*c*) and (*f*) resulting from the disposition, and

(B) if the paid-up capital in respect of a class of shares of the capital stock of a corporation was increased before Budget Day as described in subparagraph 148(7)(*f*)(iii) in respect of the disposition, the amount, if any, by which the total reduction in the paid-up capital in respect of that class — not exceeding the amount of that increase — after that increase and before Budget Day (except to the extent that the amount of the reduction was deemed by subsection 84(4) or (4.1) to be a dividend received by a taxpayer) exceeds the amount determined under subparagraph 148(7)(*a*)(i) in respect of the disposition,

(3) Subparagraph (*b*)(iii) of the definition *paid-up capital* in subsection 89(1) of the Act is replaced by the following:

(iii) where the particular time is after March 31, 1977, an amount equal to the paid-up capital in respect of that class of shares at the particular time, computed without reference to the provisions of this Act except subsections 51(3) and 66.3(2) and (4), sections 84.1 and 84.2, subsections 85(2.1), 85.1(2.1) and (8), 86(2.1), 87(3) and (9), paragraph 128.1(1)(c.3), subsections 128.1(2) and (3), section 135.2, subsections 138(11.7), 139.1(6) and (7), 148(7), 192(4.1) and 194(4.1) and sections 212.1 and 212.3,

Dentons Canada LLP Commentary: Life insurance proceeds received following the death of the insured (the "policy benefit") are generally non-taxable. The "insurance benefit limit" (the policy benefit received less the policyholder's adjusted cost base) can be added to a private corporation's capital dividend account ("CDA") or used to increase the adjusted cost base of a partnership interest. In either case this permits the payment of funds to a shareholder or partner on a tax-free basis.

Budget 2016 addresses the government's concerns that a partnership may be entitled to receive life insurance proceeds in respect of a policy which it does not own. In this case, the increase of the adjusted cost base of the partnership interest is reduced by the policyholder's interest in the policy if the death of the life insured occurs on or after the Budget Date. In addition, the adjusted cost base of the partnership interest is reduced by the amount that the fair market value of consideration given in respect of a disposition of an interest in a policy exceeds the cash surrender value of the policy.

Similarly, the Capital Dividend Account of a corporation which receives life insurance proceeds will be reduced by the adjusted cost base of any policyholder's interest in the policy.

Budget 2016 proposes to calculate the insurance benefit limit consistently, regardless of whether the corporation or partnership is also a policyholder. These measures will apply to policy benefits received after Budget Day.

58. Subsection 148(7) of the Act is replaced by the following:

(7) *Disposition at non-arm's length and similar cases.* If an interest of a policyholder in a life insurance policy is, at any time (referred to in this subsection as the "disposition time"), disposed of (other than a disposition under paragraph (2)(*b*)) by way of a gift, by distribution from a corporation, by operation of law only, or in any manner whatever to any person with whom the policyholder was not dealing at arm's length,

(*a*) the policyholder is deemed to become entitled to receive, at the disposition time, proceeds of the disposition equal to the total of

(i) the value of the interest at the disposition time, and

(ii) an amount equal to

(A) if the disposition time is before Budget Day, nil, and

(B) if the disposition time is on or after Budget Day, the amount, if any, by which the fair market value at the disposition time of the consideration given for the interest exceeds the value of the interest at the disposition time;

(*b*) the person that acquires the interest because of the disposition is deemed to acquire it, at the disposition time, at a cost equal to the total determined under paragraph (*a*) in respect of the disposition;

(*c*) in computing the paid-up capital in respect of each class of shares of the capital stock of a corporation at any time at or after the disposition time there shall be deducted the amount determined by the formula

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

where

A is the increase, if any, as a result of the disposition, in the paid-up capital in respect of all the shares of the capital stock of the corporation,

B is the total determined under paragraph (*a*) in respect of the disposition, and

C is the increase, if any, as a result of the disposition, in the paid-up capital in respect of the class of shares, computed without reference to this paragraph as it applies to the disposition;

(*d*) any contribution of capital to a corporation or partnership in connection with the disposition is deemed, to the extent that it exceeds the amount determined under subparagraph (*a*)(i) in respect of the disposition, not to result in a contribution of capital for the purpose of applying paragraphs 53(1)(*c*) and (*e*) at or after the disposition time;

(*e*) any contributed surplus of a corporation that arose in connection with the disposition is deemed, to the extent that it exceeds the amount determined under subparagraph (*a*)(i) in respect of the disposition, not to be contributed surplus for the purpose of applying subsection 84(1) at or after the disposition time; and

(*f*) if the disposition time is before Budget Day,

(i) paragraphs (*c*) to (*e*) and subparagraphs (ii) to (iv) apply in respect of the disposition only if at least one person whose life was insured under the policy before Budget Day is alive on Budget Day,

(ii) in applying paragraphs (*c*) to (*e*) in respect of the disposition, a reference in those paragraphs to "disposition time" is to be read as "the start of Budget Day",

(iii) if at any time ("the conversion time") before Budget Day the paid-up capital of a class of shares of the capital stock of a corporation was increased, the increase occurred as a result of any action by which the corporation converted any of its contributed surplus into paid-up capital in respect of the class of shares, the contributed surplus arose in connection with the disposition, and subsection 84(1) did not apply to deem the corporation to pay a dividend at the conversion time in respect of the increase, in computing the paid-up capital in respect of that class of shares on or after Budget Day, there shall be deducted the amount determined by the formula

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

where

A is the increase, if any, as a result of the conversion, in the paid-up capital in respect of all the shares of the capital stock of the corporation, computed without reference to this paragraph as it applies to the disposition,

B is the amount determined under subparagraph (*a*)(i) in respect of the disposition,

C is the increase, if any, as a result of the conversion, in the paid-up capital in respect of the class of shares, computed without reference to this paragraph as it applies to the disposition, and

D is the total amount of the corporation's contributed surplus that arose in connection with the disposition, and

(iv) in computing the paid-up capital in respect of each class of shares of the capital stock of a corporation on or after Budget Day, there shall be added the amount, if any, determined by the formula

$$A + B + C$$

where

A is the amount, in respect of that class, determined by the formula in paragraph (c) in respect of the disposition at the start of Budget Day,

B is the amount, in respect of that class, determined by subparagraph (iii) in respect of the disposition at the start of Budget Day, and

C is the paid-up capital in respect of that class immediately before the start of Budget Day.

Dentons Canada LLP Commentary: Reforming the taxation of life insurance policies and proceeds continues to be an area of concern for the government. Budget 2016 proposes new measures targeted at eliminating a particular transaction whereby taxpayers were taking advantage of a "mismatch" in the rules pertaining to the taxation of related-party dispositions of life insurance policies versus the rules applying to the transfer of other property to a corporation. Under existing subsection 148(7), where a policyholder transfers an interest in a life insurance policy to a person with whom the policyholder did not deal at arm's length, the disposition was generally deemed to occur at an amount equal to the "cash surrender value" of the policy, which in many cases is equal to the taxpayer's adjusted cost basis in the policy, so that no gain arises on the transfer. However, the policyholder could extract value from the corporation (in the form of a note or otherwise) up to the fair market value of the policy, without any benefit or dividend being included in income. In cases where the policy had a fair market value in excess of the cash surrender value, corporate surplus could be extracted tax free by transferring the policy to a corporation.

Budget 2016 seeks to preclude this result by replacing subsection 148(7) with a rule that provides, among other things, that the taxpayer will be deemed to have received proceeds of disposition equal to: (a) the cash surrender value of the policy, plus (b) nil, if the disposition occurred before March 22, 2016, and (c) the difference between the cash surrender and the fair market value of the consideration given by the corporation where the disposition occurred on or after March 22, 2016. It should be noted that the CRA takes the view that a life insurance policy is not "eligible property" for purposes of the section 85 rollover (see, for example, CRA Document No. 9211270 "ollover of Life Insurance Policies" May 11, 1992).

Additional provisions are also proposed to provide that the same result (an extraction of corporate surplus by way of a policy transfer) cannot occur by treating the transfer as a contribution of capital to a corporation, or a contribution to a partnership in exchange for an interest in the taxpayer's capital account. A PUC grind is also proposed to eliminate any addition to PUC arising on a transfer of a policy that is in excess of the amount treated as proceeds of the disposition to the transferor.

Although generally subject to grandfathering for existing transfers, proposed paragraph 148(7)*(f)* will apply to certain transfers which occurred prior to March 22, 2016, where at least one person whose life is insured under the policy is still alive as of that date.

59. The Act and *Income Tax Regulations* are further modified to make such amendments as are necessary to give effect to the proposals relating to Life Insurance Policies described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: The Act and the *Income Tax Regulations* are to be modified to make such amendments as necessary to give effect to the proposals relating to life insurance policies described in the budget documents.

Resolution 60: Debt-Parking to Avoid Foreign Exchange Gains

60. The Act is modified to give effect to the proposals relating to Debt-Parking to Avoid Foreign Exchange Gains described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: Budget 2016 proposes a new rule that applies where a taxpayer enters into a debt parking transaction to avoid the inclusion of a foreign exchange gain that would otherwise be realized when foreign currency denominated debt is settled or extinguished.

Generally, all amounts relevant to the computation of income under the *Income Tax Act* must be reported in Canadian dollars and, where a taxpayer borrows funds in a foreign currency, that amount must be converted into Canadian dollars at the time of borrowing as well as at the time of repayment. Consequently, a taxpayer may realize a gain or loss on the repayment of such a foreign currency denominated debt where the relative value of the Canadian dollar has fluctuated between the time of borrowing and the time of repayment.

To avoid realizing a foreign exchange gain on the repayment of a foreign currency denominated debt, some taxpayers entered into debt-parking transactions. Rather than directly repaying a debt with an accrued foreign exchange gain, the debtor would arrange for a person with which it does not deal at arm's length to acquire the debt from the initial creditor for a purchase price equal to its principal amount. While the original creditor will have been repaid, the actual debt would remain outstanding thereby avoiding the recognition of the foreign currency gain.

While such transactions can be challenged under the existing general anti-avoidance rule, such challenges are viewed as being both time-consuming and costly to the government.

Budget 2016 proposes amendments that will require any accrued foreign exchange gains on foreign currency denominated debt to be realized when a debt becomes a parked obligation. For these purposes a foreign currency debt would be considered to become a parked obligation as a result of its acquisition by a holder that does not deal at arm's length with the debtor. The gain will be computed as if the debtor had paid an amount in satisfaction of the principal amount (expressed in the currency in which the debt is denominated) equal to the amount for which the debt was acquired (where the becomes a parked obligation as a result of its acquisition by the current holder) and in all other cases the fair market value of the debt.

Budget 2016 also provided that exceptions would exist so that these rules would not apply to certain *bona fide* commercial transactions. In particular, a foreign currency denominated debt will not be a parked obligation if the debt is acquired by the current holder as part of a transaction, or series of transactions, that results in a significant interest in, or control of, the debtor by the current holder unless one of the main purposes of the transaction or series of transactions was to avoid a foreign exchange gain. In addition, a change in status between the debtor and the current holder (i.e. from dealing at arm's length to not dealing at arm's length or from not having a significant interest in the debtor to having one) will not cause the debt to become a parked obligation unless one of the main purposes was to avoid a foreign exchange gain. Finally related rules will provide similar relief to financially distressed debtors as are already provided in respect of the debt forgiveness rules.

Budget 2016 also proposes to introduce rules similar to those already contained in the debt forgiveness rules to determine whether a creditor is related to, and therefore not dealing at arm's length with, a debtor where trusts and partnerships are involved.

Budget 2016 did not provide the specific amendments that will be made to implement these proposals. However, the proposed changes will apply to a foreign currency debt that meets the conditions to become a parked obligation on or after March 22, 2016. There will be an exception where the meeting of these conditions occurs before 2017 and results from a written agreement entered into before March 22, 2016.

Resolutions 61 and 62 Valuation for Derivatives

61. (1) Section 10 of the Act is amended by adding the following after subsection (14):

(15) *Derivatives.* For the purposes of this section, property of a taxpayer that is a swap agreement, a forward purchase or sale agreement, a forward rate agreement, a futures agreement, an option agreement, or any similar agreement is deemed not to be inventory of the taxpayer.

(2) Subsection (1) applies to agreements entered into on or after Budget Day.

62. (1) Subsection 18(1) of the Act is amended by striking out "and" at the end of paragraph (*v*), by adding "and" at the end of paragraph (*w*) and by adding the following after that paragraph:

(*x*) *Derivatives — lower of cost and market*. any reduction in a taxation year in the value of a property if

(i) the method used by the taxpayer to value the property at the end of the year for purposes of computing the taxpayer's profit from a business or property is the cost at which the taxpayer acquired it or its fair market value at the end of the year, whichever is lower,

(ii) the property is described in subsection 10(15), and

(iii) the property is not disposed of by the taxpayer in the year.

(2) Subsection (1) applies to agreements entered into on or after Budget Day.

Dentons Canada LLP Commentary: For income tax purposes, most properties are held either on income account or capital account. On the disposition of a property on income account, the gain or loss will be ordinary gain or loss.

If the income property is inventory held in a business, special inventory valuation rules in section 10 allow the inventory to be valued at the end of a year using the lower of the acquisition cost of the property or its fair market value, whichever is lower ("LCM method"). Under the LCM method, decreases in the value of the inventory are allowed on an accrual basis, such that losses can be recognized before they are actually realized.

Apparently, some taxpayers apply the LCM method to derivatives held on income account and therefore report accrued annual losses before they are realized. A recent Tax Court of Canada decision allowed this treatment in respect of certain foreign exchange option contracts (*Kruger v. The Queen*, 2015 DTC 1127, under appeal). The Department of Finance disagrees that the LCM method is appropriate for derivatives. The Budget papers state that "the application of the lower of cost and market method to ... derivatives could lead to significant tax base concerns given their potentially higher volatility and longer holding periods."

As a result, resolutions 61 and 62 effectively prohibit the use of the LCM method for most derivatives. Proposed subsection 10(15) provides that "a swap agreement, a forward purchase or sale agreement, a forward rate agreement, a futures agreement, an option agreement, or any similar agreement" is deemed not to be inventory for the purposes of the section 10 valuation rules. Proposed paragraph 18(1)(*x*) disallows the write-down or deduction for accrued losses for the foregoing types of property. As a result, the losses, if any, will be reported upon realization.

These resolutions apply to agreements entered into on or after Budget Day.

Resolutions 61 and 62 do not affect derivatives held by financial institutions that are subject to the mark-to-market rules in section 142.2.

Resolutions 63 to 72: Eligible Capital Property

63. (1) Subsection 13(34) of the Act is replaced by the following:

(34) *Goodwill.* Where a taxpayer carries on a particular business,

(*a*) there is deemed to be a single goodwill property in respect of the particular business;

(*b*) if at any time the taxpayer acquires goodwill as part of an acquisition of all or a part of another business that is carried on, after the acquisition, as part of the particular business — or is deemed by subsection (35) to acquire goodwill in respect of the particular business — the cost of the goodwill is added at that time to the cost of the goodwill property in respect of the particular business;

(*c*) if at any time the taxpayer disposes of goodwill as part of the disposition of part of the particular business, receives proceeds of disposition a portion of which is attributable to goodwill and continues to carry on the particular business or is deemed by subsection (36) to dispose of goodwill in respect of the particular business,

(i) the taxpayer is deemed to dispose at that time of a portion of the goodwill property in respect of the particular business having a cost equal to the lesser of the cost of the goodwill property in respect of the particular business otherwise determined and the portion of the proceeds attributable to goodwill, and

(ii) the cost of the goodwill property in respect of the particular business is reduced at that time by the amount determined under subparagraph (i); and

(*d*) if paragraph (*c*) applies to more than one disposition of goodwill at the same time, that paragraph and subsection (38) apply as if each disposition had occurred separately in the order designated by the taxpayer or, if the taxpayer does not designate an order, in the order designated by the Minister.

(35) *Outlays not relating to property.* If at any time a taxpayer makes or incurs an outlay or expense on account of capital for the purpose of gaining or producing income from a business carried on by the taxpayer, the taxpayer is deemed to acquire at that time goodwill in respect of the business with a cost equal to the amount of the outlay or expense if no portion of the amount is

(*a*) the cost, or any part of the cost, of a property;

(*b*) deductible in computing the taxpayer's income from the business (determined without reference to this subsection);

(*c*) not deductible in computing the taxpayer's income from the business because of any provision of this Act (other than paragraph 18(1)(*b*)) or the *Income Tax Regulations*;

(*d*) paid or payable to a creditor of the taxpayer as, on account of or in lieu of payment of, any debt, or on account of the redemption, cancellation or purchase of any bond or debenture; or

(*e*) where the taxpayer is a corporation, partnership or trust, paid or payable to a person as a shareholder, partner or beneficiary, as the case may be, of the taxpayer.

(36) *Receipts not relating to property.* If at any time a taxpayer has or may become entitled to receive an amount (in this subsection referred to as the "receipt") on account of capital in respect of a business that is or was carried on by the taxpayer, the taxpayer is deemed to dispose, at that time, of goodwill in respect of the business for proceeds of disposition equal to the amount by which the receipt exceeds the total of all outlays or expenses that were made or incurred by the taxpayer for the purpose of obtaining the receipt and that were not otherwise deductible in computing the taxpayer's income, if the following conditions are satisfied (determined without reference to this subsection):

(*a*) the receipt is not included in computing the taxpayer's income, or deducted in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts for the year or a preceding taxation year;

(*b*) the receipt does not reduce the cost or capital cost of a property or the amount of an outlay or expense; and

(*c*) the receipt is not included in computing any gain or loss of the taxpayer from a disposition of a capital property.

(37) *Class 14.1 — transitional rules.* If a taxpayer has incurred an eligible capital expenditure in respect of a business before January 1, 2017 and carries on the business on that day,

(*a*) at the beginning of that day, the total capital cost of all property of the taxpayer included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of the business, each of which was an eligible capital property of the taxpayer immediately before that day or is the goodwill property in respect of the business, is deemed to be the amount determined by the formula

$$4/3 \times (A + B - C)$$

where

A is the amount that is the cumulative eligible capital in respect of the business at the beginning of that day

B is the amount determined for F in the definition *cumulative eligible capital* in subsection 14(5) (as that subsection applied immediately before that day) in respect of the business at the beginning of that day, and

C is the amount by which the total of all amounts determined, in respect of the business, for E or F in the definition *cumulative eligible capital* in subsection 14(5) (as that subsection applied immediately before that day), exceeds the total of all amounts determined for A to D.1 in that definition in respect of the business at the beginning of that day, including any adjustment required by subparagraph (*d*)(i);

(*b*) at the beginning of that day, the capital cost of each property of the taxpayer included in the class in respect of the business, each of which was an eligible capital property of the taxpayer immediately before that day or is the goodwill property in respect of the business, is to be determined as follows:

(i) the taxpayer shall designate the order in which the capital cost of each property that is not the goodwill property is determined and, if the taxpayer does not designate an order, the Minister may designate the order,

(ii) the capital cost of a particular property that is not the goodwill property in respect of the business is deemed to be the lesser of the eligible capital expenditure of the taxpayer in respect of the particular property and the amount by which the total capital cost of the class determined under paragraph (*a*) exceeds the total of all amounts each of which is an amount deemed by this subparagraph to be the capital cost of a property that is determined in advance of the determination of the capital cost of the particular property, and

(iii) the capital cost of the goodwill property is deemed to be the amount by which the total capital cost of the class exceeds the total of all amounts each of which is an amount deemed by subparagraph (ii) to be the capital cost of a property;

(*c*) an amount is deemed to have been allowed to the taxpayer in respect of property of the class under regulations made under paragraph 20(1)(*a*) in computing the taxpayer's income for taxation years ending before that day equal to the amount by which

(i) the total of the total capital cost of the class and the amount determined for C in paragraph (*a*)

exceeds

(ii) the amount determined for A in paragraph (*a*);

(*d*) if no taxation year of the taxpayer ends immediately before that day and the taxpayer would have had a particular amount included, because of paragraph 14(1)(*b*) (as that paragraph applied immediately before that day), in computing the taxpayer's income from the business for the particular taxation year that includes that day if the particular year had ended immediately before that day,

(i) for the purposes of the formula in paragraph (*a*), $3/2$ of the particular amount is to be included in computing the amount for B of the definition *cumulative eligible capital* in subsection 14(5) (as that subsection applied immediately before that day),

(ii) the taxpayer is deemed to dispose of a capital property in respect of the business immediately before that day for proceeds of disposition equal to twice the particular amount,

(iii) if the taxpayer elects in writing to have this subparagraph apply and files that election with the Minister on or before the filing-due date for the particular year, subparagraph (ii) does not apply and an amount equal to the particular amount is to be included in computing the taxpayer's income from the business for the particular year,

(iv) if, on or after that day and in the particular year, the taxpayer acquires a property included in the class in respect of the business, or is deemed by subsection (35) to acquire goodwill in respect of the business, and the taxpayer elects in writing to have this subparagraph apply and files that election with the Minister on or before the filing-due date for the particular year,

(A) for the purposes of subparagraphs (ii) and (iii), the particular amount is to be reduced by the lesser of the particular amount otherwise determined and $^1/_2$ of the capital cost of the property or goodwill acquired (determined without reference to clause (B)), and

(B) the capital cost of the property or goodwill acquired, as the case may be, is to be reduced by twice the amount by which the particular amount is reduced under clause (A), and

(v) if, in the particular year and before that day, the taxpayer disposed of a *qualified farm or fishing property* (as defined in subsection 110.6(1)) that was an eligible capital property of the taxpayer, the capital property disposed of under subparagraph (ii), if any, is deemed to be a qualified farm or fishing property to the extent of the lesser of

(A) the proceeds of disposition of the capital property, and

(B) the amount by which the proceeds of disposition of the qualified farm or fishing property exceed its cost.

(38) *Class 14.1 — transitional rule*. If at any time a taxpayer disposes of a particular property included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of a business and none of subsections 24(2), 70(5.1), 73(3.1), 85(1), 88(1), 98(3) and (5), 107(2) and 107.4(3) apply to the disposition, then for the purpose of determining the undepreciated capital cost of the class, the taxpayer is deemed to have acquired a property of the class immediately before that time with a capital cost equal to the least of $^1/_4$ of the proceeds of disposition of the particular property, $^1/_4$ of the capital cost of the particular property and

(*a*) if the particular property is not goodwill and is acquired before January 1, 2017 by the taxpayer, $^1/_4$ of the capital cost of the particular property;

(*b*) if the particular property is not goodwill, is acquired on or after that day by the taxpayer and subsection (39) deems an amount to have been allowed under paragraph 20(1)(*a*) in respect of the taxpayer's acquisition of the particular property, that amount;

(*c*) if the particular property (other than a property to which paragraph (*b*) applies) is not goodwill and is acquired on or after that day by the taxpayer — in circumstances under which any of subsections 24(2), 70(5.1), 73(3.1), 85(1), 88(1), 98(3) and (5), 107(2) and 107.4(3) apply — from a person or partnership that would have been deemed under this subsection to have acquired a property if none of those subsections had applied, the capital cost of the property that would have been deemed under this subsection to have been acquired by the person or partnership;

(*d*) if the particular property is goodwill, the amount by which

(i) the total of all amounts each of which is

(A) $^1/_4$ of the amount determined under subparagraph (37)(*b*)(iii) in respect of the business,

(B) if goodwill is acquired on or after that day by the taxpayer and subsection (39) deems an amount to have been allowed under paragraph 20(1)(*a*) in respect of the taxpayer's acquisition of the goodwill, that amount, or

(C) if goodwill is acquired (other than an acquisition in respect of which clause (B) applies) on or after that day by the taxpayer — in circumstances under which any of subsections 24(2), 70(5.1), 73(3.1), 85(1), 88(1), 98(3) and (5), 107(2) and 107.4(3) apply — from a person or partnership that would have been deemed under this subsection to have acquired a property if none of those subsections had applied, the capital cost of the property that would have been deemed under this subsection to have been acquired by the person or partnership

exceeds

(ii) the total of all amounts each of which is the capital cost of a property deemed by this subsection to have been acquired by the taxpayer at or before that time in respect of another disposition of goodwill in respect of the business; and

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

(39) *Class 14.1 — transitional rule*. If at any time a taxpayer acquires a particular property included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of a business, the acquisition of the particular property is part of a transaction or series of transactions or events that includes a disposition (in this subsection referred to as the "prior disposition") at or before that time of the particular property, or a similar property, by the taxpayer or a person or partnership that does not deal at arm's length with the taxpayer and subsection (38) applies in respect of the prior disposition, then for the purpose of determining the undepreciated capital cost of the class, an amount is deemed to have been allowed under paragraph 20(1)(*a*) to the taxpayer in respect of the particular property in computing the taxpayer's income for taxation years ending before the acquisition equal to the lesser of the capital cost of the property deemed by subsection (38) to be acquired in respect of the prior disposition and $^1/_4$ of the capital cost of the particular property.

(40) *Class 14.1 — transitional rule*. For the purposes of subsections (37) to (39) and subsections 40(13) to (16), *cumulative eligible capital, eligible capital expenditure, eligible capital property and exempt gains balance* have the meanings that would be assigned to those expressions if the Act read as it did immediately before 2017.

(2) Subsection (1) comes into force on January 1, 2017.

64. (1) Section 14 of the Act is repealed.

(2) Subsection (1) comes into force on January 1, 2017.

65. (1) Paragraph 20(1)(*b*) of the Act is replaced by the following:

(*b*) the lesser of

(i) the portion of the amount (that is not otherwise deductible in computing the income of the taxpayer) that is an expense incurred in the year for the incorporation of a corporation, and

(ii) $3,000 less the total of all amounts each of which is an amount deducted by another taxpayer in respect of the incorporation of the corporation;

(2) Subsection (1) comes into force on January 1, 2017 and applies in respect of expenses incurred after 2016.

66. (1) Subparagraph 39(1)(*a*)(i) of the Act is repealed.

(2) Subsection (1) comes into force on January 1, 2017.

67. (1) Section 40 of the Act is amended by adding the following after subsection (12):

(13) *Class 14.1 — transitional rules.* Subsection (14) applies in respect of a disposition by a taxpayer of a property that is included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of a business of the taxpayer if

(*a*) the property was an eligible capital property of the taxpayer immediately before January 1, 2017;

(*b*) the amount determined for Q in the definition *cumulative eligible capital* in subsection 14(5) in respect of the business immediately before that day is greater than nil;

(*c*) the amount determined for B in that definition in respect of the business immediately before that day is nil; and

(*d*) no amount is included in the taxpayer's income for a taxation year because of paragraph 13(37)(*d*).

(14) *Class 14.1 — transitional rules.* If this subsection applies in respect of a disposition at any time by a taxpayer of a property, the taxpayer's capital gain from the disposition is to be reduced by such amount as the taxpayer claims, not exceeding the amount by which

(*a*) $^2/_3$ of the amount determined for Q in the definition *cumulative eligible capital* in subsection 14(5) in respect of the business immediately before 2017

exceeds

(*b*) the total of all amounts each of which is an amount claimed under this subsection in respect of another disposition at or before that time.

(15) *Class 14.1 — transitional rules.* Subsection (16) applies in respect of a disposition by an individual of a property that is included in Class 14.1 of Schedule II to the *Income Tax Regulations* in respect of a business of the individual if

(*a*) the property was an eligible capital property of the individual immediately before January 1, 2017; and

(*b*) the individual's exempt gains balance in respect of the business is greater than nil for the taxation year that includes that day.

(16) *Class 14.1 — transitional rules.* If this subsection applies in respect of a disposition at any time by an individual of a property, the individual's capital gain from the disposition is to be reduced by such amount as the individual claims, not exceeding the amount by which

(*a*) twice the amount of the individual's exempt gains balance in respect of the business for the taxation year that includes January 1, 2017

(*b*) if paragraph 13(37)(*d*) applies in respect of the business for the individual's taxation year that includes January 1, 2017, the amount determined for D in paragraph 14(1)(*b*) for the purposes of paragraph 13(37)(*d*), and

(*c*) the total of all amounts each of which is an amount claimed under this subsection in respect of another disposition at or before that time.

(2) Subsection (1) comes into force on January 1, 2017.

68. (1) The definition *eligible capital property* in section 54 of the Act is repealed.

(2) Subsection (1) comes into force on January 1, 2017.

69. (1) The definitions *adjustment time, cumulative eligible capital , eligible capital amount, eligible capital expenditure* and *eligible capital property* in subsection 248(1) of the Act are repealed.

(2) The definition *property* in subsection 248(1) of the Act is amended by striking out "and" at the end of paragraph (*c*), by adding "and" at the end of paragraph (*d*) and by adding the following after paragraph(*d*):

(*e*) the goodwill of a business;

(3) Subsections (1) and (2) come into force on January 1, 2017.

70. (1) Paragraph 1100(1)(*a*) of the *Income Tax Regulations* is amended by adding the following after subparagraph (xii)

(xii.1) of Class 14.1, 5 per cent,

(2) Subsection 1100(1) of the Regulations is amended by adding the following after paragraph (*c*):

Additional allowances — Class 14. 1.

(*c*.1) for a taxation year that ends before 2027, such additional amount as the taxpayer may claim in respect of property of Class 14.1 of Schedule II not exceeding

(i) 2% of the particular amount by which the undepreciated capital cost of the class at the beginning of 2017 exceeds the total of all amounts each of which is

(A) the amount of a deduction taken under paragraph 20(1)(*a*) of the Act in respect of the class for a preceding taxation year, and

(B) equal to three times the amount of the capital cost of a property deemed by subsection 13(38) of the Act to be acquired by the taxpayer in the year or a preceding year, and

(ii) the amount determined by the formula

$$A - B$$

where

A is the least of

(A) $ 500,

(B) the particular amount determined under subparagraph (i), and

(C) the undepreciated capital cost of the class to the taxpayer as of the end of the year (before making any deduction under paragraph 20(1)(*a*) of the Act in respect of the class for the year), and

B is the total of all amounts deductible for the year under paragraph 20(1)(*a*) of the Act in respect of the class because of subparagraph (i) or (*a*)(xii.1);

(3) Subsections (1) and (2) come into force on January 1, 2017.

71. (1) Schedule II of the *Income Tax Regulations* is amended by adding the following after Class 14:

CLASS 14.1 *(5 per cent)*. Property of a taxpayer that, in respect of a business of the taxpayer,

(*a*) is goodwill;

(*b*) was eligible capital property of the taxpayer immediately before January 1, 2017 and is owned by the taxpayer at the beginning of that day; or

(*c*) is acquired after 2016, other than

(i) property that is tangible or corporeal property,

(ii) property that is not acquired for the purpose of gaining or producing income from business,

(iii) property in respect of which any amount is deductible (otherwise than as a result of being included in this class) in computing the taxpayer's income from the business,

(iv) property in respect of which any amount is not deductible in computing the taxpayer's income from the business because of any provision of the Act (other than paragraph 18(1)(*b*)) or these Regulations,

(v) an interest in a trust,

(vi) an interest in a partnership,

(vii) a share, bond, debenture, mortgage, hypothecary claim, note, bill or other similar property, or

(viii) property that is an interest in, or for civil law a right in, or a right to acquire, a property described in any of subparagraphs (i) to (vii).

(2) Subsection (1) comes into force on January 1, 2017.

72. The Act is further amended by making other consequential amendments as a result of sections 63 to 71.

Dentons Canada LLP Commentary: *New Rules in General*: Following up on an announcements made in each of the last two federal budgets, Budget 2016 proposes to repeal the rules in respect of eligible capital property ("ECP") and replace them with a new regime that treats these amounts as depreciable capital property subject to the capital cost allowance ("CCA") rules. Amounts formerly treated as ECP will now be added to new Class 14.1 of Schedule II of the *Income Tax Regulations* effective January 1, 2017. This overhaul of the treatment of ECP (generally, goodwill and other intangibles) requires complex legislative provisions to enact in a manner that is fair and equitable to taxpayers. Below is an overview of certain of the major changes that will accompany the switch to this new regime.

Property that was ECP will be classified as depreciable capital property and expenditures and receipts will also receive depreciable capital property treatment.

Class 14.1 includes goodwill, property that was ECP before January 1, 2017 and any property acquired January 1, 2017 or later that would have otherwise been treated as ECP. The full cost of property acquired is added to Class 14.1 versus the 75% addition for ECP.

Proposed subparagraph 1100(1)(*a*)(xii.1) of the *Income Tax Regulations* provides for CCA on Class 14.1 property at the rate of 5% on a declining balance basis deductible under paragraph 20(1)(*a*). A separate Class 14.1 must be maintained in respect of each business of the taxpayer, which is consistent with depreciable property and ECP rules.

CCA claimed on Class 14.1 property will be subject to recapture on disposition under subsection 13(1). The lesser of the proceeds and capital cost of the property disposed will be credited to the Class 14.1 pool and negative amounts will be treated as ordinary income. To the extent that proceeds of disposition are greater than the capital cost of the property disposed of, the difference will be treated as a capital gain. Importantly, because existing dispositions of ECP are considered to give rise to income from an active business, the change will result in an additional tax of approximately 10% to a Canadian-controlled private corporation that disposes of goodwill after 2016 as capital gains are treated as “aggregate investment income” for these purposes.

Special rules are proposed to account for receipts and expenditures of a business that do not relate to property (such as incorporation costs) that would have adjusted the cumulative eligible capital balance under the ECP rules. Proposed subsection 13(34) provides that every business has a goodwill property associated with it — even if the business has not previously acquired goodwill. Expenditures will increase the capital cost and undepreciated capital cost (“UCC”) of Class 14.1 property pools.

*Transitional Rules*There are a number of transitional rules of varying degrees of complexity that will require careful consideration by taxpayers in subsequent taxation years. That being said, the end result of the transitional provisions appears to be to place taxpayers in a position similar to what they would have been in if the ECP rules never existed and Class 14.1 existed all along.

(1) Additional depreciation — Prior to the 2027 taxation year expenditures incurred prior to January 1, 2017 are depreciable at a 7% rate vs. the 5% rate.

(2) Capital cost — On January 1, 2017 the capital cost of property will be determined to be $^4/_3$ of the CEC balance at that time plus $^4/_3$ of previously claimed deductions that have not been recaptured less $^4/_3$ of any negative CEC balance at that time.

(3) Undepreciated capital cost — In most cases the balance in CEC will become the UCC with the difference between capital cost and UCC being deemed to have been claimed as a deduction under paragraph 20(1)(*a*). The amount deemed to have been deducted under paragraph 20(1)(*a*) is calculated as the amount by which total capital cost and any negative CEC balance exceeds any positive CEC balance.

(4) Allocation of capital cost — Paragraph 13(37)(*b*) provides rules for allocating the total capital cost of properties as between a goodwill property and each identifiable property in the class.

(5) Deemed gain immediately before January 1, 2017 — Where a taxation year straddles January 1, 2017 and the taxpayer entered into a transaction prior to January 1, 2017 that resulted in an income inclusion under the ECP rules, the taxpayer can elect to report the transaction as business income (old rules) or as a taxable capital gain (proposed rules).

(6) Deferral of gains realized before January 1, 2017 — A taxpayer can elect to reduce the income inclusion under the ECP rules where a property described in Class 14.1 has been acquired in the same taxation year the income inclusion arose. These rules operate much the same as the ECP rules would have if a replacement property were acquired before the end of the taxation year in which an income inclusion arose.

(7) Dispositions of former ECP — To avoid excess recapture when disposing of former ECP proposed subsection 13(38) increases the UCC of Class 14.1 by 25% of the lesser of the proceeds of disposition and the cost of the property disposed of.

(8) Non-arm’s length dispositions of former ECP — Proposed subsection 13(39) is intended to prevent the use of non-arm’s length transfers to increase the amount that can be depreciated in Class 14.1. In effect, only $^3/_4$ of the cost of the former ECP is included in the UCC of Class 14.1 where the property was formerly an ECP of the

taxpayer (or certain non-arm's length persons) and subsection 13(38) applied to increase the UCC in respect of an earlier disposition of the property.

Consequential Amendments: A number of amendments to various *Income Tax Act* provisions will be required consequential to the repeal of the ECP rules and the creation of new Class 14.1 in Schedule II of the *Income Tax Regulations*. The Notice of Ways and Means Motion contains the more substantial amendments and the 2016 Budget documents note that additional amendments will be introduced at a later date.

Resolutions 73 to 75: Cross-Border Surplus Stripping

73. (1) Paragraph (*k*) of the definition *proceeds of disposition* in section 54 of the Act is replaced by the following:

(*k*) any amount that would otherwise be proceeds of disposition of property of a taxpayer to the extent that the amount is deemed by subsection 84.1(1), 212.1(1.1) or 212.2(2) to be a dividend paid to the taxpayer;

(2) Subsection (1) applies in respect of dispositions that occur on or after Budget Day.

74. (1) Section 212.1 of the Act is amended by replacing subsection (1) with the following:

212.1 *Non-arm's length sales of shares by non-residents* . (1) Subsection (1.1) applies if a non-resident person or designated partnership (in this subsection and subsections (1.1) and (1.2) referred to as the "non-resident person") disposes of shares (in this section referred to as the "subject shares") of any class of the capital stock of a corporation resident in Canada (in this section referred to as the "subject corporation") to another corporation resident in Canada (in this section referred to as the "purchaser corporation") with which the non-resident person does not (otherwise than because of a right referred to in paragraph 251(5)(*b*)) deal at arm's length and, immediately after the disposition, the subject corporation is connected (within the meaning that would be assigned by subsection 186(4) if the references in that subsection to "payer corporation" and "particular corporation" were read as "subject corporation" and "purchaser corporation", respectively) with the purchaser corporation.

(1.1) *Non-arm's length sales of shares by non-residents*. If this subsection applies,

(*a*) the amount, if any, by which the fair market value of any consideration (other than any share of the capital stock of the purchaser corporation) received by the non-resident person from the purchaser corporation for the subject shares exceeds the paid-up capital in respect of the subject shares immediately before the disposition shall, for the purposes of this Act, be deemed to be a dividend paid at the time of the disposition by the purchaser corporation to the non-resident person and received at that time by the non-resident person from the purchaser corporation; and

(*b*) in computing the paid-up capital at any particular time after March 31, 1977 of any particular class of shares of the capital stock of the purchaser corporation, there shall be deducted that proportion of the amount, if any, by which the increase, if any, by virtue of the disposition, in the paid-up capital, computed without reference to this section as it applies to the disposition, in respect of all of the shares of the capital stock of the purchaser corporation exceeds the amount, if any, by which

(i) the paid-up capital in respect of the subject shares immediately before the disposition

exceeds

(ii) the fair market value of the consideration described in paragraph (*a*),

that the increase, if any, by virtue of the disposition, in the paid-up capital, computed without reference to this section as it applies to the disposition, in respect of the particular class of shares is of the increase, if any, by virtue of the disposition, in the paid-up capital, computed without reference to this section as it applies to the disposition, in respect of all of the issued shares of the capital stock of the purchaser corporation.

(1.2) *Deemed consideration.* For the purposes of subsections (1) and (1.1), if, in the absence of this subsection, no consideration would be received by the non-resident person from the purchaser corporation for the subject shares, the non-resident person is deemed to receive consideration other than shares of the capital stock of the purchaser corporation from the purchaser corporation for the subject shares, the fair market value of which is equal to the amount, if any, by which the fair market value of the subject shares disposed of by the non-resident person exceeds the amount of any increase because of the disposition in the fair market value of the shares of the capital stock of the purchaser corporation.

(2) Subparagraph 212.1(2)(*a*)(ii) of the Act is replaced by the following:

(ii) the total that would be determined under subparagraph (i) if this Act were read without reference to paragraph (1.1)(*b*), and

(3) Paragraph 212.1(2)(*b*) of the Act is replaced by the following:

(*b*) the total of all amounts each of which is an amount required by paragraph (1.1)(*b*) to be deducted in computing the paid-up capital in respect of the particular class of shares after March 31, 1977 and before the particular time.

(4) The portion of paragraph 212.1(3)(*a*) of the Act before subparagraph (i) is replaced by the following:

(*a*) a non-resident person or designated partnership shall, for greater certainty, be deemed not to deal at arm's length with a purchaser corporation at the time of a disposition described in subsection (1) if the non-resident person or designated partnership was,

(5) The portion of paragraph 212.1(3)(*b*) of the Act before subparagraph (i) is replaced by the following:

(*b*) for the purposes of determining whether or not a particular non-resident person or designated partnership (in this paragraph referred to as the "taxpayer") referred to in paragraph (*a*) was a member of a group of less than 6 persons that controlled a corporation at any time, any shares of the capital stock of that corporation owned at that time by

(6) Subsection 212.1(4) of the Act is replaced by the following:

(4) *Where section does not apply.* Notwithstanding subsection (1), subsection (1.1) does not apply in respect of a disposition by a non-resident corporation of shares of a subject corporation to a purchaser corporation if

(*a*) immediately before the disposition, the purchaser corporation controlled the non-resident corporation; and

(*b*) it is not the case that, at the time of the disposition, or as part of a transaction or event or series of transactions or events that includes the disposition, a non-resident person or designated partnership

(i) owns, directly or indirectly, shares of the capital stock of the purchaser corporation, and

(ii) does not deal at arm's length with the purchaser corporation.

(7) Subsections (1) to (6) apply in respect of dispositions that occur on or after Budget Day.

75. (1) Paragraph 212.2(1)(*b*) of the Act is replaced by the following:

(*b*) subsection 212.1(1.1) does not apply in respect of the disposition;

(2) Subsection (1) applies in respect of dispositions that occur on or after Budget Day.

Dentons Canada LLP Commentary: Section 212.1 of the *Income Tax Act* ("Act") is an anti-surplus-stripping provision. In general terms, section 212.1 applies where the non-resident disposes of its Canadian subsidiary's shares to another corporation resident in Canada with which it does not deal at arm's length. Where it applies, subsection 212.1(1) of the Act deems a dividend to have been paid by the purchaser corporation to the non-resident to the extent that the non-share consideration given on the transfer exceeds the paid-up capital of the transferred shares. This deemed dividend will be subject to withholding tax. In addition, the paid up capital ("PUC") of the shares of the purchaser corporation is reduced by the amount by which the increase in the PUC, if any, as a result of the disposition exceeds the PUC of the transferred shares less the fair market value of any non-share consideration. Where there is an increase in the PUC of more than one class of shares, the amount of the reduction is applied proportionately.

An exception to this anti-surplus-stripping rule is found in subsection 212.1(4) of the Act, which currently provides that subsection 212.1(1) does not apply in respect of a disposition by a non-resident corporation of shares of a Canadian corporation to a purchaser corporation that immediately before the disposition controlled the non-resident corporation.

Thus, if a corporation resident in Canada (Canco A) controlled a non-resident corporation which in turn controlled another corporation resident in Canada (Canco B) (a "sandwich structure"), the non-resident corporation could transfer the shares of Canco B to Canco A without having section 212.1 of the Act apply.

Some non-resident corporations with Canadian subsidiaries have, in the government's view, misused the exception contained in subsection 212.1(4) of the Act by reorganizing the group into a sandwich structure with a view of qualifying for this exception. The group would then utilize the exception, as part of a series of transactions designed to artificially increase the PUC of the shares of those Canadian subsidiaries. This would allow the distribution of amounts from the Canadian corporation to its non-resident parent without the application of withholding tax.

For instance, consider the following situation which was posed to the CRA at the 2014 Canadian Tax Foundation Conference during the CRA Roundtable.

- A non-resident corporation contributes capital to a Canadian acquisition company to purchase a non-resident target with a Canadian subsidiary.
- Following the acquisition, the foreign target sells the shares of the Canadian subsidiary to the Canadian acquisition company in exchange for a note receivable equal to the fair market value of the shares. Any resulting capital gain would not be taxable since the foreign target is not taxable in Canada and the shares of the Canadian subsidiary are not taxable Canadian property.
- The Canadian acquisition company distributes the non-resident target to its non-resident parent as a reduction of capital, and the Canadian subsidiary pays a dividend to the Canadian acquisition company, which is deductible under subsection 112(1) of the Act. The Canadian acquisition company in turn repays the note.

In this scenario, existing subsection 212.1(4) should apply because the Canadian acquisition company controlled the foreign target corporation immediately before the disposition of the Canadian subsidiary.

Budget 2016 proposes to amend the exception contained in subsection 212.1(4) of the Act to ensure it applies as intended by clarifying that the exception does not apply where a non-resident both (i) owns, directly or indirectly, shares of the Canadian purchaser corporation, and (ii) does not deal at arm's length with the Canadian purchaser corporation. Budget 2016 also proposes to deem the non-resident to receive non-share consideration from the Canadian purchaser corporation in such situations in an amount equal to the fair market value of the shares of the lower-tier Canadian corporation received by the Canadian purchaser corporation.

The proposed amendments will be implemented by dividing subsection 212.1(1) of the Act into two new subsections, 212.1(1) and (1.1). Subsection 212.1(1) will now provide for the application rules and subsection 212.1(1.1) will contain the operative deeming rules. New subsection 212.1(1.2) will be added to deem the non-resident corporation to receive non-share consideration from the purchaser corporation for the subject shares and subsection 212.1(4) will be amended to include the new condition that the purchaser corporation cannot have any shareholders that are non-resident persons or designated partnerships who do not deal at arm's length with the purchaser corporation.

In addition, consequential amendments to the other provisions of section 212.1 of the Act will be made and paragraph (*k*) of the definition of "proceeds of disposition" contained in section 54 of the Act will be amended to refer to the new subsection 212.1(1.1) rather than 212.1(1).

On several occasions the CRA has stated that the general anti-avoidance rule would apply to transactions that attempted to misuse the exception contained in subsection 212.1(4) including, most recently, at the 2014 Canadian Tax Foundation Conference CRA Roundtable in reference to the example provided above. Budget 2016 also acknowledged the CRA is challenging these transactions using GAAR and is making these amendments to clarify the intended scope of the existing exception.

This proposal will apply in respect of dispositions occurring on or after March 22, 2016.

Resolution 76: Extension of the Back-to-Back Rules

76. The Act is modified to give effect to the proposals relating to Extension of the Back-to-Back Rules described in the budget documents tabled by the Minister of Finance in the House of Commons on Budget Day.

Dentons Canada LLP Commentary: Extension of Back-to-Back Rules

The 2014 federal budget introduced "back-to-back loan" rules to prevent the interposition of a third party in a favourable treaty jurisdiction between a Canadian borrower and a non-resident lender (see subsections 21 2(3.1) to (3.13) of the Act). The back-to-back loan rules ensure that the amount of withholding tax that would otherwise be applicable to a cross-border interest payment cannot be reduced through the use of a back-to-back arrangement.

Budget 2016 proposes to expand the scope of the back-to-back rules so that they also apply to cross-border rent and royalty payments. Budget 2016 also builds on the existing back-to-back rules by adding character substitution rules, adding back-to-back loan rules to existing shareholder loan rules and by clarifying how the back-to-back rules would apply to structures involving multiple intermediaries.

Since at least the 2013 budget, the government has expressed publicly its concern that certain taxpayers have been inappropriately "treaty-shopping"; that is, establishing an entity in a particular jurisdiction for the purpose of obtaining the benefits of a favourable tax treaty. Moreover, the government has had little success in attacking such structures through the courts. For example, in *Velcro Canada* (2012 DTC 1100), the Tax Court of Canada found that a largely back-to-back royalty arrangement between a Canadian company, an affiliated Netherlands corporation, and a corporation in Netherlands Antilles (with which Canada does not have a tax treaty) was nonetheless able to take advantage of the reduced royalty withholding tax rate provided under the Canada-Netherlands tax treaty. It appears that after several years of consideration and consultation, Canada has settled on a domestic provision to try and eliminate this perceived abuse.

Back-to-Back Rents, Royalties and Similar Payments

Paragraph 212(1)(d) of the Act imposes a 25% withholding tax on payments by a Canadian resident to a non-resident of Canada of a rent, royalty or similar payment. The 25% withholding tax rate can be reduced pursuant to an applicable income tax convention between Canada and the country in which the recipient of the payment is resident, provided that the recipient qualifies for benefits under the treaty. The concern arises where the ultimate recipient of the payment interposes an intermediary in a country with which Canada has a favourable tax treaty for the purpose of receiving the direct payment from the Canadian resident and then making a second payment to the ultimate recipient. Where such a back-to-back arrangement exists, the proposal would deem the Canadian-resident payor to have made the payment directly to the ultimate non-resident recipient and an additional amount of withholding tax equal to the amount of withholding tax otherwise avoided because of the arrangement will be applicable to the deemed payment.

A back-to-back arrangement in the context of rent, royalty and similar payment will be considered to exist where a Canadian-resident makes such a payment to a person or entity that is resident in a country with which Canada has a tax treaty (the “Canadian leg”) and the recipient has an obligation to pay an amount to another non-resident of Canada in respect of a lease, license or similar agreement, or of an assignment or an instalment sale (the “second leg”), if either:

(1) the amount that is obligated to be paid under the second leg is established, in whole or in part, by reference to the amount of the payment under the Canadian leg or the fair market value of property, or any revenue, profits, income or cash flow from property, or any other similar criteria in respect of property, where a right to use the property is granted under the Canadian leg; or

(2) it can reasonably be concluded that the reason that the Canadian leg was entered into (or permitted to remain in effect) was because the second leg was, or was anticipated to be, entered into.

The rules will not apply if the amount of withholding tax that would have otherwise applied to a direct payment from the Canadian resident to the ultimate recipient is no more than the amount of withholding tax that applied to the Canadian leg.

While not expressly stated in Budget 2016, it would be expected that where the amount of the obligation under the second leg is less than the amount paid under the Canadian leg, the additional withholding tax would only be applied on a proportionate basis.

This proposal would apply to rent, royalty or similar payments made after 2016.

Character Substitution Rules

As part of the broadening of the back-to-back rules, these proposed amendments would extend the back-to-back loan rules and the back-to-back royalty rules such that they would apply in the following situations as well:

(1) interest is paid by a Canadian resident to an intermediary where there is an agreement obligating the intermediary to make royalty payments to another non-resident;

(2) royalties are paid by a Canadian resident to an intermediary where there is a loan between the intermediary and another non-resident; or

(3) interest or royalties are paid by a Canadian resident to an intermediary and another non-resident holds shares of the intermediary that includes obligations to pay certain dividends or that are redeemable or cancellable.

Where such an arrangement exists, the Canadian resident will be deemed to have made an additional payment to the other non-resident of the same nature as paid to the intermediary. The budget papers do not provide that the withholding tax on the deemed direct payment would be limited to the amount of withholding tax otherwise avoided by the arrangement.

This proposal would apply to interest and royalty payments made after 2016.

Back-to-Back Shareholder Loans

Budget 2016 proposes to extend the existing back-to-back loan provisions to include amounts indirectly loaned by a Canadian-resident corporation to one of its shareholders through an unconnected intermediary. The proposals would apply where an intermediary person or partnership that is not connected with the shareholder is owed an amount by the shareholder or certain parties connected to the shareholder (the "shareholder debt") and either:

(1) the intermediary owes an amount to the corporation (the "intermediary debt"), where either (a) recourse in respect of the intermediary debt is limited to the amount that the intermediary recovers on the shareholder debt or (b) it can reasonably be concluded that the shareholder debt became owing or was permitted to remain owing because the intermediary debt was, or was anticipated to be, entered into; or

(2) the intermediary has a "specified right" (as defined in existing subsection 18(5)) in respect of a property that was granted to the Canadian-resident corporation and either (a) the existence of the specified right is required under the terms of the shareholder debt or (b) it can reasonably be concluded that the shareholder debt became owing or was permitted to remain owing because the specified right was, or was anticipated to be, granted.

If a back-to-back shareholder loan arrangement is found to exist, then the shareholder will be deemed to be indebted to the Canadian corporation in an amount equal to the lesser of (a) the shareholder debt and (b) the aggregate of the intermediary debt and the fair market value of the property over which the intermediary has a specified right. As a result, the indebtedness would be subject to subsection 15(2) in the case of a Canadian resident shareholder or Part XIII in the case of a non-resident. There are additional provisions dealing with subsequent changes in the amount of the indebtedness.

This proposal applies to back-to-back shareholder loan arrangements (including pre-existing arrangements) as of Budget Day.

Multiple-Intermediary Structures

Budget 2016 proposes to clarify that the rules pertaining back-to-back arrangements will apply regardless of the number of intermediaries by treating all connected arrangements as comprising part of the back-to-back arrangement. It is proposed that both the existing back-to-back loan rules, as well as the new back-to-back royalty, character substitution and shareholder loan rules will all have rules which address the use of multiple intermediaries.

Other Tax Measures in 2016 Budget (March 22, 2016)

The 2015 Federal Budget proposed to allow a tax exemption for capital gains realized on the donation of real property or private corporation shares to charities or other qualified donees, beginning in 2017. Budget 2016 states that the Government does not intend to proceed with this measure.

Classes 43.1 and 43.2 of the capital cost allowance (CCA) Regulations provide accelerated CCA rates for certain types of clean energy generation and conservation equipment. For Class 43.1 the rate is 30% and for Class 43.2 it is 50%, both on a declining-balance basis. Budget 2016 proposes to move electric vehicle charging stations, currently found in Class 8 (20%), to Class 43.1 or 43.2, depending on the power threshold of the station. Similarly, Budget 2016 proposes to move certain types of electrical storage equipment, currently found in Class 8, to either Class 43.1 or 43.2. These changes will generally apply to property acquired for use on or after Budget Day.

The 2015 Federal Budget announced that the government would be reviewing the rules relating to the types of activities that would qualify for the small business tax rate that applies to the first $500,000 of active business income carried on by Canadian-controlled private corporations. Active business income does not include "specified investment business income" of a corporation, generally unless the corporation employs more than five full-time employees in the business. The government reviewed these rules as they apply to certain activities such as those carried on at campgrounds and storage facilities. In Budget 2016, the current government announced that it has completed the review and that no changes to the rules are contemplated.

Budget 2016 confirms the Government's intention to proceeds with the following items or proposals that have not yet been legislated (many were announced in the 2015 Budget):

- proposals on the income tax rules for certain trusts and their beneficiaries (draft legislative proposals were released for comment on January 15, 2016).
- "synthetic equity arrangements" under the dividend rental arrangement rules;
- the conversion of capital gains into tax-deductible inter-corporate dividends (section 55);
- the offshore reinsurance of Canadian risks;
- alternative arguments in support of an assessment;
- an exception to the withholding tax requirements for payments by qualifying non-resident employers to qualifying non-resident employees;
- the repeated failure to report income penalty;
- the acquisition or holding of limited partnership interests by registered charities;
- the qualification of certain costs associated with undertaking environmental studies and community consultations as Canadian exploration expenses;

- the sharing of taxpayer information within the Canada Revenue Agency to facilitate the collection of certain non-tax debts;

- the sharing of taxpayer information with the Office of the Chief Actuary;

- the tax deferral in respect of the commercialization of the Canadian Wheat Board;

- the Goods and Services Tax/Harmonized Sales Tax joint venture election; and

- the relief of the Goods and Services Tax/Harmonized Sales Tax for feminine hygiene products.

Budget 2016 states that the Government of Canada confirms its willingness to discuss and put into effect direct taxation arrangements with interested Aboriginal governments. To date, the Government of Canada has entered into more than 50 taxation arrangements in respect of sales tax and personal income tax with Aboriginal governments. The government also supports direct taxation arrangements between interested provinces or territories and Aboriginal governments and will continue to facilitate such arrangements.

Lastly, Canada has been actively engaged in the multilateral efforts of the G20 and the Organisation for Economic Co-operation and Development (OECD) to address international transfer pricing, and more generally base erosion and profit shifting ("BEPS"). Budget 2016 provides that the Government is moving forward with a number of initiatives recommended by the BEPS project:

- Consistent with the recommendations of BEPS, country-by-country reporting for the purposes of the transfer pricing rules will be required for taxation years that begin after 2015. This requirement will apply only to multinational enterprise ("MNEs") with total annual consolidated group revenue of a750 million or more. Where an MNE has an ultimate parent entity that is resident in Canada (or a Canadian resident subsidiary), it will be required to file a country-by-country report with the CRA within one year of the end of the fiscal year to which the report relates.

- Arm's length prices are generally the accepted norm for international transactions between related parties. The OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations provide guidance on the application of the arm's length principle. Budget 2016 states that these guidelines, plus most recommendations arising from the BEPS project, are currently used by the CRA and consistent with the relevant provisions of the Act.

- Also in terms of the arm's length principal, the BEPS project continues follow-up work on the development of a threshold for the proposed simplified approach to low value-adding services. Work is also continuing to clarify the definition of risk-free and risk-adjusted returns for minimally functional entities (the Budget refers to these as "cash boxes"). Budget 2016 states that Canada will decide on a course of action with regards to these measures after the outstanding work is complete.

- Canada is participating in international work to develop a multilateral instrument to streamline the implementation of treaty-related BEPS recommendations, including addressing treaty abuse.
- The CRA will undertake the spontaneous exchange with other tax administrations of tax rulings that could potentially give rise to BEPS concerns in the absence of such exchange.

Customs and Excise Tax Measures

Editorial Comment: Notice of Ways and Means Motion to Amend the *Excise Tax Act* and the *Excise Act, 2001*

Sales and Excise Tax Measures

As is usually the case, Budget 2016 also includes modifications and/or clarifications related to the application of the *Excise Tax Act* ("ETA"), which imposes the Goods and Services Tax or Harmonized Sales Tax to goods and services, as well as modifications to the *Excise Act, 2001*, which imposes various duties and excise taxes to alcohol and tobacco products generally.

Health Measures

A few measures clarify or expand the scope of existing zero-rating provisions for medical and assistive devices. Such devices are usually zero-rated when specially designed to assist an individual in treating or coping with a chronic disease or illness or a physical disability in accordance with Part II of Schedule VI of the ETA.

Currently, insulin infusion pumps and insulin syringes are included in the list of such zero-rated medical devices. The Budget proposes to clarify that supplies of insulin pens, which are also used to inject insulin for the treatment of diabetes, also be zero-rated. Interestingly, this new exemption applies to supplies made after Budget Day and to supplies made before Budget Day unless the supplier charged, collected or remitted GST/HST in respect of the supply. Therefore, suppliers who failed to collect tax on sales of these goods would not be assessed, however no refund would be available if tax was collected.

Furthermore, the list of zero-rated appliances currently includes urinary appliances designed to be worn by an individual; since intermittent urinary catheters are an alternative to catheters that are left in place, the budget proposes to zero rate intermittent urinary catheters if supplied on the written order of a medical doctor, registered nurse, occupational therapist, or physiotherapist. This applies to supplies made after Budget Day.

Purely cosmetic procedures

Supplies of purely cosmetic procedures are not considered to be basic health care products and are intended to be subject to GST/HST, regardless of the status of the supplier. The Budget proposes clarifications to section 1 of Part V.1 of Schedule V of the ETA to ensure that GST/HST applies to supplies of purely cosmetic procedures provided by all suppliers, including registered charities. Therefore, all supplies aiming at enhancing or altering appearance are taxable. This includes liposuction, hair replacement procedures, hair removal, botulinum toxin injections, and teeth whitening. Cosmetic procedures required for medical or reconstructive purposes continue to be exempt. This measure applies after Budget Day.

Exported Call Centre Services

Under the GST/HST rules, exported supplies are generally zero-rated. The Budget adds section 23.1 to Part V of Schedule VI to ensure that the supply of a service of rendering technical or customer support to individuals by means of telecommunications (i.e., telephone, email, or web chat) is zero-rated if:

- the service is supplied to a non-resident that is not registered for GST/HST purposes; and
- it can be expected that the technical or customer support service is rendered primarily to individuals who are outside Canada at the time the service is rendered.

This measure applies to supplies made after Budget Day and to supplies made before that day if the supplier did not collect or remit tax in respect of such supplies.

GST/HST on Donations to Charities

GST/HST generally does not apply to a donation if the donor does not receive anything in return. However if the donor receives property or services in exchange for the donation, even if the value of the donation exceeds the value of the offered property or services, GST/HST may apply on the full value of the donation, unless specific exemption applies to those particular supplies.

The Budget proposes to bring the treatment of this type of exchange in line with the *Income Tax Act* “split-receipting” rules. Accordingly, the Budget proposes that when a charity supplies property or services in exchange for a donation where an income tax receipt is issued for a portion of the donation, only the value of the property or services supplied will be subject to GST/HST. This only applies where no other specific exemption applies to the property or services supplied. The measure ensures that the portion of the donation that exceeds the value of property or services supplied is not subject to GST/HST. This applies to supplies made after Budget Day. Special transition rules may also apply for supplies made between December 21, 2002 (when the income tax “split-receipting” rules came into effect) and Budget Day.

Application of GST/HST to Cross-border Reinsurance

GST/HST applies to domestic purchases as well as to importations of property and services. Accordingly, in certain instances certain recipients of imported taxable supplies of services and intangible personal property are required to self-assess. Additionally, special rules require a financial institution, including an insurer with a presence outside Canada, to self-assess GST/HST on certain expenses incurred outside Canada but relating to Canadian activities.

Budget 2016 clarifies that two specific components of imported reinsurance services, ceding commissions and the margin for risk transfer, do not form part of the tax base that is subject to the self-assessment provisions contained in the GST/HST imported supply rules for financial institutions. (This measure will apply as of the introduction of the special GST/HST imported supply rules for financial institutions, i.e., in respect of any specified year ending after November 16, 2005.)

A special transition rule will allow a financial institution to require a reassessment, taking into account these modifications for past years but solely for the purpose of the effect of this measure. A financial institution will have until one year after these amendments receive Royal Assent to request such a reassessment.

De Minimis Financial Institutions

The ETA includes many special rules affecting financial institutions, particularly in determining their entitlement to input tax credits. In addition, the ETA includes a provision deeming other persons that provide significant financial services to be subject to the rules for financial institutions. For example, if the person's income for the preceding taxation year from interest, fees, or other charges with respect to the making of an advance, the lending of money, the granting of credit, or credit card operations exceeds $1 million, the person will be subject to reporting rules for financial institutions.

This may even affect a person earning more than $1 million in interest income even though the earning of such interest would generally not, by itself, bring that person in competition with traditional financial institutions.

Accordingly, Budget 2016 proposes that interest earned in respect of demand deposits, as well as term deposits and guaranteed investment certificates with an original date to maturity not exceeding 364 days not be included in determining whether the person exceeds the $1 million threshold. This measure will apply to taxation years of a person beginning on or after Budget Day and to the fiscal year of a person that begins before Budget Day and ends on or after that day for purposes of determining if the person is subject to the special filing requirements for financial institutions.

Closely Related Test

Sections 150 and 156 of the ETA provide special relieving rules, in the form of specific elections, allowing members of a group closely related and partnerships to neither charge nor collect GST/HST on certain intercompany supplies in certain circumstances.

To qualify, each member of such groups must, among other requirements, be considered to be closely related to each other member of the group, supporting the assumption that the members effectively operate as a single entity.

Where subsidiaries are involved, the current test requires that the parent corporation or partnership own 90% or more of the value and number of the shares of the subsidiary corporation that have full voting rights under all circumstances. However, due to the complexity of share capital structures, it has been suggested that a parent corporation or partnership could be considered to be closely related to a subsidiary corporation even if it lacks nearly complete voting control over the subsidiary corporation.

To correct this situation, Budget 2016 proposes that, in addition to the current test, a corporation or partnership hold and control 90% or more of the votes in respect of every corporate matter of the subsidiary corporation (with limited exceptions) in order to be considered closely related. This measure will generally apply as of the day that is one year after Budget Day, but will apply as of the day after Budget Day for the purposes of determining whether the conditions of the closely related test are met in respect of elections under section 150 and section 156 that are filed after Budget Day and that are to be effective as of a day that is after Budget Day.

Reporting of Grandparented Housing Sales

Under special transition rules that applied when a province either joined the harmonized value-added tax system in 2010 or increased its HST rate, certain sales of newly constructed or substantially renovated homes were grandparented for HST purposes. Accordingly, the provincial portion of the HST did not apply under certain circumstances. Grandparenting rules applied when the purchase and sale agreement was entered into before the announcement of the transition rules and possession or ownership of the property was transferred on or after implementation of the HST or increased HST rate.

Under the current rules, builders are subject to special reporting requirements with respect to such grandparented transactions. Such reporting requirements apply where the purchase was not entitled to a GST new housing rebate or GST new residential rental property rebate. The rules include penalties for misreporting (i.e., under reporting, over reporting or failing to report)

The Budget proposes to simplify builder reporting by:

- limiting the requirements to grandparented sales where the consideration is equal to or greater than $450,000; and

- providing builders with the opportunity to correct past misreporting by allowing an election to report all past grandparented housing sales for which the consideration is equal to or greater than $450,000. This would allow them to avoid the misrepresentation penalties. This election must be filed between May 1, 2016 and December 31, 2016.

Restricting the Relief of Excise Tax on Diesel and Aviation Fuel

The ETA contains a limited number of provisions that relieve the application of tax on diesel fuel in specific circumstances, including relief for diesel fuel used as heating oil or to generate electricity. Budget 2016 proposes two measures to clarify instances in which relief is provided.

- The existing excise tax relief for heating oil broadly applies to diesel fuel consumed to produce heat for any purpose, including in industrial processes. To ensure that the relief provided for heating oil applies only to heating in respect of buildings, Budget 2016 proposes to define heating oil as fuel oil consumed exclusively for providing heat to a home, building, or similar structure, and is not consumed for generating heat in an industrial process.

- Diesel fuel consumed for motive purposes is subject to excise tax. However, the tax exemption for diesel fuel used in the generation of electricity currently applies to diesel fuel used in or by a vehicle to generate electricity if more than half of the electricity generated is used for purposes other than the operation of the vehicle. Budget 2016 proposes to remove the generation of electricity exemption for diesel fuel used in or by a vehicle, including a conveyance attached to the vehicle, of any mode of transportation. Accordingly, no relief will apply to fuel used to produce electricity in any vehicle regardless of the purpose for which the electricity is used.

These measures will apply to fuel delivered or imported after June 2016, and to fuel delivered or imported before July 2016 that is used, or intended to be used, after June 2016.

Definition of Capital Property

Many definitions in the ETA refer to the *Income Tax Act*. Such is the case, generally speaking, for "capital property". In view of the fact that changes to the *Income Tax Act* repeal the current eligible capital property regime and replace it with new capital cost allowance Class 14.1, the ETA definition of "capital property" is amended to exclude property described in new Class 14.1 of Schedule II to the *Income Tax Regulations*. This amendment comes into force as of January 1, 2017.

Enhancing Certain Security and Collection Provisions in the Excise Act, 2001

Budget 2016 proposes to enhance certain security and collection rules in the *Excise Act, 2001*.

- Tobacco manufacturers and other prescribed persons that import tobacco products must provide and maintain security with the CRA in order to be issued a tobacco licence or any duty-paid stamps. The amount of security is generally based on monthly excise duty remittances or the quantity of duty-paid stamps issued, to a maximum of $2 million. This security requirement has been capped at $2 million. Budget 2016 proposes to increase the maximum amount of security from $2 million to $5 million. This change will be effective on the later of the day following the day of Royal Assent to the legislation enacting the new collection proposal (discussed below) or three months following Budget Day.

- To enhance certain enforcement measures under the *Excise Act, 2001*, Budget 2016 proposes to give the Minister the authority to require security for payment of assessed amounts and penalties in excess of $10 million that are not otherwise collected under the *Excise Act, 2001*. If the requested security is not furnished, Budget 2016 also proposes that the Minister be provided with the authority to collect an amount equivalent to the amount of security that the Minister had required. This measure will apply to amounts assessed and penalties after the day of Royal Assent to the enacting legislation.

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