Recent Changes

Bill C-44 (received Royal Assent on June 22, 2017)

The home relocation loan deduction is eliminated effective January 1, 2018.

New Income Tax Folios

S4-F2-C2, "Business Use of Home Expenses"

S2-F1-C2, "Retiring Allowances"

S4-F11-C1, "Meaning of Farming and Farming Business"

Finance Announcements

2017 Automobile Operating Cost Benefit Rates

The general prescribed rate used to determine the taxable benefit relating to the personal portion of automobile operating expenses paid by employers for 2017 will be reduced from 26 to 25 cents per kilometre. For taxpayers employed principally in selling or leasing automobiles, the prescribed rate will also be reduced from 23 to 22 cents per kilometre. This rate is prescribed every year to reflect the costs of operating an automobile. The statutory rates used in the calculation of an automobile "standby charge" remain unchanged. The government made this announcement on December 30, 2016. See ¶2070 and ¶2085.

2017 Automobile Deduction Limits

For 2017, the ceiling on the capital cost of passenger vehicles for CCA purposes remains at $30,000, the limit of deductible leasing costs remains at $800 per month (plus applicable federal and provincial taxes), and the maximum allowable interest deduction for amounts borrowed to purchase an automobile remains at $300 per month. The limit for a deduction of tax-exempt allowances paid by employers to employees who use their own vehicle for work remains at 54 cents per kilometre for the first 5,000 kilometres and 48 cents for each additional kilometre. For Northwest Territories, Nunavut, and Yukon, the rates, set 4 cents higher, also remain at 58 cents and 52 cents, respectively. This announcement was made on December 30, 2016. See ¶2320.

2017 Limit for Money Purchase RPPs, RRSPs, and DPSPs

In 2017, the limit on total allowable employer-employee contributions to money purchase registered pension plans (RPPs) is increased from $26,010 to $26,230, the limit on contributions to registered retirement savings plans (RRSPs) is increased from $25,370 to $26,010, and the limit on deferred profit sharing plans (DPSPs) is increased from $13,005 to $13,115. See ¶2360.

Tradesperson Tools Deduction

The threshold above which the cost of eligible tools acquired by a tradesperson can be deducted increased from $1,161 in 2016 to $1,178 in 2017. See ¶2388 and ¶2389.

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RRSP/RRIF Rollover to Infirm Child

For deaths occurring in 2017, the amount of prior year income above which a physically or mentally infirm dependant is presumed not to be dependent on a parent or grandparent for RRSP rollovers on death is increased to $19,475 as a result of the indexation of the basic personal amount and the disability amount for prior year 2016. See ¶2445.

[¶2000] Computation of Income

[¶2005] General

A taxpayer is required to calculate income from each source separately and total the various amounts to compute "income" for income tax purposes.[1] The taxpayer is to include income from any source inside or outside Canada.

There are four main sources of income:

(1) business;
(2) property;
(3) office; and
(4) employment,

each of which is calculated in accordance with rules from various parts of the *Income Tax Act*.

It is currently provided that, unless a contrary intention is evident, no provision should be interpreted to require an amount to be included or deducted more than once in computing a taxpayer's income.[2] Accordingly, amounts deducted for a statute-barred taxation year and not disallowed may not be deducted again for a subsequent year, including any year in which it was actually deductible.

[¶2010] Income from a Source or Sources

A taxpayer is required to include income from all sources. Generally, income or loss is calculated on a source-by-source basis. Each "office",[3] "employment",[4] "business",[5] and "property"[6] is to be treated as a separate source of income.

"Amounts" included in income will encompass "money, rights, or things expressed in terms of the amount of money or the value in terms of money of the right or thing".[7] Barter transactions, being the reciprocal exchange of goods or services without the use of money, are considered to be within the purview of the *Income Tax Act*.[8] However, an employee giving occasional help to a friend or neighbour in exchange for something would not be taxable unless a regular habit was made of providing such service.

[¶2020] When Income Taxable

There are two methods of computing income from a business or property for tax purposes: the "cash" basis and the "accrual" basis.

Under the cash method of accounting, amounts are included in income only when received and expenses are deducted only when paid. Income from an office or employment is always computed on the cash basis.

Under the accrual method of accounting, income is computed for the period during which it has been earned, notwithstanding that it may not have been collected or actually received. When computing income from a business or property, with the exception of farmers, the accrual method rather than the cash method must be used.

[¶2025] Items Included in Income

The following items are expressly required to be included in the income of a taxpayer for a taxation year to the extent set out in the sections cited:

- Alimony or maintenance payments (not including child support payments) (s. 56(1)(*b*), s. 56(1)(*e*));
- Allowances for personal, living, or any other expenses paid to an employee or officer (s. 6(1)(*b*));
- Amounts allocated to an employee under an employees' profit sharing plan (s. 6(1)(*d*), s. 12(1)(*n*));
- Amounts deducted by the vendor on a sale of accounts receivable are included in the purchaser's income (s. 22(1));
- Amounts not taxed to a deceased person which are transferred to a beneficiary (s. 70(3));
- Amounts of an income nature payable by a trust or estate to the taxpayer as beneficiary (s. 12(1)(*m*), s. 104(13));
- Amounts of pension income allocated to the taxpayer's spouse or common-law partner (s. 56(1)(*a.2*));
- Amounts paid by a trust or estate for upkeep, etc., for property to be maintained for benefit of beneficiary (s. 105(2));
- Amounts paid on income bonds deemed dividends (s. 15(3));
- Amounts paid to another person at the direction of or with the concurrence of the taxpayer (s. 56(2));
- Amounts receivable for restrictive covenants (s. 6(3.1));

See page ii for explanation of footnotes.

[1] CCH ¶2003; Sec. 3.
[2] CCH ¶28,329y; Sec. 248(28).
[3] CCH ¶28,190; Sec. 248(1) "office".
[4] CCH ¶28,094; Sec. 248(1) "employment".
[5] CCH ¶28,024; Sec. 248(1) "business".
[6] CCH ¶28,220; Sec. 248(1) "property".
[7] CCH ¶28,012; Sec. 248(1) "amount".

See page ii for explanation of footnotes.

[8] Interp. Bul. IT-490.

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- Amounts receivable in the future for property sold or services rendered in course of business in the year (s. 12(1)(*b*));
- Amounts receivable of an income nature by a deceased person (s. 70(2));
- Amounts received for services or goods not rendered or delivered in the year, or for returnable containers (s. 12(1)(*a*));
- Amounts received on account of an earnings loss benefit, a supplementary retirement benefit, or a career impact allowance under the *Canadian Forces Members and Veterans Re-establishment and Compensation Act* (effective April 1, 2018, this act is renamed the *Veterans Well-being Act*) (s. 6(1)(*f*.1));
- Amounts received under a program established under the authority of the *Department of Employment and Social Development Act* in respect of children who are deceased or missing as a result of an offence, or a probable offence (s. 56(1)(a.3));
- Amounts received under CRA tax informant programs (s. 56(1)(*z*.4)) [effective June 19, 2014];
- Annuity payments (s. 56(1)(*d*));
- Appropriations by a corporation for the benefit of shareholders (s. 15(1));
- Automotive industry employees' transitional assistance (s. 56(1)(*a*)(v));
- Bad debts recovered (s. 12(1)(*i*) and 56(1)(*m*));
- Benefits conferred by non-arm's length transactions (s. 245(2));
- Benefits (except those constituting a distribution or payment of capital) from or under any trust (s. 12(1)(*m*), s. 105(1));
- Benefits or advantages (with certain exceptions) conferred by corporations on shareholders (s. 15(1)(*c*));
- Benefits received under a home buyers' plan (s. 56(1)(*h*.1), s. 146.01);
- Benefits received under a lifelong learning plan (s. 56(1)(*h*.2), s. 146.02);
- Benefits received under registered retirement savings plans (s. 56(1)(*h*), s. 146(8));
- Benefits received under pooled registered pension plans (s. 56(1)(*z*.3), s. 147.5(13));
- Benefits under employee benefit plans or trusts (s. 6(1)(*g*), s. 6(1)(*h*));
- Benefits under the *Labour Adjustment Benefits Act*, the *Department of Labour Act*, the Plant Workers Adjustment Program, and the Northern Cod Compensation and Adjustment Program (s. 56(1)(*a*)(vi));
- Benefits received under the new Quebec Parental Insurance Plan (s. 56(1)(*a*)(vii));
- Board, lodging, and other benefits attached to an office or employment (s. 6(1)(*a*));

- Capital gains — ½ included in income with certain exceptions (s. 3, s. 38);
- Company automobile, value of personal use (s. 6(1)(*e*), s. 6(2));
- Death benefits (s. 56(1)(*a*)(iii));
- Deemed dividends from non-tax-paid corporate surpluses, by reason of:
  - distribution or appropriation on the winding-up, discontinuance, or reorganization of business (s. 84(2)),
  - redemption, acquisition, or conversion of common shares (s. 84(3)), or
  - capitalization of undistributed income by stock dividend, increase in paid-up capital, or otherwise (s. 84(1));
- Deferred profit sharing plan payments (s. 56(1)(*i*));
- Directors' fees (s. 6(1)(*c*));
- Eligible dividends are grossed up by 38% and a dividend tax credit of 15.02% of the grossed-up dividend may be claimed. Non-eligible dividends are grossed up by 17% and a dividend tax credit of 10.52% of the grossed up dividend may be claimed. See ¶8275 for additional information (s. 82(1), s. 121);

Commentary on Notice of Ways and Means Motion (Oct. 24, 2017)

Note: When Notice of Ways and Means Motion, October 24, 2017, achieves Royal Assent, the commentary will be modified to read:

- Eligible dividends are grossed up by 38% and a dividend tax credit of 15.02% of the grossed-up dividend may be claimed. Non-eligible dividends are grossed up by 17% (this decreases to 16% effective for the 2018 taxation year, and further decreases to 15% in 2019) and a dividend tax credit of 10.52% (this decreases to 10% effective 2018, and further decreases to 9% in 2019) of the grossed up dividend may be claimed. See ¶8275 for additional information (s. 82(1), s. 121);

- Employer-paid contributions to a group sickness and accident insurance plan for an employee's coverage after 2012 to the extent that such contributions are not in respect of a wage loss replacement benefit payable on a periodic basis (s. 6(1)(*e*.1));
- Employment Insurance benefits (s. 56(1)(*a*));
- Evidence of indebtedness received in lieu of payment of income debt (s. 76);
- Fair market value of assets sold or distributed to shareholders at a price below such value (s. 69(4), s. 69(5));
- Fees (s. 6(1)(*c*));
- Fellowships, scholarships, and research grants in excess of the scholarship exemption (s. 56(1)(*n*), 56(1)(*o*), 56(3));

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- Gratuities (s. 5(1));
- Income-averaging annuity receipts (s. 56(1)(*e*), s. 56(1)(*f*));
- Income from controlled trust deemed settlor's (s. 75(2));
- Income from property transferred or loaned to certain minors attributed to transferor (s. 74.1(2));
- Income from property transferred or loaned to spouse attributed to transferor (s. 74.1(1));
- Income from eligible funeral arrangement (s. 148.1);
- Income of trusts and estates payable to beneficiaries (s. 104(13));
- Insurance payments for damage in depreciable property which are expended in the taxation year and within a reasonable time on repairing the damage (s. 12(1)(*f*));
- Inducement payments to prospective employees (s. 6(3));
- Insurance premiums (except for group life or medical services) paid by employer for the benefit of employee (s. 6(1)(*a*));
- Interest deemed received on certain loans to non-residents (s. 17(1));
- Interest on bond transferred with interest until the date of transfer (s. 20(14));
- Interest payments (s. 12(1)(*c*));
- Interest payments which are blended with capital payments (s. 16);
- Inventory sale proceeds (s. 23, s. 28);
- Loans by corporations to shareholders (s. 15(2));
- Medicare contributions by employer (s. 6(1)(*a*));
- Non-competition payments to departing employees (s. 6(3));
- Patronage dividends, except those from consumer goods and services (s. 135(7));
- Payments based on the use of or production from property (s. 12(1)(*g*));
- Payments by corporation to shareholders other than in a *bona fide* transaction (s. 15(1));
- Pension benefits (s. 56(1)(*a*));
- Periodic payments which are deemed to accrue daily where a person dies (s. 70(1));
- Portion of beneficiaries' share of profits under employees' profit sharing plan (s. 144(7));
- Profit derived from the acquisition or disposition of property under a derivative forward agreement (s. 12(1)(z.7));
- Profit from business (s. 9(1));
- Profit from property (s. 9(1));
- Recaptured depreciation (s. 13(1));
- Remuneration (s. 5(1));

- Reserves deducted in previous year (s. 12(1)(*d*), (*d*.1));

Commentary on Bill C-63 (Oct. 27, 2017)

Note: When Bill C-63, October 27, 2017, achieves Royal Assent, the commentary will be modified to read:

(1) Reserves deducted in previous year (s. 12(1)(*d*), (*d*.1)), (*d*.2);

- Resource property sale receipts (s. 59);
- Retirement compensation arrangement payments (s. 12(1)(*n*.3));
- Retiring allowances (s. 56(1)(*a*)(ii));
- RRSP payments (s. 56(1)(*h*));
- Salary (s. 5(1));
- Salary deferral arrangement payments (s. 6(1)(*e*));
- Securities received in lieu of payment of income debt (s. 76);
- Social assistance payments (s. 56(1)(*r*), s. 56(1)(*u*));
- Stock option rights granted to employees, etc. (s. 7(1));
- Superannuation benefits (s. 56(1)(*a*)(i));
- Supplementary unemployment benefit plan payments (s. 56(1)(*g*), s. 145(3));
- Top-up disability payment (s. 6(18));
- Transfer of right to income in a non-arm's length transaction (without transfer of property source of income) giving rise to inclusion of remaining income in transferor's hands (s. 56(4));
- Wages (s. 5(1));
- Workers' compensation payments (s. 56(1)(*v*)).

[¶2030] Amounts Not Included in Income

Certain payments or amounts are not included in computing the income of a taxpayer for a taxation year. The following is a list of exemptions together with references to applicable sections of the *Income Tax Act*.

- Amounts declared to be exempt by legislation of the Parliament of Canada (s. 81(1)(*a*));
- Amount of rate assistance received under s. 79.2 of the *Ontario Energy Board Act* (s. 81(1)(g.6));
- Amounts received from a mining property or for shares thereof received by a prospector, a prospector's employer, or a financial backer, if not received under an option to purchase or during or after a campaign to sell such shares to the public (s. 81(1)(*l*));
- Amounts received under War Savings Certificates or similar certificates issued by Newfoundland before April 1, 1949 (s. 81(1)(*b*));
- Amounts repaid that were previously received under CRA tax informant programs (s. 60(z.1)) [effective June 19, 2014];

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- Board and lodging of employees at special work sites (s. 5(2), s. 6(6), and s. 6(7));
- Certain payments from employees' profit sharing plans (s. 81(1)(*k*), s. 144);
- Certain payments under Government or like annuities (s. 58);
- Credits received under the Ontario Electricity Support Program after December 31, 2015 (s. 81(1)(*g.6*));
- Employees at special work sites — value of board and lodging or transportation or allowance therefor, received by construction workers and certain other employees under certain conditions (s. 6(6));
- German compensation payments (s. 81(1)(*g*));
- Group Disability benefits — Insolvent insurer (s. 6(17));
- Halifax disaster pensions (s. 81(1)(*f*));
- Income from the office of Governor-General of Canada, other than salary under the *Governor General's Act* (s. 81(1)(*n*));
- Non-resident person's income from the operation of ships or aircraft where reciprocal exemption is granted by the country of the person's residence (s. 81(1)(*c*));
- Patronage dividends in respect of consumer goods and services (s. 135(7));
- Pensions for war services (s. 81(1)(*d*));
- Portion of benefits under a pension plan which was tax-exempt at any time (s. 57(3));
- Portion of elected M.L.A.'s expense allowance, prior to January 1, 2019 (s. 81(2));
- Portion of elected municipal officer's expense allowance, prior to January 1, 2019 (s. 81(3));
- Private health services plan — benefit of employer's contributions (s. 6(1)(*a*));
- Provincial indemnities (s. 81(1)(*q*));
- Public officers' expense allowances up to 1/2 of salary, prior to January 1, 2019 (s. 81(3)(*b*));
- RCMP pension or compensation (s. 81(1)(*i*));
- Refunds of registered education savings plan payments (s. 81(1)(*o*));
- Scholarships, fellowships, and bursaries received by students enrolled in: (i) a designated educational institution in an educational program in which the taxpayer is a "qualifying student" (from 2007 to 2016, enrolment must be in a post-secondary program eligible for the education tax credit); and (ii) elementary and secondary school programs, subject to certain restrictions for students enrolled in part-time programs) (s. 56(3));
- Service pensions paid by foreign allies where reciprocal exemption exists (s. 81(1)(*e*));

- Stock rights conferred by a corporation on all holders of its common shares (s. 15(1)(*c*)).

[¶2035] Income from Office or Employment

[¶2040] Salary, Wages, and Other Remuneration

A taxpayer's income for a taxation year from an office or employment is the salary, wages, and other remuneration, including gratuities, received by the taxpayer in the year.[9] The taxpayer's loss for a taxation year from an office or employment is the amount of his or her loss, if any, for the taxation year from that source computed by applying the provisions of the Act relating to the computation of income.[10] Salaries and wages are generally taxed in the year in which they are received.

The amounts to be included in employment income extend to the value of benefits from employment, such as board and lodging (¶2055 *et seq.*), amounts received as personal and living expenses (¶2070), directors' fees (¶2075), the value of the personal use of a company automobile (¶2085), income maintenance payments (¶2095 *et seq.*), certain payments made on behalf of an employee by his or her employer (¶2110), certain group insurance premiums (¶2115), and the amounts received out of a salary deferral arrangement that exceed the amount previously included in income and taxed (¶2105). This does not include the benefits the employee derives from his or her employer's contributions to or under a registered pension fund or plan, group sickness or accident insurance plan, private health services plan, supplementary unemployment benefit plan, deferred profit sharing plan (DPSP), group term life insurance policy, employee benefit plan, employee trust, employee life and health trust, pooled registered pension plan, or retirement compensation arrangement.

"Office" means the position of an individual entitling him or her to a fixed or ascertainable stipend or remuneration. It includes a judicial office, the office of a Minister of the Crown, the office of a member of the Senate or House of Commons of Canada, a member of a legislative assembly, a member of a legislative or executive council and any other office, the incumbent of which is elected by popular vote or is elected or appointed in a representative capacity, and also includes the position of a corporation director. "Officer" means a person holding such an office.

"Employment" means the position of an individual in the service of some other person, including Her Majesty or a foreign state. "Employee" means a person holding such a position, and includes an officer of a company. "Employer", in relation to an officer, means the person from whom the officer receives his or her remuneration.[11]

See page ii for explanation of footnotes.

[9] CCH ¶2201; Sec. 5(1).
[10] CCH ¶2202; Sec. 5(2).
[11] CCH ¶28,091; Sec. 248(1) "employer".

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"Salary" has been said to possess the following characteristics:

(1) it is remuneration for services rendered;

(2) it is payable under contract (express or implied);

(3) it is computed by reference to time; and

(4) it is payable at certain definite dates or times.

"Wages" are payments made at regular intervals, whether by the day or week or month, for time during which a workman or servant is at an employer's disposal. It includes payment computed on the basis of the amount of work done by an employee.

In one case, despite the reference to the word "legacy" in their uncle's will, the $15,000 the taxpayers received from his estate to perform their duties as executors was taxable as an income from an office or employment.[12] The situation remains the same if, under the terms of a will, a taxpayer is appointed as the liquidator of an estate and given a piece of property in appreciation of his or her services. Considering that the characterization of income is not based on its amount, but rather on its source, it did not matter that the property value ($70,000) may have been in excess of any liquidator's fee.[13] Similarly, where shares of his employer were never distributed to the taxpayer and continued to be held in escrow until his employer's successor ceased operations, the value of the shares was taxable as employment income since they were issued as compensation for past services.[14]

On the other hand, not all remuneration need be classified as wages or salary. A lawyer who was the president of an insurance company and who received from it a sum of money for legal work was held to have received the fees as a lawyer rather than as income from an office or employment.[15] Where one of two shareholders of a company was to receive 1/2 of the profit from a real estate transaction in exchange for performing the company duties of the other shareholder, her share of the profit was taxable as compensation for services rendered.[16] When a company president received 9 1/2 months' salary in lieu of reasonable notice of his termination, it was determined to be income, not damages for wrongful dismissal, and was taxable as such.[17]

Damages for wrongful dismissal from employment constitute income (see ¶2160). An amount received from an employer in consideration for the release from a contract of employment was income, not a capital indemnity, nor a retirement allowance.[18] If the employee's debt to the employer was cancelled and the cancelled debt was treated as severance pay by the employer, the amount was income to the employee and was a deductible expense of the employer.[19]

"Other remuneration" includes "gratuities" which includes such items as bonuses, tips, and honoraria.

Whether a payment made by an employer to his or her employee is an advance on account of future earnings or a *bona fide* loan is a question of fact. An advance on account of future earnings is properly included in the employee's income for the year in which it is received.[20] Where an employee who is taxed on an advance subsequently, on leaving employment, repays part or all of the outstanding balance, the amount so repaid is ordinarily deductible from income for the year of repayment. When the amount repaid exceeds the advances received in the year, the excess is deductible from the preceding year. Where a loan, as distinguished from an advance, is made to an employee, the amount so received should not be included in income. The employee should include in income for the year those amounts of earnings which are applied against the loan plus any other salary, wages, or commissions that are paid to the employee.

An employee who receives a loan from an employer which is subsequently forgiven will be deemed to have received a benefit from employment which must be included in income.[21] The value of the benefit is calculated as the amount of the loan or obligation forgiven. See also ¶2130 and ¶3117 concerning low-interest loans to employees.

A taxpayer received $389,700 upon termination of employment for cancellation of rights to receive a percentage of company profits during the term of his employment. The payment was determined to be income from employment in satisfaction of an agreement made during his employment.[22]

[¶2050] Employee or Independent Contractor

Income from an office or employment is determined by different rules than those applicable to determining income from a business or property. Differences arise as to the availability of deductions, the time of recognition of income, and the "taxation year". Therefore, it is of importance to a taxpayer to determine whether his or her income or some portion thereof is from an office or employment or from a business or property.

There may be difficult cases where it will be necessary to determine the answer as a matter of fact, having reference to the definitions referred to above and the common law as to whether the income in question is from an office or employment or from business carried on by the taxpayer as an independent contractor. For example, in some circumstances it may be difficult to determine whether a commission agent receives income from an

See page ii for explanation of footnotes.

12 Messier et al., 2008 DTC 4609.
13 Boisvert, 2011 DTC 1296.
14 Lockhart, 2008 DTC 3044.
15 Biron, 62 DTC 20.
16 Stenstrom, 63 DTC 479.
17 Quance, 74 DTC 6210, Bye, 75 DTC 33.
18 Choquette, 74 DTC 6563.

See page ii for explanation of footnotes.

19 S. de Waal et al., 75 DTC 127.
20 Randall, 87 DTC 553.
21 CCH ¶2689; Sec. 6(15).
22 Markin, 96 DTC 6483.

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office or employment or from a business carried on by himself or herself. A similar problem frequently arises with entertainers and musicians.[23]

Under the common law dealing with master and servant relationships, the general test to be applied is the nature and degree of control over the person alleged to be the employee. In addition to the control test, there are three other tests which courts have developed to ascertain whether a taxpayer is an employee or an independent contractor. These are:

(a) the integration test;

(b) the economic reality test; and

(c) the specific result test.

Under the integration test, distinction is made between a contract *of* service and a contract *for* service. In the former situation one is employed as part of the business and work is done as an integral part of the business. In the latter situation, the taxpayer's work, although done for the business, is not integrated into it but is only accessory to it, and therefore the taxpayer is an independent contractor. Using this test, part-time lecturers and teachers who do not appear to be under the direct control and supervision of the educational institution have been found to be employees.[24]

Under the economic reality test, the courts have determined that a person who is in business as an independent contractor runs the risk of financing equipment, supplying the help necessary to operate and administer the business, and having to ensure that there are sufficient clients to render the business economically viable.[25]

With respect to the specific result test, the courts again make a distinction between a contract *of* service and a contract *for* service, the former indicating an employer–employee relationship.

The courts have stressed the importance of examining the facts of the alleged employment relationship in detail rather than trying to establish a mechanistic test or series of tests.[26] In other words, the factors of control, chance of profit, risk of loss, and ownership of equipment do not constitute an exhaustive list, and there is no set formula as to their application. The relative weight of each will depend on the particular facts and circumstances of the case.[27]

[¶2055] Board, Lodging and Other Employment Benefits

There is to be included in the income of a taxpayer for a taxation year from an office or employment the *value* of board, lodging, and other benefits of any kind whatsoever, received or enjoyed by the taxpayer (or any

See page ii for explanation of footnotes.

[23] Interp. Bul. IT-525R (Consolidated).

[24] Rosen, 76 DTC 6274; Hecht, 80 DTC 1438.

[25] Hauser, 78 DTC 1532; Alexander, 70 DTC 6006.

[26] Wiebe Door Services Ltd., 87 DTC 5025, Grimard, 2009 DTC 5056, O'Hara, 2009 DTC 1011.

[27] TBT Personnel Services Inc., 2011 UDTC 128, Integranuity Marketing Ltd., 2012 UDTC 1.

person related to the taxpayer) in the year in respect of, in the course of, or by virtue of an office or employment.[28]

Considering that "any kind" of economic advantage arising from a taxpayer's employer which renders his or her office of greater value to him or her requires income inclusion, the Tax Court of Canada has upheld Revenue Canada's assessment as a taxable benefit of a Christmas party at which the taxpayer and his or her guests were put up overnight at the Westin Hotel in Ottawa. The taxpayer was assessed a benefit of $200 for the party and another $100 for room charges.[29] This case attracted so much attention that Revenue Canada had to clarify that it will accept as a non-taxable privilege an employer-provided party if the cost per employee is reasonable in the circumstance. As a guideline, those events costing up to $100 per person will be considered to be non-taxable. Parties costing more than that will generally be considered to be beyond the "privilege" point and may result in taxable benefits.

Amounts included in income as board and lodging or other benefits include:

(a) the value of board and lodging;

(b) rent-free and low-rent housing;

(c) travel benefits;

(d) gifts (including Christmas gifts);

(e) holiday trips;

(f) prizes and incentive awards;

(g) frequent-flyer programs;

(h) travelling expenses of employees' spouses or common-law partners;

(i) employee premiums under provincial hospitalization and medical care insurance plans;

(j) tuition fees;

(k) reimbursement for cost of tools;

(l) wage-loss replacement plans;

(m) interest-free and low-interest loans;

(n) financial counselling and income tax return preparation; and

(o) discounts on merchandise.

See page ii for explanation of footnotes.

[28] CCH ¶2305; Sec. 6(1)(*a*); Income Tax Folio S2-F3-C2.

[29] Dunlap, 98 DTC 2053.

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Amounts not included in income are: discount commissions on sales, subsidized meals where employees pay a reasonable amount, uniforms and special clothing, certain subsidized school services in remote areas, transportation to a job, recreational facilities, removal expenses, premiums under private health service plans, employer contribution under provincial hospitalization and medical care plans, transportation passes, certain reimbursed expenses of public office holders, certain employee counselling services, and professional membership fees if the employer is the primary beneficiary.[30]

An exception to the inclusion of employer-paid tuition fees in income will be made where the course was primarily undertaken for the benefit of the employer rather than the employee.

Where an employer provides transportation to and from work, including parking, for employees who are blind or have severe and prolonged mobility impairment, such benefits are not included in income.[31]

The employer's contributions to the *Canada Pension Plan* do not constitute a taxable benefit to the employee. However, should the employer also pay the employee's contribution on the employee's behalf, the amount of the contribution would be considered a taxable benefit.

U.S. social security benefits are included in income for Canadian tax purposes, and payment of social security taxes by an employer is a taxable benefit to the employee.

Where an employer provides financial counselling by outside firms to an employee, and pays the fees, the amount of the fees is a taxable benefit to the employee. The fees are deductible from the employer's income.[32] However, financial counselling services in respect of the re-employment or the retirement of an employee will not result in a taxable benefit to the employee. Similarly, employer-provided counselling services in respect of the mental or physical health of the taxpayer or a person related to the taxpayer on the re- employment or retirement of the taxpayer will not be included in the employee's income.[33]

In calculating the benefit to be included in income, that cost is determined to be inclusive of the Goods and Services Tax (GST).[34]

The benefit relating to the operation of an employer-provided automobile is a taxable benefit;[35] see ¶2085.

In relation to tuition fees, it was determined that reimbursement of tuition fees for the instruction of the taxpayer's children paid for by the employer should not be included in the taxpayer's income. The reimbursement did not enhance the taxpayer's net worth but merely put him in the

See page ii for explanation of footnotes.

[30] Income Tax Folio S2-F3-C2.
[31] CCH ¶2694; Sec. 6(16).
[32] Income Tax Folio S2-F3-C2.
[33] CCH ¶2301; Sec. 6(1)(a).
[34] CCH ¶2630; Sec. 6(7).
[35] CCH ¶2305; Sec. 6(1)(a).

same position as if he had not been compelled by the nature of his employment to send his children to a private school.[36]

[¶2057] Administrative Exclusion of Employment Benefits

The following benefits, which would normally be included in an employee's income, are excluded by administrative policy:

- *Overtime Meals*: Employees being reimbursed for the cost of their meals if they work overtime do not have to include such a reimbursement in their employment income as a tax benefit if they work two or more hours of overtime right before or after their regular work hours, if the value of their meal does not exceed $17, and if the overtime is infrequent or occasional. Overtime less than three times a week is considered infrequent or occasional, but more than twice a week in certain peak periods could also meet the third condition.
- *Loyalty Programs*: Employees using a personal credit card for business expenses do not have to include the loyalty points collected in respect of those expenses in their employment income as a tax benefit, provided the points are not converted to cash, and the plan is neither indicative of an alternate form of remuneration nor undertaken for tax avoidance purposes. (If the employee uses a company credit card, the fair market value of any personal rewards he or she received from redeeming the points must be reported on the T4.)
- *Non-Cash Gifts and Awards*: An employee may receive any number of non-cash gifts and awards from an arm's length employer without having to include them in his or her income provided their annual total value does not exceed $500; any gift or award in excess of this $500 limit would be taxable. The employee may receive a separate non-cash, long-service or anniversary award of up to $500 in addition to the non-cash gifts and awards; any long-service or anniversary award in excess of this $500 limit would be taxable. Immaterial items like coffee mugs or t-shirts with the employer's logo are not taxable and excluded from this calculation. Note that performance-related or cash/near-cash awards are fully taxable and excluded from this calculation.
- *Surface Transit Passes*: Free or discounted passes provided to employees of bus, streetcar, subway, commuter train, and ferry services for their exclusive use are not taxable to them but those provided to members of their families are considered a tax benefit to be included in their incomes. Passes for municipal employees not working in the transit area are also taxable.

See page ii for explanation of footnotes.

[36] Guoy, 97 DTC 5267.

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For more details on these four policies, see Income Tax Folio S2-F3-C2, Benefits and Allowances Received from Employment, on the CRA's website at www.canada.ca.

[¶2060] Housing Loss Reimbursements and Other Employer-Provided Housing Subsidies

Any amount paid in respect of a housing loss (other than an eligible housing loss) to or on behalf of a taxpayer in respect of, in the course of, or because of an office or employment is deemed to be an employment benefit and is fully included in the taxpayer's income.[37] An eligible housing loss means a loss incurred on the disposition of a house in respect of an eligible relocation.[38] Generally, an "eligible relocation" means a relocation enabling the taxpayer to be employed at a location in Canada or to be a full-time student at a location of a post-secondary institution if: (i) both the taxpayer's old residence and new residence are in Canada, and (ii) the distance between the old residence and the new work location is not less than 40 kilometres greater than the distance between the new residence and the new work location.[39] Generally, only ½ of the amount in excess of $15,000 of employer-paid amounts in respect of eligible housing losses is treated as an employment benefit received by the taxpayer.[40] When the taxpayer's employment was terminated, he moved back to Ottawa and his employer purchased the house that he had built. The purchase price was the cost of construction, but was $91,870 above fair market value. The recouped loss of $91,870 was included in his income. It did not involve an "eligible relocation" to the extent that it resulted from the termination of his employment and did not occur to enable him to carry on business in Ottawa.[41]

An eligible housing loss need not be crystallized to be reimbursed. One may choose any particular time to determine the amount of the taxpayer's housing loss. A housing loss at any particular time in respect of a residence of a taxpayer is calculated as the amount by which the greater of:

(a) the adjusted cost base of the residence at that time to the taxpayer or to another person who does not deal at arm's length with the taxpayer; and

(b) the highest fair market value of the residence within the six-month period that ends at that time

exceeds:

(c) if the residence is disposed of by the taxpayer or the other person before the end of the first taxation year that begins after that time, the lesser of:

See page ii for explanation of footnotes.

[37] CCH ¶2697a; Sec. 6(19).

[38] CCH ¶2697d; Sec. 6(22).

[39] CCH ¶28,080; Sec. 248(1) "eligible relocation".

[40] CCH ¶2697b; Sec. 6(20).

[41] Thomas, 2007 DTC 5151.

(i) the proceeds of disposition of the residence, and

(ii) the fair market value of the residence at that time, and

(d) in any other case, the fair market value of the residence at that time.[42]

Example:

Paul purchases a home in 2010 in his hometown for $400,000 and begins work at a national corporation. In 2012, the land bordering Paul's home is rezoned to permit the development of an industrial park. In January 2016, Paul is offered a promotion on the condition that he relocates to a new community (11,000 kilometres from his hometown) by March 1, 2016. Paul has trouble selling his home because of the heavy industry that now surrounds the property; however, he eventually accepts an offer of $335,000 and completes the sale in August 2016. Paul's eligible housing loss therefore amounts to $65,000. His employer agrees to compensate Paul for any eligible housing loss he incurs on the sale of his property. Because of the size of the loss, the employer pays out the compensation in two payments: $30,000 in September 2016 and $35,000 in February 2017. Paul's taxable benefit in 2016 is $7,500 (one-half of the amount paid in 2016 that is more than $15,000). In 2017, Paul's taxable benefit is $17,500, calculated as follows:

- one half of the total amounts paid in 2016 and 2017 that is more than $15,000 (½ × [$65,000 - $15,000] = $25,000);

minus

- the amount included in income in 2016 ($7,500).

For greater certainty, any amount paid or the value of assistance provided by any person in respect of, in the course of, or because of an individual's office or employment in respect of the cost of, the financing of, the use of, or the right to use a residence is a taxable benefit received by the individual.[43] This provision includes virtually any employer-provided subsidy made to the employee to enable the employee to acquire or to use a residence, including interest subsidies on a mortgage, rent subsidies, payments on account of the purchase price of the home, and mortgage principal reimbursements.

[¶2065] Health and Welfare Trusts for Employees

Health and welfare benefits for employees are sometimes provided through a trust arrangement under which the trustees, usually with equal representation from the employer (or employers' group) and the employees (or their union), receive the contributions from the employer or employers' group to provide such health and welfare benefits as have been agreed to between the employer and the employees (or their union).

If the benefit programs adopted are limited to a group sickness or accident insurance plan, a private health services plan, a group term life insurance policy, or any combination thereof, and the arrangements meet

See page ii for explanation of footnotes.

[42] CCH ¶2697c; Sec. 6(21).

[43] CCH ¶2697e; Sec. 6(23).

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The TOSI will also be expanded to apply to certain adult individuals. Any of the aforementioned types of income are subject to the TOSI if the amount received exceeds what would be considered a subjectively-determined reasonable amount, having regard to:

- The labour contributed by the individual to the business;
- The capital contributed by the individual to the business;
- The risk assumed by the individual in respect of the business; and
- The total amounts paid to the individual before the end of the particular year.

Indexation

The lifetime capital gains exemption limit applicable to shares of a qualified small business corporation increased to $835,716 in 2017 (up from $824,176 in 2016).

[¶5000] General

[¶5001] Introduction

The taxable portion of a capital gain, known as a "taxable capital gain", is included in the taxpayer's income and taxed at the normal personal or corporate rates. The deductible portion of a capital loss, known as an "allowable capital loss", may be offset against a taxable capital gain,[1] with certain exceptions, such as losses from personal-use assets. Allowable capital losses that are allowable business investment losses (¶5030) may be deducted without limit from income from other sources.

A capital gain is measured by deducting the adjusted cost base and the expenses of sale from the proceeds of disposition.[2] "Proceeds of disposition" means the sale price or any compensation received for property, including insurance proceeds not expended on repairing the damage, compensation for lost or damaged property, expropriation proceeds, etc.[3] See ¶5075.

"Adjusted cost base" means the capital cost of depreciable property, and cost with adjustments for other property[4] (see ¶5080). Special transitional provisions apply when property is owned at the start of the system of taxation of capital gains in 1972. A Valuation Day is provided for valuing property as of January 1, 1972 in order to avoid taxing gains that resulted prior to beginning the system. See ¶5130.

Although gains from personal-use property are included in income, losses from such property are allowable only if they are from listed personal property. Listed personal property losses are allowable only as offsets against gains from other listed personal property and not against gains from other types of property.

See page ii for explanation of footnotes.

[1] CCH ¶6007; Sec. 38.
[2] CCH ¶6400; Sec. 40(1).
[3] CCH ¶7852; Sec. 54 "proceeds of disposition".
[4] CCH ¶7850; Sec. 54 "adjusted cost base".

Gains or losses are taxable or deductible not only upon the sale, gift, or other transfer of property, but also upon a deemed disposition which may occur in a number of instances, such as on the death of an individual taxpayer, the change of residence of a taxpayer from Canada to another country, a change in the use of assets, the expiry of an option, the settlement or cancellation of debt, and a negative adjusted cost base.

For a discussion of capital gains and losses in connection with non-residents, see ¶14,025.

Certain property and expenditures are not subject to the rules outlined above, but are instead taxed as "eligible capital property" (ECP). These include such expenditures as the acquisition of goodwill, certain intangibles, or certain legal expenses, for example. Effective January 1, 2017, and subject to transitional rules, the eligible capital property rules are repealed, and ECP is included in the new CCA Class 14.1. See ¶4240.

[¶5002] How Capital Gains and Losses Are Taxed

A taxpayer includes in income the excess of all taxable capital gains other than from listed personal property (¶5310) plus the net gain from listed personal property minus allowable capital losses other than listed personal property losses and allowable business investment losses.[5] This excess is not taxable at any special rate or by a special computation, but is merely added in with other income and subjected to the ordinary income tax rates. Therefore, due to differences in marginal tax rates (see ¶8005 and ¶8310) there can be wide variations in the rate at which the gains are actually taxed, depending on the taxpayer's total income.

If the allowable capital losses other than allowable business investment losses exceed the taxable capital gains and net gain from listed personal property, the result is called a net capital loss.[6] Provision is made for the carryforward and carryback of losses both by individuals and corporations (see ¶3381).[7] In general, net capital losses of a taxpayer for a taxation year may be carried back three years and forward indefinitely to be deducted against net taxable capital gains.

Prior to 1985, an individual could apply allowable capital losses and net capital losses from other years against taxable capital gains and up to $2,000 per year of other income. This right was withdrawn upon the introduction of the capital gains exemption (see ¶5008). However, an individual is still permitted to deduct any pre-1986 capital loss balance against other income to a maximum of $2,000 per year.[8] The pre-1986 capital loss balance is defined generally to be capital losses realized before May 23, 1985, which

See page ii for explanation of footnotes.

[5] CCH ¶2003; Sec. 3.
[6] CCH ¶16,200; Sec. 111(8).
[7] CCH ¶16,003; Sec. 111(1).
[8] CCH ¶16,090; Sec. 111(1.1).

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have not been applied, less any capital gains exemption claimed in previous years.[9]

Corporations may deduct allowable capital losses incurred in a year against taxable capital gains realized in the year, but any deductible excess cannot be applied against other income. Corporations may carry losses back three years and forward an indefinite number of years, but only against capital gains realized, until the losses are absorbed. A corporation cannot deduct losses incurred in a preceding year if the corporation undergoes a change of control[10] (see ¶3390).

[¶5005] Lifetime Capital Gains Exemption

[¶5008] Available Exemption over the Years

An individual can claim a lifetime $835,716 exemption in respect of capital gains realized on the disposition of qualified farm or fishing property (see ¶5021), or qualified small business corporation shares (see ¶5022).

The exemption limit was $824,176 in 2016, $813,600 in 2015, $800,000 in 2014, and $750,000 for several years prior. Currently, the exemption is indexed to inflation every year.[11]

Gains on qualified farm or fishing property realized after April 20, 2015 qualify for an enhanced exemption. The exemption limit on gains on such property is the greater of $1 million or the indexed general exemption amount. Thus, the additional exemption will be available until the indexed limit reaches $1 million. Thus, only gains on qualified small business corporation shares qualify only for the $835,716 exemption. For more information on the higher exemption limit for qualified farm and fishing property, see ¶5021.

Since the capital gains inclusion rate is 50%, the current lifetime exemption for taxable capital gains is $417,858 (i.e., 50% of $835,716) or $500,000 (50% of $1 million) for qualified farm or fishing property disposed of after April 20, 2015.

[¶5010] Election for Property Owned on February 22, 1994

On February 22, 1994, the federal government decided that the $100,000 capital gains exemption (or $75,000 taxable capital gains deduction, offsetting $100,000 of actual gains before being reduced to its taxable component of 75%) would be withdrawn after that date, subject to generous but very complex transitional rules in the form of the final capital gains exemption election.

See page ii for explanation of footnotes.

[9] CCH ¶16,200; Sec. 111(8).
[10] CCH ¶16,140; Sec. 111(4).
[11] CCH ¶15,976af; Sec. 110.6(2.3).

Capital property acquired at any time before February 23, 1994, and still on hand at the end of February 22, 1994, could be made the subject of a special election to utilize any amount of the $75,000 lifetime taxable capital gains deduction remaining after 1993.[12]

The concept of the final capital gains election was that an individual could elect to be deemed to have disposed of any asset or assets he or she designated. The individual had to elect a value (subject to strict limitations), and he or she was then deemed to have disposed of the property at that value and reacquired it at that value. The result was that any gain on the deemed disposition at the elected value gave rise to capital gain, and therefore taxable capital gain, which could be offset by the individual's remaining $75,000 lifetime deduction. Since the individual was deemed to have acquired the property at the new elected value, when he or she disposed of it in the future the gain at that time would be measured against the elected amount rather than the original cost and the future gain and future tax could thereby be reduced. Subject to the value limitations, the individual could spread the remaining exemption among several assets or concentrate it on one.

The general concept was varied for flow-through entities such as mutual funds and partnerships, and for eligible capital property. The same deemed disposition rules applied, but these entities were deemed to reacquire the property at its old value and the capital gain recognized went into a separate special notional account for each property for use against future gains from that source.

The election was effective at the end of February 22, 1994, so that any actual dispositions after that date could obtain the benefit of the rule to the extent of its fair market value at that date, which is the upper limit of the elected amount.

Example:

Ms. Damato has 1,000 shares of stock which cost $4,000 and are worth $10,000 on February 22, 1994. She has at least $6,000 of unused exemption ($4,500 of taxable capital gains deduction) to offset the full gain. She elects on the shares at their fair market value of $10,000. She is deemed to have sold them for proceeds of disposition of $10,000, and so a taxable capital gain of $4,500 results. She reports the $4,500 gain, which is added to income but offset in calculating taxable income by her capital gains exemption. She is deemed to have acquired the shares on February 22, 1994, at a cost of $10,000. If she sells them in 1994 or later and their value has not changed, there will be no further gain to report. If their value has increased at the time of actual sale, the gain will be measured from $10,000; if it has decreased, she will have a capital loss.

As discussed below, the elected value cannot be less than the adjusted cost base nor more than the fair market value, and this elected value must permit use of the capital gains exemption and cannot create a gain larger than the amount that can be offset by her available capital gains exemption.

See page ii for explanation of footnotes.

[12] CCH ¶15,999fi, ¶15,999fj; Sec. 110.6(19), 110.6(20).

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For each property covered by his or her final election, an individual had to select a disposition value which was not less than the adjusted cost base (ACB) of the property at the end of February 22, 1994, nor more than the fair market value of the property on February 22, 1994. An election at less than ACB on any property would render the election invalid for all properties. An election in excess of fair market value was valid but subject to penalties, as described below.

For an election to be valid, the elected value for all properties covered by an election needed to create a capital gain which could be fully offset by an individual's available capital gains exemption (or that of the individual's spouse/common-law partner, if the gain is subject to attribution rules). A loss could not be created with an election. An individual could, however, create a gain for any or all of his or her other capital assets which was less than his or her available exemption, and so spread the exemption among several assets.

If an individual overestimated the fair market value chosen for his or her election by more than 10%, there was a severe and automatic penalty.[13] Any excess over 10% further reduced the new ACB. This penalty resulted in an individual squandering the available exemption by electing too high a value, since the individual would not get even the full value of cost base adjustment he or she was entitled to, and would waste an elected amount which might have been applied to other assets. The purpose was to deter deliberate over-elections.

[¶5011] Special Election for Flow-Through Entities

Flow-through entities are defined to include investment corporations, mortgage investment corporations, mutual fund corporations, mutual fund trusts, partnerships, related segregated fund trusts, and trusts governed by an employees' profit sharing plan, and certain trusts established to hold company shares for employees, to protect security interests, or to govern corporate voting rights.[14] Related segregated fund trusts are essentially investment trusts offered by insurance companies.

Elections made on shares or interests in flow-through entities resulted in a deemed disposition and acquisition, so that the elected value and penalty rules applied. However, the capital gain which arose on deemed disposition was not added to the cost base of the asset, but rather flowed into a special account called the "exempt capital gains balance" (ECGB). The deemed reacquisition occurred at the cost to the elector immediately before the deemed disposition. The ECGB could be applied after February 22, 1994, to shelter any capital gain distributions flowed out to the investor from the flow-through entity, as well as any gain on actual disposition, until the end of the year 2004.[15] The ECGB thus preserved any remaining $100,000 capital gains exemption assigned to it into future years. Each flow-through entity subject to an election had its own related ECGB which was not transferable and had to be tracked until the account was exhausted or expired after 2004. Any remaining ECGB after its application in 2004 had to be added to the ACB of the flow-through entity to the elector, and the ECGB itself wound up.

As originally drafted, the election rules did not provide for the situation in which the value of a flow-through property fell after the election and was disposed of before 2005. In this case, there would be an unused and unusable exempt capital gains balance following the disposition. Technical amendments correct this anomaly retroactively to 1994 by adding $4/3$ before February 28, 2000, $3/2$ after February 27 and before October 18, 2000 and $2/1$ after October 17, 2000 of the unusable exempt capital gains balance to the adjusted cost base of the property immediately before the disposition, thus giving recognition to the appropriate capital loss.[16]

Example:

Paula has shares of a mutual fund that were acquired for $8,000 and were worth $10,000 on February 22, 1994. She elects to apply $2,000 of available $100,000 exemption to these shares, and elects a value of $10,000. She is deemed to dispose of them for $10,000 but to reacquire them at $8,000. The $2,000 capital gain ($1,500 taxable capital gain) is income offset by the exemption. The $2,000 (actually $4/3$ of $1,500) goes into the ECGB.

If Paula receives capital gain allocations from the investment of $600 in 1994, $800 in 1995, and $700 in 1996, the special account would offset the $600 and $800 gains completely in 1994 and 1995, and $600 of the $700 gain in 1996. At that point the $2,000 has been exhausted ($600 + $800 + $600 = $2,000) and the remaining $100 in 1996 and all later gains will be subject to capital gains tax in normal fashion. If Paula should sell the shares along the way, any remaining balance of the $2,000 would offset any actual gain on disposition.

If the election related to an interest in a partnership, special adjustments needed to be made to the partnership ACB immediately before the deemed disposition to measure the capital gain which in turn measured the ECGB.[17] Essentially, the individual member of a partnership had to add to the partnership ACB (as determined in ¶5190 immediately before the deemed disposition at the end of February 22, 1994) the total of:

(a) the pre-February 23, 1994, portion of his or her share of partnership net income for its fiscal period that included February 22, 1994, and

(b) his or her share of partnership net capital gains that arose from disposition before February 23, 1994.

For this purpose, the income of the partnership for that fiscal period was prorated on a daily basis. Where the partnership had net losses for that fiscal period and the prorated portion of the net loss was greater than the

See page ii for explanation of footnotes.

[13] CCH ¶15,999fl; Sec. 110.6(22).

[14] CCH ¶6399a; Sec. 39.1(1) "flow-through entity".

[15] CCH ¶6399; Sec. 39.1(1) "exempt capital gains balance".

See page ii for explanation of footnotes.

[16] CCH ¶7637f; Sec. 53(1)(r).

[17] CCH ¶15,999fm; Sec. 110.6(23).

partnership's pre-February 23, 1994, net taxable capital gains, the excess was required to be deducted in computing the individual's adjusted cost base immediately before the deemed disposition.

The purpose of the partnership ACB adjustments was to ensure that the income or loss of the partnership for the period up to February 22, 1994, was reflected in the value of the partnership interest on that day. In the absence of the adjustments, there would be no mechanism to separate out the February 22, 1994 date, since the mechanics of partnership ACB calculations only dealt with final gain or loss at the end of the fiscal period, not its daily accrual up to February 22, 1994. There are no lasting adjustments to ACB carried forward.

[¶5014] Effect of Election on Principal Residence Exemption

As discussed at ¶5260, an individual can claim a special exemption for his or her principal residence based on the number of years he or she claims it as a principal residence (plus 1) divided by the number of years he or she has owned it. When an individual sells a house he or she has always claimed as a principal residence, his or her gains will be wholly exempt, and it would have been foolish to waste the special $100,000 capital gains exemption on the house, and increase current income. However, an individual who was unable to claim the entire exemption, either because he or she did not occupy the house throughout the period of ownership or because he or she had more than one qualifying residence, was able to integrate the $100,000 capital gains exemption with the principal residence exemption.

If a 1994 capital gains exemption election on a principal residence was made and a principal residence exemption on the same property is then claimed on the same property for 1994 and later years, the principal residence exemption formula on actual disposition of a property after February 22, 1994, is: (i) the actual gain determined without reference to the 1994 election, reduced by (ii) the principal residence exemption as traditionally calculated using the number of years the individual designated the principal residence to be such.[18] That is, (ii) is the number of designated years plus one, divided by the number of years of ownership that end after the property was acquired. From the capital gains reduced for principal residence exemption, the individual may, if a 1994 capital gains election was made in respect of the property, deduct the lesser of:

(a) the notional capital gain resulting from the 1994 election calculated as if: (i) the 1994 and earlier years the individual is now designating were designated in the 1994 election, and (ii) the amount designated in the election were reduced to fair market value, or, if there was a penal grind, fair market value reduced by the grind, and

See page ii for explanation of footnotes.

[18] CCH ¶6490a; Sec. 40(7.1).

(b) the reported capital gains that arose from the 1994 election, using the principal residence designations actually made in the 1994 election and ignoring the principal residence designation made in the return on actual disposition.

Commentary on Bill C-63 (Oct. 27, 2017)

Note: When Bill C-63, October 27, 2017, achieves Royal Assent, the commentary will be modified to read:

As discussed at ¶5260, an individual can claim a special exemption for his or her principal residence based on the number of years he or she claims it as a principal residence (plus 1) divided by the number of years he or she has owned it. Effective for principal residences sold after October 2, 2016, the one-plus rule used to calculate the principal residence exemption is not available to a taxpayer not residing in Canada in the year of acquisition of the residence. In other words, the one-plus rule may only be used by a taxpayer resident in Canada in that year. If the seller of the principal residence resided outside Canada for the whole period of ownership of the residence, the principal residence exemption may not be claimed in respect of any portion of the capital gain realized on the sale. When an individual sells a house he or she has always claimed as a principal residence, his or her gains will be wholly exempt, and it would have been foolish to waste the special $100,000 capital gains exemption on the house, and increase current income. However, an individual who was unable to claim the entire exemption, either because he or she did not occupy the house throughout the period of ownership or because he or she had more than one qualifying residence, was able to integrate the $100,000 capital gains exemption with the principal residence exemption.

If a 1994 capital gains exemption election on a principal residence was made and a principal residence exemption on the same property is then claimed on the same property for 1994 and later years, the principal residence exemption formula on actual disposition of a property after February 22, 1994, is: (i) the actual gain determined without reference to the 1994 election, reduced by (ii) the principal residence exemption as traditionally calculated using the number of years the individual designated the principal residence to be such.[19] That is, (ii) is the number of designated years plus one, divided by the number of years of ownership that end after the property was acquired. Remember that the one-plus rule cannot be used for residences sold after October 2, 2016 if the taxpayer does not reside in Canada in the year of acquisition of the residence. From the capital gains reduced for principal residence exemption, the individual may, if a 1994 capital gains election was made in respect of the property, deduct the lesser of:

(a) the notional capital gain resulting from the 1994 election calculated as if: (i) the 1994 and earlier years the individual is now designating were designated in the 1994 election, and (ii) the amount designated in the election were reduced to fair market value, or, if there was a penal grind, fair market value reduced by the grind, and

(b) the reported capital gains that arose from the 1994 election, using the principal residence designations actually made in the 1994 election and ignoring the principal residence designation made in the return on actual disposition.

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See page ii for explanation of footnotes.

[19] CCH ¶6490a; Sec. 40(7.1).

[¶5015] Time for Election

The special 1994 election generally had to be made by April 30, 1995; however, where the election was made on eligible capital property, the filing deadline was the due date for the taxation year in which the fiscal period of the business that included February 22, 1994 ended.[20]

A personal trust must itself have elected by March 31 of the calendar year following the year in which the taxation year of the trust that included February 22, 1994 ended.

[¶5021] Exemption for Gains from Qualified Farm or Fishing Property

The lifetime capital gains exemption is currently available to an individual who disposes of qualified farm or fishing property or shares of a qualified small business corporation, as discussed at ¶5022. See ¶5008 for the current and historical amounts of the lifetime capital gains exemption.

Gains on qualified farm or fishing property realized after April 20, 2015 qualify for up to a $1 million exemption.

Prior to Budget 2014, capital gains resulting from the disposition of "qualified farm property" or "qualified fishing property" were eligible for the exemption. For 2014 and later years, capital gains resulting from the disposition of "qualifying farm or fishing property" are eligible for the exemption. "Qualified farm or fishing property" comprises real property or a fishing vessel used in the course of carrying on the business of farming or fishing in Canada, a share of the capital stock of a family farm or fishing corporation, an interest in a family farm or fishing partnership, and eligible capital property used in the course of carrying on the business of farming or fishing in Canada. Prior to these amendments, a taxpayer could only utilize these tax benefits if he or she was in the business of farming or fishing, but not a combination of these two activities. The rules were modified to allow businesses which engaged in both activities to enjoy the tax benefits.[21]

In either case, the property must meet several criteria for the owners of the property, the users of the property, and the use of the particular property to qualify.[22]

In order to meet the definition of qualified farm or fishing property of an individual at any particular time, the property must be owned at that time by the individual, the spouse or common-law partner of the individual, or a family farm or fishing partnership in which the individual or his spouse or common-law partner has an interest. Furthermore, the property must be used in the course of carrying on a farming or fishing business in Canada by the following eligible users:

(i) the individual;

See page ii for explanation of footnotes.

[20] CCH ¶15,999fn; Sec. 110.6(24).

[21] Sec. 248(29).

[22] CCH ¶15,975k; Sec. 110.6(1) "qualified farm or fishing property".

(ii) if the individual is a personal trust, a beneficiary of the trust that is entitled to receive any income or capital of the trust;

(iii) a spouse, common-law partner, child, or parent of the individual referred to in (i) or the beneficiary referred to in (ii);

(iv) a family farm or fishing corporation, a share of which is owned by any individual referred to in (i) through (iii); or

(v) a family farm or fishing partnership, an interest in which is owned by any individual referred to in (i) through (iii).

In the case of real or immovable property or a fishing vessel, the property must have been used principally in the course of carrying on a farming or fishing business.

There are two separate rules for determining whether property is considered to be used in the course of carrying on a farming or fishing business in Canada:

The first is a general rule requiring that the following two-part test be met for the property to qualify as a farming or fishing business in Canada at any particular time.

- First, throughout the 24-month period preceding the particular time (e.g., the time of disposition), the property must have been owned by the individual, the individual's spouse or common-law partner, child, or parent, or by a partnership, an interest in which is a family farm or fishing partnership interest of the individual or the individual's spouse or common-law partner. If the individual is a personal trust, the property must be so owned by the individual from whom the trust acquired the property or a spouse or common-law partner, child, or parent of the individual, or a personal trust from which the individual or a child or parent of the individual acquired the property.
- Second, during a period of at least two years, during which the property was owned by a qualified owner, the gross revenue of a qualified owner ("operator") from the farming or fishing business carried on in Canada, in which the property was principally used, exceeded the operator's income from all other sources in the year. In order to satisfy this requirement, the property must have been owned by a qualified owner for a period of at least 24 months throughout which it was used by a family farm or fishing corporation or a family farm or fishing partnership (specifically, a corporation referred to in (iv) above or a partnership referred to in (v) above) in the carrying on of the business of farming or fishing in Canada. Additionally, throughout that period, the individual referred to in (i) above, a beneficiary of a personal trust referred to in (ii) above, or a person

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referred to in (iii) above, must have been actively engaged on a regular and continuous basis in the farming or fishing business.[23]

In 1965, a taxpayer acquired a 42-acre property which he later subdivided, leaving him with 13.6 acres. When he sold this in 1993, he was entitled to the qualified farm property capital gains deduction, since the property was used principally for farming for a five-year period, from 1966 to 1971.[24]

The second rule determines whether a share of the capital stock of a family farm or fishing corporation owned by an individual at a particular time will qualify as a qualified farm or fishing property. Under this rule, two tests must be met for such a share to qualify:

- First, throughout any 24-month period ending before that time, more than 50% of the fair market value of the property owned by the corporation must be attributable to any combination of the following types of property:

  (i) property that has been used principally in the course of a Canadian farming or fishing business by:

    (a) the corporation,

    (b) the individual,

    (c) if the individual is a personal trust, a beneficiary of the trust,

    (d) a spouse, common-law partner, child, or parent of the individual or beneficiary of the trust,

    (e) a related corporation, a share of which is a share in the capital stock of a family farm or fishing corporation of an individual referred to in (b) through (d), or

    (f) a partnership, an interest in which was an interest in a family farm or fishing partnership of an individual referred to in (b) through (d);

  (Individuals described in (b) through (d) must have been actively engaged in the farming or fishing business on a regular and continuous basis.)

  (ii) shares or indebtedness of one or more corporations, all or substantially all (90% or more) of the fair market value of the assets of which are properties referred to in (i), (ii), or (iii); or

  (iii) an interest or indebtedness in one or more partnerships, all or substantially all of the fair market value assets of which are properties described in (i), (ii), or (iii).

See page ii for explanation of footnotes.

[23] Sec. 110.6(1.3)

[24] Sevy, 2004 DTC 3442.

- Second, at that time, all or substantially all (90% or more) of the fair market value of the property owned by the corporation must be attributable to properties described in (i), (ii), and (iii).[25]

A similar test determines whether a partnership interest will qualify as qualified farm or fishing property of an individual.[26] Therefore, in order for the partnership interest to qualify at a particular time (meaning the time of disposition) throughout any period of at least 24 months before that time, more than 50% of the fair market value of its property must have been attributable to any combination of the properties described in (i) through (iii) above.

Finally, Class 14.1 depreciable property (eligible capital property prior to 2017) of the farming or fishing business may qualify as qualified farm property or fishing property of an individual. To qualify, the property must have been used by the eligible users of qualified farm or fishing property referred to in (i) through (v) above.[27]

[¶5022] Small Business Corporation Shares

Gains resulting from the disposition of qualified small business corporation shares qualify for the $835,716 (for 2017) lifetime capital gains exemption.

In order for a share to be a "qualified small business corporation share", the following criteria must be met:[28]

(1) The shares must be shares of a Canadian-controlled small business corporation which, at the time of disposition, uses 90% or more of its assets either directly in an active business carried on in Canada or as a holding company for such a corporation. The 90% measurement is based on the fair market value of all assets at the time of disposition. Since the term deposits it maintained were not an integral aspect of its business operations, a corporation did not meet this 90% measurement and, hence, was not a qualified small business corporation for the purpose of the capital gains exemption.[29]

(2) The shares must be owned by the taxpayer, the taxpayer's spouse/common-law partner, or a partnership related to the taxpayer.

(3) The shares must not have been owned by anyone other than the taxpayer or a related person during the 24 months preceding disposi-

See page ii for explanation of footnotes.

[25] CCH ¶15,975m, ¶15,975ma; Sec. 110.6(1) "share of the capital stock of a family farm or fishing corporation", which incorporates the earlier definitions of 110.6(1) "share of the capital stock of a family farm corporation" and 110.6(1) "share of the capital stock of a family fishing corporation".

[26] CCH ¶15,975g, ¶15,975gf; Sec. 110.6(1) "interest in a family farm or fishing partnership", which incorporates the earlier definitions of 110.6(1) "interest in a family farm partnership" and 110.6(1) "interest in a family fishing partnership".

[27] CCH ¶15,975p, ¶15,975s; Sec. 110.6(1.2), 110.6(1.3).

[28] CCH ¶15,975l; Sec. 110.6(1) "qualified small business corporation share".

[29] Skidmore et al., 2000 DTC 6186.

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tion. This rule seems to suggest that a person can incorporate his or her personal proprietorship and sell it immediately, since the shares will not have been held by an unrelated person. It further appears that shares issued on a rollover to a holding company for common shares will qualify, or at least not be automatically disqualified. On the other hand, newly issued treasury shares are disqualified. The death of the individual does not mitigate the 24-month requirement.

(4) Throughout the 24-month holding period, at least 50% of the assets of the corporation must have been used principally in an active business, or to finance a "connected" active business.[30]

[¶5025] Capital Gains Deferral for Investment in Small Business

[¶5026] Permitted Deferral

Where an individual (other than a trust) disposes of shares of a small business corporation and realizes a capital gain, that gain can be deferred where the individual reinvests the proceeds of disposition into eligible small business corporations. Similar to the exchange of property provisions (see ¶5357), this provision only provides a deferral which is reflected in a reduction of the cost base of the new investment. The adjusted cost base of the new investment is reduced by the capital gain deferred from the initial investment. Accordingly, the gain is deferred until the disposition of the new investment (the "replacement shares"), unless the gain is deferred again on those proceeds.[31]

The shares may be acquired from a related individual due to circumstances such as a death or breakdown of a marriage or common-law partnership. For the purposes of the capital gains deferral, an individual who acquires shares in such circumstances will be considered to have acquired them at the time and under the same circumstances that the related individual originally acquired them.[32] The capital gains deferral is also available to individuals in partnerships involved in pooling their investments. For the purposes of the capital gains deferral, any transaction entered into by an investment manager on behalf of an individual under an eligible pooling arrangement is deemed to be a transaction of the individual and not a transaction of the investment manager.[33] An "eligible pooling arrangement" is an arrangement in writing between an individual and an investment manager that provides for: (i) the transfer of funds or other property by the individual to the investment manager; (ii) the use of funds or proceeds from the sale of the property by the investment manager to purchase eligible small business corporation shares on behalf of the individual within 60

See page ii for explanation of footnotes.

[30] CCH ¶24,357; Sec. 186(4).
[31] CCH ¶6750m; Sec. 44.1(2).
[32] CCH ¶6750o, ¶6750p; Sec. 44.1(4), 44.1(5).
[33] CCH ¶6750n; Sec. 44.1(3).

days; and (iii) a monthly reporting to the individual by the investment manager of the securities transactions made on behalf of the individual.[34]

[¶5027] Qualifying Dispositions

An individual can have a capital gain deferral only in respect of a gain arising on a "qualifying disposition" of the individual. A qualifying disposition of an individual is a disposition of common shares of the capital stock of a corporation owned by the individual, where each such share was a share issued by an "eligible small business corporation" at the time the share was acquired, was a common share of the capital stock of an "active business corporation" throughout the ownership period, and was owned throughout the 185-day period that ended immediately before the disposition.[35]

An eligible small business corporation is a Canadian-controlled private Corporation, all or substantially all of the fair market value of the assets of which are used principally in an active business carried on primarily in Canada by the corporation or an eligible small business corporation related to it. It can also be shares of, and/or debt issued by other related eligible small business corporations or a combination of such assets, shares, or debt.[36] To be an eligible small business corporation share, the total carrying value of the assets of the small business corporation (that is, the amount at which the assets would be valued for the purpose of the corporation's balance sheet if it was prepared in accordance with generally accepted accounting principles used in Canada at that time) and related corporations cannot exceed $50 million immediately before and immediately after the investment.[37] An eligible small business corporation and an eligible active business corporation do not include: a professional corporation; a specified financial institution; a corporation the principal business of which is the leasing, rental, development or sale or any combination thereof, of real property owned by it; and a corporation more than 50% of the value of the property of which (net of debts incurred to acquire the property) is attributable to real property.

While the individual holds the shares, the issuing corporation must be an active business corporation. Generally, this is a taxable Canadian corporation, all or substantially all of the fair market value of the assets of which are used in an active business or are shares of, and/or debt issued by other related active business corporations or a combination of such assets, shares, or debt.[38] The active business is required to be primarily carried on in Canada in the period that began when the individual last acquired the shares and ended when the disposition occurred (the "ownership period") if that period is less than 730 days. In any other case, that active business has

See page ii for explanation of footnotes.

[34] CCH ¶6750d; Sec. 44.1(1) "eligible pooling arrangement".
[35] CCH ¶6750i; Sec. 44.1(1) "qualifying disposition".
[36] CCH ¶6750e; Sec. 44.1(1) "eligible small business corporation".
[37] CCH ¶6750f; Sec. 44.1(1) "eligible small business corporation share".
[38] CCH ¶6750a; Sec. 44.1(1) "active business corporation".

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to be carried on primarily in Canada for at least 730 days during the ownership period.

[¶5028] Calculating the Capital Gains Deferral

The permitted deferral of the capital gain from the disposition of eligible small business corporation shares is determined by the following formula:

$$B \times (D \div E)$$

where

B = the total capital gain from the original sale

E = the proceeds of disposition

D = the lesser of E and the total cost of all replacement shares[39]

To be able to defer the capital gain, the individual must purchase the replacement shares in the form of eligible small business corporation shares (see ¶5027) at any time in the year of disposition of the original investment or within 120 days after the end of that year. A designation of the replacement shares in respect of each qualifying disposition must be made in the income tax return for the year of the qualifying disposition.[40] The late filing of this designation could prevent an individual from claiming the deferral, even though the shares would otherwise qualify as replacement shares. Fairness relief in the form of an extension of the time limit (see ¶15,008) is not available to such a designation. This highlights the importance of making a designation in respect of the replacement shares on a timely basis.

[¶5029] Capital Gain Deferral and ACB Reduction

The capital gain that can be deferred ("permitted deferral") in respect of a qualifying disposition of an eligible small business investment is determined as follows:[41]

$$(G \div H) \times I$$

where

G = the lesser of H and the total cost of all replacement shares (to a maximum of $2 million before February 19, 2003);

H = the proceeds of disposition; and

I = the capital gain from the original sale.

The capital gain to be reported in the year of disposition will thereby be determined by subtracting the capital gain deferral from the total capital gain realized from the disposition.[42] For example, an individual receives proceeds of $1,000,000 from a qualifying disposition of Sellco shares that have an adjusted cost base of $750,000, resulting in a capital gain of

See page ii for explanation of footnotes.

[39] CCH ¶6750s; Sec. 44.1(1) "permitted deferral".
[40] CCH ¶6750l; Sec. 44.1(1) "replacement share".
[41] CCH ¶6750g; Sec. 44.1(1) "permitted deferral".
[42] CCH ¶6750m; Sec. 44.1(2)(a).

$250,000. The individual then uses 60% ($600,000) of the proceeds to acquire Newco shares that are replacement shares. The individual would be entitled to claim a permitted deferral equal to 60% of the gain, or $150,000, since he or she has used 60% of the proceeds of disposition to acquire replacement shares. The individual would therefore only realize a capital gain of $100,000 for the year of the disposition.

The formula does not place a limit on the amount of capital gains eligible for the deferral.

Finally, the capital gain deferral must be used to reduce the adjusted cost base of *each* of the eligible replacement shares by the amount determined by the following formula:[43]

Example:

$$J \times (K \div L)$$

where

J = capital gain deferral;

K = the cost of replacement shares (to a maximum of $2 million before February 19, 2003); and

L = the total cost of all the replacement shares (to a maximum of $2 million before February 19, 2003).

The following example from the Department of Finance demonstrates the calculations required for dispositions of small business corporation shares after February 18, 2003 (see Example 1 for dispositions after October 17, 2000 and before February 19, 2003).

Facts

An individual makes a qualifying disposition of shares of corporation A with an adjusted cost base of $3,000,000 for proceeds of disposition of $4,500,000. The individual purchases replacement shares in corporation B with a cost of $2,200,000 and in corporation C with a cost of $2,300,000.

See page ii for explanation of footnotes.

[43] CCH ¶6750, ¶6750m; Sec. 44.1(1) "ACB reduction", 44.1(2)(b).

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Determinations

The capital gain of the individual otherwise determined is $1,500,000 ($4,500,000 - $3,000,000).

The permitted deferral of the individual in respect of the disposition is determined to be $1,500,000 by the formula (G/H) × I, where ($4,500,000/$4,500,000) × $1,500,000 = $1,500,000.

The capital gain from the disposition after deducting the permitted deferral in respect of the disposition is determined as $1,500,000 - $1,500,000 = nil.

[¶5030] Definitions

[¶5031] Meaning of "Capital Gain"

"Capital gain"[44] means the gain from the disposition of any property other than:

(1) property the sale of which would be taken into account in computing ordinary income, such as inventory or property acquired as part of an adventure in the nature of trade;

(2) for dispositions before 2017, eligible capital property, which includes business goodwill and other intangibles (see ¶5045);

(3) cultural property disposed of to a designated institution or public authority in Canada (see ¶5065);

(4) Canadian or foreign resource properties;

(5) an insurance policy including a life insurance policy other than a segregated fund policy;[45]

(6) specified debt obligations or mark-to-market properties;

(7) a timber resource property;

(8) a beneficiary's interest in a qualifying environmental trust, and

(9) participating interests in foreign investment entities.

The disposition of eligible capital property is taxed differently (see ¶3075 *et seq.*) and Canadian and foreign resource properties are also given special income treatment, providing for current deductions and income treatment of proceeds.[46] However, as discussed at ¶5001, eligible capital property will be treated as depreciable capital property after 2016.

Proceeds from the disposition of certain life insurance policies are to be included in income; see ¶2200. "Timber resource property" refers to certain rights or licences to cut or remove timber,[47] and proceeds from the disposition of such property are credited to the undepreciated capital cost (see ¶4385).

See page ii for explanation of footnotes.

[44] CCH ¶6002, ¶6050; Sec. 39(1); ITAR 26(1).
[45] CCH ¶20,831; Sec. 138.1(1).
[46] CCH ¶8350; Sec. 59(1).
[47] CCH ¶4562f; Sec. 13(21).

A capital gain or a capital loss is a gain or loss determined to the extent of the amount that would not otherwise be included or deducted in computing income, if the provisions relating to capital gains and losses were deleted from the Act. Therefore, a gain is considered a capital gain only to the extent that it would not otherwise be included in ordinary income. Since there are no provisions which clearly differentiate between a capital gain and a gain from an adventure in the nature of trade, which is taxed as business income,[48] taxpayers will still have to refer to the numerous Canadian and foreign court decisions that provide the rules for distinguishing between ordinary income and capital receipts. See ¶5105.

[¶5032] Meaning of "Capital Loss"

"Capital loss" is defined[49] as the loss from the disposition of any property other than:

(1) depreciable property;

(2) for dispositions before 2017, eligible capital property, which includes business goodwill and other intangibles (see ¶5045);

(3) Canadian resource property;

(4) foreign resource property;

(5) specified debt obligations or mark-to market properties;

(6) insurance policies, except for life insurance policies that are segregated fund policies;[50]

(7) an interest of a beneficiary in a qualifying environmental trust; and

(8) participating interests in foreign investment entities.

Note that capital property for determining capital loss purposes is not quite the same as for capital gain purposes (see ¶5040). As discussed at ¶5001, eligible capital property will be treated as depreciable capital property after 2016. The sale of property in an income transaction, such as the sale of inventory, does not give rise to a capital loss.

Capital losses can be applied against capital gains in the taxation year and can be carried back three years and forward indefinitely to reduce net taxable capital gains of other years (see ¶3381). Capital losses that are business investment losses are applied against all forms of income and not just capital gains[51] (see ¶5034).

[¶5033] Meaning of "Taxable Capital Gain" and "Allowable Capital Loss"

The portion of capital gains and losses that are included in computing the taxpayer's income are referred to as "taxable capital gains" or "allowable capital losses".[52] As a general rule, a taxpayer's taxable capital gain is ½ of

See page ii for explanation of footnotes.

[48] Interp. Bul. IT-459.
[49] CCH ¶6050; Sec. 39(1).
[50] CCH ¶20,831; Sec. 138.1(1).
[51] CCH ¶2003; Sec. 3.
[52] CCH ¶6007; Sec. 38.

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his or her capital gain and a taxpayer's allowable capital loss is ½ of his or her capital loss. Allowable capital losses may be offset against taxable capital gains, with certain exceptions, such as losses from personal-use assets. Allowable capital losses that are allowable business investment losses (see definition at ¶5034) may be deducted from income from all sources.

However, capital gains realized on gifts of certain capital property to a registered charity or other qualified donee may be eligible for an inclusion rate of zero.[53] This zero inclusion rate applies to capital gains deemed realized on the following gifts of property:

- a share of the capital stock of a mutual fund corporation;
- a unit of a mutual fund trust;
- an interest in a related segregated fund trust;
- a prescribed debt obligation;
- ecologically sensitive land (including a covenant, an easement, or, in the case of land in Quebec, a real servitude) donated to a qualified donee other than a private foundation; and

Commentary on Bill C-63 (Oct 27, 2017)

Note: When Bill C-63, October 27, 2017, achieves Royal Assent, the commentary will be modified to read:

- ecologically sensitive land, including a covenant or an easement (or, in the case of land in Quebec, a real servitude, or, in respect of gifts made on or after March 22, 2017, a personal servitude of at least 100 years) donated to a qualified donee other than a private foundation; and

- a share, debt obligation, or right listed on a designated stock exchange.

Where any of the above property is donated by a deceased's estate within 60 months after the deceased's death, any taxable capital gain realized on the deemed disposition upon death under section 70 (see ¶2575) is also subject to a zero inclusion rate. The estate must otherwise qualify as a "graduated rate estate" but for the fact that the time of the donation occurs after the first 36 months after the death (graduated rate estate status is allowed for a maximum of 36 months). See also ¶8206.

For donations of publicly listed shares, the zero inclusion rate has been extended to any capital gain realized on the exchange of unlisted shares of the capital stock of a corporation for those donated publicly listed shares if:

- at the time of their issuance and at the time of their exchange, the unlisted shares of the capital stock of a corporation included a condition allowing the holder to exchange them for the publicly listed share;

See page ii for explanation of footnotes.

[53] CCH ¶6007; Sec. 38(a1), 38(a2).

- the publicly listed shares are the only consideration received on the exchange; and
- the publicly listed shares are donated within 30 days of the exchange.

In cases where the exchanged securities are partnership interests (other than prescribed interests), the capital gain to be reported is the lesser of:

- the capital gain otherwise determined; and
- the amount, if any, by which the cost to the donor of the exchanged interests (plus any contributions to partnership capital by the donor) exceeds the ACB of those interests (determined without reference to distributions of partnership profits or capital).

If there is no advantage or benefit to be conferred as a result of the gift, the full amount of the capital gain is eligible for the zero inclusion rate. Otherwise, the zero inclusion rate only applies to that proportion of the gain that the "eligible amount" of the gift (see ¶8135) is of the taxpayer's total proceeds of disposition in respect of the property.

As a result of the 2011 Budget, the capital gains tax exemption on donations of publicly listed shares issued under a flow-through share ("FTS") agreement after March 21, 2011 is only available to the extent that cumulative capital gains realized on their deemed dispositions exceed their original cost, determined without regard to the nil cost base otherwise applicable to FTS agreements.[54] In effect, to the extent that a taxpayer has incurred costs to acquire shares issued under an FTS agreement after March 21, 2011 (and in respect of which the taxpayer may be entitled to a deduction), the taxpayer is required to pay tax at normal capital gains rates on capital gains realized on their dispositions whether the shares are sold for consideration, or are donated to a qualified donee.

For the purposes of the Act, a taxpayer is deemed to have a capital gain on a disposition of property if another property that is included in a "flow-through share class of property" is subject to a gifting agreement and the taxpayer has, at the time of the donation, a positive balance in a pool of the actual cost to the taxpayer of flow-through shares of that class acquired after the later of March 22, 2011 and the taxpayer's "fresh start date".[55]

For more details, refer to the commentary on the definition of "exemption threshold" at ¶3361.

[¶5034] Meaning of "Business Investment Loss"

A "business investment loss" is defined[56] as a loss that is a capital loss realized on a disposition of shares or debt owing by a small business corporation.[57] For business investment loss purposes, a small business corporation includes a corporation that was a small business corporation at any

See page ii for explanation of footnotes.

[54] Sec. 38.1.
[55] Sec. 40(12).
[56] CCH ¶6050; Sec. 39(1)(c); Income Tax Folio S4-F8-C1.
[57] CCH ¶28,271a; Sec. 248(1) "small business corporation".

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ty did not pass to and vest in the trustee in bankruptcy, but remained vested in the bankrupt. Thus, a taxpayer was only liable for taxes on business income arising after the date of bankruptcy and his tax liability for the pre-bankruptcy period was a claim provable in bankruptcy.[2] Any dealing in the bankrupt's estate or any act performed in the carrying on of the business of the bankrupt by the trustee is deemed to have been done in his or her capacity as an agent of the bankrupt, so that any trustee's income from such dealing or carrying on is income of the bankrupt and not of the trustee. Where a taxpayer's trustee in bankruptcy refused to appeal the Minister's assessment, the taxpayer was allowed to proceed in the appeal on his own behalf.[3]

When an absolute order of discharge is granted, any losses previously sustained by the bankrupt (whether or not during bankruptcy) are not deductible in computing the former bankrupt's income for any year, commencing with the year of the order.

A taxpayer corporation was granted an order discharging it from bankruptcy. Two months later the Minister reassessed the taxpayer for years prior to the discharge, and disallowed certain deductions. The tax debt claimed by the Minister was held to be a "provable claim" under the former *Bankruptcy Act* from which the taxpayer was freed by the discharge order.[4]

[¶9006] Provisions Applicable to Corporations

A new taxation year of a corporation is deemed to commence on the day of the bankruptcy and the taxation year within which the bankruptcy occurred is deemed to end on the day prior to the bankruptcy.

Where a taxation year of a corporation ends during the period in which the corporation is a bankrupt, and the corporation fails to pay its tax payable, the corporation and the trustee in bankruptcy are jointly and severally liable to pay. However, the trustee is only liable to the extent of the bankrupt's property in his or her possession, and payment by either the corporation or the trustee discharges the liability.

In any taxation year ending in the period of bankruptcy, the corporation is deemed not to be associated with any other corporation.[5]

[¶9009] Provisions Applicable to Individuals

Where an individual declares bankruptcy in the taxation year, his or her income (or loss) may be divided among three separate tax returns.

First, an individual is deemed to have a year end the day before the declaration of bankruptcy and must file a return covering that period (as if it were a whole year) by April 30 of the following year, reporting all income and loss and all normal deductions for the period covered.[6] Personal amount credits must be apportioned between this return and the third return described below. The personal amount credits claimed on this return

See page ii for explanation of footnotes.

[2] Stiliadis, 99 DTC 341.
[3] Leith, 70 DTC 1144.
[4] Beauchesne, 77 DTC 5308.
[5] CCH ¶20,003; Sec. 128(1).
[6] CCH ¶20,004; Sec. 128(2)(d).

will be prorated by days in the taxation year before the bankruptcy over days in the calendar year, and a similar calculation for days commencing with the day of bankruptcy will apply to determine credits under the third return below. In no case can any particular credit allocated between returns be greater than the amount that could be claimed if there was a single return filed for the year.

Second, the trustee must, before the end of March of the following year, file a tax return covering the trustee's dealings with the bankrupt's property and business during the bankruptcy period in the year and pay any tax payable. This return is filed as if:

(a) in computing taxable income, the individual was not entitled to any deduction, other than loss carryovers and deductions in respect of employee stock options, prospectors' shares, deferred profit sharing plan shares received in lump-sum settlements, and capital gains from the disposition of qualified farm or fishing property or qualified small business corporation shares that are eligible for the lifetime capital gains exemption; and

(b) in computing tax payable, the individual was not entitled to deduct various personal tax credits (except charitable donation tax credits for gifts made before the bankruptcy) and investment tax credits arising from expenditures incurred or properties acquired after the date of absolute discharge.[7]

Third, the individual must file a separate second return for the year, covering the period from the date of bankruptcy to December 31 (whether or not a discharge is granted).[8] This return also treats the portion of the year it covers as if it were a whole year and it must be filed by the regular filing due date — June 15 or April 30 of the following year. It covers any income or other transactions not included in the trustee's return, such as employment income for the period. Loss carryovers of any kind cannot be claimed on this return as these are only available to the trustee. Personal amount credits must be apportioned between this return and the first return, above. The deductions and credits which may be claimed on the trustee's return may not be claimed on the individual's second return even if the trustee did not claim them.

Special rules govern RRSP contributions for bankruptcies. Under these rules, notwithstanding the general division of the year into two taxation years, the two taxation years will be treated as one year for the purposes of determining all the amounts relevant to the deduction of RRSP contributions, such as earned income, RRSP deduction limit, unused RRSP deduction room, and so on. The RRSP deduction is then claimed on the taxpayer's first return, using the aggregate earnings, etc. from the two returns, for contributions made to his or her own plan or a spousal plan

See page ii for explanation of footnotes.

[7] CCH ¶20,004; Sec. 128(2)(e).
[8] CCH ¶20,004; Sec. 128(2)(f).

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during the period covered by the return or 60 days thereafter. The taxpayer's deductions on the second return will be for contributions made in the period of that return or 60 days thereafter, and his or her RRSP deduction limit will be reduced by amounts deducted on the first return.

When a taxpayer makes a withdrawal from an RRSP under the Home Buyers' Plan or the Lifelong Learning Plan prior to bankruptcy, an income inclusion will arise if the minimum annual repayments are not made to the RRSP (see ¶10,395d and ¶10,396b). The bankruptcy rules require that the inclusions for the year of bankruptcy be made on the second return and not the first return.

Income from both returns of the individual for the year of bankruptcy (first and third returns above) will be included in calculating income for the purpose of determining the GST/HST credit and the Canada Child Benefit.

When an individual receives discharge from bankruptcy, there will be two returns, assuming the discharge follows the calendar year of declaration of bankruptcy. The trustee will file a return for the period during which the trustee administers the bankrupt's affairs and the individual will file an ordinary return for the year, excluding any transactions dealt with by the trustee in the trustee's return.

An individual who is discharged absolutely from bankruptcy may not carry forward tax losses of any kind which arose in a year prior to the year in which the absolute discharge is granted, so such losses cannot be applied in the year of discharge or any later year.[9] A number of other carryforwards are limited for taxation years ending after an absolute discharge from bankruptcy. These are:

(a) minimum tax carryovers may not be deducted from the alternative minimum tax arising in taxation years ending after the absolute discharge;

(b) charitable donation tax credits may not be claimed for gifts made in taxation years ending before the absolute discharge;

(c) investment tax credits for expenditures incurred or properties acquired in taxation years ending before the absolute discharge may not be claimed; and

(d) carryforwards of unused tuition, textbook, and education tax credits (the textbook and education credits are repealed effective January 1, 2017) from taxation years ending before the absolute discharge may not be claimed.

If, for any reason, the trustee deals with any of an individual's affairs after an order of conditional discharge, the general rules covering a trustee's return will operate as if the individual were bankrupt in that year.[10]

See page ii for explanation of footnotes.

[9] CCH ¶20,004; Sec. 128(2)(g).

[10] CCH ¶20,004; Sec. 128(2)(h).

[¶9010] Change in Residence

[¶9011] Implications of Immigration

When a taxpayer establishes residence in Canada, the provisions of the Act attempt to put the taxpayer in a position such that gains or losses accrued prior to establishing residence, which are not taxable to a non-resident, are not taxable in Canada.

The taxation year of a corporation or trust that establishes residency in Canada is deemed to have ended immediately before the taxpayer becomes resident in Canada, and a new year is deemed to have commenced at the time at which residence is adopted.[11]

Any taxpayer who establishes Canadian residence is deemed to have disposed of and immediately re-acquired each property owned (with certain exceptions discussed below for individuals) at proceeds equal to fair market value immediately before the time of arrival.[12] Accordingly, gains or losses accrued prior to becoming a Canadian resident are irrelevant in determining the Canadian tax liability when the property is later disposed of. The immigrant will calculate eventual gains or losses based on fair market value at the date of immigration.

Certain types of property owned by individuals are excluded from the deemed disposition rule. The main exception is taxable Canadian property owned at the time of immigration. Accordingly, when an individual immigrates to Canada, the cost of the individual's taxable Canadian property will remain the original cost and it will not reflect the fair market value of the property at the time of immigration. Therefore, if the individual subsequently disposes of the property and realizes a gain or loss, both the pre-immigration portion and the post-immigration portion of the gain or loss will be included in the determination of income in Canada. Taxable Canadian property of a taxpayer at any particular time is defined as:

(1) real or immovable property situated in Canada;

(2) property used or held by the taxpayer in carrying on a business in Canada, including property included in Class 14.1 (prior to 2017, eligible capital property), or the inventory of such a business (other than property used in a life insurance business and property that are ships and aircraft used principally in international traffic and personal or movable property pertaining to their operation provided the country in which the taxpayer is resident grants substantially similar relief to persons resident in Canada);

(3) designated insurance property of an insurer;

See page ii for explanation of footnotes.

[11] CCH ¶20,025a; Sec. 128.1(1)(a).

[12] CCH ¶20,025b, ¶20,025c; Sec. 128.1(1)(b), 128.1(1)(c).

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(4) shares of the capital stock of a corporation not listed on a designated stock exchange, an interest in a partnership, or an interest in a trust, which derive more than 50% of their fair market value in the preceding 60 months (otherwise than through a corporation, partnership or trust the shares or interests in which were not themselves taxable Canadian property at the time) from real or immovable property situated in Canada, Canadian resource properties, timber resource properties, or an interest or option in any of the aforementioned properties (this does not include a share of a mutual fund corporation, a unit of a mutual fund trust, or an income interest in a trust resident in Canada, see (5) below);

(5) shares of the capital stock of a corporation that are listed on a designated stock exchange, a share of the capital stock of a mutual fund corporation, or a unit of a mutual fund trust, if in the preceding 60 months, 25% or more of the shares or units were owned by the taxpayer, a party (or parties) with whom the taxpayer did not deal at arm's length, or a combination thereof, and more than 50% of the fair market value of the share or unit was derived directly or indirectly from real or immovable property situated in Canada, Canadian resource properties, timber resource properties, or an interest or option in any of the aforementioned properties;

(6) an interest, option, or right in civil law to a property described in paragraphs (1) to (5);

(7) Canadian resource property and timber resource property;

(8) an income interest in a Canadian resident trust;

(9) a right to a share of the income or loss under an agreement to allocate a share of the income or loss of a partnership to a retiring partner; and

(10) a life insurance policy in Canada.[13]

This definition presents significant changes from the previous definition. The previous definition for unlisted shares held that all unlisted shares of a Canadian corporation were generally taxable Canadian property and that unlisted shares of a non-resident corporation were taxable Canadian property if the 50% test was met in fair market value derived from real property situated in Canada, Canadian resource properties, timber resource properties, or an interest or option in any of the aforementioned properties. The definition for taxable Canadian property is the same for unlisted shares of both a Canadian and non-resident corporation, which is closer to the previous definition for unlisted shares of a non-resident corporation. For shares of a listed corporation, previously they were deemed to be taxable Canadian property if only the 25% share ownership test was met. Now, there is the 50% property test requirement to be met as well.

See page ii for explanation of footnotes.

[13] CCH ¶28,284; Sec. 248(1) "taxable Canadian property".

As noted above, when an immigrated individual disposes of taxable Canadian property that was owned by the individual before the individual became resident in Canada, both the pre-immigration portion and the post-immigration portion of the gain (or loss) will be taxable in Canada. This is true even if the pre-immigration gain would have been treaty-exempt from tax in Canada, had the property been sold while the individual was non-resident. Accordingly, prior to immigration, an individual might consider selling any taxable Canadian property, if the capital gain on the property would be treaty-exempt from Canadian tax at that time.

In addition to the exception for taxable Canadian property, the deemed disposition rule does not apply to inventory or Class 14.1 property (prior to 2017, eligible capital property) used in a business carried on in Canada, or to an individual's "excluded rights or interests". Excluded rights and interests include rights under various types of pension plans and deferred income plans, including registered pension plans, registered retirement savings plans, registered retirement income funds, and foreign retirement arrangements. Excluded rights and interests also include rights to benefits under foreign social security arrangements, employee stock options, and interests in life insurance policies (other than segregated fund policies). For a complete list of excluded rights and interests, see ¶9012a.

[¶9012] Paid-Up Capital of Corporation upon Immigration

A corporation's paid-up capital will be proportionately increased or reduced, at the time it becomes resident in Canada, so that the total paid-up capital will be the amount by which the fair market value of the corporation's property exceeds its liabilities (the "paid-up capital adjustment").[14] The paid-up capital adjustment is allocated *pro rata* over the corporation's shares, based on their respective fair market values.

The paid-up capital adjustment is accounted for at the time the corporation becomes resident in Canada. If the corporation subsequently redeems shares or increases the paid-up capital of its shares, the dividend that is deemed to have been paid may result in an additional adjustment to the paid-up capital of the shares, to the extent that paid-up capital reflects a paid-up capital adjustment.[15] The subsequent adjustment is calculated as follows:

(1) Compute the absolute value of the difference between the dividends deemed to arise on the redemption/paid-up capital increase, and what those dividends would have been if there had been no paid-up capital adjustment (amount "A").

(2) If A exceeds addition to the paid-up capital of the shares under the paid-up capital adjustment, the excess is deducted from the paid-up capital of the shares.

See page ii for explanation of footnotes.

[14] Sec. 128.1(2).

[15] CCH ¶20,026a; Sec. 128.1(3).

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(3) If A is less than the reduction in the paid-up capital of the shares under the paid-up capital adjustment, the shortfall is added to the paid-up capital of the shares.

The intent of these rules is to ensure that where an adjustment to paid-up capital occurs as a result of a share redemption or an increase in paid-up capital under corporate law, resulting in a dividend to the shareholder, the same amount is not also included in the paid-up capital adjustment.

Where the redemption/paid-up capital increase occurs after March 28, 2012, these rules apply differently if the foreign affiliate dumping rules applied on immigration.[16]

[¶9012a] Implications of Emigration

A taxpayer ceasing to be resident in Canada is deemed to have disposed of each property owned by the taxpayer at its fair market value, with some exceptions for individuals, which are discussed below. In general terms, the deemed disposition ensures that an emigrating taxpayer does not avoid paying Canadian tax on unrealized appreciation in the value of property that accrued while the taxpayer was resident in Canada.

Prior to October 2, 1996, it was possible for an individual to emigrate from Canada and avoid the deemed disposition rule for many types of taxable Canadian property, then subsequently claim treaty protection and avoid paying Canadian tax when the property was sold. This prompted the government to make sweeping changes regarding taxpayer migration. Consequently, for changes of residence occurring after October 1, 1996, taxable Canadian property is no longer exempt, as a general rule, from the deemed disposition rule. However, some forms of taxable Canadian property owned by individuals are still excluded — generally speaking, those forms of taxable Canadian property whose gains are not potentially treaty-protected from tax in Canada. The properties owned by individuals that are exempt from the deemed disposition rule can be summarized as follows:

(a) real or immovable property situated in Canada, a Canadian resource property, or a timber resource property;

(b) capital property used in, property included in Class 14.1 in respect of (prior to 2017, eligible capital property in respect of), or property described in the inventory of, a business carried on by the individual through a permanent establishment (see ¶8645) in Canada immediately before departure;

(c) "excluded rights or interests" as described below;

(d) where the individual is not a trust and was resident in Canada for 60 months or less during the 120-month period ending at the time of emigration, property owned by the individual when the individual last became resident in Canada, or property inherited during the period of Canadian residency, and where the individual is not a trust and was resident in Canada for 60 months or less during the 120-month period ending at the time of emigration, property owned by the individual when the individual last became resident in Canada, or property inherited during the period of Canadian residency; and

(e) in those cases where the individual returns to reside in Canada, property in respect of which the individual makes an election to "unwind" the deemed disposition (see the commentary at ¶9012b).[17]

"Excluded rights or interests" (see (c) above) include an individual's rights under most pension and deferred income plans, including registered pension plans, retirement compensation arrangements, registered retirement savings plans, registered retirement income funds, registered education savings plans, registered disability saving plans, tax-free savings accounts, foreign retirement arrangements, and employee life and health trusts. Excluded rights or interests also include rights to receive payments under annuity contracts or income-averaging annuity contracts, rights to receive benefits under the CPP/QPP/OAS/SPP, and rights to benefits under foreign social security arrangements. Employee stock options and interests in life insurance policies (other than segregated fund policies) are also excluded rights and interests.[18]

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Individuals ceasing to be resident in Canada can elect to post security with the CRA for the purpose of deferring the payment of the tax that results from the deemed disposition rule. The election must normally be made and the security provided by the individual on or before the balance-due day for the year in which emigration takes place. In such case, the payment of the tax can be deferred until the underlying properties are actually sold. Furthermore, interest is not charged on the deferred amount of tax. Security is not required for the first $50,000 of taxable income that arises from the deemed disposition. Since one-half of capital gains are included in taxable income, security will thus not be required in respect of the first $100,000 of capital gains resulting from the deemed disposition rule. In cases of undue hardship, the Minister is authorized to accept a lesser or different security.[19]

An individual, other than a trust, may choose to treat properties described in (a) or (b) above that would otherwise be exempt from the deemed disposition rule as having been disposed of.[20] For example, an immigrant might consider this election if he wants to realize a latent loss on such property in order to offset a gain arising from the deemed disposition. Any property on which the election is made is deemed to be disposed of at

See page ii for explanation of footnotes.

[16] CCH ¶20,026a.

See page ii for explanation of footnotes.

[17] CCH ¶20,026c; Sec. 128.1(4)(b).

[18] CCH ¶20,028k; Sec. 128.1(10) "excluded right or interest".

[19] CCH ¶27,036aa–¶27,036k; Sec. 220(4.5)–220(4.71).

[20] CCH ¶20,026e; Sec. 128.1(4)(d).

fair market value, but the losses recognized on such deemed disposition cannot exceed the increase in income arising from other deemed dispositions. Losses in excess of the amounts that can be applied are no longer available.

If taxable Canadian property that was subject to the deemed disposition rule decreases in value after the individual ceases to reside in Canada, and is subsequently sold at a loss, the loss may be carried back to offset the capital gain that resulted from the deemed disposition rule upon emigration. Note that this carryback does not apply to losses incurred on property other than taxable Canadian property.[21]

If the taxable Canadian property that was subject to the deemed disposition rule was a share in a corporation, a subsequent loss on the share may be subject to the stop-loss rules, particularly where the share is redeemed or cancelled. A redemption or cancellation will normally give rise to a dividend to the shareholder which will be subject to Part XIII tax. This tax can be applied to reduce the tax that arose on the deemed disposition on emigration.[22]

[¶9012b] Returning Former Residents

Individuals, other than trusts, who emigrate from Canada and subsequently return to Canada, may elect to "unwind" the deemed disposition of taxable Canadian property that occurred in the emigration year or reduce the deemed proceeds of disposition of non-taxable Canadian property, if the property is still owned by them at the time of return.[23]

Two elections can be made, one in respect of taxable Canadian property that was subject to the deemed disposition, and the other in respect of certain property other than taxable Canadian property that was subject to the deemed disposition. These elections must be made by the individual's filing-due date for the taxation year in which the individual returns to reside in Canada. Furthermore, the Minister has discretion to allow late-filed elections.

If the election is made in respect of taxable Canadian property that was subject to the deemed disposition upon the individual's emigration, the deemed disposition does not apply to that property. Furthermore, the property is not subject to a deemed disposition upon the return to Canada, so that, subject to an adjustment described below, there will be no gain or loss in the emigration year in respect of the property, and the adjusted cost base of the property will remain what it was prior to the individual's emigration from Canada.

An adjustment may be required if the taxable Canadian property was shares in a Canadian resident corporation (or an interest in a trust or

See page ii for explanation of footnotes.

[21] CCH ¶20,028f; Sec. 128.1(8).
[22] CCH ¶18,510; Sec. 119.
[23] CCH ¶20,028d; Sec. 128.1(6).

partnership that owned such shares), the individual received taxable dividends on or in respect of the shares during the period of non-residence, and the property had a post-emigration accrued loss at the time of the return to Canada (that is, the fair market value of the shares or trust or partnership interest at that time was less than the fair market value at the time of emigration). In principle, a portion of this accrued loss can be attributed to the fact that post-emigration dividends were paid on the shares, so that the accrued loss should be reduced by a "notional loss reduction", i.e., the amount of taxable dividends received on or in respect of the shares by the individual during the period of non-residence (not exceeding the post-emigration accrued loss on the property).[24]

If the election referred to above is made, the individual is deemed to have disposed of the property upon emigration at its adjusted cost base immediately before that time plus the notional loss reduction, so that the notional loss reduction is effectively taxed as a capital gain arising at the time of emigration. An individual may, however, make a further election to the effect that all or part of the notional loss reduction not be added to the deemed proceeds of disposition upon emigration, which will have the effect of reducing the capital gain at the time of emigration by the elected amount. The elected amount is effectively limited to the adjusted cost base of the property immediately before the emigration. The elected amount will then reduce the adjusted cost base of the property (so that it will be ultimately recognized as a gain when the property is sold).[25]

A separate election is available in respect of property other than taxable Canadian property that was subject to the deemed disposition upon the individual's emigration. Where this election is made, it will allow the individual to reduce the deemed proceeds of disposition of the property upon the emigration by an elected amount, and to reduce, by the same amount, the cost of the property upon the individual's return to Canada. The elected amount is limited to the lesser of the gain on the property that accrued up to the time of emigration and the fair market value of the property at the time of the individual's return to Canada. The effect of the election is to defer the pre-emigration accrued gain on the property in whole or in part until the property is actually sold.[26]

Similar elections are available where an individual who is a beneficiary under a Canadian resident trust emigrates from Canada, receives a distribution of property from the trust while non-resident, and subsequently returns to reside in Canada while still owning the property. The provision allows the beneficiary and the trust to jointly elect to unwind or amend the tax consequences that resulted from the trust's distribution of the property to the individual. Here again, two elections can be made, one in respect of

See page ii for explanation of footnotes.

[24] Sec. 40(3.7).
[25] Sec. 128.1(6).
[26] CCH ¶20,028d; Sec. 128.1(6).

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taxable Canadian property, and the other in respect of certain property other than taxable Canadian property.[27]

[¶9013] Cross-Border Mergers

Some corporate law systems allow the reorganization of corporations resident in different jurisdictions to form a single corporation. The tax consequences of such reorganization may be uncertain, since the new corporation may be treated as a continuation of both a predecessor corporation resident in Canada, and a non-resident predecessor corporation. To clarify this situation, all predecessor corporations are treated as having had (or adopted) the same residence status as the amalgamated corporation. Thus, where a corporation formed by any reorganization in respect of two or more predecessors is resident in Canada, any predecessor that was not, before the reorganization itself resident in Canada, is deemed to have become resident here immediately before the reorganization.[28] Similarly, a Canadian-resident predecessor is deemed to have become non-resident immediately before its reorganization into a new non-resident corporation.[29] However, these rules do not apply to reorganizations occurring solely as a result of the acquisition by one corporation of another corporation's property, whether by way of purchase or on a winding-up of that other corporation.[30]

[¶9014] Private Corporations

[¶9015] Attributes of Private Corporation

The distinction between public and private corporations is important in view of their different tax treatment. Corporations that are private corporations at the time dividends are paid are subject to a 38⅓% refundable tax on portfolio dividend income (prior to 2016 the rate was 33⅓%).[31] Private corporations are also subject to a potentially lower tax rate on other investment income and, if they are Canadian-controlled private corporations, they may be eligible for the small business deduction. See Chapter VIII.

[¶9018] "Private Corporation" Defined

"Private corporation"[32] means a corporation resident in Canada (regardless of where it was incorporated) that is not a public corporation or is not controlled directly or indirectly by one or more public corporations (other than prescribed venture capital corporations),[33] by prescribed federal Crown corporations,[34] or by a combination of public and Crown corporations.

See page ii for explanation of footnotes.

[27] CCH ¶20,028e; Sec. 128.1(7).
[28] CCH ¶20,029a; Sec. 128.2(1).
[29] CCH ¶20,029b; Sec. 128.2(2).
[30] CCH ¶20,029c; Sec. 128.2(3).
[31] CCH ¶20,039; Sec. 129(1).
[32] CCH ¶11,189; Sec. 89(1) "private corporation".
[33] CCH ¶7670; Reg. 6700.
[34] CCH ¶19,521; Reg. 7100.

"Public corporation" includes a corporation resident in Canada having a class of its shares listed on a designated stock exchange in Canada.[35] (See ¶6010.) It also includes a resident corporation that complies with certain conditions relating to the number of shareholders, dispersal of ownership of shares, public trading in shares, and size of the corporation, provided the corporation has either elected to be a public corporation or the Minister has designated it as such.

A "Canadian-controlled private corporation"[36] (CCPC) is a private corporation that was incorporated in Canada (or has been resident in Canada from June 18, 1971) other than one which is controlled directly or indirectly by non-residents, public corporations (other than prescribed venture capital corporations), or a combination thereof. It was determined by the Tax Court that a unanimous shareholders' agreement restricting the ability of the majority group of non-resident shareholders from electing directors of the board was sufficient to meet the definition of CCPC.[37]

A private corporation which has a refundable dividend tax on hand (see ¶9027) will receive a refund of taxes paid (or reduction of taxes payable) when the corporation pays a taxable dividend to its shareholders. A corporation which has been public at some point during the year can obtain a dividend refund on dividends paid while the corporation was private.

Although only CCPCs generate refundable dividend tax on hand on the payment of Part I tax on investment income, all private corporations, whether Canadian-controlled or not, can generate refundable dividend tax on hand based on Part IV tax liability on dividends.

[¶9021] Investment Income

Investment income of a private corporation can be generally divided into two classes:

(1) portfolio dividends; and

(2) other investment income, including taxable capital gains and income from property, including income from a "specified investment business".

An exception is the exclusion from investment income of amounts received from an associated corporation, if the amount paid was deductible by that corporation in computing its income from an active business.[38]

Tax under Part IV is levied on portfolio dividends received by a private corporation, and the full amount of this tax may be refunded to the private corporation on the payment of taxable dividends. Apart from the tax under

See page ii for explanation of footnotes.

[35] CCH ¶11,191; Sec. 89(1) "public corporation".
[36] CCH ¶19,559a; Sec. 125(7) "Canadian-controlled private corporation".
[37] PricewaterhouseCoopers Inc., Trustee in Bankruptcy of Bioartificial Gel Technologies (Bagtech) Inc., 2013 DTC 1048 (TCC).
[38] CCH ¶20,071; Sec. 129(6).

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Part IV, dividends between Canadian corporations generally flow free of tax. The refundable tax imposed by Part IV is designed to prevent an undue deferral of tax when portfolio dividends are received by a private corporation rather than directly by an individual shareholder. However, if the shareholder's marginal rate of tax on dividends is more than $38^1/_3\%$, the fact that the dividends are received by a private corporation will result in some deferral of tax as compared to a direct receipt of such dividends by the shareholder.

Income from property, including income from a specified investment business but excluding dividends from Canadian corporations, and taxable capital gains will be subject to full corporate tax rates, but a percentage of this type of income tax may be credited to the refundable dividend tax on hand of the corporation, and this amount may be refunded to the private corporation when sufficient taxable dividends are paid. A percentage of Canadian and foreign investment income is credited to the refundable dividend tax on hand account only if the corporation is a Canadian-controlled private corporation throughout the year.

[¶9024] Special Tax on Portfolio Dividends

A $38^1/_3\%$ ($33^1/_3\%$ prior to 2016) tax is imposed on certain dividends received at a time when the shareholders are private corporations or other corporations controlled directly or indirectly by, or for the benefit of, the shareholder or a group of related shareholders.[39] A corporation that was bankrupt at any time in the year or that was a prescribed venture capital corporation, a prescribed labour-sponsored venture capital corporation, a prescribed investment contract corporation, an insurance corporation, a bank, a trust company, or a non-resident-owned investment corporation, throughout the year, is exempt from the tax. The full amount of the tax may be added to the refundable dividend tax on hand of the corporation and may be refunded when sufficient taxable dividends are paid by the corporation.

[¶9027] Refund of Taxes on other Investment Income — Refundable Dividend Tax on Hand

A corporation is entitled to a dividend refund, in respect of taxable dividends paid by it at a time when it was a private corporation, equal to the lesser of:

(a) $38^1/_3\%$ of taxable dividends paid by it in the year; and

(b) its refundable dividend tax on hand at the end of the year.[40]

For taxation years that end before 2016 the rate in (a) was $33^1/_3\%$. Where a corporation's taxation year ended after 2015 and began before 2016, the percentage used in (a) is prorated using the following formula for that year:

See page ii for explanation of footnotes.

[39] CCH ¶24,350; Sec. 186.

[40] CCH ¶20,039, ¶20,043, ¶20,060c, ¶52,247; Sec. 129(1), 129(3), 129(7); Interp. Bul. IT-243R4.

$$33^1/_3\% + 5\% \times (A/B)$$

Where:

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

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

To compute its refundable dividend tax on hand at the end of a taxation year, a corporation must first total these three amounts:

(1) where it was a Canadian-controlled private corporation throughout the year, the *least* of:

(a) $30^2/_3\%$ ($26^2/_3\%$ prior to 2016) of its aggregate investment income for the year minus the amount, if any, by which its foreign tax credit exceeds 8% ($9^1/_3\%$ prior to 2016) of its foreign investment income for the year,

(b) $30^2/_3\%$ ($26^2/_3\%$ prior to 2016) of the amount, if any, by which its taxable income for the year exceeds the aggregate of:

(i) the amount eligible for the small business deduction for the year,

(ii) $100/(38^2/_3)$ of its foreign non-business income deductible as a foreign tax credit (for taxation years that began between November 1, 2011 and December 31, 2015, this amount was $^{100}/_{35}$; $^{25}/_9$ for taxation years beginning before November 1, 2011); and

(iii) the corporation's foreign business-income tax credit for the year multiplied by the "relevant tax factor";[41] and

(c) its tax payable under Part I for the year excluding its corporate surtax;

(2) the total of its taxes payable under Part IV for the year; and

(3) where it was a private corporation at the end of its preceding taxation year, the corporation's refundable dividend tax on hand at the end of that preceding year.

Where a corporation's taxation year ended after 2015 and began before 2016, the amounts used to calculate the RDTOH are prorated for that year. The percentage applied to the calculation in (a) and (b) above is:

$$26^2/_3\% + 4\% \times (A/B)$$

Where:

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

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

See page ii for explanation of footnotes.

[41] The relevant tax factor is calculated as (1/(A-B)), where A is the general corporate tax rate and B is the general rate reduction; this adjustment therefore effectively represents the equivalent Canadian pre-tax business income represented by the foreign business-income tax that is credited.

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The same logic applies to the percentage applicable to foreign investment that is factored into the calculation in (a). The prorated percentage of a corporation's foreign investment income factored into the calculation is:

$9^{1}/_{3}\% - 1^{1}/_{3}\% \times (A/B)$

Where:

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

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

The gross-up amount applied to the corporation's foreign non-business income tax credit amount included in the calculation in (ii) is equal to:

$100/[35 + 3^{2}/_{3} \times (A/B)]$

Where:

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

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

From this total, the corporation deducts its dividend refund for its preceding taxation year. The remainder, if any, is the corporation's refundable divided tax on hand (RDTOH).

Where a tax return reporting Part IV tax payable is not filed within the required three-year limit, the Minister is not entitled to reduce the taxpayer's RDTOH balance in the following taxation year by the amount of the statute-barred dividend tax refund.[42]

[¶9030] Anti-Avoidance Rule

An anti-avoidance rule will stop certain transactions under which a dividend refund was generated without any tax being paid at the shareholder level. This could happen, for instance, if the recipient of the dividend had accumulated tax losses. This kind of abuse will be countered by deeming a dividend not to be a taxable dividend, and therefore denying the dividend refund to the dividend-paying corporation if the dividend was paid in a transaction (or series of transactions), one of the main purposes of which was to obtain the dividend refund.[43]

[¶9033] Bankrupt Corporations

No dividend refund may be obtained in respect of a taxable dividend paid to a controlling shareholder if that controlling shareholder was, at any time in the taxation year of the corporation paying the dividend, a bankrupt.[44]

[¶9036] Procedure for Dividend Refund

When a corporation files its return for a taxation year, within three years after the end of that year, the Minister may refund to the corporation as a dividend refund, the lesser of:

See page ii for explanation of footnotes.

[42] Tawa Developments Inc., 2011 DTC 1324 (TCC).

[43] CCH ¶20,040a; Sec. 129(1.2).

[44] CCH ¶20,040; Sec. 129(1.1).

(a) $38^{1}/_{3}\%$ of taxable dividends paid by the corporation in the taxation year, at a time when the corporation was a private corporation, and

(b) the corporation's refundable dividend tax on hand as at the end of the year.[45]

For taxation years that end before 2016 the rate in (a) was $33^{1}/_{3}\%$. Where a corporation's taxation year ended after 2015 and began before 2016, the percentage used in (a) is prorated using the following formula for that year:

$33^{1}/_{3}\% + 5\% \times (A/B)$

Where:

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

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

The Minister may make the refund without any application for refund having been made by the corporation. If an automatic refund is not made, the Minister must make a refund if the corporation makes an application for it within prescribed reassessment periods.[46]

Instead of making a dividend refund, the Minister may apply the refundable amount to the corporation's other tax liabilities. The Minister must notify the corporation that this has been done. In most cases, the dividend refund earned through the payment of taxable dividends will be used to offset taxes otherwise payable by the corporation as shown in its return for the year.[47]

If the return is not filed within three years of the end of the year in which the dividend is paid, the dividend refund cannot be paid or credited by the Minister, but, as noted above, the corporation's RDTOH balance is similarly not reduced.

[¶9039] "Aggregate Investment Income" and "Foreign Investment Income" Defined

A corporation's aggregate investment income for a taxation year is defined as the amount by which the total of the first three items outlined below exceeds the fourth (the result cannot be negative).[48]

(1) The "eligible portion" of its taxable capital gains in excess of the total of the "eligible portion" of its allowable capital losses for the year and the corporation's net capital losses carried over from other years and deducted in the year. This amount cannot be negative.

(2) The corporation's income from property for the year, excluding exempt income, dividend income which the corporation can deduct in computing its taxable income, receipts from a NISA Fund No. 2, and certain trust income which is otherwise deemed to be property income. The dividend exclusion will remove from aggregate investment income dividends

See page ii for explanation of footnotes.

[45] CCH ¶20,039, ¶20,041; Sec. 129(1), 129(2).

[46] CCH ¶20,049; Sec. 152(4).

[47] CCH ¶20,049; Sec. 129(2).

[48] CCH ¶20,056; Sec. 129(4) "aggregate investment income".

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received from Canadian corporations and most dividends received from foreign affiliates, but will not exclude portfolio dividends from foreign corporations.

(3) The corporation's income for the year from a "specified investment business" carried on by it in Canada (not including any income from a source outside of Canada).

minus:

(4) The current year's losses from property and losses for the year from a specified investment business carried on in Canada.

As noted above, in calculating a corporation's aggregate investment income for a year, one only includes the eligible portion of its taxable capital gains for the year, net of the eligible portion of its allowable capital losses for the year. The "eligible portion" is defined as that portion of the taxable capital gains and allowable capital losses realized on property that cannot reasonably have been considered to have accrued while that property was owned by a corporation other than a Canadian-controlled private corporation, an investment corporation, a mortgage investment corporation, or a mutual fund corporation.[49]

The rules regarding the eligible portion of a corporation's taxable capital gains and losses do not apply to "designated property". Therefore, the full amount of taxable capital gains and allowable capital losses on dispositions of designated property is taken into account. "Designated property" is defined to mean property owned by a corporation which changed its status to become a Canadian-controlled private corporation before November 13, 1981 and which was acquired before November 13, 1981 (or pursuant to a pre-November 13, 1981 agreement), or property acquired in replacement for such property as a result of one of the events of involuntary disposition.[50]

As previously noted, income from a source that is property will constitute aggregate investment income except that the following items are not included: (i) exempt income, (ii) income from a Net Income Stabilization Account (NISA), (iii) dividends which are deductible in computing taxable income, and (iv) amounts of income and benefits of a beneficiary of a trust that are deemed to be property income.

The income or loss from a "specified investment business" carried on in Canada is specifically included in the computation of aggregate investment income. A specified investment business of a corporation is defined at ¶8445. It is a business (other than the business of leasing property other than real property or the business of a credit union) the principal purpose of which is to derive income from property unless (i) the corporation employs in the business throughout the year more than five full-time employees or (ii) in the course of carrying on an active business, any other corporation associated with it provides managerial, administrative, financial, maintenance, or other similar services to it in the year and the corporation could reasonably be expected to require more than five full-time employees if those services had not been provided.

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See page ii for explanation of footnotes.

[49] CCH ¶20,057a; Sec. 129(4) "eligible portion".

[50] CCH ¶11,181c; Sec. 89(1) "designated property".

The income or loss from sources that are property does not include income or loss from any property that is incident to or pertains to an active business carried on by a corporation, or that is used or held principally for the purpose of gaining or producing income from an active business carried on by it. Rather, the income or loss from such property will be considered income or loss from the active business.[51] Thus, where a taxpayer's U.S. dollar deposits in the Philippines were committed to the carrying on of its business there, the interest earned on them was held not to constitute foreign investment income.[52]

"Foreign investment income" is essentially a corporation's "aggregate investment income" from sources outside Canada.[53] However, it is computed without regard to any deduction for net capital losses carried over from other taxation years.

[¶9042] Investment Income from Associated Companies

When income from a source that is a property is paid or payable by an associated company and deducted by the payer in computing its active business income, it is deemed to be active business income in the hands of the recipient corporation.[54] Expenses incurred in connection with this income are deemed to have been incurred by the recipient corporation for the purpose of gaining or producing the income.

For these deeming provisions to apply, the following conditions must be met:

(1) The two corporations must be associated at any time in the relevant taxation year of the recipient. See ¶15,450 and ¶15,490.

(2) The amount in question was or may be deductible in computing the Canadian active business income of the associated payer corporation in any taxation year.

(3) The amount must be otherwise includible in the property income of the recipient.

This income does not attract refundable tax (see ¶9027) but qualifies for the small business deduction. While the types of income caught by the rule include interest, rents, royalties, etc., the direct reimbursement of salaries and other expenses paid by a corporation on behalf of an associated corporation will not give rise to its application.

[¶9043] Example of Dividend Refund

The following example illustrates the manner in which refundable dividend tax on hand (RDTOH) is accumulated and refunded. It is assumed that

See page ii for explanation of footnotes.

[51] CCH ¶20,057ab; Sec. 129(4) "income or loss".

[52] Ensite Ltd., 86 DTC 6521.

[53] CCH ¶20,057aa; Sec. 129(4) "foreign investment income".

[54] CCH ¶20,071; Sec. 129(6).

the corporation is a Canadian-controlled private corporation throughout that time.

Example:

Portfolio dividends	$10,000
Taxable capital gains	5,000
Interest	5,000
Total income	$20,000
Taxable income	$10,000
Part I tax	3,867
Part IV tax	3,833
Taxable dividends paid in year	$18,000
RDTOH balance at end of preceding year	8,000
Dividend refund claimed in preceding year	7,000

RDTOH balance at end of current year:

(1) Least of: (i) $30^2/_3$% of aggregate investment income[55]

= $30^2/_3$% of ($20,000 - $10,000)

= $3,067

(ii) $30^2/_3$% of taxable income

= $30^2/_3$% of $10,000

= $3,067

(iii) Part I tax = $3,867

plus

(2) Part IV tax payable = $3,833

plus

(3) RDTOH balance at end of preceding year = $8,000

minus

(4) RDTOH refund claimed for preceding year = $7,000

Total RDTOH =

$3,067 + $3,833 + $8,000 - $7,000 = $7,900

See page ii for explanation of footnotes.

[55] CCH ¶20,056, ¶20,072b; Sec. 129(4) "aggregate investment income".

Refund for the year:

Lesser of (1) $38^1/_3$ of $18,000 = $6,900

and

(2) RDTOH at year end = $7,900

The corporation will receive a dividend refund of $6,900

[¶9045] Investment Corporations

[¶9048] General Characteristics

A corporation may qualify as an investment corporation whether or not it also qualifies as a mutual fund corporation. Similarly, a corporation may qualify as a mutual fund corporation whether or not it also qualifies as an investment corporation. An investment corporation which also qualifies as a mutual fund corporation will be subject to the same income tax treatment (see ¶9081 *et seq.*) except that:

(a) it is not required to pay the special tax on dividends which is imposed on the mutual fund and which is refundable only on the payment of dividends, and

(b) its tax on other investment income (other than dividends and capital gains) is reduced by 20% (subject to transitional adjustment).

An investment corporation may be either an open-end or a closed-end corporation, whereas a mutual fund corporation must be an open-end corporation. The distinction between open-end and closed-end corporations lies in the shareholder redemption privilege. An open-end mutual fund corporation is required to provide to shareholders the privilege of share redemption. A closed-end investment corporation or a closed-end mutual fund does not.

[¶9051] Qualification as an Investment Corporation

To qualify as an investment corporation in any year, the corporation must meet the following conditions:[56]

(1) It must be a Canadian public corporation throughout the year.

(2) At least 80% of its property throughout the year must consist of shares, bonds, marketable securities, or cash.

(3) Not less than 95% of its income must be derived from shares, bonds, or marketable securities, or from dispositions of such investments.

See page ii for explanation of footnotes.

[56] CCH ¶20,079; Sec. 130(3).

(4) Not less than 85% of its gross revenue for the year must be from sources in Canada. "Gross revenue" means the aggregate of all amounts received or receivable in a year otherwise than as capital.

(5) Not more than 25% of its gross revenue may be from interest.

(6) Not more than 10% of its property may consist, *at any time* in the year, of shares, bonds, or securities of any one corporation or debtor, other than Canadian federal, provincial, or municipal government securities.

(7) No shareholder may own more than 25% of the issued capital stock *at any time* in the year. A person is considered to own not only any shares he or she personally owns but also any shares owned by related persons and a proportionate number of shares held by most trusts or by partnerships. In this context, the definition of "related persons" is narrowed so that an individual shareholder is considered to be related only to his or her spouse/common-law partner, minor children and grandchildren and corporations controlled by them, the shareholder, or a related group. As a result of this narrow definition, an individual shareholder will not have attributed to him or her shares held by his or her siblings, adult children, or in-laws, for the purpose of the 25% share acquisition limit.

(8) Not less than 85% of certain income must be distributed to the shareholders before the end of the year. All dividends payable after December 11, 1979, except capital gains dividends, qualify as a distribution to shareholders. This income is the aggregate of:

(a) $66\frac{2}{3}\%$ of taxable income less taxed capital gains; and

(b) the amount by which intercompany dividends or dividends received from foreign affiliates that are deductible[57] exceed the company's non-capital loss for the year (assuming that the net taxable capital gains for the year are nil);

minus:

(c) any dividends or interest received in the form of shares, bonds, or other securities that are not sold before the end of the year.

Thus, an investment corporation is only obliged to effectively distribute a percentage of the investment income it receives or converts to cash in the year, net of its operating expenses.

For the purpose of meeting the 10% limitation in (6) above, an investment corporation may elect to exclude its investments in wholly owned Canadian subsidiaries and to include the property of those subsidiaries with its own.[58]

[¶9054] Income of Investment Corporation

A corporation that qualifies as an investment corporation is entitled to deduct from its tax otherwise payable an amount equal to 20% of the

See page ii for explanation of footnotes.

[57] CCH ¶16,301, ¶16,500; Sec. 112, 113.

[58] CCH ¶20,080; Sec. 130(4).

amount of its taxable income, minus the amount of any taxed capital gains.[59] An investment corporation, being a public corporation, is not subject to tax on dividends received from taxable Canadian corporations or from foreign affiliates. Other investment income, such as interest and non-deductible portfolio dividend income, is subject to an effective tax rate of approximately 15%.

[¶9057] "Taxed Capital Gains" Defined

For the purposes of investment corporations, mutual fund corporations, and mutual fund trusts, the term "taxed capital gains" means the amount of taxable gains for the year from dispositions of property, minus the aggregate of allowable capital losses from dispositions of property and the amount of deductible net capital losses.[60]

[¶9060] Capital Gains Dividends

An investment corporation is entitled to the same benefits as are available to open-end mutual fund corporations with respect to capital gains dividends (see ¶9090).[61] It may distribute its capital gains by electing to pay a special capital gains dividend.[62] This distribution is specifically excluded from the deemed dividend provisions.[63] The amount upon which the election may be made is limited to the amount of the capital gains dividend account. The election must be made with respect to the full amount of the dividend payment. If an excessive election is made, a penalty tax of three-fifths of the excess dividend is payable by the corporation.[64]

A capital gains dividend received by a shareholder out of the capital gains dividend account is treated by the shareholder as a capital gain and not as a dividend. The "capital gains dividend account" at any point of time is defined as the amount by which the total of the corporation's capital gains from dispositions after 1971 for all taxation years starting at least 60 days before that particular time, while it was an investment corporation, plus (for the 2005 and subsequent taxation years) the capital gains distributions made by a trust to the corporation, exceeds the aggregate of:

(a) capital losses from dispositions of property after 1971 for all taxation years starting at least 60 days before that particular time, while it was an investment corporation,

(b) capital gains dividends that became payable before that time and more than 60 days after the end of the last taxation year that ended more than 60 days before that time, and

(c) $^{100}/_{14}$ times the amount of capital gains refunds for previous taxation years ending more than 60 days before that time, during which it was an investment corporation.[65]

See page ii for explanation of footnotes.

[59] CCH ¶20,075; Sec. 130(1).

[60] CCH ¶20,079; Sec. 130(3).

[61] CCH ¶20,077; Sec. 130(2).

[62] CCH ¶20,101; Sec. 131(1).

[63] CCH ¶20,119; Sec. 131(4).

[64] CCH ¶24,305; Sec. 184(2).

[65] CCH ¶20,135; Sec. 131(6) "capital gains dividend account".

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In simpler terms, a corporation may pay a capital gains dividend within 60 days after its year end (end of Year 1) to the extent of its net capital gains to that year end (Year 1). Capital gains realized after the year end (in Year 2) may only be distributed as capital gains dividends more than 60 days after the year end (i.e., more than 60 days after the start of Year 2). After the capital gain is distributed as a capital gains dividend, the corporation gets a capital gains refund and the capital gains dividend account is reduced accordingly.

[¶9063] Capital Gains Refund

The Minister may make a capital gains refund without the necessity of an application by an investment corporation.[66] The capital gains refund is an amount equal to the lesser of:

(a) 14% of the total of all capital gains dividends paid by the investment corporation in the period beginning 60 days after the start of the year and ending 60 days after the year end plus the investment corporation's capital gains redemptions for the year; and

(b) the corporation's refundable capital gains tax on hand at the end of the year.

"Refundable capital gains tax on hand" means[67] the least of the following three amounts for the year and any previous years throughout which it was an investment corporation: (i) 28% of its taxable income, (ii) 28% of its taxed capital gains, and (iii) the tax payable under Part I for each of the years (not including the corporate surtax in those years to which it applied). From this amount is deducted the total of the investment corporation's capital gains refunds for any previous years when it qualified as an investment corporation.

Instead of making an automatic capital gains refund to the investment corporation, the Minister may apply the amount to other tax liabilities of the corporation. The Minister must pay interest on capital gains refunds at the prescribed rate.

[¶9066] Mortgage Investment Corporations

[¶9069] General Characteristics

Loan companies that wish to invest in real estate or leaseholds in Canada for the production of income, either alone or jointly with another corporation incorporated in Canada or any person administering a trust governed by a registered pension plan or deferred profit sharing plan, may be designated as mortgage investment corporations if they meet strict borrowing and investing requirements. In turn, these corporations are entitled

See page ii for explanation of footnotes.

[66] CCH ¶20,077; Sec. 130(2).

[67] CCH ¶20,140; Sec. 131(6) "refundable capital gains tax on hand".

to special tax treatment similar to investment corporations. A mortgage investment corporation is deemed to be a public corporation.[68]

[¶9072] Qualification as a Mortgage Investment Corporation

A corporation is a "mortgage investment corporation" if it complies with the following conditions throughout a taxation year:[69]

(1) The corporation was a Canadian corporation.

(2) Its only undertaking was the investing of funds of the corporation and it did not manage or develop any real or immovable property.

(3) The corporation did not invest in mortgages or property outside Canada, loans to non-residents of Canada other than on Canadian property, shares of corporations not resident in Canada, or real/immovable property or leasehold interests outside Canada.

(4) The number of shareholders was not less than twenty, with no one shareholder holding more than 25% of the shares of any class. A corporation will meet this requirement throughout its first taxation year if it met it on the last day of that year.[70] A person is considered to own not only shares which that person owns personally, but also (1) any shares owned by persons to whom that person is related, and (2) a proportionate number of any shares held by a trust or partnership of which that person is a beneficiary or member. In this context, the definition of "related persons" is narrowed so that an individual shareholder is considered to be related only to his or her spouse/common-law partner, minor children and grandchildren and corporations controlled by them, the shareholder, or a related group. As a result of this narrow definition, an individual shareholder will not have attributed to him or her shares held by his or her siblings, adult children, or in-laws.

(5) Preferred shareholders participated equally with common shareholders.

(6) Fifty per cent of the cost of the corporation's property (assets) was invested in residential mortgages, hypothecs, deposits insured by the Canada Deposit Insurance Corporation (or Quebec DIB), or in a credit union or held in cash.

(7) The cost of real property held did not exceed 25% of the cost of total assets.

(8) The corporation did not exceed, generally speaking, a 3-to-1 debt-equity ratio, or, if more than two-thirds of the corporation's property is invested in residential mortgages, hypothecs, or CDIC, QDIC, or credit union deposits, a 5-to-1 ratio.

[¶9075] Income of Mortgage Investment Corporation

A corporation that qualifies as a mortgage investment corporation throughout the year is entitled to deduct from its income all ordinary

See page ii for explanation of footnotes.

[68] CCH ¶20,096; Sec. 130.1(5).

[69] CCH ¶20,097; Sec. 130.1(6).

[70] CCH ¶20,099; Sec. 130.1(8).

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dividends paid to its shareholders during the year or within 90 days after the end of the year so long as they were not deducted in the preceding year, and one-half of capital gains dividends paid within the period beginning 91 days after the first of the year and ending 90 days after the year end.[71]

Regular dividends received by shareholders from a mortgage investment corporation will be treated as bond interest received by those shareholders and not as dividends from other Canadian corporations.[72]

[¶9078] Capital Gains Dividend Election

A mortgage investment corporation may elect to distribute its capital gains by electing to pay a special capital gains dividend.[73] Note that capital gains dividends must be elected and paid in the period beginning 91 days after the start of the year and ending 90 days after the year end, in respect of capital gains realized by the mortgage investment corporation in the year. Otherwise, the opportunity to distribute the Mortgage Investment Corporation's capital gains as capital gains dividends is lost.

If the capital gains dividend election was not filed as required, a late-filed election can be filed, provided the required penalty is paid.[74] This penalty is the same as that which applies to late-filed elections by mutual fund corporations (see ¶9093).

[¶9081] Mutual Fund Corporations

[¶9084] Types

A typical mutual fund may be either an open-end or closed-end fund and, if the qualifying conditions are met (see ¶9087), either one may be an investment corporation. Only an open-end mutual fund may qualify as a mutual fund corporation. The distinction between open-end and closed-end corporations lies in the shareholder share redemption privilege. This privilege applies only to an open-end corporation.

If a closed-end mutual fund qualifies as an investment corporation, it will be taxed as such. Otherwise, the corporation and its shareholders will be taxed as if the corporation were an ordinary corporation under the various rules for public and private corporations.

All prescribed labour-sponsored venture capital corporations (LSVCC) qualify as mutual fund corporations. However, special limitations apply to their mutual fund treatment (see ¶9089).[75]

[¶9087] Qualification as a Mutual Fund Corporation

To qualify as a mutual fund corporation, a corporation must be either a prescribed labour-sponsored venture capital corporation or the following conditions must be met:[76]

See page ii for explanation of footnotes.

[71] CCH ¶20,092; Sec. 130.1(1).
[72] CCH ¶20,093; Sec. 130.1(2).
[73] CCH ¶20,095; Sec. 130.1(4).
[74] CCH ¶20,095a; Sec. 130.1(4.1).
[75] Reg. 6701.
[76] CCH ¶20,147; Sec. 131(8).

(1) It must be a Canadian public corporation.

(2) Its only undertakings must be the investing of its own funds (other than real/immovable property or a leasehold interest in it), the acquiring, holding, maintaining, improving, leasing, or managing of any real/immovable property (or a leasehold interest therein) that is capital property of the corporation, or any combination of such activities.

(3) Ninety-five per cent of the issued shares of the corporation, based on their fair market value, must have conditions attached which require the corporation to accept, at the demand of the holder, the surrender of the shares at prices determined and payable in accordance with the conditions.

Corporations that would otherwise qualify as mutual fund corporations do not so qualify if they are established or maintained primarily for the benefit of non-residents of Canada.[77] The purpose of this rule is to restrict the use of mutual funds as intermediaries through which non-residents can invest in real property in Canada and other taxable Canadian property (TCP) without recognizing taxable gains on the disposition of their shares in the mutual funds. An exception to this rule provides that where all or substantially all of the property of the mutual fund consists of property other than TCP (e.g., if no more than 10% of the fund's property is TCP), the mutual fund may continue to be a mutual fund corporation even where it was established or maintained primarily for the benefit of non-residents. In the computation of the 10% threshold, Canadian resource properties and timber resource properties are included after March 22, 2004. However, any mutual fund that exceeds the 10% threshold on March 23, 2004 will have until January 1, 2007 to comply with this rule.

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Effective January 1, 2017, where a corporation was incorporated after 2014 but before March 22, 2016, and would have been a mutual fund corporation if, on March 22, 2016, it could have elected to be a public corporation under paragraph (*b*) of the definition "public corporation" in subsection 89(1) (had the conditions prescribed in paragraph 4800(1)(*b*) of the Regulation been satisfied), and it had at least one class of shares recognized under Canadian securities law as an investment fund at that time, the corporation is deemed to be a mutual fund corporation from the date it was incorporated until the earlier of the date the corporation qualifies as a mutual fund corporation under subsection 131(8) and December 31, 2017, if the corporation so elects in writing in its return of income associated with the first taxation year of the corporation that ends after March 21, 2016.[78]

[¶9089] Labour-Sponsored Venture Capital Corporations

There are several overriding provisions concerning the treatment of prescribed labour-sponsored venture capital corporations as mutual fund corporations. Taxable capital gains, allowable capital losses, and net capital losses are excluded from the determination of the refundable dividend tax on hand of a prescribed labour-sponsored venture capital corporation that

See page ii for explanation of footnotes.

[77] CCH ¶20,147a; Sec. 131(8.1).
[78] Sec. 131(8.01).