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TAXPAYER MIGRATION

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Taxpayer Migration[*]

by
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Taxpayer migration deals with taxpayers changing their country of residence from another country to Canada (immigration) or from Canada to another country (emigration). The relevant rules in section 128.1 of the *Income Tax Act*[1] are designed to subject to tax in Canada all gains realized on property accrued while a taxpayer is a Canadian resident. Accordingly, a taxpayer who ceases residence is generally deemed to dispose of each property, thus realizing any accrued gains. Where a taxpayer did not always reside in Canada, the taxpayer is deemed to dispose of each property before taking up residence and immediately re-acquire it, to ensure that gains accruing prior to Canadian residence are not taxed. Property which would be taxable on disposition in the hands of a non-resident under the Act is generally excepted from these provisions (with some important exceptions which are discussed below).

Taxpayers may be individuals, trusts or corporations.[2] This paper addresses both the immigration and emigration of taxpayers and provides a detailed review of the provisions of

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[*] I would like to express my debt to David Smith, the original author of this paper, whose careful and thoughtful consideration of the provisions surveyed herein is a model to be emulated as well as acknowledged.

[1] RSC 1985, c.1 (5th Supp.), as amended (herein referred to as the "Act"). Unless otherwise stated, statutory references are to the Act. Unless otherwise noted, this paper does not reflect proposed amendments to the Act in respect of non-resident trusts and foreign investment entities, contained in Bill C-10, introduced in November, 2007, which died on the order paper when Parliament was dissolved for the 2008 general election (the "NRT-FIE Legislation"). In the 2009 Budget, the Government announced it was reviewing these proposals in light of the report on the Advisory Panel on Canada's System of International Taxation before proceeding with measures in this area. In the 2010 Budget, the Government announced it was effectively abandoning the foreign investment entity measures but would proceed with the non-resident trust provisions with some modification from Bill C-10, but only after further consultation. The measures will be effective for trust taxation years beginning after 2006. Previous versions of the NRT-FIE Legislation were released on June 22, 2000, August 2, 2001, October 11, 2002, October 30, 2003, July 18, 2005, November 22, 2006 and November 22, 2007.

[2] Under the Act, it is not necessary to determine the residence of a partnership as it is the partners, not the partnership, who are taxable on the income of the partnership. The residence of a partnership was considered in the U.K. case of *Padmore* v. *I.R.C.*, [1989] STC 493 (C.A.). See also, "The Application of the OECD Model Tax Convention to Partnerships", Issues in International Taxation No. 6, Organization for Economic Co-Operation and Development (1999), and paragraphs 2 to 6.7 of the Commentary on Article 1 of the OECD Model Tax Convention on Income and Capital (Revised July 15, 2005). Note, also, that only Canadian partnerships qualify for certain tax-free rollovers and that a Canadian partnership is a partnership consisting

the Act relevant to a taxpayer who becomes or ceases to be a resident of Canada, with particular emphasis on individuals.[3] It also reviews the provisions of the Act relevant to distributions by Canadian-resident trusts to non-resident beneficiaries. It begins with a brief overview of the determination of residence for Canadian tax purposes.

Residence

Residence is determined in accordance with the provisions of the Act and any applicable income tax treaty. Under the Act, a person resident in Canada is taxable on the person's worldwide income from all sources, whereas a non-resident is taxable only on income from specified Canadian sources.

Individuals

Section 250 of the Act sets out several rules that are relevant to the determination of an individual's residence for purposes of the Act:

(1) A person is deemed to have been resident in Canada throughout a taxation year if the person sojourned in Canada in the year for a period of, or periods the total of which is, 183 days or more: paragraph 250(1)(a). Sojourning in Canada connotes transience and is to be distinguished from residing in Canada: *Thomson* v. *MNR* (1946), 2 DTC 812 at 813; see also *Dixon* v. *The Queen*, 2001 DTC 5407 (F.C.A.) and *Sharma* v. *The Queen*, 2001 DTC 5360 (F.C.T.D.). Canada Revenue Agency ("CRA") considers any part of a day to be a "day" for purposes of determining the number of days that an individual has sojourned in Canada in a year.

(2) Various persons serving Canada abroad (such as Canadian Forces personnel) and their dependants are deemed to be resident in Canada throughout a taxation year: paragraphs 250(1)(b) to (g) and subsection 250(2).

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only of persons resident in Canada. In some circumstances, a partnership may be deemed to be a resident or a non-resident person for Part XIII withholding tax purposes: subsection 212(13.1).

3 In this paper, a reference to an individual is to an individual other than a trust.

(3) A person resident in Canada includes a person who was at the relevant time ordinarily resident in Canada: subsection 250(3).

(4) An individual is deemed not to be resident in Canada at a time if, at that time, the individual would, but for a tax treaty, be resident in Canada for the purposes of the Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada: subsection 250(5). This rule, which previously applied only to corporations, was extended from corporations to all persons, effective after February 24, 1998.[4] Most of Canada's tax treaties contain a residence tie-breaker provision that deals with the situation where a person is otherwise considered to be a resident of both Contracting States for purposes of the relevant tax treaty.

(5) For purposes of Part XIII withholding tax, an individual may be deemed to be resident in Canada in respect of certain payments: subsections 212(13) and (13.2).

Apart from the foregoing, the term "resident" is not defined in the Act. The determination of an individual's residence is a question of fact taking into account the individual's connections with Canada, especially the factors identified in the extensive case law.[5] In determining whether an individual has become a resident of Canada or has ceased to be a resident of Canada, it is often necessary to consider each of the following:

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4 The wording of the coming-into-force provision for this amendment clarifies that an individual who was resident both in Canada and in a treaty country on February 24, 1998 is not to be subject to the new rule until the first time after February 24, 1998 (or in some cases June 27, 1999) at which the individual "tie-breaks" as a resident of a treaty country other than Canada. Thus, an individual resident in a treaty country on February 24, 1998 who subsequently changes residence to another treaty country will lose the benefit of this grandfathering provision.

5 An individual's liability for provincial income tax will depend on the individual's province of residence on December 31. The CRA generally applies the same criteria in determining the province of residence as it does for determining the country of residence. See Interpretation Bulletin IT-221R3, para. 1. See also Siân M. Matthews, "Water Runs Downhill: Interprovincial Tax Planning" in *Report of the Proceedings of the Fifty-Sixth Tax Conference*, 2004 Conference Report (Toronto: Canadian Tax Foundation 2005) 25:1 – 50. Appeals with respect to the determination of an individual's residence for provincial tax purposes must be made to the court named for appeals in the province's income tax legislation – the Tax Court of Canada may not have jurisdiction to hear such appeals: *Gardner* v. *The Queen*, 2002 DTC 6776 (F.C.A.); *Hiscock* v. *The Queen*, 2007 DTC 107 (T.C.C.); *Little* v. *The Queen*, 2007 DTC 300 (T.C.C.).

- the provisions of the Act outlined above
- any relevant tax treaty
- Canadian, English and other Commonwealth cases on residence of an individual[6]
- articles, papers and books dealing with the residence of an individual[7]
- the views of CRA, including those outlined in Interpretation Bulletin IT-221R3 (Consolidated), "Determination of an Individual's Residence Status", dated December 21, 2001.[8]

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6 The leading Canadian case is *Thomson* v. *M.N.R.*, (1946) 2 DTC 812 (S.C.C.), affirming (1945) 2 DTC 684 (Ex. Ct.). See also *Beament* v. *M.N.R.*, 52 DTC 1183 (S.C.C.); *Schujahn* v. *M.N.R.*, 62 DTC 1225 (Ex. Ct.); *The Queen* v. *Reeder*, 75 DTC 5160 (F.C.T.D.); *Griffiths* v. *The Queen*, 78 DTC 6286 (F.C.T.D.); *Fisher* v. *The Queen*, 95 DTC 840 (T.C.C.); *Boston* v. *The Queen*, 98 DTC 1124 (T.C.C.); *Min Shan Shih* v. *The Queen*, 2000 DTC 2072 (T.C.C.); *Kadrie* v. *The Queen*, 2001 DTC 967 (T.C.C.); *Harris-Eze* v. *The Queen*, 2002 DTC 1620 (T.C.C.); *McFadyen* v. *The Queen*, 2003 DTC 5015 (F.C.A.),[6] 2000 DTC 2473 (T.C.C.); *Snow* v. *The Queen*, 2004 DTC 2784 (T.C.C.); *Collins* v. *The Queen*, 2004 TCC 166; *Hauser* v. *The Queen*, 2005 DTC 1151 (T.C.C.); 2006 DTC 6447 (F.C.A.); *Laurin* v. *The Queen*, 2007 DTC 236 (T.C.C.) and *Barton*, 2007 DTC 712 (T.C.C.). For an interesting recent U.K. case on whether an individual was resident or ordinarily resident in the U.K., see *Robert Gaines-Cooper* v. *HMRC*, (2006) 9 ITLR 274 (Spec. Commissioners). For recent cases with respect to the application of the tie-breaker rules in Canada's tax treaties, see *Allchin* v. *The Queen*, 2003 DTC 935 (T.C.C.); 2004 DTC 6468 (F.C.A.) (U.S. tax treaty) and 2005 DTC 603 (T.C.C.) (re-determination); *Gaudreau*, 2005 DTC 66 (T.C.C.); 2005 DTC 5702 (F.C.A.) (Egypt tax treaty); *Yoon*, 2005 DTC 1109 (T.C.C.) (Korea tax treaty); *Bujnowski*, 2005 DTC 247 (T.C.C.); 2006 DTC 6071 (F.C.A.) (U.S. tax treaty); *Salt*, 2007 DTC 520 (T.C.C.); and *Garcia*, 2007 DTC 1593 (T.C.C.).

7 For discussions of the topic, see Paul Lefebvre, "Canada's Jurisdiction to Tax: Residency and the *Thomson* Decision 60 Years Later" (2006), vol. 54, no. 3, *Canadian Tax Journal* 762-780; Heather L. Evans, "A Guide to the Residence of Individuals", in *1997 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 1997), at 9:1-9:43; Brian G. Hansen, "Individual Residence", in *Report of Proceedings of the Twenty-Ninth Tax Conference*, 1977 Conference Report (Toronto: Canadian Tax Foundation, 1978) 682-712; and John F. Avery Jones *et al*, "Dual Residence of Individuals: The Meaning of the Expressions in the OECD Model Convention", 1981 *British Tax Review* 15, at pages 15-29 and 104-119. See also Hogg, Magee and Li, "Principles of Canadian Income Tax Law", 6th edition (Carswell 2007); Vern Krishna, "The Fundamentals of Canadian Income Tax", 9th edition (Carswell 2006). For a short discussion of the related issue of provincial residence, see Bobby B. Solhi, "Provincial Income Tax: What is the Province of Residence?," OBA, *Taxation Law Newsletter*, 19:2 (March 2009)

8 See also Form NR73, "Determination of Residency Status (Leaving Canada)", and Form NR74, "Determination of Residency Status (Entering Canada)", as well as technical interpretations provided by CRA. See also the U.K. Revenue & Customs guidance document IR20: "Residents and Non-Residents: Liability to Tax in the United Kingdom" (and a recent clarification thereof: Revenue & Customs Brief 01/07) and the U.K. Revenue & Customs document "Reviewing the Residence and Domicile Rules as They Affect the Taxation of Individuals" (2003 Budget, April 2003).

Various checklists have been developed to assist advisors and their clients in tax planning for an individual who wishes to give up or acquire Canadian residence. See, for example, Edwin G. Kroft, "Jurisdiction to Tax: An Update" in *Corporate Management Tax Conference 1993* (Toronto: Canadian Tax Foundation, 1994) 1:1-1:138, at page 1:19. See also the list set out in *Lee* v. *M.N.R.*, 90 DTC 1014 (T.C.C.).

Trusts

In the Act, a reference to a trust or estate must, unless the context otherwise requires, be read to include a reference to the trustee, executor, administrator, liquidator of the succession, heir or other legal representative having ownership or control of the trust property (subsection 104(1)). However, except for the purposes of subsections 104(1) and 104(1.1), subparagraph (b)(v) of the definition of "disposition" in subsection 248(1) and paragraph (k) of that definition, a trust is deemed not to include an arrangement under which the trust can reasonably be considered to act as an agent for all the beneficiaries under the trust with respect to all dealings with all of the trust's property. These arrangements are generally known as "bare trusts".[9] Trusts described in paragraphs (a) to (e.1) of the definition of "trust" in subsection 108(1) are expressly excluded from such an arrangement. A trust is deemed to be an individual in respect of the trust property (subsection 104(2)).[10]

There are no specific provisions in the Act dealing with the residence of a trust.[11] The provisions of subsections 250(1), (2), (3) and (5) referred to earlier with respect to an individual would be applicable in determining the residence of individual trustees, and the provisions of subsections 250(4), (5) and (5.1) referred to subsequently with respect to a corporation would be applicable in determining the residence of corporate trustees. The provisions of subsection 250(5) would also presumably apply to the trust itself if it is a "person"

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9 The exclusion of bare trusts from references to a trust in the Act applies to the 1998 and subsequent taxation years except that it does not apply to transfers of property that occur before December 24, 1998.

10 See footnote 3.

11 Subsection 250(7) deems a qualifying environmental trust that is resident in Canada to be resident in the province in which the site to which the trust relates is situated. Subsection 250(6.1) (applicable to 1990 and subsequent taxation years) deems a trust to have been resident in Canada throughout a taxation year for the purposes of certain provisions of the Act where the trust ceases to exist and it was resident in Canada immediately before that time.

for purposes of that subsection. Where the anti-avoidance provisions of paragraph 94(1)(c) of the Act apply to a non-resident trust, the trust will be deemed to be a person resident in Canada. The NRT-FIE Legislation will expand the circumstances in which a non-resident trust will be treated as being resident in Canada (proposed subsections 94(3) and (4)).

Prior to the decision of the Tax Court in *Garron Family Trust et. al.* v. *The Queen* (2009 DTC 1287), it was generally thought that the residence of a trust would be determined by reference to the residence of the trustee or trustees, particularly if they all reside in one place. This position was based on the decision in *Thibodeau Family Trust* v. *The Queen*, 78 DTC 6376 (F.C.T.D.). In that case, two trustees were resident in Bermuda and one in Canada, and the trust deed permitted a majority decision on all matters of trustee discretion. The Court held that the trust had a sole residence in Bermuda.

In *Garron*, Woods J. found that the correct test for determining trust residence was the well-established test for a corporation – that is, "where central management and control lies", with appropriate modification. In *Garron*, the Court found that management and control of the trusts in question was exercised not by the trustee in Barbados but by two individuals in Canada so that the trusts were resident in Canada. The decision is under appeal at the time of writing.

CRA's view, set out in Interpretation Bulletin IT-447, "Residence of a Trust or Estate", dated May 30, 1980, that a trust is considered to reside where the trustee who manages or controls the trust assets resides,[12] has probably been superseded by *Garron*.[13]

Corporations

Any corporation incorporated in Canada after April 26, 1965 is deemed to have been resident in Canada throughout a taxation year: paragraph 250(4)(a). A corporation

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12 See also Jack Bernstein, "Residence of Trusts and Corporations" in *1997 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 1997) 8:1-8:53; and Robert D.M. Flannigan, "Trust Obligations and Residence" (1985-86), 7 *Estates and Trusts Quarterly* 83-102.

13 Thus, where a resident trustee is substituted for a non-resident trustee, CRA's view is that the trust will have become resident in Canada, with the consequences flowing from that under s.128.1(1)(b) and (c). See CRA Document 2007-0251591E5, dated January 15, 2008.

incorporated in Canada before April 27, 1965 will be deemed to have been resident in Canada throughout a taxation year if at any time after April 26, 1965 it was resident in Canada (under the common-law test of residence) or carried on business in Canada: paragraph 250(4)(c).[14]

The following special rules in sections 250 and 128.2 of the Act are also relevant to the determination of a corporation's residence:

(1) For the purposes of subsection 250(4), where a corporation is granted articles of continuance in a jurisdiction, it is deemed to have been incorporated in that jurisdiction at the time of continuation (and not in any other jurisdiction) and at all times from the time of continuation in that jurisdiction until the time, if any, of continuation in a different jurisdiction: paragraph 250(5.1)(b). Thus, a foreign corporation that is continued under the *Canada Business Corporations Act* or under the corporations law of a Canadian province will be considered to have been incorporated in Canada and will be deemed to be resident in Canada from the time of continuation. For the purposes of the Act (other than subsection 250(4)), the corporation is also considered to have been incorporated in the jurisdiction of continuation from the time of continuation: paragraph 250(5.1)(a). Subsection 250(5.1) applies to all corporations where the time of continuation is after June 30, 1994 and to certain corporations where the time of continuation is before July 1, 1994.

(2) A predecessor corporation in a cross-border merger may be deemed to have become resident in Canada or to have ceased to be resident in Canada: section 128.2. Where a corporation formed at a particular time by the amalgamation or merger of, or by a plan of arrangement or other corporate reorganization in respect of, two or more corporations is at the particular time resident in Canada, a predecessor that was not immediately before the particular time resident in Canada is deemed to have become resident in Canada immediately before the particular time. Similarly, where a corporation formed by such a reorganization is

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14 There is an exception to this rule for a foreign business corporation incorporated before April 9, 1959 that meets certain requirements: paragraph 250(4)(b).

not resident in Canada, a predecessor that was immediately before the reorganization resident in Canada is deemed to have ceased to be resident in Canada immediately before the reorganization. These rules do not apply to reorganizations occurring solely because of the acquisition of property of one corporation by another, whether by purchase or as a winding-up distribution.

(3) A corporation is deemed not to be resident in Canada at a time if, at that time, the corporation would, but for any tax treaty, be resident in Canada for the purposes of the Act but is, under a tax treaty with another country, resident in the other country and not resident in Canada: subsection 250(5).[15] By virtue of this rule, a corporation incorporated outside Canada that is resident in Canada under the common-law test but is treated as resident in another country (and not resident in Canada) under the tie-breaker provisions of a tax treaty will be deemed not to be resident in Canada. This means, for example, that Part XIII withholding tax will apply to such a corporation.

(4) A foreign corporation that has as its principal business the operation of ships used primarily in transporting passengers or goods in international traffic (and a holding corporation of such a corporation) will be deemed not to be resident in Canada if it meets certain requirements: subsection 250(6).

(5) For purposes of Part XIII withholding tax, a corporation may be deemed to be resident in Canada in respect of certain payments: subsections 212(13) and (13.2). An authorized foreign bank may also be deemed to be resident in Canada for certain purposes connected to its Canadian banking business: subsections 126(1.1) and 212(13.3).

A corporation that is not incorporated in Canada or is not deemed to be resident in Canada by virtue of subsection 250(4) may be resident in Canada for purposes of the Act under

[15] For dates after June 27, 1999, subsection 250(5) does not apply to new paragraph 126(1.1)(a) (authorized foreign bank may be deemed, for foreign tax credit purposes, a Canadian resident in respect of its Canadian banking business).

the common-law test for residence of a corporation. Under this test, corporations are generally considered to be resident where the central management and control actually resides.[16]

In determining whether a corporation has become a resident of Canada or ceased to be a resident of Canada, the following should again be considered:

- the provisions of the Act outlined above
- any relevant tax treaty
- Canadian, English another Commonwealth cases on residence of a corporation
- books, articles and papers dealing with the topic[17]
- CRA's views.[18]

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16 Some leading cases on the residence of a corporation are: *De Beers Consolidated Mines, Limited* v. *Howe*, [1906] A.C. 455 (H.L.); *Unit Construction Co.* v. *Bullock*, [1960] A.C. 351 (H.L.); and *M.N.R.* v. *Crossley Carpets (Canada) Ltd.*, 69 DTC 5015 (Ex. Ct.). See also *Swedish Central Railway Co. Ltd*. v. *Thompson*, [1925] A.C. 495; *Yamaska Steamship Company Limited* v. *M.N.R.*, 61 DTC 716 (T.A.B.); *Zehnder and Company* v. *M.N.R.*, 70 DTC 6064 (Ex. Ct.); *Bedford Overseas Freighters Ltd*. v. *M.N.R*., 70 DTC 6072 (Ex. Ct.); *Tara Exploration and Development Co. Ltd*. v. *M.N.R.*, 70 DTC 6370 (Ex. Ct.), aff'd 72 DTC 6288 (S.C.C.); *Victoria Insurance Company Ltd.* v. *M.N.R.*, 77 DTC 320 (T.R.B.); and *Birmount Holdings Ltd.* v. *The Queen*, 78 DTC 6254 (F.C.A.). For a leading U.K. case which discusses central management and control and the importance of the place where the actual effective decisions are made, see *Wood and another* v. *Holden (Inspector of Taxes),* (2006) 8 ITLR 468 (C.A.); (2005) 7 ITLR 725 (Ch.D.).

17 For a thorough review of corporate residence, see Robert Couzin, "Corporate Residence and International Taxation", International Bureau of Fiscal Documentation (Amsterdam) 2002. See also, Julie Bouthillier, "Residence-Based Taxation and FAPI: A World of Fictions" (2005), vol. 53, no. 1 *Canadian Tax Journal* 179–204; Brian J. Arnold, Michael J. McIntyre, J. Scott Wilkie, Robert Couzin, "Policy Forum: Comments on *Corporate Residence and International Taxation* by Robert Couzin" (2003), vol. 51, no. 4 *Canadian Tax Journal* 1556–1601; Jack Bernstein, "Residence of Trusts and Corporations" in *1997 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 1997) 8:1-8:53; Edwin G. Kroft, "Jurisdiction to Tax: An Update", in *Corporate Management Tax Conference 1993* (Toronto: Canadian Tax Foundation, 1994), at pages 1:20-1:34; and O.A. Pyrcz, "The Basis of Canadian Corporate Taxation: Residence" (1973), vol. 21, no. 4 *Canadian Tax Journal* 374-90.

18 Interpretation Bulletin IT-391R, "Status of Corporations", dated September 14, 1992, deals briefly with the residence of a corporation in paragraphs 15 and 16. In addition, see "Tax Treaty Negotiation Seminar" (August 27, 1993), Doc. No. 9323666, Appendix "A". See also the U.K. Revenue & Customs documents INTM 120140 "Company Residence" (Statement of Practice SP1/90, January 9, 1990) and INTM 120120 "Company Residence: how to review residence", which summarizes the relevant U.K. jurisprudence.

Immigration

Individuals

Deemed Disposition of Property

Where an individual becomes a resident of Canada at a particular time (referred to herein as the "time of immigration"), the individual is deemed to have disposed of each property[19] owned by the individual, with certain exceptions, for proceeds equal to its fair market value: paragraph 128.1(1)(b). The time of disposition is the time that is immediately before the time that is immediately before the time of immigration and the proceeds are deemed to have become receivable and to have been received by the individual at the time of disposition. Each property deemed to have been disposed of is deemed to have been reacquired by the individual at the time of immigration at a cost equal to the proceeds of disposition of the property: paragraph 128.1(1)(c). The cost of such property for purposes of the Act will therefore be stepped up to its fair market value at the time of immigration. This allows the gain realized on a subsequent disposition of the property by the taxpayer in Canada or on a deemed disposition on emigration (as discussed below) to be calculated so as to exclude any portion of the gain which accrued prior to the time of immigration.

In valuing property owned by an individual (such as shares of a corporation) for purposes of this rule (or the deemed disposition rule in paragraph 128.1(4)(b)), where there is a life insurance policy on the life of the individual or on the life of any other non-arm's length individual (for example, a policy owned by a corporation), the fair market value of the property must be determined as though the cash surrender value of the policy were the fair market value of that policy: subsection 70(5.3). This provision ensures that life insurance proceeds payable on death are not reflected in the value of the property deemed to be acquired under paragraph 128.1(4)(c).

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[19] The rules only apply to something which is property. CRA has taken the position that a general power of appointment under a trust is not property and therefore not subject to these rules: CRA Document 2008-0280781E5 dated August 26, 2008.

The following properties owned by an individual are excepted from the deemed disposition and acquisition rules in paragraphs 128.1(1)(b) and (c):

(1) Property which is taxable Canadian property: subparagraphs 128.1(4)(b)(ii) and (iii). Taxable Canadian property is defined in subsection 248(1) of the Act and is discussed in greater detail below.

(2) Eligible capital property in respect of, or property described in the inventory of, a business carried on by the individual in Canada at the time of immigration, whether or not the business is carried on through a permanent establishment.

(3) An excluded right or interest of the individual, other than an interest in a non-resident testamentary trust that was never acquired for consideration: subparagraph 128.1(1)(b)(iv). "Excluded right or interest" is defined in subsection 128.1(10) and is discussed in detail below.

Section 114

Section 114 of the Act sets out the rules for computing an individual's taxable income for a year in which the individual was resident in Canada throughout part of the year and non-resident throughout another part of the year. Section 114 does not provide for a year-end on immigration or emigration but provides different rules for computing income in the two parts of the year. For the 1998 and subsequent taxation years, taxable income is the taxable income calculated on the basis that the individual's only income or loss for the part of the year during which the individual was non-resident is that income or losses described in paragraphs 115(1)(a) to (c) of the Act and the amount includable under subparagraph 115(1)(a)(v) if the non-resident portion of the year were the whole year. Subparagraph 115(1)(a)(v) includes in a non-resident's income the amount determined under paragraph 115(2)(e). In general, this is employment income paid to the non-resident by a person resident in Canada to certain students and researchers and former or prospective residents.

The deductions permitted in computing taxable income are the deduction for loss carry forwards permitted by subsection 111(1), relevant deductions under paragraphs 110(1)(d) to (d.2) and (f) and any other deduction permitted under the Act in computing taxable income to

the extent that either (i) can reasonably be considered to be applicable to the part of the year throughout which the individual is resident in Canada, or (ii) if all or substantially all the individual's income for the non-resident period of the year is included in taxable income earned in Canada, it can reasonably be considered to be applicable to the non-resident portion of the year.

Taxable Canadian Property

Taxable Canadian property is excluded from the deemed disposition and reacquisition on assuming Canadian residence because, under paragraph 2(3)(b) of the Act, a non-resident is, in any case, subject to tax on the disposition of a taxable Canadian property.

Taxable Canadian property is defined in subsection 248(1) of the Act to be property that is:

- real property situated in Canada
- eligible capital property in respect of, or property described in an inventory of, a business carried on in Canada, other than property used in an insurance business or ships and aircraft used in international traffic
- designated insurance property of an insurer
- a share of a private Canadian corporation (Under the 2010 Budget proposals, (contained in Bill C-9) such a share will only be taxable Canadian property if, at any time during the preceding five years, more than 50% of the fair market value of the shares was directly or indirectly derived from one or any combination of real property in Canada, Canadian resource properties or timber resource properties, or an interest or an option in respect of such property)
- a share of a corporation not resident in Canada that is not listed on a designated stock exchange if, at any time during the preceding five years, the fair market value of properties of the corporation which are taxable Canadian property, a Canadian resource property, timber resource property, an income interest in a Canadian resident trust or an interest or option in any of these properties

accounted for more than 50% of the fair market value of all of the properties of the corporation and more than 50% of the fair market value of the share was derived directly or indirectly from one or any combination of real property in Canada, Canadian resource properties or timber resource properties or an option or interest in such properties (Bill C-9 will treat such shares in the same manner as shares of a private Canadian corporation)

- a share listed on a designated stock exchange if at any time during the preceding five years the taxpayer or other non-arm's length persons own 25% more of the shares of any class of stock of the corporation (Bill C-9 will add the requirement that, at any time during such period, more than 50% of its value is derived directly or indirectly from one or any combination of real property in Canada, Canadian resource properties, timber resource properties or an option or interest in such properties)

- an interest in a partnership if at any time during the previous five years more than 50% of the fair market value of the properties of the partnership was derived from taxable Canadian property, Canadian resource property, a timber resource property, an income interest in a Canadian trust or an interest or option in such properties (Bill C-9 will treat such shares in the same manner as shares of a private Canadian corporation)

- a capital interest in a Canadian resident trust other than a unit trust (Bill C-9 will add the requirement that, at any time during such period, more than 50% of its value is derived directly or indirectly from one or any combination of real property in Canada, Canadian resource properties, timber resource properties or an option or interest in such properties)

- a unit of a unit trust other than a mutual fund trust resident in Canada (Bill C-9 will add the requirement that, at any time during such period, more than 50% of its value is derived directly or indirectly from one or any combination of real property in Canada, Canadian resource properties, timber resource properties or an option or interest in such properties)

- a unit of a mutual fund trust if, at any time during the preceding five years not less than 25% of the units of the trust were held by the taxpayer or other non-arm's length persons (Bill C-9 will treat such units in the same manner as shares of a private Canadian corporation)

- an interest in a non-resident trust if, at any time during the preceding five years, more than 50% of the fair market value of the properties of the trust was derived from taxable Canadian property, Canadian resource property, timber resource property, an income interest in a Canadian resident trust or an interest or option in such properties and more than 50% of the value of the interest in the trust was derived from one or a combination of real property situated in Canada, Canadian resource properties or timber resource properties (Bill C-9 will treat such interests in the same manner as shares of a private Canadian corporation)

- an interest or option in respect of any of the above properties.

For the purposes, among other things, of section 128.1, taxable Canadian property also includes:

- a Canadian resource property

- a timber resource property

- an income interest in a trust resident in Canada

- a right of a retired member of a partnership to income in the partnership

- a life insurance policy in Canada.

Excluded Rights or Interests

Excluded rights or interests of an individual are not deemed to have been disposed of and reacquired upon immigration. In general terms, excluded rights or interests include rights of the individual to future benefits or payments under certain plans or arrangements, and interests in certain trusts and insurance contracts. The types of rights or interests described in the

definition of excluded rights or interests are those in respect of which, generally, Canada has a continuing ability to tax in the hands of a non-resident under other provisions of the Act. An excluded right or interest of an individual is defined in subsection 128.1(10) to mean:

(1) A right under or an interest in

- certain retirement plans (a pension plan, registered retirement savings plan, registered retirement income fund, retirement compensation arrangement and foreign retirement arrangement)
- certain compensation plans (a deferred profit sharing plan, an employee profit sharing plan, an employee benefit plan (other than those described in (2) below) and a plan under which the individual has a right to receive in a year remuneration in respect of services rendered by the individual in the year or a prior year (e.g., a salary deferral arrangement, an unfunded bonus deferral, a self-funded leave of absence plan and a phantom stock plan)[20]
- a registered supplementary unemployment benefit plan
- a registered education savings plan
- a tax-free savings account
- a registered disability savings plan.

(2) A right to a benefit under an employee benefit plan that is a deferred salary arrangement for certain professional athletes and for on-ice officials of the National Hockey League which is excluded from the definition of "salary deferral arrangement" in subsection 248(1) of the Act. Such a right is an excluded right or interest only to the extent that the benefit can reasonably be considered to be attributable to services rendered by the individual in Canada.

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[20] CRA's view is that shares purchased as a condition precedent to receiving stock options would not be an excluded right or interest: CRA Document 2008-028630117, dated July 23, 2008.

(3) A right under an agreement referred to in subsection 7(1) (e.g., employee options to acquire shares of a corporation or units of a mutual fund trust).

(4) A right to a retiring allowance.

(5) A right under or an interest in certain trusts (an employee trust, an amateur athlete trust, a cemetery care trust, and a trust governed by an eligible funeral arrangement).

(6) A right to receive a payment under an annuity contract or an income-averaging annuity contract.

(7) A right to a benefit under certain government social security plans (Canada Pension Plan, Quebec Pension Plan, *Old Age Security Act*, Saskatchewan Pension Plan and foreign government social security plans).

(8) A right to a benefit described in subparagraphs 56(1)(a)(iii) to (vi) of the Act (a death benefit, certain employment insurance benefits, certain benefits provided in connection with the Canada-United States Agreement on Automotive Products and a prescribed benefit under a government assistance program).

(9) A right to a payment out of a NISA (net income stabilization account) Fund No. 2 under the *Farm Income Protection Act*.

(10) An interest in a personal trust resident in Canada if the interest was never acquired for consideration and did not arise as a consequence of a qualifying disposition by the individual (as defined by subsection 107.4(1) without reference to paragraphs (h) and (i) thereof). (A "personal trust" is defined as a testamentary trust and certain *inter vivos* trusts: subsection 248(1).) The Explanatory Notes[21] indicate that the interest in the trust must not have been acquired *by any person* for consideration. Subsection 108(7) deems certain interests in a trust not to have been acquired for consideration and paragraph 108(6)(c) addresses the issue of

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[21] "Explanatory Notes on Taxpayer Migration" issued by the Department of Finance on March 16, 2001 in conjunction with Bill C-22 (SC 2001, c.17) (herein referred to as the "Explanatory Notes").

consideration when a trust has been varied. The definition of a qualifying disposition is complex but, in general terms, it is a transfer of property to a trust where there is a change in the legal ownership of the property that does not result in a change in the beneficial ownership of the property. Subsection 107.4(3) generally provides a rollover when there is a qualifying disposition of property to a trust.[22] (See CRA Document Nos. 2003-001953 and 2004-006184 for a discussion of trust interests held at the time of emigration and an example of the computation of a capital gain where an emigrant had an indefeasibly vested interest in a non-resident *inter vivos* trust.)[23]

(11) An interest in a non-resident testamentary trust if the interest was never acquired for consideration. See the comment under (10) above. (A "testamentary trust" is defined as a trust or estate that arose on and as a consequence of the death of an individual, with certain exceptions: subsection 108(1). A proposed amendment to this definition (Bill C-10) will add an exclusion where, after December 20, 2002, the trust incurs certain indebtedness owed to, or guaranteed by, a beneficiary or a person or partnership not at arm's length with a beneficiary.)

(12) An interest in a life insurance policy in Canada, except for that part of the policy in respect of which the individual is deemed by paragraph 138.1(1)(e) to have an interest in a related segregated fund trust. A life insurance policy in Canada is a life insurance policy issued or effected by an insurer on the life of a person

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22 Subparagraph 107.4(3)(h)(ii) operates to ensure that these restrictions on trust interests which will be excluded rights or interests cannot be circumvented by way of transfer to a second trust. The provision will apply where the transferor is a trust to which property was transferred by an individual in circumstances in which subsection 107.4(3) would apply if no exception in the definition of qualifying disposition under subsection 107.4(1) were made for either transfers to which subsection 73(1) applied (paragraph (i) of subsection 107.4(1)) or transfers that included the giving to the transferee of any consideration (paragraph (h) of subsection 107.4(1)). In these circumstances, subparagraph 107.4(3)(h)(ii) will deem the transferee trust to be a trust an interest in which was acquired by the individual as a consequence of a qualifying disposition. There will therefore be a deemed disposition with respect to the interest in the transferee trust if the individual subsequently ceases to reside in Canada.

23 An appointee under a general power of appointment under a non-resident trust will not be a beneficiary under the trust so holds no property deemed to be disposed of on departure: CRA Document 2007-0235231C6, dated June 8, 2007.

resident in Canada at the time the policy was issued or effected: subsection 138(12).

Trusts

Deemed Disposition of Property

The general rule in paragraph 128.1(1)(d) will apply to a trust when it becomes resident in Canada. Under this rule, all property owned by the trust is deemed to be disposed of for proceeds equal to its fair market value at the time that is immediately before the time that is immediately before the time of immigration. Pursuant to paragraph 128.1(1)(c), each property is deemed to have been reacquired at the time of immigration at a cost equal to the proceeds of disposition of the property.

The following properties owned by a trust are excepted from the deemed disposition and acquisition rules in paragraphs 128.1(1)(b) and (c):

(1) Property which is taxable Canadian property, as discussed above: subparagraph 128.1(1)(b)(i).

(2) Eligible capital property in respect of, or property described in the inventory of, a business carried on by the trust in Canada at the time of immigration, whether or not the business is carried on through a permanent establishment: subparagraphs 128.1(1)(b)(ii) and (iii).

(3) An excluded right or interest of the trust other than an interest in a non-resident testamentary trust that was never acquired for consideration: subparagraph 128.1(1)(b)(iv). Excluded right or interest is discussed above.

Deemed Year End

The trust's taxation year that would otherwise include the time that the trust becomes resident in Canada is deemed to have ended immediately before that time and a new taxation year is deemed to have begun at that time: subparagraph 128.1(1)(a)(i). In determining the trust's fiscal period after the time of immigration, the trust is deemed not to have established

a fiscal period before the particular time (which allows the trust to choose a new fiscal period when it becomes resident): subparagraph 128.1(1)(a)(ii) and section 250.1. The deemed disposition under paragraph 128.1(1)(b) occurs immediately before the time that is immediately before the time of immigration. Since the deemed year end occurs immediately before the time of immigration, the deemed disposition will occur in the taxation year that ends immediately before the time of immigration at a time when the trust will not be resident in Canada. Section 114 will not apply to a trust because the effect of paragraph 128.1(1)(a) is to treat the period during which the trust is resident in Canada as a separate taxation year for the period of non-residence.

NRT-FIE Legislation Rules

Under the NRT-FIE Legislation, under certain circumstances a trust which is otherwise not resident in Canada is deemed under paragraph 94(3)(a) to be resident in Canada throughout the particular taxation year in which the criteria in that provision are satisfied. If the trust was not resident in Canada throughout the taxation year immediately preceding this taxation year, the trust is deemed to have disposed of each property, other than those properties described in subparagraphs 128.1(1)(b)(i) to (iv) (described above), for proceeds of disposition equal to its fair market value (subparagraph 94(3)(c)(i)) and, at the beginning of the taxation year in which the criteria are satisfied, acquired each such property at a cost equal to those proceeds of disposition: subparagraph 94(3)(c)(ii).

Corporations

Deemed Disposition of Property

When a corporation becomes resident in Canada at a particular time, the corporation is deemed to have disposed of each property owned by the corporation for proceeds equal to its fair market value at the time of disposition: paragraph 128.1(1)(b). The time of disposition is the time that is immediately before the time that is immediately before the time of immigration and the proceeds are deemed to have become receivable, and to have been received, at the time of disposition. Each property is deemed to have been reacquired at the time of immigration at a cost equal to the proceeds of disposition of the property: paragraph 128.1(1)(c). In the case of a corporation, there are no exceptions from this deemed disposition and

reacquisition rule and, in particular, the exceptions in subparagraphs 128.1(1)(b)(i) to (v) available to an individual or a trust are not available to a corporation. Accordingly, if the immigrating corporation holds any property the disposition of which would attract Canadian tax (including branch assets), such as taxable Canadian property, it will be subject to tax on immigration absent any provisions in a relevant tax treaty which would exempt the income or gain deemed to be realized from Canadian tax.

Deemed Year End

The corporation's taxation year that would otherwise include the time of immigration is deemed to have ended immediately before the time of immigration and a new taxation year is deemed to have begun at the time of immigration: subparagraph 128.1(1)(a)(i).[24] For the purpose of determining the corporation's fiscal period after the time of immigration, the corporation is deemed not to have established a fiscal period before that time (thus enabling the corporation to choose a new fiscal period once it is a resident): subparagraph 128.1(1)(a)(ii) and section 250.1. The time of the deemed disposition of the corporation's property under paragraph 128.1(1)(b) will thus occur in the taxation year ending immediately before the time of immigration, throughout which the corporation will not be resident in Canada.

Deemed Dividend by Canadian Subsidiary

Where the immigrating corporation owned a share in a Canadian resident corporation immediately before the time that it is deemed to dispose of such share, paragraph 128.1(1)(c.1) deems the Canadian corporation to have paid a dividend to the immigrating corporation at that time. The amount of the dividend is the amount by which the fair market value of the share of the Canadian corporation exceeds the total of (i) the paid-up capital in respect of the share at the time, and (ii) if the share at that time was taxable Canadian property that is not "treaty-protected property", the amount by which the fair market value of the share at that time exceeds its cost amount. "Treaty-protected property" is defined in subsection 248(1) as

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24 The election in paragraph 249(4)(c) of the Act that a corporation may make to have its last taxation year continue up to the time control is acquired where control of the corporation is acquired within the seven-day period immediately following the end of its last taxation year is not available if the last taxation year ended because of the corporation's immigration.

property the income or gain from the disposition of which would be exempted from tax under Part I of the Act because of a tax treaty between Canada and another country.

The deemed dividend is intended to represent undistributed surplus of the Canadian corporation which would be available to be distributed by way of dividend to its non-resident shareholder. The exception for the accrued gain on a share which is taxable Canadian property that is not treaty-protected property protects the immigrating corporation from double taxation which would otherwise result because any gain realized on such property is taxable on the deemed disposition in the hands of the immigrating corporation at a time when it is non-resident under paragraph 2(3)(c) of the Act and will not be exempted from Canadian tax by a tax treaty.

The deemed dividend will be subject to non-resident withholding tax under Part XIII of the Act at the rate of 25% (or at such lower rate as is provided by a relevant tax treaty). This ensures that the immigrating corporation cannot avoid paying withholding tax on a distribution of surplus from its Canadian subsidiary by becoming resident in Canada. Where, however, the Canadian corporation and the immigrating corporation act at arm's length, subsection 215(1.1) removes the requirement to withhold and remit tax in respect of the deemed dividend.

Branch Tax

A non-resident corporation which carries on business in Canada is subject to a "branch" tax under Part XIV of the Act, intended to replicate the dividend withholding tax which would be payable if the business had been carried on in a Canadian subsidiary which distributed its earnings to its parent by way of dividend. The amount subject to tax is reduced by an "investment allowance" calculated under section 808 of the Regulations intended to represent amounts notionally re-invested in the Canadian business. Under subsection 808(1.1) of the Regulations, an immigrating corporation's investment allowance for the year ending at the time of immigration is deemed to be nil, ensuring that any retained surplus at that time is subject to the Part XIV tax.

Adjustments to Paid-Up Capital

Subsection 128.1(2) provides for an adjustment to the paid-up capital of an immigrating corporation, either upward or downward, at the time of immigration, calculated in respect of each class of shares of the capital of the corporation. The adjustment is the difference, either positive or negative, between the cost to the corporation of each property deemed to be disposed of and reacquired by the corporation on immigration (which is the fair market value of each property at the time of immigration) and the amount of all debts or other obligations of the corporation to pay an amount which is outstanding at the time of immigration. The aggregate adjustment is allocated among all of the classes of shares of the immigrating corporation in proportion to the relative fair market value of the shares of each class. Finally, the adjustment so determined is reduced by the paid-up capital of the class, calculated before making the adjustment.

If the adjustment so calculated is positive, it is only added in computing the paid-up capital of the corporation if the corporation so elects in respect of all classes of its shares by notifying the Minister in writing within 90 days of the time of immigration: subparagraph 128.1(2)(b)(i). If the adjustment as calculated is negative, it must be deducted in computing paid-up capital: subparagraph 128.1(2)(b)(ii).

Deemed Dividend by the Corporation

Where an immigrating corporation has increased the paid-up capital in respect of a class of its shares pursuant to an election under subparagraph 128.1(2)(b)(i), the corporation is deemed to have paid, immediately before the time that it is deemed to have disposed of its property, a dividend on the shares of that class equal to the amount added to the paid-up capital of the class: subparagraph 128.1(1)(c.2)(i). The dividend is deemed to have been received at the same time by each person holding shares of that class in an amount equal to its *pro rata* share of the deemed dividend based on issued shares of the class: subparagraph 128.1(1)(c.2)(ii). Such dividend will generally be taxable in the hands of a Canadian resident shareholder. However, a Canadian resident in respect of whom the immigrating corporation is a foreign affiliate is not deemed to receive such dividend because paragraph 128.1(1)(d) contains provisions specifically dealing with the accrued surplus of a foreign affiliate that becomes resident in Canada (as

discussed below). This provision is similar in effect to the provisions of section 84 of the Act which deem a dividend to be paid in certain circumstances where a corporation increases its paid-up capital and prevents the corporation from increasing its paid-up capital, which can then be withdrawn tax-free by a shareholder, without attracting tax.

Subsection 128.1(3) makes a further adjustment to the paid-up capital of a class of shares where the corporation has redeemed, acquired or cancelled a share of a class or reduced the paid-up capital of the class so as to give rise to a deemed dividend under subsection 84(3), (4) or (4.1), where the corporation previously added an amount to, or subtracted an amount from, the paid-up capital of a class under subparagraph 128.1(2)(b)(i). The difference between the deemed dividend realized under section 84 and the deemed dividend which would have been realized had there been no increase in paid-up capital is deducted in computing the paid-up capital of the class at any time after the deemed dividend. The deduction can, however, in no case exceed the amount added to the paid-up capital of the class under subsection 128.1(2).

Where paid-up capital has been reduced as a result of the application of subparagraph 128.1(2)(b)(ii), the difference between the deemed dividend realized under section 84 and the dividend which would have been determined under section 84 if the paid-up capital had not been reduced under subsection 128.1(2) is added to the paid-up capital of the class at any time after the deemed dividend, provided that the upward adjustment cannot exceed the downward paid-up capital adjustment under subparagraph 128.1(2)(b)(ii).

The adjustments in subsection 128.1(3) therefore have two effects:

(1) Where the paid-up capital of a class of shares has been reduced under subparagraph 128.1(2)(b)(ii) and there has been a subsequent transaction giving rise to a deemed dividend under subsection 84(3), (4) or (4.1), the reduction will have increased the deemed dividend. In that circumstance, subsection 128.1(3) adds back to paid-up capital such increase in the amount of the deemed dividend otherwise calculated. The paid-up capital reduction is eliminated because it has already increased the taxable dividend.

(2) Where the paid-up capital of a class of shares has been increased under subparagraph 128.1(2)(b)(i), the deemed dividend resulting from a subsequent

transaction under subsection 84(3), (4) or (4.1) will be reduced as a result of the increase in paid-up capital. In that circumstance, subsection 128.1(3) reduces the paid-up capital by the amount by which the deemed dividend was reduced.

Cost of Shares of the Corporation

The amount of any dividend deemed by paragraph 128.1(1)(c.2) to be received in respect of the share of an immigrating corporation by a shareholder resident in Canada is added in computing the adjusted cost base of such share to such holder pursuant to paragraph 53(1)(b.1).

The cost of any share of an immigrating corporation to a shareholder who is not resident in Canada, other than a share that was taxable Canadian property immediately before the time of immigration, is deemed to be equal to the fair market value of the share at the time of immigration: subsection 52(8).

Former Foreign Affiliate

Where the immigrating corporation was, immediately before the time of immigration, a foreign affiliate of a Canadian resident taxpayer, subparagraph 128.1(1)(d)(i) deems the affiliate to have been a controlled foreign affiliate of the Canadian resident immediately before the time of immigration. Subparagraph 128.1(1)(d)(ii) provides for the inclusion in the foreign accrual property income ("FAPI") of the immigrating corporation for its taxation year ending immediately before the time of immigration the amount prescribed by subsection 5907(13) of the Regulations.

The amount prescribed by Regulation 5907(13) is the total of the taxable surplus of the immigrating corporation in respect of the Canadian resident at the end of the year, other than net earnings for the year in respect of FAPI, to the extent not already subject to foreign tax (including notional foreign tax in respect of deemed dispositions of property by the immigrating

corporation[25]) reduced by any FAPI in respect of preceding taxation years to the extent not distributed by the immigrating corporation to its Canadian resident shareholder.

Because the Canadian resident shareholder is required to include in computing its income for a taxation year its share of the FAPI of any controlled foreign affiliate for each taxation year of the controlled foreign affiliate ending in that taxation year, the adjustments in Regulation 5907(13) effectively deem the immigrating corporation to have distributed all of its taxable surplus to its Canadian shareholder with appropriate credit for underlying foreign tax paid and FAPI previously accrued and taxed. Such taxable surplus will be taxable in the hands of the Canadian resident corporation.

Emigration

Before October 1996, the general rule under the Act since 1971 had been that when a taxpayer ceased to be resident in Canada, the taxpayer was deemed to have disposed of all property owned by the taxpayer, other than taxable Canadian property or property that the taxpayer elected to be treated as taxable Canadian property, for fair market value proceeds. This allowed gains that accrued while a taxpayer was resident in Canada to be taxed by Canada either at the time of emigration or, in the case of taxable Canadian property, when the property was sold or otherwise disposed of. However, in many cases, Canada was not able to impose tax when the taxable Canadian property was ultimately disposed of because many former residents were able to claim a tax treaty exemption. Accordingly, amendments were announced in October 1996, applicable to taxpayers emigrating from Canada after October 1, 1996, that significantly changed the rules on taxpayer migration by eliminating the exception from the rules for taxable Canadian property and repealing the election to deem property to be taxable Canadian property. As various features have been added to the rules, mostly to ameliorate the effect of the expanded scope of the rules, they have become increasingly complex.[26]

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[25] See CRA Document 9814010 dated May 27, 1998.

[26] The taxation rules for emigrating taxpayers in a number of countries, including Canada, are described in "The Tax Treatment of Transfer of Residence by Individuals", in International Fiscal Association, *Cahiers de droit fiscal international*, vol. 87b (The Hague: Kluwer Law International, 2002). CRA has published a guide for emigrants titled "Emigrants and Income Tax" (Publication T4056).

Unless otherwise noted, the description of the taxpayer emigration and trust distribution rules which follows, assumes that the taxpayer has ceased to be resident in Canada after October 1, 1996.

Individuals

Deemed Disposition of Property

Where an individual ceases to be resident in Canada at a particular time (referred to herein as the "time of emigration"), the individual is deemed to have disposed of each property owned by the individual, with certain exceptions, for proceeds equal to its fair market value: paragraph 128.1(4)(b).[27] The time of disposition is the time that is immediately before the time that is immediately before the time of emigration, and the proceeds are deemed to have become receivable and to have been received by the individual at the time of disposition. Each property deemed to have been disposed of is deemed to have been reacquired by the individual at the time of emigration at a cost equal to the proceeds of disposition of the property: paragraph 128.1(4)(c).

Accordingly, by virtue of the deemed disposition rule in paragraph 128.1(4)(b), unless the property is within one of the exceptions described below, an emigrating individual may realize accrued capital gains and losses on capital property, recapture of capital cost allowance or a terminal loss in respect of depreciable property, income that is an eligible capital amount, and accrued profits or losses on non-capital property such as foreign resource property, accruing interest,[28] a right described in subsection 96(1.1) to income from a partnership or property held as part of an adventure in the nature of trade.[29] The resulting net income or loss

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[27] In the case of a share acquired before emigration and before February 28, 2000 under an agreement with a Canadian-controlled private corporation to which subsection 7(1.1) applied, paragraph 128.1(4)(d.1) will reduce the proceeds of disposition. This provision is discussed subsequently in connection with employee stock options.

[28] See *Holzhey* v. *The Queen*, 2007 TCC 247 (T.C.C.) where the emigrating taxpayer claimed capital gains treatment in respect of an amount of accrued interest on a loan held by him. The Tax Court found that the accrued interest was includible as income under paragraph 12(1)(c) as an amount in lieu of interest, relying on the decision of the Federal Court of Appeal in *Trans Ocean Offshore Limited* v. *The Queen*, 2005 DTC 5201 as authority for interpreting the words "in lieu of" in paragraph 12(1)(c) broadly.

[29] The deemed disposition that occurs when a taxpayer ceases to be resident in Canada is specifically excluded from the application of a number of stop-loss rules in the Act, including subsection 13(21.2) (depreciable property); subsection 14(12) (eligible capital property); subsection 18(15) (a property described in an inventory

from the application of the departure tax rules will be included in the individual's tax return for the year of emigration in accordance with the provisions of section 114, discussed further subsequently.[30] The tax on any additional net income will be payable on the balance-due date for the year of emigration, subject to the special provisions for deferring payment of such tax by providing adequate security.

Where the property subject to the deemed disposition is property, including a partnership interest, used by the individual or the spouse of the individual in a fishing or farming business, a share of a corporation held by the individual which carries on a business of farming or fishing or the shares of a corporation held by the individual which carries on an active business in Canada[31], the gain may be eligible for the exemption in respect of up to $750,000 of capital gains contained in section 110.6 of the Act[32]. In order to be eligible for the exemption, the individual must have been resident in Canada in the year of emigration and throughout the immediately preceding or the immediately following year.

As noted above, in valuing property owned by an individual (such as shares of a corporation) for purposes of the deemed disposition rule in paragraph 128.1(4)(b), where there is a life insurance policy on the life of the individual or on the life of any other non-arm's length individual (e.g., a policy owned by a corporation), the fair market value of the property must be determined as though the cash surrender value of the policy were the fair market value of that policy: subsection 70(5.3). The purpose of this provision is to ensure that life insurance

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of a business that is an adventure or concern in the nature of trade, or certain indebtedness used or held in the ordinary course of a business that includes the lending of money); subsection 18.1(10) (a right to receive production to which a matchable expenditure relates); and subparagraph 40(2)(g)(i) (capital property – superficial loss). The deemed disposition that occurs when a taxpayer ceases to be resident in Canada will not apply to a transferee spouse or common-law partner for purposes of the capital gains attribution rule in subsection 74.2(1), unless the transferor and transferee elect to have it apply at the emigration time: subsections 74.2(3) and (4).

30 See *Tower et al* v. *M.N.R. et al*, 2002 DTC 7315 (F.C.T.D.); 2003 DTC 5540 (F.C.A.) and *Grant et al* v. *The Queen*, 2006 DTC 3071 (T.C.C.) (under appeal to F.C.A.) for examples of a "departure trade" plan to create a deduction in the year of emigration to offset an income inclusion resulting from emigration. Salary receivable and dividends receivable at the time of emigration may be deemed to have been received and thus includable in the resident portion of the emigration year tax return. See CRA Document No. 9640475.

31 Each of these classes of property is defined in considerable detail in the relevant definitions in section 110.6 of the Act which must be reviewed carefully in any particular situation.

32 Eligibility for the exemption may be reduced or eliminated by certain losses. The provisions of section 110.6 must be reviewed carefully in every instance.

proceeds payable on death are not reflected in the value of the property deemed to be disposed of by virtue of paragraph 128.1(4)(b).

In valuing a capital interest in a trust owned by an individual at the time of emigration where the trust interest is indefeasibly vested and is not an "excluded right or interest" (discussed subsequently), subsection 107.4(4) may apply to deem the fair market value of the capital interest to be not less than a *pro rata* portion of the fair market value of the trust's assets.

The following properties owned by an individual are excepted from the deemed disposition rule in paragraph 128.1(4)(b):

(1) Real property[33] situated in Canada, a Canadian resource property or a timber resource property: subparagraph 128.1(4)(b)(i). The individual may elect (Form T2061A) to have the deemed disposition rule apply to such property: subparagraph 128.1(4)(d)(i).[34] Any losses as a result of this election may only offset the increase, if any, in the individual's income as a result of the deemed disposition rule: subparagraphs 128.1(4)(d)(ii) and (iii). If, subsequent to emigration, the non-resident individual disposes of such a property, any gain will be subject to Canadian tax because these properties are taxable Canadian property for purposes of section 2 of the Act. Canada's tax treaties normally reserve to Canada the right to tax a resident of the treaty country on the disposition of these properties.

(2) Capital property used in, eligible capital property in respect of, or property described in the inventory of, a business carried on by the individual through a permanent establishment (as defined by Regulation 8201) in Canada at the time of emigration: subparagraph 128.1(4)(b)(ii). The individual may elect (Form T2061A) to have the deemed disposition rule apply to such property: subparagraph 128.1(4)(d)(i). Any losses as a result of this election may only

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33 Pending draft legislation on bi-juralism proposes to substitute "real or immovable property" for real property, effective on Royal Assent.

34 For late-filed, amended or revoked elections, see Regulation 600(c).

offset the increase, if any, in the individual's income as a result of the deemed disposition rule: subparagraphs 128.1(4)(d)(ii) and (iii). If, subsequent to emigration, the non-resident individual ceases to carry on the branch business in Canada, the individual will be deemed to dispose of capital property used in (subsection 13(9) and paragraph 45(1)(d)), eligible capital property in respect of (subsection 14(14)), and property described in the inventory of (subsection 10(12)), the Canadian branch business. The same result will pertain if the asset is withdrawn from the Canadian branch business.

(3) An excluded right or interest of the individual: subparagraph 128.1(4)(b)(iii). "Excluded right or interest" is defined in subsection 128.1(10) and is described in detail above.

(4) If the individual was not, during the 120-month period that ends at the time of emigration, resident in Canada for more than 60 months, property that was owned by the individual at the time he or she last became resident in Canada or that was acquired by the individual by inheritance or bequest after the individual last became resident in Canada: subparagraph 128.1(4)(b)(iv).[35]

(5) If the individual ceased to be resident in Canada after October 1, 1996 and subsequently becomes resident in Canada, any property in respect of which the returning resident has elected under paragraph 128.1(6)(a) not to have the deemed disposition rule apply at the time of emigration: subparagraph 128.1(4)(b)(v). To be eligible for this election, the property must be taxable Canadian property of the individual continuously from the time of emigration until the subsequent return to Canada. The provisions of subsection 128.1(6) applicable to returning former residents are described in detail subsequently.

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35 See the subsequent discussion under the heading "Replacement Shares".

Foreign Exploration and Development Expenses/Foreign Resource Expenses[36]

A taxpayer is normally entitled to deduct in a taxation year the greater of 10% of the taxpayer's undeducted foreign exploration and development expense ("FEDE") balance or an amount of FEDE equal to the taxpayer's foreign resource income in the year.[37] The opening wording of subsection 66(4) indicates that the subsection applies only to a taxpayer who is resident in Canada throughout a taxation year. However, subsection 66(4.3) (which applies to the 1998 and subsequent taxation years) provides that, for purposes of subsection 66(4), a part-year resident's taxation year is the part of the taxation year throughout which the individual was resident in Canada. Furthermore, subsection 66(4.3) provides that, for the purposes of 66(4), subsection 66(13.1) (proration of deductions for short taxation years) does not apply to the individual for the year. Where a taxpayer ceases to be resident in Canada after February 27, 2000, paragraph 115(1)(e.1) and subsection 115(4.1) provide that any unused FEDE balance can be applied by the non-resident to offset taxable income earned in Canada on a declining balance basis of 10% per year, in the non-resident portion of the year.

Under section 66.21, for taxation years beginning after 2000, expenses that were formerly FEDE now fall under the definition of foreign resource expenses ("FRE"), which is essentially the same as FEDE except that FRE is allocated on a country-by-country basis. Generally, under paragraph 66.21(4)(a), a taxpayer is entitled to deduct in a taxation year, in respect of a particular country, a minimum of 10% and a maximum of 30% of the taxpayer's adjusted cumulative FRE in respect of that country at the end of the year. However, the amount deducted cannot exceed the taxpayer's foreign resource income for the year in respect of the country.[38] Under paragraph 66.21(4)(b), a taxpayer may deduct an additional amount of cumulative FRE in respect of a particular country beyond the 30% maximum set out in paragraph 66.21(4)(a). Generally, the taxpayer may elect (in prescribed form) in respect of a

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36 Foreign exploration and development expenses do not include an expenditure incurred after February 27, 2000 except in limited circumstances. They also do not include a foreign resource expense (described below).

37 For 1999 and subsequent taxation years, the amount deductible must relate to FEDE expenses incurred by the taxpayer while resident in Canada: subparagraph 66(4)(a)(i).

38 As well, the amount deducted cannot exceed the amount determined under clause 66.21(4)(a)(ii)(C) or 66.21(4)(a)(ii)(D).

particular country, to deduct up to 30% of the taxpayer's *total* cumulative FRE, subject to sufficient global foreign resource income.

The deduction under subsection 66.21(4) is limited to a taxation year throughout which the taxpayer is resident in Canada. However, subsection 66.21(5) provides that, where an individual at any time in a taxation year ceases to be resident in Canada, for the purposes of subsection 66.21(4), the individual's taxation year will be the period or periods throughout which the individual was resident in Canada.[39] As well, the 30% limitation under paragraph 66.21(4)(a) does not apply to this short year with the result that FRE for a country can be deducted to the extent of income in that year in respect of that country.[40] Furthermore, as with FEDE, by virtue of paragraph 115(1)(e.1) and subsection 115(4.1), any unused FRE balance of a non-resident taxpayer (who ceased to be resident in Canada after February 27, 2000) can be applied by the non-resident to offset taxable income earned in Canada on a declining balance basis of 10% per year.

Deemed Year End for Non-Canadian Business

If the individual carries on a business at the time of emigration, otherwise than through a permanent establishment (as defined by regulation[41]) in Canada, the fiscal period of the business is deemed to have ended immediately before the time of emigration and a new fiscal period is deemed to have begun at the time of emigration: paragraph 128.1(4)(a.1). The income or loss of the business for the pre-emigration period will be included in the individual's income computation for the period in the taxation year of emigration during which he or she was resident in Canada. A new fiscal period for the business can be chosen after the time of emigration.

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39 Subsection 66.21(5) also provides that, for the purpose of section 66.21, subsection 66(13.1) (proration of deductions for short taxation years) does not apply to the individual for the year in which he or she ceases to be resident in Canada.

40 Clause 66.21(4)(a)(ii)(A).

41 Regulation 8201 does not include a reference to paragraph 128.1(4)(a.1), and thus does not define "permanent establishment" for the purposes of paragraph 128.1(4)(a.1). This may be an oversight.

Instalment Obligations

If the deemed disposition rule in paragraph 128.1(4)(b) applies to an individual and has the effect of increasing the individual's total taxes payable for the year, the tax instalment and instalment interest obligations of the individual for the year of emigration will be determined as if subsection 128.1(4) did not apply for purposes of computing the individual's total taxes payable for the year: subsection 128.1(5).

Excluded Rights or Interests

Excluded rights or interests (which are described in detail above) of an individual are not deemed to have been disposed upon emigration.[42]

Deferral of Departure Tax by Providing Security

An individual who ceases to be resident in Canada and is deemed to dispose of a property by virtue of paragraph 128.1(4)(b) may elect under subsection 220(4.5), upon providing adequate security, to defer payment of tax owing as a result of the deemed disposition without incurring interest or penalty charges.[43] This election (Form T1244) is not available in respect of a property that is a right to a benefit under an employee benefit plan.[44] The election (Form T1244) must be made in prescribed manner (Regulation 1301 has not been updated to refer to subsection 220(4.5)) on or before the individual's balance-due date for the year of emigration. Balance-due date is defined in subsection 248(1) and, for an individual, is April 30 in the

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42 Pursuant to section 124(1) of SC 2001, c. 17, individuals who emigrated from Canada after 1992 but before October 2, 1996 were permitted to elect to have their excluded rights or interests exempted from the deemed disposition rules at departure, provided that such election was made in writing before December 31, 2001. If this election was made, it will also have the effect of backdating the amendment to subparagraph 115(1)(a)(i) (income of a non-resident from employment performed in Canada). See the coming-into-force rule in subsection 90(11) of SC 2001, c. 17.

43 The Explanatory Notes state that it is intended that this deferral also operate in respect of the corresponding provincial taxes for which the Government of Canada has assessment and collection responsibilities, with the settlement of accounts between the governments taking place as the tax is collected.

44 The only rights under an employee benefit plan to which the deemed disposition rule would apply (because the rights would not be an excluded right or interest) would be rights that are not within the description of paragraph (b) of the definition of excluded right or interest in subsection 128.1(10) (i.e., the benefit under the plan described in paragraph (b) cannot reasonably be considered to be attributable to services rendered by the individual in Canada).

following year unless the individual has died after October in the year and before May in the following year, in which case it is 6 months after the day of death.

If an election under subsection 220(4.5) is made, the Minister of National Revenue is required to accept adequate security until the individual's balance-due date for the taxation year following the year of emigration and so on, on a yearly basis. This permits the Minister to assess the adequacy of the security on an annual basis.

The security is for the increased tax resulting from the deemed disposition rule in paragraph 128.1(4)(b).[45] The amount of tax is the total amount of tax under Part I that would be payable for the year of emigration (without taking into account the exclusion or deduction of amounts referred to in paragraph 161(7)(a)) but that would not have been so payable if each property (other than a right under an employee benefit plan) deemed to have been disposed of under paragraph 128.1(4)(b), and that has not subsequently been disposed of before the beginning of the taxation year for which security is being provided,[46] were not deemed to have been disposed of by the individual at the time of emigration, to the extent that those taxes have not been deemed under the Act or any other Act to have been paid for the emigration year: subparagraph 220(4.5)(a)(i). As property is disposed of following emigration, the amount of tax the payment of which can be deferred by providing security decreases. The security in place during the taxation year in which the property is disposed of will be reviewed by the Minister by the balance-due date for that year and the amount for which the Minister will be obliged to accept security thereafter will be reduced. The taxes for which security is provided cannot exceed, where the taxation year in respect of which security is being provided does not immediately follow the year of emigration, the amount for which security was provided for the immediately preceding year: subparagraph 220(4.5)(a)(ii).

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45 The amount of tax for which security is accepted by the Minister is deemed not to have been assessed under the Act for purposes of the tax collection agreements under which the federal government collects income taxes on behalf of a province: subsection 152(10).

46 A subsequent disposition will include a deemed disposition, such as death or a return to Canada upon immigration. See CRA Document No. 2002-0126445. Section 128.3, discussed subsequently (under the heading "Replacement Shares"), provides that certain share exchanges will not be treated as a disposition of the old share.

An individual will be deemed to have provided adequate security (and therefore will not actually have to furnish security) for an amount at least equal to the taxes payable (at the highest rate applicable to individuals) on the first $50,000 of income resulting from the deemed disposition of property by virtue of subsection 128.1(4).[47] Subsection 220(4.51) provides that where an individual elects under subsection 220(4.5), the Minister is deemed to have accepted at any time after the election is made adequate security (and that security is deemed to have been furnished by the individual before the individual's balance-due date for the emigration year) for a total amount of tax payable under Part I by the individual for the emigration year equal to the lesser of two amounts. The first amount is the total amount of those taxes that would be payable at the highest rate that applies to individuals on taxable income of $50,000.[48] The second amount is the greatest amount for which the Minister is required to accept security under subsection 220(4.5) for any particular taxation year of the individual.

The amount for which security has been accepted by the Minister is treated, for purposes of computing interest and penalties on unpaid tax, as if the amount were an amount paid by the individual on account of the tax liability: paragraph 220(4.5)(b). Thus, by furnishing adequate security, an emigrating individual can defer payment of the departure tax without interest or penalty charges until particular properties are sold or otherwise disposed of.[49] This provision does not apply for the purposes of the instalment provisions of subsections 161(2), (4) and (4.01)[50]. With respect to computing arrears interest, the deemed tax payment rule will only

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47 The Explanatory Notes indicate that the amount of $50,000 was chosen because it represents the taxable portion of a capital gain of $100,000. To reflect the three-quarters inclusion rate for capital gains that applied before the 2000 federal budget, a transitional rule in paragraph 178(2)(a) of SC 2001, c. 17 provides that "$50,000" in paragraph 220(4.52)(a) shall be read as "$75,000" in respect of emigration years that are before 2001.

48 Subsection 220(4.51) establishes the tax rate by reference to the tax rate applicable to an *inter vivos* trust resident in Canada (other than a trust described in subsection 122(2)). Subsection 122(1) sets a tax rate for such a trust that is the same as the top marginal rate for an individual. This rate is currently 29%; therefore adequate security is deemed to have been provided for tax of up to $14,500. However, for former residents of Quebec, the tax amount is $12,107.50 by virtue of the amount of federal tax deemed to have been paid (Quebec abatement) by virtue of subsection 120(2) and section 27 of the *Federal-Provincial Fiscal Arrangements Act*, RSC 1985, c. F-8.

49 See CRA Document No. 2002-0172287 for several examples of interest computation where security has or has not been provided.

50 Where a taxpayer has paid, by instalments, an amount greater than the tax payable absent s. 128.1, and gives adequate security for the additional tax payable as a result of emigration, the overpayment of instalments can be recovered under CRA's administrative policy: Technical Interpretation, CRA Document 2008 – 0299841E5(F), dated May 4, 2009.

apply for a particular taxation year where security is accepted by the Minister throughout that year.

Paragraph 220(4.5)(a) requires the Minister to accept security for the amount of departure tax described in that paragraph and no interest will be charged on the amount of tax for which security is accepted. Subsection 220(4.52) deems the Minister at any time not to have accepted security in respect of an individual's emigration year for an amount greater than the total additional tax payable under Part I of the Act for that year by virtue of the application of subsection 128.1(4) (calculated without reference to any of the deductions or exclusions listed in paragraph 161(7)(a) of the Act, in respect of which the day determined under paragraph 161(7)(b) is after that time).

The Minister is required to accept "adequate security". The Explanatory Notes state that the security must be acceptable to the Minister and that the adequacy of any particular proposal for security is a matter of fact. They also state that, in respect of tax on a gain from the deemed disposition of shares of a corporation, it is understood that the Minister will not exclude the possibility of accepting some or all of the shares as security. It is understood that the Minister will accept illiquid assets that are deemed to have been disposed of and have given rise to the departure tax (such as shares of a private corporation) as adequate security for the tax. (See CRA's guide "Emigrants and Income Tax Act" (T4056). See also CRA Document No. 2001-0093235.) However, the degree of flexibility on the Minister's part will depend on the particular circumstances and the security that will be acceptable to the Minister will result from negotiations between the taxpayer and the CRA.[51]

If it is determined subsequently at a particular time that security accepted by the Minister is not adequate to secure the particular amount for which it was furnished, the Minister must notify the individual in writing of the determination and the security will thereafter secure only the amount for which it is adequate security at that time: subsection 220(4.53). The balance of the amount will be unsecured and interest on the unpaid amount will accrue for the entire

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[51] With respect to the provision of adequate security, see Jack Bernstein and Kay Leung, "Taxpayer Emigration: The Provision of Security for Departure Tax", in *Tax Profile*, August 2003, CCH Canadian Limited, and Jack Bernstein and Ron Choudhury, "*Tax Planning for Emigration from Canada to the United States*", section XII, in *Tax Profile*, December 2008, CCH Canadian Limited.

taxation year in which the particular time occurs. However, the individual may furnish additional security within 90 days after the day of notification and, to the extent it is accepted as adequate security for all or any part of the particular amount, it is deemed to have been accepted as adequate security at the particular time. As a result, the amount in question should be treated as having been covered continuously by adequate security and interest should not accrue by virtue of there not having been adequate security throughout a taxation year.

Subsection 220(4.7) authorizes the Minister, in a case of undue hardship, to accept security different from, or of lesser value than, that which would otherwise be required. The Minister is not under any obligation to accept reduced security and can only do so where an individual who has made an election under subsection 220(4.5) cannot, without undue hardship, pay or reasonably arrange to have paid on the individual's behalf an amount of taxes to which security under that subsection would relate or provide or reasonably arrange to have provided on the individual's behalf adequate security under that subsection. In making a determination for purposes of subsection 220(4.7), the Minister is directed to ignore any transaction that is a disposition, lease, encumbrance, mortgage, hypothec, or other voluntary restriction by a person or partnership of the person's or partnership's rights in respect of a property, if the transaction can reasonably be considered to have been entered into for the purpose of influencing the determination: subsection 220(4.71).

Subsection 220(4.54) is another relieving measure that allows the Minister to extend the time for making the election under subsection 220(4.5) to provide security for the departure tax if, in the opinion of the Minister, it is just and equitable to do so. The discretion to extend time limits also extends to the time for furnishing and accepting security under subsection 220(4.5) and the 90-day period for the acceptance of security under subsection 220(4.53).

Returning Former Residents – Taxable Canadian Property

If an individual ceased to be resident in Canada after October 1, 1996 and subsequently becomes resident in Canada, the individual may elect under paragraph 128.1(6)(a) not to have the deemed disposition and acquisition rules in paragraphs 128.1(4)(b) and (c) apply in respect of taxable Canadian properties (discussed above) as a result of the individual's cessation of residence at the emigration time. The election is available regardless of how long

the returning former resident was non-resident. This election will apply to all properties that were taxable Canadian properties of the individual throughout the period that began at the time of emigration and ended at the time of re-establishing Canadian residence.[52] It will not apply to any other properties. The election must be made in writing and filed with the Minister on or before the filing-due date for the year in which the individual re-establishes Canadian residence.[53] The election under paragraph 128.1(6)(a) does not directly affect the obligations that arise on emigration; rather, it allows the obligations to be modified retrospectively.

An anti-surplus stripping rule applies to taxable Canadian properties in respect of which an election has been made under paragraph 128.1(6)(a). Under paragraph 128.1(6)(b), where certain conditions are met, a property will be deemed to have been disposed of on emigration notwithstanding paragraph 128.1(6)(a). The conditions for the application of paragraph 128.1(6)(b) to a particular taxable Canadian property are that the property has declined in value between the time of emigration and the time immediately before re-establishing Canadian residence and that, if the property were disposed of at fair market value immediately before re-establishing Canadian residence, subsection 40(3.7) would reduce the amount that, but for subsection 40(3.7) and subsection 128.1(6), would be the individual's loss from the disposition. (Subsection 40(3.7) is a stop-loss rule directed at reducing a loss where dividends were received by an individual while a non-resident. It is described subsequently under the heading "Stop-Loss Rule and Section 119 Credit".)

Where paragraph 128.1(6)(b) applies, the proceeds of disposition of the property for purposes of the deemed disposition under paragraph 128.1(4)(b) in respect of the time of emigration will be the total of (A) the adjusted cost base of the property immediately before such disposition and (B) the amount by which the notional loss reduction under subsection 40(3.7) would exceed the lesser of such adjusted cost base of the property and such amount as the individual may specify in respect of the property in the election under paragraph 128.1(6)(a). The individual will be deemed to have re-acquired the property at the time of emigration at a cost

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52 The property must have been owned at the time of emigration. There is a limited replacement property rule for shares in section 128.3, discussed subsequently under the heading "Replacement Shares".

53 By virtue of Regulation 600(c), the provisions of paragraphs 220(3.2)(a) and (b) of the Act dealing with late-filed, amended and revoked elections apply to paragraphs 128.1(6)(a) and (c), paragraphs 128.1(7)(d) and (g) and paragraph 128.1(8)(c).

equal to the amount by which (A) in the preceding sentence exceeds the lesser of the notional loss reduction under subsection 40(3.7) and the amount referred to in (B) in the preceding sentence that is specified by the individual.

The result of these rules is that the dividends which resulted in the notional loss reduction under subsection 40(3.7) are treated as a capital gain at the time of emigration unless the individual specified an amount for purposes of (B), in which case, depending on the amount specified, the dividends are treated as a gain at the time of emigration or after the individual has re-established Canadian residence (in the latter case through a reduction in the cost of the property in the deemed acquisition of the property at the time of emigration). The specified amount mechanism allows the individual to reduce the gain in respect of the property at the time of emigration (and defer it to the post-return period – subject to other adjustments to adjusted cost base and to changes in fair market value) up to the amount of the adjusted cost base of the property at the time of emigration. However, where the dividends in question exceed the adjusted cost base of the property, the return to Canada will result in some portion of the dividends being taxed at the time of emigration as if they were a capital gain (rather than at the withholding tax rate applicable to dividends to a non-resident).

Section 119 of the Act (discussed subsequently) will provide a credit for withholding tax under Part XIII on the dividends that resulted in paragraph 128.1(6)(b) becoming applicable because paragraph 128.1(6)(b) deems the individual to have disposed of the property for purposes of section 119 immediately before re-establishing Canadian residence.

The Explanatory Notes provide the following example to illustrate the operation of the anti-surplus stripping rules in paragraph 128.1(6)(b):

> "Marie emigrates from Canada in 1999. Marie is the majority shareholder of a Canadian-controlled private corporation (CCPC) when she leaves Canada. The shares, which are taxable Canadian property to Marie, have a fair market value (FMV) at that time of $50,000 and an adjusted cost base (ACB) of $15,000, for a latent gain of $35,000. Marie receives $35,000 of dividends from the CCPC in 2000. In 2001, Marie returns to Canada. At that time, the shares have an FMV of $15,000. Marie uses the election in subsection 128.1(6) to minimize the tax consequences of her earlier emigration from Canada.

> If Marie actually disposed of the shares immediately before re-establishing Canadian residence, subsection 40(3.7) of the Act would reduce her loss. Therefore, paragraph 128.1(6)(b) applies in respect of the shares.
>
> Under paragraph 128.1(6)(b), Marie is treated as having disposed of and reacquired the shares on emigration. Assuming she elects $10,000, Marie's emigration proceeds of disposition are deemed to be $40,000, being the emigration ACB ($15,000) plus the difference between the subsection 40(3.7) reduction ($35,000) and the ACB/specified amount ($10,000). Marie thus realizes a $25,000 capital gain in the emigration year.
>
> Marie's reacquisition cost is deemed to be $5,000, being the original ACB ($15,000) minus the lesser of the subsection 40(3.7) reduction ($35,000) and the specified amount ($10,000). Since the shares have an FMV of $15,000, Marie will eventually realize a gain of $10,000 (subject to other adjustments to ACB and FMV).
>
> The result is that Marie's $25,000 gain on departure and remaining $10,000 latent gain equal the $35,000 she extracted in the form of dividends. The full $35,000 will thus be realized as capital gains, and section 119 will give Marie credit for any withholding tax she paid on the dividends.
>
> Marie could have altered the timing of her capital gains on the shares. For example, if she had elected an amount of $5,000 under paragraph (a) in respect of the property, Marie's emigration proceeds of disposition would have been $45,000 ($15,000 ACB + ($35,000 s.40(3.7) reduction - $5,000 elected amount)), giving an emigration gain of $30,000. This would have been balanced by an increase in Marie's reacquisition cost from $5,000 to $10,000, which in turn would reduce the eventual gain Marie will realize on the shares."

Notwithstanding subsections 152(4) to (5), any reassessments of tax as are necessary to take an election under paragraph 128.1(6)(a) into account must be made: paragraph 128.1(6)(d). However, no such reassessment will affect (i) the computation of interest payable under the Act to or by an individual in respect of a period that is before the day on which the individual's return of income is filed for the taxation year that includes the time at which the individual re-established Canadian residence or (ii) any penalty payable under the Act.

Returning Former Residents – Other Property

An individual who ceased to be resident in Canada after October 1, 1996 and subsequently becomes resident in Canada may also elect under paragraph 128.1(6)(c) in respect of property that the individual owned throughout the period which began at the time of emigration and ended at the time of re-establishing Canadian residence[54] and that is deemed by paragraph 128.1(1)(b) to have been disposed of because the individual became resident in Canada. (Paragraph 128.1(1)(b), which deals with immigration to Canada, generally applies to property other than, in the case of an individual, taxable Canadian property and an excluded right or interest, and deems such property to have been disposed of and reacquired prior to immigration at fair market value.) The election is available without regard to how long the returning former resident was non-resident. The election under paragraph 128.1(6)(c) (which must be made separately from any election under paragraph 128.1(6)(a)) must be made in writing and filed with the Minister on or before the filing-due date for the year in which the individual re-establishes Canadian residence.[55] The election covers all property that is described in paragraph 128.1(6)(c). An election can be made under paragraph 128.1(6)(c) without making an election under paragraph 128.1(6)(a) and *vice versa*.

When an election is made under paragraph 128.1(6)(c), the deemed proceeds of disposition of each property for purposes of the emigration rules in paragraph 128.1(4)(b) and the deemed cost of acquisition of each property for purposes of the immigration rules in paragraph 128.1(1)(c) are adjusted. The amount that would otherwise be the deemed proceeds of disposition of a property under paragraph 128.1(4)(b) is reduced by the least of (i) the amount that would otherwise be the individual's gain in respect of the property by virtue of the deemed disposition under paragraph 128.1(4)(b), (ii) the fair market value of the property at the time the individual re-establishes Canadian residence, and (iii) the amount that the individual specifies in respect of the property in the election. The amount that would otherwise be the deemed cost of acquisition of a property under paragraph 128.1(1)(c) is reduced by the least of the same three amounts. The effect of these rules is that, by specifying an appropriate amount, an individual

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[54] See footnote 52 regarding replacement shares.

[55] See footnote 53 with respect to late-filed, amended and revoked elections.

can defer Canadian tax on all or part of a gain accrued before emigration by reducing the cost of the property that would otherwise be established upon immigration (i.e., the fair market value of the property at that time). If the property has declined in value with the result that the fair market value of the property immediately before immigration is less than the amount of the gain accrued before emigration, only the portion of the gain equal to such fair market value can be deferred through the election under paragraph 128.1(6)(c).

The following example of the operation of the paragraph 128.1(6)(c) election is set out in the Explanatory Notes:

> "Noah emigrates from Canada in 1999. Noah owns shares of a foreign corporation. When Noah leaves, the shares have a fair market value of $25,000 and an adjusted cost base of $15,000, for an accrued gain of $10,000. In 2012, Noah returns to Canada. At that time the shares have a fair market value of $80,000. Noah chooses to take advantage of the election in paragraph 128.1(6)(c) to control the tax consequences of ceasing to be a Canadian resident. Because he had a capital loss in 1999 of $7,000 from another source, Noah is content to realize a $7,000 capital gain on emigration, but he does not want to realize the other $3,000 accrued gain. Noah therefore chooses an elected amount of $3,000.
>
> Noah's proceeds of disposition under paragraph 128.1(4)(b) are deemed to be $22,000, being the proceeds of disposition that would otherwise be determined under paragraph 128.1(4)(b) ($25,000) minus the least of:
>
> - the amount that would have been Noah's gain on the shares under paragraph 128.1(4)(b) had this paragraph not applied ($10,000);
> - the fair market value of the property at the particular time ($80,000); and
> - the elected amount specified ($3,000).
>
> Noah thus reduces his emigration-year gain to $7,000. The same $3,000 that reduces Noah's emigration proceeds is also subtracted from his reacquisition cost under paragraph 128.1(1)(c) ($80,000), leaving his new adjusted cost base in respect of the property $77,000. The property thus has a latent gain of $3,000 at the time Noah re-establishes Canadian residence in 2012.

> Noah could have deferred tax on the full $10,000 gain that accrued before emigration, by increasing his elected amount in respect of the shares to $10,000."

Paragraph 161(7)(a) (dealing with arrears interest) and subsection 164(5) (dealing with refund interest) contain references to paragraph 128.1(6)(c).

Paragraph 128.1(6)(d) also applies with respect to any reassessments of tax as are necessary to take into account an election under paragraph 128.1(6)(c).

Post-Emigration Loss

Subsection 128.1(8) permits an individual in certain circumstances to reduce a gain realized in respect of a property upon emigration where the property has subsequently declined in value. If an individual was deemed by paragraph 128.1(4)(b) to have disposed of a capital property at any time after October 1, 1996, has disposed of the property at a later time at which it was a taxable Canadian property[56] of the individual and elects in writing in the individual's tax return for the year that includes the later time,[57] the individual may specify that the proceeds of disposition under paragraph 128.1(4)(b) be reduced and the amount of the reduction be added to the proceeds of disposition of the property at the later time. The amount of the reduction will be the least of (i) the amount specified in the election, (ii) the amount that, but for the election, would be the individual's gain in respect of the property by virtue of paragraph 128.1(4)(b), and (iii) the amount that, but for the election, would be the individual's loss in respect of the property at the later time (such loss to be determined having reference to every other provision of the Act including subsection 40(3.7) and section 112).

The cost of the property to the individual at the time of emigration as a result of the deemed reacquisition of the property under paragraph 128.1(4)(c) will not be affected by the election under subsection 128.1(8) and will continue to be the fair market value of the property at the time of disposition under paragraph 128.1(4)(b). Therefore, by specifying an appropriate amount in the election, proceeds of disposition can be shifted from the time of emigration,

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[56] See footnote 52 regarding replacement shares.

[57] See footnote 53 with respect to late-filed, amended and revoked elections.

thereby reducing the gain at that time, to the time of actual disposition where they will be sheltered by the high adjusted cost base of the property. Paragraph 152(6)(f.2) will ensure that any necessary reassessments of tax will be made to give effect to the election, provided that the requirements of that paragraph for requesting an adjustment are followed. (These requirements are discussed subsequently in connection with the foreign tax credit provisions of subsection 126(2.21).)

The Explanatory Notes provide the following example of the operation of the subsection 128.1(8) election:

> "Odile emigrates from Canada in 1999, owning a capital interest in a trust resident in Canada that she purchased in 1997. The interest has a fair market value at the emigration time of $150,000 and an adjusted cost base of $40,000, for a latent gain of $110,000 on departure. Odile's tax is assessed on that basis, and she posts security for the tax.
>
> In 2001, Odile sells her trust interest for $60,000. Since Odile has realized a smaller gain than assumed in her tax assessment on emigration, she elects under subsection 128.1(8) to reduce the gain she was deemed to have realized when she emigrated.
>
> To obtain the maximum benefit from the subsection, Odile specified an amount of $90,000 in respect of the election. Her proceeds of disposition at the emigration time are deemed to be $60,000, being the proceeds of disposition that would otherwise be determined under paragraph 128.1(4)(b) ($150,000) minus the least of:
>
> - the amount specified ($90,000);
> - the amount that would have been her taxable gain in respect of the trust interest under paragraph 128.1(4)(b) had this paragraph not applied ($110,000); and
> - the amount that would have been her loss on actual disposition of the trust interest had this paragraph not applied ($150,000 - $60,000 = $90,000).
>
> The same $90,000 amount is added to Odile's proceeds of the actual disposition of the trust interest. The result is that, in respect of the trust interest, Odile is treated as having realized a $20,000

> gain in 1999, and no gain or loss on the actual disposition of the property in 2001."

The election under subsection 128.1(8) will not affect any interest or penalties owing by the individual at the time of making the election, including interest and penalties calculated without reference to the election arising from the deemed disposition under paragraph 128.1(4)(b). Paragraph 161(7)(a) (dealing with the calculation of arrears interest where tax payable is reduced because of certain deductions or exclusions) and subsection 164(5) (dealing with refund interest in similar circumstances) contain references to subsection 128.1(8). Subsection 128.1(8) applies to changes in residence that occur after October 1, 1996.

Subsection 128.1(8) only provides relief where the property is taxable Canadian property at the time of its actual disposition and it provides broader relief than the three-year loss carryback provision of subsections 111(1) and (9) of the Act. Subsection 111(9) limits a non-resident taxpayer's capital losses for loss carryback purposes to losses from dispositions of taxable Canadian property. Section 114 also provides relief for taxable Canadian property where the actual disposition occurs in the non-resident portion of the year of emigration. However, no relief is provided for other property where a loss is incurred after departure in the year of emigration or in a following year.

Stop-Loss Rule and Section 119 Credit

Subsection 40(3.7) of the Act is a stop-loss rule directed at reducing a loss from a disposition of a property where taxable dividends were received by an individual (directly or through a partnership or trust) after the time the individual last acquired the property and while the individual was a non-resident. It applies to dispositions of property that occur after December 23, 1998 by individuals who ceased to be resident in Canada after October 1, 1996. The property could be shares of a corporation, a partnership interest or a trust interest. Subsection 40(3.7) (which applies where an individual is or has been a non-resident) operates by cross-referencing to the comprehensive stop-loss system for corporations. For the purpose of applying subsections 100(4), 107(1) and 112(3) to (3.32) and (7) of the Act in computing the individual's loss from the disposition, subsection 40(3.7) deems the individual to be a corporation and deems the dividends to have been deductible under section 112 when received. The rule

applies to dividends paid on shares and to dividends deemed under Part XIII to have been paid to the individual (for example, where section 212.1 applies).

The stop-loss rule in subsection 40(3.7) would apply, for example, where an individual owning a significant interest in a Canadian corporation ceased to be resident in Canada and received dividends from the corporation during the period of non-residence. The rule applies to all dividends and does not distinguish between ordinary dividends, which may not have contributed to the diminution in value that created the loss, and special dividends, which may be directly responsible for the reduced value.

Section 119 of the Act allows a credit in certain circumstances for Part XIII tax where the stop-loss rule in subsection 40(3.7) has reduced an individual's loss from the disposition of a taxable Canadian property. It applies to dispositions after December 23, 1998 by individuals who ceased to be resident in Canada after October 1, 1996. The purpose of section 119 is to address the possible overlap between the Part I tax resulting from the subsection 128.1(4) deemed disposition of a property and the Part XIII tax on dividends that reduce the individual's loss on the property (thereby reducing the amount of the loss that may be available to offset the gain which resulted from the subsection 128.1(4) deemed disposition). The section applies where the individual was deemed by subsection 128.1(4) to have disposed of a capital property that was a taxable Canadian property.[58] The property must have been a taxable Canadian property of the individual throughout the period from the time of disposition under subsection 128.1(4) to the first time at which the individual subsequently disposes of the property.[59] The credit applies to tax payable under Part I of the Act for the year of emigration. The amount of the credit is the lesser of (a) the amount of Part I tax for the year of emigration attributable to the taxable capital gain from the disposition of the property by virtue of subsection 128.1(4)[60] and (b) the amount of Part XIII tax on dividends in respect of the property or deemed

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58 The expanded definition of taxable Canadian property for purposes of section 128.1 would not appear to apply to the reference to taxable Canadian property in section 119.

59 Section 128.3 (discussed subsequently under the heading "Replacement Shares") deems certain share exchanges not to have been a disposition of the old share and treats the new share as if it were the old share.

60 Note that, unlike the foreign tax credit in subsection 126(2.21) (discussed subsequently under the heading "Credit for Foreign Tax"), which, in effect, provides a credit for "incremental" Canadian tax, section 119, in effect, only provides a credit for "average" tax.

dividends that can reasonably be considered to relate to the property paid during the period referred to above to the extent such dividends have reduced the individual's loss from the property by virtue of subsection 40(3.7).[61]

A credit under section 119 currently does not reduce the amount of alternative minimum tax ("AMT") payable under the Act by an individual. As such, if a credit under section 119 applies to reduce an individual's tax payable in the individual's departure year from Canada to a level at which AMT applies to that individual or if the individual is otherwise liable for AMT in this year, double taxation could result as the individual would have been subjected to both AMT and withholding tax without any relief. However, the Department of Finance in comfort letters dated September 9, 2004 and December 7, 2004, stated that it would recommend to the Minister of Finance that amendments be made to the Act that would (i) prevent a taxpayer who has emigrated from Canada being reassessed for AMT in the taxpayer's year of departure solely due to the application of a section 119 credit to that year; and (ii) enable a taxpayer that has paid AMT for the year of departure from Canada to claim a section 119 credit against the AMT paid. In the second comfort letter, the Department of Finance stated that it would recommend that the proposed amendments affect dispositions after December 23, 1998 by individuals who ceased to be resident in Canada after October 1, 1996.[62]

Paragraph 152(6)(c.1) will ensure that any necessary reassessments of tax will be made in order to permit the deduction under section 119, provided that the requirements of that paragraph for requesting an adjustment are followed. (These requirements are described subsequently in connection with the foreign tax credit provisions of subsection 126(2.21).)

The claiming of a credit under section 119 will not affect interest or penalties owing by the individual at the time of the subsequent disposition: paragraph 161(7)(a) (arrears interest) and subsection 164(5) (refund interest).

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[61] In the CRA's view, the Part XIII tax is based on the treaty rate. See CRA Document No. 2003-0033421.

[62] See Jack Bernstein, "Finance: The Section 119 Fix", Vol. 12, No. 12, *Canadian Tax Highlights* (December 2004), Canadian Tax Foundation.

Credit for Foreign Tax

A major difficulty posed by the departure tax resulting from the deemed disposition of property on emigration is the potential for overlap between Canadian tax on the income arising from the deemed disposition and foreign tax imposed by the emigrant's new country of residence on income arising when the property is actually disposed of. Unlike Canada, most countries do not step-up the tax cost of property owned by a person at the time of acquiring residence in the country. Upon a subsequent disposition of the property, the new country of residence would determine the amount of any gain subject to tax in that country based on the historical cost of the property. The same increase in economic value could be taxed by both countries and could result in a punitive rate of tax if one country or the other does not provide relief.

This potential for double taxation has always been present for property that was not taxable Canadian property, but relief was potentially available through an election by the emigrating individual to deem the property to be taxable Canadian property[63] (thus permitting a realization of gain for Canadian and foreign tax purposes at the same time with the opportunity to claim a treaty exemption for the Canadian tax or to claim a foreign tax credit under subsection 126(2.2)). The expansion of the deemed disposition rule in paragraph 128.1(4)(b) for individuals emigrating after October 1, 1996 to include all taxable Canadian property (such as shares of a Canadian private corporation) other than Canadian real or immovable property and the other limited types of property described in subparagraphs 128.1(4)(b)(i) to (iii), and the elimination of the election to deem non-taxable Canadian property to be excluded from the deemed disposition upon emigration, has greatly expanded the potential for double taxation.

Except with respect to Canadian real or immovable property and shares of companies deriving their value principally from such property, most of Canada's tax treaties cede the right to tax capital gains realized on a disposition of taxable Canadian property by a resident of the other country to that country. There is usually a provision (sometimes referred to as a

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[63] Paragraph 48(1)(c) and subsection 48(2), as they read in their application before 1993, or subparagraph 128.1(4)(b)(iv) and paragraph 128.1(4)(e), as they read in their application before October 2, 1996. Where this election was made to defer the recognition of gain until a subsequent actual or deemed disposition, adequate security had to be furnished to CRA.

claw-back) whereby Canada retains the right to tax such capital gains realized by a former Canadian resident individual for a minimum period of time after giving up Canadian residency. For example, this period of time in the Canada-U.S. Income Tax Convention is 10 years (Article XIII(5)) and in the Canada-U.K. Income Tax Convention is 6 years (Article 13(9)). There are also related provisions in Articles XXIV(2)(c) and (3)(b) of the U.S. Convention regarding foreign tax credits. Appendix A lists Canada's tax treaties which include a claw-back provision.

The potential for double taxation of pre-departure gain is illustrated by the following example set out in the Explanatory Notes:

> "Lee emigrates from Canada to Treatyland at a time when he owns a house in Treatyland. Lee bought the house while resident in Canada; at the time of emigration, the house has an adjusted cost base of $60,000 and a fair market value of $100,000. The resulting $40,000 latent capital gain will produce a taxable capital gain of $30,000 immediately before departure, and that taxable capital gain will be subject to Canadian tax.
>
> Assume that the house increases in value to $120,000 after Lee leaves Canada, and that Lee sells the property in 2005 for that amount.
>
> In principle, the gain that has been subject to Canadian tax ought not to be taxed a second time. However, Treatyland may not yet recognize the tax effect of changes in residence and may simply tax Lee, when the property is disposed of, on the full amount of his gain since first acquiring the property. In that case, Treatyland will tax not only the $20,000 gain realized since Lee left Canada, but also the $40,000 gain that accrued while Lee was resident in Canada. In the end, Lee is taxed twice on the same gain."

Canada intends to seek a modification to its tax treaties to resolve this issue of overlapping Canadian and foreign taxes by having the foreign country recognize the Canadian tax that arises on departure.[64] The Fifth Protocol to the Canada-United States Income Tax Convention provides, in amended paragraph 7 of Article XIII, that where one country's tax rules treat an individual as having disposed of a property and subject to tax, the individual can choose to

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64 Presumably, this would require the foreign country to agree to amend its domestic tax legislation as well as the treaty with Canada.

be treated under the other country's rules as also having disposed of and reacquired such property at fair market value, whether or not (in the case of a Canadian resident who is not a U.S. citizen and who is not subject to U.S. tax on the deemed dispositions[65]. Where tax is payable in the destination country (i.e., real estate situate in that country) the new rule ensures appropriate tax crediting.

Appendix B lists Canada's tax treaties that include a "migration step-up" provision. The tax treaty with Chile signed on January 31, 1998 was the first of Canada's tax treaties to include a step-up provision following the announcement of the revised migration rules in October 1996. Today, more than 30 signed tax treaties or protocols have a step-up provision. However, a number of treaties or protocols signed subsequent to the Chile tax treaty did not include a step-up provision (Bulgaria, Indonesia, Japan, Jordan, Kyrgyzstan, Lebanon, Slovenia, and Uzbekistan). Thus, Canada has not enjoyed complete success when negotiating tax treaties or amendments to tax treaties in adding such a provision to the capital gains article to permit a tax cost step-up in the new country of residence.

However, in recognition that treaty changes can take considerable time, the provisions of section 126 of the Act dealing with foreign tax credits also address this issue by providing some limited relief for taxes paid to a country with which Canada has a tax treaty in respect of dispositions of property (other than real property).[66] In the case of real property, a credit is provided for taxes paid to the country in which the property is situated regardless of whether Canada has a tax treaty with that country. The special treatment for real property recognizes the general international principle that the country in which real property is situated has the first right to tax gains on that real property. In the case of property other than real property, no relief is provided for taxes paid to a non-treaty country.

Subsection 126(2.21), which applies to the 1996 and subsequent taxation years, provides a credit for foreign taxes to a non-resident individual who disposes of a property in a

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65 See Revenue Procedure 2010-19, 2010-13 IRB, for IRS guidance on the election.

66 These provisions have no expiry date but the Department of Finance News Release of June 5, 2000 accompanying the June 5, 2000 draft legislation states that "the Government will monitor the need for a definitive expiry date as additional countries implement protection against double taxation in respect of capital gains in renegotiated treaties." The Explanatory Notes state: "It is intended that these interim foreign tax credits will be reviewed by the Government of Canada as appropriate treaty changes are put in place."

taxation year that the individual last acquired because of the application at any time (referred to as the "acquisition time") after October 1, 1996 of paragraph 128.1(4)(c).[67] The credit is available to reduce tax otherwise payable under Part I for the year that includes the time immediately before the acquisition time (i.e., the year of emigration). The taxes that are eligible for the credit are business-income tax or non-business-income tax paid by the individual for the taxation year in which the property was disposed of that can reasonably be regarded as having been paid in respect of that portion of any gain or profit from the disposition of the property that accrued while the individual was resident in Canada and before the time the individual last ceased to be resident in Canada: paragraph 126(2.21)(a).[68] In addition,

- where the property is real property[69] situated in a country other than Canada, the tax must be paid either to the government of the country in which the property is situate or, to the government of a country with which Canada has a tax treaty at the particular time the property is disposed of and in which the individual is resident at that particular time; and
- where the property is not real property, the tax must be paid to the government of a country with which Canada has a tax treaty at the particular time the property is disposed of and in which the individual is resident at that particular time.[70]

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67 For a non-resident individual who emigrated before October 2, 1996, a foreign tax credit was available under subsection 126(2.2) in respect of a disposition of a property that was deemed to be taxable Canadian property by virtue of old subsection 48(2) or old paragraph 128.1(4)(e). See also footnote 52 regarding replacement shares.

68 The definitions of business-income tax and non-business-income tax in subsection 126(7) include tax paid to a state, province or other political subdivision of a foreign country as well as to the government of that country. A deemed disposition upon emigration is not recognized as a disposition for purposes of the specific anti-avoidance rules in subsections 126(4.1) to (4.4) of the Act, which exclude foreign taxes from a taxpayer's business-income tax or non-business-income tax where the taxpayer acquires a property (other than a capital property) in respect of which it is reasonable to expect at that time that the taxpayer will not realize an "economic profit", or where the taxpayer receives dividends or interest on a share or debt obligation held for one year or less.

69 Pending draft legislation on bi-juralism proposes to substitute "real or immovable property" for "real property", effective on royal assent.

70 In many treaties, the first right to tax of the country in which real or immovable property is situated often extends to shares that derive their value principally from real or immovable property situated in that country. Such shares would be governed by this requirement in subsection 126(2.21) and not the requirement relating to real or immovable property.

The amount of the credit for foreign tax cannot exceed the amount by which the tax under Part I otherwise payable by the individual for the emigration year (after taking into account the application of foreign tax credits under subsection 126(2.21) in respect of prior dispositions) exceeds the amount of such tax that would have been payable if the particular property had not been deemed by subsection 128.1(4) to have been disposed of in the emigration year: paragraph 126(2.21)(b).

The amount of the foreign tax credit that may be claimed under subsection 126(2.21) will be reduced by any tax credit (or other reduction in the amount of a tax) to which the individual was entitled for the year in which the property was disposed of under the law of the foreign country or under a tax treaty between Canada and the foreign country because of taxes paid or payable by the individual under the Act in respect of the disposition or previous disposition of the property: subsection 126(2.23). This rule is intended to ensure that a credit is only available to the extent that another country is not required to give credit for Canadian tax in respect of the disposition or a prior disposition of the property. Annex 1 to the Department of Finance News Release of December 17, 1999 accompanying the December 17, 1999 draft legislation stated that the rule in subsection 126(2.23) "ensures a three-stage calculation: first, the Canadian tax on a pre-departure . . . gain is assessed; second, any foreign tax payable on the same gain is reduced by any available credit for that Canadian tax; and third, any remaining foreign tax is creditable (subject to the other limits provided) against the Canadian tax."

Where a non-resident individual has filed a tax return for the year of emigration and wishes to claim a foreign tax credit for the year of emigration under subsection 126(2.21) in respect of foreign tax paid in a subsequent year, the individual must file a prescribed form (T1 ADJ: Adjustment Request) on or before the day the individual is required to file a tax return for that subsequent year (or would be so required if a tax under Part I were payable by the individual for that subsequent year): paragraph 152(6)(f.1). The Minister is then required to reassess the year of emigration in order to take into account the foreign tax credit claimed.

Using the facts in the example set out immediately above with respect to Lee who emigrates from Canada to Treatyland, the Explanatory Notes provide the following example designed to illustrate the operation of the new credit:

> "In the example above, Lee will be able to claim a credit for the lesser of 2/3 ($40,000/$60,000) of the Treatyland tax on the total amount of the gain, and the Canadian tax that arose because of the deemed disposition on emigration. The credit will be applied against Lee's Canadian tax for the emigration year, with amended subsection 152(6) allowing any necessary reassessment.
>
> Note that since the property in question (a house) is real property, Lee could also claim a credit for tax paid to another treaty country in respect of his pre-emigration gain, if he lived in that other country. For example, if the house were located not in Treatyland but in Nontreatyland, Lee could - as a resident of Treatyland - claim a credit in respect of both Treatyland tax and Nontreatyland tax."

Paragraph 161(7)(a) (arrears interest) and subsection 164(5) (refund interest) contain a reference to subsection 126(2.21).

Although subsection 126(2.21) partially addresses the potential overlapping of Canadian and foreign taxes, the following statement by the Department of Finance recognizes that it may not be enough:

> "It is reasonable to expect, however, that other situations will arise where Canada's rules and the rules of another country conflict, and where resolution through a tax treaty is not possible in the short term. Provided that Canadian and/or foreign tax is paid at full Canadian rates (in other words, that there is no net avoidance of tax), it may be appropriate in certain of these cases for Canada to recognize and accommodate the foreign tax. Therefore, while the government will continue its efforts to find treaty solutions, it will also consider other options where the scale and frequency of a problem make that appropriate."

Replacement Shares

Section 128.3 of the Act provides that certain tax-deferred share-for-share exchanges will not adversely impact the relief available under section 119 and subsections 126(2.21) to (2.23) (credit for foreign tax), subsection 128.1(6) (returning former resident), subsection 128.1(7) (returning trust beneficiary), subsection 128.1(8) (post-emigration loss), and subsection 220(4.5) (security for departure tax) by deeming, for the purposes of these provisions, the old share not to have been disposed of and the new share to be the same share as the old

share. The share-for-share exchanges to which section 128.3 applies are section 51 (convertible property), subparagraphs 85.1(1)(a)(i) and (ii) (exchange of shares of one corporation for shares of another corporation), section 86 (reorganization of share capital), and section 87 (amalgamation). Section 128.3 does not apply to a share-for-share exchange where an election has been filed under subsection 85(1).

It should be noted that section 128.3 does not apply for purposes of the short-term resident exception in subparagraph 128.1(4)(b)(iv). Under this exception, a property is not subject to the deemed disposition rule on emigration if, during the last 120 months, the individual was not resident in Canada for more than 60 months *and* owned the property continuously since the individual last became resident in Canada. If the property is shares and new shares have been received in a reorganization after the individual last became resident in Canada, the exception will not be available. However, a Department of Finance comfort letter dated June 2, 2003 describes a proposal to amend section 128.3 so that it will apply for purposes of subparagraph 128.1(4)(b)(iv) where new shares are received in a reorganization to which any of sections 51, 85.1, 86 or 87 applies. The amendment would apply to the 2002 and subsequent taxation years.

Employee Stock Options

Section 7 of the Act deals with employee stock options granted by a corporation. For these purposes an option is a right under an agreement with the individual's employer corporation (or a corporation not at arm's length with the employer) to acquire shares of the employer (or of a corporation not at arm's length with the employer) where the rights were acquired by the individual by virtue of the employment relationship. Equivalent rules apply to options on units of a mutual fund trust. For ease of description, unless the context clearly requires otherwise or unless otherwise noted, the following discussion refers only to shares and a corporation but is equally applicable to units and a mutual fund trust.

An employment benefit equal to the difference between the fair market value of the shares at the time the option is exercised and the exercise price under the option is recognized when the employee exercises the option and acquires the shares (paragraph 7(1)(a)) except (i) where the option is to acquire shares of a Canadian-controlled private corporation (a "CCPC")

and (ii) where the option is to acquire non-CCPC shares, the shares were acquired in a qualifying acquisition and an election is made to defer recognition of the employment benefit. In the case of CCPC shares, by virtue of subsection 7(1.1), the recognition of the employment benefit is deferred from the year the option is exercised to the year in which the shares are disposed of (or deemed to be disposed of) by the employee (subsection 7(1.1)). In the case of qualifying non-CCPC shares, by virtue of subsection 7(8), recognition of the employment benefit may also be deferred from the year the option is exercised to the year in which the shares are disposed of (or deemed to be disposed of) by the employee. Where certain requirements are satisfied, paragraphs 110(1)(d) and (d.1) of the Act provide a special deduction that has the effect of measuring the amount of the employment benefit on an equivalent-to-capital-gains basis. The adjusted cost base of the shares will be increased at the time the shares are acquired by the amount of the employment benefit recognized at that time or, in the case of shares acquired after February 27, 2000, by the amount of the deferred benefit provided for CCPC shares under subsection 7(1.1) or for non-CCPC shares under subsection 7(8).

In general, the deferral in respect of non-CCPC employee options is available in the following circumstances:

- the shares or units were acquired after February 27, 2000 and the employee would have qualified at that time for a deduction under paragraph 110(1)(d) in respect of the acquisition
- in the case of a share, it is of a class that, at the time of acquisition, is listed on a prescribed stock exchange[71] and, at the time the option was granted, the employee was not a specified shareholder (as defined in subsection 248(1) - with certain modifications) of the corporation or certain other persons
- the employee was resident in Canada at the time of acquisition and elects to have the deferral apply by filing a prescribed form before January 16 of the year following the year of acquisition with the employer (or certain other persons)

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[71] Where one or more option exchanges occurred to which subsection 7(1.4) applied before the share was acquired, each of the preceding options must have been to acquire listed shares.

- the deferral is subject to an annual limit of $100,000 based on the year in which the options first became exercisable and on the fair market value of the underlying shares or units at the time the option was granted.

Options Owned at Emigration Time

A right of an individual under an agreement referred to in subsection 7(1) is an excluded right or interest of the individual and is not deemed to have been disposed of by the individual under paragraph 128.1(4)(b) upon emigration. As a result, emigration will not cause an income inclusion under section 7 in respect of employee stock options held at the time of emigration.

A non-resident who at no time in a taxation year is resident in Canada is subject to Canadian tax on the non-resident's taxable income earned in Canada for the year (other than treaty-protected income): subsections 2(3) and 115(1). Where an individual is resident in Canada for part of a year and non-resident throughout the other part, the taxable income of the individual for that year will include, for the non-resident period, only the income earned in Canada as determined under paragraphs 115(1)(a) to (c): section 114. This includes income from the duties of offices and employments performed by the non-resident person in Canada and, if the person was resident in Canada at the time the person performed the duties, outside Canada: subparagraph 115(1)(a)(i). The extension of subparagraph 115(1)(a)(i) to include income from duties performed outside Canada applies to the 1998 and subsequent taxation years. An employee stock option benefit is income from employment. If a stock option is granted to an employee who is resident in Canada at a time when the option is granted and the employee is later transferred to another country and exercises the option at a time when the employee is a non-resident, it is not clear to what extent a stock option benefit will relate to duties performed while a resident of Canada or duties performed outside Canada after becoming a non-resident. The stock option benefit is deemed to be received by virtue of employment, but is it employment at the time the option was granted or became vested, or subsequent employment? CRA usually takes the position that, if the option was granted when the employee was a resident of Canada,

the entire benefit is attributable to Canadian employment.[72] Accordingly, if an individual is granted an employee stock option while a resident of Canada and exercises the option after becoming a non-resident, the full amount of the stock option benefit will be included in taxable income earned in Canada (unless a tax treaty exempts such income from Canadian tax). If the option is in respect of CCPC shares, recognition of the benefit will be deferred by virtue of subsection 7(1.1) until the disposition of the shares. The deferral in respect of non-CCPC shares is not available to a non-resident.

CCPC Shares - Deferred Benefit

The stock option benefit deferred by virtue of subsection 7(1.1) at the time CCPC shares are acquired is not recognized when the individual emigrates. Subsection 7(1.6) provides that, for purposes of section 7 and paragraph 110(1)(d.1), the deemed disposition rule in paragraph 128.1(4)(b) does not apply to a share acquired under circumstances to which subsection 7(1.1) applied. The benefit will be recognized when the individual, as a non-resident, subsequently disposes of the shares: subparagraph 115(1)(a)(i).

The CCPC shares will be deemed to have been disposed of by virtue of paragraph 128.1(4)(b) for all other purposes of the Act and any gain or loss accrued since the shares were acquired will be recognized at the time of emigration. However, in the case of CCPC shares acquired after February 27, 2000, when the CCPC shares were acquired at the time the option was exercised, the adjusted cost base of the shares was increased by virtue of paragraph 53(1)(j) by the amount of the deferred benefit (i.e., the fair market value of the shares at the time the option was exercised less the exercise price). Thus, the deferred benefit will not be taxed at the time of emigration.[73]

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[72] Interpretation Bulletin IT-113R4 dated August 7, 1996, para. 22. See also CRA Documents No. 9715797; 9800277; 1999-0009425; 1999-0009407. See also *Hurd* v. *The Queen,* 81 DTC 5140 (F.C.A.); *Hale* v. *The Queen*, 92 DTC 6473 (F.C.A.); and *Tedmon* v. *MNR*, 91 DTC 962 (T.C.C.). Paragraphs 12 to 12.15 of the Commentary on Article 15 of the OECD Model Convention discuss the treatment of employee stock options.

[73] However, if the value of the CCPC shares has decreased between the time of acquisition and the time of emigration, a capital loss would be recognized at the time of emigration.

There is a special transitional rule for CCPC shares acquired before February 28, 2000 because, for shares acquired before that date, paragraph 53(1)(j) only increased the adjusted cost base of the shares by the amount of the employment benefit at the time the shares were disposed of - there was no increase at the time of acquisition. Therefore, for purposes of applying paragraph 128.1(4)(b) at the time of emigration, the proceeds of disposition of such shares are reduced by the amount of the benefit that the individual would have had to include in income under section 7 of the Act if the shares had been disposed of immediately before emigration for purposes of that section: paragraph 128.1(4)(d.1). The purpose of this adjustment is to recognize that, if the emigration had triggered an income inclusion under section 7, there would have been an increase in the adjusted cost base of the shares by virtue of paragraph 53(1)(j) of the Act. The section 7 benefit will eventually be taxed when the shares are actually disposed of. The Explanatory Notes illustrate this special transitional rule by way of the following example:

> "From 1993 to 1998, Katharine was employed by a Canadian-controlled private corporation (CCPC). Part of Katharine's compensation for 1995 was an option to buy 100 shares of the corporation at a price of $1 a share. In 1996, when the shares were worth $2 each, Katharine exercised the option. In 2002, when the shares are worth $6 each, Katharine emigrates from Canada.
>
> Under amended paragraph 128.1(4)(b), Katharine will be treated as having disposed of the shares for proceeds of $600 (=100 x $6 fair market value). Ordinarily, the disposition would trigger an income inclusion of $100 under section 7 (=100 x ($2 - $1)), a corresponding addition of $100 to the ACB of the shares under paragraph 53(1)(j) (resulting in a total ACB of $200), a deduction of $50 (=.5 x $100) under paragraph 110(1)(d.1) in computing taxable income, and a taxable capital gain of $200 (=.5 x ($600 - $200).
>
> However, as a result of new subsection 7(1.6), Katharine will not be subject to any income inclusion under section 7 in respect of the deemed disposition and, thus, there will be no addition to the ACB of the shares under paragraph 53(1)(j). Were it not for new paragraph 128.1(4)(d.1), this would result in Katharine having a taxable capital gain of $250 (=.5 ($600 - $100)) on the deemed disposition of the shares under paragraph 128.1(4)(b), and an additional income inclusion of $100 minus $50 on the actual disposition of the shares.

> Paragraph 128.1(4)(d.1) addresses this by deducting from the proceeds of disposition, for capital gains purposes, the $100 that paragraph 53(1)(j) would have added to the ACB of the shares if there had been an income inclusion under section 7 on emigration. As a result, Katharine will realize a taxable capital gain of $200 on the deemed disposition of the shares (and an additional income inclusion of $100 less $50 when she actually disposes of the shares)."

Non-CCPC Shares - Deferred Benefit

The stock option benefit deferred in respect of qualifying non-CCPC shares acquired after February 27, 2000 where an election is made under subsection 7(8) will be recognized at the time of emigration when the shares are deemed to have been disposed of by virtue of paragraph 128.1(4)(b). The deemed disposition will also result in recognition of any accrued gain or loss with respect to the shares, but for these purposes, the adjusted cost base of the shares would have been increased under paragraph 53(1)(j) at the time the shares were acquired by the amount of the deferred benefit. If the value of the shares has decreased from the time of acquisition to the time of emigration, the individual will have employment income based on the higher value at the time of acquisition as well as a capital loss based on that value; however, the capital loss cannot be used to offset the employment income.

Other Consequences

A CCPC is a Canadian corporation that is not, among other things, controlled by one or more non-resident persons. Consequently, when a shareholder of a CCPC becomes a non-resident of Canada, the corporation may cease to be a CCPC. This would affect the corporation's entitlements to the small business deduction (section 125) and the computation of the corporation's refundable dividend tax on hand (section 129) for a taxation year of the corporation during which it ceased to be a CCPC and for subsequent taxation years. Further, capital dividends paid by a private corporation, which are not included in the income of a resident of Canada, are subject to withholding tax when paid to a non-resident of Canada: paragraph 212(2)(b). The loss of these features of the system for integrating corporate and shareholder income will increase the net overall Canadian tax cost to the non-resident

shareholder of distributions to the shareholder out of income that would otherwise qualify for the small business deduction or increase refundable dividend tax on hand.[74]

Subsections 110.6(2), (2.1) and (2.2) provide an exemption to an individual who was resident in Canada throughout a taxation year for up to $375,000[75] of taxable capital gains realized on the disposition in the year of a qualified farm property, a qualified fishing property[76] or a qualified small business corporation share. An individual who was resident in Canada throughout the taxation year immediately preceding the year of emigration will be deemed to have been resident in Canada for purposes of subsections 110.6(2), (2.1) and (2.2) throughout the emigration year: subsection 110.6(5). Therefore, where the farm property, fishing property or small business corporation share otherwise qualifies for the exemption, the capital gains exemption can be claimed in the year of emigration with respect to gains realized as a result of the deemed disposition under paragraph 128.1(4)(b), but it will not be available with respect to gains realized by the emigrating individual in a taxation year following the emigration year. Further, it appears that subsection 110.6(13) may prevent a claim for the exemption with respect to gains realized in the year of emigration following the time of emigration.[77]

Paragraph 104(4)(a.3) provides that where a taxpayer transfers capital property to a trust after December 17, 1999 on a rollover basis under subsection 73(1) of the Act (transfer to a spousal trust or after 1999, to a joint spousal trust or an alter ego trust) and it is reasonable to conclude that the property was transferred in anticipation that the taxpayer would subsequently cease to reside in Canada, the trust will be deemed to have disposed of such property for fair market value proceeds on the first day after that transfer during which the taxpayer ceases to reside in Canada. The deemed disposition does not apply with respect to property that is exempt from the deemed disposition upon emigration under subparagraphs 128.1(4)(b)(i) to (iii).

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74 Other advantages of CCPC status include enhanced investment tax credits, which may be refundable, for qualified expenditures on scientific research and experimental development and an additional month to pay the balance of taxes owing for a year.

75 For dispositions prior to March 19, 2007, $250,000.

76 For taxation years that end after May 1, 2006.

77 In the case of shares of a corporation disposed of in the year of emigration but after the time of emigration, if the corporation has ceased to be a CCPC at the time of disposition, it would no longer be a small business corporation and the shares would not be qualified small business corporation shares.

The anti-avoidance rule in paragraph 104(4)(a.3) cannot be circumvented through the use of a second trust. Subparagraph 107.4(3)(h)(i) applies where the transferor was a trust to which property was transferred by an individual in anticipation of ceasing to reside in Canada, where subsection 73(1) applied to the original transfer. The provision deems the transferee trust to be a trust to which the individual had transferred property in anticipation of the individual ceasing to reside in Canada and in circumstances to which subsection 73(1) applied for the purposes of paragraph 104(4)(a.3) and, accordingly, there may be a deemed disposition by the transferee trust upon the individual ceasing to reside in Canada.

The rules in paragraph 104(4)(a.3) and subparagraph 107.4(3)(h)(i) will prevent the deferral of tax or the deferral of payment of tax where an individual, in anticipation of emigrating, transfers capital property to a trust that will remain a resident of Canada so that upon emigration the individual either does not own the property (directly or through an interest in a trust) or has an interest in the trust that is an excluded right or interest. Proposed draft legislation replacing sections 210 and 210.1 with a revised section 210, effective December 20, 2002, will impose Part XII.2 tax, in addition to Part I tax, on the trust in these circumstances.

The NRT-FIE Legislation proposes to add paragraph 104(4)(a.5) to the Act. This new provision will deem the trust to have disposed of its capital property and certain other property at fair market value in certain circumstances. One such circumstance may occur where a contributor (as defined in proposed new section 94) ceases to be resident in Canada. The proposed legislation will also add subsection 94(5) to the Act which will deem such a trust to cease to be resident in Canada in certain circumstances (and therefore will be deemed to dispose of its property at fair market value). One such circumstance may occur where there is no longer a resident contributor (as defined in proposed new subsection 94(1)) to the trust. Thus, where a resident of Canada is a contributor to a non-resident trust and such person ceases to be resident in Canada, the trust may realize gains as a consequence which are subject to tax under the Act. The individual may have joint and several liability for such tax.

Where a retired partner has a right to income of the partnership described in subsection 96(1.1) of the Act, this right will be deemed to have been disposed of upon emigration by virtue of paragraph 128.1(4)(b) (such a right is not an excluded right or interest). This right to income is not a capital property (subsection 96(1.4)) and is considered to be

separate and distinct from any residual interest of the retired partner in the partnership described in paragraph 98.1(1)(a), which would be a capital property. Ordinarily, this right to income would not have a cost to the retired partner and the full amount of the fair market value of the right to income will be included in the retired partner's income for the year of emigration (subsection 96(1.2)). Such fair market value will also become the cost of the right to income upon the deemed reacquisition of this right at the time of emigration. As income is allocated by the partnership in future years to the non-resident retired partner, it will be deemed to be income of the retired partner from carrying on business in Canada and will be subject to Canadian tax (subsection 96(1.6)). However, the retired partner will be able to avoid double taxation by claiming a deduction under subsection 96(1.3) in an amount up to the cost of the right to income (which reflects the amount previously included in income upon emigration).

Subsection 28(1) of the Act permits a taxpayer to compute income from a farming or fishing business using the cash method. Where, at the end of a taxation year, the taxpayer is a non-resident *and* does not carry on the business in Canada, the taxpayer must include in income the fair market value of all accounts receivable not previously included in income: subsection 28(4). If the taxation year is the year of emigration, the income inclusion will be for the part of the year throughout which the taxpayer was resident in Canada.

Where a resident taxpayer has sold a capital property and the proceeds are payable on an instalment basis, the taxpayer may claim a deferred payment reserve under subparagraph 40(1)(a)(iii) of the Act. However, such a reserve is not available if the taxpayer was a non-resident at the end of the year or at any time in the immediately following year: subparagraph 40(2)(a)(i). If a resident individual who has been claiming such a reserve emigrates, the deferral will come to an end in the taxation year preceding the year of emigration.

Section 114

Section 114 of the Act sets out the rules for computing an individual's taxable income for the year of emigration where the individual was resident in Canada throughout part of the year and non-resident throughout another part of the year. Form T1243 detailing the gain or loss with respect to properties deemed to be disposed of upon emigration must be completed and attached, along with Schedule 3, to the T1 tax return for the year of emigration. For the 1998

and subsequent taxation years, the taxable income for the year of emigration is the individual's income for the year less certain deductions, but for the non-resident period the only income or losses included are those described in paragraphs 115(1)(a) to (c) of the Act in computing taxable income earned in Canada. The deductions permitted in computing taxable income are the deductions for loss carry-overs permitted by subsection 111(1), relevant deductions under paragraphs 110(1)(d) to (d.2) and (f) and any other deduction permitted under the Act in computing taxable income to the extent that either (i) it can reasonably be considered to be applicable to the part of the year throughout which the individual was resident in Canada, or (ii) if all or substantially all of the individual's income for the non-resident period of the emigration year is included in taxable income earned in Canada, it can reasonably be considered to be applicable to the non-resident period. CRA's guide "Emigrants and Income Tax" (T4056) provides details for completing an emigrant's tax return for the year of departure. In *Grant et al* v. *The Queen*, 2006 DTC 3071 (T.C.C.); affirmed 2007 DTC 5351 (F.C.A.), the taxpayer, in connection with ceasing to be resident in Canada, carried out a "departure trade"[78] under which interest expense would be deducted in the resident portion of the emigration year and interest income would be included in the following "non-resident" year. The interest was paid on the day following the day the taxpayer ceased to be resident in Canada. The Court denied the interest deduction holding that the phrase "any other deduction permitted for the purpose of computing taxable income" in section 114 was confined to deductions permitted in computing taxable income under Division C and did not include interest expense which was a deduction in computing income under Division B of the Act.

The wording of section 114 clarifies that if a gain is realized on emigration with respect to a taxable Canadian property by virtue of paragraph 128.1(4)(b), and the property is subsequently disposed of in the emigration year at a loss, the gain and the loss will both be taken into account in computing the income amount for the year of emigration.

Information Reporting

An individual who ceases to be resident in Canada after 1995 must file a prescribed form (T1161-List of Properties by an Emigrant of Canada) listing all reportable

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[78] See footnote 30.

properties that the individual owned immediately after ceasing to be resident in Canada: subsection 128.1(9). The form need not be filed if the total fair market value of all reportable properties owned by the individual does not exceed $25,000. If such value exceeds $25,000, the form must list all reportable properties.

A reportable property is defined in subsection 128.1(10) as any property other than

- money that is legal tender in Canada and deposits of such money;
- an excluded right or interest other than a right or interest described in paragraphs (c) (employee options), (j) (certain interests in resident personal trusts) and (l) (interests in a life insurance policy in Canada[79]) of the definition of that term;
- property of short-term residents (not resident in Canada for more than 60 months in the preceding 120-month period) described in subparagraph 128.1(4)(b)(iv) that is not taxable Canadian property; and
- any item of personal-use property the fair market value of which at the time of emigration is less than $10,000.

The prescribed form must be filed with the Minister on or before the individual's filing-due date for the year of emigration.

Trusts

Many of the rules in the Act relating to the emigration of an individual also apply when a trust ceases to be resident in Canada. The following discussion notes the differences but does not review the rules applicable to trusts in the same detail as the preceding discussion regarding individuals, except where those rules are substantially different.

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[79] For purposes of s.128.1(9), CRA's view is that an interest in a life insurance policy which is a reportable property should be valued at its fair market value, not its cash surrender value, taking into account the factors described in paras. 40 and 41 of Information Circular 89-3, dated August 25, 1989. See CRA Document 2008-0270401C6, dated April 29, 2008.

It should also be noted that, although a trust may cease to be resident in Canada under the general rules for determining the residence of a trust, the trust may nonetheless be deemed to be resident in Canada. Under the NRT-FIE Legislation, a non-resident trust will be deemed to be resident in Canada for most purposes if there is a resident contributor (as defined) to the trust or a resident beneficiary (as defined) under the trust.

Deemed Disposition of Property

The general rule in paragraph 128.1(4)(b) will apply to a trust when it ceases to be resident in Canada. Under this rule, all property owned by the trust is deemed to be disposed of for proceeds equal to its fair market value, with certain exceptions.[80] Each property is deemed to have been disposed of at the time that is immediately before the time that is immediately before the time of emigration, and the proceeds are deemed to have become receivable and to have been received by the trust at the time of disposition. Pursuant to paragraph 128.1(4)(c), each property is deemed to have been reacquired at the time of emigration at a cost equal to the proceeds of disposition of the property.

The following properties owned by a trust are excepted from the deemed disposition rule in paragraph 128.1(4)(b):

(1) Real property[81] situated in Canada, a Canadian resource property or a timber resource property: subparagraph 128.1(4)(b)(i). A trust is not entitled to make the election in paragraph 128.1(4)(d) to treat such a property as having been disposed of at fair market value.

(2) Capital property used in, eligible capital property in respect of, or property described in the inventory of, a business carried on by the trust through a permanent establishment (as defined by regulation) in Canada at the time of emigration: subparagraph 128.1(4)(b)(ii). Paragraph 128.1(4)(d) also does not apply to such a property.

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[80] Various stop-loss rules in the Act will not apply. See footnote 29. As well, the suspended loss rules in subsections 40(3.3) to (3.5) do not apply to an emigrating trust.

[81] See footnote 33.

(3) An excluded right or interest of the trust: subparagraph 128.1(4)(b)(iii). Most items within the definition of an "excluded right or interest" (subsection 128.1(10)) would not be relevant to a trust, but some items could be applicable to a trust such as a right to receive a payment under an annuity contract or an interest in certain trusts or an interest in a life insurance policy in Canada.

The exceptions for short-term residents (subparagraph 128.1(4)(b)(iv)) and returning former residents (subparagraph 128.1(4)(b)(v)) are only available to individuals, and not to a trust that ceases to be resident in Canada.

Deemed Year End

The trust's taxation year that would otherwise include the time that the trust ceases to be resident in Canada is deemed to have ended immediately before that time and a new taxation year is deemed to have begun at that time: subparagraph 128.1(4)(a)(i). In determining the trust's fiscal period after the time of emigration, the trust is deemed not to have established a fiscal period before the particular time (which allows the trust to choose a new fiscal period when it becomes non-resident): subparagraph 128.1(4)(a)(ii) and section 250.1. The deemed disposition under paragraph 128.1(4)(b) occurs immediately before the time that is immediately before the time of emigration. Since the deemed year end occurs immediately before the time of emigration, the deemed disposition will occur in the taxation year that ends immediately before the time of emigration, and the trust will be resident in Canada throughout such year. Section 114 would not apply to a trust because the effect of paragraph 128.1(4)(a) is to treat the period during which the trust was resident in Canada as a separate taxation year from the period of non-residence.

Foreign Exploration and Development Expenses/Foreign Resource Expenses

The provisions regarding the deduction of FEDE (subparagraph 66(4)(b)(i.1)) or FRE (section 66.21) of an emigrating individual would also be available to an emigrating trust for its taxation year ending immediately before it ceases to be resident in Canada and for its taxation years after it becomes a non-resident (to the extent permitted by paragraph 115(1)(e.1) and subsection 115(4.1)). Since a taxation year of the trust ends immediately before it ceases to be resident in Canada, subsections 66(4.3) and 66.21(5), which provide that an emigrating

individual's taxation year for the purposes of applying subsections 66(4) and 66.21(4), respectively, is the period or periods in the year in which the individual was resident in Canada, should not be relevant to a trust.

Instalment Obligations

Subsection 128.1(5) applies to a trust and the trust's instalment obligations for its final taxation year before ceasing to be resident in Canada preceding emigration will be determined as if subsection 128.1(4) did not apply.

Relieving Provisions

The exclusion from the deemed disposition rule for short-term residents in subparagraph 128.1(4)(b)(iv), and the provisions of paragraph 128.1(4)(d) permitting certain property that would otherwise be excluded from the deemed disposition rule to have been disposed of at fair market value (which, for example, could allow a loss to be recognized to offset a gain that would otherwise occur), do not apply to a trust that ceases to be resident in Canada.

The relieving provisions in subsection 128.1(6) for returning former residents, subsection 128.1(7) for returning trust beneficiaries and subsection 128.1(8) for post-emigration losses do not apply to a trust that ceases to be resident in Canada.

The special foreign tax credit provisions in subsections 126(2.21) and (2.23) apply to a trust that ceases to be resident in Canada as well as to an emigrating individual. The tax credit provisions of section 119 (and subsection 180.1(1.4)) are available to a trust that ceases to be resident in Canada as well as to an emigrating individual, but the stop-loss rule of subsection 40(3.7) also applies to an emigrating trust.

The provisions of subsections 220(4.5) to (4.54), (4.7) and (4.71) permitting the deferral of departure tax by providing adequate security (and the related benefit of avoiding interest charges on the unpaid tax) apply to a trust that ceases to be resident in Canada as well as to an emigrating individual, with one exception. Subsection 220(4.51), which deems an individual to have provided adequate security for tax in an amount equal to the highest marginal rate of tax on a taxable capital gain of $50,000, does not apply to a trust.

Information Reporting

The information reporting requirements of subsection 128.1(9) apply to a trust which ceased to be resident in Canada after 1995.

Trust Distributions

In many circumstances, a distribution of trust property by a personal trust to a beneficiary occurs on a rollover basis. However, where the distribution is to a non-resident beneficiary, the trust is deemed to have disposed of the property (with certain exceptions) at fair market value and the rollover does not apply. As part of the extensive revision of the taxpayer migration rules first announced on October 2, 1996, the rules applicable to trust distributions to non-resident beneficiaries were also revised and tightened, and tied in with the taxpayer migration rules.[82]

The changes to the trust distribution rules apply to distributions made after October 1, 1996. However, as a result of modifications in the rules as they evolved through several sets of draft legislation, some of the rules differ depending on the date of the distribution.

Distributions to Non-Residents

Where property (other than certain excepted types of property described below) is distributed after 1999 by a trust resident in Canada to a non-resident beneficiary (including a partnership other than a Canadian partnership) in satisfaction of all or part of the beneficiary's capital interest in the trust, the deemed disposition rules of subsection 107(2.1) will apply: subsection 107(5). The NRT-FIE Legislation proposes to amend subsection 107(5), effective for distributions made after February 27, 2004, to delete the reference to a trust resident in Canada so that the subsection will apply whether the trust making the distribution is resident in Canada or not.

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[82] In fact, the stimulus for the changes to the taxpayer migration rules stemmed from the controversy that arose after the Auditor General's 1996 Report criticized an advance tax ruling issued in 1991 by Revenue Canada (as it then was) with respect to the distribution of trust property to a non-resident beneficiary. See *Harris* v. *The Queen*, 2001 DTC 5058 (F.C.T.D.), 2001 DTC 5247 (F.C.A.). See also, *Harris* v. *The Queen*, 98 DTC 6072; 99 DTC 5018 (F.C.T.D.), 2000 DTC 6373 (F.C.A.) (leave to appeal to S.C.C. denied on October 26, 2000).

Subsection 107(5) does not apply to distributions of the following types of property; consequently, distributions of these types of property by a personal trust to a non-resident beneficiary may be made on a rollover basis under subsection 107(2):

(1) A share of the capital stock of a non-resident-owned investment corporation.[83]

(2) Real property[84] situated in Canada, a Canadian resource property or a timber resource property.

(3) Capital property used in, eligible capital property in respect of or property described in the inventory of, a business carried on by the trust through a permanent establishment (as defined by regulation) in Canada at the particular time.

(4) An "excluded right or interest" of the trust. Most items within the definition of an "excluded right or interest" (subsection 128.1(10)) would not be relevant to a trust, but some items could be applicable to a trust such as a right to receive a payment under an annuity contract or an interest in certain trusts or an interest in a life insurance policy in Canada.

Where subsection 107(2.1) applies, the trust is deemed to have disposed of the property, and the beneficiary is deemed to have acquired the property, for proceeds equal to its fair market value at that time: paragraphs 107(2.1)(a) and (b). Under paragraph 107(2.1)(c),[85] the beneficiary's proceeds of disposition of the portion of the beneficiary's capital interest in the trust disposed of on the distribution[86] are deemed to be equal to the amount, if any, by which the

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83 A non-resident-owned investment corporation ("NRO") is defined in subsection 133(8). Pursuant to subsection 131(5) of S.C. 2001, c. 17, the NRO provisions in section 133 were repealed and replaced with a transition period that phased out existing NROs by the end of their last taxation year that began before 2003.

84 See footnote 33.

85 A special rule may apply to a mutual fund trust - see paragraph 107(2.1)(e).

86 Paragraph (d) of the definition of "disposition" in subsection 248(1) provides, in respect of a beneficiary's capital interest (or part thereof) in a trust, that a disposition includes a payment made after 1999 to the beneficiary from the trust that can reasonably be considered to have been made because of the beneficiary's capital interest in the trust. An exception is provided in paragraphs (h) and (i) of the definition for a payment from a unit trust which does not cause a reduction in the number of issued units of the trust and for a payment

trust's deemed proceeds of disposition under paragraph 107(2.1)(a) (other than the portion of the proceeds that is a payment to which paragraph (h) or (i) of the definition of disposition in subsection 248(1) applies) *exceeds* the total of the following:

- where the property is not a Canadian resource property or a foreign resource property, the amount, if any, by which the fair market value of the property at the time of distribution exceeds the cost amount to the trust of the property immediately before the time of distribution (however, the portion of this excess that represents a payment to which paragraph (h) or (i) of the definition of disposition in subsection 248(1) applies is disregarded): subparagraph 107(2.1)(c)(ii); and

- all amounts which are "eligible offsets" of the beneficiary at the time of distribution in respect of the beneficiary's capital interest in the trust: subparagraph 107(2.1)(c)(iii). An eligible offset is the portion of any debt or obligation that is assumed by the beneficiary on the distribution that can reasonably be considered to be applicable to the distributed property if the distribution is conditional on the assumption of the debt or obligation: subsection 108(1).

The Explanatory Notes provide the following example to illustrate the operation of the rules in subsection 107(2.1):

"Example 2

In 2001, a personal trust distributes non-depreciable capital property (shares that are not taxable Canadian property) to its non-resident beneficiary in satisfaction of the beneficiary's capital interest in the trust. The adjusted cost base of the shares is $40. The adjusted cost base of the beneficiary's capital interest, determined before the application of paragraph 107(1)(a), is $0. The fair market value of the property is $100.

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after 1999 out of the income or capital gains of the trust for a year if the payment was made in such year or the right to the payment was acquired in such year. If the distribution of trust property does not result in a disposition of a capital interest because of paragraph (h) or (i), in some circumstances, the distribution will reduce the adjusted cost base of the interest: paragraph 53(2)(h).

Results:

(1) Subsection 107(2.1) applies to the distribution because of the application of amended subsection 107(5).

(2) The trust is deemed by paragraph 107(2.1)(a) to have disposed of the property for $100 proceeds, so there is a capital gain of $60 from the resulting disposition and a taxable capital gain of $30.

(3) The beneficiary is deemed by paragraph 107(2.1)(b) to have acquired the property at a $100 cost.

(4) Because the distribution gives rise to a capital gain, the amount of the capital gain ($60) reduces the proceeds of the beneficiary's capital interest under subparagraph 107(2.1)(c)(ii). The beneficiary is deemed to have disposed of the capital interest for $40 proceeds ($100 – $60). The alternative analysis in paragraph 4 of Example 1 would likewise result in deemed proceeds of $40.[87]

(5) The capital interest in the trust constitutes taxable Canadian property for the non-resident beneficiary. For the purposes of computing capital gains, the adjusted cost base of the capital interest under subsection 107(1) is $40, being the greater of its adjusted cost base (nil) determined before the application of that subsection and the cost amount ($40) to the trust of the distributed property. Consequently, the taxable capital gain from the disposition of the capital interest is nil.

(6) The allowable capital loss from the disposition of the capital interest is also nil."

The income realized by a trust (including taxable capital gains) from a deemed disposition under subsection 107(5) should be considered to be paid to the non-resident beneficiary and thus deductible under subsection 104(6), which generally provides for the deduction, in computing the income of a trust for a taxation year, of any income paid to a

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[87] The alternative analysis is as follows:

"Alternatively, in the event that the payment of the gain were considered to be payment of the capital gains of the trust to which paragraph (i) of the definition 'disposition' in subsection 248(1) applied, $40 would be determined under subparagraph 107(2.1)(c)(i) and no amount would be determined under subparagraph 107(2.1)(c)(ii)."

beneficiary under the trust (or income in respect of which the beneficiary is entitled to enforce payment).[88] However, no deduction may be made under subsection 104(6) in respect of income paid (or payable) by a non-resident trust to a non-resident beneficiary: subsection 104(7). Part XIII withholding tax is applicable on the income portion of distributions from a trust resident in Canada to a non-resident beneficiary: paragraph 212(1)(c). Furthermore, an *inter vivos* trust must pay Part XII.2 tax on its designated income which includes taxable capital gains on dispositions of the trust's taxable Canadian property. (Tax paid by a trust under Part XII.2 is deducted in computing the income of the trust for purposes of Part I of the Act: subsection 104(30).) Part XII.2 tax does not apply to a testamentary trust: paragraph 210.1(a).

Subsection 107(2.11) allows a trust to elect that any income arising from a deemed disposition under subsections 107(2.1) or 107(5) be taxed at the trust level, which could offset any losses of the trust. In the case of property distributed after 1999, if a trust makes one or more distributions of property to which subsection 107(5) applied, the trust may elect, where resident in Canada at the time of each distribution, that the income of the trust for the year (determined without reference to subsection 104(6)) shall, for the purposes of subsections 104(6) and (13), be computed without regard to those distributions if the trust so elects: paragraph 107(2.11)(b). The election must be in prescribed form filed with the trust's return for the year or a taxation year that precedes the distribution. If such an election is made, both an *inter vivos* and a testamentary trust will be subject to Part I tax only.[89]

It would appear that the provisions of section 116 of the Act may be applicable to a distribution of property by a trust to a non-resident beneficiary because the trust interest is taxable Canadian property and the beneficiary will be deemed to dispose of all or part of the trust interest when the property is distributed.[90]

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88 See CRA Document No. 2003-0000695.

89 See Virginia Chan and François Morin, "Distributions by Canadian Testamentary Trusts", (2005) vol. 53, no. 4 *Canadian Tax Journal* 1090-1110 at 1104 for a discussion of the general rules applicable to distributions by testamentary trusts to non-residents.

90 See CRA Document 2005-0149961E5 dated March 6, 2006. See also Elisabeth Atsaidis, "Capital Distributions by a Testamentary Trust to a Non-Resident" (2003), Vol. XII, No. 1 *Goodman on Estate Planning* 924 (Federal Press).

Security for Tax on Distributions of Taxable Canadian Property to Non-Resident Beneficiaries

Under subsection 220(4.6), a trust may elect, on providing adequate security, to defer payment of an amount of Part I tax that it owes as a result of the distribution of a taxable Canadian property to a non-resident beneficiary because of the application of subsection 107(5). The election must be made in the prescribed manner on or before the trust's balance-due day for the distribution year: paragraph 220(4.6)(b). Balance-due date is defined in subsection 248(1) and, for a trust, is the day that is 90 days after the end of the year. The scheme allowing security to be given applies to distributions made after October 1, 1996.

In most other respects, the deferral operates in a similar manner to deferral for emigrating individuals under subsections 220(4.5) to (4.54). The exception is that there is no equivalent to subsection 220(4.51) (deemed security) for a trust distribution to a non-resident beneficiary. Consequently, a trust must provide security for the full amount of the deferred tax that it owes as a result of the distribution of taxable Canadian property to a non-resident beneficiary.

Credit for Foreign Tax

A trust that has made a distribution after October 1, 1996 to a non-resident beneficiary of trust property to which subsection 107(5) applied may claim a foreign tax credit under subsection 126(2.22) against Part I tax for the year of distribution in certain circumstances where the beneficiary subsequently disposes of the property.[91] Taxes that are eligible for the credit are business-income tax or non-business income tax paid by the beneficiary for the taxation year in which the property was disposed of that can reasonably be regarded as having been paid in respect of that portion of any gain or profit from the disposition of the property that accrued before the distribution and after the latest of the times, before the distribution, at which:

- the trust became resident in Canada
- the individual became a beneficiary under the trust, or

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91 See footnote 52 with respect to replacement shares.

- the trust acquired the property.

The mechanics of subsection 126(2.22) are identical to the foreign tax credit under subsection 126(2.21) for emigrating individuals except that subsection 126(2.22) involves two taxpayers and permits foreign taxes paid by the beneficiary to be credited against Canadian taxes paid by the trust.

Returning Trust Beneficiary - Taxable Canadian Property

Subsection 128.1(6) provides relief from the tax payable by an individual when the individual ceases to be resident in Canada in circumstances where the individual subsequently re-establishes Canadian residence. Subsection 128.1(7) provides special relieving rules, which parallel subsection 128.1(6), where an individual who is a beneficiary under a trust (other than a beneficiary who is itself a trust) emigrates from Canada, receives distributions of trust property as a non-resident, and then re-establishes residence in Canada while still owning the property. For subsection 128.1(7) to apply, the following conditions must be met:

(1) The individual ceased to be resident in Canada after October 1, 1996.

(2) The individual was a beneficiary of the trust at the time he or she ceased to be resident in Canada and subsequently received a distribution of property from the trust before the individual re-establishes residence in Canada.

(3) Subsection 107(2) (distribution by a personal trust) would have applied to the distribution but for subsection 107(5) (distribution by a trust to a non-resident).

(4) At the time the individual re-establishes Canadian residence, he or she continues to own the property received on the trust distribution.[92]

If the above conditions are met, the individual and the trust may jointly elect under paragraph 128.1(7)(d) not to have the deemed disposition and acquisition rules in

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[92] See footnote 52 with respect to replacement shares.

subsection 107(2.1)[93] apply to the distribution in respect of all properties acquired by the individual on the distribution that were taxable Canadian properties of the individual throughout the period beginning at the distribution time and ending at the time of re-establishing residence.[94] The election must be made in writing jointly by the individual and the trust and filed with the Minister on or before the earlier of their respective filing-due dates for their taxation years that include the day on which the individual re-establishes Canadian residence.[95] If the trust ceases to exist before the individual's filing-due date for the taxation year in which residence in Canada is re-established, paragraph 128.1(7)(h) allows the individual to make the election alone.[96]

An anti-surplus stripping rule applies to taxable Canadian properties in respect of which an election has been made under paragraph 128.1(7)(d). Under paragraph 128.1(7)(f), where certain conditions are met, the trust will be deemed to have received certain proceeds of disposition in respect of the distributed taxable Canadian properties notwithstanding the election not to have subsection 107(2.1) apply to the distribution. The conditions for the application of paragraph 128.1(7)(f) to a particular taxable Canadian property are identical to those that trigger the surplus-stripping rules for individuals under paragraph 128.1(6)(b)) (i.e., a decline in value between the time of emigration and re-establishing Canadian residence and, if the property were disposed of at fair market value immediately before the latter time, subsection 40(3.7) would apply): paragraph 128.1(7)(e).

Where paragraph 128.1(7)(f) applies, notwithstanding paragraph 107(2.1)(a), the trust is deemed to have disposed of the property at the distribution time for proceeds of disposition equal to the total of (A) the cost amount to the trust immediately before the

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93 For the period October 2, 1996 to December 31, 1999, subsection 107(5) itself contained the deemed disposition rule for trust property distributed to a non-resident beneficiary. After 1999, subsection 107(5) cross-references to subsection 107(2.1), but this subsection only applies to distributions of trust property made after 1999. The Explanatory Notes indicate that subsection 128.1(7) was intended to apply to trust distributions after October 1, 1996 and not just those made after 1999. Therefore, it appears that there should be a transitional rule for subsection 128.1(7) so that, for the period after October 1, 1996 and before 2000, it refers to subsection 107(5) rather than subsection 107(2.1).

94 See footnote 52 regarding taxable Canadian property.

95 See footnote 53 with respect to late-filed, amended and revoked elections.

96 If the individual alone makes an election or specification under subsection 128.1(7), both the individual and the trust are jointly and severally liable for any amount payable under the Act by the trust as a result of this election or specification.

distribution time, and (B) the amount by which the notional loss reduction under subsection 40(3.7) would exceed the lesser of such cost amount and such amount as the individual and the trust jointly specify in respect of the property in the election under paragraph 128.1(7)(d). Notwithstanding paragraph 107(2.1)(b), the individual will be deemed to have reacquired the property at the distribution time at a cost equal to the amount, if any, by which the amount otherwise determined under paragraph 107(2)(b) exceeds the lesser of the notional loss reduction under subsection 40(3.7) and the amount jointly specified by the individual and the trust. These rules for determining the trust's proceeds of disposition and the individual's cost of the distributed property are similar to those in paragraph 128.1(6)(b).

Notwithstanding subsections 152(4) to (5), any reassessments of tax as are necessary to take an election under paragraph 128.1(7)(d) into account must be made: paragraph 128.1(7)(i). However, no such assessment will affect the computation of (i) interest payable under the Act to or by the trust or the individual in respect of a period that is before the individual's filing-due date for the taxation year that includes the time at which the individual re-established Canadian residence or (ii) any penalty payable under the Act.

Returning Trust Beneficiary - Other Property

Paragraph 128.1(7)(g) provides relief for property other than taxable Canadian property, similar to the relieving measure in paragraph 128.1(6)(c). The conditions for making an election under paragraph 128.1(7)(g) are the same as the conditions for making an election under paragraph 128.1(7)(d). An election can be made under paragraph 128.1(7)(g) without making an election under paragraph 128.1(7)(d), and *vice versa*. The election under paragraph 128.1(7)(g) must be made jointly by the individual and the trust, in writing, and filed on or before the later of their respective filing-due dates for their taxation years that include the time the individual re-establishes Canadian residence.[97] Where the election is made, it applies to each property that the individual owned throughout the period which began at the distribution time and ended at the time of re-establishing Canadian residence[98] and that is deemed by paragraph 128.1(1)(b) to have been disposed of because the individual became resident in Canada.

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[97] See footnote 53 with respect to late-filed, amended and revoked elections.

[98] See footnote 52 regarding replacement shares.

(Paragraph 128.1(1)(b), which deals with immigration to Canada, generally applies to property other than, in the case of an individual, taxable Canadian property and an excluded right or interest, and deems such property to have been disposed of and reacquired prior to immigration at fair market value.)

Where paragraph 128.1(7)(g) applies, notwithstanding paragraphs 107(2.1)(a) and (b), the trust's proceeds of disposition under paragraph 107(2.1)(a) at the distribution time, and the individual's cost of acquiring the property at the time at which the individual re-established residence, are adjusted. The amount that would otherwise be the trust's deemed proceeds of disposition of a property under paragraph 107(2.1)(a) is reduced by the least of (i) the amount that would otherwise be the trust's gain in respect of the property by virtue of the deemed disposition under paragraph 107(2.1)(a), (ii) the fair market value of the property at the time the individual re-establishes Canadian residence, and (iii) the amount that the individual and the trust jointly specify in respect of the property in the election. The amount that would otherwise be the individual's deemed cost of acquisition of a property under paragraph 128.1(1)(b) at the time of re-establishing Canadian residence is reduced by the least of the same three amounts. The effect of these adjustments, which are similar to those in paragraph 128.1(6)(c), is to permit an accrued gain of the trust in respect of a property distributed by the trust to be deferred (to the extent specified by the trust and the individual but not in excess of an amount equal to the property's fair market value at the time of immigration) by reducing the cost of the property to the beneficiary upon re-establishing Canadian residence.

Paragraph 161(7)(a) (dealing with arrears interest) and subsection 164(5) (dealing with refund interest) contain references to paragraph 128.1(7)(g).

Paragraph 128.1(7)(i) also applies with respect to any reassessments of tax as are necessary to take into account an election under paragraph 128.1(7)(h).

Corporations[99]

Deemed Disposition of Property

When a corporation ceases to be resident in Canada at a particular time, the corporation is deemed to have disposed of all property owned by the corporation for proceeds equal to its fair market value at the time of disposition: paragraph 128.1(4)(b).[100] The time of disposition is the time that is immediately before the time that is immediately before the time of emigration and the proceeds are deemed to have become receivable and to have been received at the time of disposition. Each property is deemed to have been reacquired at the time of emigration at a cost equal to the proceeds of disposition of the property: paragraph 128.1(4)(c). In the case of a corporation, there are no exceptions from this deemed disposition rule. The exceptions in subparagraphs 128.1(4)(b)(i) to (v) available to an individual or a trust are not available to a corporation.

Deemed Year End

The corporation's taxation year that would otherwise include the time of emigration is deemed to have ended immediately before the time of emigration and a new taxation year is deemed to have begun at the emigration time: subparagraph 128.1(4)(a)(i).[101] The time of the deemed disposition of the corporation's property under paragraph 128.1(4)(b) will occur within the pre-emigration deemed taxation year and the corporation will be resident in Canada throughout such year. For the purpose of determining the corporation's fiscal period after the time of emigration, the corporation is deemed not to have established a fiscal period before that time (thus enabling the corporation to choose a new fiscal period once it is a non-resident): subparagraph 128.1(4)(a)(ii) and section 250.1.

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99 For a discussion of corporate migration generally, see Firoz Talakshi and Patrick A. Jackman, "Corporate Migration: A Comparison of Canadian and U.S. Income Tax Rules" in *Report of Proceedings of the Fifty-Third Tax Conference*, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2002) 21:1-34.

100 Various stop-loss rules in the Act will not be applicable. See footnote 29. As well, the suspended loss rules in subsections 40(3.3) to (3.5) will not apply to an emigrating corporation.

101 The election in paragraph 249(4)(c) of the Act allowing a corporation to elect to have its last taxation year continue up to the time control is acquired where control of the corporation is acquired within the 7-day period immediately following the end of its last taxation year is not available if the last taxation year ended because of the corporation's emigration.

Foreign Exploration and Development Expenses/Foreign Resources Expenses

The provisions regarding the deduction of FEDE (subparagraph 66(4.3) or FRE (section 66.21(5)) by an emigrating individual are not needed for an emigrating corporation because its taxation year ends immediately before it ceases to be resident in Canada and for its taxation years after it becomes a non-resident.

No Relieving Provisions

There are no special provisions of the Act available to a corporation that are intended to provide relief from the deemed disposition rule in paragraph 128.1(4)(b). The various relieving provisions available to an individual or a trust (subsections 128.1(5) (instalments), (6) (returning former resident), (7) (returning trust beneficiary), (8) (post-emigration losses), 126(2.21) (foreign tax credit), section 119 (special tax credit where subsection 40(3.7) applies) and subsections 220(4.5) to (4.71) (security for departure tax)) do not apply to a corporation or are not needed.[102]

Additional Tax on Corporate Emigration

By virtue of the deemed disposition rule in paragraph 128.1(4)(b), when a corporation ceases to be resident in Canada, it will realize recapture of capital cost allowance and other income amounts such as accrued inventory gains and accrued gains with respect to eligible capital property and it will also realize taxable capital gains with respect to capital property. These amounts will be included in computing income for its last taxation year before it becomes a non-resident, and tax will be payable under Part I of the Act on its taxable income for that taxation year. The corporation will also be liable for an additional tax under section 219.1 (which is in Part XIV of the Act) that is analogous to a dividend withholding tax on the corporation's surplus. Under section 219.1, the corporation is liable in its last taxation year before ceasing to be resident in Canada to pay a tax of 25% of the amount by which the fair market value of all of the property owned by the corporation immediately before the end of such taxation year exceeds the total of (i) the paid-up capital of all the issued shares of the corporation

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[102] The stop-loss rule in subsection 40(3.7) does not apply to a corporation. As well, the special information reporting requirements of subsection 128.1(8) do not apply to a corporation.

immediately before the end of such year, and (ii) all debts owing by the corporation (or obligations of the corporation to pay an amount) at the end of such taxation year (other than amounts payable by the corporation in respect of dividends and amounts payable under section 219.1).[103] Part I taxes and federal and provincial capital taxes owing by the corporation with respect to such taxation year would be included in debts owing at the end of such year. The additional departure tax under section 219.1 is payable on or before the corporation's filing-due date for its last taxation year before ceasing to be resident in Canada.

Where the corporation that has ceased to be resident in Canada becomes resident in a country with which Canada has a tax treaty and is entitled to the benefits of that treaty at the beginning of its first taxation year after its last taxation year before ceasing to be resident in Canada, the 25% rate of tax under section 219.1 will be reduced to the rate of tax imposed on a dividend paid by a corporation resident in Canada to a corporation resident in the other country that owns all of the shares of the corporation resident in Canada: section 219.3. Generally, Canada's tax treaties reduce the rate of withholding tax on dividends to 15% and, in many cases, to a lower rate (such as 5%) where the dividends are paid to a shareholder (in many cases, that shareholder must be a corporation) that owns all of the shares of the corporation paying the dividend. The provisions of section 219.3 do not apply if it can reasonably be concluded that one of the main reasons that the corporation became resident in the other country was to reduce the amount of tax payable under Part XIII or XIV of the Act.

The potential negative tax results under sections 128.1(4) and 219.1 may be avoided by "replacing" a Canadian corporation with a foreign corporation through the use of a triangular amalgamation. In *Re Canada Business Corporations Act*,[104] the Ontario Court of Appeal held that the use of a triangular amalgamation to effectively replace a Canadian holding corporation

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103 Where tax was payable by the corporation under subsection 219(1) or section 219.1 for a preceding taxation year that began before 1996 and after the corporation last became resident in Canada, an additional deduction is permitted equal to four times such tax (determined as if such tax were at the rate of 25%, i.e., ignoring any rate reductions by virtue of section 219.2 or 219.3 or any tax treaty). This additional deduction in calculating the base for the additional section 219.1 tax is intended to avoid double taxation that could arise in limited circumstances where a corporation was resident in Canada but not a Canadian corporation or ceased to be a Canadian corporation and subsequently ceases to be resident in Canada after 1995 at a time when it had surplus on which tax had previously been paid under subsection 219(1) (branch tax) or section 219.1.

104 (1991), 80 D.L.R (4th) 619.

by a foreign holding corporation could not properly be described as an exportation of the company since, on the amalgamation, there was no discontinuance of any of the amalgamating corporations under the CBCA. In that case, on the amalgamation of Canco and a newly-incorporated Canadian corporation to form Amalco, Canadian shareholders of Canco received shares of a new U.S. corporation (Forco) and a small number of redeemable shares of Amalco. Amalco issued shares to Forco in consideration for Forco shares, mostly issued directly by Forco to Canco shareholders but some issued to Amalco and used by it to redeem its shares received by the shareholders of Canco on the amalgamation. The requirements for rollover treatment of the Canco shareholdings in section 87(4) and (9) were not met because the consideration received by the Canco shareholders included shares of Forco but the amalgamation did qualify for treatment under section 87(2). Canco, as a result of these transactions, was in a sense exported without attracting section 128.1(4) or 219.1.[105]

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[105] See A.M. Schwartz, "Statutory Amalgamations, Arrangements and Continuance: Tax and Corporate Law Considerations", Canadian Tax Foundation, *1991 Conference Report* 9:1-77 at 16-19.