REVENU QUÉBEC

INTERPRETATION AND ADMINISTRATIVE BULLETIN CONCERNING THE LAWS AND REGULATIONS

Income Tax

IMP. 522-1/R1 **Disposition of Property to a Taxable Canadian Corporation: Separate Elections, Applications to the Minister and Rollover Applications**

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Reference(s): *Taxation Act* (CQLR, c. I-3), sections 518, 520.1, 521.2, 522, 523, 524, 526 and 526.1

This version of interpretation bulletin IMP. 522-1 supersedes that of May 31, 2001. The bulletin was revised to include rollover applications. Editorial revisions and changes in respect of conformity were made to ensure technical accuracy.

This bulletin presents Revenu Québec's interpretation of the legislative provisions concerning separate elections, applications to the Minister made under the third paragraph of section 522 of the *Taxation Act* (TA) and the limits on the amount agreed on in the case of a separate election. The bulletin also briefly sets out the rules that apply where a rollover election under subsection 85(1) of the *Income Tax Act* (R.S.C., 1985, c. 1, 5th Supp.) (ITA) cannot be made because subsection 13(21.2) of the ITA applies.

APPLICATION OF THE ACT

GENERAL

1. The rules provided for in sections 518 to 533 of the TA allow a taxpayer[1] (hereinafter the "Transferor") to defer or limit tax at the time of the transfer of property to a taxable Canadian corporation[2] (hereinafter the "Corporation") (see the current version of interpretation bulletin IMP. 521.2-1). These rules are hereinafter referred to as the "rules for tax-deferred transfers."

1 This interpretation bulletin also applies, with the necessary adjustments, to partnerships that make a valid election for the purposes of subsection 85(2) of the ITA in respect of a disposition of property to a taxable Canadian corporation for consideration that includes a share of the capital stock of the corporation, in accordance with section 529 of the TA.

2 This bulletin also applies, with the necessary adjustments provided for in the second paragraph of section 614 of the TA, to a Canadian partnership that acquires from a taxpayer (the Transferor) property referred to in that paragraph. The Transferor and all the members of the partnership must make a valid election in order for the provisions of subsection 97(2) of the ITA to apply in respect of the acquisition of the property.

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2. Under section 521.2 of the TA, where the Transferor and the Corporation have made the election referred to in section 518 of the TA in respect of the disposition of property, the Transferor's proceeds of disposition of the property and the cost to the Corporation of the property are deemed to be equal to such amount as is established in respect of the property under subsection 85(1) of the ITA for federal income tax purposes.

AMOUNT AGREED ON FOR QUÉBEC INCOME TAX PURPOSES THAT DIFFERS FROM THE AMOUNT AGREED ON FOR FEDERAL INCOME TAX PURPOSES

3. Pursuant to the first paragraph of section 522 of the TA, the Transferor and the Corporation may, if they meet the conditions given in the second paragraph of that section (see point 7 of this bulletin), agree on an amount in respect of the property disposed of to the Corporation, where such amount represents the Transferor's proceeds of disposition of the property and the cost of the property to the Corporation. Said amount is determined according to the Québec tax attributes of the property and may differ from the amount agreed on for federal income tax purposes.

ROLLOVER APPLICATIONS

4. Section 518 of the TA provides that, where an election under subsection 85(1) of the ITA cannot be made because subsection 13(21.2) of the ITA applies, the Transferor and the Corporation may choose to apply the rules for tax-deferred transfers by completing the prescribed form provided for in section 520.1 of the TA.

APPLICATIONS TO THE MINISTER

5. Pursuant to the third paragraph of section 522 of the TA, the Minister may, on a joint application by the Transferor and by the Corporation using the prescribed form (form TP-518-V), allow the Transferor and the Corporation

(a) to agree on an amount determined according to the Québec tax attributes of the property that differs from the amount the Transferor and the Corporation agreed on in respect of the property for federal income tax purposes, if they did not originally do so using the prescribed form referred to in the first paragraph of section 520.1 of the TA (form TP-518-V);

(b) to cancel the election made in respect of the disposition of property, where, at the time of the election, the Transferor and the Corporation agreed on a different amount determined according to the Québec tax attributes of the property;

(c) to amend the election made in respect of the disposition of property, where, either at the time of the election or at the time of a rollover application, the Transferor and the Corporation agreed on a different amount determined according to the Québec tax attributes of the property.

DIFFERENCE JUSTIFIED BY A DIFFERENCE IN TAX ATTRIBUTES

6. Any amount determined that differs from the amount agreed on for federal income tax purposes must, in all cases, be approved by the Minister. All or substantially all of the difference between the

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two amounts must be justified by a difference between the cost amount of the property for Québec income tax purposes and the cost amount of the property for federal income tax purposes, or by another reason considered by the Minister to be acceptable in the circumstances. For example, agreement by the Transferor and the Corporation on an amount that differs from the amount agreed on for federal income tax purposes will generally be accepted where the Transferor has greater cumulative losses for federal purposes than for Québec purposes.

APPLICABILITY

7. Pursuant to the second paragraph of section 522 of the TA, in order to file an application to the Minister, to file a rollover application or to agree on an amount that differs from that agreed on for federal income tax purposes, the Corporation and the Transferor, respectively, must meet the following conditions:

(a) in the case of the Corporation, the proportion that the business carried on by the Corporation in Québec is of the aggregate of the business carried on in Canada or in Québec and elsewhere, as established by the regulations made under section 771 of the TA for its taxation year in which the disposition is made, must be not less than 9/10;

(b) in the case of the Transferor,

- where the Transferor is an individual, he or she must be resident in Québec at the end of the individual's taxation year in which the disposition is made and, if the individual carries on a business in Canada but outside Québec, the proportion applicable in respect of the individual under the second paragraph of section 22 of the TA for that year must be not less than 9/10;
- where the Transferor is a corporation, the proportion that the business carried on by the corporation in Québec is of the aggregate of the business carried on in Canada or in Québec and elsewhere, as established by the regulations made under section 771 of the TA for its taxation year in which the disposition is made, must be not less than 9/10;
- where the Transferor is a partnership, the proportion that the business carried on in Québec is of the aggregate of the business carried on in Canada or in Québec and elsewhere that would be established in its respect by the regulations made under section 771 of the TA for its taxation year in which the disposition is made, if the partnership were a corporation and if its fiscal period were a taxation year, must be not less than 9/10.

LIMITS ON THE AMOUNT AGREED ON

8. Where, under section 522 of the TA, the parties to a transfer agree on an amount that differs from the amount agreed on for federal income tax purposes, such amount must fall within the limits set forth in sections 522 to 524 of the TA. The same applies in the case of a rollover application.

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Upper limit

9. Under subparagraph (c) of the first paragraph of section 522 of the TA, the amount agreed on cannot exceed the fair market value of the property disposed of.

Lower limit

10. Sections 523 and 524 of the TA provide for a lower limit, which varies according to the type of property disposed of (see points 11 to 13 of this bulletin), on the amount agreed on. Under the second paragraph of section 523 and subparagraph (b) of the first paragraph of section 522 of the TA, the amount agreed on can in no case be less than the fair market value of the non-share consideration received for the property disposed of.

Incorporeal capital property

11. Where the property disposed of is incorporeal capital property, if the proceeds of disposition would otherwise be less than the least of the following amounts, the amount agreed on is deemed to be equal to the least of these amounts:

- 4/3 of the eligible incorporeal capital amount of the Transferor in respect of the business immediately before the disposition;
- the cost to the Transferor of the property;
- the fair market value of the property at the time of its disposition.

Depreciable property

12. Where the property disposed of is depreciable property, if the proceeds of disposition would otherwise be less than the least of the following amounts, the amount agreed on is deemed to be equal to the least of these amounts:

- the undepreciated capital cost to the Transferor of all property of the same class as the property disposed of, immediately before the disposition;
- the cost to the Transferor of the property;
- the fair market value of the property at the time of its disposition.

Non-depreciable capital property and inventory[3]

13. Where the property disposed of is non-depreciable capital property or inventory, if the proceeds of disposition would otherwise be less than the lesser of the following amounts, the amount agreed on is deemed to be equal to the lesser of these amounts:

- the fair market value of the property at the time of its disposition;
- the cost amount to the Transferor of the property at the time of disposition.

3 Including a NISA fund No. 2 or property that is referred to in either paragraph 85(1.1)(g) or 85(1.1)(g.1) of the ITA.

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BENEFIT CONFERRED ON A RELATED PERSON

14. Section 526 of the TA provides for a presumption in respect of the amount agreed on, where that amount is determined according to the Québec tax attributes of the property, as allowed under section 522 of the TA, and where the property is disposed of in the following circumstances:

- the fair market value of the property disposed of, immediately before the time of the disposition, exceeds the greater of the fair market value, immediately after that time, of the consideration (including shares) received and the amount agreed on; and
- it is reasonable to regard any part of the excess as a benefit that the Transferor desired to have conferred on a person related to the Transferor, other than a corporation that is a wholly-owned corporation of the Transferor immediately after the disposition.

15. In this case, the excess must be added to the amount agreed on in respect of the property, except for the determination of the cost to the Transferor of any shares received as consideration. In such a case, the amount originally agreed on by the parties is increased to include such benefit. The amount agreed on, as revised, thus becomes the Transferor's proceeds of disposition of the property and the cost to the Corporation of the property. Because of the increase in the Transferor's proceeds of disposition, the Transferor will realize a capital gain or earn additional income. However, for the purposes of determining the cost of the shares received in the rollover, the original amount agreed on must be used as the starting point, rather than the amount agreed on as revised under section 526 of the TA.

16. As stated above, this rule does not apply in the case of a disposition to a corporation that, immediately after the disposition, is a wholly-owned corporation of the Transferor, that is, a corporation all the issued and outstanding shares of the capital stock of which belong to either the Transferor or a corporation that is a wholly-owned corporation of the Transferor, or a combination of the two.

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