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

Preface

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

The Honourable François-Philippe Champagne, P.C., M.P.
Minister of Finance and National Revenue

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

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Income Tax Act and Income Tax Regulations

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

Capital Gains Rollover on Investments

Clause 1

ITA
44.1(1)

Definitions

The existing definition "common share" is currently relevant for the purposes of the definition "eligible small business corporation share" and subsection 44.1(7). A common share is a share prescribed by the *Income Tax Regulations* for the purpose of paragraph 110(1)(d).

The definition "common share" is repealed consequential on the removal of the requirement that an eligible small business corporation share be a common share.

This amendment applies as of January 1, 2025.

The definition "eligible small business corporation share" of an individual is relevant for the purposes of the term "qualifying disposition" of an individual and subsections 44.1(6) and (7) An eligible small business corporation share of an individual is currently a common share issued by a corporation to the individual where at the time the

share is issued the corporation was an eligible small business corporation and immediately before and after that time the total carrying value of its assets and the assets of corporations related to it does not exceed \$50 million.

The definition "eligible small business corporation share" is amended to remove the requirement that an eligible small business corporation share of an individual be a common share.

In addition, paragraph (b) of the definition is amended to increase the existing limit of the total carrying value of the corporation's assets and the assets of corporations related to it from \$50 million to \$100 million.

These amendments apply to dispositions that occur on or after January 1, 2025.

The definition "qualifying disposition" of an individual is relevant for the purposes of the term "permitted deferral" and subsection 44.1(2). An individual is entitled to a capital gain deferral only in respect a gain arising on a qualifying disposition of the individual. A qualifying disposition of an individual is a disposition of shares of the capital stock of a corporation owned by the individual where each such share was an eligible small business corporation share of the individual, was a common share of the capital stock of an active business corporation throughout the time it was owned by the individual and was owned by the individual throughout the 185-day period that ended immediately before the disposition.

The definition "qualifying disposition" is amended to remove the requirement that the share be a common share throughout the time it was owned by the individual.

This amendment applies to dispositions that occur on or after January 1, 2025.

The definition "replacement share" of an individual is relevant for the purposes of the term "permitted deferral". A replacement share of an individual in respect of a particular qualifying disposition of the individual in a taxation year means a share of an eligible small business corporation that was designated by the individual in the individual's return of income to be a replacement share of the individual in respect of the qualifying disposition and that was acquired by the individual in the year the qualifying disposition was made or within 120 days after the end of that year.

Paragraph (a) of the definition "replacement share" is amended to extend the time for acquiring replacement shares to any time in the year in which the qualifying disposition is made or within the following calendar year.

In addition, paragraph (b) of this definition is amended to correct a grammatical error in the cross reference to the French language version of this definition at the end of the paragraph (« action de remplacement »).

This amendment applies to dispositions that occur on or after January 1, 2025.

ITA 44.1(7)

Subsection 44.1(7) provides special rules where an individual, in a qualifying disposition, disposes of common shares of an active business corporation for consideration consisting only of new common shares of another active business corporation issued to the individual. Where the individual's proceeds of disposition for the exchanged shares equals the individual's adjusted cost base of those shares and section 51, paragraph 85(1)(h), subsection 85.1(1), section 86 or subsection 87(4) applies to the individual in respect of the new shares, the new shares are deemed to be eligible small business shares of the individual that were owned by the individual throughout the period that the exchanged shares were owned by the individual and the new shares are deemed to be shares of an active business corporation that were owned by the individual throughout the period that the exchanged shares were owned by the individual. In effect, the individual's eligibility to claim a permitted deferral with respect to a capital gain arising on a disposition of the exchanged shares is rolled over to new shares.

This subsection is amended to remove the requirements that the disposed of shares, and the shares received in consideration, be common shares.

This amendment applies to dispositions that occur on or after January 1, 2025.

ITA
44.1(9)

Subsection 44.1(9) is relevant in determining whether a disposition is a qualifying disposition. Currently, a disposition of a common share of an active business corporation by an individual that would otherwise be a qualifying disposition is deemed not to be a qualifying disposition unless the active business of the corporation referred to in paragraph (a) of the definition "active business corporation" was carried on primarily in Canada, at all times in the period that began when the individual last acquired the share 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 to be carried on primarily in Canada for at least 730 days during the ownership period.

Subsection 44.1(9) is amended to remove the requirement that the share disposed of be a common share.

This amendment applies to dispositions that occur on or after January 1, 2025.

Reporting by Non-profit Organizations

Clause 1

ITA
149(12)

Subsection 149(12) requires an agricultural organization, board of trade, chamber of commerce or non-profit organization, which is exempt from tax under paragraph 149(1)(e) or (l), to file an information return if the organization meets one or more of the enumerated conditions. In particular, the organization must file an information return for the period if it has received dividends, interest, rentals or royalties in excess of \$10,000 in that period, if the total assets of the organization exceed \$200,000 at the end of the immediately preceding fiscal period, or if the organization was required to file an information return under this subsection for a previous fiscal period.

Subsection 149(12) is amended to add new paragraph (d) which will require these organizations to file an information return if the receipts, including capital receipts, of the organization for the period exceed \$50,000.

This amendment applies to fiscal periods that begin on or after January 1, 2026.

ITA
149(13)

New subsection 149(13) requires any organization exempt from tax under paragraph 149(1)(e) or (l) to file an information return (unless the organization is otherwise required to file a return under subsection 149(12) for the same period). This short-form information return must contain prescribed information including a description of the organization's activities (including whether it conducts activities outside Canada), the organization's total assets, total liabilities and total amounts received for the period, and the name and address of each director, officer or trustee of the organization.

This amendment applies to fiscal periods that begin on or after January 1, 2026.

Scientific Research and Experimental Development Tax Incentive Program

Clause 1

Scientific research and experimental development

ITA

37

The scientific research and experimental development (SR&ED) program delivers support to businesses through, among other things, an immediate deduction against income under section 37. Currently, eligible expenditures under the SR&ED program are generally limited to certain expenditures of a current nature. Capital expenditures were removed from eligibility under the SR&ED program for expenditures made after 2013.

The 2024 Fall Economic Statement proposed to restore the eligibility of capital expenditures for the deduction against income under the SR&ED program. The rules would be generally the same as those that existed prior to 2014. Section 37 is amended in several respects to effect this change.

Scientific research and experimental development

ITA

37(1)

Subsection 37(1) is amended in two respects. First, subsection 37(1) is amended to add paragraph (b) to restore the eligibility of certain capital expenditures for the deduction against income under the SR&ED program. In general, paragraph 37(1)(b) describes expenditures of a capital nature made by a taxpayer on SR&ED carried on in Canada, where the SR&ED is directly undertaken by or on behalf of the taxpayer and is related to the taxpayer's business.

Second, paragraph 37(1)(d) is amended to ensure that it will apply in respect of expenditures described in paragraph 37(1)(b) made on or after December 16, 2024.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Expenditures of a capital nature

ITA

37(6)

Subsection 37(6) treats amounts claimed under subsection 37(1) in respect of expenditures of a capital nature as capital cost allowance allowed to the taxpayer in respect of the property only if the property is acquired before 2014.

Consequential on the addition of paragraph 37(1)(b), subsection 37(6) is amended to ensure that it applies in respect of property described in paragraph 37(1)(b) that is acquired on or after December 16, 2024.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Loss restriction event

ITA

37(6.1)

Subsection 37(6.1), together with paragraph 37(1)(h), restricts a taxpayer's ability to carry forward its pool of unused SR&ED deductions where there has been an acquisition of control of the taxpayer. In general terms, the undeducted portion of SR&ED expenditures made before control is acquired may be carried forward to be deducted in computing income for a subsequent taxation year only if certain conditions are met.

ITA
37(6.1)(a)(i)(B)

Consequential on the addition of paragraph 37(1)(b), clause 37(6.1)(a)(i)(B) is amended to ensure that subsection 37(6.1) applies in respect of expenditures and property described in paragraph 37(1)(b) made or acquired on or after December 16, 2024.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Interpretation

ITA
37(8)

Generally, subsection 37(8) provides rules for determining which expenditures incurred in respect of SR&ED are eligible for inclusion in subsection 37(1), in the case of expenditures incurred in Canada, and subsection 37(2), in the case of expenditures incurred outside Canada.

ITA
37(8)(a)

Subparagraph 37(8)(a)(ii) provides rules for interpreting the expression "expenditures on or in respect of scientific research and experimental development" incurred in Canada.

Subclauses 37(8)(a)(ii)(A)(III) and 37(8)(a)(ii)(B)(I), (III) and (VI) are added consequential on the addition of paragraph 37(1)(b). Subclause 37(8)(a)(ii)(B)(II) is also amended to ensure that it applies to expenditures of a capital nature.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

ITA
37(8)(e)

Paragraph 37(8)(e) is added consequential on the addition of paragraph 37(1)(b) to provide, among other things, that a capital expenditure made in respect of the acquisition of a building or a leasehold interest therein (other than a prescribed special-purpose building) does not qualify as an expenditure on, or in respect of, SR&ED. Section 2903 of the Regulations describes a prescribed special-purpose building for these purposes.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Look-through rule

ITA
37(14)

Subsection 37(14) provides a look-through rule to ensure that expenditures incurred by a taxpayer in respect of SR&ED performed on behalf of the taxpayer or by third-party entities include only expenditures of a current nature.

Subsection 37(14) is repealed consequential on the addition of paragraph 37(1)(b).

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Reporting of certain payments

ITA
37(15)

Subsection 37(15) provides that where a taxpayer is required to reduce an expenditure because of the expenditure look-through rule in subsection 37(14), the SR&ED performer (the person or the partnership referred to in subsection 37(14)) is required to inform the taxpayer in writing of the amount of the reduction.

Subsection 37(15) is repealed consequential on the addition of paragraph 37(1)(b).

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Clause 2

Continuing corporation

ITA
87(2)(j.6)

Paragraph 87(2)(j.6) provides continuity rules. Specifically, it provides that for the purposes of a number of provisions, including subsection 127(10.2), the corporation formed as the result of an amalgamation is considered to be the same corporation as, and a continuation of, each predecessor corporation. Because of paragraph 88(1)(e.2), these continuity rules also apply in the context of a winding-up to which subsection 88(1) applies.

Paragraph 87(2)(j.6) is amended to add a reference to subsections 127(10.31) and (10.32), which allow Canadian-controlled private corporations (CCPCs) to elect to have their expenditure limit for the enhanced SR&ED investment tax credit determined based on the same revenue phase-out structure as eligible Canadian public corporations (ECPCs).

This amendment applies to taxation years beginning on or after December 16, 2024.

Clause 3

Deductions from Part I tax

ITA
127

Section 127 allows a taxpayer to take certain deductions in computing tax payable in respect of, among other things, investment tax credits (ITCs).

The scientific research and experimental development (SR&ED) program delivers support to businesses through, among other things, an ITC under section 127. Currently, eligible expenditures under the SR&ED program are generally limited to certain expenditures of a current nature. Capital expenditures were removed from eligibility under the SR&ED program for property acquired after 2013. The 2024 Fall Economic Statement proposed to restore the eligibility of capital expenditures for the ITC under the SR&ED program. The rules would be generally the same as those that existed prior to 2014.

In addition, the 2024 Fall Economic Statement proposed to increase the expenditure limit on which the enhanced 35 per cent rate can be earned from \$3 million to \$4.5 million. The taxable capital phase-out thresholds for

determining the expenditure limit would also be increased from \$10 million and \$50 million to \$15 million and \$75 million, respectively.

Finally, the 2024 Fall Economic Statement also proposed to extend eligibility for the enhanced refundable ITC to eligible Canadian public corporations.

Section 127 is amended to effect these changes.

Definitions

ITA
127(9)

"consolidated financial statements"

"Consolidated financial statements" means financial statements in which the assets, liabilities, income, expenses and cash flows of the members of a group are presented as those of a single economic entity.

This amendment applies to taxation years beginning on or after December 16, 2024.

"consolidated group"

"Consolidated group" means a group of entities in respect of which an ultimate parent entity (UPE) is required to prepare consolidated financial statements, or would be so required if equity interests in any of the entities were traded on a public securities exchange.

The hypothetical "traded on a public securities exchange" component of the definition is relevant where an entity would otherwise be the UPE, but it is not required to prepare consolidated financial statements. In this case, the group includes all entities that would be included in the consolidated financial statements that the relevant entity would be required to prepare if it were traded on a public securities exchange. In applying this component of the definition, it is irrelevant whether or not equity interests of the particular entity are in fact able to be so traded, taking into account, among other things, the jurisdiction's company law and/or regulations governing the relevant public securities exchange.

For instance, in Canada (and in certain other jurisdictions, such as the United States) there is generally a distinction drawn, in determining whether consolidated financial statements are required to be prepared, between entities which have equity interests traded on a public securities exchange and those whose equity interests are not so traded. In this case, the hypothetical trading on a public securities exchange component of the definition would be relevant in determining the entities in a group where the UPE is an entity whose equity interests are not traded on a public securities exchange.

This amendment applies to taxation years beginning on or after December 16, 2024.

"contract payment"

The definition "contract payment" in subsection 127(9) avoids the duplication of ITCs where a person performing SR&ED receives payments or compensation from another person in respect of that SR&ED.

There are a number of ways in which SR&ED can be performed. Taxpayers can perform SR&ED in-house, have someone else perform the SR&ED on their behalf (contract-SR&ED), or make payments for SR&ED to be carried on by certain third-party entities (third-party SR&ED).

A taxpayer is entitled to claim ITCs in respect of a "qualified expenditure" as defined in subsection 127(9). In the case of contract-SR&ED and third-party SR&ED, qualified expenditures of a performer are reduced by the amount of a payor's contract payment to the performer. This ensures that both the payor and the performer cannot claim ITCs on the same qualified expenditure.

Paragraph (b) of the definition "contract payment" is amended, consequential on the addition of paragraph 37(1) (b), to ensure that expenditures of a capital nature are also relevant for the purposes of the definition.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

"eligible Canadian public corporation"

An ECPC may be eligible for the enhanced refundable ITC.

In general, an ECPC is either a corporation that meets the four requirements of paragraph (a) or an eligible subsidiary. For more information on the "eligible subsidiary" definition, refer to the commentary on that definition.

A corporation must meet four requirements to qualify under paragraph (a) of the definition.

First, it must be resident in Canada (subparagraph (a)(i)).

Second, it must be a public corporation (as defined in subsection 89(1)) or would be such a public corporation if the words "designated stock exchange in Canada" in paragraph (a) of the definition public corporation in subsection 89(1) were read as "designated stock exchange" (subparagraph (a)(ii)). This component of the definition captures corporations listed on any designated stock exchange, regardless of whether the designated stock exchange is in Canada.

Third, the corporation must not be controlled, directly or indirectly in any manner whatever, by one or more non-resident persons (subparagraph (a)(iii)).

Fourth, subparagraph (a)(iv) requires that the corporation would not, if each share of its capital stock that is owned by a non-resident person were owned by a particular person, be controlled by the particular person. Subparagraph (a)(iv) generally parallels the hypothetical non-resident shareholder test of paragraph (b) of the definition "Canadian-controlled private corporation" in subsection 125(7) but adapted to the circumstances of a publicly-traded corporation.

Specifically, in light of the fact that a publicly-traded corporation may not be in a position to determine all of its public shareholders, particularly those with a small interest in the corporation, paragraph (a)(iv) provides that, absent actual knowledge, the determination is to be based on publicly available information. For this purpose, publicly available information includes information filed pursuant to applicable securities laws, such as the filings required under Part 5 of National Instrument 62-104. In that respect, a corporation would be able to rely on the filings that are current as of the end of the prior taxation year and would not be required to take into account filings made in the current taxation year. This is intended to provide more certainty in allowing publicly-traded corporations to determine if this specific requirement is met at the beginning of the year. However, as mandated by subsection 127(10.1), all the other requirements of the definition would have to be satisfied throughout the taxation year for the corporation to qualify for the enhanced ITC.

The actual knowledge standard ensures that a corporation cannot disregard known shareholders the identity of which may not be publicly available, such as shareholders holding shares that may not be currently publicly tradeable. This standard, however, is not otherwise intended to impose a positive obligation on the corporation to inquire into the identity of its shareholders.

This amendment applies to taxation years beginning on or after December 16, 2024.

"eligible subsidiary"

"Eligible subsidiary" means a corporation that is resident in Canada, not less than 90% of the issued shares of each class of the capital stock of which are owned, directly or indirectly, by

one or more corporations that are eligible Canadian public corporations (ECPCs) because of paragraph (a) of that definition (i.e., one or more ECPCs that are not themselves eligible subsidiaries). The reference to "indirectly" in paragraph (b) of the definition ensures that the 90% ownership test cannot be diluted below 90% within the ECPC corporate chain.

The definition is relevant to the definition "eligible Canadian public corporation".

This amendment applies to taxation years beginning on or after December 16, 2024.

"entity"

"Entity" means a corporation, partnership or trust, or any other arrangement, association, organization or body whether registered or unregistered for which separate financial accounts are prepared.

This amendment applies to taxation years beginning on or after December 16, 2024.

"financial statements"

"Financial statements" means financial statements prepared in accordance with "acceptable accounting standards" as defined in subsection 18.21(1).

This amendment applies to taxation years beginning on or after December 16, 2024.

"first term shared-use equipment"

Currently, ITCs are not available in respect of either first term shared-use-equipment or second term shared-use equipment due to the repeal, in 2012, of paragraph 37(1)(b) in respect of expenditures made after 2013.

The definition "first term shared-use-equipment" described certain depreciable property of a taxpayer acquired before 2014 that was eligible for an ITC.

The definition "first term shared-used-equipment" is amended, consequential on the addition of paragraph 37(1)(b), to ensure that it will apply in respect of property acquired on or after December 16, 2024.

In addition, the definition "first term shared-use-equipment" is amended to correct a reference to subsection 127(11.5).

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

"fiscal year"

"Fiscal year" means an annual accounting period in respect of which a corporation prepares its financial statements.

This amendment applies to taxation years beginning on or after December 16, 2024.

"qualified expenditure"

The definition "qualified expenditure" in subsection 127(9) sets out the type of expenditures incurred by a taxpayer on SR&ED that are eligible for ITCs. Currently, paragraph (a) of the definition "qualified expenditure" includes expenditures described in paragraph 37(1)(a).

Consequential on the addition of paragraph 37(1)(b), paragraph (a) of the definition "qualified expenditure" is amended to include expenditures described in paragraph 37(1)(b), and expenditures for first term shared-use-equipment and second term shared-use-equipment as those terms are defined in subsection 127(9).

Further, paragraph (d) of the definition "qualified expenditure" is repealed, as that paragraph is no longer applicable.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

"second term shared-use equipment"

The definition "second term shared-use-equipment" is amended to correct a reference to subsection 127(11.5).

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

"ultimate parent entity"

"Ultimate parent entity" in respect of a group of entities means the member of the group that would be the ultimate parent entity (as defined in subsection 233.8(1)) of the group if the group were a "multinational enterprise group" (as defined in subsection 233.8(1)).

This amendment applies to taxation years beginning on or after December 16, 2024.

Additions to investment tax credit

ITA
127(10.1)

Subsection 127(10.1) provides an enhanced 20% ITC in addition to the basic 15% ITC for certain SR&ED expenditures incurred by a Canadian-controlled private corporation (CCPC). As a result, such expenditures qualify for a total ITC of 35%.

The 2024 Fall Economic Statement proposed to extend eligibility for the enhanced refundable ITC to ECPCs. Subsection 127(10.1) is amended to apply in respect of a corporation that is an ECPC throughout the taxation year.

This amendment applies to taxation years beginning on or after December 16, 2024.

Expenditure limit – CCPC

ITA
127(10.2)

Subsection 127(10.2) determines a corporation's expenditure limit for the purpose of the additional ITC provided in subsection 127(10.1).

Currently, the expenditure limit of a corporation for a particular taxation year is an amount from nil to \$3 million, as determined by the formula set out in subsection 127(10.2). The formula begins to reduce the expenditure limit where the taxable capital employed in Canada of the corporation and any associated corporations exceeds an initial threshold amount (currently, \$10 million). The expenditure limit is reduced to nil where taxable capital reaches a second threshold amount (currently, \$50 million).

Subsection 127(10.2) is amended in three respects. First, the maximum expenditure limit is increased to \$4.5 million. Second, the two threshold amounts for taxable capital employed in Canada are increased to \$15 million and \$75 million, respectively. Third, consequential on the extension of the refundable ITC to ECPCs (see subsections 127(10.1) and (10.6)), it is now specified that the particular corporation described in subsection 127(10.2) is a CCPC.

This amendment applies to taxation years beginning on or after December 16, 2024.

Shared limit – associated CCPCs

ITA
127(10.3)

Subsection 127(10.3) allows a group of associated CCPCs to file an election with the Minister of National Revenue in which the group allocates the maximum expenditure limit for the group determined under subsection 127(10.2) among the members of the group.

Subsection 127(10.3) is amended to reflect the new election under subsection 127(10.32) allowing a group of associated CCPCs to have its expenditure limit for the enhanced SR&ED ITC determined based on the same revenue phase-out structure as ECPCs. See the commentary on subsection 127(10.32) for more information.

This amendment applies to taxation years beginning on or after December 16, 2024.

Revenue election for single CCPC

ITA
127(10.31)

Subsection 127(10.31) provides the new election allowing a CCPC that is not associated with another corporation to have its expenditure limit for the enhanced SR&ED ITC determined under subsection 127(10.6) using the same revenue phase-out structure as an ECPC that is not a member of consolidated group. A CCPC has the option of making this election each year. Where the election is made for a taxation year, the expenditure limit based on taxable capital employed in Canada under subsection 127(10.2) does not apply to the corporation for that year.

This amendment applies to taxation years beginning on or after December 16, 2024.

Revenue election for CCPC having associated corporations

ITA
127(10.32)

Subsection 127(10.32) provides the new election allowing a group of associated CCPCs to have its expenditure limit for the enhanced SR&ED ITC determined under subsection 127(10.6) based on the same revenue phase-out structure as ECPCs. Specifically, the expenditure limit under subsection 127(10.6) is to be calculated as if each CCPC in the group were an ECPC and the group were a consolidated group, subject to certain modifications described below.

First, the expenditure limit is to be calculated as if the amount determined under subparagraph (a)(ii) of the description of A in the formula in subsection (10.6) were the total of all amounts, each of which is the average, over the period of three fiscal years immediately preceding and ending in the last calendar year that ended before the end of the particular taxation year, of annual revenue reflected in the financial statements of each corporation that is a member of the group (paragraph (10.32)(c)).

As the fiscal years of the associated corporations may not coincide, paragraph (10.32)(c) provides that the relevant period corresponds to the three-fiscal-year period ending in the last calendar year that ended before the end of the particular taxation year. This generally parallels the current approach to determine taxable capital employed in Canada of a group of associated corporations under subsection 127(10.2).

The size of a group of associated corporations may vary during the three-fiscal-year lookback period, such as when a new corporation becomes, or ceases to be, associated. Where that is the case, the rule in paragraph (10.32)(c) requires first identifying all the corporations that are associated in the taxation year for which the

expenditure limit is being determined, and then taking into account the revenue of all these corporations for the entire three-fiscal-year lookback period, regardless of whether such corporations were associated during that period. For instance, if during the three-fiscal-year lookback period (years 1, 2 and 3) a corporation becomes associated with a group in year 2, then by virtue of paragraph (10.32)(c) the revenue of the associated group for year 1 will be increased by the corporation's revenue for year 1 even though the corporation was not associated in year 1. This generally parallels the current approach to determine taxable capital employed in Canada of a group of associated corporations under subsection 127(10.2). This result is to be contrasted with that of a consolidated group under subsection 127(10.6) – see the commentary on subsection 127(10.6) for more information.

Second, such annual revenue must include each associated corporation's reasonable share of annual revenue reflected in the financial statements of any partnership or trust in which the corporation held an interest (subparagraph (10.32)(d)(i)). This modification ensures that the revenue of a partnership or trust in which an associated corporation holds an interest is taken into account, regardless of how such revenue is reported (if at all) on the financial statements of the corporation.

Third, the annual revenue may include reasonable adjustments to reflect the annual revenue of the group as that of a single economic entity (subparagraph (10.32)(d)(ii)). Since paragraph (10.32)(c) refers to unconsolidated "financial statements", subparagraph (10.32)(d)(ii) allows reasonable adjustments to reflect the annual revenue of the associated group as that of a single economic entity. This would cover, for instance, applicable intercompany transactions.

A group of associated CCPCs has the option of making the election under subsection 127(10.32) each year. Where the election is made for a taxation year, the expenditure limit based on taxable capital employed in Canada under subsection 127(10.2) does not apply to the group for that year.

This amendment applies to taxation years beginning on or after December 16, 2024.

Expenditure limit determination in certain cases

ITA
127(10.5)

Existing subsection 127(10.6) is renumbered as subsection 127(10.5). New subsection 127(10.6) now provides the expenditure limit for an ECPC – see the commentary on subsection 127(10.6).

This amendment applies to taxation years beginning on or after December 16, 2024.

Expenditure limit – ECPC

ITA
127(10.6)

Subsection 127(10.6) determines an ECPC's expenditure limit for the purpose of the additional ITC provided in subsection 127(10.1).

The expenditure limit of a corporation for a particular taxation year is an amount from nil to \$4.5 million, as determined by a formula set out in subsection 127(10.6). The formula has the effect of reducing the expenditure limit to the extent that the applicable revenue reflected in the applicable financial statements exceeds a threshold amount. The applicable revenue corresponds to:

- If the ECPC is not a member of a consolidated group in the particular taxation year, the amount that is the average, over the period of three fiscal years immediately preceding and ending before the particular taxation year, of the ECPC's annual revenue based on the amounts reflected in the financial statements of the ECPC; and

- If the ECPC is a member of a consolidated group in the particular taxation year, the amount that is the average, over the period of three fiscal years immediately preceding and ending in the last calendar year that ended before the end of the particular taxation year, of the annual revenue reflected in the consolidated financial statements of the consolidated group.

In the case of a consolidated group, the consolidated financial statements of the consolidated group are those of the ultimate parent entity – see the commentary on the definitions "consolidated group" and "ultimate parent entity".

The size of a consolidated group may vary during the three-fiscal-year lookback period, such as when a new entity becomes a member of the group or an existing member leaves the group. Where that is the case, the general rule in paragraph (a)(ii) of element A of subsection 127(10.2) requiring the use of the revenue of the consolidated group, based on how those revenue are actually reflected in the consolidated financial statements of the group, remains applicable. Accordingly, there is no requirement to make additional adjustments to the revenue of the group to account for a change in the size of the group during the three-fiscal-year lookback period if revenue adjustments for that change are not otherwise reflected in the consolidated financial statements of the group. For instance, if during the three-fiscal-year lookback period (years 1, 2 and 3) an entity becomes a member of a consolidated group in year 2 and the revenue reflected in the group's consolidated financial statements for year 1 (prepared in accordance with acceptable accounting standards as defined in subsection 18.21(1)) do not include the entity's revenue for year 1, then for purposes of subsection 127(10.6) the revenue of the group for year 1 do not have to be increased by the entity's revenue for year 1. This result is to be contrasted with that of a group of associated CCPCs electing under subsection 127(10.32) to have its expenditure limit determined under subsection 127(10.6) – see the commentary on subsection 127(10.32) for more information.

The expenditure limit provided for in subsection 127(10.6) may be subject to certain adjustments under subsection 127(10.64) – see the commentary on subsection 127(10.64).

This amendment applies to taxation years beginning on or after December 16, 2024.

Expenditure limits – consolidated ECPCs

ITA
127(10.61)

Subsection 127(10.61) provides that the expenditure limit for a taxation year of an ECPC that is, at any time in the year, member of a consolidated group is nil, except as otherwise provided in section 127. Subsection 127(10.61) generally parallels the existing rule for a group of associated CCPCs in subsection 127(10.21). See also the commentary on subsections 127(10.62) and (10.63) for more information.

This amendment applies to taxation years beginning on or after December 16, 2024.

Consolidated ECPCs

ITA
127(10.62)

Subsection 127(10.62) allows a consolidated group to file an election with the Minister of National Revenue in which the group allocates the maximum expenditure limit for the group determined under subsection 127(10.6) among the ECPCs that are members of the group. Subsection 127(10.62) generally parallels the existing rule for a group of associated CCPCs in subsection 127(10.3). See also the commentary on subsections 127(10.61) and (10.63) for more information.

This amendment applies to taxation years beginning on or after December 16, 2024.

Failure to file agreement

ITA
127(10.63)

Subsection 127(10.63) provides that in the event that a consolidated group fails to file an election within 30 days after the Minister has requested this information, the Minister will allocate the expenditure limit determined under subsection 127(10.6) among the group. Subsection 127(10.63) generally parallels the existing rule for a group of associated CCPCs in subsection 127(10.4). See the commentary on subsections 127(10.61) and (10.62) for more information.

This amendment applies to taxation years beginning on or after December 16, 2024.

Determinations in certain cases

ITA
127(10.64)

Subsection 127(10.64) provides various application rules for determining a corporation's expenditure limit under subsection 127(10.2).

First, paragraph 127(10.64)(a) determines the expenditure limit of an ECPC that has two or more taxation years ending in the same calendar year and in two or more of those taxation years it is a member of a consolidated group in which another ECPC has a taxation year ending in the same calendar year. This rule provides that, subject to the prorating rule in paragraph 127(10.64)(b), the expenditure limit for each such taxation year of the ECPC is the amount allocated to the corporation for its first such taxation year under subsection 127(10.62) or (10.63). Paragraph 127(10.64)(a) generally parallels the existing rule for a group of associated CCPCs in (now) paragraph 127(10.5)(a).

Second, paragraph 127(10.64)(b) determines an ECPC's expenditure limit for a short taxation year. This provision applies to all ECPCs, whether or not members of a consolidated group, and requires a proration of the limit for any taxation year of less than 51 weeks in duration. It provides that an ECPC's expenditure limit for such a taxation year is its limit otherwise determined multiplied by the number of days in the taxation year and divided by 365. Paragraph 127(10.64)(b) generally parallels the existing rule for a CCPC in paragraph 127(10.5)(b).

Third, paragraphs 127(10.64)(c) and (d) determine the applicable revenue of an ECPC or UPE for a short fiscal year and require an increase (a "gross up") of the revenue for any fiscal year of less than 51 weeks in duration. It provides that the revenue reflected in the financial statements of the ECPC or the consolidated financial statements of the UPE for such a fiscal year is multiplied by 365 and divided by the number of days in the taxation year.

Fourth, paragraph 127(10.64)(e) determines the relevant period over which the average annual revenue of an ECPC or UPE (or electing CCPC or group of associated CCPCs) is calculated if there are less than three fiscal years. It provides that, in such a case, the average annual revenue is to be calculated over the actual number of fiscal years (i.e., one or two fiscal years).

These amendments apply to taxation years beginning on or after December 16, 2024.

Investment tax credit

ITA
127(11.1)(c.1)

Paragraph 127(11.1)(c.1) is repealed, as that paragraph is no longer applicable.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Time of acquisition

ITA
127(11.2)

In general, subsection 127(11.2) provides that, for the purposes of claiming an ITC under subsection 127(5) or allocating an ITC under subsection 127(7) or (8), property is not considered to have been acquired by a taxpayer until the property is considered to have become "available for use" by the taxpayer. Subsection 127(11.2) is amended in two respects.

First, the reference to "qualified resource property", which is no longer applicable, is removed.

Second, consequential on the addition of paragraph 37(1)(b), references to "first term shared-used equipment" and "expenditures incurred to acquire property described in paragraph 37(1)(b)" are added.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Adjustments to qualified expenditures

ITA
127(11.5)

Subsection 127(11.5) reduces, in certain circumstances, qualified expenditures incurred by a taxpayer. Subsection 127(11.5) is amended in two respects consequential on the addition of paragraph 37(1)(b).

First, paragraph 127(11.5)(a) is amended to require that, for the purposes of the definition "qualified expenditure" in subsection 127(9), the amount of a qualified expenditure in respect of a capital property is to be determined without reference to subsections 13(7.1) and (7.4).

Second, paragraph 127(11.5)(b) is added to require that where an expenditure is for first term shared-use-equipment or second term shared-use-equipment, only $\frac{1}{4}$ of the capital cost of the equipment is taken into account and the capital cost of such property is to be determined without capitalized interest being added to the capital cost under section 21 and without reference to subsections 13(7.1) and (7.4).

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Non-arm's length costs

ITA
127(11.6)

Subsection 127(11.6) provides rules for determining expenditures for the purposes of subsection 127(11.5) in respect of purchases of goods and services acquired from non-arm's length parties. Consequential on the addition of paragraph 37(1)(b), the mid-amble of subsection 127(11.6) and subparagraph 127(11.6)(d)(i) are amended by adding "capital" before the expression "cost to the taxpayer of the property".

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Interpretation for non-arm's length costs

ITA
127(11.8)

Subsection 127(11.8) provides additional rules relating to non-arm's length purchases of goods and services.

Consequential on the addition of paragraph 37(1)(b), paragraph 127(11.8)(c) is added to provide that the leasing of a property is considered to be the rendering of a service for purposes of subsections 127(11.6), (11.7) and (11.8).

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Certain non-arm's length transfers

ITA
127(33)

Subsections 127(33) to (35) apply where a non-arm's length transfer of property to another taxpayer would otherwise trigger the SR&ED ITC recapture provisions. Subsection 127(33) provides that the SR&ED ITC recapture provisions do not apply to a taxpayer who disposes of SR&ED property to a non-arm's length purchaser if the purchaser continues to use the property all or substantially all for SR&ED.

Consequential on the addition of paragraph 37(1)(b) and subclauses 37(8)(a)(ii)(A)(III) and (B)(III), subsection 127(33) is amended to ensure that the non-application of the recapture rules will remain in effect for non-arm's length transfers of SR&ED property on or after December 16, 2024.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Clause 4

Refundable investment tax credit

ITA
127.1

Section 127.1 provides for the refundability of ITCs under certain circumstances. A qualifying corporation may be eligible for either a 40% or 100% refund for its ITCs depending on the nature of the expenditures.

Definitions

ITA
127.1(2)

Subsection 127.1(2) sets out definitions relevant for the purposes of section 127.1.

"qualifying income limit"

The "qualifying income limit" definition sets out the threshold limit for determining whether a CCPC is a "qualifying corporation", which is also defined in subsection 127.1(2).

The qualifying income limit of a corporation is an amount from nil to \$500,000, as determined by a formula that begins to reduce the limit where the taxable capital employed in Canada of the corporation and any associated corporations exceeds an initial threshold amount. The qualifying income limit is then reduced to nil where taxable capital reaches a second threshold amount. The relevant threshold amounts (currently, \$10 million and \$50 million) mirror those set out in subsection 127(10.2).

Consequential on the amendment to the threshold amounts in subsection 127(10.2), the threshold amounts used in determining the qualifying income limit of a CCPC are also increased to \$15 million and \$75 million,

respectively.

This amendment applies to taxation years beginning on or after December 16, 2024.

"refundable investment tax credit"

The definition "refundable investment tax credit" defines the portion of ITCs that are refundable in a taxation year of a taxpayer that are earned by the taxpayer in respect of a qualified expenditure as defined in subsection 127(9).

Consequential on the addition of paragraph 37(1)(b), subparagraph (f)(i) of the definition "refundable investment tax credit" is amended to add the expression "(other than expenditures of a capital nature)". As a result, the rate of refund is 40% for SR&ED expenditures of a capital nature.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Addition to refundable investment tax credit

ITA
127.1(2.01)

Subsection 127.1(2.01) provides for the refundability of certain ITCs earned by a CCPC that is neither a qualifying corporation nor an excluded corporation as defined in subsection 127.1(2). For such a CCPC, the rate of refund of the 35% ITC is 100% for SR&ED expenditures of a current nature. Subsection 127(2.01) is amended in two respects.

First, consequential on the addition of paragraph 37(1)(b), subsection 127.1(2.01) is amended by adding new elements A and B and redesigning existing paragraphs (a) and (b) as elements C and D, respectively. As a result, the rate of refund of the 35% ITC is 40% for SR&ED expenditures of a capital nature and 100% for SR&ED expenditures of a current nature.

Second, subsection 127.1(2.01) is amended to apply in respect of an ECPC that is neither a qualifying corporation nor an excluded corporation as defined in subsection 127.1(2). As a result, such an ECPC is also eligible for the refundability of the 35% ITC at a rate of 40% for SR&ED expenditures of a capital nature and 100% for SR&ED expenditures of a current nature.

These amendments apply in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Clause 5

ITR
2902(b)

Paragraph 2902(b) of the Regulations provides that certain expenditures are prescribed expenditures for the purposes of the definition "qualified expenditure" in subsection 127(9) of the Act. Prescribed expenditures do not qualify for investment tax credits (ITCs).

Consequential on the addition of paragraphs 37(1)(b) of the Act and amendment to the definition "qualified expenditure" in subsection 127(9) of the Act, paragraph 2902(b) of the Regulations is amended to ensure that certain expenditures of a capital nature qualify for ITCs. Those expenditures include expenditures incurred for first term shared-use-equipment or second term shared-use-equipment. Those expenditures also include expenditures incurred for the provision of premises, facilities or equipment if, at the time of the acquisition of the property, it was intended that the property would be used during all or substantially all of its operating time in its

expected useful life for the prosecution of SR&ED in Canada, or that all or substantially all of its value would be consumed in the prosecution of SR&ED in Canada.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

ITR
2903

Expenditures in respect of the capital cost of a building are generally not deductible under section 37 of the Act except in the case of a prescribed special-purpose building.

Consequential on the addition of paragraphs 37(1)(b) and 37(8)(e) of the Act, section 2903 of the Regulations is added to describe a prescribed special-purpose building for the purposes of paragraph 37(8)(e) of the Act.

This amendment applies in respect of property acquired on or after December 16, 2024 and, in the case of lease costs, to amounts that first become payable on or after December 16, 2024.

Crypto-Asset Reporting Framework and the Common Reporting Standard

Clause 1

Common Reporting Standard – Definitions

This Part is amended based on the 2023 amendments to the *Common Reporting Standard* by the OECD principally resulting from the adoption of the new *Crypto-Asset Reporting Framework*. In particular, the amendments ensure that this Part applies to certain electronic money products and central bank digital currencies as well as various forms of investments in crypto-assets.

These amendments apply to the 2026 and subsequent calendar years.

Definitions

ITA
270(1)

"2012 FATF recommendations"

The "2012 FATF recommendations" mean the *Financial Action Task Force Recommendations — International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*, adopted in February 2012 and as amended from time to time.

This definition is added for ease of reference as references to these recommendations are added to this Part.

"anti-money laundering and know your customer procedures" or "AML/KYC procedures"

The French version of this definition is amended to better align the French and English versions.

"central bank digital currency"

"Central bank digital currency" means any digital fiat currency issued by a central bank.

This new definition is relevant for the purposes of applying several new and amended definitions in this subsection.

"controlling persons"

The "controlling persons" in respect of an entity are the natural persons (i.e., individuals other than trusts) who exercise control over the entity, and include

- in the case of a trust,
 - its settlors,
 - its trustees,
 - its protectors (if any),
 - its beneficiaries (for this purpose, a discretionary beneficiary of a trust will only be considered a beneficiary of the trust in a calendar year if a distribution has been paid or made payable to the discretionary beneficiary in the calendar year), and
 - any other natural persons exercising ultimate effective control over the trust; and
- in the case of a legal arrangement other than a trust, persons in equivalent or similar positions to those described above.

Consequential to the enactment of the new definition "2012 FATF recommendations", this definition is amended to amend the reference to those recommendations in the definition.

"crypto-asset"

A "crypto-asset" means a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions (being the definition in subsection 296(1)).

This new definition is relevant for the purposes of applying several new and amended definitions in this subsection.

"depository account"

A "depository account" includes

- any commercial, chequing, savings, time or thrift account, or an account that is evidenced by a certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness or other similar instrument maintained by a financial institution in the ordinary course of a banking or similar business; and
- an amount held by an insurance company under a guaranteed investment contract or similar agreement to pay or credit interest on the contract.

Paragraph (a) of that definition is amended by replacing the reference to "a financial institution in the ordinary course of a banking or similar business" with a reference to "depository institution".

The definition is also amended to provide that a "depository account" also includes

- an account or notional account that represents all specified electronic money products held for the benefit of a customer; and
- an account that holds one or more central bank digital currencies for the benefit of a customer.

"depository institution"

A "depository institution" is any entity that accepts deposits in the ordinary course of a banking or similar business.

The definition is amended to provide that a "depository institution" also means any entity that holds specified electronic money products or central bank digital currencies for the benefit of customers.

"exchange transaction"

"Exchange transaction" means any exchange between relevant crypto-assets and fiat currencies or any exchange between one or more forms of relevant crypto-assets.

This new definition is relevant for the purposes of applying the amended definition "investment entity" in this subsection.

"excluded account"

An "excluded account" currently includes several different types of accounts that meet the detailed requirements set out in the definition.

The definition is amended so that it also includes:

- an account established in connection with a contribution of capital to or incorporation of a corporation, if the account meets the following conditions:
 - the account is used exclusively to deposit amounts that are to be used for the purpose of the incorporation of or the making of contributions of capital to a corporation, in accordance with applicable law;
 - any amounts held in the account are blocked until the reporting financial institution obtains an independent confirmation regarding the incorporation or contribution of capital;
 - the account is closed or transformed into an account in the name of the corporation after the incorporation or contribution of capital;
 - any repayments resulting from the failed incorporation or contribution of capital, net of service provided and similar fees, are made solely to the persons who contributed the amounts; and
 - the account has not been established more than 12 months ago, and
- a depository account that only includes all specified electronic money products held for the benefit of a customer, if the rolling average 90 day end-of-day aggregate account balance or value during any period of 90 consecutive days did not exceed 10,000 USD on any day during the calendar year.

Finally, the preamble of the definition is amended to specify that the term means the above "at any time".

"fiat currency"

"Fiat currency" means the official currency of a jurisdiction, issued by a jurisdiction or by a jurisdiction's designated central bank or monetary authority, as represented by physical bank notes or coins or by money in different digital forms, including bank reserves and central bank digital currencies.

"Fiat currency" also refers to commercial bank money and electronic money products, including specified electronic money products.

This new definition is relevant for the purposes of applying several new definitions in this subsection.

"financial asset"

The definition "financial asset" is intended to encompass any assets that may be held in an account maintained by a financial institution, and includes certain specified assets, such as an interest (including a futures or forward contract or option) in a security, partnership interest, commodity, swap, insurance contract or annuity contract.

The definition is amended to provide that a "financial asset" also includes any interest in a relevant crypto-asset.

"investment entity"

Generally, an "investment entity" means an entity the business of which is primarily comprised of carrying on investment activities or operations on behalf of other persons.

Specifically, an "investment entity" is any entity (other than an entity that is an "active NFE" because of any of paragraphs (d) to (g) of that definition)

- that primarily carries on as a business one or more of the following activities or operations for or on behalf of a customer
 - trading in money market instruments (such as cheques, bills, certificates of deposit and derivatives), foreign exchange, transferable securities or commodity futures, exchange, interest rate and index instruments,
 - individual and collective portfolio management, or
 - otherwise investing, administering or managing financial assets or money on behalf of other persons; or
- the gross income of which is primarily attributable to investing, reinvesting or trading in financial assets, if the entity is managed by another entity that is
 - a depository institution,
 - a custodial institution,
 - a specified insurance company, or
 - an entity that primarily conduct as a business investment activities or operations on behalf of other persons.

The definition "investment entity" is to be interpreted in a manner consistent with similar language set forth in the definition of "financial institution" in the Financial Action Task Force Recommendations (FATF/OECD (2013), *International Standards on Combating Money Laundering and the Financing of Terrorism and Proliferation*).

This definition is amended to provide that "investing, reinvesting or trading" can relate to relevant crypto-assets as well and that, for the purpose of subparagraph (a)(iii), that expression excludes services effectuating exchange transactions for or on behalf of customers.

Also, the enumeration of instruments at subparagraph (a)(i) of the English version of the provision is slightly amended for greater readability.

"lower value account"

A "lower value account" is a preexisting individual account with an aggregate balance or value as of June 30, 2017 that does not exceed 1 million USD.

This definition is amended to provide for a December 31, 2025 valuation date for an account that is treated as a financial account only because of the amendments to this Part that came into force in 2025.

"new account"

A "new account" is a financial account maintained by a reporting financial institution opened after June 2017.

This definition is amended to provide for the relevant opening date for an account that is treated as a financial account only because of the amendments to this Part that came into force in 2025.

"non-reporting financial institution"

A "non-reporting financial institution" is a Canadian financial institution that is listed in any of paragraphs (a) to (f) of the definition.

Paragraph (b) of the definition provides that a governmental entity or international organization is a "non-reporting financial institution", other than with respect to a payment that is derived from an obligation held in connection with a commercial financial activity of a type engaged in by a specified insurance company, custodial institution or depository institution.

Paragraph (b) is amended to provide that the term does not include a governmental entity or international organization with respect to the activity of maintaining central bank digital currencies for account holders which are not financial institutions, governmental entities, international organizations or central banks.

"preexisting account"

A "preexisting account" is either a financial account maintained by a reporting financial institution on June 30, 2017 or an account that meets the conditions provided in paragraph (b) of the definition.

Paragraph (a) of this definition is amended to provide for a December 31, 2025 date of reference for an account that is treated as a financial account only because of the amendments to this Part that came into force in 2025.

"reportable person"

A "reportable person" is a reportable jurisdiction person other than

- a corporation the stock of which is regularly traded on one or more established securities markets;
- any corporation that is a related entity of a corporation the stock of which is regularly traded on one or more established securities markets;
- a governmental entity;
- an international organization;
- a central bank; or
- a financial institution.

This definition is amended to replace the references to "corporation" in the first two carve-outs above with references to "entity".

"relevant crypto-asset"

"Relevant crypto-asset" means any crypto-asset that is not a central bank digital currency, a specified electronic money product or any crypto-asset for which the reporting crypto-asset service provider has adequately determined that it cannot be used for payment or investment purposes (being the definition in subsection 296(1)).

This new definition is relevant for the purposes of applying several new and amended definitions in this subsection as well as amended subsection (3).

"specified electronic money product"

"Specified electronic money product" means any product that is:

- a digital representation of a single fiat currency;
- issued on receipt of funds for the purpose of making payment transactions;
- represented by a claim on the issuer denominated in the same fiat currency of which it is a digital representation;
- accepted in payment by a person other than the issuer; and
- by virtue of regulatory requirements to which the issuer is subject, redeemable at any time and at par value for the same fiat currency upon request of the holder of the product,

but does not include a product created for the sole purpose of facilitating the transfer of funds from a customer to another person pursuant to instructions of the customer.

This new definition is relevant for the purposes of applying several new and amended definitions in this subsection.

Interpretation

ITA
270(2)

Subsection 270(2) provides an interpretive rule that applies for the purposes of Part XIX. This Part is drafted in a manner that is intended to be generally consistent with the model Common Reporting Standard. This forms the context in which the text of the provisions is to be interpreted.

This rule clarifies that taxpayers should interpret the provisions of Part XIX, unless the context otherwise requires, consistently with the model CRS and associated commentary that was published by the Organisation for Economic Co-operation and Development (and as amended from time to time).

This rule is amended for greater certainty by the addition of an explicit reference to the commentary to the CRS.

Interpretation — investment entity

ITA
270(3)

Subsection 270(3) provides an interpretive rule that applies for the purposes of the definition of "investment entity".

Specifically subsection 270(3) provides that an entity will be considered to primarily carry on as a business one or more of the activities described in paragraph (a) of the definition "investment entity", or an entity's gross income will be considered to be primarily attributable to investing, reinvesting, or trading in financial assets for the purposes of paragraph (b) of that definition, if the entity's gross income attributable to the relevant activities equals or exceeds 50% of the entity's gross income during the shorter of

- the three-year period that ends at the end of the entity's last fiscal period; and
- the period during which the entity has been in existence.

Consequential to the addition of the reference to "relevant crypto-assets" in the definition of "investment entity" in subsection (1), subsection (3) is amended to make the same reference.

Interpretation — specified electronic money product

ITA
270(5)

Subsection 270(5) provides an interpretive rule that applies for the purposes of the new definition of "specified electronic money product".

Specifically subsection 270(5) provides that a product is not created for the sole purpose of facilitating the transfer of funds if, in the ordinary course of business of the transferring entity, either the funds connected with such product are held longer than 60 days after receipt of instructions to facilitate the transfer, or, if no instructions are received, the funds connected with such product are held longer than 60 days after receipt of the funds.

Clause 2

General reporting requirements

ITA
271(1)

Subject to certain exceptions, subsection 271(1) requires that each reporting financial institution report specific information to the Minister with respect to each of its reportable accounts. The reference in the preamble to the exceptions is amended consequential to the enactment of new subsections (5) and (6). Several other amendments are also made to modify the information that must be reported.

First, paragraph 271(1)(a) is amended so that whether the account holder has provided a valid self-certification must be reported with respect to each reportable account.

Further, paragraph 271(1)(b) is amended so that, in the case of any entity that is an account holder of the account and that, after applying the due diligence procedures in sections 275 to 277, is identified as having one or more controlling persons that is a reportable person, the role(s) by virtue of which each reportable person is a controlling person of the entity and whether a valid self-certification has been provided for each reportable person must be reported with respect to each reportable account.

Finally, paragraph 271(1)(c) is amended so that the type of account and whether the account is a preexisting account or a new account must be reported with respect to each reportable account.

New paragraph 271(1)(i) provides that whether the account is a joint account and, if so, the number of joint account holders must be reported with respect to each reportable account.

New paragraph 271(1)(j) provides that, in the case of any equity interest held in an investment entity that is a legal arrangement, the role(s) by virtue of which the reportable person is an equity interest holder must be reported with respect to each reportable account.

ITA

271(3)

Subsection 271(3) provides an exception to the reporting requirements in paragraphs (1)(a) and (b) for preexisting accounts that the TIN or date of birth is not required to be reported if the TIN or date of birth (as appropriate)

- are not in the records of the reporting financial institution, and
- are not otherwise required to be collected by the reporting financial institution under the Act.

However, even if the exception provided in this subsection applies, a reporting financial institution is required to use reasonable efforts to obtain the TIN and date of birth with respect to a preexisting account by the end of the second calendar year following the year in which the preexisting account is identified as a reportable account.

Subsection 271(3) is amended so that a reporting financial institution is also required to use reasonable efforts to obtain the TIN and date of birth with respect to a preexisting account despite the exception in this subsection whenever it is required to update the information relating to the preexisting account pursuant to AML/KYC procedures.

Exception — Part XXI

ITA

271(5)

New subsection 271(5) provides an exception to the reporting requirements in subparagraph (1)(f)(ii) for custodial accounts that, unless the reporting financial institution elects otherwise with respect to any clearly identified group of accounts, the gross proceeds from the sale or redemption of a financial asset are not required to be reported if they are already reported by the reporting financial institution under new Part XXI. Part XXI is the new reporting regime for crypto-assets.

Transitional rule

ITA

271(6)

New subsection 271(6) is a transitional rule that provides that with respect to each reportable account that is maintained by a reporting financial institution as of January 1, 2026 and for reporting periods ending before 2028, each reporting financial institution must only report information under any of subparagraph (1)(b)(iii) and paragraph (1)(j) if such information is available in the electronically searchable data maintained by the reporting financial institution.

Clause 3

Due diligence for new entity accounts

ITA

276

This section describes the due diligence procedures for new entity accounts.

Subparagraph 276(b)(ii) is amended to provide that for the purposes of determining the controlling persons of an account holder, a reporting financial institution may only rely on information collected and maintained pursuant to AML/KYC procedures if those are consistent with the 2012 FATF recommendations, and if the reporting financial institution is not legally required to apply AML/KYC procedures that are consistent with the 2012 FATF recommendations, it must apply substantially similar procedures for the purpose of determining the controlling persons.

This amendment applies to the 2026 and subsequent calendar years.

Clause 4

Special due diligence rules – new account

ITA

277(1.1)

New subsection 277(1.1) provides that, in exceptional circumstances where a self-certification cannot be obtained by a reporting financial institution in respect of a new account in time to meet its due diligence and reporting obligations with respect to the reporting period during which the account was opened, the reporting financial institution must apply the due diligence procedures for preexisting accounts, until such self-certification is obtained and validated.

This amendment applies to the 2026 and subsequent calendar years.

Clause 5

Anti-avoidance

ITA

280

Section 280 provides an anti-avoidance rule. This rule provides that where a person enters into an arrangement or engages in a practice, the primary purpose of which is to avoid an obligation under Part XIX, the person is

subject to the obligation as if the person had not entered into the arrangement or engaged in the practice.

Section 280 is amended so that it applies more broadly to an "individual or entity" instead of a "person".

Also, section 280 is amended so that its effect is that Part XIX applies as if the individual or entity had not entered into the arrangement or engaged in the practice. This change provides more certainty that an individual or entity cannot circumvent the anti-avoidance rule by having an intermediary enter into an arrangement or engage in a practice the purpose of which is to avoid an obligation under Part XIX.

This amendment applies to the 2026 and subsequent calendar years.

Clause 6

The following new Part implements the reporting and due diligence standards of the Crypto-Asset Reporting Framework (CARF) developed by the Organisation for Economic Co-operation and Development that underpins the automatic exchange of financial account information. Implementation of the CARF entails the introduction of rules that require crypto-asset service providers to report certain information to the Canada Revenue Agency and to follow due diligence procedures as set out in this Part.

Definitions

ITA
296(1)

"active entity"

This definition is relevant to determine the obligations of a reporting crypto-asset service provider as this Part contains many exclusions regarding an "active entity". Most notably, a reporting crypto-asset service provider does not have to carry out the due diligence procedures to determine if the active entity has controlling persons. For this reason, to the extent that an "active entity" is not itself a "reportable person", the crypto-asset service provider would not have reporting obligations in respect of the entity.

An "active entity" is an entity that meets any of the following criteria:

- less than 50% of the entity's gross income for the preceding calendar year is passive income and less than 50% of the assets held by the entity during the preceding calendar year are assets that produce or are held for the production of passive income;
- both
 - all or substantially all of the activities of the entity consist of holding (in whole or in part) the outstanding stock of, or providing financing and services to, one or more subsidiaries that engage in trades or businesses other than the business of a financial institution, and
 - the entity does not function as (and is not represented or promoted to the public as) an investment fund, including
 - a private equity fund,
 - a venture capital fund,
 - a leveraged buyout fund, and
 - an investment vehicle whose purpose is to acquire or fund companies and then hold interests in those companies as capital assets for investment purposes;
- the entity
 - is not yet operating a business,
 - has no prior operating history,
 - is investing capital into assets with the intent to operate a business other than that of a financial institution, and
 - was initially organized no more than 24 months prior to that time;

- the entity has not been a financial institution in any of the past five years and is in the process of liquidating its assets or is reorganizing with the intent to continue or recommence operations in a business other than that of a financial institution;
- the entity primarily engages in financing and hedging transactions with, or for, related entities that are not financial institutions, and does not provide financing or hedging services to any entity that is not a related entity, provided that the group of those related entities is primarily engaged in a business other than that of a financial institution; and
- the entity meets all of the following requirements:
 - it
 - is established and operated in its jurisdiction of residence exclusively for religious, charitable, scientific, artistic, cultural, athletic or educational purposes, or
 - is established and operated in its jurisdiction of residence and it is a professional organization, business league, chamber of commerce, labour organization, agricultural or horticultural organization, civic league or an organization operated exclusively for the promotion of social welfare,
 - it is exempt from income tax in its jurisdiction of residence,
 - it has no shareholders or members who have a proprietary or beneficial interest in its income or assets,
 - the applicable laws of the entity's jurisdiction of residence or the entity's formation documents do not permit any income or assets of the entity to be distributed to, or applied for the benefit of, a private person or non-charitable entity other than pursuant to the conduct of the entity's charitable activities, or as payment of reasonable compensation for services rendered, or as payment representing the fair market value of property which the entity has purchased, and
 - the applicable laws of the entity's jurisdiction of residence or the entity's formation documents require that, upon the entity's liquidation or dissolution, all of its assets be distributed to a governmental entity or other non-profit organization, or escheat to the government of the entity's jurisdiction of residence or any political subdivision thereof.

"anti-money laundering and know your customer procedures or AML/KYC procedures"

This defined term means the record keeping, verification of identity, reporting of suspicious transactions and registration requirements required of a reporting crypto-asset service provider under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* .

"branch"

A "branch" means a unit, business or office of a reporting crypto-asset service provider that is treated as a branch under the regulatory regime of a jurisdiction or that is otherwise regulated under the laws of a jurisdiction as separate from other offices, units, or branches of the reporting crypto-asset service provider.

"controlling persons"

This term has the same meaning as under subsection 270(1) which provides that "controlling persons" refer to the natural persons exercising control over the entity. Identifying the "controlling persons" is necessary to determine whether an entity that is not a reportable person is nonetheless an entity in respect of which the crypto-asset service provider must report.

"crypto-asset"

A "crypto-asset" means a digital representation of value that relies on a cryptographically secured distributed ledger or a similar technology to validate and secure transactions.

"crypto-asset user"

A "crypto-asset user" has two main meanings. First, it means an individual or entity that is a customer of a reporting crypto-asset service provider for purposes of carrying out relevant transactions, other than an individual or entity (other than a financial institution or a reporting crypto-asset service provider) acting as a crypto-asset user for the benefit of, or on behalf of, another individual or entity as agent, custodian, nominee, signatory, investment advisor or intermediary.

Second, with respect to a reportable retail payment transaction, it means the customer that is the counterparty to the merchant for such transaction, if a reporting crypto-asset service provider provides a service effectuating reportable retail payment transactions for or on behalf of the merchant and the reporting crypto-asset service provider is required to verify the identity of the customer under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*.

Finally, paragraph (b) of that definition clarifies that the individual or entity for the benefit or on behalf of whom another entity or individual acts as a crypto-asset user is to be treated as the customer.

"custodial institution"

This term has the same meaning as under subsection 270(1) which provides that an entity is a custodial institution if its gross income attributable to the holding of financial assets for the account of others and related financial services meets a certain threshold.

"depository institution"

This term has the same meaning as under subsection 270(1) which provides that a depository institution means any entity that accepts deposits in the ordinary course of a banking or similar business.

"entity"

This term has the same meaning as under subsection 270(1) which provides that an entity means a person (other than a natural person) or a legal arrangement, such as a corporation, partnership, trust or foundation.

"entity crypto-asset user"

An "entity crypto-asset user" means a crypto-asset user that is an entity.

"exchange transaction"

An "exchange transaction" means any exchange between relevant crypto-assets and fiat currencies or any exchange between one or more forms of relevant crypto-assets.

"excluded person"

An "excluded person" means any entity the stock of which is regularly traded on one or more established securities market or any entity that is a related entity of such an entity, a governmental entity, an international organization, a central bank, or a financial institution other than an investment entity described in paragraph (b) of the definition "investment entity" in this subsection.

This definition is relevant to determine the obligations of a reporting crypto-asset service provider as this Part contains many exclusions regarding an "excluded person". Most notably, a reporting crypto-asset service provider does not have to carry out the due diligence procedures to determine if the excluded person has controlling persons. That being said, the reporting crypto-asset service provider must carry out the due diligence procedures in respect of an entity crypto-asset user to determine whether that person is in fact an excluded person. If so, the reporting crypto-asset service provider will not be subject to reporting in respect of the excluded person as it is not, by definition, a reportable user.

"fiat currency"

This term has the same meaning as under subsection 270(1) which provides that a fiat currency generally refers to a jurisdiction's official currency as well as commercial bank money and electronic money products.

"financial asset"

This term has the same meaning as under subsection 270(1) and includes, among other things, a security, a commodity, and a partnership interest, while excluding a non-debt, direct interest in real or immovable property.

"financial institution"

A "financial institution" means a custodial institution, a depository institution, an investment entity or a specified insurance company.

"governmental entity"

This term has the same meaning as under subsection 270(1).

"individual crypto-asset user"

An "individual crypto-asset user" means a crypto-asset user that is an individual (other than a trust).

"investment entity"

This definition is almost identical to the definition of the same term under subsection 270(1) and provides that an investment entity is either an entity that primarily carries on as a business one or more of the activities or operations enumerated under that definition for or on behalf of customers or an entity managed by such entity and that meets a certain income threshold.

Further, that term excludes an entity that is an active entity because of any of paragraphs (b) to (e) of that definition under this subsection. This term is notably relevant to the definition "excluded person".

"partner jurisdiction"

A "partner jurisdiction" means each jurisdiction identified as a partner jurisdiction by the Minister on the Internet webpage of the Canada Revenue Agency or by any other means that the Minister considers appropriate.

"preexisting crypto-asset user"

A "preexisting crypto-asset user" means a crypto-asset user that has established a relationship with the reporting crypto-asset service provider as of December 31, 2025.

"related entity"

An entity is related to another entity if either entity controls the other entity or the two entities are controlled by the same entity or individual.

This definition is relevant to the definitions "active entity" and "excluded person" under this subsection.

For the purposes of this definition, control includes direct or indirect ownership of

- in the case of a corporation, shares of the capital stock of a corporation that give their holders more than 50% of the votes that could be cast at the annual meeting of the shareholders of the corporation and have a fair market value of more than 50% of the fair market value of all the issued and outstanding shares of the capital stock of the corporation;
- in the case of a partnership, an interest as a member of the partnership that entitles the member to more than 50% of the income or loss of the partnership, or the assets (net of liabilities) of the partnership if it

- were to cease to exist; and
- in the case of a trust, an interest as a beneficiary under the trust with a fair market value that is greater than 50% of the fair market value of all interests as a beneficiary under the trust.

"relevant crypto-asset"

A "relevant crypto-asset" means any crypto-asset that is not a central bank digital currency, a specified electronic money product or any crypto-asset for which the reporting crypto-asset service provider has adequately determined that it cannot be used for payment or investment purposes or a crypto-asset that meets prescribed conditions.

This definition is central in determining the reporting obligations of a reporting crypto-asset service provider since a relevant transaction is one necessarily involving a relevant crypto-asset.

"relevant transaction"

A "relevant transaction" means any exchange transaction and any transfer of a relevant crypto-asset.

This definition is central in determining the reporting obligations of a reporting crypto-asset service provider under subsection 298(1).

"reportable jurisdiction"

A "reportable jurisdiction" means any jurisdiction, including Canada.

"reportable person"

A "reportable person" means a natural person or an entity, other than an excluded person, that is resident in a reportable jurisdiction under the tax laws of that jurisdiction, or an estate of an individual who was a resident of a reportable jurisdiction under the tax laws of that jurisdiction immediately before death, and, for this purpose, an entity that has no residence for tax purposes is deemed to be resident in the jurisdiction in which its place of effective management is situated.

This definition is central in determining the obligations of a reporting crypto-asset service provider under this Part, notably because the service provider is only subject to reporting obligations in respect of crypto-asset users that are reportable persons or have controlling persons who are reportable persons.

"reportable retail payment transaction"

A "reportable retail payment transaction" means a transfer of a relevant crypto-asset in consideration of goods or services for a value exceeding 50,000 USD.

"reportable user"

A "reportable user" means a crypto-asset user that is a reportable person.

This definition is central in determining the obligations of a reporting crypto-asset service provider under this Part, notably because the service provider is only subject to reporting obligations in respect of reportable users or crypto-asset users that have controlling persons who are reportable persons.

"reporting crypto-asset service provider"

A "reporting crypto-asset service provider" means any individual or entity that, as a business, provides a service effectuating exchange transactions for or on behalf of customers, including by acting as a counterparty, or as an intermediary, to such exchange transactions, or by making available a trading platform.

This definition is central in determining the obligations of an individual or entity under this Part since both the due diligence obligations and the reporting obligations only apply to reporting crypto-asset service providers.

"specified insurance company"

This definition has the same meaning as under subsection 270(1) which provides that a "specified insurance company" means any entity that is an insurance company (or the holding company of an insurance company) that issues, or is obligated to make payments with respect to, cash value insurance contracts or annuity contracts.

"TIN"

This term has the same meaning as under subsection 270(1) and includes, among other things, a social insurance number, a business number, and a trust account number.

"transfer"

A "transfer" means a transaction that moves a relevant crypto-asset from or to the crypto-asset address or account of one crypto-asset user, other than one maintained by the reporting crypto-asset service provider on behalf of the same crypto-asset user, where, based on the knowledge available to the reporting crypto-asset service provider at the time of transaction, the reporting crypto-asset service provider cannot determine that the transaction is an exchange transaction.

This definition is notably relevant to the definitions "reportable retail payment transaction" and "relevant transaction" which are the two types of transactions on which a reporting crypto-asset service provider must report.

"USD"

"USD" means dollars of the United States of America.

Interpretation

ITA
296(2)

Subsection 296(2) provides an interpretive rule that applies for the purposes of Part XXI. This Part is drafted in a manner that is intended to be generally consistent with the model Crypto-Asset Reporting Framework and its official commentary. This forms the context in which the text of the provisions is to be interpreted.

This rule clarifies that taxpayers should interpret the provisions of Part XXI, unless the context otherwise requires, consistently with the model Crypto-Asset Reporting Framework and associated commentary that was published by the Organisation for Economic Co-operation and Development (and as amended from time to time). These are relevant in addition to the guidance to be published by the Canada Revenue Agency.

Interpretation — investment entity

ITA
296(3)

Subsection 296(3) provides an interpretative rule that applies for the purposes of the definition of "investment entity" in this Part.

Specifically, subsection 296(3) provides that an entity is considered to be primarily carrying on as a business one or more of the activities described in paragraph (a) of that definition, or an entity's gross income is primarily attributable to investing, reinvesting or trading in financial assets for the purposes of paragraph (b) of that

definition, if the entity's gross income attributable to the relevant activities equals or exceeds 50% of the entity's gross income during the shorter of

- the three-year period that ends at the end of the entity's last taxation year, and
- the period during which the entity has been in existence

Interpretation — branch

ITA
296(4)

Subsection 296(4) provides an interpretative rule that applies for the purposes of the definition of "branch" in this Part.

Specifically, subsection 296(4) provides that all units, businesses and offices of a reporting crypto-asset service provider in a single jurisdiction shall be treated as a single branch.

Application of sections 298 and 299

ITA
297(1)

Subsection 297(1) provides for the conditions under which sections 298 and 299, which set out reporting and due diligence obligations, will apply in respect of a reporting crypto-asset service provider. Specifically, the sections will apply for a calendar year if the provider is any of the following:

- an entity or individual resident in Canada;
- an entity that is organized under the laws of Canada or a province and has an obligation to file tax returns or tax information returns in Canada;
- a partnership managed from Canada; or
- an entity or individual that carries on a business in Canada.

Application — branch

ITA
297(2)

Subsection 297(2) clarifies that, irrespective of subsection 297(1), sections 298 and 299 apply for a calendar year in respect of a reporting crypto-asset service provider with respect to relevant transactions effectuated through a branch based in Canada.

Exception — jurisdiction of residence

ITA
297(3)

Subsection 297(3) provides an exception to the obligation to fulfill the requirements set out at sections 298 and 299 pursuant to paragraphs (1)(b) to (d) if equivalent requirements are completed by the service provider in a partner jurisdiction by virtue of the service provider being resident for tax purposes in such jurisdiction.

Exception — jurisdiction of incorporation or organization

ITA
297(4)

Subsection 297(4) provides an exception for a reporting crypto-asset service provider that is an entity to the obligation to fulfill the requirements set out at sections 298 and 299 pursuant to any of paragraphs (1)(c) to (d) if equivalent requirements are completed by such reporting crypto-asset service provider in a partner jurisdiction by virtue of it being an entity that is incorporated or organized under the laws of such partner jurisdiction and either has legal personality in the partner jurisdiction or has an obligation to file tax returns or tax information returns to the tax authorities in the partner jurisdiction with respect to the income of the entity.

Exception — jurisdiction of management

ITA
297(5)

Subsection 297(5) provides an exception for a reporting crypto-asset service provider that is an entity to the obligation to fulfill the requirements set out at sections 298 and 299 pursuant to paragraph (1)(d) if equivalent requirements are completed by such reporting crypto-asset service provider in a partner jurisdiction by virtue of it being managed from such jurisdiction.

Exception — branch jurisdiction

ITA
297(6)

Subsection 297(6) provides a general exception to the obligation to fulfill the requirements set out at sections 298 and 299 with respect to relevant transactions effectuated through a branch in a partner jurisdiction, if equivalent requirements are completed by such branch in such jurisdiction.

Exception — substantially similar nexus

ITA
297(7)

Subsection 297(7) provides an exception to the obligation to fulfill the requirements set out at sections 298 and 299 pursuant to subsection (1) if the service provider has notified the Minister in the specified manner confirming that equivalent requirements are completed by the provider under the rules of a partner jurisdiction pursuant to a nexus that is substantially similar to one of those described in paragraphs (1)(a) to (d) to which the reporting crypto-asset service provider is subject in Canada.

Reporting Requirements

ITA
298(1)

Subsection 298(1) sets out the information that a service provider must report. Specifically, subsection 298(1) provides that a reporting crypto-asset service provider must report the following information with respect to its crypto-asset users that are reportable users or that have controlling persons that are reportable persons at any time during the year:

- the name, address, jurisdiction of residence, TIN and date of birth (in the case of a natural person) of each reportable user;
- in the case of any entity that has one or more controlling persons that is a reportable person,
 - the name, address, jurisdiction of residence and TIN of the entity,
 - the name, address, jurisdiction of residence, TIN and date of birth of each reportable person, and
 - the role by virtue of which each reportable person is a controlling person of the entity; and
- the name, address, TIN or other identifying number of the reporting crypto-asset service provider.

Also, for each crypto-asset user and for each type of relevant crypto-asset with respect to which it has effectuated relevant transactions during the calendar year, the service provider must report the following:

- the full name of the type of relevant crypto-asset;
- the aggregate gross amount paid, the aggregate number of units and the number of relevant transactions in respect of acquisitions against fiat currency;
- the aggregate gross amount received, the aggregate number of units and the number of relevant transactions in respect of dispositions against fiat currency;
- the aggregate fair market value, the aggregate number of units and the number of relevant transactions in respect of acquisitions against other relevant crypto-assets;
- the aggregate fair market value, the aggregate number of units and the number of relevant transactions in respect of dispositions against other relevant crypto-assets;
- the aggregate fair market value, the aggregate number of units and the number of reportable retail payment transactions;
- the aggregate fair market value, the aggregate number of units and the number of relevant transactions, and subdivided by transfer type where known by the reporting crypto-asset service provider, in respect of transfers to the reportable user (except acquisitions against fiat currency and acquisitions against other relevant crypto-assets, which are already covered in this subsection);
- the aggregate fair market value, the aggregate number of units and the number of relevant transactions, and subdivided by transfer type where known by the reporting crypto-asset service provider, in respect of transfers by the reportable user (except dispositions against fiat currency, dispositions against other relevant crypto-assets and reportable retail payment transactions, which are already covered in this subsection); and
- the aggregate fair market value, as well as the aggregate number of units in respect of transfers by the reportable crypto-asset user effectuated by the reporting crypto-asset service provider to wallet addresses not known by the reporting crypto-asset service provider to be associated with a virtual asset service provider or financial institution.

Exception — TIN

ITA
298(2)

Subsection 298(2) provides an exception that the TIN is not required to be reported if a TIN is not issued by the relevant reportable jurisdiction, or the domestic law of the relevant reportable jurisdiction does not require the collection of the TIN issued by such jurisdiction.

Currency — amount paid or received

ITA
298(3)

Subsection 298(3) provides that an amount paid or received that is described at subparagraph (1)(d)(ii) or (iii) must be reported in the fiat currency in which it was paid or received, and, if the amount was paid or received in multiple fiat currencies, the amount must be reported in Canadian dollars, converted at the time of each relevant transaction in a manner that is consistently applied by the reporting crypto-asset service provider.

Currency — fair market value

ITA
298(4)

Subsection 298(4) provides that for the purposes of subparagraphs (1)(d)(iv) to (ix), fair market value must be reported in Canadian dollars, valued at the time of each relevant transaction in a manner that is consistently applied by the reporting crypto-asset service provider.

Due diligence procedures

ITA
299(1)

Subsection 299(1) provides that a crypto-asset user is treated as a reportable user beginning as of the date it is identified, or should have been identified, within the time specified in subsection (6), as such pursuant to the due diligence procedures set out in this section. Determining whether a crypto-asset user is a reportable user is relevant for the purposes of the reporting requirements.

Due diligence procedures — individual crypto-asset users

ITA
299(2)

Subsection 299(2) provides that a reporting crypto-asset service provider must apply the following due diligence procedures to determine whether an individual crypto-asset user is a reportable user:

- obtain a valid self-certification that allows it to determine the individual crypto-asset user's residence for tax purposes, and
- confirm the reasonableness of such self-certification based on the information obtained by the reporting crypto-asset service provider, including any documentation collected pursuant to AML/KYC procedures.

Due diligence procedures — entity crypto-asset users

ITA
299(3)

Subsection 299(3) provides that a reporting crypto-asset service provider must apply the following due diligence procedures to determine whether an entity crypto-asset user is a reportable user or is an entity, other than an excluded person or an active entity, with one or more controlling persons who are reportable persons:

- obtain a valid self-certification that allows it to determine the entity crypto-asset user's residence for tax purposes and whether it is an active entity;
- confirm the reasonableness of such self-certification based on the information obtained by the reporting crypto-asset service provider, including any documentation collected pursuant to AML/KYC procedures;
- if the entity crypto-asset user certifies that it has no residence for tax purposes, rely on the place of effective management or on the address of the principal office to determine the residence of the entity crypto-asset user; and
- if the self-certification indicates that the entity crypto-asset user is resident in a reportable jurisdiction, treat the entity crypto-asset user as a reportable user, unless it reasonably determines based on the self-certification or on information in its possession or that is publicly available, that the entity crypto-asset user is an excluded person.

In respect of an excluded person or an active entity, the reporting crypto-asset service provider must carry out these procedures to determine whether the person or entity is a reportable user but not to determine whether it has controlling persons who are reportable persons.

Due diligence procedures — controlling person

ITA
299(4)

Subsection 299(4) provides that a reporting crypto-asset service provider must apply the following due diligence procedures with respect to an entity crypto-asset user, other than an excluded person or an active entity, to determine whether it has one or more controlling persons who are reportable persons:

- rely on a valid self-certification from the entity crypto-asset user or such controlling person that allows the reporting crypto-asset service provider to determine the controlling person's residence for tax purposes; and
- confirm the reasonableness of the self-certification based on the information obtained by the reporting crypto-asset service provider, including any documentation collected pursuant to AML/KYC procedures.

AML/KYC procedures — controlling person

ITA
299(5)

Subsection 299(5) provides that to determine the controlling persons of an entity crypto-asset user, a reporting crypto-asset provider may rely on information collected and maintained pursuant to AML/KYC procedures, provided that such procedures are consistent with the *2012 FATF recommendations* (as defined in subsection 270(1)) or, if it is not legally required to apply such procedures, substantially similar procedures.

Timing of review

ITA
299(6)

Subsection 299(6) provides that a reporting crypto-asset service provider must complete the due diligence procedures set out in this section when establishing the relationship with the crypto-asset user or, with respect to preexisting crypto-asset users, before 2027.

Change of circumstances

ITA
299(7)

Subsection 299(7) provides that upon a change of circumstances of a crypto-asset user or its controlling person that causes the reporting crypto-asset service provider to know, or have reason to know, that the original self-certification is incorrect or unreliable, the reporting crypto-asset service provider cannot rely on the original self-certification and must obtain a valid self-certification, or a reasonable explanation and documentation supporting the validity of the original self-certification.

Self-certification — individual crypto-asset user

ITA
299(8)

Subsection 299(8) provides that a self-certification provided by an individual crypto-asset user or controlling person is valid only if it is signed or positively affirmed by the individual crypto-asset user or controlling person, it is dated on the latest at the date of receipt by the reporting crypto-asset service provider and it contains the following information with respect to the individual crypto-asset user or controlling person:

- first and last name;
- address of residence;
- jurisdiction of residence for tax purposes;
- the TIN with respect to each reportable jurisdiction; and
- date of birth.

Self-certification — entity crypto-asset user

ITA
299(9)

Subsection 299(9) provides that a self-certification provided by an entity crypto-asset user is valid only if it is signed or positively affirmed by the crypto-asset user, it is dated on the latest at the date of receipt by the reporting crypto-asset service provider and it contains the following information with respect to the entity crypto-asset user:

- legal name;
- address;
- jurisdiction of residence for tax purposes;
- the TIN with respect to each reportable jurisdiction;
- in case of an entity crypto-asset user, other than an active entity or an excluded person, the information described in subsection (7) with respect to each controlling person of the entity crypto-asset user, unless such controlling person has provided a self-certification pursuant to subsection (7), as well as the role by virtue of which each reportable person is a controlling person of the entity, if not already determined on the basis of AML/KYC procedures; and
- if applicable, information as to the criteria it meets to be treated as an active entity or excluded person.

Exception — TIN

ITA
299(10)

Subsection 299(10) provides that a TIN of a reportable person is not required to be collected if the jurisdiction of residence of the reportable person does not issue a TIN to the reportable person, or if the domestic law of the relevant reportable jurisdiction does not require the collection of the TIN issued by the reportable jurisdiction.

Exception — Part XIX

ITA
299(11)

Subsection 299(11) provides that a reporting crypto-asset service provider that is also a financial institution within the meaning of subsection 270(1) may rely on the due diligence procedures completed under sections 274 and 276 for the purposes of the due diligence procedures in this section.

Exception — self-certification

ITA
299(12)

Subsection 299(12) provides that a reporting crypto-asset service provider may rely on a self-certification already collected for other tax purposes for the purposes of the due diligence procedures in this section, provided the self-certification meets the requirements of subsection (7) or (8).

Delegation

ITA
299(13)

Subsection 299(13) provides that a reporting crypto-asset service provider may rely on a third party to fulfil the due diligence obligations set out in this section, but such obligations remain the responsibility of the reporting crypto-asset service provider.

Reporting

ITA
300(1)

Subsection 300(1) provides that every reporting crypto-asset service provider, to which sections 298 and 299 apply, shall file with the Minister, before May 2 of each calendar year, an information return in prescribed form containing the information that is required to be reported in respect of the preceding calendar year under this Part.

Electronic filing

ITA
300(2)

Subsection 300(2) provides that the information return required under subsection (1) shall be filed by way of electronic filing.

Record keeping

ITA
301(1)

Subsection 301(1) provides that every reporting crypto-asset service provider shall keep, at the service provider's place of business or at such other place as may be designated by the Minister, records that the service provider obtains or creates for the purpose of complying with this Part, including self-certifications and records of documentary evidence.

Form of records

ITA
301(2)

Subsection 301(2) provides that every reporting crypto-asset service provider required by this Part to keep records that does so electronically shall retain them in an electronically readable format for the retention period referred to in subsection (3).

Retention of records

ITA
301(3)

Subsection 301(3) provides that every reporting crypto-asset service provider that is required to keep, obtain or create records under this Part shall retain those records for a period of at least six years following the end of the last calendar year in respect of which the record is relevant.

Anti-avoidance

ITA
302

Section 302 provides that if an individual or an entity enters into an arrangement or engages in a practice, the primary purpose of which can reasonably be considered to be to avoid an obligation under this Part, this Part shall apply as if the individual or entity had not entered into the arrangement or engaged in the practice. A

practice the primary purpose of which can reasonably be considered to be to avoid an obligation under this Part includes partitioning a transaction to avoid the definition of *reportable retail payment transaction* .

Production of TIN

ITA
303(1)

Subsection 303(1) provides that every reportable person and every crypto-asset user that has controlling persons that are reportable persons shall provide their TIN and the TIN of each of their controlling persons, if applicable, at the request of a reporting crypto-asset service provider that is required under this Part to make an information return requiring the TIN.

Confidentiality of TIN

ITA
303(2)

Subsection 303(2) provides that a person required to make an information return referred to in subsection (1) shall not knowingly use, communicate or allow to be communicated, otherwise than as required or authorized under this Act or a regulation, the TIN without the written consent of the person to whom the TIN relates.

Penalty

ITA
303(3)

Subsection 303(3) provides for a penalty for failure to provide a TIN. Specifically, it provides that every reportable person and every crypto-asset user that has controlling persons that are reportable persons who fails to provide on request their TIN to a reporting crypto-asset service provider that is required under this Part to make an information return requiring the TIN is liable to a penalty of \$500 for each such failure.

However, subsection 303(3) provides for an exception to the penalty in the following circumstances:

- an application for the assignment of the TIN is made to the relevant reportable jurisdiction not later than 90 days after the request was made and the TIN is provided to the reporting crypto-asset service provider that requested it within 15 days after the person to whom the TIN relates received it; or
- the reportable person or the crypto-asset user that has controlling persons that are reportable persons is not eligible to obtain a TIN from the relevant reportable jurisdiction (including because the relevant reportable jurisdiction does not issue TINs).

Assessment

ITA
303(4)

Subsection 303(4) provides that the Minister can assess the penalty provided for under subsection 303(3) and provides that the administrative provisions of Divisions I and J will apply. However, by excluding subsections 164(1.1) to (1.3), an individual or entity liable for the penalty will not be entitled to any repayment of a penalty in dispute by filing an objection.

Clause 7

ITR

9005

Section 9005 prescribes certain entities for the purposes of the definition "non-reporting financial institution" in subsection 270(1) of the Act.

Consequential to the enactment of new paragraph 9006(m), this section is amended by repealing paragraph (a) in order to remove a labour-sponsored venture capital corporation as prescribed in section 6701 of the Act from the enumerated entities.

ITR
9006

Section 9006 prescribes the accounts for the purposes of the definition "excluded account" in subsection 270(1) of the Act.

This section is amended to add a non-registered account held in a prescribed labour-sponsored venture capital corporation as set out in section 6701 of the Act (new paragraph (m)) (if the total value of contributions to the account made in any calendar year does not exceed 50,000 USD).

These amendments apply to the 2026 and subsequent calendar years.

Employee Ownership Trust Tax Exemption

Clause 1

ITA
110.61(1)(a)

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

Paragraph 110.61(1)(a) provides that for subsection (2) to apply, no individual may have, prior to the disposition time, claimed a deduction under subsection (2) in respect of another disposition of shares that, at the time of that disposition, derived their value from an active business that is also relevant to the determination of whether the disposition of the subject shares satisfies the condition set out in paragraph (a) of the definition qualifying business transfer in subsection 248(1).

This paragraph is amended to add that no individual may have, prior to the disposition time, claimed a deduction under section 110.62 (i.e., the deduction available for dispositions of shares under a qualifying cooperative conversion) in respect of another disposition of shares that, at the time of that disposition, derived their value from an active business that is also relevant to the determination of whether the disposition of the subject shares satisfies the condition set out in paragraph (a) of the definition qualifying business transfer in subsection 248(1).

This condition is intended to ensure that an interest in a business is effectively transferred only once pursuant to a qualifying business transfer for which the capital gains deduction in subsection (2) is available, preventing multiplication of the deduction under subsection (2) and section 110.62 in respect of the same business.

This paragraph is also amended to clarify that the determination of whether a prior deduction was sought under section 110.61 or 110.62, in respect of a disposition of shares that derived their value from an active business that is relevant to the determination of whether the disposition of the subject shares satisfies the conditions set out in paragraph (a) of the definition "qualifying business transfer" in subsection 248(1), is to be made on a look-through basis.

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

ITA
110.61(1)(b)

Paragraph 110.61(1)(b) provides the conditions that the subject shares must meet throughout the 24 months immediately prior to the disposition time under the qualifying business transfer. Subparagraph (i) requires that, during this period, the subject shares were not owned by anyone other than the individual or a person or partnership related to the individual (referred to as "the holding period test"). Subparagraph (b)(ii) requires that, during this period, more than 50% of the fair market value of the subject shares was derived from assets which were used principally in an active business (referred to as "the active business test").

Paragraph (b) is amended to ensure that the holding period and the active business asset tests operate effectively where shares are received in substitution for other shares. Under amended paragraph (b), the holding period test may be met if the original share throughout the part of the 24-month period immediately preceding the disposition time that is before the time of substitution was a share of a corporation that meets the active business asset test and was not owned by a person or partnership other than a person or partnership described in subparagraph (b)(i).

Subparagraph (b)(ii) is also amended to clarify that the active business test may be met where the value of the subject shares and the substituted shares (if any) is derived, directly or indirectly, from assets used principally in an active business. This amendment is intended to clarify that the sale of shares of a holding corporation could satisfy this condition; for example, if the holding corporation's sole property were shares of a wholly-owned subsidiary corporation all of whose assets were used in an active business.

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

ITA
110.61(1)(d)(ii)

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

Subparagraph 110.61(1)(d)(ii) requires that throughout any 24-month period ending before the disposition time, the individual claimant, or a spouse or common-law partner of the individual, was actively engaged in the business that is relevant to the determination of whether the subject shares satisfy the condition set out in paragraph (a) of the definition "qualifying business transfer" in subsection 248(1). This subparagraph is amended to qualify that the active engagement takes place on a regular, continuous and substantial basis (including within the meaning of paragraph 120.4(1.1)(a)). An individual working at least an average of 20 hours per week during the portion of the year in which the business operates is deemed to satisfy this condition per the provision's reference to paragraph 120.4(1.1)(a).

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

Capital gains deduction – qualifying business transfers

ITA
110.61(2)

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

This subsection is amended and reorganized in order to incorporate limitations equivalent to those currently applicable to the lifetime capital gains exemption (i.e., limitations equivalent to the "annual gains limit" and

similar to the "cumulative net investment loss", both defined in section 110.6). These restrictions prevent multiple deductions from being claimed against the same amount.

\$10 million gains limit

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

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

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

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

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

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

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

Reduction of capital gains deduction

New paragraph (2)(b) requires that certain other deductions, if claimed, are first applied against the relevant taxable capital gain realized on the subject shares before the deduction under section 110.61 can be claimed. This limit ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has also claimed allowable capital losses under paragraph 3(b) (to the extent the allowable capital losses exceed their taxable capital gains excluding the amount deducted previously in the year by the individual under section 110.61) or allowable business investment losses (ABILs), and to the extent that the taxpayer's investment expense exceeds their investment income (referred to, here, as "net investment losses"). This limit also ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has claimed net capital loss carryovers under paragraph 111(1)(b) (to the extent the net capital loss carryovers exceed their net taxable capital gains under paragraph 3(b) excluding any amounts deducted previously in the year by the individual under section 110.61). (For the ordering of deductions claimed by an individual under subsection 110.61(2) in a taxation year, see the commentary to new subsection 110.61(2.1).)

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

Variable G

Variable G is the lesser of subparagraph (i), the individual's net taxable capital gains for the year under paragraph 3(b) (except any portion that relates to a prior deduction claimed by the individual in the year under this section for another qualifying business transfer), and subparagraph (ii), their net taxable capital gains from the disposition of the subject shares.

Variable H

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

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

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

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

For the purposes of subparagraph (ii) of variable H, "investment income" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "amount determined in respect of the individual for the year for A in the definition annual gains limit" in paragraph (f) of that definition is to be read as "total of all amounts determined in respect of the individual for the year for the description of G in subsection 110.61(2) (except any amount that previously reduced the amount otherwise deductible by the individual in the year under subsection 110.61(2))".

Subparagraph (iii) is the individual's net capital losses for other taxation years deducted by the individual in the year under paragraph 111(1)(b) to the extent the deducted net capital loss carryovers exceed the individual's net taxable capital gains under paragraph 3(b) (excluding any amounts deducted previously in the year by the individual under subsection 110.61(2)).

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

Example

This example assumes that the capital gains inclusion rate is $\frac{1}{2}$.

Imene owns shares of two unrelated operating corporations (20% of the fair market value of all shares of Opco1 and 15% of Opco2). In September 2025, Imene and the other Opco1 shareholders sold all of their Opco1 shares to an employee ownership trust (EOT1) pursuant to a qualifying business transfer. Similarly, in October 2025, Imene and all the other Opco2 shareholders sold all their Opco2 shares to another employee ownership trust (EOT2). All the Opco1 and Opco2 shares are "qualified small business corporation shares" (QSBC shares), as defined under subsection 110.6(1). Imene's sale of Opco1 shares resulted in a capital gain of \$3,000,000 (taxable capital gain of \$1,500,000) and Opco2 shares resulted in a capital gain of \$1,000,000 (taxable capital gain of \$500,000). Under the joint election for the capital gains deduction for selling to an employee ownership trust (EOTCGE) provided under subsection 110.61(1)(e), EOT1 effectively allocates \$2,000,000 and EOT2 effectively allocates \$1,500,000 of their respective \$10,000,000 EOTCGE to Imene. Imene has never used her lifetime capital gains exemption (LCGE) prior to this transaction.

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

In December 2025, Imene disposed of portfolio shares resulting in a capital gain of \$200,000 (\$100,000 taxable capital gain). The portfolio shares do not qualify for the LCGE. Lastly, Imene has \$100,000 of net capital losses carried forward from her 2023 taxation year (i.e., the portion of a \$200,000 capital loss realized in 2023 that is an

allowable capital loss) that she will use to fully shelter the capital gain realized on the portfolio shares in December 2025.

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

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

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

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

Step 1a – Calculate EOTCGE amount for Opco1 shares

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

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

In this case, variable G is the lesser of Imene's net taxable capital gains for the year (i.e., \$2,100,000) and Imene's net taxable capital gains from the Opco1 shares sold to EOT1 (i.e., \$1,500,000). Therefore, variable G is \$1,500,000.

Variable H is the total of Imene's (i) ABILs for the year (i.e., \$100,000), (ii) net investment losses for the year (i.e., \$100,000 - \$600,000 = nil), and (iii) net capital losses deducted in the year that exceeds the amount, if any, by which her net taxable capital gains exceeds the amount determined for G (i.e., \$100,000 - (\$2,100,000 - \$1,500,000) = nil). Therefore, variable H is \$100,000 (from the ABILs).

The amount calculated under the formula " $G - H$ " under paragraph (b) is \$1,400,000 (i.e., \$1,500,000 - \$100,000).

The maximum amount that Imene may claim for her Opco1 shares under subsection 110.61(2) is the lesser of the amounts under paragraphs (a) (i.e., \$1,000,000) and (b) (i.e., \$1,400,000). Imene may therefore claim the EOTCGE for her Opco1 shares in the amount of \$1,000,000 in computing her taxable income for her 2025 taxation year.

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

Step 1b – Calculate EOTCGE amount for Opco2 shares

Applying the formula provided under paragraph 110.61(2)(a), this amount is \$750,000 (i.e., \$1.5 million of the \$10 million EOT exemption limit was allocated to Imene multiplied by the fraction of her capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year (1/2)).

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

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

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

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

The maximum amount that Imene may claim for her Opco2 shares under subsection 110.61(2) is the lesser of the amounts under paragraph (a) (i.e., \$750,000) and (b) (i.e., \$400,000). Imene may therefore claim the EOTCGE for her Opco2 shares in the amount of \$400,000 in computing her taxable income for her 2025 taxation year.

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

Step 2 – Calculate LCGE amount

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

Paragraph (a):

For the 2025 taxation year, the LCGE limit is \$1,250,000, it follows that the amount corresponding to paragraph (a) is \$625,000.

Paragraph (b):

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

Paragraph (c):

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

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

(a) Imene's net taxable capital gains (\$2,100,000) except any portion related to an EOTCGE (\$1,000,000 (Opco1) + \$500,000 (Opco2) = \$1,500,000). Thus, the amount under paragraph (a) is \$600,000 (\$2,100,000 - \$1,500,000); and

(b) Imene's net taxable capital gains from the disposition of Opco1 and Opco2 shares (\$2,000,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the EOTCGE. Thus, the amount under paragraph (b) is \$500,000 (\$2,000,000 - \$1,500,000).

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

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

(a) the amount, if any, by which Imene's net capital losses deducted in the year (\$100,000) exceeds the amount, if any, by which the amount of net taxable capital gains (except any portion related to an EOTCGE) (\$2,100,000 -

\$1,500,000 = \$600,000) exceeds the amount determined for A in respect of the individual for the year (\$500,000). Therefore, paragraph (a) is \$nil (\$100,000 – (\$600,000 – 500,000)); and

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

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

Consequently, the annual gains limit (paragraph (c)) is \$500,000 (\$500,000 – 0).

Paragraph (d):

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

In computing Imene's taxable income for the 2025 taxation year, she may claim the LCGE under subsection 110.6(2.1) on her taxable capital gain, resulting from the sale of the Opco1 and Opco2 shares, an amount not exceeding the least of paragraphs (a) (\$625,000), (b) (\$500,000), (c) (\$500,000) and (d) (\$500,000), i.e., equal to \$500,000.

Step 3 – Conclusion

Imene's taxable capital gains for the 2025 taxation year from the sale of Opco1 shares is \$1,500,000 and Opco2 shares is \$500,000, for a total of \$2,000,000. The total deductions claimed for these shares under the EOTCGE is \$1,400,000 (\$1,000,000 + \$400,000) and under the LCGE is \$500,000, for a total of \$1,900,000. The \$100,000 reduction in these exemptions reflect the ABILs incurred in the year that offset the remaining taxable capital gains from these share dispositions. However, the \$100,000 net capital losses do not reduce the exemptions because they do not exceed the taxable capital gains from sources unrelated to the disposition of the relevant properties (i.e., the net capital losses deducted does not exceed the taxable capital gains from portfolio shares). As a result of these exemptions, Imene's taxable income for her 2025 taxation year is nil. (Note that this example does not consider the possible impact of the alternative minimum tax (AMT) under sections 127.5 to 127.55.)

This amendment is deemed to have come into force on August 12, 2024.

ITA
110.61(2.1)

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

This amendment is deemed to have come into force on August 12, 2024.

ITA
110.61(3)(b)

Paragraph 110.61(3)(b) provides that a disqualifying event in respect of a qualifying business transfer occurs at the time that is the beginning of the taxation year of a qualifying business of an employee ownership trust (EOT) in which less than 50% of the fair market value of the shares of the qualifying business of the EOT is attributable to assets used principally in an active business carried on by one or more qualifying businesses controlled by the

EOT at both that time and at the beginning of the preceding taxation year of the qualifying business (referred to as the "active business test").

Paragraph 110.61(3)(b) is amended to provide an exception to its application where an active business of a qualifying business ceases to be carried on due to the disposition of all the assets that were used to carry on the business in order to satisfy debts owed to creditors of the EOT or of a qualifying business controlled by the EOT. Such a liquidation event would presumably be beyond the control of the qualifying business and the EOT and would leave the qualifying business and the EOT without the ability to pay an additional income tax liability. A taxpayer seeking to use a sale to an EOT to rely on this exception in order to liquidate a business on a tax-free basis would be subject to the existing anti-avoidance rule under subsection 84(2) and to the "qualifying business transfer" requirements under paragraph (c) of the definition in subsection 248(1) that a taxpayer deal at arm's length and not retain any right or influence that, if exercised, would allow the taxpayer to control, directly or indirectly in any manner whatever, the subject corporation, the trust or any purchaser corporation.

Paragraph 110.61(3)(b) is also amended to replace the term "attributable to" with "derived, directly or indirectly, from". This amendment is intended to clarify, for greater certainty, that the active business test applies on a look-through basis to arrangements where assets are owned and used principally in the active business of a subsidiary corporation that is owned by a holding corporation of an EOT. This amendment is deemed to have come into force on January 1, 2024.

ITA 110.61(4)(b)

Paragraph 110.61(4)(b) provides the consequences for an employee ownership trust of a disqualifying event (within the meaning of subsection 110.61(3)) at any time following the day that is 24 months after the disposition time for a qualifying business transfer to the trust. If it applies, paragraph (b) deems the trust to have realized a capital gain during the year in which the disqualifying event occurs equal to the elected amount (within the meaning of clause (1)(e)(ii)(A)) under the joint election referred to in paragraph (1)(e) for the qualifying business transfer.

Paragraph (b) is amended to limit the consequences of a disqualifying event to any time between the day that is 24 months after the disposition time for the qualifying business transfer and 8 years from that time. Consequently, the consequences of a disqualifying event under subsection (4) apply for up to 10 years after the disposition time for a qualifying business transfer.

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

ITA 110.61(11)(b.1)

Deemed relationship – spouse or common-law partner immediately before deceased individual's death

New paragraph 110.61(11)(b.1) clarifies that, for purposes of section 110.61, a spouse or common-law partner of a particular individual includes another individual who was a spouse or common-law partner of the particular individual immediately before the death of the other individual. This is relevant for the conditions under subparagraphs (1)(b)(i) and (d)(i) that an individual (or their spouse or common-law partner) must satisfy to claim a deduction under subsection (2).

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

Clause 2

ITA 248(1)

"employee ownership trust"

Paragraph (j) of the definition "employee ownership trust" requires that all or substantially all the fair market value of the property of the trust is attributable to shares of the capital stock of one or more qualifying businesses that the trust controls. This condition is intended to ensure that the tax benefits provided under the Act for the creation and continuation of employee ownership trusts (EOTs) are targeted at facilitating employee ownership of active businesses (and not other assets).

Paragraph (j) is amended to replace the term "attributable to" with "derived, directly or indirectly, from".

Paragraph (j) is also amended to allow all or substantially all the fair market value of the property of the trust to be derived from both shares and indebtedness of a qualifying business that the trust controls. Lastly, paragraph (j) is amended to add that the qualifying business that the trust controls carry on an active business.

These amendments are intended to clarify, for greater certainty, that paragraph (j) may be satisfied on a "look-through" basis, such as where the sole property of an EOT is shares of a wholly-owned holding corporation whose sole asset is the shares of a wholly-owned subsidiary corporation that is a qualifying business that carries on an active business. These amendments also permit indebtedness owed by such a qualifying business to satisfy the fair market value test under paragraph (j). The "look-through" approach under paragraph (j) is not intended to apply beyond the shares or indebtedness of a qualifying business that carries on an active business; for example, if such a qualifying business owns shares of a foreign subsidiary corporation this would not be relevant for purposes of new paragraph (j).

The French version of sub-paragraph (b)(iv) of this definition is also amended to better align the French and the English.

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

"qualifying business"

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

Paragraph (c) is amended to clarify that the non-arm's length or affiliated person described in the definition does not include a subject corporation referred to in paragraph (a) of the definition "qualifying business transfer" that controlled and wholly-owned the corporation immediately before the time the trust acquired control of the corporation. This amendment is intended to accommodate qualifying business transfers, under which the trust acquires the shares of a holding corporation that wholly-owns a subsidiary corporation, the employees of which are the intended beneficiaries of the trust.

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

"qualifying business transfer"

Paragraph (a) of the definition "qualifying business transfer" is amended to replace the term "attributable to" with "derived, directly or indirectly, from". This amendment is intended to clarify, for greater certainty, that the determination of whether all or substantially all the fair market value of the assets (other than an interest in a partnership) that are used principally in an active business carried on by the subject corporation or a wholly-owned subsidiary of the subject corporation may be satisfied where all of the assets of the subject corporation consists of all of the shares of a wholly-owned subsidiary all of the assets of which are used principally in carrying on its active business. For example, the fair market value requirement provided in this paragraph could be met where a subject corporation is a holding corporation, the sole property of which is all of the shares of a wholly-owned subsidiary corporation all of whose assets are used principally in an active business carried on by the subsidiary.

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

Workers Cooperatives

Clause 1

Capital gains deduction for qualifying cooperative conversion – conditions

ITA
110.62(1)

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

Claimant is an individual (other than a trust)

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

Disposition occurs between 2024 and 2026

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

Disposition occurs under a qualifying cooperative conversion

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

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

New paragraph 110.62(1)(a) provides that for subsection (2) to apply, no individual may have, prior to the disposition time, claimed a deduction under subsection (2) or section 110.61 (i.e., the deduction available for dispositions of shares to an employee ownership trust pursuant to a qualifying business transfer) in respect of another disposition of shares that, at the time of that disposition, derived their value, directly or indirectly, from an active business that is also relevant to the determination of whether the disposition of the subject shares satisfies the condition set out in paragraph (a) of the definition qualifying cooperative conversion in subsection 248(1). This condition is intended to ensure that an interest in a business is effectively transferred only once pursuant to a qualifying cooperative conversion for which the capital gains deduction in subsection (2) is available, preventing multiplication of the deduction under subsection (2) and section 110.61 in respect of the same business.

24-month holding period

New paragraph 110.62(1)(b) provides the conditions that the subject shares must meet throughout the 24 months immediately prior to the disposition time under the qualifying cooperative conversion. Subparagraph (i) requires that, during this period, the subject shares were not owned by anyone other than the individual or a person or partnership related to the individual (referred to as "the holding period test"). The holding period test may be met if the original share throughout the part of the 24-month period immediately preceding the disposition time that is before the time of substitution was a share of a corporation that meets the condition in subparagraph (b)(ii) and was not owned by a person or partnership other than a person or partnership described in subparagraph (b)(i).

For more information on the interpretation of related persons for the purposes of this section, see the commentary on subsection (11).

Active business requirement

New subparagraph (b)(ii) requires that, during the 24-month period immediately prior to the disposition time, more than 50% of the fair market value of the subject shares and the substituted shares (if any) was derived, directly or indirectly, from assets which were used principally in an active business (referred to as "the active business test"). This requirement could be satisfied, for example, if the subject corporation's sole property were shares of a wholly-owned subsidiary corporation all of whose assets were used in an active business.

Subject corporation is not a professional corporation

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

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

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

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

Claimant is an adult

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

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

New subparagraph 110.62(1)(d)(ii) requires that throughout any 24-month period ending before the disposition time, the individual claimant, or a spouse or common-law partner of the individual, was actively engaged on a regular, continuous and substantial basis (including within the meaning of paragraph 120.4(1.1)(a)) in the business that is relevant to the determination of whether the subject shares satisfy the condition set out in paragraph (a) of the definition "qualifying cooperative conversion" in subsection 248(1). An individual working at least an average of 20 hours per week during the portion of the year in which the business operates is deemed to satisfy this condition per the provision's reference to paragraph 120.4(1.1)(a). This requirement restricts the deduction under subsection (2) to owner-managers and their spouses or common-law partners.

Example

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

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

Residency of members of the purchaser corporation at disposition time

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

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

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

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

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

Joint election

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

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

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

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

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

Capital gains deduction — qualifying cooperative conversions

ITA
110.62(2)

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

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

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

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

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

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

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

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

Paragraph (b) – January 1, 2024 – August 11, 2024

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

This version of paragraph (b) applies on a temporary basis for dispositions that occur between January 1, 2024 and August 11, 2024. It is replaced as of August 12, 2024 with a version that includes additional limits, as provided below.

Paragraph (b) – Beginning August 12, 2024

Subsection 110.62(2) is amended to replace its existing paragraph (b) as of August 12, 2024.

New paragraph (b) requires that certain other deductions, if claimed, are first applied against the relevant taxable capital gain realized on the subject shares before the deduction under section 110.62 can be claimed. This limit ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has also claimed allowable capital losses under paragraph 3(b) (to the extent the allowable capital losses exceed their taxable capital gains excluding amounts deducted previously in the year by the individual under section 110.61 or 110.62) or allowable business investment losses (ABILs), and to the extent that the taxpayer's investment expense exceeds their investment income (referred to, here, as "net investment losses"). This limit also ensures that, in computing taxable income, the exemption is reduced to the extent the taxpayer has claimed net capital loss carryovers under paragraph 111(1)(b) (to the extent the net capital loss carryovers exceed the amount determined in respect of the individual for the year under paragraph 3(b) excluding amounts deducted previously in the year by the individual under section 110.61 or 110.62). (For the ordering of deductions claimed by an individual under subsection 110.62(2) in a taxation year, see the commentary to new subsection 110.62(2.1).)

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

Variable G

Variable G is the lesser of subparagraph (i), the individual's net taxable capital gains for the year under paragraph 3(b) (except any portion that relates to a prior deduction claimed by the individual in the year under section 110.61 or under this section for another qualifying cooperative conversion), and subparagraph (ii), their net taxable capital gains from the disposition of the subject shares.

Variable H

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

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

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

For the purposes of subparagraph (ii) of variable H, an "investment expense" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "amount determined in respect of the individual for the year under paragraph (a) of the description of B in the definition annual gains limit" in paragraph (f) of that definition is to be read as "total of all amounts determined in respect of the individual for the year under subparagraph (iii) of the description of H in subsection 110.62(2) and subparagraph (iii) of the description of H in subsection 110.62(2) (to the extent that amount reduces the amount otherwise deductible under that subsection)".

For the purposes of subparagraph (ii) of variable H, "investment income" of an individual for a year, has the meaning assigned by subsection 110.6(1) except that, the reference to "amount determined in respect of the individual for the year for A in the definition annual gains limit in paragraph (f)" of that definition is to be read as "total of all amounts determined in respect of the individual for the year for the description of G in subsection 110.62(2) and the description of G in subsection 110.62(2) (except any amount that previously reduced the amount otherwise deductible by the individual in the year under subsection 110.61(2) or 110.62(2))".

Subparagraph (iii) is the individual's net capital losses for other taxation years deducted by the individual in the year under paragraph 111(1)(b) to the extent the deducted net capital loss carryovers exceed the individual's net taxable capital gains under paragraph 3(b) (excluding any amounts deducted previously in the year by the individual under subsection 110.61(2) or under this subsection).

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

Example

This example assumes that the capital gains inclusion rate is $\frac{1}{2}$.

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

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

In 2025, Adam also earned employment income from Opco.

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

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

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

Step 1 – Calculate WCCGE amount

Applying the formula provided under paragraph 110.62(2)(a), this amount is \$750,000 (i.e., \$1.5 million of the \$10 million WC exemption limit was allocated to Adam multiplied by the fraction of the taxpayer's capital gain from the disposition of the subject shares that is a taxable capital gain under paragraph 38(a) that applies to the subject shares in the year ($\frac{1}{2}$)).

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

Variable G functions to reduce the capital gains deduction for the individual's allowable capital losses (\$150,000 from portfolio shares) to the extent it exceeds their taxable capital gains from sources unrelated to the qualifying cooperative conversion (\$100,000 from portfolio shares). Consequently, the capital gains deduction should be reduced by the excess of \$50,000 (\$150,000 - \$100,000). More specifically, variable G is the lesser of Adam's net taxable capital gains for the year (i.e., \$950,000) and Adam's net taxable capital gains from the Opco shares sold to the WC for the year (i.e., \$1,000,000). Therefore, variable G is \$950,000.

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

The amount calculated under the formula " $G - H$ " under paragraph (b) is \$950,000 (i.e., \$950,000 - nil).

The maximum amount that Adam may claim for his Opco shares under subsection 110.62(2) is the lesser of the amounts under paragraph (a) (i.e., \$750,000) and (b) (i.e., \$950,000). Adam may therefore claim the WCCGE for his Opco shares in the amount of \$750,000 in computing his taxable income for his 2025 taxation year.

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

Step 2 – Calculate LCGE amount

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

Paragraph (a):

For the 2025 taxation year, the LCGE limit is \$1,250,000. It follows that the amount corresponding to paragraph (a) is \$625,000.

Paragraph (b):

The cumulative gains limit at the end of 2025 is \$250,000 (from variable A of the annual gains limit – see below).

Paragraph (c):

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

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

(a) Adam's net taxable capital gains (except any portion related to a WCCGE). Thus, the amount under paragraph (a) is \$200,000 (\$950,000 - \$750,000); and

(b) Adam's net taxable capital gains from the disposition of Opco shares (\$1,000,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the WCCGE. Thus, the amount under paragraph (b) is \$250,000 (\$1,000,000 - \$750,000).

Consequently, variable A is the lesser of paragraph (a) (i.e., \$200,000) and paragraph (b) (i.e., 250,000), therefore \$200,000.

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

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

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

Therefore, variable B is nil.

Consequently, the annual gains limit is \$200,000 (\$200,000 – nil).

Paragraph (d):

Paragraph (d) is the net taxable capital gains under paragraph 3(b), if the only properties referred to in that paragraph were properties that, at the time they were disposed of, were the QSBC shares (\$1,000,000). However, under new subsection 111.1(2), no amount may be claimed under the LCGE in respect of a taxable capital gain that has been deducted under the WCCGE. Consequently, paragraph (d) is \$250,000 (\$1,000,000 - \$750,000).

In computing Adam's taxable income for the 2025 taxation year, he may claim the LCGE under subsection 110.6(2.1) on his taxable capital gain resulting from the sale of the Opco shares an amount not exceeding the

least of paragraphs (a) (i.e., \$625,000), (b) (i.e., \$250,000), (c) (i.e., \$200,000) and (d) (i.e., \$250,000), equal to \$200,000.

Step 3 – Conclusion

Adam's taxable capital gains for the year from the sale of Opco shares is \$1,000,000. He also has taxable capital gains from the sale of portfolio shares of \$100,000 and allowable capital losses from the sale of other portfolio shares of \$150,000. The total deductions claimed for the Opco shares is \$950,000 (\$750,000 under the WCCGE and \$200,000 under the LCGE). The \$50,000 reduction in these exemptions reflect the allowable capital losses incurred in the year that exceeds taxable capital gains from sources unrelated to the QSBC shares (i.e., \$150,000 - \$100,000), that offset the remaining taxable capital gains from these share dispositions. This reduction ensures that the WCCGE and LCGE are not used to shelter other taxable income (such as Adam's employment income).

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

This amendment is deemed to come into force on August 12, 2024.

Disqualifying event

ITA
110.62(3)

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

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

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

Paragraph 110.62(3)(b) provides relief to a worker cooperative or qualifying cooperative business, in certain circumstances, from the tax consequences of a disqualifying event where there is a distribution of business assets to satisfy creditors. Specifically, paragraph 110.62(3)(b) will not apply if the underlying active business of a qualifying cooperative business or of a worker cooperative has ceased to be carried on due to the disposition of all the assets that were used to carry on the business in order to satisfy debts owed to creditors of the worker cooperative (or of a qualifying cooperative business controlled by the worker cooperative). Such a liquidation event would presumably be beyond the control of the worker cooperative (or the qualifying cooperative business) and would leave the worker cooperative without the ability to pay an additional income tax liability. A taxpayer seeking to use a sale to a worker cooperative to rely on this exception in order to liquidate a business on a tax-free basis would be subject to the existing anti-avoidance rule under subsection 84(2) and to the "qualifying cooperative conversion" requirements under paragraph (c) of the definition in subsection 248(1) that a taxpayer deal at arm's length and not retain any right or influence that, if exercised, would allow the taxpayer to control, directly or indirectly in any manner whatever, the subject corporation or any purchaser corporation.

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

Example 1 – Asset lease to an arm's length party

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

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

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

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

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

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

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

Consequences of a disqualifying event

ITA
110.62(4)

New subsection 110.62(4) provides the consequences for a worker cooperative of a disqualifying event (within the meaning of subsection 110.62(3)).

If the disqualifying event occurs within 24 months of the disposition time for the qualifying cooperative conversion, new paragraph (a) deems the capital gains deduction provided under subsection (2) to have never applied in respect of the subject shares disposed of under the qualifying cooperative conversion. See the commentary to paragraph 152(4)(b.941) for information regarding the 3-year extension of the normal

reassessment period for an individual in respect of a deduction claimed under subsection (2), and subsection 160(1.7) regarding joint and several liability of the parties to an election under paragraph 110.62(1)(e) if the deduction under subsection (2) is denied.

If the disqualifying event occurs any time between the day that is 24 months after the disposition time for the qualifying cooperative conversion and 8 years from that time, new paragraph (b) deems the worker cooperative to have realized a capital gain equal to the elected amount (within the meaning of clause (1)(e)(ii)(A)) included in the joint election referred to in paragraph (1)(e), for the year in which the disqualifying event occurs. Consequently, the consequences of a disqualifying event under subsection (4) apply for up to 10 years after the disposition time for a qualifying cooperative conversion.

Example

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

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

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

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

Anti-avoidance

ITA
110.62(5)

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

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

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

Failure to report capital gain

ITA
110.62(6)

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

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

Deduction not permitted

ITA
110.62(7)

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

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

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

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

Deduction not permitted

ITA
110.62(8)

New subsections 110.62(8) and (9) are anti-avoidance rules to prevent the conversion of dividend income into exempt capital gains of individuals. These rules are intended to prevent corporations from issuing shares that have attributes designed to facilitate the realization of the yield by way of a capital gain rather than by way of dividends. These rules would apply, for example, to preferred shares that do not pay dividends or pay relatively low dividends but that are retractable or redeemable at a substantial premium. An individual will be denied the

deduction under subsection (2) with respect to capital gains realized on a disposition of those types of shares. This rule will not apply, however, in the case of prescribed shares (within the meaning of subsection 110.6(8)).

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

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

Average annual rate of return

ITA
110.62(9)

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

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

Deduction not permitted

ITA
110.62(10)

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

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

Related persons, etc.

ITA
110.62(11)

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

Ordering rule

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

Personal trusts

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

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

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

Deemed relationship – spouse or common-law partner immediately before deceased individual's death

New paragraph 110.62(11)(c) clarifies that, for the purposes of section 110.62, a spouse or common-law partner of a particular individual includes another individual who was a spouse or common-law partner of the particular individual immediately before the death of the other individual. This is relevant for the conditions under subparagraphs (1)(b)(i) and (d)(ii) that an individual (or their spouse or common-law partner) must satisfy to claim a deduction under subsection (2).

Partnerships

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

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

Holding corporations

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

Issued shares

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

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

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

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

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

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

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

ITA
110.62(2.1)

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

This amendment is deemed to have come into force on August 12, 2024.

Clause 2

ITA
248(1)

"qualifying cooperative business"

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

Canadian-controlled Private Corporation

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

Governance and Board Representation

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

Paragraph (c) requires that the qualifying cooperative business deals at arm's length and is not affiliated with any person (other than a subject corporation referred to in paragraph (a) of the definition "qualifying cooperative conversion" that controlled and wholly-owned the corporation immediately before the time the trust acquired control of the corporation) or partnership that owned 50% or more of the fair market value of the shares of the capital stock or indebtedness of the corporation immediately before the time the WC acquired control of the corporation. The exception to the affiliated person condition in this definition is intended to accommodate qualifying cooperative conversions, under which the WC acquires the shares of a holding corporation that wholly-owns a subsidiary corporation, the employees of which are the intended qualifying cooperative workers of the WC.

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

"qualifying cooperative conversion"

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

Paragraph (a) provides requirements for the subject corporation being disposed of. Specifically, immediately before the disposition, all or substantially all the fair market value of the assets of the subject corporation must be derived, directly or indirectly, from assets (other than an interest in a partnership) that are used principally in an active business carried on by the subject corporation or by a corporation that is controlled and wholly-owned by the subject corporation. For example, the fair market value requirement provided in this paragraph could be met where a subject corporation is a holding corporation, the sole property of which is all of the shares of a wholly-owned subsidiary corporation all of whose assets are used principally in an active business carried on by the subsidiary.

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

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

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

"qualifying cooperative worker"

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

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

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

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

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

Paragraph (d) excludes as "qualifying cooperative workers" individuals who immediately before the time of a qualifying cooperative conversion to the cooperative, owned, directly or indirectly, together with any person or partnership that is related to or affiliated with the individual, shares

of the capital stock or indebtedness of the cooperative or a qualifying cooperative business controlled by the cooperative, the value of which is equal to or greater than 50% of the fair market value of the shares of the capital stock and indebtedness of the cooperative or the qualifying cooperative business controlled by the corporation.

Paragraph (e) excludes as "qualifying cooperative workers" individuals who claimed, or are related to an individual who claimed, a deduction under subsection 110.62(2) in respect

of a disposition of shares of the cooperative or a qualifying cooperative business controlled by the cooperative.

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

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

"worker cooperative"

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

Residence

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

Incorporation or continuance under a law governing cooperative corporations

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

Purpose of the cooperative

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

Control by worker members

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

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

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

At least 75% of employees are members of the cooperative

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

Membership

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

Governance

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

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

Paragraph (h) prohibits more than 40% of the directors of the cooperative from consisting of individuals each of whom, immediately before the time of a qualifying cooperative conversion that involved the cooperative, owned, directly or indirectly, together with any person or partnership that is related to or affiliated with the director, 50%

or more of the fair market value of the shares of the capital stock or indebtedness of the cooperative or a qualifying cooperative business (as defined under subsection 248(1)) controlled by the cooperative.

Distribution of surplus earnings

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

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

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

Non-Compliance with Information Requests

Clause 1

Information gathering

ITA
231.1(1)

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

A "listed international agreement" is defined in subsection 248(1) to mean the *Convention on Mutual Administrative Assistance in Tax Matters*, concluded at Strasbourg on January 25, 1988, as amended from time to time by a protocol or other international instrument as ratified by Canada and a comprehensive tax information exchange agreement that Canada has entered into, and that has effect, in respect of another country or jurisdiction.

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

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

Information or document

ITA
231.1(1)(f)

Subsection 231.1(1) is also amended to add new paragraph (f) to the powers granted to authorized persons. New paragraph (f) confirms that an authorized person may require a taxpayer or any other person to provide and deliver any information or additional information including a return of income or a supplementary return, or any document. The authorized person may require a taxpayer or any other person to provide this additional information in a reasonable manner and within a reasonable period of time.

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

Not applicable to unnamed persons

ITA
231.1(4)

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

This amendment comes into force on royal assent.

Clause 2

Requirement to provide documents or information

ITA
231.2(1)

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

Subsection 231.2(1) is amended to confirm that the Minister may by notice require that any person provide information or documents within such reasonable time and in such reasonable manner as is stipulated in the notice.

Judicial authorization

ITA
231.2(3)(b)

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

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

This amendment comes into force on royal assent.

Clause 3

Documents and information – oath or affirmation

ITA
231.41

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

This amendment comes into force on royal assent.

Clause 4

Copies

ITA
231.5

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

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

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

This amendment comes into force on royal assent.

Clause 5

Compliance

ITA
231.51

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

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

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

This amendment comes into force on royal assent.

Clause 6

Definition of foreign-based information or document

ITA
231.6(1)

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

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

Requirement to provide foreign-based information

ITA
231.6(2)

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

Subsection 231.6(2) is amended to provide that an authorized person may require a taxpayer or any other person to provide this additional information in such reasonable manner and within such reasonable period of time as is stipulated in the notice.

Notice

ITA
231.6(3)(a)

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

Powers on review

ITA
231.6(5)

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

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

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

ITA
231.6(7)

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

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

Consequence of failure

ITA
231.6(8)

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

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

This amendment comes into force on royal assent.

Clause 7

Compliance order

ITA
231.7(1)

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

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

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

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

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

Penalties

ITA
231.7(6)

New subsection 231.7(6) is added to provide that if an order has been issued by a judge under subsection (1) with respect to a taxpayer's failure to comply with a requirement under section 231.1, 231.2 or 231.6 in respect of a taxation year of the taxpayer, the taxpayer is

liable to a penalty of up to 10% of the aggregate amount of tax payable by the taxpayer under this Act for each taxation year of the taxpayer in respect of which the order relates.

New subsection 231.7(6) only applies if the order relates to a taxpayer's failure to comply with a requirement in respect of a taxation year of the taxpayer. As such, the penalty does not apply if an order is obtained in respect of a person's failure to provide access, assistance, information or a document in respect of the taxation year of another taxpayer. In other words, the penalty is not applicable in the context of a third-party request for information.

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

Penalty does not apply

ITA
231.7(7)

New subsection 231.7(7) is added to provide that a penalty under subsection (6) may not be imposed upon a taxpayer in specified circumstances.

Paragraph 231.7(7)(a) stipulates that a penalty under subsection (6) may not be imposed upon a taxpayer in respect of their failure to comply with a requirement to provide information, documents or to answer questions if one of the reasons for not complying with the requirement was the taxpayer's reasonable belief that the information, documents or answers were protected from disclosure from solicitor-client privilege. As such, if it is ultimately determined that privilege did not exist, but that there was a reasonable belief that it did, no penalty under subsection (6) would be imposed.

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

Make application at any time

ITA
231.7(8)

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

Assessment

ITA
231.7(9)

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

Requirement to vacate or vary assessment

ITA
231.7(10)

New subsection 237.1(10) is added to provide that if a taxpayer objects to an assessment of a penalty made under subsection (9), the Minister must vacate or vary the assessment if they determine that the penalty is, in the circumstances, disproportionate or unfair, and they may reduce the amount of the penalty or provide any other relief that they deem appropriate.

This amendment comes into force on royal assent.

Clause 8

Time period not to count

ITA
231.8(1)

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

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

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

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

When finally disposed of

ITA
231.8(2)

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

This amendment comes into force on royal assent.

Clause 9

Overview

ITA
231.9

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

Notice of non-compliance

ITA
231.9(1)

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

Contents of notice of non-compliance

ITA
231.9(2)

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

Notice

ITA
231.9(3)

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

Request for review

ITA
231.9(4)

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

Minister's review

ITA
231.9(5)

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

When required to set aside

ITA
231.9(6)

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

Notice deemed vacated

ITA
231.9(7)

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

Application for review of decision

ITA
231.9(8)

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

Powers on review

ITA
231.9(9)

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

When notice vacated

ITA
231.9(10)

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

When notice outstanding

ITA
231.9(11)

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

Penalty

ITA
231.9(12)

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

Reasonable belief that privileged

ITA
231.9(13)

New subsection 231.9(13) provides that no person sent or served with a notice of non-compliance in respect of a requirement or notice to provide information, documents or to answer questions under subsection (1) is liable to

a penalty if one of the reasons for the person not complying with the requirement or notice was their reasonable belief that the information, documents or answers were protected from disclosure by solicitor-client privilege.

Assessment

ITA
231.9(14)

New subsection 231.9(14) empowers the Minister of National Revenue to assess the penalty provided for under subsection (12) and provides that the administrative provisions of Division I and J will apply, with such modifications as the circumstances require, in respect of the assessment as though it had been made under section 152.

This amendment comes into force on royal assent.

Excessive Interest and Financing Expenses Limitation Rules

Clause 1

ITA
18.2

Section 18.2, together with section 18.21 and paragraph 12(1)(1.2), is the core rule of the excessive interest and financing expenses limitation (EIFEL) regime.

Definitions

ITA
18.2(1)

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

"Canadian regulated energy utility business"

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

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

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

entity does not include an entity described in paragraph (d) of that definition, namely a corporation all the shares of which are held by governments or other government entities.

"exempt interest and financing expenses"

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

Pursuant to variable A of the definition "interest and financing expenses", exempt interest and financing expenses are not included in a taxpayer's interest and financing expenses. Accordingly, they are not subject to a deduction denial under subsection 18.2(2) or an income inclusion under paragraph 12(1)(1.2).

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

The definition of "exempt interest and financing expenses" is amended to add two exemptions to the EIFEL rules.

This involves amending the preamble of the definition to clarify that the conditions of the exemptions are in respect of the person or partnership that enters into a borrowing from which the exempt interest and financing expenses are derived. In other words, where a partnership of which a taxpayer is a member enters into the borrowing, the partnership (not the taxpayer) is the borrower for purposes of determining eligibility under the new exemptions.

New paragraph (a) contains the existing rules relating to P3 infrastructure project; these rules are unaffected by the amendments. The definition of "exempt interest and financing expenses" is also amended to add new paragraphs (b) and (c):

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

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

- The expenses were paid or payable, before 2036, to either (i) a person who deals at arm's length with the borrower or (ii) to a particular person who does not deal at arm's length with the borrower if it may reasonably be considered that all or substantially all of the amount paid to this particular person was paid to one or more persons who deal at arm's length with the borrower (subparagraph (b)(i)).
- The expenses are reasonably attributable to the portion of the borrowing used directly by the borrower to acquire or build a purpose-built residential rental or convert a property into a purpose-built residential rental (subparagraph (b)(ii)). For more information on the new definition "purpose-built residential rental", please see the commentary for that definition in this subsection.
- At the time that the expenses were paid or payable, the property that is acquired, or that is in the process of being built or converted, is owned by the borrower, and is a purpose-built residential rental or is being built or converted to become one. This condition ensures, for instance, that a taxpayer cannot continue to

claim exempt interest and financing expenses on a borrowing that was used to build, acquire or convert a property held in a preceding taxation year that has since been disposed of by the taxpayer (subparagraph (b)(iii)).

- The taxpayer must file an election in respect of the borrowing for the year, by the filing due date of the taxpayer for the year, to have this paragraph apply. This election is made annually (subparagraph (b)(iv)).

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

- The expenses were paid or payable to either (i) a person who deals at arm's length with the borrower or (ii) a particular person who does not deal at arm's length with the borrower if it may reasonably be considered that all or substantially all of the amount paid to the particular person was then paid to one or more persons who deal at arm's length with the borrower (subparagraph (c)(i)).
- The expenses are reasonably attributable to the portion of the borrowing that is used for the purpose of gaining or producing income from a Canadian regulated energy utility business carried on directly by the borrower (subparagraph (c)(ii)). For more information on the new definition "Canadian regulated energy utility business", see the commentary on that definition in this subsection.
- All or substantially all of the property of the borrower is used or held for the purpose of gaining or producing income from a Canadian regulated energy utility business and is situated in Canada (subparagraph (c)(iii)). To prevent this condition from negatively impacting corporate transactions undertaken to allow losses of one group member to be offset against the income of another group member, an exception is provided for property acquired using borrowed money the interest from which is excluded interest (as defined in this subsection).
- The taxpayer elects, on or before the filing-due date of the taxpayer for the taxation year, or has already elected in a preceding taxation year, to have this paragraph apply. Under this condition, once the taxpayer has made an election for a particular taxation year, this condition has been satisfied for that particular taxation year and any subsequent taxation year (subparagraph (c)(iv)).

"purpose-built residential rental"

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

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

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

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

"residential rental unit"

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

Deeming rule

ITA
18.2(20)

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

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

Deeming rule

ITA
18.2(21)

New subsection 18.2(21) introduces a rule to provide that, for greater certainty, if the borrower (as referred to in the "exempt interest and financing expenses" definition) is a partnership that carries on a business or activity (such as a Canadian regulated energy utility business), a taxpayer that is a member of that partnership is not considered to be also carrying on that business solely because it is a member of that partnership.

Consistent with the broader EIFEL rules, the amendments to section 18.2 would apply to taxation years that begin on or after October 1, 2023. For purposes of subparagraphs (b)(iv) and (c)(iv) of the definition "exempt interest and financing expenses", the taxpayer would be permitted to file an otherwise late election within 90 days of royal assent of the enacting legislation to ensure that taxpayers are not prevented from relying on these exceptions only because the enacting legislation has not yet received royal assent.

Clause 2

Deeming rule

ITA
18.21(9)

Section 18.21 sets out the "group ratio" rules that are available to potentially reduce a taxpayer's excessive interest and financing expenses limitation under subsection 18.2(2). Section 18.21 is amended to add new subsection 18.21(9) to provide, in the context of the "group ratio", a deeming rule similar to new subsection 18.2(20) introduced as part of the Canadian regulated energy utility business exemption.

In general, the portion of net income reported in the "consolidated financial statements" of a "consolidated group" (both defined in subsection (1)) that can reasonably be considered to be earned by a borrower in respect of a borrowing ("borrower" and "borrowing" as within the meaning of the "exempt interest and financing expenses" definition in subsection 18.2(1)) that results in exempt interest and financing expenses of the borrower are excluded from the calculation of the consolidated group's group adjusted net book income.

New subsection 18.21(9) introduces a deeming rule for a taxpayer that is a member of a consolidated group that elects in a taxation year that ends in a relevant period (as defined in subsection (1)), or in any preceding taxation year, under subparagraph (c)(iv) of the definition "exempt interest and financing expenses" in subsection 18.2(1). In that case, any net income of the taxpayer reported in the consolidated financial statements of the consolidated group from a Canadian regulated energy utility business (as defined in subsection 18.2(1)) carried on by the taxpayer, or a partnership of which the taxpayer is a member, will be deemed to be earned by the taxpayer in

respect of a borrowing that results in exempt interest and financing expenses of the taxpayer. In other words, where such an election has been made in a year, any net income of the taxpayer, reported in the consolidated financial statement, from a Canadian regulated energy utility business carried on by the taxpayer, or carried on by a partnership of which the taxpayer is a member, will be excluded from the consolidated group's group adjusted net book income for the year and for all subsequent years.

Clause 3

Borrowed Money

ITA
20(3)

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

Subsection 20(3) ensures continuity of purpose in respect of money borrowed to repay money previously borrowed. For the purposes of the provisions of the Act set out in subsection 20(3), the borrowed money is treated as having been used for the same purpose as that of the money previously borrowed but repaid. Subsection 20(3) is amended to add a reference to the definition "exempt interest and financing expenses" in subsection 18.2(1) in order to make this subsection also apply for the purposes of that definition. The "exempt interest and financing expenses" definition is relevant to the interest deductibility rules in section 18.2 and provides that certain amounts may be exempt from those restrictions to the extent such amounts are in respect of P3 projects, purpose-built residential rentals, or a Canadian regulated energy utility business.

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

Substantive CCPCs

Clause 1

ITA
55(5)(c)

Paragraph 55(5)(c) provides that the income earned or realized by a corporation ("safe income") for the period in which it was a private corporation is its income otherwise determined for the period without deducting amounts under former section 37.1 or former paragraph 20(1)(gg) (both now repealed). These existing adjustments to safe income are moved to new subparagraph (i).

New subparagraph (ii) is also added for taxation years that begin on or after April 7, 2022, consequential upon the introduction of new paragraph (h) of the "capital dividend account" (CDA) definition in subsection 89(1) which addresses the integration of certain after-tax earnings of foreign affiliates repatriated to a corporation resident in Canada. To prevent double counting of the same earnings in both safe income and CDA, new subparagraph 55(5)(c)(ii) specifies that safe income is determined on the assumption that any amount deductible by a corporation under section 113 and included in its CDA under paragraph (h), was not included in its income.

This amendment applies to taxation years that begin on or after April 7, 2022.

Clause 2

Definitions

"capital dividend account"

The "capital dividend account" (CDA) is a mechanism intended to achieve integration by generally allowing amounts that have borne a sufficient level of tax at the corporate level to flow through a private corporation without attracting an extra level of tax. To the extent that a private corporation has a CDA balance, it may generally elect to treat dividends that it pays as capital dividends. Capital dividends may be received tax-free by the corporation's shareholders.

Consequential to changes to the definition of "relevant tax factor" (RTF), new paragraph (h) is added to the definition of CDA to address the integration of certain earnings of foreign affiliates as they are repatriated to and distributed by Canadian-controlled private corporations (CCPCs) and substantive CCPCs to their individual shareholders.

Under the current rules, amounts repatriated from foreign affiliates to CCPCs and distributed to individual shareholders are generally integrated through the system of deductions available for dividends received from foreign affiliates in section 113 and through the "general rate income pool" (defined in subsection 89(1), and from which CCPCs may distribute eligible dividends). However, due to the new RTF for CCPCs and substantive CCPCs, the current rules would not effectively integrate such amounts.

To address integration, new paragraph (h) provides additions to the CDA of a CCPC or a substantive CCPC. The amount added to CDA approximates the portion of certain after-tax earnings repatriated to the corporation from its foreign affiliate to the extent such earnings had been subject to a notional tax rate of 52.63 per cent (represented by the new "relevant tax factor" of 1.9 applicable to such corporations). This addition to the CDA represents after-tax income that was subject to tax at a rate approximating the highest combined federal and provincial personal income tax rate and therefore, to achieve integration, should not be subject to additional Canadian income tax upon its distribution to the corporation's Canadian resident individual shareholders.

More specifically, new paragraph (h) provides additions to the CDA equal to the total of all amounts each of which is, if the corporation was a CCPC throughout the year or a substantive CCPC at any time in the year,

- an amount deductible under paragraph 113(1)(a.1) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate less the amount determined under sub-subclause 113(1)(a.1)(ii)(A)(II)1 in respect of the dividend (i.e. the non-taxable portion of hybrid surplus plus the after-tax amount of the taxable portion of hybrid surplus that was subject to sufficient foreign tax, as determined based on the RTF of 1.9, less any foreign withholding tax paid in respect of the dividend prescribed to have been paid out of hybrid surplus), and
- the total of the amounts deductible under paragraphs 113(1)(b) and (c) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate if
 - no election was made by the corporation for the particular taxation year under subsection 93.4(3) with respect to that amount, or
 - an election was made under subsection 93.4(3), to the extent that the amount was determined under paragraph 93.4(3)(c) less the amount determined under clause 113(1)(c)(i)(A) in respect of the dividend (i.e. the after-tax amount of the taxable surplus that was subject to sufficient foreign tax, as determined based on the RTF of 1.9, plus the after-tax amount of withholding tax-sheltered amounts).

For amounts deductible under paragraphs 113(1)(b) and (c) in computing the taxable income of the corporation for the particular taxation year in respect of a dividend received on a share of the capital stock of a foreign affiliate where an election under subsection 93.4(3) has been made, the amounts determined under paragraph 93.4(3)(b) would have been subject to the higher RTF of 4 and would not have borne a sufficient level of tax at

the corporate level to justify being included in a corporations' CDA; such amounts would thus instead be added to the corporation's general rate income pool.

These amendments apply to taxation years that begin on or after April 7, 2022.

For more information, see the commentary on the definition of "general rate income pool" in subsection 89(1), section 93.4 and the definition "relevant tax factor" in subsection 95(1).

"general rate income pool "

The definition "general rate income pool" (GRIP) in subsection 89(1) of the Act is relevant for determining the extent to which a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation can pay eligible dividends in any given taxation year. Generally, a corporation's GRIP reflects the amount of its after-tax income that was subject to tax at the general corporate tax rate.

Existing paragraph (b) of variable E of the definition adds to GRIP all amounts in respect of dividends received from foreign affiliates of the taxpayer to the extent those amounts are deductible under any provision of section 113. A number of amendments are made in respect to this paragraph.

First, paragraph (b) of variable E is amended consequential to the amendment to the definition "relevant tax factor" (RTF) in subsection 95(1) and the resulting adjustment to the determination of the deduction for inter-corporate dividends paid to a CCPC or a substantive CCPC from the hybrid surplus or taxable surplus of a foreign affiliate under subsection 113(1). More specifically, paragraph (b) of variable E is amended to remove from the GRIP of a CCPC an amount equal to the deductions claimed in respect of amounts deductible under paragraphs:

- 113(1)(a.1) (i.e. repatriations of a foreign affiliate's hybrid surplus (representing certain capital gains)),
- 113(1)(b) (i.e. repatriations of a foreign affiliate's taxable surplus), unless an election was filed with respect to the amount under subsection 93.4(3) and to the extent that the amount was determined under paragraph 93.4(3)(b) (in other words, the portion of an amount deductible under paragraph 113(1)(b) that was calculated using the RTF of 4 will remain in GRIP),
- 113(1)(c) (in respect of the payment of withholding tax to a foreign government on inter-corporate dividends received from a foreign affiliate prescribed to be paid out of taxable surplus) (unless an election was filed with respect to the amount under subsection 93.4(3) and to the extent that the amount was determined under paragraph 93.4(3)(b) (in other words, the portion of an amount deductible under 113(1)(c) that was calculated using the RTF of 4 will remain in GRIP)).

The integration of these amounts will now be addressed through the capital dividend account. For more information, see the commentary on the definition "capital dividend account" in subsection 89(1), section 93.4, and the definition "relevant tax factor" in subsection 95(1).

Second, the amount that can be added to a deposit insurance corporation's GRIP with respect to amounts deductible under section 113 is modified to better represent the amount of the after-tax earnings repatriated to the corporation from a foreign affiliate. This is accomplished by removing the amount of foreign withholding tax paid with respect to the dividend from the amount that is added to GRIP under variable E of the definition. This amendment more accurately reflects the after-tax amount determined under the general corporate rate and that remains on hand for distribution.

These amendments apply to taxation years that begin on or after April 7, 2022.

Third, paragraph (b) of variable E is amended to exclude amounts deductible under paragraph 113(1)(d) or subsection 113(2), both of which represent *de facto* returns of capital rather than true dividends.

This amendment applies to taxation years that begin on or after August 9, 2022.

Clause 3

Specified provisions for subsection (1)

ITA
93.1(1.1)

Where a Canadian-resident corporation owns shares of a non-resident corporation through a partnership, subsection 93.1(1) applies in determining whether the non-resident corporation is a foreign affiliate of the Canadian-resident corporation for the purposes of certain provisions of the Act and Regulations. In those circumstances, subsection 93.1(1) provides a look-through rule that deems the Canadian corporation to own its proportionate number of the non-resident corporation's shares based on the relative fair market value of its interest in the partnership. The rule also applies where a foreign affiliate of the Canadian corporation owns shares of another non-resident corporation through a partnership.

Subsection 93.1(1.1) lists the purposes for which the look-through rule in subsection 93.1(1) applies. Paragraph 93.1(1.1)(a) is amended by adding a reference to section 93.4 (other than subsection 93.4(2)) to ensure that foreign affiliate status can flow through a partnership for the purposes of the new elective relieving regime with respect to foreign accrual business income earned by an affiliate.

This amendment generally applies to taxation years that begin after 2025. However, as section 93.4 applies to earlier taxation years where an election is filed under subsection 93.4(4) or (5), the amendments to subsection 93.1(1.1) apply to earlier taxation years where an election is filed under subsection 93.4(4) or (5). For more information, see the commentary on those subsections.

Clause 4

Foreign accrual business income

ITA
93.4

Overview

Neutrality is a fundamental principle of Canadian tax policy. The Canadian income tax system aims to achieve neutrality by ensuring that income earned through a corporation is taxed at roughly the same rate as income that is earned directly by a Canadian resident individual. This objective is commonly referred to as integration.

To encourage business investment and growth, the business income of a corporation is subject to a low rate of tax in the corporation and is integrated only once dividends are paid out to shareholders. In contrast, the "aggregate investment income" (AII) of Canadian-controlled private corporations (CCPCs) and substantive CCPCs (SCCPCs) is subject to additional refundable tax that approximates the highest marginal tax rate payable by Canadian resident individuals. This ensures no tax deferral advantage can be obtained by Canadian resident individuals earning their investment income through a holding corporation rather than directly. This refundable tax forms part of a system of rules that link the taxation of income earned by corporations and their individual shareholders to achieve integration. The foreign accrual property income (FAPI) rules are a component of the system of integration.

Very generally, the FAPI rules aim to prevent Canadian taxpayers from gaining a tax deferral advantage from earning investment income and certain other types of highly mobile income through controlled foreign affiliates (i.e., generally, a non-resident corporation in which the taxpayer has a controlling interest). The rules do this by requiring a Canadian shareholder to include in its income for a taxation year its participating share of any controlled foreign affiliate's FAPI for the year on an accrual basis under subsection 91(1), regardless of whether such amounts are distributed to the Canadian shareholder. If the Canadian shareholder is a CCPC or SCCPC, any

FAPI amounts included under subsection 91(1) minus any deductions claimed under subsection 91(4) for the year are included in AII and subject to the same additional refundable tax described above.

To prevent double taxation, a "foreign accrual tax" (FAT) deduction is available under subsection 91(4) in respect of foreign taxes paid on FAPI that is included in a Canadian shareholder's income under subsection 91(1). The deductible amount is determined by grossing up the foreign taxes paid by the "relevant tax factor" (RTF), which is defined in subsection 95(1). The RTF definition is being amended to subject CCPCs, SCCPCs and certain partnerships to an RTF of 1.9, instead of the RTF of 4 that previously applied, in order to more accurately reflect the corporate tax rate (approximating the highest personal income tax bracket) that would otherwise apply to investment income earned directly by a CCPC or a SCCPC. Prior to the amendment, FAT of \$25 on FAPI of \$100 was sufficient to eliminate any FAPI inclusion. With the new RTF of 1.9, each dollar of FAT now provides CCPCs, SCCPCs and certain partnerships with approximately half of the tax shelter it previously provided.

To account for the fact that FAPI, as defined in subsection 95(1), includes certain types of income that are not included in AII when earned directly by a CCPC or SCCPC in Canada, section 93.4 is introduced to provide an elective relieving regime that allows CCPCs and substantive CCPCs to preserve the higher RTF of 4 on amounts included under the new definitions "foreign accrual business income" (FABI) and "FABI surplus" contained in subsection 93.4(1). This elective regime is intended to improve integration by aligning the treatment of these amounts under the domestic and foreign anti-deferral regimes.

FABI and FABI surplus

Very generally, the FABI of a foreign affiliate for a taxation year consists of amounts included in the affiliate's FAPI that would not be AII if the affiliate were a CCPC (and all amounts included in its FAPI were from a source in Canada), but does not include amounts that are derived from direct or indirect payments to the affiliate that erode income of a non-arm's length taxpayer that would otherwise have been taxed at a high rate or that reduce the FAPI (other than FABI) of a foreign affiliate. Thus, a payment received by the affiliate will be treated as FAPI (other than FABI) and be subject to the RTF of 1.9 if:

- it is made by a payer that is
 - a taxpayer of whom the affiliate is a foreign affiliate, or a person not dealing at arm's length with the affiliate or with any taxpayer of whom the affiliate is a foreign affiliate,
 - a foreign affiliate of a taxpayer of whom the affiliate is a foreign affiliate or of another taxpayer that does not deal at arm's length with such a taxpayer or with the affiliate, or
 - a partnership any member of which is a person or partnership listed above, and
- the payment is deductible in computing the income of the payer that would otherwise be taxable at a rate that approximates the highest personal income bracket – for example, AII or FAPI (other than FABI).

A foreign affiliate's FABI surplus is the amount that would be the affiliate's taxable surplus if it was limited to:

- the affiliate's FABI;
- dividends received out of another affiliate's FABI surplus, less dividends paid out of the affiliate's own FABI surplus; and
- the active business earnings of the affiliate that are not FAPI but are included in its taxable surplus.

For more information, see the commentary on those definitions in subsection 93.4(1).

New elections

New section 93.4 provides CCPCs, SCCPCs and partnerships all the members of which (other than non-resident persons) are corporations in the year with two new relieving elections:

- an election under subsection 93.4(2) to use the RTF of 4 in calculating a deduction under subsection 91(4) in respect of FAT that can reasonably be regarded as attributable to the FABI of a controlled foreign affiliate; and

- an election under subsection 93.4(3) to use the RTF of 4 in calculating a deduction under paragraphs 113(1)(b) and (c) on the portion of any dividend that is considered to be paid out of a foreign affiliate's FABI surplus.

The new election under subsection 93.4(2) ensures that any FABI income inclusion under subsection 91(1) that may reasonably be regarded as attributable to FABI will be completely offset by a deduction under subsection 91(4) where the tax rate of the foreign tax that may reasonably be regarded as attributable to FABI is equal to or exceeds 25 per cent. Similarly, the election under subsection 93.4(3) results in a deduction under subsection 113(1) that completely offsets a dividend received from an affiliate out of its FABI surplus where the rate of foreign taxes imposed on the underlying income included in the FABI surplus is equal to or exceeds 25%. Each of these relieving elections allows Canadian shareholders to apply the RTF of 4, which more accurately reflects the combined federal and provincial corporate tax rate that would have applied had the FABI or the income included in FABI surplus been earned by the Canadian shareholder directly.

Consequential amendments are made to the definition "income" or "loss" in subsection 129(4) to ensure that the portion of an amount included in a corporation's income under subsection 91(1) (or deducted under subsection 91(4)) that can reasonably be considered to be attributable to the FABI of a controlled foreign affiliate is disregarded in determining the AII of a CCPC or SCCPC. Consequential amendments are also made to the definitions "capital dividend account" and "general rate income pool" in subsection 89(1) (as well as to paragraph 55(5)(c)) to ensure proper treatment of FABI and non-FABI amounts when they are earned by a foreign affiliate and repatriated to the Canadian corporation. Lastly, consequential amendments are made under new subsection 93.4(6) for the purpose of computing the "tax-free surplus balance" (as defined under subsection 5905(5.5) of the Regulations) of a foreign affiliate in respect of which an election has been made under new section 93.4. For more information, see the commentary on paragraph 55(5)(c), the definitions "capital dividend account" and "general rate income pool" in subsection 89(1), new subsection 93.4(6), and the definition "income" or "loss" in subsection 129(4).

Pre-2026 taxation years

New subsections 93.4(4) and (5) generally aim to extend the same treatment as described above with respect to amounts that would be included in FABI or FABI surplus, as the case may be, where such amounts arise in a taxation year that ends before the taxpayer's first taxation year beginning after 2025 and an election is made on or before the filing-due date for the taxpayer's first taxation year beginning after 2025.

Other amendments

To facilitate the application of certain deeming rules applicable in respect of partnerships that hold shares in a foreign affiliate, references to certain provisions in section 93.4 are added to paragraph 93.1(1.1)(a). Further, to allow late-filed elections under subsections 93.4(2) and (3) in certain circumstances, paragraph 600(b) of the Regulations is also amended to add references to those subsections. For more information, see the commentary on subsection 93.1(1.1) and on section 600 of the Regulations.

Effective date

Section 93.4 generally applies to taxation years that begin after 2025. However, section 93.4 also applies to earlier taxation years where an election is filed under subsection 93.4(4) or (5). For more information, see the commentary on those subsections.

Definitions

ITA
93.4(1)

"FABI surplus"

The definition "FABI surplus" in new subsection 93.4(1) is relevant where a taxpayer elects under new subsection 93.4(3), in determining the deductions available to a corporation resident in Canada under paragraphs 113(1)(b) and (c) in respect of foreign taxes paid on the earnings of a foreign affiliate when distributed to the corporation out of the affiliate's taxable surplus. It is also relevant in determining a foreign affiliate's "tax-free surplus balance" (discussed further in the commentary to new subsection 93.4(6)).

This definition draws on the existing definition "taxable surplus" but adapts the amounts included in that definition to limit it to the following items:

- the subject affiliate's FABI;
- dividends received out of another affiliate's FABI surplus, less dividends paid out of the affiliate's own FABI surplus; and
- the subject affiliate's net earnings or net loss from an active business carried on by it in a country.

Paragraph (a) of the definition includes in the subject affiliate's FABI surplus any inter-affiliate dividends received by the subject affiliate that are paid out of the payer affiliate's FABI surplus. Specifically, it includes the lesser of:

- the portion of any dividend included in the subject affiliate's taxable surplus under subparagraph (iii) of the description of A of the definition "taxable surplus" in subsection 5907(1) of the Regulations; and
- the proportion of the payer affiliate's FABI surplus at the time the dividend was paid that the dividend received is of the whole dividend referred to in paragraph 5900(1)(b) of the Regulations.

Paragraph (b) of the definition reduces the subject affiliate's FABI surplus for any dividends paid by the subject affiliate out of its FABI surplus and determines such amounts to be the lesser of:

- the portion of the whole dividend deemed under paragraph 5901(1)(b) of the Regulations to be paid out of the subject affiliate's taxable surplus; and
- the subject affiliate's FABI surplus at that time.

Paragraphs (a) and (b), in effect, each provide an ordering rule which treats amounts paid out of a foreign affiliate's taxable surplus as being paid out of its FABI surplus ahead of any taxable surplus other than FABI surplus.

Paragraph (c) of the definition provides that the computation of the subject affiliate's FABI surplus takes into consideration only two other categories of amounts that were included in computing the affiliate's net earnings and net loss.

The first category is amounts in respect of FAPI that can reasonably be considered to be attributable to the subject affiliate's FABI in respect of which an election has been made under subsection 93.4(2). By referencing amounts included in computing the subject affiliate's net earnings or net loss "in respect of FAPI" that are taken into consideration in computing its taxable surplus, this ensures the subject affiliate's FABI surplus is:

- reduced for any losses in respect of FABI (or "FABLs") and any income or profits tax paid that can reasonably be regarded as tax applicable to the subject affiliate's FABI, and
- increased for the subject affiliate's FABI and any income or profits tax refunds that can be reasonably be regarded as tax refunded in respect of the subject affiliate's FABI.

In other words, it is necessary to redetermine the amounts under paragraph (b) of the definitions "net earnings" and "net loss", and under subparagraph (b)(ii) of the definitions "taxable earnings" and "taxable loss", in subsection 5907(1) of the Regulations on the basis that each of those paragraphs and subparagraphs referred only to the affiliate's FABI or FABL for the year. While an election under subsection 93.4(2) will generally be made by a taxpayer in a taxation year when its controlled foreign affiliate has an amount of FABI, a FABL from one year is generally applied notionally against a FABI amount from another year for which an election is made and thus reduces the subject affiliate's FABI surplus in the year it is applied against the FABI amount. If, however,

the FABL is applied against FAPI amounts other than the subject affiliate's FABl (as would generally be the case where the FABL exceeds the portion of the subject affiliate's taxable surplus that is attributable to FABl), this will not reduce the affiliate's FABl surplus. The impact of income or profits tax paid or refunded on FABl surplus will generally follow the treatment of the income to which it can reasonably be regarded as applicable (as either FABl or FAPI (other than FABl)), thereby potentially requiring a detailed review of the application of FAPLs and FABLs over multiple years. For further details on the use of FABLs and its impact on a taxpayer's deduction under subsection 91(4), see the commentary on subsection 93.4(2).

The second category of amounts included under paragraph (c) of the "FABl surplus" definition is the affiliate's net earnings or net loss from an active business carried on by it in a country that are included in its taxable surplus. Notably, this ensures the FABl surplus of the subject affiliate is reduced for any income or profits tax paid in respect of such income and increased for any income or profits tax refunded to the affiliate that can be reasonably be regarded as tax refunded in respect of such income.

In certain situations, it is necessary to reset or establish (depending on the provision) the amount of a foreign affiliate's taxable surplus or taxable deficit under section 5905. The preamble of the definition "FABl surplus" requires a determination of the taxable surplus or deficit of the subject affiliate, which in turn requires a determination of the subject affiliate's opening taxable surplus or opening taxable deficit – factoring in only the items in paragraphs (a) to (c) of the "FABl surplus" definition. The opening taxable surplus or taxable deficit is then included under subparagraph (i) of the description of A or B, respectively, which feeds into the subject affiliate's FABl surplus. Similarly, any adjustments included in subparagraphs (iv) and (iv.1) of the description of A, and subparagraphs (v) and (vi) of the description of B, of the definition "taxable surplus" must be reasonably allocated between the affiliate's FABl surplus and taxable surplus amounts other than its FABl surplus. Paragraphs (a) to (c) of the "taxable surplus" definition remain unaltered for the purposes of the "FABl surplus" definition, meaning that the start and end dates for the period in respect of which a foreign affiliate's taxable surplus is being determined are the same as the dates applicable for determining its taxable surplus.

"foreign accrual business income"

The definition "foreign accrual business income" (or "FABl") in new subsection 93.4(1) is relevant when an election is made under new subsection 93.4(2). That relieving election provides an enhanced deduction under subsection 91(4) to a taxpayer that is a CCPC, SCCPC or a partnership all of the members of which (other than non-resident persons) are corporations, in respect of foreign taxes paid on the FAPI of a foreign affiliate of the taxpayer that is attributable to the affiliate's FABl and is included in the taxpayer's income pursuant to subsection 91(1). In other words, these provisions aim to identify the portion of the FAPI of a foreign affiliate that would have been subject to a high tax rate (approximating the highest marginal tax rate applicable to individuals) and the portion that would have been eligible for the lower corporate tax rates on active business income, had the income been earned in Canada by the affiliate, and to subject each of those portions to a similar tax treatment to what they would have received had they been earned directly by the taxpayer in Canada. This is achieved through the application of a different RTF to each portion.

Consequential amendments are made to the definition "income" or "loss" in subsection 129(4) to ensure that the portion of an amount included in a taxpayer's income under subsection 91(1) (or deducted under subsection 91(4)) that can reasonably be considered to be attributable to the FABl of a controlled foreign affiliate is disregarded in determining the AII of a CCPC or SCCPC. For more information, see the commentary on the definition "income" or "loss" in subsection 129(4).

In general terms, the FABl definition draws on the existing FAPI definition in subsection 95(1), but is limited to the portion of the FAPI of a foreign affiliate that (i) would not be AII if the affiliate were a CCPC (paragraph (a) of the definition) and (ii) did not arise as a consequence of certain base erosion payments (paragraph (b) of the definition).

Paragraph (a) of the definition limits FABl to the portion of the affiliate's FAPI that would not be included in the computation of the affiliate's AII. That is, each item of income or loss that is included in computing the affiliate's FAPI is evaluated on the basis of the AII definition in subsection 129(4). To account for the fact that the affiliate

is a non-resident corporation and may derive income from sources outside Canada, paragraph (a) contains two assumptions that aim to ensure a proper assessment of amounts that would be included in the computation of the affiliate's AII:

- Subparagraph (a)(i) provides that the determination of the amounts that would not be included in the computation of the affiliate's AII is to be made as if the affiliate were, at all times, a CCPC. The phrase "at all times" ensures the affiliate is always considered a CCPC such that any of its capital gains or capital losses included in computing its FAPI satisfy the requirements of the definition "eligible portion" in subsection 129(4) and are thus included in the affiliate's hypothetical AII under subparagraph (a)(ii) of the AII definition in subsection 129(4).
- Subparagraph (a)(ii) treats all income or loss amounts that were relevant in the computation of the affiliate's FAPI as if they were from a Canadian source. This is necessary because a foreign affiliate will generally carry on its activities outside of Canada and paragraph (a) of the definition "income" or "loss" in subsection 129(4), and consequently AII, excludes income or loss from certain sources outside Canada. This assumption ensures that it is only necessary to evaluate the character, and not the source, of the various income, loss, capital gain and capital loss amounts included in computing an affiliate's FAPI under this AII test.

The scope of the assumption in subparagraph (a)(ii) is limited to the source and does not extend to attribute any further specific characteristics to a person or partnership from whom the amount may arise. For example, where a foreign affiliate receives a dividend from a non-resident corporation, subparagraph (a)(ii) would apply, for the purpose of determining the affiliate's FAPI for a taxation year, to treat the dividend itself as coming from a Canadian source, but it would not treat the payer corporation as resident in Canada (which could be relevant in determining whether the dividend would be included in the affiliate's hypothetical AII).

Paragraph (b) of the FAPI definition ensures that an affiliate's FAPI derived from certain base erosion payments that would not have been included in the affiliate's AII is nonetheless excluded from FAPI. This is intended to prevent arrangements that would otherwise convert high-tax income of a taxpayer into FAPI through payments that would not be included in the affiliate's AII but that reduce the taxable income of a non-arm's length party or the FAPI (other than FAPI) of another foreign affiliate that would have otherwise been subject to a tax rate that approximates the highest personal income tax bracket. This anti-base erosion rule will apply to prevent an amount from being included in an affiliate's FAPI if:

- It is derived from an amount paid or payable by a CCPC, a substantive CCPC, a corporation carrying on a personal services business (as defined in subsection 125(7)), an individual resident in Canada (including trusts), another foreign affiliate or a partnership any member of which is one of those enumerated persons;
- If the payer, or a member of the payer partnership, is a person other than a foreign affiliate, the payer or member, as the case may be, is not a taxpayer of whom the affiliate is a foreign affiliate and does not deal at arm's length with the affiliate or any taxpayer of whom the affiliate is a foreign affiliate; and
- The amount paid or payable
 - is deductible in computing the AII of, or reduces the tax otherwise payable under section 123.3 for a taxation year by, the payer or the relevant member, as the case may be (where the payer or relevant member is a CCPC or substantive CCPC),
 - is deductible in computing the income for a taxation year of the payer or a relevant member, as the case may be (where the payer or relevant member is a corporation carrying on a personal services business or an individual resident in Canada), or
 - is deductible in computing the FAPI (other than FAPI) for a taxation year of the payer affiliate or the relevant member, as the case may be (where the payer or relevant member is another foreign affiliate).

Example

Facts

Canco, a CCPC, holds all of the issued and outstanding shares of CFA, a non-resident corporation that is a controlled foreign affiliate of Canco.

Canco provides a wide range of business IT services.

CFA operates a call center in a foreign country. This call center employs dozens of employees and provides support to Canco's clients. Canco pays an arm's length fee for the services provided to it by CFA.

Analysis

The income earned by CFA would be deemed to be from a separate business, other than an active business, under clause 95(2)(b)(i)(A), since the amounts paid in consideration for the services it provides to Canco are deductible in computing the income from a business carried on in Canada by Canco. As such, CFA's income would be FAPI. However, CFA's income would qualify as FABI because:

- CFA's income is not from a source that is property. Consequently, it would not be included in the computation of CFA's AII if CFA were a CCPC and the income were from a source in Canada; and
- Canco does not earn income from property. Consequently, it does not have AII and has no liability under section 123.3, such that the payments made by Canco to CFA cannot be considered to reduce Canco's AII or its tax otherwise payable under section 123.3 (in other words, the payments do not erode income of Canco that was subject to a high rate of tax).

As such, Canco could file elections under subsections 93.4(2) and (3) to benefit from the higher RTF of 4 when the income is earned and repatriated.

Example

Facts

Canco, a CCPC, holds all of the issued and outstanding shares of CFA1 and CFA2, two non-resident corporations that are controlled foreign affiliates of Canco.

Canco owns a number of real or immovable properties in Canada and operates a long-term rental business that generates rental income. Canco has one employee.

CFA1 owns a number of rental properties in a foreign country and operates a long-term rental business that generates rental income from third parties. CFA1 has two employees.

CFA2 provides services in support of Canco's and CFA1's rental businesses and receives management fees in consideration for those services from both corporations. CFA2 has one employee.

Analysis

Canco

Canco's rental business would likely qualify as a "specified investment business", as defined in subsection 125(7). Considering that the rental properties are located in Canada, the income earned from Canco's rental operation would be included in its AII and subject to the additional refundable tax under section 123.3.

CFA1

CFA1's rental operation would likely qualify as an "investment business" under the definition in subsection 95(1). As such, its rental income would qualify as "income from property" and be included in FAPI under variable A of the definition.

None of CFA1's rental income would be FABI as it would not satisfy the requirement under paragraph (a) of the FABI definition. Indeed, if CFA1 were a CCPC and its rental income were derived from a source in Canada, its income, like Canco's rental income, would likely be income from a "specified investment business" (from a source in Canada) and would be included in AII.

CFA2

The provision of services by CFA2 would be deemed to be a separate business, other than an active business, under clauses 95(2)(b)(i)(A) (for the portion provided to Canco) and (B) (for the portion provided to CFA1). As such, the management fees earned by CFA2 would be included in its FAPI under variable A of the FAPI definition.

The management fees earned by CFA2 would not be included in AII if it were a CCPC and the fees were derived from a source in Canada. Thus, its income would not be excluded from FABI under paragraph (a) of the definition.

However, the anti-base erosion rule in paragraph (b) of the FABI definition would prevent CFA2's management fee income from qualifying as FABI since that income is derived from a combination of:

- amounts paid by a non-arm's length CCPC (Canco) that reduce the tax otherwise payable under section 123.3 by the payer (in other words, the payments erode the AII of a non-arm's length CCPC); and
- amounts paid by another foreign affiliate of Canco (CFA1) that are deductible in computing the other FA's FAPI (other than FABI) (in other words, the payment erodes the FAPI (other than FABI) of another foreign affiliate in the corporate group).

Just as a foreign affiliate's FAPI is relevant in computing its taxable surplus, a foreign affiliate's FABI is relevant in determining its FABI surplus. The inclusion of a foreign affiliate's FABI in its FABI surplus is provided in subparagraph (c)(i) of the definition "FABI surplus". For more information, see the commentary to that definition.

"underlying FABI surplus tax"

The definition "underlying FABI surplus tax" in new subsection 93.4(1) is relevant (along with the definition "FABI surplus") where a taxpayer elects under new subsection 93.4(3), in determining the deductions available to a corporation resident in Canada under paragraphs 113(1)(b) and (c) in respect of foreign taxes paid on the earnings of a foreign affiliate when distributed to the corporation out of the affiliate's taxable surplus.

An affiliate's underlying FABI surplus tax is also relevant in determining its "tax-free surplus balance" under subsection 5905(5.5) of the Regulations because of new subsection 93.4(6). For more information, see the commentary to subsection 93.4(6).

This definition draws on the existing definition "underlying foreign tax" in subsection 5907(1) of the Regulations but includes only amounts that would be included in a foreign affiliate's underlying foreign tax if it were limited to amounts that can reasonably be regarded as applicable in respect of the affiliate's FABI surplus. Accordingly, in determining an affiliate's underlying FABI surplus tax for the purpose of determining the amount deductible under paragraph 113(1)(b), it is necessary to identify the income or profits tax paid to a government of a country by the affiliate that can reasonably be regarded as having been paid in respect of its FABI surplus and that was included in computing its underlying foreign tax. This could include, for example, the income or profits taxes paid on the affiliate's income earned from a real estate development business that is included in computing its FABI surplus, as well as withholding taxes paid by the affiliate on any FABI surplus dividends received by it from another foreign affiliate. Similarly, it is necessary to identify the income or profits tax refunded by a

government of a country to the affiliate that can reasonably be regarded as having been refunded in respect of its FABI surplus. Further, it is necessary to identify underlying foreign taxes applicable to dividends paid by the affiliate that can reasonably be regarded as underlying FABI surplus tax applicable in respect of dividends paid out of the subject affiliate's FABI surplus.

Similar to how FAPLs applied in determining a foreign affiliate's FAPI can impact which RTF applies to a taxpayer's deduction under subsection 91(4) in respect of FAT (depending on whether the FAPLs are in respect FABI, or FAPI (other than FABI)), an assessment of whether the FAPLs were notionally applied against earnings included in computing an affiliate's FABI surplus or to amounts other than its FABI surplus is required to determine the affiliate's "underlying FABI surplus tax". See the commentary to subsection 93.4(2) for more information regarding the determination of whether tax was paid in respect of FABI, or FAPI (other than FABI), including in the event of loss carryovers.

Where an election was previously made to disproportionately allocate underlying foreign tax to a taxable surplus dividend to increase the amount deductible in respect of the dividend under paragraph (b) of the definition "underlying foreign tax applicable" in subsection 5907(1) of the Regulations, it will be necessary to evaluate what portion of the underlying foreign tax applicable relates to underlying FABI surplus tax and determine the remaining underlying FABI surplus tax, if any, available for distributions after the disproportionate UFT election.

Example

Facts

1. Canco is a CCPC that holds all of the issued and outstanding shares of CFA, a controlled foreign affiliate of Canco.
2. Canco elected in 2026 under subsection 93.4(4), with the result it is deemed to have timely made the election under subsection 93.4(2) for each of its taxation years that begin before April 7, 2022.
3. A portion of CFA's FAPI in some taxation years before 2020 can reasonably be considered to be attributable to FABI.
4. In 2021, CFA paid a dividend of \$180, which was deemed to be paid out of its taxable surplus under paragraph 5901(1)(b) of the Regulations. At the time of the dividend payment, CFA's taxable surplus balance was \$270 (\$220 of which was reasonably considered to be in respect of FABI surplus and \$50 of which was amounts other than its FABI surplus) and its underlying foreign tax was \$30 (\$23 of which was reasonably considered to be underlying FABI surplus tax while \$7 was amounts other than its underlying FABI surplus tax).
5. Canco made an election to disproportionately allocate underlying foreign tax to the taxable surplus dividend to increase the amount deductible in respect of the dividend under paragraph (b) of the definition "underlying foreign tax applicable" in subsection 5907(1) of the Regulations. The elected amount was \$25.

Analysis

Under paragraph (b) of the definition "FABI surplus" in subsection 93.4(1), the dividend of \$180 deemed to be paid out of CFA's taxable surplus is treated as having been paid entirely out of its FABI surplus.

Absent a disproportionate underlying foreign tax election, the underlying foreign tax applicable to the dividend in 2021 would be \$20 and thus the underlying FABI surplus tax applicable to the dividend would also be \$20. The disproportionate underlying foreign tax election resulted in an additional \$5 of underlying foreign tax being applicable in respect of the dividend in 2021, and 100% of the dividend is considered to be paid out of the affiliate's FABI surplus. Thus, \$3 of that additional \$5 of underlying foreign tax applicable is considered underlying FABI surplus tax applicable.

Assuming there were no further increases or decreases to the affiliate's underlying foreign tax and underlying FABI surplus tax from 2021 to 2024, the affiliate's underlying foreign tax at the start of 2025 is \$5, \$0 of which is considered to be underlying FABI surplus tax.

Amounts deductible under subsection 91(4)

ITA

93.4(2)

New subsection 93.4(2) provides taxpayers with an election to use the RTF of 4 in calculating a deduction in respect of FAT under subsection 91(4) for a taxation year, to the extent that the FAT can reasonably be regarded as applicable to the FABI of a controlled foreign affiliate. If a taxpayer so elects, any FAPI inclusion under subsection 91(1) for the taxation year that may reasonably be regarded as attributable to FABI will be completely offset by a deduction under subsection 91(4) where the tax rate of the foreign tax that may reasonably be regarded as attributable to FABI equals or exceeds 25 per cent.

Paragraph (a) sets out a requirement to compute two separate deductions under subsection 91(4) – one deduction for any portion of the "income amount" (as defined in subsection 91(4)) that may reasonably be regarded as attributable to the FABI of any controlled foreign affiliate (referred to as the "FABI amount"), and the other deduction for any portion of the income amount other than the FABI amount (referred to as the "excess amount"). The FABI amount reflects FABI of controlled foreign affiliates whose shares are owned by the taxpayer either directly or indirectly through other controlled foreign affiliates.

Paragraph (b) provides that in determining the amount deductible under subsection 91(4) in respect of any FABI amount, each reference to "income amount" in subsection 91(4) is to be read as a reference to the "FABI amount" and the RTF of 4 applies in determining that deduction. This more accurately reflects the combined federal and provincial corporate tax rate that would have applied to this type of income had the FABI been earned by the Canadian shareholder directly.

Paragraph (c) provides that in determining the amount deductible under subsection 91(4) for any excess amount, each reference to "income amount" in subsection 91(4) is to be read as a reference to the "excess amount". The default RTF of 1.9 is used in determining the deduction under subsection 91(4) for any excess amount.

To determine the FAT applicable to each of the FABI amount and the excess amount of any controlled foreign affiliate, the first step is to determine the amount of FAPI included in income under subsection 91(1) that "may reasonably be regarded as attributable" to the affiliate's FABI. Notably, an affiliate can have an amount of FAPI that is comprised of any combination of (1) positive or negative amounts of FABI (i.e., a FABI amount or a FABL), and (2) positive or negative amounts of FAPI (other than FABI) (i.e., an excess amount or a FAPL). By replacing the "income amount" references in subsection 91(4) with references to the "FABI amount" or "excess amount", the reading rules in paragraph 93.4(2)(b) require an affiliate's FAPI and FAPLs to be attributed to either FABI (or FABL), or FAPI other than FABI (or FAPL other than FABL).

The second step requires allocating the FAT between the FABI amount and the excess amount. Just as the FAT definition in subsection 95(1) requires an assessment of whether an amount of income or profits tax may reasonably be regarded as applicable to income included under subsection 91(1), it is necessary to determine whether the FAT may reasonably be regarded as applicable to the FABI amount or the excess amount.

Allocating the FAT between the FABI amount and the excess amount requires a review of all the facts. It may also require looking at multiple taxation years, as illustrated by the example below.

As this election is made on an annual basis, in circumstances where a taxpayer has a FABI amount for the year that forms part of the FAPI imputed under subsection 91(1) but no deduction is being claimed under subsection 91(4) (e.g., where the foreign tax has not yet been paid), the taxpayer can nonetheless make an election in the year of the FAPI inclusion so that the FABI amount for the year is excluded from its AII. For more information, see the commentary to the definition "income" or "loss" in subsection 129(4).

Example

Facts

Canco is a corporation resident in Canada which holds all of the issued and outstanding shares of CFA, a controlled foreign affiliate of Canco.

CFA is resident in Country X, which imposes a corporate income tax at a rate of 20%.

CFA earns income that is included in FAPI, a portion of which is (in some years) FABI.

Canco files an election under subsection 93.4(2) for each of the taxation years in which CFA has an amount of FABI.

Over years 1 through 5, the situation can be summarized as follows:

Years 1 through 5						
	Year 1	Year 2	Year 3	Year 4	Year 5	Totals
FABI	(50)	50	20	60	-	80
FAPI (other than FABI)	-	100	-	40	(10)	130
Total FAPI / FAPL (before carryovers)	(50)	150	20	100	(10)	210

Analysis

The loss carryovers over the years can be summarized as follows:

Loss carryovers						
	Year 1	Year 2	Year 3	Year 4	Year 5	Totals
FABL carryover	-	(50)*	-	-	-	N/A
FAPL (other than FABL) carryover	-	(10)**	-	-	-	N/A
Income inclusion under subsection 91(1)	-	90	20	100	-	210

*Year 1 FABL carried forward to Year 2

**Year 5 FAPL carried back to Year 2

Deductions under subsection 91(4)

The amounts deductible under subsection 91(4) as a consequence of the elections made under subsection 93.4(2) are summarized in the following table and further described below:

Deductions under subsection 91(4)

	Year 1	Year 2	Year 3	Year 4	Year 5	Totals
91(1) inclusion attributable to FABI	-	-	20	60	-	80
91(1) inclusion attributable to FAPI (other than FABI)	-	90	-	40	-	130
FAT	-	(18)	(4)	(20)	-	(42)
RTF	-	1.9	4	4 / 1.9	-	N/A
Deduction under subsection 91(4)	-	(34.20)	(16)	(48) / (15.20)	-	(113.40)

Year 1

In Year 1, CFA realized a FABL of \$50, which constitutes a FAPL that is carried forward and applied against FAPI otherwise arising in Year 2. Although Canco has no FABI amount and does not elect under subsection 93.4(2) for Year 1, the \$50 FABL is nonetheless treated as a FABL and applied against FABI (as discussed below).

Year 2

In Year 2, CFA earned \$50 of FABl and \$100 of FAPI (other than FABl). However, the \$50 FABL from Year 1 and the \$10 FAPL (other than a FABL) from Year 5 are applied against the \$150 of FAPI otherwise arising in Year 2, with the result that Canco's income inclusion under subsection 91(1) for the year is equal to \$90. The FAT applicable to that \$90 income inclusion is equal to \$18.

Although CFA earned \$50 of FABl in Year 2, the \$50 FABL from Year 1 that is applied in Year 2 results in CFA having, on a cumulative basis over Years 1 and 2, no net income from FABl sources. Similarly, the \$10 FAPL applied in Year 2 results in CFA having \$90 of net income from FAPI (other than FABl) sources. Consequently, the \$18 of FAT in Year 2 may reasonably be regarded as applicable to Canco's income inclusion in respect of CFA's FAPI (other than FABl), and thus the RTF of 1.9 applies, resulting in a deduction to Canco of \$34.20 under subsection 91(4).

Year 3

In Year 3, CFA earns \$20 of FABl and pays \$4 of FAT, all of which may reasonably be regarded as applicable to Canco's income inclusion under subsection 91(1) in respect of CFA's FABl. Accordingly, in determining the amount deductible by Canco under subsection 91(4) – where that subsection is read in the manner set out in subsection 94.3(2) – \$20 is considered the FABl amount and the RTF of 4 applies to the \$4 of FAT, resulting in a deduction of \$16 under subsection 91(4).

Year 4

In Year 4, CFA earns \$60 of FABl and \$40 of FAPI (other than FABl) and pays \$20 of FAT. As the FAT was paid at the same 20 per cent rate in respect of all sources of FAPI, in applying subsection 91(4) in the manner set out in subsection 94.3(2), \$12 of the FAT can reasonably be regarded as applicable to the FABl amount, while \$8 of the FAT can reasonably be regarded as applicable to the excess amount. Consequently, the RTF of 4 applies to the \$12 of FAT, resulting in a deduction under subsection 91(4) of \$48 in respect of the FABl amount, while the RTF of 1.9 applies to the remaining \$8 of FAT, resulting in a deduction of \$15.20 in respect of the excess amount.

Year 5

In Year 5, CFA realizes a \$20 FAPL (other than FABL), which is carried back and applied against Year 2's FAPI. See the explanation under Year 2.

As noted above, the subsection 91(4) deduction is also relevant in determining a CCPC's or SCCPC's AII (for more information, see the commentary to the definition "income" or "loss" in subsection 129(4)). Similarly, the income or profits tax that can reasonably be regarded as applicable to an affiliate's FABl or amounts of FAPI (other than its FABl) is relevant in determining the applicable RTF when determining the amount deductible under paragraphs 113(1)(b) and (c) in respect of dividends paid by a foreign affiliate out of its FABl surplus or taxable surplus other than its FABl surplus to a corporation resident in Canada. For more information, see the commentary to the definition "underlying FABl surplus tax" in subsection 93.4(1).

Dividends received from foreign affiliates

ITA
93.4(3)

New subsection 93.4(3) provides taxpayers with an election to use the RTF of 4 in calculating a deduction under paragraphs 113(1)(b) or (c) in respect of the portion of any dividend paid out of the taxable surplus of a foreign affiliate that is considered to be paid out of the affiliate's FABl surplus. If a taxpayer so elects, specific rules in paragraphs 93.4(3)(a) to (c) apply in determining the deductions under paragraphs 113(1)(b) and (c).

Paragraph (a) determines the portion, of the dividend prescribed to be paid out of a foreign affiliate's taxable surplus, that is paid out of the affiliate's FABI surplus (referred to as the "FABI surplus dividend"). This paragraph, in effect, provides an ordering rule ensuring that a foreign affiliate's FABI surplus is distributed first, before taxable surplus amounts other than FABI surplus. For more information, see the commentary to the definition "FABI surplus" in subsection 93.4(1).

The overall aim of paragraph (b) is to allow for the RTF of 4 to be used to determine the deductions under paragraphs 113(1)(b) and (c) in respect of a FABI surplus dividend. It does so by modifying paragraphs 113(1)(b) and (c) and the RTF definition, as follows:

- Subparagraph (i) modifies the references in paragraphs 113(1)(b) and (c) to the taxable surplus portion of the dividend to refer solely to the FABI surplus dividend. This ensures that the limitations under subparagraphs 113(1)(b)(ii) and (c)(ii) are capped at the amount of the FABI surplus dividend. It also ensures that a deduction under paragraph 113(1)(c) in respect of the FABI surplus dividend is to be determined using only the non-business-income tax applicable to that portion of the dividend.
- Subparagraph (ii) provides that, in determining a deduction under paragraph 113(1)(b) in respect of a FABI surplus dividend, the amount prescribed to be the foreign tax applicable (as set out in paragraph 5900(1)(b) of the Regulations) consists only of the affiliate's underlying FABI surplus tax.
- Subparagraph (iii) modifies to the reading of the RTF definition in subsection 95(1), to allow the RTF of 4 to apply for deductions under paragraphs 113(1)(b) and (c) in respect of FABI surplus dividends.

Under paragraph (c), the RTF of 1.9 is to be used for the portion of the taxable surplus dividend other than the affiliate's FABI surplus dividend. This is achieved by modifying paragraphs 113(1)(b) and (c), as follows:

- Subparagraph (i) modifies the references in paragraphs 113(1)(b) and (c) to the taxable surplus portion of the dividend to refer solely to the portion of the taxable surplus dividend other than the FABI surplus dividend. This ensures that the limitations under subparagraphs 113(1)(b)(ii) and (c)(ii) are capped at the portion of the taxable surplus dividend other than the FABI surplus dividend. It also provides that a deduction under paragraph 113(1)(c) in respect of the portion of the taxable surplus dividend other than the FABI surplus dividend is to be determined using only the non-business-income tax applicable to that portion of the dividend.
- Subparagraph (ii) provides that, in determining a deduction under paragraph 113(1)(b) in respect of the portion of the taxable surplus dividend other than the FABI surplus dividend, the amount prescribed to be the foreign tax applicable (as set out in paragraph 5900(1)(b) of the Regulations) consists only of underlying foreign tax amounts other than the affiliate's underlying FABI surplus tax.

Applying the RTF of 4 in determining the deductions under paragraphs 113(1)(b) and (c) for distributions of FABI surplus, and the RTF of 1.9 for the deductions in respect of distributions of taxable surplus amounts other than FABI surplus, more accurately reflects the combined federal and provincial corporate tax rate that would have applied to the earnings underlying each type of distribution had they been earned by the Canadian shareholder directly.

Consequential amendments are also made to the definitions of "capital dividend account" and "general rate income pool" to improve the integration of a foreign affiliate's earnings as they are distributed through a corporate chain to the ultimate Canadian individual shareholder. For more information, see the commentary on the definitions "capital dividend account" and "general rate income pool" in subsection 89(1) and the definition "relevant tax factor" in subsection 95(1).

Pre-2023 taxation years

ITA
93.4(4)

While new section 93.4 generally applies for taxation years beginning after 2025, there are circumstances where a taxpayer may wish to elect under subsection 93.4(2) for each of its taxation years that begin before April 7,

2022 (referred to as "pre-2023 taxation years"). A taxpayer will be deemed to have timely made elections for the pre-2023 taxation years if the taxpayer makes an election under subsection 93.4(4) in prescribed form and manner by the filing-due date for its first taxation year or fiscal period that begins after 2025.

This deemed election for pre-2023 taxation years is intended to deal with two circumstances.

First, it addresses situations where a taxpayer included in computing its income its participating share of a controlled foreign affiliate's FAPI under subsection 91(1) for a taxation year beginning before April 7, 2022, and the FAPI may reasonably be regarded as attributable to FAPI of the taxpayer's controlled foreign affiliates, but the FAT is paid in a taxation year that begins on or after that date. In that case, this election allows the taxpayer to be deemed to elect under subsection 93.4(2) in order to use the RTF of 4 in determining the amount deductible under subsection 91(4) in the taxation year when it paid the FAT for the portion of the FAPI that may reasonably be regarded as attributable to FAPI included under subsection 91(1) for its taxation year beginning before April 7, 2022.

Second, this election also addresses situations where a foreign affiliate pays a dividend out of taxable surplus in a taxation year beginning on or after April 7, 2022, to a corporation that is a CCPC or a SCCPC, and the corporation wishes to apply the RTF of 4 in determining the amounts deductible under paragraphs 113(1)(b) and (c) in respect of the portion of the dividend that would be considered to be paid out of the affiliate's FAPI surplus if the affiliate were able to earn FAPI for taxation years beginning before April 7, 2022. This election causes the taxpayer to be deemed to elect under subsection 93.4(2) for the taxation years beginning before April 7, 2022, in order to satisfy the requirement under subparagraph (c)(i) of the definition "FAPI surplus" in subsection 93.4(1). This results in the taxpayer being considered to earn FAPI for those taxation years and thus accumulating FAPI surplus, in respect of which the taxpayer can apply the RTF of 4 on distributions in taxation years beginning on or after April 7, 2022.

Pre-2026 taxation years

ITA
93.4(5)

Similar to the election in subsection 93.4(4), a taxpayer can elect under subsection 93.4(5) to have an election under subsection 93.4(2), and subsection (3) as applicable, deemed to have been timely made for each of its taxation years that begins after April 6, 2022 and before 2026. This election is required to be filed by the taxpayer in prescribed form and manner by its filing-due date for its first taxation year or fiscal period that begins after 2025.

The expression "as applicable" in the preamble of this subsection acknowledges that an election under subsection 93.4(3) is not relevant for a taxpayer that is a partnership given the deeming rule in subsection 93.1(2), which deems each member of a partnership to receive its proportionate share of a dividend received by the partnership from a foreign affiliate of the member. Therefore, an election under subsection 93.4(2) will be applicable for a taxpayer that is a CCPC, SCCPC or partnership all the members of which (other than non-resident persons) are corporations, whereas an election under subsection 93.4(3) will be applicable only for a taxpayer that is a CCPC or a SCCPC.

The election in subsection 93.4(5) is separate from the one in subsection 93.4(4), which applies to taxation years that begin before April 7, 2022, in recognition that taxpayers may wish to be deemed to make elections under subsections 93.4(2) for taxation years that begin before April 7, 2022, but not for taxation years beginning after that date and before 2026. For example, a taxpayer that is a CCPC or SCCPC may prefer not to make an election under subsection 93.4(5) if the amounts deducted by the taxpayer under paragraphs 113(1)(b) and (c) in respect of a dividend received from a foreign affiliate have already been included in computing its CDA and the taxpayer has paid a capital dividend in respect of such amounts. To avoid having to recalculate its CDA and the potential Part III tax applying in respect of excess capital dividend amounts, the taxpayer may in those cases decide not to make an election under subsection 93.4(5).

Computation of tax-free surplus balance

ITA
93.4(6)

The "tax-free surplus balance" (or "TFSB") of a foreign affiliate is defined in subsection 5905(5.5) of the Regulations. It is a measure of the "good" surplus inherent in the affiliate and is relevant for purposes of determining the safe income of a corporation resident in Canada that holds shares of the affiliate, as well as for determining adjustments to the adjusted cost base, surpluses, and deficits of the affiliate or another foreign affiliate in the context of certain share transactions and corporate reorganizations. "Good" surplus is, generally, the aggregate of exempt surplus, the tax-free portion of the hybrid surplus, and the grossed-up amount of underlying foreign tax (i.e., taxes paid in respect of taxable surplus).

New subsection 93.4(6) contains special rules which apply when determining the TFSB of a foreign affiliate where a taxpayer has made an election under any of subsections 93.4(2) to (5) for a taxation year. The overall aim of this rule is to align the computation of a foreign affiliate's TFSB in respect of its FABI surplus and underlying FABI surplus tax (each defined in subsection 93.4(1)) with the treatment under subsection 93.4(3), by applying an RTF of 4 to gross up the affiliate's underlying FABI surplus tax in computing its TFSB. This is accomplished by modifying the computation of a foreign affiliate's TFSB to be determined as though subparagraph 5905(5.5)(b)(i) contained a modified formula. With this modified formula, the amount included in a foreign affiliate's TFSB at any time in respect of taxable surplus is the lesser of two amounts:

- The first amount is the aggregate of:
 - the amount that could be distributed out of the affiliate's FABI surplus free of tax, which is equal to the lesser of (i) its underlying FABI surplus tax grossed up by a factor equal to the RTF of 4 minus 1, and (ii) its FABI surplus at that time, and
 - the amount that could be distributed out of the affiliate's taxable surplus other than its FABI surplus free of tax, which is equal to the lesser of (i) its underlying foreign tax grossed up by a factor equal to the RTF of 1.9 minus 1, and (ii) its taxable surplus at that time,
- The second amount is the affiliate's taxable surplus minus any offsetting deficits.

Clause 5

Definitions

ITA
95(1)

The definition "relevant tax factor" (RTF) in subsection 95(1) is used in determining the Canadian tax relief provided in respect of foreign taxes imposed on the earnings of a foreign affiliate of a taxpayer.

Relief for foreign tax paid, based on the taxpayer's RTF, is provided

- under subsection 91(4), in respect of foreign tax paid on foreign accrual property income (FAPI) of a controlled foreign affiliate that is included in the taxpayer's income pursuant to subsection 91(1), or
- under section 113, in respect of foreign tax paid on earnings of a foreign affiliate that are repatriated to a corporation resident in Canada.

The RTF can also indirectly affect the taxation of distributions paid to the ultimate Canadian resident individual shareholder of a corporation, since amounts deductible under section 113 are added to certain corporations'

"general rate income pool" (which is relevant for determining the extent to which a Canadian-controlled private corporation (CCPC) or a deposit insurance corporation can pay eligible dividends in any given taxation year).

The existing definition provides that the RTF for a corporation (or a partnership all the resident members of which are corporations) is the reciprocal of the basic corporate tax rate less the general rate reduction (i.e., $1/(0.38-0.13)$, or 4). The RTF for individuals and for other partnerships is 1.9.

The RTF definition is amended to generally subject CCPCs, substantive CCPCs and partnerships one or more members of which are CCPCs or substantive CCPCs to the RTF of 1.9. The RTF of 1.9 more accurately reflects the corporate tax rate (approximating the highest personal income tax bracket) that would otherwise apply to investment income earned by a CCPC or a substantive CCPC.

An elective relieving regime is also introduced in section 93.4 to allow CCPCs and substantive CCPCs to preserve the high RTF of 4 on certain types of income that are included in FAPI and/or taxable surplus and that would generally not have been subject to the high tax rate on investment income had they been earned domestically rather than through a foreign affiliate. For more information, see the commentary on new section 93.4 and the amended definition of "income" or "loss" in subsection 129(4).

Consequential amendments are also made to the definitions of "capital dividend account" and "general rate income pool" to improve the integration of a foreign affiliate's earnings as they are distributed through a corporate chain to the ultimate Canadian individual shareholder.

The purpose of these amendments is to improve neutrality by further aligning the domestic and international anti-deferral regimes.

For more information, see the commentary on the definitions "capital dividend account" and "general rate income pool" in subsection 89(1), section 93.4 and the definition "income" or "loss" and "non-eligible refundable dividend tax on hand" in subsection 129(4).

These amendments apply to taxation years that begin on or after April 7, 2022.

Clause 6

Definitions

ITA
129(4)

The definitions "income" or "loss" in subsection 129(4) determine what income or loss from a source that is a property means for the purposes of determining a corporation's "aggregate investment income" (AII) for a taxation year. AII is relevant in establishing the corporation's surtax liability under section 123.3, the availability of the general rate reduction under section 123.4, and the "non-eligible refundable dividend tax on hand" balance.

Paragraph (b) of the definition "income" or "loss" provides that no account is to be taken of income or loss from a property that is incident to or pertains to an active business carried on by the corporation, or that is used or held by the corporation principally to gain or produce income from an active business.

Consequential on the introduction of the new elective relief mechanism with respect to "foreign accrual business income" (FABI) earned by a controlled foreign affiliate of a Canadian corporation in section 93.4, paragraph (b) is amended and reorganized to ensure that, where an election under subsection 93.4(2) has been filed by the corporation or by a partnership of which the corporation is a member (or of which the corporation is deemed to be a member under subsection 93.1(3), which provides a look-through rule for tiered partnership structures), no account is to be taken of the portion of an amount included in a corporation's income under subsection 91(1) (or

deducted under subsection 91(4)) to the extent that it can reasonably be considered to be attributable to the FABI of a controlled foreign affiliate.

More specifically, new clause (b)(iii)(A) is meant to ensure that, where an election under subsection 93.4(2) has been made, the "FABI amount" for the year under that subsection (i.e., the portion of the amount, if any, included in computing the taxpayer's income for the year under subsection 91(1) that may reasonably be regarded as attributable to the FABI of any controlled foreign affiliate) – which would generally not be included in AII had it been earned directly by the Canadian corporation – is not indirectly included in the corporation's AII through the foreign accrual property income (FAPI) regime. Similarly, new clause (iii)(B) aims to ensure that deductions claimed under subsection 91(4) in computing the corporation's income do not unduly reduce the corporation's AII if the deduction can reasonably be considered to be attributable to foreign accrual tax paid in respect of FABI.

For more information, see the commentary on subsection 93.4(2).

Example

Facts

Canco is a Canadian corporation which holds all of the issued and outstanding shares of CFA, a controlled foreign affiliate of Canco.

CFA earns income that is included in FAPI, a portion of which can (in some years) reasonably be considered to be attributable to FABI.

Over years 1 through 4, the situation can be summarized as follows:

	Years 1 through 4			
	Year 1	Year 2	Year 3	Year 4
FAPI (other than FABI)	100	-	-	30
FABI	-50	50	20	20
Total 91(1) inclusion	50	50	20	50
Foreign Accrual Tax	-10	-10	-4	-
Relevant Tax Factor	1.9	1.9	4	4
Total 91(4) deduction	-19	-19	-16	-

Analysis

Determining Canco's AII without the amendment to paragraph (b) of the "income" or "loss" definition

Without the amendment to paragraph (b) of the definition "income" or "loss", the following amounts – representing the difference between the amount included in computing Canco's income for the year under subsection 91(1) and the amount deducted in computing Canco's income for the year under subsection 91(4) – would be included in Canco's AII for each year pursuant to the new relevant tax factor rules:

Year 1: \$31

Year 2: \$31

Year 3: \$4

Year 4: \$50

Determining Canco's AII with the amendment to paragraph (b) of the "income" or "loss" definition

By virtue of new subparagraph (b)(iii) of the definition "income" or "loss" in subsection 129(4), the following amounts are included in Canco's AII for each year:

Year 1: \$31

In Year 1, Canco earned FAPI (other than FAB I) and generated a foreign accrual business loss (FABL). Thus, no portion of the amounts included and deducted in computing Canco's income under subsections 91(1) and (4), respectively, can reasonably be considered to be attributable to CFA's FAB I. Consequently, subparagraph (b)(iii) does not apply and the amount included in Canco's AII for the year is unchanged.

Year 2: \$31

In Year 2, CFA earned \$50 of FAB I, which is included in computing Canco's income for the year under subsection 91(1). However, since CFA had realized an equivalent FABL in Year 1, its net FAB I over the period is nil. It would thus be reasonable to consider that no portion of CFA's tax liability is attributable to FAB I, such that no election under subsection 93.4(2) could be made (hence the relevant tax factor of 1.9). Consequently, new subparagraph (b)(iii) would not apply and an amount of \$31 – representing the difference between the amount included in Canco's income for the year under subsection 91(1) and the amount deducted in computing Canco's income for the year under subsection 91(4) – would be included in Canco's AII for the year.

Year 3: \$0

In Year 3, Canco can file an election under subsection 93.4(2) and it is reasonable to consider that the entirety of the amounts included and deducted in computing Canco's income for the year under subsections 91(1) and (4), respectively, are attributable to CFA's FAB I. As such, both amounts will be disregarded in determining Canco's AII for the year. In other words, the amount of \$20 included in Canco's income under subsection 91(1) will not be included in Canco's AII and the amount of \$16 deducted in computing Canco's income under subsection 91(4) cannot be used to reduce Canco's AII for the year (if, for example, Canco had other sources of AII in the year, the \$16 deduction under subsection 91(4) could not be applied against it).

Year 4: \$30

In Year 4, Canco earns \$20 of FAB I and \$30 of FAPI (other than FAB I) and pays no tax. While the FAB I amount (i.e., the portion of an amount in respect of a share that has been included in computing the income of Canco under subsection 91(1) for a taxation year or for any of the 5 immediately preceding taxation years that can reasonably be regarded as attributable to the FAB I of CFA) is a cumulative amount, clause (iii)(A) only applies to disregard amounts added to the FAB I amount for the year, or in this case, \$20. Therefore, although no foreign tax was paid in the year, Canco could file an election under subsection 93.4(2) in order to ensure that an amount of \$20 is disregarded in calculating its AII for the year, resulting in an addition of \$30 to its AII for the year.

In the French version of the Act, the definitions "income" and "revenue" are also reorganized in order to better align with the English definitions.

This amendment applies to taxation years that begin on or after April 7, 2022.

Clause 7

Prescribed provisions for late elections

ITR
600

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

Paragraph 600(b) is amended to add a reference to subsections 93.4(2) to (5). For more information, see the commentary on new section 93.4.

This amendment applies to taxation years that begin after 2025.

Date modified:
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