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Implementation bill for variety of Canadian tax measures introduced

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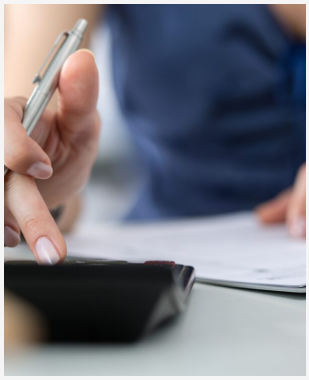

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Osler's National Tax Group has prepared in-depth analysis of these developments. See our Updates on the revised EIFEL rules and the clean energy tax credits.

The *Fall Economic Statement Implementation Act, 2023* includes a variety of tax measures that were introduced in Parliament on November 30, 2023, as Bill C-59. The bill includes measures first announced in the 2023 Fall Economic Statement, as well as updated versions of draft legislation released in August 2023, the 2023 federal budget and earlier. The Canadian federal government also released Explanatory Notes [PDF] in respect of most of the measures in Bill C-59 on the same day.

Key outstanding measures that are not included in Bill C-59 are the *Global Minimum Tax Act* (draft legislation released August 4, 2023), amendments to Canada's transfer pricing regime (consultation paper released June 6, 2023) and the second legislative package of hybrid mismatch rules. Each of those measures is expected to be released at a later date.

Table of contents

- EIFEL rules
- Green initiatives
- Revised GAAR amendments
- Hybrid mismatch rules
- Share buyback tax
- Digital services tax
- Substantive CCPCs
- Employee ownership trusts
- Intergenerational business transfers
- Retirement compensation arrangements – letters of credit

EIFEL rules

Bill C-59 contains a number of revisions to the draft excessive interest and financing expenses limitation (EIFEL) rules that were last released on August 4, 2023. The proposed EIFEL rules are intended to limit the deduction of interest and financing expenses, net of interest and financing revenues, that are considered by the Canadian federal government to be "excessive" compared to earnings based on whether they exceed a fixed ratio equal to

30% of adjusted taxable income (or, in some circumstances, a higher group ratio).

The proposed coming-into-force date for the EIFEL rules has not changed: once enacted, the EIFEL rules would generally apply to corporations and trusts with taxation years beginning on or after October 1, 2023. A higher transitional 40% fixed ratio would only apply for taxation years that begin before January 1, 2024.

Bill C-59 does not contain significant structural changes to the draft EIFEL rules previously released by the Department of Finance. However, there are a number of noteworthy and technical changes, some of which are favourable to taxpayers. Please see the separate Osler Update that focuses on the EIFEL rules for an in-depth discussion of the changes.

Green initiatives

Bill C-59 includes updated legislation to implement the following clean energy related tax measures:

- the Carbon Capture, Utilization and Storage investment tax credit (CCUS ITC)
- the Clean Technology investment tax credit (Clean Tech ITC)
- the prevailing wages and apprenticeship hour requirements (Labour Requirements) applicable to the Clean Tech ITC, CCUS ITC and several other clean energy investment tax credits that the Canadian government has announced

Even though these measures have undergone, in some cases, several rounds of public consultation and revisions, there were further substantive amendments made in the updated legislation included in Bill C-59. Please see the separate Update on these proposals for a more detailed discussion.

Revised GAAR amendments

Following the release of a consultation paper in August 2022, Budget 2023 introduced draft amendments to the General Anti-Avoidance Rule (GAAR). Updated draft amendments, accompanied by Explanatory Notes, were released on August 4, 2023. Further amendments to the GAAR were proposed in Bill C-59, accompanied by revised Explanatory Notes.

The amendments maintain the introduction of a novel preamble that is intended to assist with interpretative issues, a lower threshold for establishing whether there is an avoidance transaction, and an extended limitation period for assessing under the GAAR. The new "economic substance" test to be applied in the misuse and abuse analysis and the new GAAR penalty have both been revised.

Coming into force

Bill C-59 confirms that the amended definition of "avoidance transaction" in subsection 245(3) of the *Income Tax Act* (the Act) and the addition of the economic substance test in subsections 245(4.1) and (4.2) will apply to transactions that occur on or after January 1, 2024. Similarly, the extended limitation period for GAAR assessments in paragraph 252(4)(b) applies to transactions that occur on or after January 1, 2024.

The new penalty provision in subsections 245(5.1) to (5.3) will apply to transactions that occur on or after the later of January 1, 2024, and the date on which Bill C-59 receives Royal Assent.

Economic substance rule for misuse and abuse analysis

The revised draft amendments provide that where an avoidance transaction (or series of transactions that includes an avoidance transaction) is significantly lacking in economic substance (SLES), it is "an important consideration" that "tends to indicate" that the transaction results in misuse or abuse. This is largely a reversion to the language originally proposed in Budget 2023 and a reversal of the rebuttable presumption of misuse or abuse proposed in the August 4 draft amendments. As a result of the amendments, the onus remains on the Crown to establish misuse or abuse. However, the revised draft amendments add a statement, not in the original language in Budget 2023, that a lack of economic substance is to be regarded as "an important consideration" in that analysis.

The Explanatory Notes state that these revisions are intended to ensure that the economic substance test in subsection 245(4.1), as framed in the prior draft amendments, is not interpreted "simply as a procedure shifting of the onus" from the Crown to the taxpayer. Rather, if the transaction (or series) in issue is found to be SLES, "the starting point would be that there is a misuse or abuse." Among other things, a taxpayer could address this by showing that the underlying rationale of the impugned provisions was to encourage particular activities and that the effect of the transaction was what Parliament intended to encourage.

The revised draft legislation maintains the three factors that establish whether a transaction is SLES previously set out in Budget 2023 and the August 4 draft legislation:

1. the opportunity for gain or loss is unchanged among the taxpayer and non-arm's length parties
2. the expected value of the tax benefit exceeds the expected non-tax economic return
3. the entire, or almost entire, purpose of the transaction was to obtain a tax benefit

The first factor — namely, whether the opportunity for gain or loss is unchanged — is itself measured by four enumerated, but non-exhaustive, *indicia*. However, this factor has been amended to clarify that in determining whether the potential for gain or loss remains unchanged, parties not at arm's length with the taxpayer who can be reasonably considered to have economic interests that are largely adverse from those of the taxpayer should not be considered. The Explanatory Notes state that this exception is a "limited narrowing" to "recognize that sometimes people who do not deal at arm's length . . . may nonetheless operate separately from an economic point of view."

The revised draft amendments also clarify that the three factors in subsection 245(4.2) are non-exhaustive and non-cumulative. All three factors do not need to be satisfied for a transaction to be SLES. A transaction will be SLES if "any" factor is present. In addition, the Explanatory Notes clarify that economic substance is "generally" assessed by examining the series as a whole, but notes that there may be situations where a transaction, or subset of transactions within the series, should be used to assess economic substance instead.

The Explanatory Notes contain a significant amount of commentary about the interpretation and application of the economic substance provisions in subsections 245(4.1) and (4.2). In certain circumstances, the Explanatory Notes appear to be attempting to expand the GAAR in various ways beyond the proposed legislative changes.

The revised penalty

Budget 2023 proposed to introduce a 25% penalty where the GAAR is found to apply. Bill

C-59 proposes to revise the penalty formula to include a new variable B, which is focused on GAAR adjustments that result in a reduction of refundable tax credits. In this regard, it is notable that Bill C-59 also includes a number of refundable tax credits focused on the green energy sector.

The revised formula is: (A + B) x 25% − C, where

- A is the increase in the amount of tax payable by the person for the year as a result of the application of the GAAR
- B is the amount that the person's refundable tax credits for the year are reduced as a result of the application of the GAAR
- C is the amount of penalty payable under subsection 163(2) (known as the gross negligence penalty) with respect to the transaction or series that includes the transaction

In addition, the revised draft amendments provide that sections 152, 158, 159, 160.1, 164 to 167 and Division J of Part I apply to the penalty provision with such modifications as the circumstances require.

No additional revisions were made to the exception to the penalty, which applies where it was reasonable for the taxpayer to conclude that the GAAR would not apply because the transaction was "identical or almost identical" to a transaction that was the subject of (1) published administrative guidance or statements made by the Minister; or (2) one or more court decisions. However, the Explanatory Notes clarify that this exception is not intended to replace any other defenses that may be available under applicable law. This is consistent with the jurisprudence that establishes that taxpayers are entitled to assert a due diligence defense, regardless of whether there is express language permitting such a defense.

Hybrid mismatch rules

The hybrid mismatch rules were first announced in Budget 2021. Draft legislation for the first of two legislative packages of rules was released by the Department of Finance on April 29, 2022, accompanied by Explanatory Notes. These rules have been revised in Bill C-59.

The first package of hybrid mismatch rules applies to deduction/non-inclusion mismatches that arise from payments under financial instruments where the mismatch is attributable to the terms of the instrument (and not the hybridity of the entity). The rules generally apply retroactively to payments arising on or after July 1, 2022. This is consistent with the anticipated timeline set out in Budget 2021. However, some exceptions and transitional rules to the coming-into-force are included in Bill C-59. These are described below.

Scope of the first legislative package

The rules in the first legislative package target three types of arrangements:

1. hybrid financial instrument arrangements, which involve financial instruments directly
2. hybrid transfer arrangements, which involve the transfer of a financial instrument
3. substitute payment arrangements, which involve payments related to other payments or amounts under a financial instrument that was loaned, disposed of or otherwise transferred

Arrangements that fall within one of these three categories and that are either between participants who do not deal at arm's length or are "structured arrangements" where all or a

portion of the economic benefit of the mismatch is reflected in the price, fall within the scope of the rules. With respect to the structured arrangement branch, the initial draft of the rules referred simply to "the economic benefit" meeting this test. Bill C-59 expands this to refer to "all or a portion of the economic benefit."

Bill C-59 maintains the three categories of hybrid mismatch arrangements, but introduces some modifications to the scope of hybrid transfer arrangements and substitute payment arrangements:

- With respect to hybrid transfer arrangements, Bill C-59 carves out "exempt dealer compensation payments" in the conditions for the hybrid transfer arrangement rule found in subsection 18.4(12) (with reference to the definition of "dealer compensation payment" in subsection 260(1) of the Act and the analysis under Example 1.34 in the BEPS Action 2 Report).
- With respect to substitute payment arrangements, the draft rules in Bill C-59 require that there be a cross-border element before the rules can apply. Unlike the conditions for hybrid financial instrument arrangements and hybrid transfer arrangements, the initial draft rules released in April 2022 could result in purely domestic arrangements qualifying as substitute payment arrangements. Bill C-59 now requires that any one of the transferor, the transferee, a recipient of the payment, a payer of the payment, the issuer of the financial instrument, a recipient of the underlying return or a partner in a partnership that falls under any of these categories be a non-resident.

Bill C-59 also provides an exception to the deeming rule relating to specified entities in subsection 18.4(17). The "specified entity" definition in subsection 18.4(1), with reference to the deeming rule in subsection 18.4(17), is relevant in determining whether the relationship tests in each of the three categories in the first legislative package is met. New paragraph (b) is an exception to the general rule in paragraph (a) that deems one entity to be a specified entity in respect of another entity (generally, owning at least 25% of votes or equity value). Paragraph (b) states that a particular entity is deemed not to be a specified entity in respect of another entity in certain circumstances involving security for debt. An entity that would otherwise be deemed to be a specified entity is deemed not to be if

- there was an agreement or arrangement in place at that time that would end the specified entity relationship between the two entities, if a certain condition or event happened that was reasonably expected to happen
- the reason why the particular entity became a specified entity was to protect its own rights or interests, or those of an entity that it is closely related to, in relation to a debt that was owed to it or to the related entity by the other entity or by a third party

The Explanatory Notes state that paragraph (b) ensures that entities will not be considered specified entities solely because a security interest is granted in the ordinary course of a debt transaction.

Interpretive rule in 18.4(2)

The hybrid mismatch rules include an interpretive rule in proposed subsection 18.4(2) with reference to the BEPS Action 2 Report. According to the Explanatory Notes, the interpretive rule in subsection 18.4(2) gives the BEPS Action 2 Report an "enhanced status as an interpretive source, in applying a textual, contextual and purposive analysis of the provisions" in the hybrid mismatch rules.

The initial draft stated that section 18.4, section 12.7 and subsection 113(5) are to be interpreted consistently with the BEPS Action 2 Report, as amended from time to time, unless the context otherwise requires. Bill C-59 expands the application of this consistency rule to refer to "related provisions of the Act and the Income Tax Regulations". Of note, the Department of Finance kept the ambulatory reference to the BEPS Action 2 Report — as amended from time to time — despite numerous criticisms that this could amount to an improper delegation (or subdelegation) of Parliament's legislative authority over tax legislation to a supranational body. The Explanatory Notes explain that any changes that are made to the BEPS Action 2 Report following the enactment of the hybrid mismatch rules are only relevant to the extent they relate to the interpretation or application of a provision of the hybrid mismatch rules. This clarifies that the interpretive rule does not incorporate aspects of the BEPS Action 2 Report that have not been implemented in domestic legislation. Bill C-59 also removes precise dates of publication for source documents from the OECD (including the BEPS Action 2 Report, the BEPS Action 4 Report and the GloBE Model Rules).

New filing requirements

Bill C-59 introduces new filing requirements. In particular:

- Subsection 18.4(21) requires taxpayers to report on a prescribed form any payments that are not deductible under the primary rule in subsection 18.4(4) or included in income under the secondary rule in subsection 12.7(3).
- Subsection 113(7) requires taxpayers to report on a prescribed form any amounts that are not treated as dividends received from foreign affiliates because of the dividends received deduction denial in subsection 113(5).

Deduction for foreign taxes under DRD denial rule

Bill C-59 provides relief for foreign withholding tax paid on dividends that are subject to proposed subsection 113(5) by allowing a grossed-up deduction for foreign taxes under subsection 113(6). This relief was not contemplated in the initial draft of the rules, but was addressed in the CBA/CPA Joint Committee submissions during the consultation period.

Application to foreign affiliates

The initial draft of the rules did not clearly address the applicability of the rules to foreign affiliates of Canadian-resident taxpayers. Generally, paragraph 95(2)(f) deems a foreign affiliate to be a Canadian-resident taxpayer for the purposes of computing its income or loss from certain sources, unless otherwise specified or required by the context. Bill C-59 clarifies that

1. the primary rule in subsection 18.4(4) is specifically excluded (in the same manner as the thin-capitalization rules in subsection 18(4)) in determining a foreign affiliate's income or loss from property, non-active business and non-qualifying business
2. the secondary rule in subsection 12.7(3) applies in computing FAPI

This means the hybrid mismatch rules do not restrict deductions in the foreign affiliate context, but the secondary rule in subsection 12.7(3) applies in computing FAPI.

Bill C-59 also includes clarifications regarding the computation of FAPI. In general, inter-affiliate dividends are not included in computing FAPI. Bill C-59 amends the relevant variables

in the computation of FAPI to exclude any portion of the inter-affiliate dividend that would be denied under subsection 113(5) if the affiliate were a corporation resident in Canada. As a result, if a foreign affiliate receives an inter-affiliate dividend that is deductible for foreign income tax purposes, the dividend may be included in computing FAPI.

Refund for overpayment of withholding tax

Bill C-59 introduces a parallel provision in the hybrid mismatch arrangement context to the refund in subsection 227(6.1) for Part XIII tax where a shareholder loan subject to Part XIII withholding tax has been repaid.

Subsection 214(18) imposes deemed dividend withholding tax treatment for interest expense that is not deductible because of the hybrid mismatch rules. The initial draft did not provide a refund of withholding tax withheld and remitted in circumstances where the taxpayer subsequently demonstrates that the amount has been included in foreign ordinary income.

Bill C-59 introduces new subsection 227(6.3), which provides for a refund, on application by the non-resident person on whose behalf tax was remitted under subsection 214(18), where a deduction is subsequently allowed in respect of the payment, or a portion of it, under paragraph 20(1)(yy). The deadline for the application is two years after the assessment allowing the deduction.

Coming into force

As noted, the hybrid mismatch rules generally apply to payments arising on or after July 1, 2022, subject to exceptions and transitional rules included in Bill C-59.

The notional interest expense rule in subsection 18.4(9) applies as of January 1, 2023. This delay is appropriate since the provision, which deems a debt on which a notional interest deduction is available to be a hybrid mismatch arrangement, reflects a departure from the BEPS Action 2 Report on which the hybrid mismatch rules are generally based.

No parallel delay has been provided for the deemed dividend and consequent withholding tax under subsection 214(18), another key difference from the BEPS Action 2 Report. Submissions made by the CBA/CPA Joint Committee to the Department of Finance had called for a delayed coming into force for both of these proposals, as it was difficult for stakeholders to have anticipated the measures and restructured their arrangements accordingly.

There is also a later coming-into-force date of July 1, 2023, for the reporting requirements introduced in Bill C-59 for payments or receipts to which the hybrid mismatch rules apply.

The provisions of the hybrid mismatch rules that apply in computing the foreign accrual property income of a foreign affiliate will apply after June 30, 2024.

The initial draft of the hybrid mismatch rules published in April 2022 included references to subsection 18.2(2), the operative provision of the EIFEL rules. Bill C-59 effectively provides that these references will only be operative as of October 1, 2023, which is the effective date for the EIFEL rules. Prior to that date, the hybrid mismatch rules will be read without these references.

Share buyback tax

Draft legislation to implement a 2% tax on the annual net value of equity repurchases by publicly traded entities was first released in Budget 2023, and revised legislative proposals were released on August 4, 2023. Bill C-59 includes further technical changes to the prior draft, including several changes that are relieving in nature.

The measure will apply to "covered entities", which includes Canadian-resident corporations with shares listed on a designated stock exchange at any time in a taxation year (but excludes mutual fund corporations). "Covered entities" also include certain trusts and partnerships with units listed on a designated stock exchange, such as real estate investment trusts, specified investment flow-through (SIFT) trusts and SIFT partnerships. In addition, the measure generally applies to publicly traded entities that would be SIFT trusts or SIFT partnerships if their assets were located in Canada.

Under the latest proposals, however, a trust will not be a "covered entity" if it is a mutual fund trust and its units are in continuous distribution. This exclusion is intended to provide relief from certain adverse tax consequences under this measure that would have otherwise applied to exchange-traded funds (ETFs).

The tax is generally equal to 2% of the difference between

1. the total fair market value of equity redeemed, acquired or cancelled by the covered entity in the year (other than as part of a reorganization transaction to the extent certain types of qualifying equity consideration is received as consideration) and
2. the total fair market value of equity issued in the year in a "qualifying issuance"

Issuances and cancellations of non-participating debt-like preferred shares and units (i.e., "substantive debt") are excluded from the calculation of share buyback tax.

Compared to the prior draft, Bill C-59 expands the scope of "reorganization transaction" to include share cancellations that occur in exchange partly for qualifying equity consideration and partly for non-equity consideration. (The corresponding definition in the prior draft legislation had required the share cancellation to occur *solely* in exchange for qualifying equity consideration, which resulted in the share buyback tax potentially applying to the entire value of shares redeemed as part of an exchange even if only a small part of the overall consideration is non-equity consideration.)

In Bill C-59, where shares are redeemed or cancelled in exchange partly for qualifying equity consideration and partly for other consideration (i.e., non-equity consideration), the share buyback tax applies only to the extent of the fair market value of non-equity consideration (i.e., the excess of the fair market value of the cancelled shares over the fair market value of qualifying equity consideration). For these purposes, qualifying equity consideration on a share exchange includes equity of the covered entity (i.e., the issuer), equity of another entity that is related to the covered entity immediately before the exchange and is a covered entity immediately after the exchange (i.e., a Canadian-resident subsidiary subject to a spin-off), and equity of another covered entity that controls the covered entity (or an amalgamated successor) immediately after the exchange (e.g., the parent in a triangular amalgamation).

The scope of "reorganization transaction" has also been expanded to include a redemption or cancellation pursuant to the exercise of a statutory right of dissent, and a redemption of units in a unit trust for an amount that does not exceed the fair market value of the units at the time of redemption. The latter exception appears intended to mitigate adverse tax consequences that could otherwise apply to ETFs that, by virtue of not being mutual fund

trusts, are covered entities. However, the exception appears not to be available where, immediately before a redemption, the ETF's units happen to trade at a discount compared to the securities in its portfolio.

In addition, the scope of "qualifying issuances" (the fair market value of which reduce share buyback tax liability) has been expanded to include an "in-kind" issuance to arm's length and unaffiliated persons or partnerships in exchange for active business assets. Other types of "qualifying issuances" (previously included in the August 4 proposals) include issuances in exchange for cash, issuances in exchange for convertible debt issued solely for cash consideration and issuances to an employee of the covered entity (or related entity) in the course of the employee's employment. Bill C-59 provides that a qualifying issuance can refer to any portion of an issuance.

The scope of "substantive debt" (i.e., debt-like instruments, the issuance and cancellation of which do not affect the calculation of the buyback tax) has been modified such that

1. the requirement for the instrument to be non-voting allows for an exception in the event of a failure or default under the terms of the instrument
2. the requirement for fixed dividends or other distributions can be satisfied where such dividends or distributions are calculated as a fixed amount (in addition to dividends or distributions calculated by reference to a percentage of the issue price)
3. the requirement for fixed redemption entitlement takes into account any amount attributable to foreign exchange fluctuations

Bill C-59 maintains the *de minimis* rule whereby no tax is payable if equity repurchases are less than $1 million (on a gross basis) for a taxation year. It also maintains rules to deem the acquisition of equity by certain "subsidiary" affiliates to have been a repurchase by the entity itself (with exceptions for ordinary-course acquisitions by registered securities dealers, certain equity-based compensation arrangements, and acquisitions by trusts governed by employee profit-sharing plans or deferred profit-sharing plans) and anti-avoidance rules that address certain transactions undertaken to avoid payment of the tax.

The tax applies to transactions on or after January 1, 2024. Entities that redeem, acquire or cancel equity after that date will be required to file an annual return in prescribed form and pay any amount of share buyback tax owing on or before its balance-due day for the year (or, in the case of a partnership, the earlier of five months after the end of the taxation year and March 31 of the year immediately following the calendar year in which the taxation year ended).

Digital services tax

Bill C-59 includes a revised version of the proposed *Digital Services Tax Act* (DSTA) and related regulations. The first draft of the DSTA was released on December 14, 2021, and a second draft was released on August 4, 2023. While Explanatory Notes were released with prior drafts of the DSTA, no revised Explanatory Notes have been released to date in respect of the DSTA in conjunction with Bill C-59. Once effective, the DSTA will retroactively apply a 3% tax on certain digital services revenue earned in or after 2022 in respect of an online marketplace, online targeted advertising, a social media platform or the use of collected user data.

Consistent with the previous two drafts, the latest draft of the DSTA delegates to the Governor in Council the right to determine the day on which the DSTA will come into force, provided that the date is not earlier than January 1, 2024. Given the messaging adopted by

the government in the Fall Economic Statement 2023 and strong U.S. opposition to the DSTA (including the U.S. threat of trade tariffs and other retaliatory measures), it is possible that Canada could delay the effective date of the DSTA or make certain amendments prior to the DSTA coming into effect.

Generally, the latest draft introduces new definitions and a due diligence defense for taxpayers and replaces certain descriptive provisions with formulaic provisions. Crucially, it moves key thresholds, deductions and rates to the regulations. Although the substance of these elements remains unchanged compared to the prior drafts, moving them to the regulations gives the government greater flexibility to revise the amounts and rates in the future. For example, the government could now change the tax rate or remove the DSTA's retroactive application by order in council, rather than through a legislative amendment that would be subject to a much more cumbersome process (in particular, requiring Parliamentary approval).

The latest draft of the DSTA removes the Minister's controversial right to demand that taxpayers provide and maintain security in an amount and as determined by the Minister on account of the taxpayers' obligation to make payments under the DSTA that were payable or that may become payable.

A due diligence defense is introduced such that a person would not be convicted of an offence under section 91 or 95 of the DSTA if the person established that they exercised "all due diligence to prevent the commission of the offence."

Bill C-59 provides that interest payments under the DSTA are not deductible for income tax purposes.

Unfortunately, Bill C-59 does not address the many criticisms that the U.S. and others have made with respect to the DSTA (particularly its retroactive application to 2022 and the inability to credit the DSTA against income taxes payable). As a result, the DSTA is expected to result in instances of double taxation and therefore increase the effective tax rates for certain revenue of digital businesses (particularly certain U.S.-based MNEs operating highly digitized businesses).

Substantive CCPCs

Budget 2022 proposed to create a new category of corporation that would be taxed as if it were a Canadian-controlled private corporate (CCPC) because it was a "substantive CCPC." This measure is aimed at the perceived avoidance of the anti-deferral rules applicable to investment income earned by a CCPC. Draft legislation for the measure was released on August 9, 2022.

Bill C-59 is generally in line with the substantive CCPC measures announced in Budget 2022 and the prior draft legislation other than the changes set out below.

The prior draft legislation included several measures targeting the perceived tax-deferral advantage of a CCPC earning investment income through a controlled foreign affiliate (CFA). These measures are absent from Bill C-59 (although we understand that a revised version of those measures is expected to be released at a later date).

Several comments were previously made to the Department of Finance regarding the scope of these rules. For example, the prior draft legislation did not provide any carve-outs for FAPI that would not qualify as aggregate investment income (and be subject to CCPC anti-deferral rules) if that income had been earned directly by the CCPC — for example, services income

earned by a CFA that is included in FAPI because of the recharacterization rule in paragraph 95(2)(b) or income from foreign real estate development activities that would qualify as an "investment business" (as defined in subsection 95(1)).

Employee ownership trusts

Budget 2023 introduced a new set of rules to facilitate the creation of an employee ownership trust (EOT). An EOT is an arrangement where a trust holds shares of a corporation for the benefit of the corporation's employees. EOTs are intended to provide an alternative business succession method for retiring business owners.

With the stated goal of encouraging more business owners to sell to an EOT, the Fall Economic Statement 2023 (FES) released on November 21, 2023, shortly before the release of Bill C-59, proposed a new exemption from taxation for the first $10 million in capital gains realized on the sale of a business to an EOT. This incentive would apply for the 2024, 2025 and 2026 taxation years. Consistent with the reference in the FES that further details of this new exemption will be provided in the coming months, Bill C-59 did not include any legislation to implement this proposed $10-million capital gains exemption.

While largely consistent with the draft legislation previously released on August 4, 2023, Bill C-59 has maintained the requirement that the interest of each beneficiary must be determined in the same manner as other employee beneficiaries based solely on any combination of their length of service, remuneration and hours worked, but these factors are now measured for a particular time period. Bill C-59 also introduced a cap on the total compensation factor of an amount not to exceed a limit of twice the highest marginal income tax bracket for a calendar year (as adjusted for inflation) and prorated for the number of days in the calendar year in the particular period.

More than 50% of the beneficiaries of the EOT who are current or former employees are required to approve certain fundamental changes to the qualifying business controlled by the EOT. Bill C-59 has removed the approval requirement for a disposition of all or substantially all of the assets of a qualifying business but has added the requirement that 50% of the beneficiaries must approve any transaction (or series of transactions or events) that results in at least 25% of the beneficiaries losing their status as beneficiaries of the EOT (other than resulting from a termination for cause). A winding up or amalgamation of a qualifying business must also be approved by the same percentage of beneficiaries unless it is in the course of a transaction or event (or a series of transactions or events) that involves only persons or partnerships that are affiliated with the qualifying business.

Intergenerational business transfers

Budget 2023 announced several amendments to section 84.1 to ensure that only genuine intergenerational business transfers could take place. It proposed options for an immediate and a gradual transfer, and bolstered them with five additional safeguard conditions. The draft legislation released on August 4, 2023, proposed additional interpretive rules, as well as two new relieving rules.

Since the draft legislation was released four months ago, the tax community has raised a possible issue with the requirement that the transferor taxpayer have control prior to the transfer. This requirement would have prevented some genuine intergenerational business transfers. For instance, a parent transferring their 50% ownership interest in a company to their child would not have met the prior-control requirement, and therefore would not have qualified under the amendments to section 84.1. Bill C-59 no longer contains this

requirement, which is a welcomed change.

The proposed changes would apply to dispositions of shares that occur on or after January 1, 2024.

Retirement compensation arrangements – letters of credit

Bill C-59 includes the amendments to the retirement compensation arrangement rules relating to letters of credit and surety bonds that were first announced in Budget 2023. Bill C-59 makes only minor changes to the August 4, 2023, draft legislation containing this measure.

If you have any questions or require additional analysis on Bill C-59, please contact any member of our National Tax Department.