

Income Tax

IMP. 1029.7.2-1 Increase in the Credit for Wages and the Part of the Remuneration Attributable to Wages Paid in respect of Scientific Research and Experimental Development (SR & ED) Provided for in Section 1029.7 of the *Taxation Act*
The Assets of a Designated Corporation and the Net Shareholders' Equity Shown in its Books and Financial Statements Submitted to the Shareholders
Expenditure Limit and Apportionment among Associated Corporations

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Reference(s): *Taxation Act* (R.S.Q., c. I-3), sections 21.19 to 21.24, 1029.7, 1029.7.2 to 1029.7.10

The purpose of this bulletin is to give further details as to the application of the rules concerning the increase of the credit provided for in section 1029.7 of the *Taxation Act* (the "Act") to 40%, the rules for computing the assets of a designated corporation and the net shareholders' equity, the notion of expenditure limit and its apportionment among associated corporations.

APPLICATION OF THE ACT

40% Credit

1. In accordance with section 1029.7.2 of the Act, where the taxpayer referred to in section 1029.7 of the Act is a corporation that has been, during the whole taxation year contemplated therein, a corporation that is not controlled, directly or indirectly, in any manner whatever, by one or more persons not resident in Canada and the assets or the net shareholders' equity, shown in its books and financial statements submitted to the shareholders for its preceding taxation year, or, where the corporation is in its first fiscal period, at the beginning of its first fiscal period, were less than \$25 000 000 or no more than \$10 000 000, respectively, the rate of 20% mentioned in the said section 1029.7 of the Act, shall be replaced by a rate of 40%, to the extent that it is applied to the wages and portion of the remuneration contemplated therein, the aggregate of which does not exceed the expenditure limit of the corporation for the year.

Rules for Computing the Assets and Net Shareholders' Equity

2. For the purposes of section 1029.7.2 of the Act, in computing the assets or the net shareholders' equity of a corporation at the time contemplated therein, the amount representing the surplus reassessment of its property and the amount of its intangible assets shall be subtracted, in accordance with the first paragraph of section 1029.7.3 of the Act, to the extent that the amount indicated in their respect exceeds the expenditure made in their respect. For the purposes of the

first paragraph of section 1029.7.3 of the Act, where all or part of the expenditure made in respect of intangible assets consists of shares of the corporation's capital stock, all or the part of the expenditure, as the case may be, is deemed to be nil in accordance with the second paragraph of the said section 1029.7.3 of the Act.

Example 1

A corporation described in section 1029.7.2 of the Act (Co. X) carries on a business in Canada and undertakes for its own account SR & ED in Québec. At the end of its fiscal period ending on April 30, 1990, its assets are \$27 million (M) and the net shareholders' equity is \$9.5 M. The cost of its goodwill is \$1.5 M, \$1.0 M of this cost being constituted of shares of the capital stock of the corporation, and fixed assets amounting to \$6 M with a \$2.5 M appraisal increase credit.

Computation of the assets of Co. X for its fiscal period ending on April 30, 1990, for the purposes of computing the credit provided for in section 1029.7.2 of the Act in respect of its fiscal period ending on April 30, 1991:

Assets	\$27,0 M
- Appraisal increase credit	- \$2,5 M
- Portion of the cost amount of goodwill constituted of a share of the capital stock of the corporation	<u>- \$1,0 M</u>
Assets for the purposes of section 1029.7.2 of the Act	\$23,5 M

Since the assets for the purpose of computing the credit are less than \$25 M, Co. X qualifies for the 40% tax credit provided for in section 1029.7.2 of the Act, if it fulfils all the other related conditions. At any rate, it should be noted that the net shareholders' equity shown in its books and financial statements submitted to the shareholders for its 1990 taxation year is no more than \$10 M (the net shareholders' equity of Co. X is, according to the facts presented in this example, \$6.0 M).

3. In accordance with section 1029.7.4 of the Act, and for the purposes of section 1029.7.2 of the Act, the assets of a corporation that is associated in a taxation year with one or more other corporations is equal to the amount by which the aggregate of the assets of the corporation and of each corporation associated with it, as determined under sections 1029.7.2 and 1029.7.3 of the Act, exceeds the aggregate of the amount of investments the corporations own in each other and the balance of accounts between the corporations.

Example 2

The following facts add themselves to the facts of Example 1. Co. X is associated with a corporation controlled by residents of the United States (Co. W). Co. X owns \$0.5 M investments in shares and \$0.5 M investments in loans and advances in Co. W and the balance of accounts between the corporations is \$0.5 M. Co. W's assets at the end of its preceding taxation year determined in accordance with sections 1029.7.2 and 1029.7.3 of the Act is \$4 M.

Computation of the assets of Co. X for its fiscal period ending on April 30, 1990, for the purposes of computing the credit provided for in section 1029.7.2 of the Act in respect of its fiscal period ending on April 30, 1991:

<u>The amount by which</u>		
- Co. X assets	\$23,5 M	
plus		
- Co. W assets	<u>+ \$4,0 M</u>	
	\$27,5 M	\$27,5 M
<u>exceeds</u>		
- Co. X investments	\$1,0 M	
plus		
- balance of accounts between the corporations	<u>+ \$0,5 M</u>	
	\$1,5 M	<u>- \$1,5 M</u>
Co. X assets for the purposes of section 1029.7.2 of the Act		\$26,0 M

Since the assets of Co. X are not less than \$25 M, it must be ascertained whether Co. X otherwise qualifies for the increase of the tax credit provided for in section 1029.7.2 of the Act to 40%.

4. In accordance with section 1029.7.5 of the Act and for the purposes of section 1029.7.2 of the Act, the net shareholders' equity of a corporation that is associated in a taxation year with one or more other corporations is equal to the amount by which the aggregate of the net shareholders' equity of the corporation and of each corporation associated with it, as determined under sections 1029.7.2 and 1029.7.3 of the Act, exceeds the amount of investments in shares the corporations own in each other.

Example 3

The following fact adds itself to the facts of examples 1 and 2. The net shareholders' equity of Co. W at the end of its preceding taxation year determined in accordance with sections 1029.7.2 and 1029.7.3 of the Act is \$3.0 M.

Computation of the net shareholders' equity of Co. X for its fiscal period ending on April 30, 1990, for the purposes of computing the credit provided for in section 1029.7.2 of the Act in respect of its fiscal period ending on April 30, 1991:

The amount by which

Net shareholders' equity of Co. X	\$9,5 M	
- Appraisal increase credit	- \$2,5 M	
-Portion of the cost amount of the goodwill constituted of a share of the capital stock of the corporation	<u>- \$1,0 M</u>	
Net shareholders' equity of Co. X as computed under section 1029.7.3 of the Act	\$6,0 M	\$6,0 M
plus		
- Net shareholders' equity of Co. W		<u>+ \$3,0 M</u>
		\$9,0 M
<u>exceeds</u>		
- Amount of the investments in shares of Co. X in Co. W		<u>- \$0,5 M</u>
Net shareholders' equity of Co. X for the purposes of section 1029.7.2 of the Act		\$8,5 M

Since the net shareholders' equity of Co. X is less than \$10.0 M, Co. X qualifies for the 40% credit provided for in section 1029.7.2 of the Act if it fulfils all the other related conditions.

5. Where, in a taxation year, a corporation or a corporation associated with it, reduces, by a transaction, its assets or the net shareholders' equity and where, but for that reduction, the corporation would not be contemplated in section 1029.7.2 of the Act, those assets are or that net shareholders' equity is, as the case may be, deemed, in accordance with section 1029.7.6 of the Act and for the purposes of sections 1029.7.2 to 1029.7.5 of the Act, not to have been so reduced, except if the Minister decides otherwise.

Expenditure Limit and Apportionment among the Associated Corporations

6. In accordance with section 1029.7.7 of the Act and for the purposes of section 1029.7.2 of the Act, the expenditure limit of a corporation for a taxation year is equal to \$2 000 000, except where the corporation is associated in the year with one or more other corporations that are not controlled, directly or indirectly, in any manner whatever by one or more persons not resident in Canada, in which case, subject to sections 1029.7.8 to 1029.7.10 of the Act, its expenditure limit for the year is nil.

Notwithstanding section 1029.7.7 of the Act, where all of the corporations that are not controlled, directly or indirectly, in any manner whatever by one or more persons not resident in Canada and that are associated with each other in a taxation year have filed with the Minister, in prescribed form, an agreement whereby, for the purposes of section 1029.7.2 of the Act, they allocate an amount to one or more of them for the taxation year and the amount or the aggregate of the amounts so allocated, as the case may be, equals \$2 000 000, the expenditure limit for the year of each of the corporations is, in accordance with section 1029.7.8 of the Act, equal to the amount so allocated to it.

If any of the corporations that are not controlled, directly or indirectly, in any manner whatever by one or more persons not resident in Canada and that are associated with each other in a taxation year fails to file with the Minister an agreement as contemplated in section 1029.7.8 of the Act, within thirty days after notice in writing by the Minister is forwarded to any of them that such an agreement is required for the purpose of any assessment of tax under Part I of the Act, the Minister shall, for the purposes of section 1029.7.2 of the Act, allocate an amount to one or more of them for the taxation year, which amount or the aggregate of which amounts, as the case may be, shall equal \$2 000 000, and in any such case, notwithstanding section 1029.7.7 of the Act, the expenditure limit for the year of each of the corporations equals the amount so allocated to it.

Notwithstanding any other provision contained in sections 1029.6.1 to 1029.8.0.2 of the Act:

- (a) in accordance with paragraph *a* of section 1029.7.10 of the Act, where a corporation that is not controlled, directly or indirectly, in any manner whatever by one or more persons not resident in Canada (the “first corporation”), has more than one taxation year ending in the same calendar year and it is associated in two or more of those taxation years with another such corporation that has a taxation year ending in that calendar year, the expenditure limit of the first corporation for each taxation year in which it is associated with the other corporation ending in that calendar year is, subject to paragraph *b* of section 1029.7.10 of the Act, an amount equal to its expenditure limit for the first such taxation year determined without reference to paragraph *b* of the said section 1029.7.10 of the Act; and
- (b) in accordance with paragraph *b* of section 1029.7.10 of the Act, where a corporation that is not controlled, directly or indirectly, in any manner whatever by one or more persons not resident in Canada for a taxation year that is less than 51 weeks, its expenditure limit for the year is that proportion of its expenditure limit for the year determined without reference to that paragraph *b* of the said section 1029.7.10 of the Act that the number of days in the year is of 365.