

Income Tax

IMP. 772-1/R2 Foreign tax credit for a corporation

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Reference(s): *Taxation Act* (R.S.Q., c. I-3), ss. 146.1, 771, 772.6, 772.7 and 772.12
Regulation respecting the Taxation Act (R.R.Q., 1981, c. I-3, r.1, as amended),
ss. 771R1, 771R2 and 771R3

This version of bulletin IMP. 772-1 supersedes the version of January 24, 1983. The bulletin was revised to take into account amendments made to fiscal legislation and to explain certain aspects of the legislation.

This bulletin states the policy of the Ministère du Revenu du Québec concerning the foreign tax credit that a corporation resident in Canada that carries on a business in Québec at any time in the taxation year may deduct from the tax otherwise payable.

APPLICATION OF THE ACT

GENERAL

1. Section 772.6 of the *Taxation Act* (TA) deals with the foreign tax credit that a corporation resident in Canada that carries on a business in Québec at any time in a taxation year may deduct from the tax otherwise payable for that year. This credit applies only in respect of the tax on income or profits paid by the corporation to the government of a foreign country or of a political subdivision of a foreign country on its non business income from sources in that foreign country.

FOREIGN TAX CREDIT

2. Paragraph *b* of section 772.6 of the TA indicates how to compute the foreign tax credit that may be deducted by such a corporation. The deduction is, however, limited by the second paragraph of section 772.7 of the TA.

3. The purpose of paragraph *b* of section 772.6 of the TA is to allow a corporation to deduct, in computing its tax payable, the portion of the foreign tax it paid on its non-business income which cannot be deducted from its federal tax payable due to the fact that the amount of the latter taken into consideration in computing the federal foreign tax credit relating to the corporation's

non-business income is reduced by the provincial abatement deducted by the corporation pursuant to section 124 of the *Income Tax Act* (R.S.C., 1985, c. 1 (5th Supp.)); hereinafter the “ITA”).

4. Under paragraph *b* of section 772.6 of the TA, the amount of the foreign tax credit relating to the non-business income of a corporation which may be deducted by the corporation from the tax otherwise payable is equal to the amount by which the deduction that would be granted to the corporation under subsection 1 of section 126 of the ITA, if the provincial abatement deducted were not taken into account in computing the deduction, exceeds the actual deduction granted to the corporation under that subsection. The amount is deductible in the proportion that the corporation’s business carried on in Québec is of its business carried on in Canada, computed in the manner prescribed in the regulations made under section 771 of the TA, with the necessary modifications (see point 6 below).

5. Along the same lines, paragraph *b* of section 772.6 of the TA also provides that the rate of 30% under subsection 4.2 of section 126 of the ITA must be replaced by a rate of 40%. That subsection includes a special rule that limits the federal foreign tax credit, in certain circumstances, by applying a fictitious foreign tax rate of 30% (that is, the rate of 40% reduced by the provincial abatement of 10% provided for in section 124 of the ITA) to certain non-business income. However, since the purpose of the foreign tax credit computation under paragraph *b* of section 772.6 of the TA is to determine the portion of the foreign tax which, due to the provincial abatement, cannot be deducted from the federal tax payable, it is first necessary to change the post-abatement rate of 30% to the pre-abatement rate of 40%.

6. The proportion of business to which paragraph *b* of section 772.6 of the TA refers is determined in the manner prescribed in Title XX of the *Regulation respecting the Taxation Act* (RTA), with the necessary modifications. Thus, where all the establishments of a corporation are in Québec, its business is deemed to be carried on totally in Québec, under section 771R1 of the RTA; conversely, where a corporation has no establishment in Québec, its business is deemed to be carried on totally outside Québec. Finally, subject to the special rules applicable to certain types of businesses and to foreign corporations, where a corporation has establishments in Québec and outside Québec, the proportion that its business carried on in Québec is of its business carried on in Canada is, for the year, pursuant to section 771R3 of the RTA with the necessary modifications, one half of the aggregate of

- (a) the proportion that its gross revenue for the year reasonably attributable to its establishment or establishments in Québec is of its total gross revenue for the year attributable to its establishments in Canada; and
- (b) the proportion that the salaries and wages paid by the corporation in the year to the employees of its establishment or establishments in Québec is of the total salaries and wages paid by the corporation in the year to the employees of its establishments in Canada.

Maximum credit

7. The second paragraph of section 772.7 of the TA provides for the maximum foreign tax credit that a corporation may deduct under paragraph *b* of section 772.6 of the TA for a taxation year in

relation to a foreign country. The amount that may be deducted by the corporation must not exceed 10% of the proportion (that is, the proportion that the corporation's business for the year carried on in Québec is of its business carried on in Canada or in Québec and elsewhere) of its net foreign non-business income, computed on the basis of certain assumptions. That proportion is determined in the manner prescribed in the regulations made under section 771 of the TA (see point 9 below).

8. For the purposes of the maximum credit, a corporation's net foreign non-business income is the amount for the year by which the total of the corporation's income exceeds the total of the corporation's losses, from sources situated in the foreign country in question, computed in accordance with the TA

- (a) on the assumption that no businesses were carried on by the corporation in the foreign country through an establishment situated in that country;
- (b) without taking into account any income from shares of the capital stock of a foreign affiliate of the corporation;
- (c) without taking into account any portion of income that is deductible under section 737.14 of the TA by the corporation in computing the corporation's taxable income for the year (deduction relating to the operations of an international financial centre); and
- (d) without taking into account any income or loss from a source situated in the foreign country, if any income of the corporation from the source would be tax-exempt income.

One of the reasons for applying the limitations in computing the net foreign non-business income is so that the foreign tax credit cannot be claimed in respect of foreign income that is not subject to tax.

9. In order to determine the maximum foreign tax credit that may be claimed, the proportion to be applied to the net foreign non-business income is determined in the manner prescribed in Title XX of the RTA. Thus, where all the establishments of a corporation are in Québec, its business is deemed to be carried on totally in Québec, under section 771R1 of the RTA; conversely, where a corporation has no establishment in Québec, its business is deemed to be carried on totally outside Québec. Finally, subject to the special rules applicable to certain types of businesses and to foreign corporations, where a corporation has establishments in Québec and outside Québec, the proportion that its business carried on in Québec is of its business carried on in Québec and elsewhere is, for the year, pursuant to section 771R3 of the RTA, one half of the aggregate of

- (a) the proportion that its gross revenue for the year reasonably attributable to its establishment or establishments in Québec is of its total gross revenue for the year; and
- (b) the proportion that the salaries and wages paid by the corporation in the year to the employees of its establishment or establishments in Québec is of the total salaries and wages paid by the corporation in the year.

COMPUTING THE CREDIT

10. In short, paragraph *b* of section 772.6 and the second paragraph of section 772.7 of the TA apply by determining the lesser of the following amounts:

(a) for the purposes of paragraph *b* of section 772.6 of the TA, the amount equal to such proportion, as is represented by the proportion that the business carried on in Québec is of the business carried on in Canada, of the amount by which the lesser of A or B exceeds C, where

A is the foreign tax paid (adjusted as indicated in point 5 above, where applicable);

B is the proportion that the net foreign non-business income, computed under the ITA, is of the total net income, computed under the ITA, multiplied by the federal income tax payable before the provincial abatement (see section 124 of the ETA); and

C is the amount of the foreign tax credit granted under the ITA; or

(b) for the purposes of the second paragraph of section 772.7 of the TA, the amount equal to 10% of the net foreign non-business income, computed under the TA, multiplied by the proportion that the business carried on in Québec is of the business carried on in Québec and elsewhere.

11. Where a corporation deducts an amount under section 146.1 of the TA in computing its income, that amount must be deducted from the foreign tax paid, represented by the letter A in the computation set out in point 10.

12. Where a corporation, in determining its federal tax payable, elects to deduct an amount as a foreign tax credit that is less than the credit amount to which it is entitled under subsection 1 of section 126 of the ITA, the Québec foreign tax credit must be computed in the manner indicated in point 10 of this bulletin without taking into account of the amount claimed by the corporation under the ITA. In other words, the letter C in the computation refers to the amount of the federal foreign tax credit the corporation is allowed to deduct from its income, not to the amount it actually deducts.

13. Where a corporation does not have sufficient tax payable for a particular taxation year to be able to deduct the full amount of the foreign tax credit computed in the manner indicated in point 10 of this bulletin, it may carry over the portion of the credit that was not deducted and deduct it for other taxation years, to the extent permitted under section 772.12 of the TA.