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Focus on Select Proposed Technical Amendments

Wednesday, October 12, 2022

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1. Foreign affiliate share - for - share exchanges (subsections 85.1(3) and(4))
2. Foreign mergers (subsections 87(8) and (8.3))
3. Partnerships deemed resident in Canada for Part XIII (paragraph 212(13.1)(a))
4. Partnerships that cease to exist (subsections 98(3) and (5))
5. Shareholder loan exception (subsection 15(2.3))

August 9, 2022 Proposed Technical Amendments



Proposed Technical Amendments

- Department of Finance News Release (August 9, 2022) describes the proposed technical amendments as intended “to improve the certainty and integrity of the tax system”
 - Canadians invited to provide comments by September 30, 2022
- August 9, 2022 release includes other technical amendments, as well as legislative proposals to implement Budget 2022 tax measures

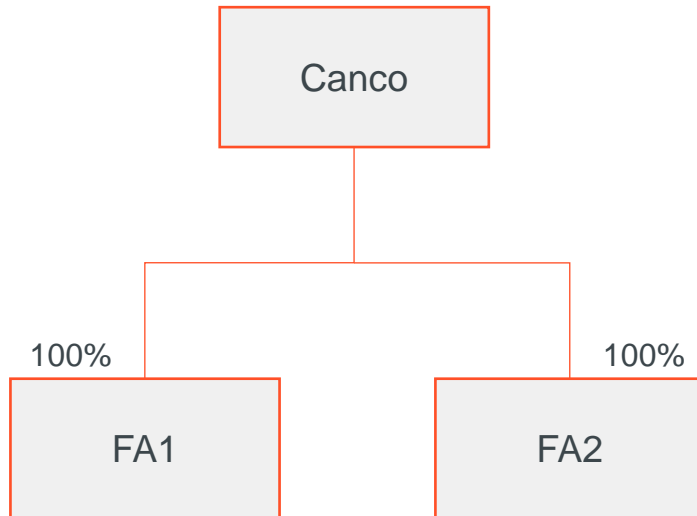
ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

ITA s. 85.1(3) and (4)

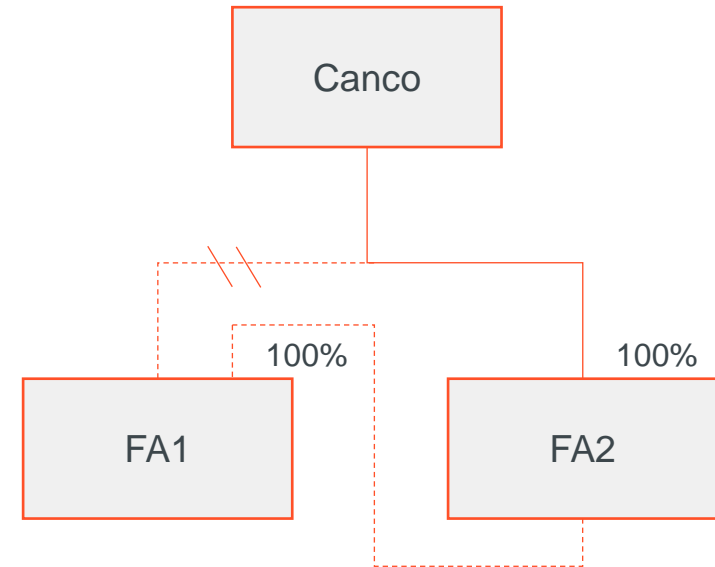
- S. 85.1(3) allows a taxpayer to transfer capital property that is foreign affiliate shares (FA1) to another foreign affiliate (FA2) of the taxpayer in exchange for shares of FA2 on a tax-deferred rollover basis
- S. 85.1(3) does not apply if the anti-avoidance rules in s. 85.1(4)(a) or (b) apply

Example 85.1(3)

Before:



After:



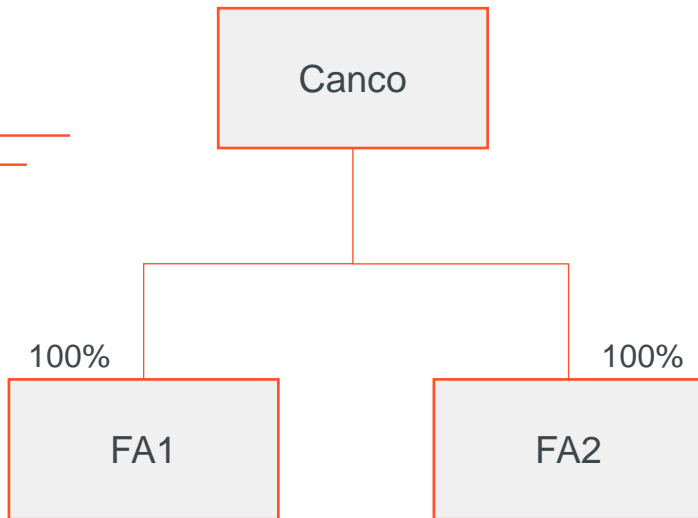
ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

CURRENT S. 85.1(4)(a)

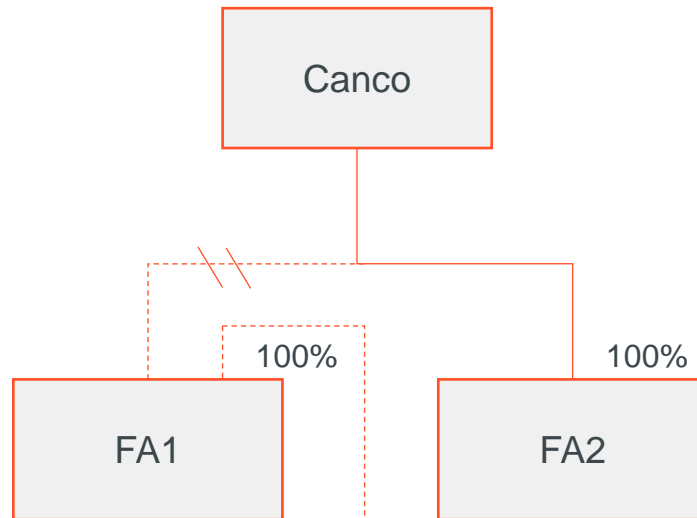
- Provides that s. 85.1(3) does not apply in respect of a disposition at any time by a taxpayer of a share of FA1 to FA2 if both of the following conditions are satisfied:
 1. **Excluded property condition:** all or substantially all of the property of FA1 was, immediately before that time, excluded property (within the meaning assigned by subsection 95(1)) of FA1
 2. **Arm's length acquirer condition:** the disposition is part of a transaction or event or a series of transactions or events for the purpose of disposing of the share to a person or partnership that, immediately after the transaction, event or series, was a person or partnership (other than a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest (within the meaning assigned by paragraph 95(2)(m)) at the time of the transaction or event or throughout the series, as the case may be) with whom the taxpayer was dealing at arm's length

Example 85.1(4)

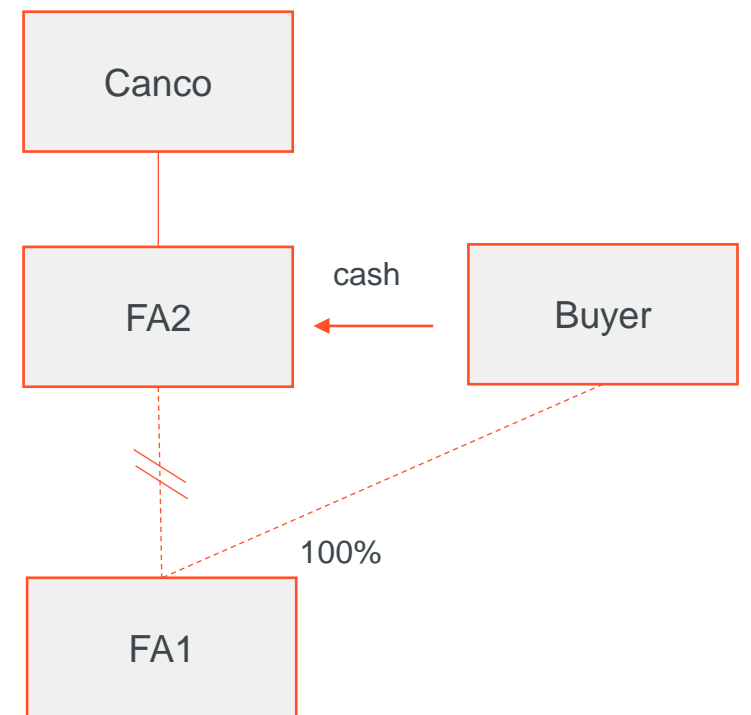
Before:



First Transfer:



Sale:



ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

PROPOSED S. 85.1(4)(a)(i)

Excluded property condition: all or substantially all of the property of FA1 was, immediately before the time of the disposition, excluded property of FA1 or at the time of the other disposition, the property that is disposed of is excluded property of a foreign affiliate of the taxpayer

ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

PROPOSED S. 85.1(4)(a)(ii)

Arm's length or non-resident acquirer ("bad acquirer") condition: the particular disposition is part of a transaction or event or a series of transactions or events that includes another disposition ("Series"), of the share, one or more properties substituted for the share or a property any of the fair market value of which is derived, directly or indirectly, from the share or the substituted property, to an acquirer — other than a non-resident corporation that is a controlled foreign affiliate of the taxpayer for the purposes of section 17 at the time of the transaction or event or throughout the Series, as the case may be — that, immediately after the transaction, event or Series, was dealing at arm's length with the taxpayer or was a non-resident person with whom the taxpayer was not dealing at arm's length

ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

Arm's length or non-resident acquirer ("bad acquirer") condition:

1. As part of the same Series that includes the disposition of the shares of FA1, there is a disposition of:
 - the shares of FA1;
 - one or more properties substituted for the shares of FA1 ("**FA1 Shares Substituted Property**"); or
 - property any of the fair market value of which is derived, directly or indirectly, from the shares of FA1 or the FA1 Shares Substituted Property

(collectively, the "**Bad Property**")

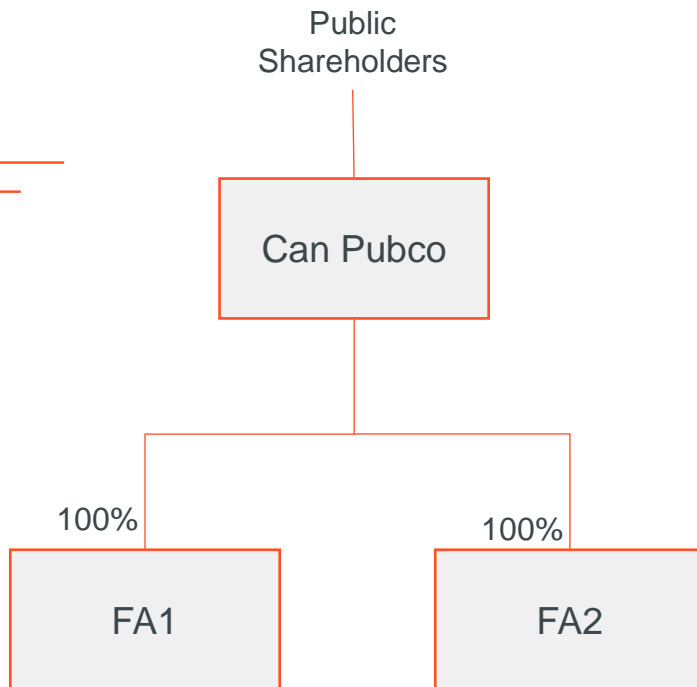
ITA s. 85.1 Foreign Affiliate Share-for-Share Exchange

Arm's length or non-resident acquirer ("bad acquirer") condition (cont'd):

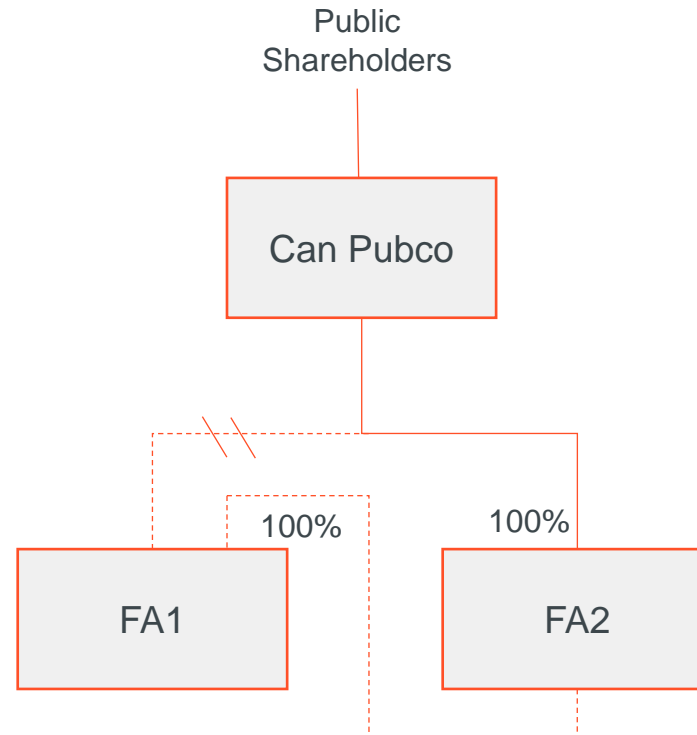
2. The Bad Property is disposed of to to an acquirer (other than a controlled foreign affiliate (for the purpose of section 17) of Canco) that immediately after the series was either ("**Bad Acquirer**"):
 - dealing at arm's length with Canco; or
 - was a non-resident person with whom Canco was not dealing at arm's length

Example Proposed 85.1(4)

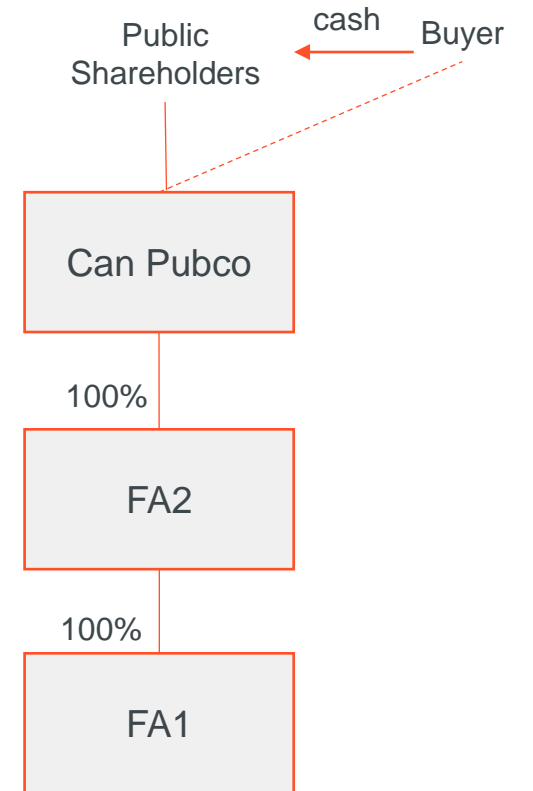
Before:



First Transfer:



Sale:



ITA s. 87(8.3) Foreign Mergers

FOREIGN MERGERS S. 87(8) and (8.3)

- S. 87(8) generally allows certain foreign mergers to qualify for the tax-deferred amalgamation provisions in s. 87(4) and (5).
- S. 87(8.3) is an anti-avoidance rule that is intended to prevent foreign merger transactions from being used to effectively transfer shares of a foreign affiliate in a manner that is inconsistent with the anti-avoidance rule in s. 85.1(4)
 - S. 87(8.3) is proposed to be amended in parallel to the proposed amendments to s. 85.1(4)

ITA s. 87(8.3) Foreign Mergers

CURRENT S. 87(8.3)

- Provides that s. 87(8) does not apply in respect of a taxpayer's shares of a predecessor foreign corporation that are exchanged for/become, on a foreign merger, share of the new foreign corporation/foreign parent corporation if three conditions are satisfied:

1. Foreign affiliate condition

The new foreign corporation is, at the time that is immediately after the foreign merger, a foreign affiliate of the taxpayer

2. Excluded property condition

Shares of the new foreign corporation are, at that time, excluded property of another foreign affiliate of the taxpayer

ITA s. 87(8.3) Foreign Mergers

CURRENT S. 87(8.3) (cont'd)

3. Arm's length acquirer condition

The foreign merger is part of a transaction or event or a series of transactions or events that includes a disposition of shares of the capital stock of the new foreign corporation, or property substituted for the shares, to

- a person (other than a foreign affiliate of the taxpayer in respect of which the taxpayer has a qualifying interest (within the meaning assigned by paragraph 95(2)(m)) at the time of the transaction or event or throughout the series, as the case may be) with whom the taxpayer was dealing at arm's length immediately after the transaction, event or series; or
- a partnership a member of which is, immediately after the transaction, event or series, a person described in immediately above

ITA s. 87(8.3) Foreign Mergers

PROPOSED S. 87(8.3)

- Provides that s. 87(8) does not apply in respect of a taxpayer's shares of a predecessor foreign corporation that are exchanged for/become, on a foreign merger, shares of the new foreign corporation/foreign parent corporation if three conditions are satisfied:

1. Foreign affiliate condition

The new foreign corporation is, at the time that is immediately after the foreign merger, a foreign affiliate of the taxpayer

- no change under August 9, 2022 proposed amendments

ITA s. 87(8.3) Foreign Mergers

PROPOSED S. 87(8.3) (cont'd)

2. Disposition of property condition

The foreign merger is part of a transaction or event or a series of transactions or events that includes a disposition of property that is:

- shares of the new foreign corporation
- property substituted for shares of the new foreign corporation, or
- property any of the FMV of which is derived, directly or indirectly, from property referred to above

ITA s. 87(8.3) Foreign Mergers

PROPOSED S. 87(8.3) (cont'd)

3. Arm's length or non-resident acquirer condition

The disposition referred to in the second condition is to an acquirer that:

- is not, immediately after the transaction, event or series, a person resident in Canada with which the taxpayer does not deal at arm's length, and
- is not, at the time of the transaction or event, or throughout the series, as the case may be, a controlled foreign affiliate of the taxpayer for the purposes of section 17
- See also: proposed s. 87(8.31) for deeming rules, including where the taxpayer and/or the acquirer is a partnership. See also consequential amendments to ITA s. 93.1(3)(c)

ITA s. 87(8.3) Foreign Mergers

PROPOSED S. 87(8.3) (cont'd)

4. Excluded property condition

Any of the following conditions is satisfied:

- all or substantially all of the property of the predecessor foreign corporation was, immediately before the foreign merger, excluded property of the predecessor foreign corporation; or
- at the time of the disposition referred to in paragraph (b), the property that is disposed of is excluded property of a foreign affiliate of the taxpayer.

ITA s. 85.1(4) and 87(8.3) Summary

- Expanded scope of transactions potentially caught: “other” disposition of the share, substituted property, or property that derives *any* of its FMV from the FA1 shares or substituted property
- Expanded scope of ‘bad’ acquirers: *all* non-residents, and partnerships any member of which is an arm’s length person or non-arm’s length non-resident
- Restricts the scope of the exception: formerly included an FA in which the taxpayer had a “qualifying interest” (95(2)(m)) → now must be a controlled foreign affiliate (ITA s. 17 meaning)
- May need to demonstrate that the “other” disposition is not part of the series
 - Common law series, ITA s. 248(10) series
- Amendments proposed to apply in respect of dispositions that occur on or after August 9, 2022

ITA s. 212(13.1)(a) Partnerships and Part XIII

CURRENT ITA s. 212(13.1)(a)

- If a partnership pays/credits an amount to a non-resident person, it is deemed to be a person resident in Canada for Part XIII purposes (other than s. 216) in respect of the portion of the amount that is deductible in computing the partnership's Canadian-source income/loss under s. 96(1)(f) or (g)
- August 9, 2022 proposed amendments to s. 212(13.1)(a) apply to amounts paid/credited no earlier than date of future release of draft legislation, to occur after consultation period for August proposals

ITA s. 212(13.1)(a) Partnerships and Part XIII

PROPOSED ITA s. 212(13.1)(a)

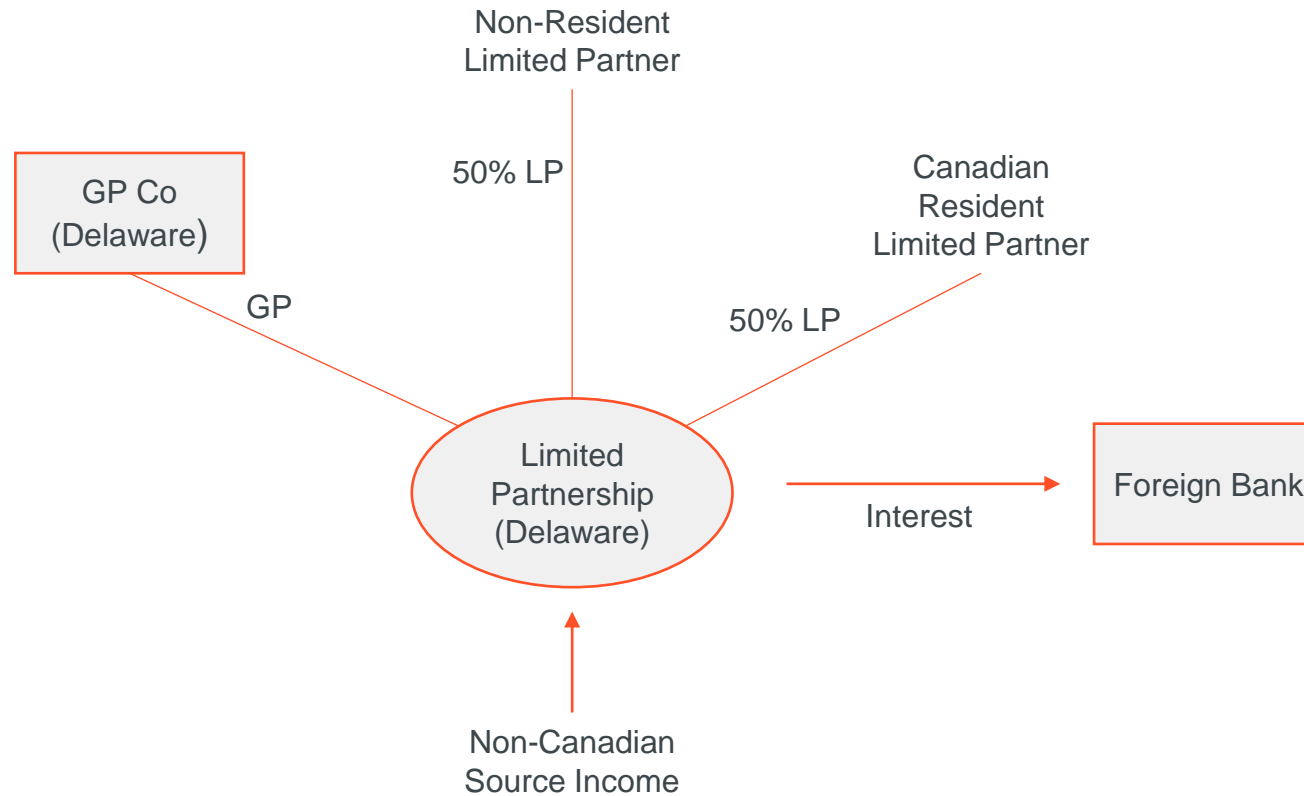
- If a partnership pays/credits a particular amount to a non-resident person, the partnership is deemed to be a person resident in Canada in respect of the total of all amounts each of which is a portion of the particular amount that is deductible, or that would but for section 21 be deductible, in computing, with respect to each member of the partnership:
 - **Canadian-resident member:** the member's share of the partnership's income/loss
 - **Non-resident member:** the portion of the member's share of the partnership's income/loss that is included in (i) the member's taxable income earned in Canada, or (ii) the amount on which the member is liable to pay tax under Part I because of section 216

ITA s. 212(13.1)(a) Partnerships and Part XIII

PROPOSED ITA s. 212(13.1)(a) (cont'd)

- Deeming rule under s. 212(13.1)(a) no longer tied to payments deductible in computing the partnership's Canadian-source income → rule applies to any payment by the partnership to a non-resident person if payment can be deducted in computing income subject to Part I tax of a member
- See also: proposed s. 212(13.11) for deeming rules, including where a partnership pays/credits an amount to another partnership (other than a “Canadian partnership”), and look-through rules for tiered partnerships

Example Proposed 212(13.1)(a)



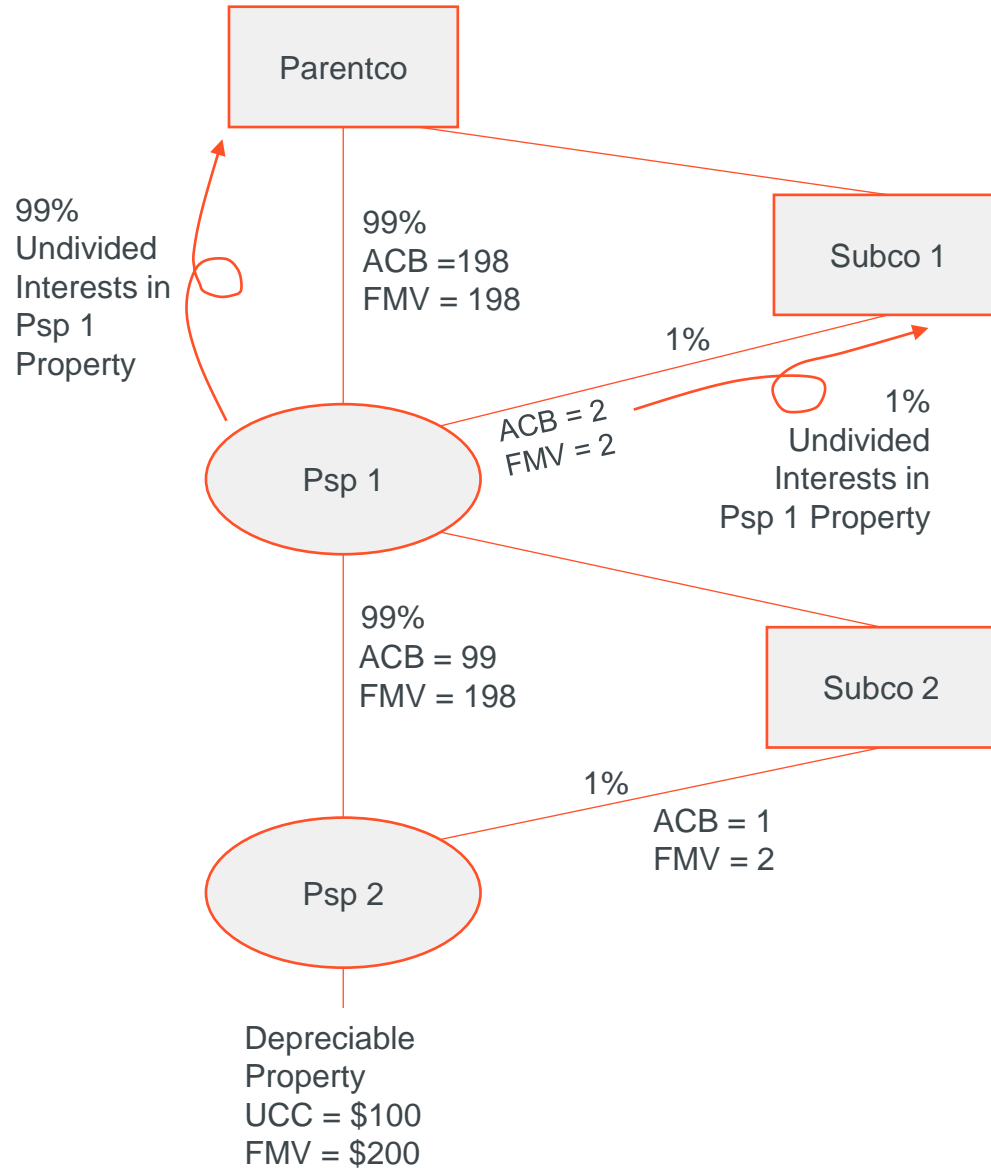
ITA s. 98(3)(c) Partnership Dissolution

CURRENT ITA s. 98(3)(c)

- Subsection 98(3) provides tax deferred treatment on the liquidation and dissolution of a partnership where:
 - Canadian partnership has ceased to exist
 - Each partner receives undivided interests in partnership property proportionate to each partner's interest in the partnership
 - Each partner jointly elects in prescribed form and within prescribed time to have subsection 98(3) apply
- Paragraphs 98(3)(b) and (c) allow a partner to “bump” the cost of non-depreciable capital property received on the liquidation and dissolution up to its FMV if the partners' ACB in its partnership interest exceeds the amount of money and the cost amount of distributed partnership property (“Excess”)
- Paragraph 98(3)(e) provides for bump rules applicable to depreciable property distributed on the liquidation and dissolution and causes to partners to assume the potential recapture on a future sale of the property

Example Current 98(3)(c)

— Parentco can bump cost of interest in Psp 2 to \$197*

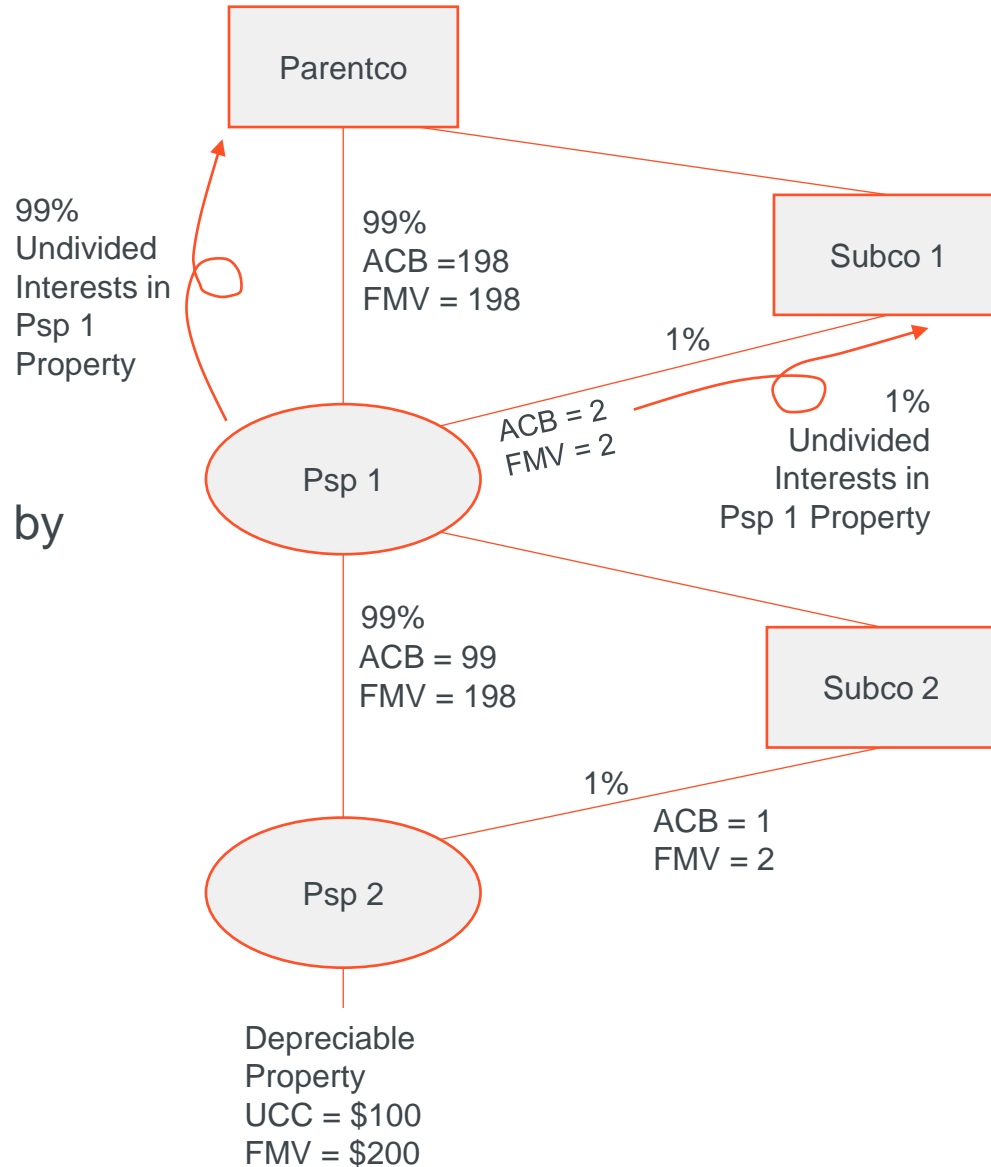


Proposed Amendment 98(3)(c)

- Proposed amendments provide a limit on the amount that a partnership interest received on a subsection 98(3) liquidation and dissolution can be bumped.
- If the property received is a partnership interest, the FMV of the partner's interest in the partnership is deemed to be:
 - The FMV otherwise determined; less
 - The portion of the amount by which the FMV of the partnership interest exceeds the partner's percentage of the cost amount to the partnership being dissolved of the partnership interest as may reasonably be attributable to:
 - The FMV of depreciable property in excess of its cost amount;
 - The FMV of resource property; or
 - The FMV of property that is not capital property or resource property in excess of its cost amount

Proposed 98(3)(c)

No bump is available because excess is attributable to the amount by which the FMV of depreciable property exceeds its cost amount



Shareholder Loans Overview

CURRENT SUBSECTIONS 15(2) AND 15(2.3)

- Generally, a loan received by non-corporate shareholder (or non-resident corporate shareholder) is included in the shareholder's income in the year the loan arose
- Ordinary course of business exception which excludes from the income inclusion:
 - Debts arising in the ordinary course of the creditor's business
 - Loans made in the ordinary course of the lender's ordinary business of lending money

But only where *bona fide* arrangements for repayment are made at the time the debt or loan arose

Shareholder Loans Revised Exception

PROPOSED SUBSECTION 15(2.3)

- Subsection 15(2.3) revised to narrow the money lending business branch of the exception
- Effective for loans outstanding on January 1, 2023:
 - a money lending business where less than 90% of the aggregate outstanding amount of the loans of the business is owing by borrowers that deal at arm's length with the lender is excluded from the protection of subsection 15(2.3)
- Effectively excludes “captive” money lenders within a corporate group from the ordinary course of business exception
- See also new subsection 15(2.31) which provides interpretive rules for determining application of subsection 15(2.3) where one of the parties is a partnership

Thank you.

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