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# Global Tax Alert

News from Americas Tax Center

## Finance Canada releases draft legislation for 2019 budget measures

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### Executive summary

On 30 July 2019, the Canada's Department of Finance released for public comment draft legislative proposals (and accompanying explanatory notes) to implement measures remaining from the 2019-20 federal budget,<sup>1</sup> as well as revisions to the recently enacted measures concerning accelerated capital cost allowance (CCA) and resource expenses.<sup>2</sup>

Interested parties are invited to provide comments on the draft legislative proposals by 7 October 2019.

The following is a summary of the income tax measures included in the package of draft legislative proposals.

### Detailed discussion

#### Business income and international tax measures

- ▶ **Foreign affiliate dumping** – Expansion of the foreign affiliate dumping rules in section 212.3 of the *Income Tax Act* to apply to a corporation resident in Canada that is controlled by a nonresident individual, a nonresident trust, or a group of non-arm's-length persons that includes any combination of nonresident corporations, nonresident individuals, and nonresident trusts.

In addition, the meaning of “related” for this and other specified purposes will be extended to ensure that a nonresident trust will be considered to be related to another nonresident person in circumstances similar to those in which a nonresident corporation would be so related. These measures will apply to transactions or events that occur on or after 19 March 2019.

▶ **Cross-border securities lending arrangements** –

Amendments targeting certain cross-border securities lending arrangements, including the following measures:

– **Arrangements involving shares of a Canadian corporation** –

Amendments to ensure that a dividend compensation payment made under a securities lending arrangement by a Canadian borrower to a nonresident in respect of a Canadian share is always treated as a dividend (and, accordingly, subject to Canadian withholding tax), whether or not the arrangement is “fully collateralized.” As well, amendments are proposed to extend the characterization rules to apply to “specified securities lending arrangements.” In general terms, this will extend the application of the characterization rules to payments in respect of any arrangement that is substantially similar to a securities lending arrangement but that, as a technical matter, fails certain conditions required to meet the definition of “securities lending arrangement.” Additional amendments are proposed to ensure that the securities lending arrangement rules cannot be used to obtain other unintended withholding tax benefits. These measures will apply to compensation payments made on or after 19 March 2019, unless a securities loan was in place before this date, in which case the amendments will apply to compensation payments made after September 2019.

– **Arrangements involving shares of a nonresident corporation** –

Broadening of the withholding tax exemption for dividends to include any dividend compensation payment made by a Canadian borrower to a nonresident under a securities lending arrangement, if either the securities lending arrangement is “fully collateralized” or the borrower and lender are dealing at arm’s length, and the lent security is a foreign share. This measure will apply to dividend compensation payments made on or after 19 March 2019.

▶ **Transfer pricing** – Amendments to clarify that the interaction between the transfer pricing rules in section 247 of the *Income Tax Act* and the application of other provisions in the *Income Tax Act*, including provisions relating to income computation in Part I. In particular, the proposed

rules require that a taxpayer first establish amounts that would be determined for purposes of the *Income Tax Act* (referred to as the “initial amounts”), if the *Income Tax Act* were read without reference to the transfer pricing rules and the general anti-avoidance rule (GAAR). The transfer pricing rules in subsection 247(2) are to then be applied to make adjustments, if any, to the initial amounts (to arrive at the “adjusted amounts”). Finally, the other provisions of the *Income Tax Act* (including GAAR) are to then be applied using the adjusted amounts. The current exceptions to the application of the transfer pricing rules that pertain to situations in which a Canadian resident corporation has an amount owing from, or extends a guarantee in respect of an amount owing by, a controlled foreign affiliate will continue to apply. This measure will apply to taxation years that begin on or after 19 March 2019.

▶ **Mutual funds: “allocation to redeemers” methodology** – Introduction of a new rule that would deny a mutual fund trust a deduction in respect of the portion of an allocation made to a unitholder on a redemption of a unit of the mutual fund trust that is greater than the capital gain that would otherwise have been realized by the unitholder on the redemption, if the allocated amount is a capital gain and the unitholder’s redemption proceeds are reduced by the allocation. This measure will ensure that any capital gains realized by a mutual fund trust in a taxation year in excess of the capital gains realized by redeeming unitholders in that year will be taxed in that year either at the mutual fund trust level or in the hands of the remaining unitholders. Similarly, to prevent the conversion of ordinary income to capital gains for the remaining unitholders (i.e., in circumstances where the redeeming unitholders hold their units on income account and the remaining unitholders hold their units on capital account), a new rule will be introduced to deny a mutual fund trust a deduction in respect of an allocation made to a unitholder on a redemption if the allocated amount is ordinary income and the unitholder’s redemption proceeds are reduced by the allocation. These measures will apply to taxation years of mutual fund trusts that begin on or after 19 March 2019, subject to certain transitional rules.

▶ **Extended reassessment period** – Expansion of the extended three-year reassessment period for reassessments made as a consequence of a transaction involving a taxpayer and a non-arm’s-length nonresident to apply to a “transaction” as defined in subsection 247(1) of the *Income Tax Act*. The expanded definition of “transaction” includes an arrangement or event. As a result of this amendment, the

extended reassessment period will apply to a reassessment made as a consequence of a transaction, arrangement, or event involving a taxpayer and a nonresident with whom the taxpayer does not deal at arm's length. This measure will apply to taxation years for which the normal reassessment period ends on or after 19 March 2019.

- ▶ **Electronic delivery of requirements for information** – Amendments to allow the Canada Revenue Agency (CRA) to send requirements for information (under the *Income Tax Act*) in respect of third-party financial information to banks and credit unions electronically, effective 1 January 2020. To receive such requirements electronically, the bank or credit union must notify the CRA that it consents to this method of service. Similar amendments are also made for requirements for information under the *Excise Tax Act*, the *Excise Act, 2001*, the *Air Travellers Security Charge Act*, and the *Greenhouse Gas Pollution Pricing Act*.
- ▶ **Accelerated investment incentive for depreciable property and resource expenditures** – Various technical amendments relating to the accelerated investment incentive rules and accelerated CCA for zero-emission vehicles, which were recently enacted as part of Bill C-97, *Budget Implementation Act, 2019*, No. 1, including:
  - Amendment to ensure the short taxation rule in subsection 66(13.1) of the *Income Tax Act* applies in determining the amount of a taxpayer's accelerated Canadian development expense and accelerated Canadian oil and gas property expense (applicable for taxation years that end after 30 July 2019)
  - Amendments to ensure the appropriate factors apply to the calculation of accelerated CCA for property included in Class 43, 43.2 or 53 in a taxation year prior to when the property becomes available for use (i.e., since inclusion in these classes depends on the date of acquisition, whereas the accelerated investment incentive factor depends on when the property becomes available for use)
  - Amendment to the definition of accelerated investment incentive property to ensure the exclusion of property for which CCA has been claimed by any person or partnership (including the taxpayer) in a taxation year ending prior to the acquisition of the property
  - Introduction of new rules (in proposed subsection 1104(4.1) of the *Income Tax Regulations*) to ensure the accelerated investment incentive property rules apply appropriately in circumstances where property is constructed over multiple taxation years and is transferred between non-arm's-length parties before being put into use

- Amendments to the rules (in new subsection 1100(2.02) of the *Income Tax Regulations*), which ensure that the full expensing or accelerated investment incentive is generally not available in respect of certain property acquired after 20 November 2018 from a non-arm's-length person or partnership
- Broadening of the anti-avoidance rule (in new subsection 1102(20.1) of the *Income Tax Regulations*) to prevent taxpayers from entering into artificial arrangements with a view to satisfying the arm's-length condition in new subsection 1100(2.02) of the *Income Tax Regulations* to benefit from the accelerated CCA treatment on certain arm's-length property transfers (applicable in respect of property acquired after 30 July 2019)
- Amendments to the calculation of the taxpayer's proceeds of disposition for a zero-emission passenger vehicle (where the cost to the taxpayer of the vehicle exceeds the prescribed amount that is eligible for Class 54 treatment and the disposition is to an arm's-length person or partnership) to take into account any government assistance received or repaid in respect of the vehicle (applicable in respect of dispositions made on or after 30 July 2019)

Unless otherwise indicated above, these amendments apply in respect of property acquired after 20 November 2018.

## Personal and other income tax measures

- ▶ **Change in use rules for multi-unit residential properties**
  - Amendments to ensure that the tax treatment for owners of multi-unit residential properties is consistent with tax treatment for owners of single-unit residential properties when there is a change in use of the property. Specifically, the amendments will allow a taxpayer to elect that the deemed disposition that normally applies on a change in use of part of a property not apply (applicable in respect of a change in use of property that occurs on or after 19 March 2019).
- ▶ **Registered plans: Additional types of annuities** – Introduction of two new types of permitted annuities for certain registered plans, effective as of 1 January 2020, including:
  - **Advanced life deferred annuities** – Amendments will permit an advanced life deferred annuity (ALDA) to be a qualifying annuity purchase under an RRSP, RRIF, deferred profit sharing plan (DPSP), pooled registered pension plan (PRPP) and a defined contribution registered pension

plan (RPP), as well as a qualified investment for a trust governed by an RRSP or RRIF. An ALDA will be a life annuity, the commencement of which may be deferred until the end of the year in which the annuitant turns 85. Individuals will be subject to both a lifetime ALDA limit in relation to a transfer from a particular qualifying plan (referred to as an “excess ALDA transfer”), as well as a comprehensive lifetime ALDA dollar limit of CA\$150,000 for all qualifying plans (indexed to inflation for taxation years after 2020, rounded to the nearest CA\$10,000). Individuals who exceed the ALDA dollar limit or have an excess ALDA transfer will generally be subject to a 1% per-month penalty tax on the greater of the two excesses; however, in certain circumstances this tax may be waived or cancelled. Various conditions and rules related to the taxation of annuity payments, death benefits and refunds are set out in proposed section 146.5, and the penalty tax rules are set out in proposed Part XI of the *Income Tax Act*.

– **Variable payment life annuities** – Amendments will permit PRPPs and defined contribution RPPs to provide a variable payment life annuity (VPLA) to members directly from the plan. A VPLA will provide payments that may be adjusted annually depending on the investment performance of the underlying annuities fund and on the mortality experience of VPLA annuitants. Administrators of a PRPP or defined contribution RPP will be allowed to establish a separate annuities fund under the plan to receive transfers of amounts from members’ accounts to provide VPLAs (i.e., direct employee and employer contributions to the annuities fund will be prohibited). For a plan to establish such an arrangement, a minimum of 10 retired members must participate in the VPLA arrangement on an ongoing basis. Additional requirements must also be met by a VPLA. For example, payments must commence by the later of the end of the year in which the member attains 71 years of age and the end of the calendar year in which the VPLA is acquired.

▶ **Registered disability savings plans (RDSP)** – Amendments to remove the time limitation on the period that an RDSP may remain open after a beneficiary ceases

to be eligible for the disability tax credit (DTC), and to remove the requirement for medical certification that the beneficiary is likely to become DTC-eligible in the foreseeable future, effective as of 1 January 2021. As a transitional measure, an RDSP issuer will not be required to close an RDSP after 18 March 2019 and before 2021 solely because an RDSP beneficiary ceases to be eligible for the DTC or a previous election to allow an RDSP holder to keep an RDSP open ceases to be valid. Amendments will also permit a rollover of proceeds from a deceased individual’s RRSP, RRIF, PRPP or RPP to the RDSP of a financially dependent infirm child or grandchild that is not DTC-eligible provided the rollover occurs by the end of the fourth calendar year following the first full year throughout which the beneficiary is ineligible for the DTC (effective as of 19 March 2019).

▶ **Specified multi-employer plan (SMEP) contributions** – Amendments to prohibit contributions to an SMEP for a member of the plan after the calendar year in which the member turns 71, and to a defined benefit provision of an SMEP during a period (other than a qualifying period) in which the member is in receipt of retirement benefits from a defined benefit provision of the plan. A qualifying period generally refers to a period in which the member is employed by an employer who participates in the plan. These amendments apply in respect of contributions made pursuant to any collective bargaining agreement entered into after 2019 (other than to contributions made on or before the date the agreement is entered into).

▶ **Pensionable service under individual pension plans (IPPs)** – Amendments to prohibit tax-deferred transfers to an IPP in respect of past years of employment that were pensionable service under a defined benefit plan of an employer other than the IPP’s participating employer (or its predecessor employer). Any assets transferred from a former employer’s defined benefit plan to an IPP that relate to benefits provided in respect of prohibited service will be considered to be a non-qualifying transfer that is required to be included in the income of the member for income tax purposes. This measure generally applies as of 19 March 2019.

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## Endnotes

1. See EY Global Tax Alert, [Canada issues Federal Budget 2019/20: Investing in the middle class](#), dated 20 March 2019.
2. See EY Global Tax Alert, [Canada’s CCA acceleration measures enacted as part of 2019 budget implementation bill](#), dated 25 June 2019.

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