September 16, 2015

Ms. Alexandra MacLean
Director, Tax Legislation Division
Tax Policy Branch
Department of Finance
90 Elgin Street
Ottawa, ON. K1A 0G5

Dear Ms. MacLean:

Re: July 31, 2015 Draft Legislation – Charitable Gifting

I am writing on behalf of the Conference for Advanced Life Underwriting (CALU). CALU is a national professional membership association of established financial advisors (life insurance, wealth management and employee benefits), accounting, legal, tax and actuarial professionals. For over 20 years, CALU has engaged in political advocacy and government relations activities on behalf of its members and the members of its sister organization, Advocis. Through these efforts, CALU represents the interests of more than 11,000 insurance and financial advisors and in turn the interests of millions of Canadians.

We are writing to provide you with our comments on certain proposed changes contained in the draft legislation released on July 31, 2015 pertaining to charitable gifts arising on the disposition of shares in private corporations and real estate.

Introduction

Further to the announcement in the 2015 Federal budget, on July 31, 2015 the Department of Finance ("Finance") released draft legislation that includes an exemption from capital gains tax with respect to certain arm's length dispositions of shares in private corporations and real estate (collectively referred to as the "property"), where cash proceeds are donated to a qualified donee within 30 days of the date of disposition (the "legislation"). Included in the legislation are rules designed to prevent planning arrangements that could give rise to unintended tax benefits.

While CALU is supportive of the overall tax policy goals of the legislation, we do have a number of questions and concerns relating to its operation in certain situations, as discussed below.

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1. Residency Requirement

One of the requirements for the exemption to be available is that the taxpayer must be resident in Canada at the end of the taxation year in which the disposition of the property takes place.[1] We note that such a residency requirement does not exist for similar exemptions from capital gains taxation under paragraphs 38(a.1), 38(a.2) and 38(a.3) of the Income Tax Act (Canada) (the "Act"). It is also unclear what tax policy concern would require the taxpayer to remain a resident in Canada until the end of the taxation year to gain access to the exemption.

Recommendation: that the requirement for the taxpayer to be resident in Canada at the end of the taxation year in which the disposition takes place be modified to require the taxpayer to be resident in Canada at both the time of the disposition and the gift of cash proceeds to a qualified donee.

2. 30-Day Period to Make the Gift

Another requirement for the exemption to be available is that a cash gift be made by the taxpayer to the qualified donee not more than 30 days after the disposition.[2] For sales transactions involving shares of private corporations and real estate, due to escrow arrangements, undertakings, post-closing adjustments or the need to satisfy other post-closing conditions, it is not unusual to see terms whereby all or a portion of the cash proceeds are not available to be advanced for up to two years or more after closing, and it is typical that the final purchase price determination is delayed for 60 to 90 days or more (this can result in an increase or decrease in the actual sale proceeds ultimately received). As a result, the 30-day condition would significantly limit access to the exemption for many typical sales and consequently act as a disincentive to making larger charitable gifts.

Recommendation: that the time frame for making the cash gift be not more than 30 days after receiving the cash proceeds from the disposition, provided such cash proceeds are received within 36 months after the disposition.

3. Designation of the Gift by the Taxpayer or Deceased's Estate

Item B of the formulas in draft subparagraphs 38.3(a)(i) and 38.3(b)(ii) require the taxpayer or the deceased's legal representatives, respectively, to make a designation in the relevant tax return as to the amount of the cash gift. However, the amount that is to be used in the formula for the purpose of determining the exemption is the lesser of the two amounts in clauses (A) and (B) for item B.

Recommendations: assuming this designation is intended to notify the Canada Revenue Agency (CRA) of the amount of the gift to be used for the formula in draft section 38.3, CALU recommends that the taxpayer or legal representative, as the case may be, be required to designate the lesser of the two amounts calculated under clauses (A) and (B) for item B.

We further recommend that there be provision made for late filing this designation with Ministerial approval.

[1] Draft clause 38(a.4)(i)(C) of the legislation.
[2] Draft clauses 38(a.4)(i)(B) and 38(a.4)(ii)(D) of the legislation.

4. Rules Applicable on the Death of the Taxpayer

CALU is pleased that the legislation contains rules that permit the graduated rate estate (GRE) of a deceased taxpayer to dispose of the property, make a gift of cash to a qualified donee, and designate the gift in order that all or a portion of the capital gains arising in respect of that property under section 70 of the Act can be reported as nil.

However, we have identified a number of situations where the legislation may need to be modified (or at least clarified), as outlined below.

a) The Taxpayer Dies (Or a Trust is Wound Up) Before the End of the Year in which the Property is Disposed and a Gift is Made

In these circumstances, even though the taxpayer has completed the steps to qualify for the exemption, that taxpayer will not be resident in Canada at the end of the taxation year and therefore doesn't meet the requirements of draft paragraph 38(a.4). Similarly, if a trust sells the property and makes a gift that otherwise complies with draft paragraph 38(a.4), and the trust winds up before the end of its taxation year, it will not meet the end of year residency test.[3]

This further supports the recommendation above that the requirement for the taxpayer to be resident in Canada at the end of the taxation year in which the disposition takes place be modified to require the taxpayer to be resident in Canada at both the time of the disposition and the gift of cash proceeds to a qualified donee.

b) The Taxpayer Dies in the Year the Property is Disposed, Estate Makes the Gift

The rules in draft paragraph 38(a.4), applicable to either an individual taxpayer or the GRE of a deceased taxpayer, require that the relevant taxpayer both dispose of the property and make the gift not more than 30 days after the disposition.

There will be situations where the individual taxpayer has disposed of the property but dies prior to completing the gift of cash to a qualified donee. In these circumstances the deceased's will could require the estate to complete a cash gift to a qualified donee within the required period of time. However, as noted, since the disposition and the gift are made by two different taxpayers, the exemption would not be available.

Recommendation: that the legislation be modified to permit the exemption to be claimed in the terminal return of a deceased taxpayer where the disposition of property is completed in the year of death, and the GRE of the deceased taxpayer makes a cash gift from the proceeds of disposition to a qualified donee within the prescribed time period.

c) The Estate Disposes of the Property for an Amount That is Lower than the Section 70 Inclusion Amount

It is not clear whether the formula in draft paragraph 38.3(b)(i) operates as intended where there is a capital loss realized by the deceased's GRE in respect of the property.

[3] In both situations, there is no provision in the Act that will deem an accelerated year end.

Consider the following example:

Assume Ms. A, a widow, owns a vacant lot worth $1 million and dies in 2017. At the time of her death the vacant lot has an adjusted cost base (ACB) of $200,000. Assume her estate, which qualifies as a GRE at that time, sells the lot for $800,000, receiving cash proceed of $200,000 which are donated to a registered charity.

Ms. A will realize $800,000 in capital gains in respect of the deemed disposition of the vacant lot under section 70 of the Act.

The exemption determined under draft paragraph 38.3(b)(i) will be calculated as follows:

$800,000 x $200,000 / $800,000 = $200,000. The resulting capital gain reported in Ms. A's terminal return in respect of the property will be reduced to $600,000.

In addition, the estate will have a $200,000 capital loss, which can be retained and utilized to offset gains realized in the estate or, if the loss is realized in the first taxation year of the estate, carried back to offset capital gains in the terminal return (whether in respect of the same property or other property of the deceased taxpayer).[4] The overall tax benefit is $400,000 of sheltered capital gains.

This tax result is better than would be the case for an individual taxpayer who owns and disposes of the same property for $800,000 and then makes a cash gift of $200,000 to a qualified donee. In this case the initial capital gain would be $600,000 and the exemption would be calculated as follows:

$600,000 x $200,000 / $800,000 = $150,000, resulting in a net capital gain reported of $450,000.

The overall tax benefit is only $150,000 of sheltered capital gains, plus $200,000 of reduced capital gains (compared to the death scenario), totalling $350,000. As can be seen, the exemption under the estate scenario is $50,000 higher than the exemption that would arise if the individual taxpayer disposed of the same property and made the gift.

CALU is seeking confirmation that the formula is working as intended in the above situation.

d) The Estate Disposes of the Property for an Amount That is Higher than the Section 70 Inclusion

In this situation we would like clarification as to whether the estate of the deceased has access to a separate exemption arising from the gift of cash to a qualified donee.

Consider the following example:

Assume Ms. A, a widow, owns a vacant lot worth $1 million and dies in 2017. At the time of her death the vacant lot has an ACB of $200,000. Assume that her estate, which qualifies as a GRE at that time, sells the lot for $1,200,000, receiving cash proceed of $200,000 which is donated to a registered charity.

[4] Subsection 164(6) of the Act.

The exemption determined under draft paragraph 38.3(b)(i) will be calculated as follows:

$800,000 x $200,000 / $1,200,000 = $133,333, resulting in a net gain of $666,667 in the terminal return.

The estate would also have a capital gain of $200,000 from this sale transaction. Assuming the estate is entitled to claim an exemption under subparagraph 38(a.4)(i) the amount of the exemption determined under draft paragraph 38.3(a)(i) would be calculated as follows:

$200,000 x $200,000 / $1,200,000 = $33,333. This would reduce the estate's capital gain to $166,667.

CALU believes this is the appropriate result and would appreciate Finance confirming that the estate is eligible to claim an exemption in respect of its gain arising on the disposition and making of the gift as determined above.

(e) *The Estate's Proceeds of Disposition are Reduced by a Deemed Dividend*

CALU would like clarification of how the formula under draft paragraph 38.3(b)(i) should operate where the estate disposes of shares by way of redemption to a private corporation, which gives rise to a deemed dividend that otherwise reduces the estate's "proceeds of disposition".[5]

Consider the following example:

Ms. A and Mr. B deal at arm's length. Ms. A owns 40% of the outstanding shares in Opco with an ACB and paid-up capital of $1,000. Mr. B owns the remaining 60% of the outstanding shares in Opco, which has a fair market value ("FMV") of $2 million. An agreement between Ms. A and Mr. B specify that in the event of a shareholder's death, his/her shares will be redeemed by Opco or purchased by the surviving shareholder for their FMV using life insurance proceeds received on the death.

Ms. A's will directs her executors to make a cash gift of $200,000 within 30 days of the redemption or purchase of the shares as a consequence of her death.

Ms. A dies in 2017. She is deemed to dispose of her shares under section 70 for their FMV of $800,000. This results in a capital gain of $799,000 in the terminal return. Ms. A's estate now has an ACB of $800,000 in the shares.

The redemption of shares from Ms. A's estate results in a deemed dividend of $799,000[6] for which Opco elects to be a capital dividend under subsection 83(2) of the Act. The estate's "proceeds of disposition" on the disposition of the shares are reduced from $800,000 to $1,000 due to the deemed dividend, resulting in a capital loss of $799,000. This loss is reduced to $399,500 by virtue of the stop-loss rules.[7]

The $399,500 capital loss is carried back to the terminal return,[8] reducing the total capital gains in the terminal return to $399,500.[9]

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[5] Paragraph (j) of the definition of proceeds of disposition in section 54 of the Act.
[6] Subsection 84(3) of the Act.
[7] Subsection 112(3.2) of the Act.
[8] Subsection 164(6) of the Act.
[9] Assuming no other property was owned by Ms. A at the time of her death that resulted in a capital gain or loss by virtue of section 70 of the Act.

The exemption under draft paragraph 38(a.4) would appear to be determined under draft paragraph 38.3(b) as follows:

A = $799,000 (the capital gain under section 70 of the Act)
B = lesser of cash gift ($200,000) and cash received as proceeds from the subsequent disposition ($200,000)
D = estate's proceeds of the subsequent disposition = $800,000 (assuming it is not reduced by the deemed dividend of $799,000)

$799,000 x $200,000 / $800,000 = $199,750

CALU seeks confirmation that the exemption calculation in this example is correct, and in particular that the "estate's proceeds of the subsequent disposition" will not be reduced by the amount of the deemed dividend.

5. Impact of Claiming a Capital Gains Reserve

Many purchase and sale agreements involving the shares of a private corporation or real estate involve debt being provided as consideration for the purchase price. CALU would like clarification of the application of the new rules in draft section 38.3 to the following situation:

Mr. A owns real estate valued at $1 million and an ACB of nil. He plans to sell the property in 2017 to Ms. B, who is at arm's length to Mr. A. The parties agree that on closing Ms. B will pay $200,000 in cash to Mr. A, and provide a promissory note of $800,000, repayable in four equal instalments on the following anniversary dates from the date of sale. Mr. A makes a gift of $200,000 from the cash proceeds to a registered charity within the applicable time period,

When filing his tax return for the year of disposition, Mr. A claims a reserve of $800,000 under subparagraph 40(1)(a)(iii) of the Act, resulting in a capital gain of $200,000 to be reported.

The exemption calculated under the formula in draft paragraph 38.3(1)(a) would appear to be as follows:

$200,000 x $200,000 / $1,000,000 = $40,000

In subsequent taxation years Mr. A will receive the remaining payments under the promissory note, which will be brought into his income as capital gains under subparagraph 40(1)(a)(ii). However, it is not clear whether draft paragraph 38(a.4) and the formula in draft section 38.3 would allow Mr. A to claim an exemption of $40,000 against the gains arising in the four following taxation years, such that the total exemption would be $200,000 (as would be the case if no reserve had been claimed by Mr. A).

CALU is seeking confirmation that in these circumstances Mr. A could claim an exemption of $40,000 in each of the following four taxation years.

6. Impact of Debt on Claiming the Exemption

As noted in the preceding section, many purchase and sale agreements involving the shares of a private corporation or real estate involve debt being provided as consideration for the purchase price. In certain situations the debt can be short-term in nature pending the finalization of external longer term financing arrangements or the availability of other funds. It would appear that the formula under draft section 38.3 could significantly impact sale arrangements where debt is taken back, as illustrated using the following example:

Mr. A owns real estate valued at $1 million and which has an ACB of nil. He plans to sell the property in 2017 to Ms. B, who is at arm's length to Mr. A. The parties agree that on closing Ms. B will pay $200,000 in cash to Mr. A, and provide a promissory note of $800,000, repayable before the end of the year.

Mr. A makes a gift of $400,000 to a registered charity within the applicable time period and Ms. B subsequently repays the promissory note of $800,000 before the end of the taxation year.

Clause (B) of Item B of the formulas in draft subparagraphs 38.3(a)(i) and 38.3(b)(ii) restricts the amount of the gift that can be included in Item B to "the amount of money received by the taxpayer, as proceeds from the disposition, prior to the making of the gift." Applying this restriction would mean that only $200,000 of the gift can be included in the formula rather than the entire $400,000 gift, even though the entire proceeds of disposition were received in cash before the end of the taxation year.

Recommendation: that Clause (B) of Item B of the formulas in draft subparagraphs 38.3(a)(i) and 38.3(b)(ii) be amended to be as follows: "*the amount of money received by the taxpayer [individual's estate], as proceeds from the [subsequent] disposition, in the taxation year of the [subsequent] disposition".*

7. Anti-Avoidance Rules

We understand that Finance is concerned that certain tax planning may be undertaken to obtain "unintended tax benefits, beyond the scope of the targeted incentive."[10] While we can appreciate Finance's desire to control planning arrangements that "could otherwise result in unintended and undesirable effects from a tax policy perspective,"[11] this must be weighed against the main policy objective of encouraging greater gifting to qualified donees. We believe that the rules as currently drafted may deny access to the exemption; expose potential donors to significant tax risks; and/or expose registered charities to reputational risk in situations where there has been no intent to derive unintended tax benefits, as discussed below.

a) Property That Derives its Value from the Property

Certain sale transactions relating to shares in private corporations and real estate, taking place between a vendor and an arm's length/non-affiliated corporation, may involve consideration being provided to the vendor that includes common shares of the purchasing corporation. We are concerned that the acquisition of shares in the purchasing corporation could be treated as "property that derives its value from the property", such that the exemption is denied by virtue of draft clause 38.4(1)(c)(i)(C).

Recommendation: that there be a specific exception to draft paragraph 38.1(1)(c)(i)(C) where the taxpayer receives consideration that includes shares of the purchaser corporation, provided the taxpayer is at arm's length and not affiliated with the purchaser corporation immediately after the disposition.

[10] Finance explanatory notes to the draft legislation released on July 31, 2015.
[11] Ibid.

b) Reorganization of Shares in a Private Corporation

In contemplation of the sale of shares in a private corporation, a taxpayer may undertake a reorganization of shares to facilitate an ongoing interest in that corporation subsequent to the sale.[12] Draft subparagraph 38.4(1)(c)(i) denies the capital gains exemption if the taxpayer "acquires in the taxation year, directly or indirectly, all or any portion of the property, [or] property substituted for the property [sold]" whether before or after the time of the sale. In our view such pre-sale reorganizations should not prevent the taxpayer from being able to claim an exemption in respect of the sale of the new class of shares and a subsequent cash gift to a qualified donee.

Recommendation: that the acquisition of shares received by a taxpayer as a consequence of a corporate reorganization (where such shares are in exchange for shares owned by the taxpayer that were not acquired in that year), which takes place in the same year as the disposition of such shares and cash gift to a qualified donee, be excluded for the purposes of draft subparagraph 38.4(1)(c)(i).

c) Estate's Acquisition of Property From the Deceased

The estate of a deceased is a separate taxpayer from the deceased, and depending on the circumstances is deemed to acquire the capital property of the deceased at either the FMV[13] of such property, or the property's ACB.[14] Draft subparagraph 38.4(1)(c)(i) denies the capital gains exemption if the taxpayer "acquires in the taxation year, directly or indirectly, all or any portion of the property [sold]" whether before or after the time of the sale. On a plain reading, this appears to apply to the acquisition of the property by the estate as a consequence of the death of the deceased taxpayer. As a result, if the sale of the property by the estate takes place in the first taxation year of the estate the capital gains exemption will not be available. If a deceased taxpayer is considered to not deal at arm's length with his/her estate, it also appears to prevent a capital gains exemption with regard to a sale and donation that occurs in the same taxation year of the deceased's death.

Recommendation: that the acquisition of the property by the estate as a consequence of the death of a taxpayer be excluded for purposes of draft subparagraph 38.4(1)(c)(i).

d) Application of the Rules Where the Property is Shares in a Private Corporation

Draft paragraph 38.4(1)(a) and subparagraph 38.4(1)(c)(ii) in effect provide that property, in relation to shares of a private corporation, to be "a share of the capital stock of a private corporation". This would seem to indicate that in determining the application of the rules in draft section 38.4 (both in terms of the availability of the exemption and the possible claw-back of the exemption), that the rules will apply on a share by share basis. For example, if a taxpayer already owns 500 Class A common shares in a private corporation and acquires another 100 Class A common shares in that corporation, and in the same year disposes of 600 Class A common shares, the provisions of draft subparagraph 38.4(1)(c)(i) should only apply to the 100 Class A common shares acquired in the year. In other words, an exemption may still be claimed for the 500 Class A common shares acquired in a prior taxation year. Also, in interpreting "all or any portion of the property" as used in section 38.4 with respect to shares in a private corporation, it applies to all or any

[12] For example, the taxpayer may (1) exchange a single class of shares for multiple classes for the purpose of selling a separate class of shares to a buyer; (2) simplify an issued share structure that has multiple classes of shares so that there is only a single class of shares; or (3) put in place a new corporation for the purpose of selling the corporation (this is a typical scenario when a taxpayer incorporates a business for sale).
[13] Subsection 70(5) of the Act.
[14] Subsection 70(6) of the Act.

portion of a share, and is not meant to apply where a number of shares of the same or different classes have been sold.

CALU is seeking confirmation that this is the correct interpretation of "property" and "all or any portion of the property" when referencing shares in a private corporation under draft section 38.4.

e) Time at Which the Parties are not Dealing at Arm's Length or are Affiliated

Draft subparagraph 38.4(1)(c)(ii) and clause 38.4(4)(c)(ii)(A) apply where there is a redemption, acquisition or cancellation of shares previously disposed of, at a time when the taxpayer or certain other parties do not deal at arm's length or are affiliated with the corporation.

CALU seeks confirmation as to whether the provision is meant to apply in the situation where the taxpayer is at arm's length (and not affiliated) with the corporation prior to the redemption, acquisition or cancellation of the shares, but as a consequence of the redemption, acquisition or cancellation of shares, no longer deals at arm's length or has become affiliated with the corporation.

f) Reputation Risk Concerns for Registered Charities

Draft subsections 38.4(2) and (3) provide rules that will reverse the capital gains exemption under draft paragraph 38(a.4) where certain transactions take place within 60 months of the disposition of the property, including certain transactions undertaken by the qualified donee. For example, under draft paragraph 38.4(3)(a), a claw-back of the exemption will occur if the qualified donee acquires *"directly or indirectly, all or any portion of the property, property substituted for the property, or property that derives its value from the property"* within 60 months after the time of the particular donation.

It must be recognized that the registered charity may be totally unaware that the property it is acquiring (either through a donation or purchase transaction) has any relationship to a cash gift received in the past five years. There is also no reason for the registered charity to be aware that the original cash gift was part of a transaction resulting in a capital gain exemption to a donor. However, the acquisition of the property by the registered charity could have an extremely negative tax impact on one of its donors.

It would appear that the only way a registered charity could prevent this from occurring would be to require all cash donors to report if their gift relates to the disposition of shares in a private corporation or real estate, and similarly require any prospective donor who is making a non-cash gift to provide detailed information relating to the acquisition and ownership of that asset. The registered charity would then need to cross-check all cash gifts made in the past five years against all non-cash gifts to determine if this will impact a donor's exemption. This would clearly create donor privacy concerns and result in a significant administrative burden for a number of charities. The net result would be that they may need to stop accepting non-cash donations to ensure this issue does not arise.

A similar concern arises for a taxpayer who has claimed an exemption under draft paragraph 38(a.4). A claw-back may arise from the actions of arm's length third parties, undertaken without the taxpayer's knowledge or approval. For example, the taxpayer may have sold real estate to an arm's-length purchaser and made a cash gift to a registered charity that gives rise to a capital gains exemption. As noted above, the registered charity may not be aware that the cash gift related to the sale of any property. Within the relevant 60-month period the arm's length purchaser could choose to sell or donate the real estate to the registered charity without the knowledge of the taxpayer. This transaction will result in the taxpayer being required to include an amount in income under draft subsection 38.4(2) for that taxation year, without even being aware of the circumstances that has created this tax obligation.

Recommendation: that paragraph 38.4(3)(a) be amended to only apply where the qualified donee's acquisition of the property was part of a series of transactions that includes the original sale of property and donation of cash to the qualified donee.

g) Concerns with the "Ceasing to Exist" Anti-Avoidance Rules

Draft subsection 38.4(4) is designed to capture situations where the taxpayer claiming the exemption has "ceased to exist" (e.g. an individual taxpayer has died or a corporate taxpayer has been wound-up) and another person who was not at arm's length with the taxpayer immediately before ceasing to exist, directly or indirectly acquires an interest in the property (or substituted property) that was previously disposed of by the taxpayer In this situation draft subsection 38.4(2) operates to include the previously exempted capital gain in the income of that non-arm's length person. We believe this is intended to prevent a taxpayer from establishing another entity (a corporation or trust) to sell the property and claim the exemption, and then subsequently wind-up that taxpayer in order to avoid the claw-back of the exemption under draft subsection 38.4(2).

CALU believes this provision could lead to unfair tax results where a taxpayer has "ceased to exist" as a consequence of death. Consider the following example:

> *Mr. A owns 40% and Ms. B (Mr. A's daughter) owns 60% of the shares of Opco. Mr. A sells his shares to Mr. C (who is at arm's length to Mr. A and Ms. B) and subsequently makes a charitable gift that results in an exemption from capital gains tax under draft paragraph 38(a.4). Ms. B and Mr. C enter into a buy-sell agreement that governs the purchase of shares on the death, disability or retirement of a shareholder. Mr. A dies three years later at which time he is no longer a shareholder in Opco. Assume that within the relevant 60 month period of time Mr. C wishes to retire and Ms. B purchases his shares. The purchase of Mr. C's shares will trigger the application of draft subsection 38.4(4), which will result in Ms. B having to include in her income for that year a capital gain equal to the exemption amount claimed by Mr. A on the sale of shares to Mr. C.*

Given our view that this provision is intended to prevent planning strategies designed to avoid rules that deny access to the exemption, and that the death of a taxpayer typically not a planned event that would give rise to these types of concerns, we don't believe these provisions should apply on death. We also note that the application of this rule on death can result in financial inequities within a family situation. For example, by having the capital gain included in the income of Ms. B, she is effectively funding the tax that should have been borne by Mr. A and, ultimately, his/her beneficiaries. It is not clear why Ms. A should bear this tax burden under these circumstances**.**

Recommendation: that there be a specific exemption from the application of section 38.4(4) where the taxpayer has ceased to exist as a consequence of death.

Alternatively, CALU recommends that draft subsection 38.4(4) only apply where it is part of a series of transactions designed to gain access to the exemption.

(h) Interest on Capital Gain Claw-Back

Draft subsection 38.4(5) provides rules that impact the interest that will be applied in the event there is a claw-back under draft subsection 38.4(2). In effect, for the purposes of applying interest on outstanding amounts of tax (subsection 161(1) of the Act), the draft provision will treat the tax on the capital gain claw-

back as having been outstanding and overdue since the first day after the year of the original sale of the property (the sale that qualified under draft paragraph 38(a.4).

We have two concerns with the provision as drafted.

First, draft paragraph 38.4(5)(c) provides that the outstanding tax is determined as if "the **amount** were the taxpayer's only taxable income for the year" [emphasis added]. The "amount" referred to is the amount deemed to be a capital gain of the taxpayer under draft subsection 38.4(2). It is not the taxable capital gain. As such, on a plain reading, it appears that the entire amount of the capital gain is included as taxable income for the purposes of these rules. We presume this should be amended so that it is the taxable capital gain that should be included.

Recommendation: that draft paragraph 38.4(5)(c) should be amended to provide: "one-half of the amount was the taxpayers' only taxable income for the year;"

Second, draft paragraph 38.4(5)(f) essentially provides that the amount of tax on the capital gain should be treated as outstanding from the first day of the taxation year immediately following the taxation year in which the original sale took place until the balance due day for the taxation year in which the deemed capital gain under draft subsection 38.4(2) applies. If, for example, the original sale took place in 2017 and the deemed capital gain occurs in 2019, assuming the taxpayer is an individual, the taxpayer will be charged interest from the period January 1, 2018 until April 30, 2020 in respect of the "claw-back". If the taxpayer had recognized the capital gain in the year of original sale, his/her tax would have been payable on the balance due day for the year (April 30, 2018). It is not clear why the interest on a deemed capital gain under draft subsection 38.4(2) should be calculated from January 1, 2018.

Recommendation: that the beginning of the period in draft paragraph 38.4(5)(f) be the taxpayer's balance due day for the taxation year in which the original sale took place.

Thank you for this opportunity to comment on the draft legislation released on July 31, 2015 relating to an exemption from capital gains tax with respect to certain arm's length dispositions of shares in private corporations or real estate. We'd appreciate the opportunity to discuss the issues raised in this submission at your earliest convenience.

Yours truly,

Kevin Wark, LLB, CLU, TEP
President, CALU

cc. Roger Thorpe, RHU, REBC, GBA
Chair, CALU