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The Joint Committee on Taxation of
The Canadian Bar Association
and

The Canadian Institute of Chartered Accountants

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June 1, 2007

Mr. Brian Ernewein
General Director
Tax Policy Branch
Department of Finance
17 Floor, East Tower
140 O'Connor Street
OTTAWA K1A 0G5

Dear Mr. Ernewein:

Proposed Amendments to Foreign Affiliate Rules

We are writing to reiterate a request we have previously made that the proposed amendments to the foreign affiliate rules be split into two packages. This would enable the technical and other non-controversial amendments to be enacted at the earliest opportunity while consultations continue on certain of the more substantive amendments. This course of action would partially alleviate the difficulties and uncertainties that taxpayers are facing as a result of the continuing delay in the implementation of these proposed amendments.

Proposed Amendments

There are three sources of proposed amendments to the foreign affiliate rules. The principal source is the draft legislation released on February 27, 2004. The proposed amendments contained in this draft legislation (the "**February 2004 amendments**") are a revised and expanded version of the proposed amendments that were released on December 20, 2002. Once enacted, most of these proposed amendments will apply to past taxation years. Many of the amendments are to be effective for taxation years that begin after December 20, 2002 or for transactions that occur after that date. Some of the amendments apply to taxation years beginning after 1995, and so for some taxpayers they first apply to taxation years that have ended more than 10 years ago.

The second source of the proposed amendments is the more than 20 comfort letters that the Department of Finance has issued since February 27, 2004. These letters describe remedial changes to the February 2004 amendments that the Department intends to recommend.

Lastly, the 2007 federal budget announced additional specific changes to the foreign affiliate rules. The budget documents also indicated that the February 2004 amendments will be reviewed and evaluated in light of the budget's international tax measures, "to ensure the appropriate functioning of the system at a technical as well as a policy level."

Difficulties for Taxpayers

The continuing overhang of proposed amendments to the foreign affiliate rules creates significant difficulties and burdens for taxpayers.

For planning purposes, taxpayers generally take into account proposed amendments to the income tax rules. On the other hand, under Canadian generally accepted accounting principles (GAAP) a proposed change in tax law cannot be taken into account for purposes of tax provisions in financial statements until the change is “substantively enacted.” An amendment to the *Income Tax Act* is considered to be “substantively enacted” when a bill containing the amendment has received first reading in the House of Commons (third reading if there is a minority government). An amendment to the *Income Tax Regulations* is not considered to be “substantively enacted” until it is actually enacted. To date, none of the proposed amendments to the foreign affiliate rules are substantively enacted.

Consequently, taxpayers must undertake two sets of analyses in connection with material transactions to which the proposed amendments apply. For planning purposes, they will determine the tax consequences giving effect to the amendments. For financial statement purposes, however, they must determine the tax consequences on the basis of current law. Thus, the current situation results in taxpayers being saddled with additional burden and expense.

Further, the fact that the amendments continue to be at the proposal stage means that financial statements do not reflect “tax reality.” The financial information provided to shareholders is based on legislative provisions that, in all likelihood, will not be the provisions that govern particular transactions.

An additional problem—and a particularly important one—is that the planning and implementation of some transactions can be difficult and uncertain because of the need to rely on draft legislation that is subject to change, comfort letters that do not provide sufficient details, and informal discussions with Finance officials.

The current situation also creates difficulties with respect to tax returns. Taxpayers must determine whether to prepare their tax returns on the basis of current law or the proposed amendments. If they rely on current law, revised returns will have to be prepared once amendments to the foreign affiliate rules are enacted. Revised returns may also be required even where the proposed amendments have been anticipated, if the amendments that are actually made differ from those that were proposed. The preparation of revised returns imposes a further burden on taxpayers. Moreover, taxpayers may not be able to file revised returns for taxation years that have become statute barred, unless waivers have been provided to the CRA.

Recommendation

To partially alleviate the above difficulties faced by taxpayers, we recommend that the proposed amendments to the foreign affiliate rules be split into two sets of amendments. One set would consist of the amendments that have been fully considered and are ready to be enacted. These are amendments for which the policy basis and the form of the amendments are clear. Amendments to the *Income Tax Act* that are in this set would be included in the next tax bill. Concurrently, the necessary steps would be taken to implement the amendments to the *Income Tax Regulations* that are in this set. The second set of amendments would consist of amendments that remain controversial, or that otherwise require further consideration and consultation. These would be set out in draft legislation that would provide a basis for further discussions and submissions.

We have previously made this recommendation in a letter to you dated October 8, 2004 and in a letter to the Minister of Finance dated April 25, 2006. We are making the recommendation again because of the continued delay in the enactment of the amendments as well as the likelihood that a significant amount of time may be required to resolve certain of the amendments (including new amendments that we understand are to be released).

The table included with this letter indicates which of the proposed amendments we think should be included in each set of amendments. The amendments marked as technical changes (retroactive or prospective) are the amendments that we believe should be proceeded with now.¹ The remaining amendments—those marked as policy changes—are the amendments that, in our view, require further consultation. In a few cases, amendments are shown as both technical and policy changes. To the extent that the technical aspect of an amendment can be separated from the policy aspect, the technical aspect would be included in the first set of amendments.

In general, amendments have been categorized as policy changes if they relate to or involve suspended surplus, foreign paid-up capital or the subsection 93(1) election. Most other amendments have been categorized as technical changes.

The Joint Committee would be pleased to meet with you and your colleagues to discuss this recommendation and to further assist with identifying which of the proposed amendments are suitable for enactment now.

Yours truly,



Bruce Harris, CA
Chair, Taxation Committee
Canadian Institute of Chartered Accountants



William R. Holmes
Chair, Taxation Section
Canadian Bar Association

c: Wallace Conway, Tax Legislation Division, Department of Finance
Gerard Lalonde, Tax Legislation Division, Department of Finance

¹ Technical amendments have been categorized as retroactive if (i) they have an effective date that is before they were first announced (in draft legislation or in a comfort letter), or (ii) the taxpayer can elect to have the amendments apply retroactively. The remaining technical amendments have been categorized as prospective.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
88(3)	Proposed subsection 88(3) is expanded to cover “distributions” of property that arise outside of the liquidation context, by any foreign affiliate (not just controlled foreign affiliates of a taxpayer). Comfort Letters – April 12, 2006 and June 9, 2006		✓ ¹	✓	Property received after February 27, 2004, although it is anticipated that they will not be available for distributions after the next announcement date of changes including distributions/liquidations not completed prior to the next announcement date. Taxpayers can opt out of these February 27, 2004 proposals and, in the case of a liquidation and dissolution, into the Qualifying Liquidation and Dissolution (“QLD”) rules and, in the case of other new 88(3) transactions, into the new 88(3) regime for distributions after February 27, 2004.			
92(1.1) to (1.4)	Due to the new rules regarding the reduction of surplus balances and the elimination of deficit balances as a result of a 93(1) election, 92(1.1) to (1.4) adjust the ACB of the shares of FAs by a corresponding amount.		✓		Generally, apply to 93(1) or (1.2) elections in respect of dispositions that occur after December 20, 2002. (Subject to certain exceptions.)			
93(1)(a), (1.1) and (1.2)(a)(i)	The elected amount pursuant to proposed 93(1)(a) cannot exceed the lesser of the proceeds of disposition and the consolidated net surplus of the disposed foreign affiliate. Proposed 93(1.1) will no longer require the disposed FA shares to be excluded property.		✓		Dispositions that occur after December 20, 2002. (Subject to certain exceptions.)			

¹ Policy change insofar as the tax consequence of distributions is based on the FPUC concept. The changes to this provision should be passed into law as soon as possible except to the extent that the change relates to the FPUC concept.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
	Proposed subparagraph 93(1.2)(a)(i) limits the elected amount to the capital gain and the consolidated net surplus of the disposed foreign affiliate. Comfort Letter – April 19, 2006							
93(1.2) pre-amble	Minor change – requires the election to be filed within “the prescribed time”.	✓			Dispositions that occur after November 1999.			
93(1.4)	No subsection 93(1) or (1.2) election may be made if any of the following applies: 88(3)(a), 95(2)(d)(i), (d.1)(i), (e)(i), (e.1)(i), (e.2)(i), (e.3)(i), (e.4)(i) and (e.5)(i).		✓		Dispositions that occur after February 27, 2004.			
93(2), 93(2.1), 93(2.2) and 93(2.3)	Subsection 93(2) provides that a loss from the disposition of a share of a FA is deemed to be nil to the extent that the shareholder previously received “exempt dividends”. Subsection 93(2) will be amended to permit a loss on the FA shares to the extent that there is a corresponding FX gain in Canada. Similar to subsection 93(2), subsections 93(2.1)-(2.3) are being amended to permit a loss on the partnership interest to the extent that there is a corresponding FX gain in Canada.			✓	Taxation years of FA that begin after February 27, 2004.	✓		
93.1	The April 19/06 comfort letter proposes to amend subsection 93.1(1) such that it will apply for purposes of subsection 95(2.2). Paragraphs 95(2.2)(a) and (b) are to be amended so that the expression “person” in subparagraphs 95(2)(a)(i) and (b)(i) is replaced by the expression “person or partnership”.	✓			Taxation years of FA that end after 1999.			

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	Further, subsection 93.1 is to be modified so that subsection 93.1(2) applies to multi-tiered partnerships (i.e., where a partnership is itself a member of another partnership).				Applies for dividends received after November 1999.			
95(1) "controlled foreign affiliate"	Most significant change is the way the control test is to be applied to a group. Former test required a certain "group of persons" controlling the FA. Proposed change requires the shareholdings of a taxpayer, non-arm's length persons, up to four other Canadian residents and any persons that are non-arm's length to those Canadian residents to be notionally aggregated.			✓	Three separate definitions for the following periods: -taxation years of FA that begin after 1995 and before 2003; -taxation years of FA that begin after 2002 and on or before February 27, 2004; -taxation years of FA that begin after February 27, 2004.			
95(1) "entity"	This new definition is relevant for proposed new subsection 95(3.6).		✓		Taxation years of FA that end on or after December 20, 2002.			
95(1) "excluded property" (a), (c) and (c.1)	Definition is clarified and broadened to characterize additional types of property as excluded property.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
95(1) "excluded property" (b)	Specifies that fair market value should be used in determining whether the shares of a FA are excluded property.			✓	Taxation years of FA that begin after December 20, 2002.			
95(1) "foreign accrual property income" ("FAPI")	Changes to FAPI formula (revised B and E). B is revised: (1) to exempt from FAPI, gains and losses of excluded property that are not capital property; and (2) deems there to be FAPI where the taxpayer elects to have a gain where a provision would otherwise provide for a rollover. E is revised to remove the reference to paragraphs 95(2)(c), (d) and (e).	✓ related to E	✓ related to B		Taxation years of FA that begin after December 20, 2002.			

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		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(1) "investment business" (a)(i)	Proposed subparagraph (a)(i) of the "investment business" definition (which deals with banks, trust companies, credit unions, insurance companies and brokers), is expanded to provide more opportunities to meet the regulation requirement.	✓			Taxation years of FA that begin after 1999.			
95(1) "investment business" Pre-amble of (b), (b)(ii)(B) and (C), post-amble (b)(ii)	Amendment expands the 5-employee exception in the investment business definition.	✓			Taxation years that end after 1999.		✓	
95(1) "taxable Canadian business"	New definition for new paragraphs 95(2)(j.1), (k), (k.2) and (k.4).	✓			Taxation years of FA that begin after December 20, 2002.			✓
95(2)(a)	The proposed amendment will extend the 95(2)(a) recharacterization rules to apply to situations where the taxpayer is related to the foreign affiliate but will not apply to the proposed NRT and FIE rules.			✓	Taxation years of FA that begin after December 20, 2002.			
95(2)(a)(i)(A)	The July 17/06 comfort letter expands the scope of clause 95(2)(a)(i)(A) to apply not only where the payer foreign corporation is related to the recipient FA and the taxpayer but also where the payer foreign corporation is a FA of the taxpayer to which the recipient is related and in respect of which the taxpayer has a qualifying interest.	✓			Taxation years of FA that end after 2005.			
95(2)(a)(i)(A)(II) and (B)(II)	Amendments will accommodate the use of a foreign affiliate of the insurer, a taxpayer who controls the insurer or taxpayer that is controlled by the insurer.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
95(2)(a)(ii)(A)(II), (B)(II), (C)	Permits 95(2)(a)(ii) recharacterization rules to apply where the affiliate is "qualifying member" of a partnership. "Qualifying member" is defined in proposed 95(2)(o).	✓			Taxation years of FA that begin after December 20, 2002.		✓	

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	The April 19/06 comfort letter clarifies the references to “year” in subclauses 95(2)(a)(ii)(A)(I) and (II) to mean a taxation year of the non-resident corporation or the partnership, as the case may be. The other uses of the expression “the year” in clause 95(2)(a)(ii)(A) would remain as references to “the year” of the particular affiliate. Such clarifying modifications would apply in various other clauses in subparagraph 95(2)(a)(ii) and in various provisions in subparagraph (d)(ii) of the definition “exempt earnings”, and subparagraph (c)(ii) of the definition “exempt loss”, in subsection 5907(1) of the Regulations.							
95(2)(a)(ii)(D)	<p>The amendments to the conditions for application of Clause D are intended to eliminate barriers that currently impede the provision’s operation where a FA (Second Affiliate) borrows to acquire shares of another FA (Third Affiliate).</p> <p>The Oct. 13/06 comfort letter expands the scope of 95(2)(a)(ii)(D) to apply not only where the Second Affiliate is related to the recipient FA and the taxpayer, but also where the Second Affiliate is a FA of the taxpayer to which the recipient FA is related and in respect of which the taxpayer has a qualifying interest. The proposed change is effective for taxation years of FA that begin after February 27, 2004.</p>	✓			Taxation years of FA that begin after December 20, 2002.	✓		
95(2)(a)(ii)(E)	<p>Refer to section 95(2)(a)(i)(A)(II) and (B)(II).</p> <p>The July 17/06 comfort letter proposes to amend paragraph 95(2)(a.3) to ensure that it will not deny active business income treatment to income (in respect of the taxpayer’s foreign insurance business) that is deemed to be from an active business under 95(2)(a)(ii)(E).</p>	✓			<p>Taxation years of FA that begin after December 20, 2002.</p> <p>Comfort letter – taxation years of FA that end after February 27, 2004.</p>		✓	
95(2)(a)(v) and (vi)	95(2)(a)(v) deems income/loss derived from the disposition of excluded property that is non-capital property to be income/loss from an active business.	✓			Taxation years of FA that begin after December 20, 2002.		✓	

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	95(2)(a)(vi) deems income/loss derived as a result of an agreement in relation to a foreign currency exposure in respect of a 95(2)(a) deemed amount to be income/loss from an active business.							
95(2)(a.1)(i)	Adds to a FA's income from a business other than an active business (i.e., its FAPI). Applicable to a FA's income from the sale of property. No significant changes (one new defined term) to the proposal in the February 27, 2004 draft legislation.	✓			Taxation years of FA that begin after December 20, 2002.	✓		
95(2)(b)	Scope of services provided by a FA (formerly CFA requirement) will be deemed to be FAPI.			✓	Taxation years of FA that begin after December 20, 2002. (Transitional rules apply for taxation years of FA that begin after December 20, 2002 and on or before February 27, 2004.)			
95(2)(c.1) to (c.6)	New paragraphs 95(2)(c.1) to (c.6) introduce a rule that essentially suspends the recognition of a capital gain arising from the internal disposition of FA shares that are excluded property until a "triggering disposition" occurs.		✓		Dispositions that occur after December 20, 2002.	✓ ²		

² Election causes a different version to apply.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(2)(d)	Relieving changes are proposed for paragraph 95(2)(d.1). Provided the foreign merger occurs on a rollover basis, the merging FAs will be deemed to have disposed of all of their property on a rollover basis.		✓ ³	✓	Foreign mergers that occur after February 27, 2004.			
95(2)(d.1)	<p>Proposed paragraph (n) of the definition of “disposition” under subsection 248(1) will deem there to be no disposition arising from the cancellation of the sub FA shares if there is an upstream merger.</p> <p>Proposed 95(2)(d) will provide for rollover treatment in respect of the disposition of the excluded property assets of the merging FAs. All other properties will be deemed to be disposed of at fair market value. Proposed paragraph 95(2)(d) will also provide a rollover of the shares of the merging FA shares if they are excluded property immediately before the merger.</p> <p>Finance issued a comfort letter (dated June 9, 2006) proposing additional relieving changes to paragraph 95(2)(d.1). The requirement for no gain/loss under foreign tax law will be removed. Accordingly, the proposed merger will result in a rollover of the assets of the merging FAs into the merged FA and a rollover in respect of the disposition of the merging FA shares if these shares become shares of the merged FA, which are worth at least 90% or more of the total fair market value of the merging FA shares. This change is supposed to be effective for foreign mergers beginning after December 20, 2002.</p>		✓ ⁴	✓	Foreign mergers that occur after December 20, 2002.			

³ Policy change insofar as the tax consequence is based on the FPUC concept. The changes to this provision should be passed into law as soon as possible except to the extent that the change relates to the FPUC concept.

⁴ Ibid.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(2)(e)	<p>Proposed 95(2)(e) will provide for rollover treatment in respect of the disposition of the excluded property assets of the liquidating FA. All other properties will be deemed to be disposed of at fair market value.</p> <p>Changes for proposed paragraph 95(2)(e.1) are relieving in nature such that an inside rollover of all assets (as opposed to only capital assets) of the liquidating foreign affiliate will apply.</p> <p>Finance issued a comfort letter (dated April 12, 2006) proposing additional relieving changes to paragraph 95(2)(e.1). The requirement for no gain/loss under foreign tax law will be removed. Therefore, the liquidation of a foreign affiliate will receive inside and outside rollover treatment if the Canadian taxpayer has at least a 90% surplus entitlement percentage in the liquidating foreign affiliate or 90% or more of the properties of the liquidating foreign affiliate will be distributed to its foreign affiliate parent. The additional relieving changes to paragraph 95(2)(e.1) apply to liquidations that begin after December 20, 2002, except if the taxpayer makes an election that applies in respect of all liquidations of its FAs. If an election is made, the proposals issued on February 27, 2004 would apply.</p> <p>Comfort Letters - April 12, 2006 and June 9, 2006</p>		✓ ⁵	✓	Liquidations that begin after February 27, 2004.			
95(2)(e.1)	<p>Finance issued a comfort letter (dated April 12, 2006) proposing additional relieving changes to paragraph 95(2)(e.1). The requirement for no gain/loss under foreign tax law will be removed. Therefore, the liquidation of a foreign affiliate will receive inside and outside rollover treatment if the Canadian taxpayer has at least a 90% surplus entitlement percentage in the liquidating foreign affiliate or 90% or more of the properties of the liquidating foreign affiliate will be distributed to its foreign affiliate parent. The additional relieving changes to paragraph 95(2)(e.1) apply to liquidations that begin after December 20, 2002, except if the taxpayer makes an election that applies in respect of all liquidations of its FAs. If an election is made, the proposals issued on February 27, 2004 would apply.</p> <p>Comfort Letters - April 12, 2006 and June 9, 2006</p>		✓ ⁶	✓	Liquidations that begin after December 20, 2002.			
95(2)(e.2)	<p>New paragraph 95(2)(e.2) provides that a redemption, acquisition or cancellation of the shares of FA will be treated as a liquidation and a dissolution.</p>		✓		Redemptions, acquisitions, cancellations of shares that occur after February 27, 2004.			

⁵ Policy change insofar as the tax consequence is based on the FPUC concept. The changes to this provision should be passed into law as soon as possible except to the extent that the change relates to the FPUC concept.

⁶ Ibid.

Summary of February 27, 2004 FA Amendments and Comfort Letters

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		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(2)(e.3) to (e.6)	<p>New paragraphs 95(2)(e.3) to (e.6) put into place a regime that is intended to provide rollover treatment for dispositions of excluded property of the FA to a <i>specified purchaser</i> (defined in new subsection 95(3.2)) via distributions or redemptions.</p> <p>New paragraph 95(2)(e.6) provides a look-through rule for the purposes of applying subparagraphs 95(2)(e) and (e.3) to (e.5) where a partnership is involved.</p> <p>Comfort Letter – June 6, 2006</p>		✓		A receipt, after February 27, 2004, by a specified purchaser in respect of the corporation resident in Canada from a FA of the corporation of property as a dividend or distribution in respect of a share of the FA, or as consideration in respect of a redemption, purchase or acquisition of a share of the FA.			
95(2)(f) pre-amble	<p>Amended to clarify that the paragraph applies to compute FA's capital gains/losses from a disposition of property by a person or a partnership.</p> <p>Comfort Letter – September 1, 2006</p>	✓			Taxation years of FA that end after 1999.			
95(2)(f)(i)	<p>Subparagraph (i) is extended to refer to new provisions – (c.2), (d.1), (e.3) to (e.5) and (f.4).</p> <p>Comfort Letter – September 1, 2006</p>		✓ ⁷	✓	Taxation years of FA that end after December 20, 2002.			

⁷ Policy change to the extent the amendments relate to new policy proposals. The changes to this provision should be passed into law as soon as possible except where the change relates to new policy proposals.

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95(2)(f) mid-amble	The mid-amble is revised in two ways: (1) The words “at the time it last became a foreign affiliate” are deleted, and (2) The words “owned by the affiliate” are replaced with “owned by the person or partnership” Comfort Letter – September 1, 2006	✓			Taxation years of FA that begin after December 20, 2002.	✓	✓	
95(2)(f)(viii)	Reference to certain partnerships is added. Comfort Letter – September 1, 2006			✓	Taxation years of FA that begin after February 27, 2004.			
95(2)(f.1)	Paragraph 95(2)(f.1) does two things: 1) Income from property and income from a business other than an active business are to be computed as if the affiliate were resident in Canada, in Canadian currency. 2) Pre-acquisition income or loss is excluded. Comfort Letter – September 1, 2006			✓	Taxation years of FA that begin after December 20, 2002. (Transitional rules apply for taxation years that begin after December 20, 2002 and on or before February 27, 2004.)		✓	
95(2)(f.2)	Income or loss of an FA from the disposition of non-capital excluded property is to be computed in the calculating currency of the FA, unless any of 95(2)(d) to (e.1), (e.3) to (e.5), (f.4) or 88(3)(a) applies to the disposition.			✓	Taxation years of FA that begin after December 20, 2002.		✓	
95(2)(f.3) to (f.9)	New paragraphs 95(2)(f.3) to (f.9) suspend the recognition of income or a capital gain from the disposition of excluded property (other than shares of a foreign affiliate) in an internal disposition. The rules essentially replace existing Regulation 5907(5.1). Comfort Letter – June 6, 2006		✓		Dispositions of property that occur after February 27, 2004.			

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95(2)(f.91), (f.92), (f.93)	New paragraphs 95(2)(f.91) to (f.93) introduce rules relating to the determination of the cost of eligible capital property, and the capital cost and the undepreciated capital cost of depreciable capital property of a non-resident corporation that becomes a FA of a taxpayer resident in Canada for the purposes of computing the FA's FAPI.			✓	In respect of non-resident corporations that become FAs after February 27, 2004.			
95(2)(f.94)	New paragraph 95(2)(f.94) provides that, for the purposes of paragraphs 95(2)(f.5) and (f.91) to (f.93), if the "specified" affiliate has been wound up or merged, the foreign parent corporation or the new foreign corporation, as the case may be, is deemed to be the same corporation as the specified affiliate.		✓		Applies after February 27, 2004.			
95(2)(g)	95(2)(g) is expanded to apply to a FA to which the taxpayer is related throughout a taxation year.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
95(2)(g.01) and (g.02)	95(2)(g.01) deems any income, loss, capital gain/loss of a FA to be nil where it is derived from the purchase, sale, or exchange of currency made to reduce its risk of fluctuations in the value of currency (with respect to any source, any particular income, gain/loss determined by paragraph 95(2)(g) to be nil). Proposed paragraph 95(2)(g.02) provides that, in applying subsection 39(2), the gains/losses of a FA in respect of excluded property must be computed separately from its other gains/losses.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
95(2)(h) to (h.5)	New paragraphs 95(2)(h) to (h.5) suspend the loss from the disposition of property other than depreciable property, eligible capital property and excluded property in an internal disposition until a "triggering disposition" occurs or the related purchaser ceases to be a specified purchaser.		✓		Dispositions of property that occur after February 27, 2004.			
95(2)(i)	Modification of 95(2)(i) to expand the circumstances where a gain/loss of a FA arising under subsection 39(2) is deemed to be a gain/loss from the disposition of excluded property.	✓			Taxation years of FA that begin after December 20, 2002.		✓	

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	The July 17/06 comfort letter proposes to remove the requirement that a gain or loss is to be determined in accordance with subsection 39(2). As a result, proposed 95(2)(i) will also apply to a gain or loss on income account.							
95(2)(j.1) and (j.2)	New provisions ensure that a FA that carries on an insurance business is eligible to claim certain policy reserves in computing its FAPI.	✓			Taxation years of FA that begin after December 20, 2002.			✓
95(2)(k) to (k.1)	<p>Paragraph 95(2)(k) is revised and paragraphs (k.1) to (k.7) are introduced. As a result of the changes, the rules will now apply to:</p> <ul style="list-style-type: none"> • A business carried on through a partnership; • A business deemed by paragraph 95(2)(l) to be earning income from property or by paragraph 95(2)(b) to be a business other than an active business; • A business that changes from passive to active; and • Capital gains and losses. <p>Also, the amendments clarify that the rules do not apply in the first year of operations (start-up corporations).</p> <p>Gains/losses resulting from an active to passive change are deferred until disposition.</p> <p>Gains/losses resulting from a passive to active change are included in FAPI unless the taxpayer elects to defer FAPI until disposition.</p> <p>The April 19/06 comfort letter proposes to modify subparagraph 95(2)(k.7)(i) to allow it to apply for purposes of a number of provisions (including paragraph 95(2)(o) and subclause 95(2)(a)(ii)(A)(II)) so that a person or partnership that is (or is deemed by paragraph 95(2)(k.7) to be) a member of any partnership that is a member of another partnership is deemed to be a member of that other</p>	✓			Taxation years of FA that begin after December 20, 2002 (a number of transitional rules also apply).			✓
95(2)(k.2) to (k.3)					Taxation years of FA that begin after December 20, 2002 (transitional rule also applies).			
95(2)(k.4)					Taxation years of FA that begin after December 20, 2002.			✓
95(2)(k.5) to (k.7)					Taxation years of FA that begin after December 20, 2002.			✓

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
	partnership.							
95(2)(1)(iii)	Modification to the exception from FAPI where a FA earns income from the trading or dealing in certain indebtedness.	✓			Taxation years of FA that begin after 1999.			
95(2)(n)	Proposed paragraph 95(2)(n) accommodates structures where FAs are owned via different Canadian chains of companies.	✓			Taxation years of FA that end after 1999.	✓		
95(2)(o), (p)	<p>New paragraph 95(2)(o) defines “qualifying member” for the amended “investment business” definition in subsection 95(1) and for amended subparagraph 95(2)(a)(ii).</p> <p>New paragraph 95(2)(p) defines “qualifying shareholder” for the amended “investment business” definition in subsection 95(1).</p> <p>The July 17/06 comfort letter proposes to expand the definition of “qualifying shareholder” (for purposes of the more than 5 full-time employee test in the “investment business” definition) to allow for a look-through rule not only in respect of holding partnerships and trusts (as presently found in proposed 95(2)(q)) but also in respect of holding corporations. The proposed change is effective for taxation years of FA that end after 2005.</p>	✓			Taxation years of FA that end after 1999.		✓	
95(2)(q), (r), (s), (t)	<p>New paragraph 95(2)(q) provides a look-through rule for purposes of the qualifying member (95(2)(o)) and qualifying shareholder (95(2)(p)) definitions.</p> <p>New paragraph 95(2)(r) provides a rule for attributing qualifying interest status.</p> <p>New paragraphs 95(2)(s) and 95(2)(t) define “designated corporation” and “designated partnership” for purposes of the definition of “investment business” in subsection 95(1).</p>	✓			Taxation years of FA that end after 1999.		✓	

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(2)(u), (v), (w), (x)	The proposed changes to the “controlled foreign affiliate” definition are accompanied by a series of share ownership attribution rules in new paragraphs 95(2)(u) through (x).			✓	Taxation years of FA that begin after February 27, 2004.			
95(2)(y)	New paragraph 95(2)(y) clarifies the meaning of “government of a country” for certain provisions.		✓ ⁸	✓	Applies after December 20, 2002.			
95(2.1)(c)	Subsection 95(2.1) provides a rule for the arm’s length test in paragraph (a) of the investment business definition. Paragraph (c) is amended to accommodate regulated FAs of Canadian resident life insurance companies that carry on business in a country other than the country of formation.	✓			Taxation years of FA that begin after 1999.	✓	✓	
95(2.2) preamble	Currently 95(2.2) applies for all of subsection 95(2). The pre-amble is amended to narrow its scope, by carving out (f) and (f.1). Comfort Letter – April 19, 2006	✓			Taxation years of FA that end after 1999.	✓	✓	
95(2.2)(b)	The amendment ensures that the existence of a right to acquire shares of a non-resident corporation (“NR”) referred to in 251(5)(b) that was exercised and the exercise resulted in the NR becoming related in the year to Canco would not preclude 95(2.2)(b) from deeming the non-resident to be related to Canco throughout the year. Comfort Letter – April 19, 2006	✓			Taxation years of FA that end after 1999.	✓		
95(2.21)	Subsection 95(2.21) is a companion provision to 95(2)(f.1). It prevents pre-acquisition property income from being re-characterized as active.	✓			Taxation years of FA that end after 1999.	✓	✓	

⁸ Policy change to the extent that this provision relates to new policy proposals. This provision should be passed into law as soon as possible except where 95(2)(y) relates to new policy proposals.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(2.3)(b)	Broadens the exception to the application of paragraph 95(2)(a.1).	✓			Taxation years of FA that begin after 1999.			
95(2.4)(a)	Subsections 95(2.4), (2.41), and (2.5) are broadened to include more situations encountered by financial institutions and insurance companies. These amendments allow for additional situations that will be excluded from the application of paragraph 95(2)(a.3). The July 17/06 comfort letter narrows the definitions of “excluded revenue” and “excluded income” to include only income or revenue derived from a Canadian resident in respect of the use of property outside of Canada. This change indirectly expands the 90% gross revenue exception to paragraph 95(2)(a.3). The proposed amendment is effective for taxation years of FA that begin after the announcement date of the draft legislation incorporating such amendment. However, if the taxpayer makes an election, the amendment will apply with the same coming-into-force as for these definitions.	✓			Taxation years of FA that begin after 1999.			
95(2.41)					Taxation years of FA that begin after 1999.		✓	
95(2.5) “indebtedness”, “excluded revenue” and “excluded income”						Taxation years of FA that begin after 1999.		
95(3)(c)	New paragraph 95(3)(c) deems the transmission of electronic signals or electricity along a transmission system located outside Canada to not be “services” for the purpose of paragraph 95(2)(b).	✓			Applies to 2001 and subsequent taxation years of the FA.	✓		
95(3)(d)	New paragraph 95(3)(d) deems certain types of contract manufacturing services provided by a FA to not be “services” for the purpose of paragraph 95(2)(b).	✓			Applies to 2001 and subsequent taxation years of the FA.	✓	✓	
95(3.1) “designated property”	New subsection 95(3.1) defines “designated property” for the purpose of amended subparagraph 95(2)(a.1)(i).	✓		✓	Taxation years of FA that begin after December 20, 2002.	✓		

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
95(3.2), (3.3), (3.4) and (3.5)	<p>New subsections 95(3.2) to (3.5) provide definitions for purposes of: 95(3.2), (3.3) to (3.6); 95(2)(c.1) to (c.6); (e.2) to (e.5); (f.3) to (f.9); and (h) to (h.5).</p> <p>The May 11/05 and July 17/06 comfort letters propose to modify the “specified discontinuance” and “triggering disposition” definitions to broaden the circumstances under which suspended gains/losses will be realized.</p>		✓		Apply after December 20, 2002.			
95(3.6), (3.7) and (3.8)	<p>New subsection 95(3.6) provides rules for the purposes of new paragraphs 95(2)(c.1) to (c.5), (e.3) to (e.5), (f.3) to (f.9) and (h) to (h.5) and subsections 95(3.2) to (3.5) to be used in determining if a non-resident corporation is a FA, a person, partnership, or trust.</p> <p>New subsection 95(3.7) is an anti-avoidance rule that deems a trust not to be an “exempt trust” in certain circumstances.</p> <p>New subsection 95(3.8) is an anti-avoidance rule to prevent the premature recognition of exempt surplus (the non-taxable portion of a capital gain) on an internal sale of excluded property.</p>		✓		Apply after December 20, 2002.			

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
Regulations								
5902	Limits the 93(1) election to the “consolidated net surplus” attributable to the disposed shares. Consolidated net surplus is computed by consolidating the surplus and deficit balances of the disposed affiliate and each other affiliate in which the disposed affiliate has an equity interest.		✓		Apply in respect of 93(1) or (1.2) elections for dispositions that occur after December 20, 2002. Different 5902 applies in respect of a disposition that occurs after December 20, 2002 and before February 27, 2004, if 95(2)(c.1) to (c.6) separate election filed. Transitional rules also apply.			
5905(1)	Clarification to the rule for computing surplus where the surplus entitlement percentage increases because of an acquisition of the FA shares.			✓	Applies to acquisitions after February 27, 2004.			
5905(2), (4), (5), (6)	Additional rules to reduce the surplus/deficit balances of all the FAs that have been “counted” in computing the consolidated net surplus of a FA for purposes of a 93(1) or (1.2) election. Generally, the surplus will be reduced where a surplus amount has been “used” in computing a deemed dividend or had a deficit applied against it.		✓		Applies in respect of dispositions in respect of which an election was made in respect of which proposed subsection 5902(1) applies.			
5905(5.1), (5.2), 88(1)(d.4)	Exempt/taxable surplus and UFT of a FA is reduced where the ACB of the FA shares is increased under a vertical amalgamation or wind-up in conjunction with 88(1)(d).			✓	Applies to amalgamations that occur, and windings-up that begin after December 20, 2002.			
5905(7) to (7.4)	Elevates dissolving affiliate’s surplus/deficit to foreign parent while decreasing it in dissolving affiliate.			✓	Dissolutions that occur after December 20, 2002.			

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5905(8)	For “internal” transfers, the surplus balances of all affiliates relevant to the calculation are reduced for their proportionate share of the 93(1) or (1.2) elected amount; deficits are reset to zero and reallocated among the relevant affiliates with positive surplus balances.		✓		Dispositions that occur after December 20, 2002.			
5905(16) to (23)	Refer to description for regulations 5905(2), (4), (5), (6).		✓		Apply in respect of dispositions in respect of which an election was made in respect of which proposed new subsection 5902(1) applies.			
5907(1) “earnings” subparagraph (a)(iii)	<p>May 16/05 comfort letter proposes to amend the definition such that it is read without reference to subsection 18(4) (thin capitalization rules).</p> <p>The Aug. 17/05 comfort letter indicates that the change will apply for taxation years that begin after 1994 where a taxpayer makes a Global 95 election.</p> <p>The letter also proposes another election that will allow a taxpayer to elect to have this change apply to all of its FAs for the 1976 and subsequent taxation years of the FAs.</p>	✓			Taxation years of FA that begin after December 20, 2002.	✓	✓	
5907(1) “earnings” (b)	Proposed paragraph (b) ensures that “earnings” of a FA will reflect the total of all its paragraph 95(2)(a) income/loss.			✓	Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) “exempt deficit” (b)	Modifies the existing provision to insert a reference to new subparagraph (viii) of the description of A in the definition of “exempt surplus” in Regulation 5907(1).		✓ ⁹	✓	Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) “exempt earnings” (a.1)	New paragraph (a.1) is added to include the untaxed portion of the gain from the sale of excluded property that is eligible capital property.	✓			Taxation years of FA that begin after December 20, 2002.		✓	

⁹ To the extent amendments relate to proposed changes to Regulation 5902.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5907(1) "exempt earnings" (d)(ii) [Different July 17/06 letter?]	<p>Modifications to subparagraph (d)(ii) are made to reflect proposed amendments made to paragraph 95(2)(a).</p> <p>The April 19/06 comfort letter proposes to amend the "exempt earnings" definition such that it would treat non-residents in certain circumstances as subject to tax in a given country where the entity is a flow-through entity for tax purposes in that country.</p> <p>The June 9, 2006 and July 17, 2006 comfort letters propose to modify paragraph (c) of the "excluded property" definition for purposes of clause (d)(ii)(H) to contemplate payer partnerships or payer non-resident corporations that are not foreign affiliates of the Canadian resident taxpayer.</p> <p>The July 17/06 comfort letter also proposes to amend definitions consequential to the amendments to subclause 95(2)(a)(i)(A)(II).</p>	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "exempt loss" pre-amble, (c), post-amble	<p>Consequential to the proposed amendments made to paragraph 95(2)(a). Ensures that deemed paragraph 95(2)(a) losses are included in the "exempt loss" of the affiliate.</p> <p>Minor clarification to the pre-amble and post-amble of the definition.</p> <p>Comfort letters propose similar modifications to the "exempt loss" definition as those for the "exempt earnings" definition.</p>	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "exempt surplus" A(iii)	Amendment is consequential to the division of subsection 5905(7) of the Regulations into subsections 5905(7) to (7.4).			✓	Taxation years of FA that begin after December 20, 2002.			
5907(1) "exempt surplus" A(viii) and B(v)	The amendments to A(viii) and B(v) of the "exempt surplus" definition in Regulation 5907(1) is consequential to the additional rules introduced in Regulations 5905(2), (4), (6), and (8).		✓ ¹⁰	✓	Taxation years of FA that begin after December 20, 2002.			

¹⁰ To the extent amendments relate to proposed changes to Regulation 5902.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5907(1) "loss"	Consequential to the amendments to paragraph 95(2)(a). Ensure that deemed active business losses are included in computing the "loss" of the affiliate.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "net earnings" (d)	The amendment ensures that FAPI gains from the disposition of excluded property, where subsection 88(3) applies, are not double counted in computing net earnings.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "net loss" (d)	Unnecessary references to 95(2)(c), (d), and (e) are removed.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "taxable deficit" (b)	Inserts a reference to new subparagraph (vi) of the description A in the definition "taxable surplus" in Regulation 5907(1).		✓ ¹¹	✓	Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "taxable earnings" (b)(v)	The amendment ensures that FAPI gains from the disposition of excluded property where subsection 88(3) applies are not double counted in computing taxable earnings.	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "taxable loss" (b)	New subparagraph (b)(i.1) includes 95(2)(a)(v) and (vi) deemed active business losses. Unnecessary references to 95(2)(c), (d), and (e) are removed. Also, consequential amendment due to proposed changes to the definition of "loss" in Regulation 5907(1).	✓			Taxation years of FA that begin after December 20, 2002.		✓	
5907(1) "taxable surplus" A(vi) and B(v)	Consequential to the proposed changes in Regulations 5905(2), (4), (6), and (8).		✓ ¹²	✓	Applies in respect of dispositions in respect of which an election was made in respect of which proposed subsection 5902(1) applies.			

¹¹ Ibid.

¹² To the extent amendments relate to proposed changes to Regulation 5902.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5907(1) "underlying foreign tax" B(iii)	Subparagraph (iii) of the description of B of the definition "underlying foreign tax" has been amended to remove the reference to paragraph 5902(4)(c), and to add a reference to subparagraph 5905(4)(a)(iii).		✓		Applies in respect of dispositions in respect of which an election was made in respect of which proposed subsection 5902(1) applies.			
5907(1) "whole dividend" (b)	The amendment replaces a reference to "5902(1)(c)" with a reference to "5902(1)(g)".		✓		Applies in respect of dispositions in respect of which an election was made in respect of which proposed subsection 5902(1) applies.			
5907(1.1) pre-amble and (b)(ii)	<p>In general terms, the amendments to subparagraph (b)(ii) ensure that the primary affiliate's surplus balances are reduced, and the secondary affiliate's surplus balances are increased, by the amount of the payment by the primary affiliate to the secondary affiliate for the use of the secondary affiliate's tax credit.</p> <p>The June 9/06 comfort letter proposes to remove the requirement that the primary and secondary FAs be resident in the foreign country as described in the preamble and expand the application of 5907(1.1) to situations where they are FAs of another corporation resident in Canada that is related to the taxpayer. The proposed amendments are effective for the 2004 and subsequent taxation years of the FAs.</p>			✓	Applies to payments made after December 20, 2002.			
5907(2)(f)	Paragraph 5907(2)(f) is proposed to be amended to delete subparagraph (ii) consequential to the introduction of the rules in paragraphs 95(2)(c.2) to (c.6), and 95(2)(f.3) to (f.8) of the Act.		✓		Dispositions made by a FA after December 20, 2002.			
5907(2.01)	New subsection 5907(2.01) provides that, notwithstanding any other provision of the Regulations, in determining the earnings of a FA where property was acquired by a particular person or partnership from another person or partnership (the "vendor") in respect of which any of paragraphs 5907(2)(c.2), (d), (e), (e.3) to (e.5) and (f.4) of the Regulations applied to the vendor, the cost of the property to the particular person or partnership is to be determined using the rules in those paragraphs.		✓	✓	Dispositions made by a FA after December 20, 2002.			

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5907(2.7)	Modification to existing provision. Applies to 95(2)(a) income rather than only 95(2)(a)(i) and (ii). Requires 95(2)(a) (other than under Clause D) payments to be deducted against the non-resident corporation's earnings from an active business.	✓			Taxation years of FA that begin on or after December 20, 2002.		✓	
5907(2.8) to (2.83)	The exempt surplus of the second and possibly other affiliates is reduced to the extent of clause 95(2)(a)(ii)(D) recharacterized interest. A deficit is generated for the second affiliate only once the exempt surplus of the other relevant FAs has been eliminated.			✓	Applies to taxation years of FA to which new proposed clauses 95(2)(a)(ii)(D)(III) to (V) apply.			
5907(2.9) and (2.91)	If paragraph 95(2)(k) [fresh start rules] applies, there is a corresponding rule in Regulation 5907(2.9) to adjust the surplus accounts.	✓			Taxation years of FA that begin after December 20, 2002.			✓
5907(5.1)	Repealed.							
5907(9) and (9.1)	5907(9) amended such that it will be subject to proposed 95(2)(e), (e.1) and 88(3). Pertains to treatment of distributed property arising from a liquidation. New 5907(9.1) applies to the dividend or distribution of property by a FA to its shareholder.		✓ ¹³	✓	Dissolutions, payments of dividends and distributions made after December 20, 2002.			
5907(13)(a)	Immigration of FA to Canada. Amendment refines computation of FA's taxable surplus from deemed disposition of property.	✓			Generally applies after 1992.			
5907(14)	Amendment refines computation of FA's UFT from deemed disposition of property.	✓			Generally applies after 1992.			

¹³ To the extent proposed FPUC rules are applicable.

Summary of February 27, 2004 FA Amendments and Comfort Letters

Amended Section/Regulation	Description	Type of Amendments			Effective Date (no election)	Separate Election Available	Global 95 Election Available	Fresh Start Election Available
		Retroactive Technical Change	Policy Change	Prospective Technical Change				
5911 to 5919	<p>5911 – ACB adjustments for 93(1) elections.</p> <p>5912 to 5914 – Suspended gain/income/loss computation where 95(2)(c.3), (f.5) or (h.3) applies.</p> <p>5915 to 5919– Election requirements where 95(2)(c.3), (d), (e), (e.3), (e.4), (e.5), (f.4), (k.3) or 88(3)(a) applies.</p>		✓		Apply after December 20, 2002.			