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STANDING COMMITTEE ON BANKING,
TRADE AND COMMERCE, 1970/72.

Final report on the Summary
of 1971 tax reform legislation.

BIBLIOTHÈQUE DU PARLEMENT

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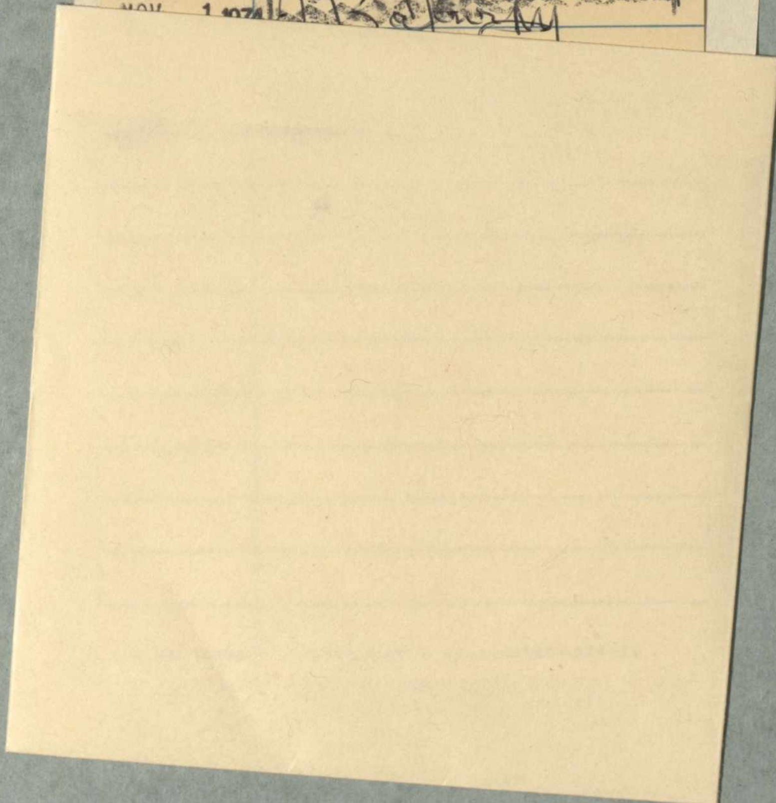

Mr. Paquette

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THE SENATE
CANADA

Monday, December 13, 1971.

STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

FINAL REPORT
ON
THE SUMMARY OF 1971 TAX REFORM LEGISLATION

The Honourable Salter A. Hayden, Q.C., Chairman

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MEMBERSHIP OF THE COMMITTEE

THE STANDING SENATE COMMITTEE ON BANKING
TRADE AND COMMERCE

The Honourable Salter A. Hayden, Chairman,

and

The Honourable Senators

Aird
Beaubien
Benidickson
Blois
Burchill
Carter
Choquette
Connolly (Ottawa West)
Cook
Croll
Desruisseaux
Everett
Gelinas
Giguere
Grosart
Haig
Hays
Isnor
Lang
Macnaughton
Molson
Smith
Sullivan
Walker
Welch
White
Willis

Ex officio members: Flynn and Martin

(Quorum 7)

ORDER OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, September 14, 1971:

"With leave of the Senate,

The Honourable Senator Hayden moved, seconded by the Honourable Senator Denis, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and consider the Summary of 1971 Tax Reform Legislation, tabled this day, and any bills based on the Budget Resolutions in advance of the said bills coming before the Senate, and any other matters relating thereto; and

That the Committee have power to engage the services of such counsel, staff and technical advisers as may be necessary for the purpose of the said examination.

After debate, and -

The question being put on the motion, it was -

Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

FINAL REPORT OF THE COMMITTEE

The Standing Senate Committee on Banking, Trade and Commerce having completed its examination and consideration of the Summary of 1971 Tax Reform Legislation and bills based on the Budget Resolutions in accordance with its terms of reference of September 14, 1971, now makes its final Report.

Two earlier reports called Preliminary Report and Preliminary Report No. 2 were tabled in the Senate on November 4, 1971, and November 30, 1971, respectively.

Attached to this Report is a statement prepared by our advisers setting out a list of technical changes required in Bill C-259 to clarify or correct the language of many provisions of the said bill.

Attached hereto is, as well, a list of the persons who made submissions to and appeared before your Committee to present their case for changes in the said Bill to avoid hardship in their operations. There is also set out a list of those who made submissions but did not personally appear.

Earlier today your Committee held its final meeting in connection with the reference made to it by the Senate. At this meeting the Minister of Finance appeared in response to an invitation extended by your Committee. Prior thereto the Chairman, with the approval of the Committee had several interviews with the Minister of Finance to discuss the recommendations made by the Committee in its several reports to the Senate and to obtain, if possible, some indication of the attitude of the Minister in relation thereto.

With the approval of the Committee, a list of top priority items among the recommendations in our two Reports was submitted to the Minister, together with amendments which in the view of our expert advisers and our Committee would incorporate the substance of the top priority recommendations contained in your Committee's Reports. This list is also attached hereto. In speaking by way of explanation to the Senate the Chairman of the Committee will discuss these items indicating how many have already been dealt with and the reaction of the Minister to other of these items expressed in the House of Commons on December 10, 1971,

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and to your Standing Committee earlier this day.

The Minister of Finance stated in the House of Commons and before our Committee that an amending Bill would be put forward in the next session. In the House of Commons he said--

> "There are a number of areas that the Government is actively studying at this time and I want to give the House some indication of our present thinking.----- there will undoubtedly be a number of important amendments introduced next year and I think it is only fair that people should be aware of the direction of our planning."

In the Committee the Minister repeated what he said in the House of Commons and dealt in a particular way with the subject matter of the recommendations in your Committee's several Reports. These will be referred to in the course of the explanations given by the Chairman and will appear in the Hansard report of proceedings this day of the Committee.

Your Committee would direct your attention to the Hansards of its proceedings, particularly numbers 35 and 39. There you will find clear explanations of the principal subjects dealt with in Bill C-259, namely:

(1) Changes in personal Tax	- Report P. 35-5 to P. 35-16
(2) Capital Gains (with Summary at P. 35-16)	- Report P. 35-16 to P. 35-42
(3) Valuation and Tax Free Zone	- Report P. 35-39 to 40
(4) Partnerships and Professional Income	- Report P. 35-43 to 51
(5) Corporations and Distributions to Shareholders	- Report P. 35-51 to 61
(6) Dividend Tax Credit	- Report P. 35-52
(7) Small Business	- Report P. 35-54
(8) Inter Corporate Dividends	- Report P. 35-54
(9) Designated Surplus	- Report P. 35-54 to 55
(10) Investment Income of Private Companies	- Report P. 35-55
(11) Complexity	- Report P. 35-56 and 57

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(4) Partnerships and Professional Income	- Report P. 35-43 to 51
(5) Corporations and Distributions to Shareholders	- Report P. 35-51 to 61
(6) Dividend Tax Credit	- Report P. 35-52
(7) Small Business	- Report P. 35-54
(8) Inter Corporate Dividends	- Report P. 35-56
(9) Designated Surplus	- Report P. 35-56 to 58
(10) Investment Income of Private Companies	- Report P. 35-55
(11) Complexity	- Report P. 35-56 and 57

(12) International - Report P. 35-17 to 25

(13) Taxation with Summary - Report P. 39-17

(14) Estates and Death Duties
(Summary at P. 39-5)
and Trusts - Report P. 39-5 to 16

The above references are to a series of lectures or explanations on the various provisions of Bill C-259 with section references. Your Committee wishes to express its great appreciation of the efforts of Arthur R.A. Scace and Stephen Smith and for their assistance. It should be noted that the services of Messrs. Scace and Smith were given without remuneration - expressly so stipulated.

In many of its aspects this Bill C-259 is very beneficial to taxpayers in Canada. The elimination from the tax rolls was estimated in 1970 at approximately 750,000 persons* now subject to tax and the increase in personal exemptions of all the taxpayers, the improved deductions for wage and salary earners, the incentives to small business, the deductibility of interest on money borrowed by one company to buy shares in another company, the ability of a corporation to distribute its 1971 undistributed income on hand on payment of a special 15% tax and thereupon to distribute without further tax its 1971 capital surplus on hand, the elimination of gift taxes and estate taxes, the continuance of dividend tax credit although different in form but beneficial - all these are some of the beneficial features of Bill C-259.

In addition to the above sources of information available to Senators, Senate Hansard of November 24 and December 1, 1971, contain statements in narrative form of the meaning and scope and effect of the various provisions in Bill C-259 referred to in the several reports of your Committee.

Further however, there is the Report of your Committee to the Senate on the White Paper Proposals for Tax Reform, dated September 1970. Therein you will find

* Source: Senate Report on White Paper Proposals for Tax Reform.

(12) International - Report P. 25-17 to 23

(13) Taxation with Summary - Report P. 30-17

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* Source: Senate Report on White Paper Proposals for Tax Reform.

all the subject matter of the White Paper Proposals dealt with. Many of the headings are carried through to the Summary of 1971 Tax Reform Legislation and Bill C-259.

Your Committee wishes to acknowledge in a particular way the contribution of the Honourable Lazarus Phillips to our study of this Tax Reform Legislation and Bill C-259 as Chief Counsel to the Committee. You will recall he was Vice-Chairman of the Committee in its study of the White Paper Proposals. In the drafting of the Report of the Senate thereon and in the preparation of the several reports of the Committee on its examination and consideration of Bill C-259, his advice and direction were invaluable.

Mr. Allan Irving and Mr. Douglas Ewens were part of our team of legal advisers. We were very fortunate in securing Mr. Irving's services at this time as he had worked with your Committee throughout the study of White Paper Proposals. Mr. Ewen's services were valuable to your Committee in the analysis of the submissions received and as an adviser to the Chairman. Both these men worked on the preparation of our several Reports and in the drafting of amendments. We wish to acknowledge the skill and judgment they brought to bear on the consideration of these matters.

Your Committee retained the services of Mr. Albert Poissant and Mr. Charles B. Mitchell, senior partners in the accounting firm of Thorne, Gunn, Helliwell and Christenson. Their services were invaluable in every phase of the work of your Committee.

As a result of all this work and the information thereby available to Senators, the consideration of this bill should be greatly facilitated. The introduction of an amending bill next year, which the Minister's statement would indicate, will afford the opportunity to the Senate to propose further amendments at that time, the nature and extent of which may be governed by such further and amending provisions

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as are incorporated in the amending Bill.

Respectfully submitted,

Salter A. Hayden,
Chairman.

APPENDIX "A"

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

SUBJECT: Summary of 1971 Tax Reform Legislation

BRIEFS SUBMITTED AND HEARD BY THE COMMITTEE

Date	Proceeding Number	
October 6, 1971	36	The Canadian Chamber of Commerce.
October 13, 1971	40 (A.M.)	Canadian Federation of Agriculture.
October 13, 1971	40 (P.M.)	Canadian Construction Association.
October 14, 1971	41	National Association of Canadian Credit Unions; Co-Operative Union of Canada; Allstate Insurance Company of Canada.
October 20, 1971	42 (A.M.)	Massey-Ferguson; Canadian Jewish Congress.
October 20, 1971	42 (P.M.)	Aluminium Company of Canada Limited.
October 21, 1971	43 (A.M.)	Canadian Bar Association.
October 21, 1971	43 (P.M.)	Simpson Sears Ltd. and Simpsons Limited; Independent Petroleum Association of Canada.
October 27, 1971	44 (A.M.)	Noranda Mines Limited; Bethlehem Copper Corporation Ltd.; The Canadian Gas Association.
October 27, 1971	44 (P.M.)	ad hoc Committee of Voluntary Agencies.
October 28, 1971	45 (A.M.)	Canadian Petroleum Association; Mining Association of Canada; The Canadian Mutual Funds Association.
October 28, 1971	45 (P.M.)	The Canadian Pulp and Paper Association.
November 3, 1971	46 (A.M.)	Hollinger Mines Limited; The Canadian Life Insurance Association; Dominion Foundries and Steel Limited.
November 3, 1971	46 (P.M.)	The Canadian Institute of Chartered Accountants.
November 3, 1971	8:00 (P.M.)	In camera Meeting.

... /2

November 10, 1971	49	Institute of Profit Sharing; Insurance Bureau of Canada; The Royal Architectural Institute of Canada; Teachers Insurance and Annuity Association of America; Mining Association of British Columbia; Texaco Canada Limited.

BRIEFS SUBMITTED BUT NOT HEARD BY THE COMMITTEE

Investment Dealers Association of Canada;
Canadian International Power Company Limited;
Trans Canada PipeLine Limited;
Trust Companies Association of Canada;
Vancouver Board of Trade;
John Labatt Limited.

September 29, 1971 and September 30, 1971	Education Sessions on Bill C-259 with Messrs. Scace and Smith.

APPENDIX "B"

TOP PRIORITY RECOMMENDATIONS BY THE STANDING COMMITTEE ON BANKING TRADE AND COMMERCE OF THE SENATE IN ITS CONSIDERATION OF THE SUMMARY OF 1971 TAX REFORM BILL

1. GIFTS,BEQUESTS AND DEVISES TO CHARITIES (1st Senate Report P.47-10)

2. EMPLOYEES PROFIT SHARING PLANS (1st Senate Report P.47-8)

3. DEFERRED PROFIT SHARING PLANS (1st. Senate Report P 47-8)

4. PASSIVE INCOME (1st Senate Report P 47-5)

5. DE MINIMIS RULE (1st Senate Report P47-7)

6. TAX-EXEMPT NON-RESIDENT INVESTORS (2nd Senate Report P50-7)

7. NON-RESIDENT OWNED INVESTMENT CORPORATIONS (2nd Senate Report P50-9)

8. PRIVATE GENERAL INSURANCE CORPORATIONS (2nd Senate Report P50-10)

9. DEEMED REALIZATION ON CEASING TO BE A RESIDENT OF CANADA (1st. Senate Report P47-9)

SECONDLY - AN ASSURANCE THAT FURTHER CONSIDERATION WILL BE GIVEN TO ITEMS RECOMMENDED IN THE Senate REPORTS BUT NOT SET OUT IN THE LIST OF TOP PRIORITY RECOMMENDATIONS, MORE PARTICULARLY IN RELATION TO ROLLOVERS (1st Senate Report P47-14) CONSOLIDATED RETURNS (1st Senate Report P47-15) MINING AND PETROLEUM (1st Senate Report P47-10) (2nd Senate Report P50-8)

TAXATION OF INDIVIDUALS

1. Section 6(1)(e) and 15(5) - standby charge for automobile

Section 15(6) provides that the formula set out in Section 6(2) for determining the amount that would be a reasonable standby charge for an automobile that was made available to an employee by his employer shall also apply where a company car has been made available to a shareholder. These subsections fail to consider the situation where one car is made available for several shareholders and/or employees and appropriate amendments should be made.

2. Section 62(3) - Moving expenses (C.I.C.A.)

Subsection (3) of Section 62 provides that the cost of cancelling a lease on one's residence is an allowable moving expense for purposes of determining the amount deductible under Section 62(1) in respect of expenses incurred in moving to a new work location. There is no similar provision for bona fide costs incurred in connection with the assignment of such a lease. As all landlords may not be prepared to cancel a taxpayer's lease and the taxpayer may therefore be forced to sub-let (incurring costs in connection therewith), the definition of the term "moving expenses" should be extended by amending paragraph (d) of Section 62(3) to read as follows:

"(d) the cost to him of cancelling or otherwise disposing of the lease, if any, by virtue of which he was the lessee of his old residence".

3. Section 63 - Child care expenses (C.B.A.)

Where a taxpayer is employed by his spouse, the taxpayer's remuneration from such employment is to be included in the spouse's income for tax purposes under the provisions of Section 74(3) of Bill C-259 and excluded from the taxpayer's income for tax purposes. Because of this and because one of the limitations on the amount

allowable as a deduction under Section 63 in respect of child care expenses is that the deduction cannot exceed two-thirds of the taxpayer's earned income for the year, a married woman who is employed by her husband may be unable to take advantage of the child care expense deduction. Further, no deduction will be allowed to the husband in these circumstances as he will not comply with the conditions contained in paragraph (b) of Section 63(1) because his wife was not incapacitated or confined to prison. Provision should be made to allow the husband a deduction in these circumstances, at least in those cases where it can be established that his wife was a bona fide full-time employee for the period in respect of which the expenses were incurred.

A similar problem arises as a result of the attribution rules in Section 74(4) where a married woman is employed by a partnership of which her husband is a partner.

In addition, where a husband and wife are partners in a business and the Minister of National Revenue exercises his discretionary power under the provisions of Section 74(5) and thereby attributes all of the firm's income to the husband, one of the effects may be to deny any deduction for child care expenses even though the expenses were incurred to enable the taxpayer's wife to devote her time and energies to the partnership business.

CAPITAL GAINS

1. Section 2(3)(c) - Tax payable by non-resident persons (C.A.B.)

The first specific clause in Bill C-259 which deals with disposition of properties on which a taxable capital gain may be realized by non-residents is Section 2(3)(c). This provision appears to define persons not resident in Canada who can fit within the categories outlined in Division D of the Bill and implies that any person who at any time in the past disposed of "taxable Canadian property" (as defined in Section 115(1)(b)) is subject to the provisions of Division D - even though he may have no taxable income for purposes of Division D and, hence, not be subject to tax in any event. There seems to be no apparent necessity for drawing the net so wide.

2. Section 13(4) - Insurance proceeds and other compensation in respect of the loss or destruction of property (C.I.C.A.)

Section 13(4) of Bill C-259 has the same technical defect as its predecessor in the present Income Tax Act (viz. Section 20(5a)).

The purpose of this provision is to allow taxpayers an additional period of grace in which to expend insurance proceeds or other compensation received in respect of the loss or destruction of depreciable assets without being subject to tax on recaptured capital cost allowance. Ordinarily, where a class of depreciable assets is in credit balance at the end of a taxation year because the taxpayer disposed of assets for an amount in excess of the undepreciated capital cost of property in that class and did not expend a sufficient portion of the proceeds in that same year to bring the class into debit balance at the end of the year by acquiring additional depreciable assets of that class, the amount of the credit balance is included

Appendix "D"

CAPITAL GAINS

1. Section 2(3)(c) - Tax payable by nonresident persons (C.A.R.)

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in income as recaptured capital cost allowance. However, where the credit balance arises because of insurance proceeds or other compensation receivable in respect of the loss or destruction of depreciable assets, then, by virtue of Section 13(4) the amount of the credit balance will not be treated as recaptured capital cost allowance to the extent that it is expended by the taxpayer in the immediately following taxation year on the acquisition of depreciable property of the same class as that lost or destroyed.

Where the asset destroyed is a building, the taxpayer will obtain the benefit of this relieving provision to the extent that any credit balance in the relevant class of buildings at the end of the taxation year in which the insurance proceeds or other compensation becomes payable is expended by him in the immediately following taxation year on the acquisition of a building of any class, whether or not it is of the same class as the building that was destroyed. However, because of an anomaly in the Bill (and in the present Act), where a taxpayer chooses to replace a destroyed building by a building of another class and he does so by acquiring such other building in the taxation year in which the proceeds of insurance or other compensation becomes payable (rather than in the immediately following taxation year) he will, upon a technical interpretation, be subject to tax on recapture.

In order to remove this anomaly, it is recommended that paragraph (c) of Section 13(4) be amended to read as follows:

"(c) the amount shall, to the extent that it has been expended by the taxpayer

(i) in the taxation year immediately following the initial year on acquiring property of the same class,

(ii) in the initial year or in the taxation year immediately following the initial year on acquiring, if the property so lost, destroyed, taken or sold was a building, a building of a prescribed class, or

(iii) ...."

3. Section 44 - Deferral of gain on involuntary dispositions (C.C.C.)

Section 44 provides for a deferral of gain on involuntary dispositions of capital property where the gain arises by virtue of the fact that the taxpayer has received (or is entitled to receive)

(a) proceeds of insurance or other compensation in respect of the loss or destruction of capital property,

(b) compensation for capital property taken under statutory authority, or

(c) the proceeds of sale of capital property which was sold to a person by whom notice of intention to take under statutory authority was given,

and the taxpayer has expended an amount at least equal to the gain before the end of the immediately following taxation year acquiring a replacement for the former property.

It is recommended that these deferral provisions be extended to apply to a gain realized where capital property is unlawfully taken and the taxpayer becomes entitled to receive compensation therefor. This amendment may be accomplished by changing Section 44 to read as follows:

> "Where in a taxation year a taxpayer has received proceeds of disposition described in subparagraph 54(h)(ii), (iii) or (iv) of any property.........."

4. Section 53(2)(a)(i) - Adjustments to the cost base of capital property (C.C.C.)

Subparagraph (i) of Section 53(2)(a) provides that any amount received by a taxpayer after 1971 as a dividend (other than a taxable dividend or a capital dividend) on the share of the capital stock of a corporation resident in Canada shall be deducted in computing the adjusted cost base to the taxpayer of such share. Any dividend received from a mutual fund corporation that is deemed under Section 131(1) to be a capital gains dividend should also be excluded, along with taxable dividends and capital dividends, from the amounts that are to be deducted under Section 53(2)(a)(i) in computing the adjusted cost base of shares to the taxpayer. A capital gains dividend is deemed to be a capital gain in the year in which received and is taxed accordingly. Therefore, it should not reduce the adjusted cost base of shares since such an adjustment would result in double taxation.

5. Section 53(2)(m) - Adjustments to cost base of capital property (C.B.A.)

Section 53(2)(m) provides that, in computing the adjusted cost base to a taxpayer of capital property at any time, there shall be deducted

It is recommended that these deferral provisions be extended to apply to a gain realized where capital property is unlawfully taken and the taxpayer becomes entitled to receive compensation therefor. This amendment may be accomplished by changing Section 44 to read as follows:

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5. Section 53(2)(m) - Adjustments to cost base of capital property (C.R.A.)

Section 53(2)(m) provides that, in computing the adjusted cost base to a taxpayer of capital property at any time, there shall be deducted

> "such part of the cost to the taxpayer of the property as was deductible (otherwise then by virtue of this subdivision) in computing the taxpayer's income for any taxation year commencing before that time."

It is to be noted that the deduction to be made under this paragraph is based on the deductibility of the amount specified therein regardless of the amount actually deducted in computing income. It is recommended that the paragraph be amended to read as follows:

> "(m) such part of the cost to the taxpayer of the property,
>
> (i) as was deducted (otherwise than by virtue of this subdivision) in computing the taxpayer's income for any taxation year that ended on or before that time, or
>
> (ii) where the adjusted cost base is being computed as of a date other than the end of a taxation year, as was deductible (otherwise than by virtue of this subdivision) in computing the taxpayer's income for the first taxation year ending after that date."

6. Section 54(g) - Principal residence (C.B.A.)

It is recommended that the definition of the term "principal residence" be amended specifically to include,

(a) a condominium unit (which may not fall within the present definition),

and

(b) a dwelling-place located on property which is held under a long term lease rather than owned by the taxpayer

7. Section 74 - Income or gains from property transferred to one's spouse

Subsections (1) and (2) of Section 74 provides that a taxpayer must include in his or her income for tax purposes any income and net taxable capital gains (i.e. taxable capital gains less allowable capital losses) which his or her spouse may derive from property transferred to the spouse by the taxpayer (or from property substituted therefor). The purpose of this provision is to prevent a taxpayer from

reducing his income for tax purposes by transferring income-producing properties to his spouse.

It has been suggested that Bill C-259 be amended specifically to provide that these attribution rules will not apply in respect of property transferred to a spouse more than one year prior to the date on which the transferor first became a resident of Canada. This suggestion appears to have merit and it is recommended that the following amendment be made:

> Section 74(6)
> "Subsections (1) and (2) of this section do not apply in respect of property transferred to a spouse more than one year prior to the date on which the transferor first became resident in Canada or in respect of property substituted for such transferred property."

A similar amendment should be made to the attribution rules contained in Section 75 which relates to property transferred

(a) to a person under eighteen years of age, and

(b) to certain inter vivos trusts.

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> Section 74(6)
> "Subsections (1) and (2) of this section do not apply in respect of property transferred to a spouse more than one year prior to the date on which the transferor first became resident in Canada or in respect of property substituted for such transferred property."

A similar amendment should be made to the attribution rules contained in Section 75 which relates to property transferred

(a) to a person under eighteen years of age, and

(b) to certain inter vivos trusts.

CORPORATIONS AND THEIR SHAREHOLDERS

1. Section 83(2) - Capital dividends (C.B.A.)

Section 83(2) provides

(a) that a private corporation may elect, subject to specified conditions, to treat a dividend payable by it to its shareholders after 1971 as a capital dividend if the amount does not exceed the corporation's capital dividend account immediately before the date on which the dividend becomes payable, and

(b) that no part of such a dividend shall form part of the recipient shareholder's income.

Under Section 89(1)(b), a corporation's capital dividend account at any particular time is defined to include only amounts attributed to such account in taxation years ending before that time. Accordingly, if a corporation paid a dividend in kind by distributing part of its capital assets and the fair market value of the property distributed exceeded the adjusted cost base of the assets to the corporation, gain would only accrue on payment of the dividend and the corporation could not elect to treat the dividend in kind as a capital dividend out of the one-half non-taxable portion of that capital gain. It is recommended that provision be made to enable a private corporation to treat the one-half non-taxable portion of any capital gain arising from the payment of a dividend in kind as part of its capital dividend account at the time the dividend became payable.

2. Section 87(1) - Definition of an amalgamation (C.C.C.)

The definition of the word "amalgamation", as defined in Section 87(1) of Bill C-259, is similar to that contained in Section 85I of the present Act in that, in order to qualify for the treatment set out in Section 87 of the Bill (previously Section 85I), it will still be necessary that all of the assets and liabilities of the amalgamating corporations become assets and liabilities of the amalgamated corporation. This requirement often causes corporate taxpayers an undue amount of trouble and expense arranging to settle amounts owing between amalgamating corporations immediately prior to an amalgamation so as to ensure that the amalgamation will in fact be treated as such for income tax purposes.

It is accordingly recommended that paragraphs (a) and (b) of Section 87 be amended to read as follows:

"(a) all of the property of the predecessor corporations immediately before the merger (other than amounts receivable from, or investments in shares of the capital stock of, any of the other predecessor corporations) becomes property of the new corporation by virtue of the merger,

(b) all of the liabilities of the predecessor corporations immediately before the merger (other than amounts owing to one predecessor corporation to another predecessor corporation) becomes liabilities of the new corporation by virtue of the merger, and"

3. Section 87(2)(r)) Amalgamated corporation's 1971 capital surplus
4. Section 87(2)(s)) on hand or paid-up capital deficiency (C.C.C.)

Paragraphs (r) of Section 87(2) provides that, in computing the 1971 capital surplus of an amalgamated corporation, any 1971 capital surplus which the amalgamated corporation may itself have on hand shall be increased by the amount, if any, by which

(a) the aggregate of each predecessor corporation's 1971 capital surplus on hand, if any, immediately before the amalgamation

exceeds

2. Section 87(1) - definition of an amalgamation (C.C.C.)

The definition of the word "amalgamation", as defined in Section 87(1) of Bill C-259, is similar to that contained in Section 851 of the present Act in that, in order to qualify for the treatment set out in Section 87 of the Bill (previously Section 851), it will still be necessary that all of the assets and liabilities of the amalgamating corporations become assets and liabilities of the amalgamated corporation. This requirement often causes corporate taxpayers an undue amount of trouble and expense arranging to settle amounts owing between amalgamating corporations immediately prior to an amalgamation so as to ensure that the amalgamation will in fact be treated as such for income tax purposes.

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> (b) all of the liabilities of the predecessor corporations immediately before the merger (other than amounts owing to one predecessor corporation to another predecessor corporation) become liabilities of the new corporation by virtue of the merger, and"

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(a) the aggregate of each predecessor corporation's 1971 capital surplus on hand, if any, immediately before the amalgamation

exceeds

(b) the aggregate of each predecessor corporation's paid-up capital deficiency, if any, immediately before the amalgamation.

There is no provision to the effect that, where the amount described in (b) above exceeds the amount described in (a), the excess must be deducted from the amount otherwise determinable in computing the amalgamated corporation's 1971 capital surplus on hand. Unless such a provision is introduced, it may be possible to eliminate a corporation's paid-up capital deficiency by means of an amalgamation without decreasing the 1971 capital surplus of the amalgamated corporation by a like amount. It is therefore recommended that a new paragraph be added to Section 87(2) to the following effect:

> "(r.1) where the amount described in subparagraph (r)(ii) exceeds the amount described in subparagraph (r)(i), there shall be deducted from the aggregate of the amounts determined under subparagraphs 89(I)(1)(i) to (iv) for the purpose of computing the 1971 capital surplus on hand of the new corporation at any particular time an amount equal to such excess."

A similar problem exists with respect to subparagraph (s) of Section 87(2), relating to the computation of an amalgamated corporation's paid-up capital deficiency.

5. Section 87(2)(aa) - Amalgamated corporation's refundable dividend tax on hand for purposes of determining its cumulative deduction account (C.C.C.)

Section 87(2)(aa) provides for the flow-through to an amalgamated corporation of any refundable dividend tax which each predecessor corporation may have on hand immediately prior to the amalgamation. It is not clear, however, whether the amalgamated corporation will be deemed to have inherited such amounts as of the end of a taxation year immediately preceding its first taxation year, or whether such amounts will not be included in computing its own refundable dividend tax on hand until the

(b) the aggregate of each predecessor corporation's paid-up capital deficiency, if any, immediately before the amalgamation.

There is no provision to the effect that, where the amount described in (b) above exceeds the amount described in (a), the excess must be deducted from the amount otherwise determinable in computing the amalgamated corporation's 1971 capital surpl on hand. Unless such a provision is introduced, it may be possible to eliminate a corporation's paid-up capital deficiency by means of an amalgamation without decrea the 1971 capital surplus of the amalgamated corporation by a like amount. It is therefore recommended that a new paragraph be added to Section 87(2) to the followi effect:

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end of its first taxation year (following the amalgamation). If the latter interpretation is correct and the amalgamated corporation is, therefore, not entitled to deduct the predecessor corporation's refundable dividend tax on hand for purposes of computing its cumulative deduction account immediately prior to the amalgamation (see Section 87(2)(y)), an amalgamated corporation which qualifies as a Canadian-controlled private corporation (as defined in Section 125(6)(a)) could be deprived of a small business deduction for its first taxation year even though it should, in equity, be entitled to such a deduction.

To ensure that there is no anomaly in this regard, it is recommended that Section 87(2)(aa) be amended to read as follows:

> "(aa) in the case of a new corporation that is a private corporation for the purpose of computing the refundable dividend tax on hand (within the meaning assigned by subsection 129(3)) of the new corporation <u>at the end of a taxation year immediately preceding its first taxation year or</u> at the end of any <u>subsequent</u> taxation year, where a predecessor corporation had refundable dividend tax on hand immediately before the amalgamation the amount thereof shall be added to the aggregate determined under subsection 129(3) from which the new corporation's dividend refunds are to be subtracted;"

6. Section 129(3)(a) - Refundable dividend tax on hand (C.C.C.)

Section 129 provides that a corporation "Canadian investment income" and "foreign investment income" are to be computed separately but it does not provide that a loss obtained from one or other of these "sources" is to be deducted from income derived from the other "source" in computing the amount described in paragraph (a) of Section 129(3). As a result, the amount of refundable dividend tax which may be credited to a private corporation's refundable dividend tax account in respect of a particular taxation year could be greater than the amount properly creditable thereto.

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To ensure that there is no anomaly in this regard, it is recommended that Section 87(2)(aa) be amended to read as follows:

> "(aa) in the case of a new corporation that is a private corporation for the purpose of computing the refundable dividend tax on hand (within the meaning assigned by subsection 129(3)) of the new corporation at the end of a taxation year immediately preceding its first taxation year or at the end of any subsequent taxation year, where a predecessor corp-oration had refundable dividend tax on hand immediately before the amal-gamation the amount thereof shall be added to the aggregate determined under subsection 129(3) from which the new corporation's dividend refunds are to be subtracted;"

6. Section 129(3)(a) - Refundable dividend tax on hand (C.C.C.)

Section 129 provides that a corporation "Canadian investment income" and "foreign investment income" are to be computed separately but it does not provide that a loss obtained from one or other of these "sources" is to be deducted from income derived from the other "source" in computing the amount described in paragra (a) of Section 129(3). As a result, the amount of refundable dividend tax which ma be credited to a private corporation's refundable dividend tax account in respect o a particular taxation year could be greater than the amount properly creditable tha

It is suggested that this anomaly could be eliminated by making the following amendments:

(a) Paragraph (a) of Section 129(3) would be amended to read as follows:

"(a) 25% of the amount, if any, by which its 'total investment income for the year', as defined in paragraph (4)(c), exceeds the amount deductible under paragraph 111(1)(b) from the corporation's income for the year,"

(b) Subsection (h) of Section 129 would be amended by the addition of the following paragraph:

"(c) 'total investment income' of a corporation for a taxation year means the amount, if any, by which the aggregate of

(i) the aggregate of the amounts described in subparagraphs (a)(i) to (iii) in respect of the corporation for the year, and

(ii) the amount that would be determined under subparagraphs (a)(i) to (iii) in respect of the corporation for the year if the references in subparagraphs (a)(i) to (iii) to 'in Canada' were read as references to 'outside Canada',

exceeds the aggregate of

(iii) the aggregate of amounts each of which is a loss of the corporation for the year from a source that is a property or business other than an active business, and

(iv) the aggregate of all amounts deductible under section 113 from the corporations income for the year."

7. Section 129(3)(b) - Refundable dividend tax on hand (C.C.C.)

Any inactive business income from foreign sources will form part of "foreign investment income" for purposes of the refundable dividend tax provisions but any foreign tax credit relating to such income (being a credit allowed under Section 126(2)) will not be taken into account in determining whether the limitation contained in Section 129(3)(b) is applicable. Thus, even though no Canadian income tax is payable on inactive business income from foreign sources after deducting the

It is suggested that this anomaly could be eliminated by making the following amendments:

(a) Paragraph (a) of Section 129(3) would be amended to read as follows:

> "(a) 25% of the amount, if any, by which its 'total investment income for the year', as defined in paragraph (4)(c), exceeds the amount deductible under paragraph 111(1)(b) from the corporation's income for the year,"

(b) Subsection (4) of Section 129 would be amended by the addition of the following paragraph:

> "(c) 'total investment income' of a corporation for a taxation year means the amount, if any, by which the aggregate of
>
> (i) the aggregate of the amounts described in subparagraphs (a)(i) to (iii) in respect of the corporation for the year, and
> (ii) the amount that would be determined under subparagraphs (a)(i) to (iii) in respect of the corporation for the year if the references in subparagraphs (a)(i) to (iii) to 'in Canada' were read as references to 'outside Canada',
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> (iii) the aggregate of amounts each of which is a loss of the corporation for the year from a source that is a property or business other than an active business, and
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7. Section 129(3)(b) - Refundable dividend tax on hand (C.C.C.)

Any investive business income from foreign sources will form part of "foreign investment income" for purposes of the refundable dividend tax provisions but any foreign tax credit relating to such income (being a credit allowed under Section 126(2)) will not be taken into account in determining whether the limitation contained in Section 129(3)(b) is applicable. Thus, even though no Canadian income tax is payable on investive business income from foreign sources after deducting the

provincial tax abatement and the foreign tax credit, an amount equal to 25% thereof could be credited to the refundable dividend tax account.

8. Section 189(4)(b) - Ineligible investments (C.C.C.)

Further statutory clarification is required to minimize the number of problems which could be encountered in determining the cost of ineligible investments on hand at any time. For example:

1. Where there is a change in the use made of a capital asset, will the use to which it was originally put govern its classification for the purpose of Section 189(4)(b) for all subsequent years?
2. If a capital asset, such as a building, is used in part for active business purposes and in part for rental purposes, will the entire cost be treated as not falling within the ineligible category?
3. If, for example, a Canadian-controlled private corporation owned a minority interest in another company at December 31, 1971, and it acquired a further 100 shares of that company but disposed of the latter before the end of its 1972 year should not be treated as an ineligible investment?

BUSINESS AND PROPERTY INCOME

1. Section 16 - Debt obligations issued at at discount (C.I.C.A.)

Subsections (2) and (3) of Section 16 provide that, where a debt obligation is issued at a discount by a tax-exempt person, a non-resident person not carrying on business in Canada, a government or certain other public bodies, the amount of the discount is, under certain circumstances, to be included in the investor's income for tax purposes. Subsection (2) relates to debt obligations which are issued before June 18, 1971 and subsection (3) deals with debt obligations issued after that date. Neither deals with debt obligations which are issued on June 18, 1971. Subsection (2) should accordingly be amended to apply to debt obligations issued on that date as well as to those issued prior thereto.

2. Section 24 - Deduction in respect of eligible capital amounts (goodwill and other "nothings") on ceasing to carry on business (C.C.C.)

The combined effect of subsections (1) and (2) of Section 24 in a situation where an individual ceases to carry on business and the business is thereafter carried on by his spouse or by a corporation controlled by him appears to prevent any deduction under Section 20(1)(b) (relating to the amortization of goodwill and other "nothings") for either the individual, or his spouse or the controlled corporation for the year in which the business is transferred if both the transferor and the transferee have the same fiscal year end or if the fiscal year of the transferor ends at a later date in the year than the transferee's.

In order to remedy this inequity, it is recommended that subsection (2) of Section 24 be amended to read as follows:

Appendix E

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2. Section 24 - Deduction in respect of eligible capital amounts (goodwill and other "nothings") on ceasing to carry on business (C.C.C.)

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In order to remedy this inequity, it is recommended that subsection (2) of Section 24 be amended to read as follows:

Section 24

"(2) Notwithstanding subsection (1), where an individual has ceased to carry on a business and thereafter his spouse, or a corporation controlled directly or indirectly in any manner whatever by him, has carried on the business,

(a) in computing the individual's income for his fiscal period in which he so ceased to carry on the business, the following rules shall apply;

(i) the provisions of subsection (1) shall be read without reference to paragraphs (a) and (b) thereof and as if the reference in paragraph (c) thereof to 'the time he so ceased to carry on the business' were read as a reference to 'the end of the fiscal period in which he so ceased to carry on the business'; and

(ii) the amount allowed as a deduction under paragraph 20 (1)(b) in respect of the business shall not exceed that proportion of the maximum amount otherwise allowable that

(A) the number of days in the period from the commencement of the fiscal period to date on which he ceased to carry on the business,

is of

(B) 365;

(b) in computing the cumulative eligible capital in respect of the business of the spouse or the corporation, as the case may be, at any time after the end of the fiscal period in which the individual so ceased to carry on the business, there shall be included the amount of the individual's cumulative eligible capital in respect thereof at the end of that fiscal period; and

(c) in computing the income of the spouse or the corporation, as the case may be, for the fiscal period in which the spouse or corporation commenced to carry on the business, the amount allowed as a deduction under paragraph 20(1)(b) in respect of the amount included in the spouse's or corporation's cumulative eligible capital amount under paragraph (b) shall not exceed that proportion of the maximum amount otherwise allowable in respect thereof that

(A) the number of days in the period from the date on which the spouse or corporation commenced to carry on the business to the end of the fiscal period,

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(B) 365."

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(i) the provisions of subsection (1) shall be read without reference to paragraphs (a) and (b) thereof and as if the reference in paragraph (c) thereof to 'the time he so ceased to carry on the business' were read as a reference to 'the end of the fiscal period in which he so ceased to carry on the business'; and

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(B) 365;

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(c) in computing the income of the spouse or the corporation, as the case may be, for the fiscal period in which the spouse or corporation commenced to carry on the business, the amount allowed as a deduction under paragraph 20(1)(b) in respect of the amount included in the spouse's or corporation's cumulative eligible capital amount under paragraph (b) shall not exceed that proportion of the maximum amount otherwise allowable in respect thereof that

(A) the number of days in the period from the date on which the spouse or corporation commenced to carry on the business to the end of the fiscal period,

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(B) 365."

Subdivision K - Trusts and their Beneficiaries

Sec. 104. Reference to trust or estate.

(1) In this Act, a reference to a trust or estate (in this subdivision referred to as a "trust") shall be read as a reference to the trustee or the executor, administrator, heir or other legal representative having ownership or control of the trust property.

Sec. 104(2)

(2) Taxed as individual. A trust shall, for the purposes of this Act, and without affecting the liability of the trustee or legal representative for his own income tax, be deemed to be in respect of the trust property an individual; but where there is more than one trust and

(a) substantially all of the property of the various trusts has been received from one person, and

(b) the various trusts are conditioned so that the income thereof accrues or will ultimately accrue to the same beneficiary, or group or class of beneficiaries,

such of the trustees as the Minister may designate shall, for the purposes of this Act, be deemed to be in respect of all the trusts an individual whose property is the property of all the trusts and whose income is the income of all the trusts.
(See also S. 128(1); S. 248(1); Regs. Part 11.)

Sec. 104(3)

(3) Deductions not permitted. No deduction may be made under section 109 or paragraph 110(1) (d) from the income of a trust.
(See also S. 109(1); S. 110(1)(d).)

Sec. 104(4)

(4) Deemed disposition of property by a trust. Every trust shall, on each of the following days, be deemed to have disposed of each capital property of the trust, other than depreciable property, for proceeds equal to its fair market value on that day, and to have reacquired such property immediately thereafter for an amount equal to that fair market value; and for the purposes of this Act those days are:

(a) where the trust is a trust created by a taxpayer, whether during his lifetime or by his will, under which
(i) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and
(ii) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust, the day on which the spouse dies;

(aa) Where the trust is a classified trust the day prescribed by regulation.

Subdivision K - Trusts and their Beneficiaries

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(2) Taxed as individual. A trust shall, for the purposes of this Act, and without affecting the liability of the trustee or legal representative for his own income tax, be deemed to be in respect of the trust property an individual; but where there is more than one trust and

(a) substantially all of the property of the various trusts has been received from one person, and

(b) the various trusts are conditioned so that the income thereof accrues or will ultimately accrue to the same beneficiary, or group or class of beneficiaries,

such of the trustees as the Minister may designate shall, for the purposes of this Act, be deemed to be in respect of all the trusts an individual whose property is the property of all the trusts and whose income is the income of all the trusts.
(See also S. 125(1); S. 248(1); Regs. Part II.)

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(See also S. 109(1); S. 110(1)(d).)

Sec. 104(4)

(4) Deemed disposition of property by a trust. Every trust shall, on each of the following days, be deemed to have disposed of each capital property of the trust, other than depreciable property, for proceeds equal to its fair market value on that day, and to have reacquired such property immediately thereafter for an amount equal to that fair market value; and for the purposes of this Act those days are:

(a) where the trust is a trust created by a taxpayer, whether during his lifetime or by his will, under which
(i) his spouse is entitled to receive all of the income of the trust that arises before the spouse's death, and
(ii) no person except the spouse may, before the spouse's death, receive or otherwise obtain the use of any of the income or capital of the trust, the day on which the spouse dies;

(aa) where the trust is a classified trust the day prescribed by regulation;

Comment: This amendment is designed to permit the Minister to prescribe alternative rules for trusts such as protective trusts which are worthy of special treatment.

(b) that day that is 21 years after the latest of
   (i) January 1, 1972,
   (ii) the day on which the trust was created, and
   (iii) where applicable, the day referred to in paragraph (a); and

(c) the day that is 21 years after any day that is, by virtue of this subsection, a day on which the trust is deemed to have disposed of each such property.

Sec. 104(5)

(5) Idem. Every trust shall, on each day described in subsection (4), be deemed to have disposed of all depreciable property of a prescribed class of the trust for proceeds equal to,

(a) where the fair market value of that property on that day exceeds the undepreciated capital cost thereof to the trust on that day, the amount of that undepreciated capital cost plus ½ of the amount of the excess, and

(b) in any other case, the fair market value of that property on that day plus ½ of the amount, if any, by which the undepreciated capital cost thereof to the trust on that day exceeds that fair market value,

and to have reacquired each such depreciable property of that class immediately thereafter at a capital cost (in this subsection referred to as the "deemed capital cost") equal to that proportion of the proceeds determined under paragraph (2) or (b), as the case may be, that the amount that was the fair market value of that property on that day is of the aggregate of the amounts that were the fair market values of all properties of that class on that day, except that

(c) where the amount that was the capital cost to the trust of any particular property of that class exceeds the deemed capital cost to the trust of the property, for the purposes of sections 13 and 20 and any regulations made under paragraph 20(1)(a) as they apply in respect of the property at any subsequent time,

   (i) the capital cost to the trust of the property shall be deemed to be the amount that was the capital cost to the trust of the property, and

   (ii) the excess shall be deemed to have been allowed to the trust in respect of the property under paragraph 20(1)(a) in computing income for taxation years before the reacquisition by the trust of the property, and any other amount allowed to the trust in respect of the property under that paragraph in computing income for those years shall be deemed to be nil, and

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 (i) January 1, 1972,
 (ii) the day on which the trust was created, and
 (iii) where applicable, the day referred to in paragraph (a); and
(c) the day that is 21 years after any day that is, by virtue of this subsection, a day on which the trust is deemed to have disposed of each such property,

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(b) in any other case, the fair market value of that property on that day plus ½ of the amount, if any, by which the undepreciated capital cost thereof to the trust on that day exceeds that fair market value,

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s the case may be, that the amount that was the fair market value
f that property on that day is of the aggregate of the amounts
hat were the fair market values of all properties of that class
n that day, except that

(c) where the amount that was the capital cost to the trust of any particular property of that class exceeds the deemed capital cost to the trust of the property, for the purposes of sections 13 and 20 and any regulations made under paragraph 20(1) (a) as they apply in respect of the property at any subsequent time,

 (i) the capital cost to the trust of the property shall be deemed to be the amount that was the capital cost to the trust of the property, and
 (ii) the excess shall be deemed to have been allowed to the trust in respect of the property under paragraph 20(1)(a) in computing income for taxation years before the reacquisition by the trust of the property, and any other amount allowed to the trust in respect of the property under that paragraph in computing income for those years shall be deemed to be nil, and

(d) subsection 13(2) is not applicable in respect of any such reacquisition.

Sec. 104(6)

(6) Deduction in computing income of trust. For the purposes of this Part, there may be deducted in computing the income of a trust for a taxation year such part of the amount that would, but for this subsection, subsection (12) and subsection 105(2), be its income for the year as was payable in the year to a beneficiary.

Sec. 104(7)

(7) Non-resident beneficiary. No deduction may be made under subsection (6) in computing the income for a taxation year of a trust in respect of such part of an amount that would otherwise be its income for the year as was payable in the year to a person who, at the time such part of that amount became so payable, was not resident in Canada, unless at that time, the trust was resident in Canada.

(See also C. 104(6).)

Sec. 104(8)

(8) Limitation on deduction. No deduction may be made under subsection (6) in computing the income for a taxation year of an inter vivos trust that had income for the year from a business carried on by it in Canada, in respect of such part of an amount that would, but for subsections (6) and (12), be its income for the year as was payable in the year to a person who, at the time the amount became so payable, was

(a) a non-resident person;
(b) a non-resident-owned investment corporation; or
(c) a trust resident in Canada other than
(i) a testamentary trust, or
(ii) a trust that throughout the period commencing on April 26, 1965 and ending at the time the amount became so payable, was a beneficiary under the trust by whom the amount became so payable, which latter-mentioned trust was throughout such period carrying on a business in Canada.

(See also S. 2(1); S. 104(6).)

Sec. 104(9)

(9) Idem. No deduction may be made under subsection (6) in computing the income for a taxation year of a trust other than a mutual fund trust, in respect of any amount that is deemed by subsection (21) to be a taxable capital gain for the year of a non-resident person or of a non-resident-owned investment corporation from the desposition of capital property.

Sec. 104(10)

(10) Where property owned for non-residents. Where all the property of a trust is owned by the trustee for the benefit of non-resident persons or their unborn issue, in addition to the amount that may be deducted under subsection (6), there may be deducted in computing the income of the trust for a taxation year for the purposes of this Part, such part of the dividends and interest received by the trust in a year from a non-resident-owned investment corporation as are not deductible under subsection (6) in computing the income of the trust for the year.

(See also S. 106(1)(b).)

Sec. 104(11)

(11) Dividend received from non-resident-owned investment corporation. Where any part of the dividends received in a taxation year by a trust described in subsection (10) from a non-resident-owned investment corporation are deductible under subsection (10) in computing the income of the trust for the year, for the purposes of Part XIII the trust shall be deemed to have paid to a non-resident person on the last day of the year an amount equal to that part, as income of the non-resident person from the trust.

Sec. 104(12)

(12) Deduction of part of accumulating income included in preferred beneficiary's income. For the purposes of this Part, there may be deducted in computing the income of a trust for a taxation year such part of its accumulating income for the year as was required by subsection (14) to be included in computing the income of a preferred beneficiary.

Sec. 104(13)

(13) Such part of the amount that would be the income of a trust for a taxation year if no deduction were made under subsection (6) or under regulations made under paragraph 20(1)(a) as was payable in the year to a beneficiary shall be included in computing the income of the person to whom it so became payable whether or not it was paid to him in that year and shall not be included in computing his income for a subsequent year in which it was paid.

Comment: The purpose of this subsection is to make an amount deductible by reason of its allocation to a beneficiary, taxable in the hands of the beneficiary. The words "or (12)" deleted in the version above, are unnecessary in that subsection (14) provides for the inclusion of the amount deducted under (12) in the income of the preferred beneficiary concerned.

Sec. 104(10)

(10) Where property owned for non-residents. Where all the
roperty of a trust is owned by the trustee for the benefit of
on-resident persons or their unborn issue, in addition to the
mount that may be deducted under subsection (6), there may be
educted in computing the income of the trust for a taxation year
or the purposes of this Part, such part of the dividends and
nterest received by the trust in a year from a non-resident-owned
nvestment corporation as are not deductible under subsection
6) in computing the income of the trust for the year.
(See also S. 106(1)(b).)

Sec. 104(11)

(11) Dividend received from non-resident-owned investment
orporation. Where any part of the dividends received in a taxa-
tion year by a trust described in subsection (10) from a non-
resident-owned investment corporation are deductible under
subsection (10) in computing the income of the trust for the
year, for the purposes of Part XIII the trust shall be deemed
to have paid to a non-resident person on the last day of the
year an amount equal to that part, as income of the non-resident
person from the trust.

Sec. 104(12)

(12) Deduction of part of accumulating income included in
preferred beneficiary's income. For the purposes of this Part,
there may be deducted in computing the income of a trust for a
taxation year such part of its accumulating income for the year
as was required by subsection (14) to be included in computing
the income of a preferred beneficiary.

Sec. 104(13)

(13) Such part of the amount that would be the income of a
trust for a taxation year if no deduction were made under sub-
section (6) or under regulations made under paragraph 20(1)(a)
as was payable in the year to a beneficiary shall be included
in computing the income of the person to whom it so became payable
whether or not it was paid to him in that year and shall not be
included in computing his income for a subsequent year in which
it was paid.

Comment: The purpose of this subsection is to make an amount
deductible by reason of its allocation to a beneficiary, taxable
in the hands of the beneficiary. The words "or (12)" deleted in
the version above, are unnecessary in that subsection (14) pro-
vides for the inclusion of that amount under (12) in the
income of the preferred beneficiary concerned.

Sec. 104(14)

(14) Where a trust and a preferred beneficiary thereunder jointly so elect in respect of a taxation year in prescribed manner and within prescribed time, such part of the accumulating income of the trust for the year as is designated in the election, not exceeding the preferred beneficiary's share therein, shall be included in computing the income of the preferred beneficiary for the year, and shall not be included in computing <u>the income of any tax payer</u> in a subsequent year in which it was paid.

Comment: "The income of any tax payer" is substituted for the words "his income" as the accumulating income may in a subsequent year be paid to someone other than the person so electing.

Sec. 104(15)

(15) Preferred beneficiary's share. The share of a particular preferred beneficiary under a trust in the accumulating income of the trust for a taxation year is,

(a) where the trust is a trust described in paragraph (4)(a) and the taxpayer's spouse referred to therein is alive at the end of the year, an amount equal to,
  (i) if the particular preferred beneficiary is the taxpayer's spouse, the trust's accumulating income for the year, and
  (ii) in any other case, nil;

(b) in any case not referred to in paragraph (a), where the shares in which the accumulating income of the trust would be payable to the beneficiaries thereunder do not depend upon the exercise by any person of, or the failure by any person to exercise, any discretionary power,
  (i) if at the end of the year a particular beneficiary was a member of a class of beneficiaries under the trust each of whom was <u>prospectively</u> entitled, as a member of that class, to share equally in any <u>accumulating</u> income of the trust the portion of the trust's accumulating income in the year that may reasonably be regarded as having been earned for the benefit of beneficiaries of that class divided by the number of beneficiaries (other than registered Canadian charitable organizations) of that class in existence at the end of the year.

Comment: This subsection provides a code to establish the amount in respect of which a particular preferred beneficiary can elect for the purposes of 104(14). The whole context, therefore, is one of income which is not, in fact, being paid but which is prospectively allocable to a particular preferred beneficiary. Consequently, in sub-paragraph (b) and particularly in clause (i) thereof, words suggesting that anyone is "entitled" to share in income should be changed. In addition, the right to elect only arises in connection with accumulating income so that any reference to income should be modified by the adjective "accumulating".

(ii) in any other case, the portion of the trust's accumulating income for the year that may reasonably be regarded as having been earned for the benefit of the particular preferred beneficiary;

(c) in any case not referred to in paragraph (a) or (b), where each beneficiary under the trust whose share of the accumulating income of the trust depends under the exercise by any person of, or the failure by any person to exercise, any discretionary power, is a preferred beneficiary or a registered Canadian charitable organization, the portion of the trust's accumulating income for the year that may reasonably be regarded as having been earned for the benefit of the particular beneficiary, not exceeding the amount determined in prescribed manner to be his or its discretionary share of the trust's accumulating income for the year; and

(ca) in the case of a classified trust the amount prescribed.

(d) in any case not referred to in paragraph (a), (b), (c) or (ca), nil.

Comment: These amendments are designed to permit the Minister to prescribe alternative rules for trusts such as protective trusts which are worthy of special treatment.

Sec. 104(16)

(16) Capital cost allowance deduction. A beneficiary under a trust may deduct from the amount that would otherwise be his income from the trust by virtue of subsection (13) or (14), as the case may be, such part of the amount that would otherwise be deductible from the income of the trust for the year under regulations made under paragraph 20(1)(a) as the trust may determine; and any amount deductible under this subsection for a taxation year shall be deducted from he amount that the trust would otherwise be able to deduct under those regulations but shall, for the purposes of section 13, be deemed to have been allowed to the trust under those regulations in computing its income for the year. (See also S. 20(1)(a).)

Sec. 104(17)

(17) Depletion allowance. Where an amount is payable in a taxation year by a trust to a beneficiary under the trust, no part of that amount shall be deemed, for the purpose of subsections (6) and (13), to be payable out of an amount deductible in computing the income of the trust for the yeat under regulations made under subsection 65(1) except such part thereof as the trust designates as being so payable.

Sec. 104(18)

(18) Trust for infant. Where the income of a trust for a

taxation year or any part thereof was not payable in the year but was held in trust for an infant or minor whose right thereto had vested and the only reason that it was not payable in the year was that the beneficiary was an infant or minor, it shall, for the purpose of subsections (6) and (13), be considered to have been payable.

(See also S. 65(1).)

Sec. 104(19)

(19) Portion of taxable dividends deemed to be dividends received by beneficiary. Such portion of

(a) the aggregate of taxable dividends received by a trust in a taxation year on shares of the capital stock of taxable Canadian corporations,

as

(b) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to be part of the amount that, by virtue of subsection (13) or (14) or section 105, as the case may be, was included in computing the income for the year of a particular beneficiary under the trust, and

(c) was not designated by the trust in respect of any other beneficiary thereunder,

shall, if so designated by the trust in respect of the particular beneficiary in the return of its income for the year under this Part, be deemed, for the purposes of section 82 and this subsection, to be a taxable dividend received by the particular beneficiary in the year from a taxable Canadian corporation, and not to be a taxable dividend received by the trust in the year from a taxable Canadian corporation.

Sec. 104(20)

(20) Portion of non-taxable dividends not to be included in beneficiary's income. Where an amount has, in a taxation year, become payable by a trust to a particular beneficiary thereunder, such portion thereof as

(a) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to have derived from an amount received by the trust in the year as, on account or in lieu of payment of, or in satisfaction of, a dividend on a share of the capital stock of a corporation resident in Canada other than a taxable dividend, and

(b) was not designated by the trust in respect of any other beneficiary thereunder,

shall, if so designated by the trust in respect of the particular beneficiary in its return of income for the year under this Part, not be included in computing the income of the particular beneficiary for the year.

Sec. 104(21)

(21) Portion of taxable capital gains deemed gain of beneficiary. Such portion of

(a) the amount, if any, by which the aggregate of the taxable capital gains of a trust for a taxation year exceeds the aggregate of
 (i) its allowable capital losses for the year, and
 (ii) the amount, if any, deductible under paragraph III(1)(b) from its income for the year

as

(b) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to be part of the amount that, by virtue of subsection (13) or (14) or section 105, as the case may be, was included in computing the income for the taxation year of a particular beneficiary under the trust, and

(c) was not designated by the trust in respect of any other beneficiary thereunder,

shall, if so designated by the trust in respect of the particular beneficiary in the return of its income for the year under this Part, be deemed, for the purposes of sections 3 and 111, to be a taxable capital gain for the year of the particular beneficiary from the disposition of capital property.

Sec. 104(22)

(22) Deduction for foreign taxes. For the purpose of section 126, the following rules apply:

(a) such portion of the income of a trust for a taxation year (before making any deduction under subsection (6) or (12)) from sources in a foreign country as
 (i) may reasonably be considered (having regard to all the circumstances including the terms and conditions of the trust arrangement) to be part of the income that, by virtue of subsection (13) or (14), as the case may be, was included in computing the income for a taxation year of a particular beneficiary under the trust, and
 (ii) was not designated by the trust in respect of any other beneficiary thereunder,

shall, if so designated by the trust in respect of the particular beneficiary in its return of income for the year under this Part, be deemed to be income of the particular beneficiary for the taxation year from sources

in that country;

(b) a beneficiary under a trust shall be deemed to have paid as income tax for a taxation year, on the income that he is deemed by paragraph (a) to have for the year from sources in a foreign country, to the government of that country an amount equal to that proportion of the income or profits tax paid by the trust for the year to the government of that country or to the government of a state, province or other political subdivision of that country (except such portion of that tax as was deductible under subsection 20(11) or (12) in computing its income for the year) that

(i) such portion of the amount included in computing his income for the year by virtue of subsection (13) or (14), as the case may be as is deemed by paragraph (a) to be income for the year from sources in that country,

is of

(ii) the income of the trust for the year from sources in that country (before making any deduction under subsection (6) or (12));

(c) the income of a trust from sources in a foreign country for a taxation year shall be deemed to be its actual income therefrom for the year minus the aggregate of the amounts deemed by paragraph (a) to be the income therefrom for the year of all beneficiaries under the trust; and

(d) a trust shall be deemed to have paid as income tax to the government of a foreign country for a taxation year an amount equal to the income or profits tax actually paid by it for the year to the government of that country, or to the government of a state, province or other political subdivision of that country (except such portion of that tax as was deductible under subsection 20(11) or (12) in computing its income for the year), minus the aggregate of the amounts deemed by paragraph (b) to have been paid to the government of that country for the year by all beneficiaries under the trust.

Sec. 104(23)

(23) Testamentary trusts. In the case of a testamentary trust, notwithstanding any other provision of this Act the following rules apply:

(a) the taxation year of the trust is the period for which the accounts of the trust have been ordinarily made up and accepted for purposes of assessment under this Act and, in the absence of an established practice, the period adopted by the trust for that purpose (but no such period may exceed 12 months and a change in a usual and accepted period may not be made for the purpose of this Act without the concurrence of the Minister);

(b) when a taxation year is referred to by reference to a calendar year, the reference is to the taxation year or years coinciding with, or ending in, that year;

(c) the income of a person for a taxation year from the trust shall be deemed to be his benefits from or under the trust for the taxation year or years of the trust that ended in the year determined as provided by this section and section 105;

(d) where an individual having income from the trust died after the end of a taxation year of the trust but before end of the calendar year in which that taxation year ended, a separate return of his income from the trust after the end of the trust's taxation year to the time of death shall be filed and tax under this Part shall be paid thereon as if that income were the income of another person; and

(e) in lieu of making the payments required by section 156, the trust shall pay to the Receiver General of Canada within 90 days from the end of each taxation year, the tax for the year as estimated under section 151.
(See also S. 70(2); S. 105(1); S. 150(4); S. 151; S. 156; S. 249(1).)

Sec. 104(24)

(24) "Amount payable". For the purposes of subsections (6), (7), (8), (13) and (20), an amount shall not be considered to be payable in a taxation year unless it was paid in the year to the person to whom it was payable or he was entitled in that year to enforce payment thereof.
(See also S. 104(6); S. (7),(8),(13).)

Sec. 104(25)

(25) An election under subsection (14) hereof on behalf of a preferred beneficiary under a disability can be made by the person designated in the trust to make such election and if none by a parent or guardian of such preferred beneficiary and if non by the trustee.

Comment: Doubt has been expressed as to the ability of persons to elect when otherwise entitled to do so as preferred beneficiaries in respect of accumulating income. It is understood that the Department of Justice has given the opinion to the Department of Finance that no problem arises under the provincial law with these elections. It is further understood that the Department of National Revenue has informed the Department of Finance that no problem arises in connection with the rights to elect which presently exist insofar as persons under a diability are concerned. The Bar

(b) when a taxation year is referred to by reference to a calendar year, the reference is to the taxation year or years coinciding with, or ending in, that year;

(c) the income of a person for a taxation year from the trust shall be deemed to be his benefit from or under the trust for the taxation year or years of the trust that ended in the year determined as provided by this section and section 105;

(d) where an individual having income from the trust died after the end of a taxation year of the trust but before end of the calendar year in which that taxation year ended, a separate return of his income from the trust after the end of the trust's taxation year to the time of death shall be filed and tax under this Part shall be paid thereon as if that income were the income of another person; and

(e) in lieu of making the payments required by section 153, the trust shall pay to the Receiver General of Canada within 90 days from the end of each taxation year, the tax for the year as estimated under section 151.
(See also S. 70(2); S. 103(1); S. 150(4); S. 151;
S. 155; S. 249(1).)

Sec. 104(24)

(24) "Amount payable". For the purposes of subsections (6), (7), (8), (13) and (14), an amount shall not be considered to be payable in a taxation year unless it was paid in the year to the person to whom it was payable or he was entitled in that year to enforce payment thereof.

(See also S. 104(6); S. (7),(8),(13).)

Sec. 104(25)

(25) An election under subsection (17) hereof on behalf of a preferred beneficiary under a disability can be made by the person designated in the trust to make such election and if none by a parent or guardian of such preferred beneficiary and if not by the trustee.

Comment: Doubt has been expressed as to the ability of persons to elect when otherwise entitled to do so as preferred beneficiaries in respect of incompetent infants. It is understood that the Department of Justice has given the opinion to the Department of Finance that no problem arises under the provincial law with these elections. It is further understood that the Department of National Revenue has informed the Department of Finance that no problem arises in connection with the rights to elect which presently exist insofar as persons under a disability are concerned. The Bar

Association does not dispute the advice tendered by either Department but in the particular context under discussion here, it does not consider that either advice meets the problem. It is perfectly true that the legal institutions exist in all of the provinces under which a person could become competent to elect on behalf of an infant but the institutions often involve tedious procedures and considerable expense as they are necessarily designed to cope with the awkward problems which arise in connection with the property of a person under a disability. The most common disability with which we will be concerned in connection with the right of election by a preferred beneficiary will be the disability of infancy. Other disabilities such as mental incapacity or absenteeism are uncommon or even exotic and the likelihood of resort to a proper procedure which would result in the appointment of a legal personal representative is great. Very few parents however, bother to become guardians of their own children. It is considered that the Statute should give the right to a parent to make the election. This would not interfere with the provincial right to determine the matter of guardianship but would simply say that a federal election can be made by a particular category of person.

SEC. 105. Benefits under trust, contract, etc.

(1) The value of all benefits (other than a distribution or payment of capital) to a taxpayer during a taxation year from or under a trust, contract, arrangement or power of appointment, irrespective of when made or created shall, subject to subsection (2), be included in computing his income for the year.
(See also S.56(2); S.76(1).)

Sec. 105(2)

(2) Upkeep, etc. Such part of an amount paid by a trust out of income of the trust for the upkeep, maintenance or taxes of or in respect of property that, under the terms of the trust arrangement, is required to be maintained for the use of a tenant for life or a beneficiary as is reasonable in the circumstances shall be included in computing the income of the tenant for life or other beneficiary from the trust for the taxation year for which it was paid.
(See also S. 12(1)(m); S. 104(6),(13); S. 248(1).)

SEC. 106 Income interest in trust.

(1) Where an amount in respect of a taxpayer's income interest in a trust has been included in computing his income for a taxation year by virtue of subsection 104(13) or subsection (2) of this section, there may be deducted in computing his income for the year the lesser of

(a) the amount so included in computing his income for the year, and

eciation does not discuss the advice developed by either Depart-
ent but it the particular section under discussion. . . , it does
ot consider that either advice meets the problem. It is perfectly
rue that the legal institutions exist in all of the provinces
nder which a parent could become competent to elect on behalf of
n infant but the institution often involve tedious procedures
nd considerable expense as they are not really designed to cope
ith the answers problems which arise in connection with the
roperty of a person under a disability. The most common disa-
ility with which we will be concerned in connection with the
ight of election by a deceased beneficiary will be the disability
f infancy. Other disabilities such as mental incapacity or
bsenteeism are unusual or even exotic and the likelihood of
esort to a proper procedure which would result in the appointment
f a legal personal representative is great. Very few parents
owever, bother to seek a guardianship of their own children. It is
onsidered that the Statute should give the right to a parent to
ake the election. This would not interfere with the provincial
ight to determine the matter of guardianship but would simply
ay that a federal election can be made by a particular category
f persons.

SEC. 105. Benefits under trust, contract, etc.

(3) The value of all benefits (other than a distribution or
payment of capital) to a taxpayer during a taxation year from or
under a trust, contract, arrangement or power of appointment,
irrespective of when made or created shall, subject to subsection
(2), be included in computing his income for the year.
(See also S.56(2); S.70(2).)

Sec. 105(2)

(2) Upkeep, etc. Such part of an amount paid by a trust out
of income of the trust for the upkeep, maintenance or taxes of or
in respect of property that, under the terms of the trust arrange-
ment, is required to be maintained for the use of a tenant for
life or a beneficiary as is reasonable in the circumstances shall
be included in computing the income of the tenant for life or
other beneficiary from the trust for the taxation year for which
it was paid.

(See also S. 12(1)(m), S. 104(6),(13),
S. 246(1).)

SEC. 106 Income interest in trust.

(1) Where an amount in respect of a taxpayer's income interest
in a trust has been included in computing his income for a
taxation year by virtue of subsection 104(13) or subsection (2)
of this section, there may be deducted in computing his income
for the year the lesser of
(a) the amount so included in computing his income for the
year, and

(b) the amount, if any, by which the cost to the taxpayer of the income interest exceeds the aggregate of all amounts in respect of the interest that were deductible by virtue of this subsection in computing his income for previous taxation years.

Sec. 106(2)

(2) Disposition by taxpayer of income interest. Where in a taxation year a taxpayer disposes of an income interest in a trust,

(a) except where subsection (3) is applicable, there shall be included in computing his income for the year the proceeds of the disposition;
(b) any taxable capital gain or allowable capital loss of the taxpayer from the disposition shall be deemed to be nil; and
(c) for greater certainty, the cost to the taxpayer of each property received by him as consideration for the disposition is the fair market value of the property at the time of the disposition.

Sec. 106(3)

(3) Proceeds of disposition of income interest. For greater certainty, where at any time any property of a trust has been distributed by the trust to a taxpayer who was a beneficiary under the trust in satisfaction of all or any part of his income interest in the trust, the trust shall be deemed to have disposed of the property for proceeds of disposition equal to the fair market value of the property at that time.

SEC. 107 Disposition by taxpayer of capital interest.

(1) Where a taxpayer has disposed of a capital interest in a trust,
(a) for the purposes of computing his taxable capital gain, if any, from the disposition of the interest, the adjusted cost base to him thereof immediately before the disposition shall be deemed to be an amount equal to the greater of the adjusted cost base to him thereof otherwise determined immediately before that time and the cost amount to him of the interest immediately before that time, and

(b) for greater certainty, for the purposes of computing his allowable capital loss, if any, from the dispositon of the interest, the adjusted cost base to him thereof immediately before the disposition is the adjusted cost base to him of the interest immediately before that time as determined under this Act without reference to paragraph (a),

except that where the interest was an interest in an inter vivos trust not resident in Canada that was purchased by the taxpayer, paragraph (a) does not apply in respect of the disposition thereof except where subsection (2) is applicable in respect of any distribution of property by the trust to him in satisfaction of all or any part of the interest.

Sec. 107(1)

(1) Where a taxpayer has disposed of a capital interest in a trust,

(a) for the purposes of computing his taxable capital gain, if any, from the disposition of the interest, the adjusted cost base to him thereof immediately before the disposition shall be deemed to be an amount equal to the greater of the adjusted cost base to him thereof otherwise determined immediately before that time and the cost amount to him of the interest immediately before that time, and

(b) for greater certainty, for the purposes of computing his allowable capital loss, if any, from the disposition of of the interest, the adjusted cost base to him thereof immediately before the disposition is the adjusted cost base to him of the interest immediately before that time as determined under this Act without reference to paragraph (2),

except that where the interest was an interest in an inter vivos trust not resident in Canada that was purchased by the taxpayer, paragraph (a) does not apply in respect of the disposition thereof except where subsection (2) is applicable in respect of any distribution of property by the trust to him <u>as or on account of</u> all or any part of the interest.

Sec. 107(2)

(2) Where at any time any property of the trust has been distributed by the trust to a taxpayer who was a beneficiary under the trust <u>as or on account of</u> all or any part of his capital interest in the trust.

Comment: Some doubt has been expressed as to whether a capital encroachment for a beneficiary represents the distribution of property by a trust to a beneficiary "in satisfaction of all or any part of his capital interest". The problem seems to be with the word "satisfaction". The doubt has been expressed in print by writers such as David Ward and has been felt privately by those in the Bar Association concerned with the preparation of this brief. It seems to us that the problem can simply be solved by changing the phrase where it appears in both subsections from "in satisfaction of" to "as or on account of".

except that where the interest was an interest in an inter vivos trust not resident in Canada that was purchased by the taxpayer, paragraph (a) does not apply in respect of the disposition thereof except where subsection (2) is applicable in respect of any distribution of property by the trust to him in satisfaction of all or any part of the interest.

Sec. 107(1)

(1) Where a taxpayer has disposed of a capital interest in a trust,

(a) for the purposes of computing his taxable capital gain, if any, from the disposition of the interest, the adjusted cost base to him thereof immediately before the disposition shall be deemed to be an amount equal to the greater of the adjusted cost base to him thereof otherwise determined immediately before that time and the cost amount to him of the interest immediately before that time, and

(b) for greater certainty, for the purposes of computing his allowable capital loss, if any, from the disposition of the interest, the adjusted cost base to him thereof immediately before the disposition is the adjusted cost base to him of the interest immediately before that time as determined under this Act without reference to paragraph (a),

except that where the interest was an interest in an inter vivos trust not resident in Canada that was purchased by the taxpayer, paragraph (a) does not apply in respect of the disposition thereof except where subsection (2) is applicable in respect of any distribution of property by the trust to him as or on account of all or any part of the interest.

Sec. 107(2)

(2) Where at any time any property of the trust has been distributed by the trust to a taxpayer who was a beneficiary under the trust as or on account of all or any part of his capital interest in the trust,

Comment: Some doubt has been expressed as to whether a capital encroachment for a beneficiary represents the distribution of property by a trust to a beneficiary "in satisfaction of all or any part of his capital interest". The problem seems to be with the word "satisfaction". The doubt has been expressed in print by writers such as Bruce Ward and has been felt privately by those in the tax profession associated with the preparation of this brief. It seems to us that the problem can simply be solved by changing the phrase where it appears in both subsections from "in satisfaction of" to "as or on account of".

Sec. 107(3)

(3) Determination of cost of property other than non-depreciable capital property. Where the property referred to in subsection (2) that was distributed by a trust to a taxpayer was property, other than capital property that was not depreciable property, for the purpose of determining the cost to the taxpayer of the property under paragraph (2)(b) (except for the purposes of paragraph (2)(b) as it applies to determine the taxpayer's proceeds of dispositon of his capital interest under paragraph (2)(c), the reference in paragraph (2)(b) to "that proportion" shall be read as a reference to "½ of that proportion".

Sec. 107(4)

(4) Where trust in favour of spouse. Where the trust referred to in subsection (2) was a trust described in paragraph 104(4)(a) and

(a) the property so distributed by the trust was capital property other than depreciable property,
(b) the taxpayer to whom the property was so distributed was a person other than the spouse, and
(c) the spouse was alive at the time the property was so distributed,

notwithstanding paragraphs (2)(a) to (d), the following rules apply:
(d) the trust shall be deemed to have disposed of the property for proceeds equal to its fair market value at that time;
(e) the taxpayer shall be deemed to have acquired the property at a cost equal to that fair market value, and
(f) the taxpayer shall be deemed to have disposed of all or part, as the case may be, of his interest in the trust, for proceeds of disposition equal to that fair market value.

Sec. 107(5)

(5) Distribution to non-resident beneficiary. Where subsection (2) is applicable in respect of the distribution by a trust of any property of the trust to a non-resident taxpayer who was a beneficiary under the trust and the property was not taxable Canadian property or property that would be taxable Canadian property if at no time in the taxation year of the trust in which it was so distributed the trust had been resident in Canada, notwithstanding paragraphs (2)(a) to (c) the provisions of paragraphs (4)(d) to

Sec. 107(3)

(3) Determination of cost of property other than non-depreciable capital property. Where the property referred to in subsection (2) that was distributed by a trust to a taxpayer was property, other than capital property, that was not depreciable property, for the purpose of determining the cost to the taxpayer of the property under paragraph (2)(b) (except for the purposes of paragraph (2)(b) as it applies to determine the taxpayer's proceeds of disposition of his capital interest under paragraph (2)(c)), the reference in paragraph (2)(b) to "that proportion" shall be read as a reference to ¾ of that proportion.

Sec. 107(4)

(4) Where trust in favour of spouse. Where the trust referred to in subsection (2) was a trust described in paragraph 104(4)(a) and

(a) the property so distributed by the trust was capital property other than depreciable property,
(b) the taxpayer to whom the property was so distributed was a person other than the spouse, and
(c) the spouse was alive at the time the property was so distributed,

notwithstanding paragraphs (2)(a) to (d), the following rules apply:

(d) the trust shall be deemed to have disposed of the property for proceeds equal to its fair market value at that time,
(e) the taxpayer shall be deemed to have acquired the property at a cost equal to that fair market value, and
(f) the taxpayer shall be deemed to have disposed of all or part, as the case may be, of his interest in the trust for proceeds of disposition equal to that fair market value.

Sec. 107(5)

(5) Distribution to non-resident beneficiary. Where subsection (2) is applicable in respect of the distribution by a trust of any property of the trust to a non-resident taxpayer who was a beneficiary under the trust and the property was not taxable Canadian property or property that would be taxable Canadian property if at no time in the taxation year of the trust in which it was so distributed the trust had been resident in Canada, notwithstanding paragraphs (2)(a) to (c) the provisions of paragraphs (4)(d) to

(f) are applicable in respect of the property as if the reference in paragraph (4)(f) to "that fair market value" were read as a reference to "the adjusted cost base to him of the interest or part thereof, as the case may be immediately before the property was so distributed".

SEC. 108. Definitions.

(1) In this subdivision,

Sec. 108(1)(a)

(a) "Accumulating income". - "accumulating income" of a trust for a taxation year means the amount that, but for subsections 104(6) and 104(12) would be its income for the year;

Comment: The words "104(6)" would appear to have been omitted by oversight.

Sec. 108(1)(b)

(b) "Beneficiary". - "beneficiary" under a trust includes a person beneficially interested therein;

Sec. 108(1)(c)

(c) "Capital interest". - "Capital interest" of a taxpayer in a trust means a right (whether immediate or future and whether absolute or contingent) of the taxpayer as a beneficiary under the trust to, or to receive, all or any part of the capital of the trust;

Sec. 108(1)(d)

(d) "Cost amount" of capital interest. - "cost amount" of any capital interest of a taxpayer in any trust at any time means,

(i) in any case where any money or property of the trust has been distributed by the trust to the taxpayer in full satisfaction of the whole of his caital interest (whether on the winding-up of the trust or otherwise), the aggregate of the money so distributed and all amounts each of which is the cost amount to the trust, immediately before the distribution, of each such property so distributed to the taxpayer, and

(ii) in any other case, that proportion of the amount, if any, by which the aggregate of all money of the trust on hand immediately before that time and all amounts each of which is the cost amount to the trust, immediately before that time, of each property of the

trust exceeds the aggregate of all amounts each of which is the amount of any debt owing by the trust, or of any other obligation of the trust to pay any amount, that was outstanding immediately before that time, that

(A) the fair market value at that time of the capital interest in the trust, is of

(B) the fair market value at that time of all capital interests in the trust;

Sec. 108(1)(e)

(e) "Income interest". - "income interest" of a taxpayer in a trust means a right (whether immediate or future and whether absolute or contingent) of the taxpayer as a beneficiary under the trust to, or to receive, all or any part of the income of the trust;

Sec. 108(1)(f)

(f) "Inter vivos trust". - "inter vivos trust" means a trust other than a testamentary trust;

Sec. 108(1)(g)

(g) "Preferred beneficiary". - "preferred beneficiary" under any trust means an individual resident in Canada who is a beneficiary under the trust and is

(i) the settlor of the trust,

(ii) the spouse or former spouse of the settlor of the trust, or

(iii) a child, grandchild or great grandchild of the settlor of the trust, or the spouse of any such person;

Sec. 108(1)(h)

(h) "Settlor". - "settlor",

(i) in relation to a testamentry trust, means the individual referred to in paragraph (i), and

(ii) in relation to an inter vivos trust,

(A) if the trust was created by the transfer, assignment or other disposition of property thereto (in this paragraph referred to as property "contributed") by not more than one individual and the fair market value of such of the property of the trust as was contributed by him at the time of the creation of the trust or at any subsequent time exceeds the fair market value of such of the property of the trust as was contributed by any other person or persons at any subsequent time (such fair market values being determined at the time of the making of any such contribution), means that individual, and

trust exceeds the aggregate of all amounts each of which is the amount of any debt owing by the trust, or of any other obligation of the trust to pay any amount, that was outstanding immediately before that time, that

(A) the fair market value at that time of the capital interest in the trust, is of

(B) the fair market value at that time of all capital interests in the trust;

Sec. 108(1)(e)

(e) "income interest". - "income interest" of a taxpayer in a trust means a right (whether immediate or future and whether absolute or contingent) of the taxpayer as a beneficiary under the trust to, or to receive, all or any part of the income of the trust;

Sec. 108(1)(f)

(f) "inter vivos trust". - "inter vivos trust" means a trust other than a testamentary trust;

Sec. 108(1)(g)

(g) "preferred beneficiary". - "preferred beneficiary" under any trust means an individual resident in Canada who is a beneficiary under the trust and is

(i) the settlor of the trust,

(ii) the spouse or former spouse of the settlor of the trust, or

(iii) a child, grandchild or great grandchild of the settlor of the trust, or the spouse of any such person;

Sec. 108(1)(h)

(h) "settlor". - "settlor",

(i) in relation to a testamentary trust, means the individual referred to in paragraph (i), and

(ii) in relation to an inter vivos trust,

(A) if the trust was created by the transfer, assignment or other disposition of property thereto (in this paragraph referred to as property "contributed") by not more than one individual and the fair market value of such of the property of the trust as was contributed by him at the time of the creation of the trust or at any subsequent time exceeds the fair market value of such of the property of the trust as was contributed by any other person or persons at any subsequent time (such fair market values being determined at the time of the making of any such contribution), means that individual, and

(B) if the trust was created by the contribution of property thereto jointly by an individual and his spouse and by no other person and the fair market value of such of the property of the trust as was contributed by them at the time of the creation of the trust or at any subsequent time exceeds the fair market value of such of the property of the trust as was contributed by any other person or persons at any subsequent time (such fair market values being determined at the time of the making of any such contribution). means that individual and his spouse;

Sec. 108(1)(i)

(i) "Testamentary trust". - "testamentary trust" means a trust or estate that arose upon the death of an individual and in consequence of his death, but for greater certainty does not include any such trust that was created by any person other than that individual; and

Sec. 108(1)(j)

(j) "Trust". - "trust" includes an inter vivos trust and a testamentary trust but, in subsections 104(4), (5), (12) (14) and (15) and sections 105 to 107 does not include
(i) a unit trust, or
(ii) a trust governed by a registered pension fund or plan, an employees profit sharing plan, a registered supplementary unemployment benefit plan, a registered retirement savings plan or a deferred profit sharing plan.

Sec. 108(1)(k)

(k) "Classified trust". - "classified trust" means a trust which has been accepted by the Minister for inclusion in a class prescribed by regulation.

Comment: This amendment is designed to permit the Minister to prescribe alternative rules for trusts such as protective trusts which are worthy of special treatment.

Sec. 108(2)

(2) Meaning of expression "unit trust". For the purposes of this Act, a trust is a unit trust at any particular time if, at that time, it was an inter vivos trust the interest of each beneficiary under which was described by reference to units of the trust, and
(a) the issued units of the trust included
(i) units having conditions attached thereto that included conditions requiring the trust to accept, at the demand of the holder thereof and at prices determined and

(h) if the trust was created by the contribution of property thereto jointly by an individual and his spouse and by no other person and the fair market value of such of the property of the trust as was contributed by them at the time of the creation of the trust, or at any subsequent time exceeds the fair market value of such of the property of the trust as was contributed by any other person or persons at any subsequent time (such fair market values being determined at the time of the making of any such contribution), means that individual and his spouse;

Sec. 108(1)(i)

(i) "Testamentary trust". - "testamentary trust" means a trust or estate that arose upon the death of an individual and in consequence of his death, but for greater certainty does not include any such trust that was created by any person other than that individual; and

Sec. 108(1)(j)

(j) "Trust". - "trust" includes an inter vivos trust and a testamentary trust but, in subsections 104(4), (5), (12) (14) and (15), and sections 105 to 107 does not include
(i) a unit trust, or
(ii) a trust governed by a registered pension fund or plan, an employees profit sharing plan, a registered supplementary unemployment benefit plan, a registered retirement savings plan or a deferred profit sharing plan.

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Sec. 108(2)

(2) Meaning of expression "unit trust". - For the purposes of this Act, a trust is a unit trust at any particular time if, at that time, it was an inter vivos trust the interest of each beneficiary under which was described by reference to units of the trust, and
(a) the issued units of the trust included
(i) units having conditions attached thereto that included conditions requiring the trust to accept, at the demand of the holder thereof, and at prices determined and

payable in accordance with the conditions the surrender of the units, or fractions or parts thereof, that are fully paid, or

(ii) units qualified in accordance with prescribed conditions relating to the redemption of the units by the trust,

and the fair market value of such of the units as had conditions attached thereto that included such conditions or as were so qualified, as the case may be, was not less than 95% of the fair market value of all of the issued units of the trust (such fair market values being determined without regard to any voting rights attaching to units of the trust), or

(b) throughout the taxation year in which the particular time occurred it complied with the following conditions:
(i) it was resident in Canada,
(ii) its only under taking was the investing of funds of the trust,
(iii) at least 80% of its property throughout the year consisted of shares, bonds, mortgages, marketable securities, or cash, or of rights to or interests in any rental or royalty computed by reference to the amount or value of production from an oil or gas well, or from a mineral resource, situated in Canada,
(iv) not less than 95% of its income for the year was derived from, or from dispositions of, investments described in subparagraph (iii),
(v) at no time in the year did more than 10% of its property consist of shares, bonds or securities of any one corporation or debtor other than Her Majesty in right of Canada or a province or a Canadian municipality, and
(vi) all holdings of and transactions, if any, in its units accorded with prescribed conditions relating to the number of its unit holders, dispersal of ownership of its units and public trading of its units.

Sec. 108(3)

(3) For the purposes of paragraph 70(6)(b), paragraphs 73(1)(a) and (b), paragraph 104(4)(a) (herein called the "rollover provisions:) and of paragraph 108(1)(e)

(a) the income of a trust is its income computed without reference to the provisions of this Act.
(b) where the trust directs the application of the income of the trust for the benefit of the spouse, the spouse, shall for the purposes of this Act, be deemed to be entitled to receive the income so directed to be applied.
(c) the fact that debts of the taxpayer or taxes exigible by reason of his death or administration expenses of the trust are payable out of the property of the trust shall not for that reason only prevent the application of the rollover provisions.

payable in accordance with the conditions the currency of the units, or fractions or parts thereof, that are fully paid, or
(ii) units qualified in accordance with prescribed conditions relating to the redemption of the units by the trust,

and the fair market value of such of the units as had conditions attached thereto that included such conditions or as were so qualified, as the case may be, was not less than 95% of the fair market value of all of the issued units of the trust (such fair market values being determined without regard to any voting rights attaching to units of the trust), or

(b) throughout the taxation year in which the particular time occurred it complied with the following conditions:
(i) it was resident in Canada,
(ii) its only undertaking was the investing of funds of the trust,
(iii) at least 80% of its property throughout the year consisted of shares, bonds, mortgages, marketable securities, or cash, or of rights to or interests in any rental or royalty computed by reference to the amount or value of production from an oil or gas well, or from a mineral resource, situated in Canada,
(iv) not less than 95% of its income for the year was derived from, or from dispositions of, investments described in subparagraph (iii),
(v) at no time in the year did more than 10% of its property consist of shares, bonds or securities of any one corporation or debtor other than Her Majesty in right of Canada or a province or a Canadian municipality, and
(vi) all holdings of and transactions, if any, in its units accorded with prescribed conditions relating to the number of its unit holders, dispersal of ownership of its units and public trading of its units.

Sec. 108(3)

(3) For the purposes of paragraph 70(6)(b), paragraphs 73(1)(c) and (b), paragraph 104(4)(a) (herein called the "rollover provisions") and of paragraph 108(1)(a)

(a) the income of a trust is its income computed without reference to the provisions of this Act
(b) where the trust directs the application of the income of the trust for the benefit of the spouse, the spouse shall for the purposes of this Act, be deemed to be entitled to receive the income so directed to be applied,
(c) the fact that costs of the trust or taxes payable by reason of its death or administration expenses of the trust are payable out of the property of the trust shall not for that reason only prevent the application of the rollover provisions.

Comment: The Bar Association feels concern on two points in connection with the exclusive trust for a spouse. In the first place if money is spent for the benefit of a spouse rather than being paid to a spouse it ought to be treated in the same way. There is some concern that it would not be so treated and that the possibility of spending income for the benefit of a spouse would disqualify the trust. Similarly there is concern that if the trust must bear taxes payable to a province or to a municipality or debts of the deceased, that the trust would be disqualified. A section such as section 7(4) of the Estate Tax Act together with its interpretation is required and the Association is satisfied with the language which is proposed for this purpose.

Additional Sections to be amended.

110 (2) (a) Where an individual was, during the taxation year a member of a religious order and had, as such, taken a vow of perpetual poverty, he may, in lieu of the deduction permitted by paragraph (1)(a), deduct from his income for the year an amount equal to his earned income for the year as defined by section 63 if, of his income, that amount has been paid to the order.

(b) Where a taxpayer has died in a taxation year in applying paragraph (1)(a) for the purpose of computing his taxable income for that year that paragraph shall be read without reference to the words "not exceeding 20%".

Comment: The Bill now limits charitable deductions to an amount equal to 20% of the taxable income in the terminal period. It is, in fact, not uncommon for a taxpayer to give all of his property, or all of his property subject to a life interest in favour of his spouse (and perhaps other dependants) to charity. The effect of the present provisions of the Bill would be to make some part of the charitable gift an amount in excess of the 20% limit and hence taxable. It is, therefore, suggested that in the year of death a 100% deduction should be available for charity. It is to be noted that this is not a novel suggestion. A 100% deduction is now available under the Estate Tax Act of Canada and is as well available under the Income Tax Act when a gift is being made to that well-known charity, the Crown. The Bar Association requests that the 100% deduction be generally applicable to all charitable gifts in the year of death.

54 (e) "listed personal property" of a taxpayer means his personal-use property that is all or any portion of, or any interest in or right to, any

(i) print, etching, drawing, painting, sculpture, or other similar work of art,
(ii) jewellery,
(iii) rare folio, rare manuscript, or rare book,
(iv) stamp,
(v) coin,
(vi) antique funiture,
(vii) gold, silver, antique flatware or plate,
(viii) antique or rare china.

Comment: In the Minister's explanation of the Bill, the categories of listed personal property were explained as being examples of items which did not normally depreciate through use and would hence normally attract a gain on disposition. However, the technique in the Statute understandably has been to define a specific list for the purposes of listed personal property and the list contains omissions. Ordinary furniture depreciates through use but genuine antiques do not. The difficulty of establishing what is an antique can be resolved and is resolved for the purposes of the customs regulations. The present list includes coins, jewellery and works of art. These categories do not embrace gold or sterling silver tableware. Such articles do not depreciate through use and as they acquire patina of age they also acquire value. Similar articles made of more base metals such as pewter or copper or brass while normally belonging to the category of things which depreciate through use, may, if they are very old, move into the category of antiques and like the antique furniture, begin to appreciate by the passage of time whether or not used. Finally, antique or rare china describes two classes of pottery which do not depreciate through use. Every member of the Senate must be acquainted with particular items which, whether or not used, are more valuable now than when they were purchased. The characteristic of antiquity is here the more important qualification. Rare china which is not also old china will not commonly arise. However, certain of the most artistic makers of fine china are in the habit of issuing special limited editions which immediately commence growing in value.

40 (2) (k) For the purposes of paragraph 69(1)(b) and subsections 70(5) and 104(4) there may be deducted from the proceeds of disposition otherwise determined of property (other than depreciable property) an amount equal to the reasonable expenses which would have been incurred by the taxpayer in the disposition of the property deemed to be disposed of by him had he actually disposed of that property.

Comment: Commission on the sale of property and other similar expenses are deductible in computing the capital gain to be paid by the taxpayer. It seems only fair that allowance be made for this type of expense which the property is deemed to be realized rather than actually realized.

122 (2) Subsection (1) is not applicable for a taxation year of an inter vivos trust other than a mutual fund trust or a classified trust if the trust

(a) was established before June 18, 1971

(b) was resident in Canada on June 18, 1971 and without interrruption thereafter until the end of the year,

(c) did not carry on any active business in the year,

(d) has not received any property by way of gift after Royal Assent has been given to this Act,

(e) has not after Royal Assent has been given to this Act insured
  (i) any debt
  (ii) any other obligation to pay an amount to, or guaranteed by, any person with whom any beneficiary of the trust was not dealing at arms length.

Comment: Many trusts have been unintentionally put into the minimum 50% taxation category by additional gifts or borrowings since June 18, 1971. The authors of the Bill have their sights set upon sophisticated taxpayers indulging in constant tax planning. For such persons the rule of June 18 is undoubtedly fair. Those people all heard about this particular provision over the weekend of June 19 and 20. However, small trusts, often for children, are legion, not attended by formality and not always or even most largely, created by sophisticated people. The mother who banks her family allowance cheques in the name of the children, the grandfather who buys a $50 Canada Savings Bond each year for his grandchildren, are examples. Those trusts should be saved by the creation of a new category of infants' trusts but pending such salvation, it would be more equitable to give a greater amount of time to taxpayers to become acquainted with the rule. At the time of the last amendment Section 13(4) of the Estate Tax Amendment Act, 1968-1969 allowed taxpayers to engage in post mortem variations of wills in order to qualify within the definition of the spouse-exempt trust created by section 7(1)(b) of the Estate Tax Act. Such variation was permitted until August 1, 1969 and the purpose was to allow a sufficient period of time to elapse to catch the cases where persons would not have had a reasonable opportunity to alter wills. The same principle is applicable here.

Comment for Classified Trust. At present the Bill recognizes the following categories of trusts:

Unit Trusts

Testamentary Trusts
(a) exclusive spouse trust
(b) other trust

Inter Vivos Trusts
(a) exclusive spouse trust
(b) other trust created before June 18, 1971 and not contaminated by gifts or borrowing since that time
(c) other inter vivos trusts

The effect of the Bill is to treat generously spouse trusts, testamentary trusts and pre-June 18 trusts but all living trusts

(d) has not received any property by way of gift after Royal Assent has been given to this Act,

(e) has not after Royal Assent has been given to this Act incurred
  (i) any debt
  (ii) any other obligation to pay an amount to, or guaranteed by, any person with whom any beneficiary of the trust was not dealing at arms length.

Comment: Many trusts have been unintentionally put into the minimum 50% taxation category by additional gifts or borrowings since June 18, 1971. The authors of the Bill have their sights set upon sophisticated taxpayers indulging in constant tax planning. For such persons the rule of June 18 is undoubtedly fair. Those people all heard about this particular provision over the weekend of June 19 and 20. However, small trusts, often for children, are legion, not attended by formality and not always or even mostly, created by sophisticated people. The mother who banks her family allowance cheques in the name of the children, the grandfather who buys a $50 Canada Savings Bond each year for his grandchildren, are examples. These trusts should be saved by the creation of a new category of infants' trusts but pending such salvation, it would be more equitable to give a greater amount of time to taxpayers to become acquainted with the rule. At the time of the last amendment Section 12(4) of the Estate Tax Amendment Act, 1968-1969 allowed taxpayers to engage in post mortem variations of wills in order to qualify within the definition of the spouse-exempt trust created by section 7(1)(b) of the Estate Tax Act. Such variation was permitted until August 1, 1969 and the purpose was to allow a sufficient period of time to elapse to catch the cases where persons would not have had a reasonable opportunity to alter wills. The same principle is applicable here.

<u>Remedy for Disqualified Trust.</u> At present the Bill recognizes the following categories of trusts:

Unit Trusts

Testamentary Trusts
(a) exclusive spouse trust
(b) other trust

Inter Vivos Trusts
(a) exclusive spousal trust
(b) other trust created before June 18, 1971 and not contaminated by gifts or borrowing since that time
(c) other inter vivos trusts.

The effect of the Bill is to treat generously spouse trusts, testamentary trusts and pre-June 18 trusts but all living trusts

created after June 18 are treated punitively as if there never were any reason for employing them except tax avoidance. The Bar Association finds it tiresome to have to reiterate over and over again in argument with tax policy officials at the federal level that there are other uses and reasons for trusts than tax avoidance and that these uses are of everyday application. In the 1968-1969 amendments it was recognized that an infant's trust was a legitimate device. There was also recognition in the estate tax context of a trust for an incapable person. It is suggested that the revenue has nothing to fear from the creation of further types of trusts to be treated on a less punitive basis both as to the time when the trust is deemed to dispose of its capital assets and as to the applicable rate of tax on accumulating income. The Bar Association would suggest that the two categories most urgently required are the category of a protective trust and the category of infant's trust. In each case conditions could be established to protect the revenue while at the same time leaving criteria which could be met in ordinary cases. The Bar Association considers that flexibility could be obtained in this connection by building in the possibility of prescribing categories of trusts by regulation and in this way making provision in the future not only for the two types mentioned, but also for other types. The required amendment is extremely simple.

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