Bulletin d'information

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Subject: BROADENING OF THE FILM TAX CREDIT TO VARIETY AND MAGAZINE-TYPE PROGRAMS, MORATORIUM ON CERTAIN FINANCIAL ARRANGEMENTS UNDER THE QBIC PROGRAM, AND OTHER FISCAL MEASURES

MEASURES CONCERNING INCOME TAX, THE TAX ON CAPITAL, THE COMPENSATORY TAX ON FINANCIAL INSTITUTIONS, AND LAND TRANSFER DUTIES

Broadening of the refundable tax credit for Québec film productions to variety and magazine-type television programs

The Québec tax system plays an essential role in financing Québec film and television production by providing corporations that produce an eligible production with assistance of up to 18% of production costs.

In the Budget Speech of May 9, 1995, the government announced that it intended to study the possibility of broadening the application of the refundable tax credit for Québec film productions to variety and magazine-type television programs. Currently, the bulk of financing for such productions stems from assistance programs administered by the Société de développement des entreprises culturelles (SODEC).

The government is now in a position to announce the broadening of the refundable tax credit for Québec film productions to variety and magazine-type television programs.

- ***Newly eligible productions***

To qualify for the refundable tax credit for Québec film productions, a production must satisfy the criteria stipulated in the *Règlement sur la reconnaissance d'un film comme film québécois* and SODEC must have issued a certificate for it attesting to the fact that it meets these criteria. Under the regulations, the only eligible variety and magazine-type television programs are those produced for children under 13 years of age.

The regulations will be amended to eliminate this age reference. In addition, variety-type television programs will have to satisfy either of the following requirements:

- at least two-thirds of their content must consist of performances, other than interviews, by artists such as singers, comedians, impressionists, dancers and musicians, with or without a host;

- be a talk show at least two-thirds of whose content deals with culture, namely arts and letters.

Finally, both variety and magazine-type television programs must be broadcast during prime-time hours, i.e., for a program broadcast from Monday to Friday, between 6 p.m. and midnight and, for a program broadcast on Saturday or Sunday, between 9 p.m. and midnight.

However, to further encourage regional production of television programs, the prime-time broadcasting requirement will not apply to programs that satisfy the following requirements:

- they mainly target an audience outside the metropolitan Montréal region;

- a minimum of 60% of the total expenses incurred for their production, except those relating to financing, is paid to natural persons domiciled outside the metropolitan Montréal region for at least two years before date on which shooting begins, or to corporations whose principal place of business is located outside the metropolitan Montréal region;

- they are produced by a firm that does not have a place of business in the metropolitan Montréal region.

For the purposes of this measure, the metropolitan Montréal region shall be understood to include the Island of Montréal, Île Jésus and Montérégie.

The *Règlement sur la reconnaissance d'un film comme film québécois* will also be amended so that, from now on, educational games, quiz shows and contests for children under 13 years of age are expressly recognized as eligible productions subject to the same conditions as those that apply to variety and magazine-type television programs produced for the same audience.

Finally, a technical correction will be made to this regulation to specify that an instructional film is excluded, but not a film produced for educational or pedagogical purposes.

- ***Restriction on the combination of tax assistance and assistance received under SODEC production assistance programs***

The section of SODEC production assistance programs designed for variety and magazine-type television programs will be eliminated beginning in the government's 1996-1997 fiscal year. Firms that have produced a production entitling them to the refundable tax credit for Québec film productions will be able to receive, regarding such production, assistance from SODEC as part of its production assistance programs.

However, to prevent a firm that produces a newly eligible production from receiving assistance from the Québec government in excess of 18% of production costs, the amount of the tax credit otherwise determined will be reduced by the amount of any assistance received or to be received from SODEC as part of its production assistance programs.

- ***Application date***

These changes will apply to a production for which the principal photography or taping of the film or tape began after May 9, 1995.

The cost of this broadening of the refundable tax credit for Québec film productions is estimated at $6 million a year.

Progress of work concerning the eligibility of multimedia productions for the refundable tax credit for Québec film productions

The government also announced, in the May 9, 1995 Budget Speech, that it intended to study the possibility of extending the application of the refundable tax credit for Québec film productions to multimedia productions and works. In this regard, in spite of the work done to date, more study is required.

Moratorium on certain types of financial arrangements under the Québec Business Investment Companies (QBIC) program

The objective of the QBIC program is to encourage small and mid-sized businesses (SMBs) operating in an eligible sector to improve their permanent capitalization. The government reaffirmed its commitment in the May 9, 1995 Budget Speech by raising the ceiling on eligible investments from $2.5 million to $5 million.

More specifically, the government wants to help existing shareholders of SMBs seeking genuine partners, i.e. with the same rights and obligations as the existing shareholders. In principle, the risk borne by such partners should apply to the business itself, and not to a specific project of the business.

The Société de développement industriel du Québec (SDI) is responsible for administering the QBIC program. As such, it must validate each investment by a QBIC so that the shareholders can enjoy the tax benefits they are entitled to. In carrying out its mandate, SDI must ensure that the investment complies with the legislation.

In recent months, projects prepared on the basis of financial arrangements that strayed from the objective of the QBIC program have forced SDI to make use of its discretionary power under the *Act respecting Québec Business Investment Companies*. The essential purpose of some of these arrangements is to finance scientific research and experimental development (R&D) projects carried out by research laboratories. The promoters of these projects offer potential shareholders of the QBIC a return on their investment that results from an option to sell to be exercised from two to five years after the date of the investment and redeemed in large part from the R&D tax credits flowing from these projects. In short, these arrangements resemble outside financing mechanisms for R&D cumulating tax benefits, more than an initiative whose objective is to capitalize a business.

In the May 20, 1993 Budget Speech, the government eliminated all external financing mechanisms for R&D expenditures because the financial arrangements that were developed were such that investors bore almost no risk. Among the steps taken to achieve this objective, the rules of the QBIC program that facilitated the financing of R&D by means of the QBIC/R&D vehicle were eliminated. In view of these new attempts to use the QBIC program in this way, it is important not only to reaffirm the basic principles of the fiscal policy regarding outside financing of R&D expenditures, but also to review all the requirements applicable to issues of shares under the QBIC program.

A moratorium is accordingly announced regarding any investment by a QBIC as part of a financial arrangement that stipulates the granting of an option to sell to shareholders of the QBIC, directly or indirectly. In addition, SDI will pay particular attention to any investment project, notably a financial arrangement providing for payment of dividends, whose effect is to divert the QBIC program from its objectives.

Over the next few months, the ministère des Finances and SDI will conduct joint studies to finalize the rules in this regard.

This measure applies regarding an investment by a QBIC made after the day of this information release.

Measures concerning the stock savings plan (SSP)

- ***Eligibility of convertible securities***

For taxation years 1991 to 1994, a deduction was allowed under the SSP regarding the acquisition of certain eligible convertible securities. If the issuer was a growth corporation, in general a corporation with less than $250 million in assets, the rate of the deduction allowed was 50%, i.e. half the rate stipulated for the acquisition of common shares. To this end, in general, a convertible security consisted of a non-guaranteed preferred share or debenture acquired for money.

To further encourage the capitalization of businesses, eligible convertible securities will again entitle the taxpayer to a deduction as part of the SSP under the same terms and conditions as those applicable for taxation year 1994.

This measure applies to eligible convertible securities acquired during the years 1995 or 1996 following an SSP issue for which the receipt for the final prospectus is granted after the day of this information release.

- ***Technical correction***

The taxation legislation currently contains a provision to the effect that the splitting or replacement of an eligible share or security does not, under certain circumstances, result in such share or security being withdrawn from an individual's SSP.

The Budget Speech of May 2, 1991 contained an announcement that shares of corporations with assets of $2.5 billion or more would be deemed to be withdrawn from an SSP on January 1, 1994.

To give precedence to the taxation policy announced at that time, a technical change will be made to the tax legislation so that a share issued as a result of a split or replacement of another, following a share exchange, capital reorganization or amalgamation transaction, must be a share of a corporation with less than $2.5 billion in assets in order to be included in an individual's SSP and prevent having the split or replaced share withdrawn from the plan.

This change will apply regarding a share issued, as a result of a split or replacement, after the day of this information release.

Measures concerning tax credits for scientific research and experimental development (R&D)

- ***Taxpayers eligible for the refundable tax credit for contributions and fees payable to a research consortium***

A tax measure was introduced in the Budget Speech of May 14, 1992 to enable a corporation that is a member of an eligible research consortium and which pays an eligible contribution to such organization, to receive a refundable tax credit equal to 40% of such contribution for a taxation year. To this day, only corporations are able to claim this tax credit.

To enable more taxpayers to benefit from this measure, eligible taxpayers will from now on be the same as those who can currently benefit from tax credits relating to a university research contract. Accordingly, members of a partnership which itself is a member of an eligible research consortium will be entitled to a tax credit for contributions and fees paid by the partnership to such a consortium, on the basis of the expenditures made by the consortium for R&D concerning a business of such partnership. In this regard, the existing rules that apply regarding refundable tax credits for R&D, concerning corporate members of a partnership, will apply to all members of the partnership.

This change will apply regarding a contribution or fee paid to an eligible research consortium after the day of this information release.

- ***Transitional measure regarding the application of the limit on tax credit refunds***

In its Budget Speech of May 9, 1995, the Québec government announced a limit on the refund applicable for certain tax credits, notably R&D tax credits. However, this refund limit applies only to large corporations, i.e. those with assets $25 million or more and net shareholders' equity of more than $10 million. In general, for such corporations, R&D tax credits can be applied to reduce or totally offset tax payable and any excess is refundable up to the amount of the tax on capital and the employer contribution to the Health Services Fund (HSF) payable by the corporation for a taxation year. The non-refundable portion can be carried forward and applied against tax payable, the tax on capital and the contribution to the HSF for the subsequent seven taxation years.

However, transitional rules were stipulated so that, in general, projects in progress continue to be subject to the rules applicable before the Budget Speech. For instance, in the case of projects regarding which a certificate was obtained from the ministère de l'Industrie, du Commerce, de la Science et de la Technologie (MICST), or recognition obtained from Cabinet, no later than May 9, 1995, the tax credits earned after such date are not covered by this new measure.

To acknowledge the fact that some taxpayers had gone to considerable lengths to have projects qualify as catalyst projects or pre-competitive research projects, applications for recognition, under the catalyst project assistance program, filed with the Technology Development Fund no later than May 9, 1995, as well as applications for certification relating to pre-competitive research projects filed with the MICST no later than the same date, will give rise to the same tax treatment as that prevailing before such date, provided the amount of the expenditures does not exceed that stipulated in this regard in the applications and that the recognition or certificate, as the case may be, is obtained no later than December 31, 1996.

- ***Application date of the new definition of R&D activities applicable to information technologies and financial institutions***

The government announced, in the Budget Speech of May 9, 1995, that it intended to include, for the purposes of Québec's tax legislation, the restrictions announced by the federal government in the federal Budget Speech of February 27, 1995 relating to R&D activities carried out by financial institutions and linked to information technologies.

On July 19, 1995, the federal government released a draft bill containing the detailed rules it proposes to apply to this effect. Contrary to normal practice, this bill does not contain, except for tax-exempt organizations and those dedicated to carrying out R&D, transitional rules regarding R&D activities arising from projects under way on February 27, 1995.

To remove any concern in this regard in the Québec research community, and regardless of the final position federal authorities may take, the Québec government intends to exempt from the application of this new definition of R&D activities those carried out after February 27, 1995 as part of a catalyst project, a pre-competitive research project or an environmental technology innovation project duly validated as at that date, as well as those carried out after such date in accordance with a research contract concluded with an eligible university entity, an eligible research centre or an eligible research consortium, provided the ministère du Revenu has issued an advance ruling on such contract no later than that date.

Easing of the notion of training expenses eligible for the refundable training tax credit (RTTC)

Under current tax rules, corporations' training expenses generally entitle them to a refundable tax credit at the rate of 20% for large corporations and 40% for small businesses. To be eligible, training expenses, i.e. tuition and related fees, must be paid directly to the establishment providing the training.

This requirement was included in the tax legislation to facilitate the administration of the RTTC. In practice, it appears that taxpayers acting in good faith have been unduly penalized for having used payment methods that did not totally comply with this requirement.

The tax legislation will therefore be eased so that the definition of the expression "qualified training costs" also covers expenses reimbursed to another person or entity as training costs, provided such other person or entity paid them directly to the establishment providing the training.

This change will apply regarding training expenses thus incurred since the implementation of the RTTC.

Tax relief granted to former employees of the Singer Company

Decisions by the Québec Court of Appeal and the Supreme Court of Canada have confirmed the rights of former employees of the Singer Company to the surplus assets of the pension plan in which they participated until it was terminated, on March 31, 1986.

Accordingly, the administrator of this pension plan has begun to divide the surplus assets in accordance with the distribution plan to be approved by the court. The former employees of the Singer Company or, if deceased, their spouses and heirs, can claim payment of their share of the plan's surplus assets.

Under current tax rules, individuals are generally taxed on the income they receive during the year. As a result of this basic rule, the former employees of the Singer Company and, by extension, their surviving spouses, could face an unduly heavy tax burden. Because of the progressive nature of tax rates which notably rise with taxable income, a large amount received in a single year is generally taxed more heavily than if that amount were divided into several annual payments.

In order to be fair to taxpayers who find themselves in such a situation, Québec's tax legislation allows retroactive payments to be taxed over a number of years. However, the current rules relating to this measure do not apply in the case of the former employees of the Singer Company because of the special characteristics of this exceptional situation.

A change will therefore be made to the legislation to allow former employees of the Singer Company or, in the event of death, their spouses, to spread, in equal proportions over the period beginning in 1986 and ending in the year of payment, the taxation of the lump sum corresponding to the surplus assets of the Singer Company pension plan.

Remission order of tax concerning the payment of expenses for the transportation of food to an employee living in Nunavik

In June 1994, the Groupe de travail sur la fiscalité au Nunavik, consisting of representatives from the ministère des Finances and the ministère du Revenu as well as representatives from the Secrétariat aux affaires autochtones, the Conseil du trésor and the local community, submitted a report to the government dealing with various taxation issues affecting the inhabitants of this region.

One of the issues discussed in the report concerns the tax treatment of food transportation expenses incurred by some employers to enable their employees to obtain supplies directly from a large urban centre. The task force recommended that the government maintain its current tax rules, which stipulate that the value of this assistance must be taxed as employment income. The government intends to act on this recommendation.

In 1990 and 1991, some employers, acting in good faith, omitted to declare the value of this assistance on the income slips provided to their employees and to make the corresponding deductions at source. To spare these employees the inconvenience this omission could have caused, the task force also recommended that the government remit the taxes, interest and penalties resulting from the inclusion in the calculation of income, for the years 1990 and 1991, of the value of this assistance relating to the transportation of food.

The government will also act on this recommendation, provided the employer has not covered the cost of such additional tax, and the related interest and penalties.

The "Renovate" and "Revitalization of Old Neighbourhoods" programs

The "Renovate" and "Revitalization of Old Neighbourhoods" programs, which have been in effect since September 22, 1995, are designed to stimulate the construction industry and counter clandestine labour.

To prevent the assistance granted to taxpayers as part of these programs from being included in the calculation of their income, the tax legislation will be amended so that no benefit relating to such assistance is taken into consideration for income tax purposes.

Under Québec's tax legislation, when an employee takes out a loan from his employer either at a reduced rate of interest or interest-free, he must include the value of this benefit in calculating his income.

To prevent an employee of a financial institution from being penalized in the case where he receives an interest-free loan from his employer as part of the "Renovate" residential renovation stimulation program, the tax legislation will be amended to provide that no taxable benefit is conferred in such a case.

These changes will apply regarding a loan or grant made under the "Renovate" and "Revitalization of Old Neighbourhoods" programs since their inception, i.e. since September 22, 1995.

Co-owners syndicates

The Budget Speech of May 14, 1992 indicated that in view of the coming into force of the Québec Civil Code, Québec's tax legislation would be amended to make the treatment of interest income from a co-owners syndicates' contingency fund identical for federal and Québec tax purposes.

The amendments to the *Taxation Act* to that effect were based on the administrative policy applied by federal authorities. This administrative policy has recently been changed and federal authorities now consider a co-owners syndicate as being generally a non-profit corporation, and as such exempt from income tax.

Consequently, the specific provisions in question in the *Taxation Act* will be repealed and the tax treatment applicable to co-owners syndicates will henceforth be that applied to non-profit organizations if, in fact, these co-owners syndicates carry out a non-profit activity.

This change will apply to a taxation year of a co-owners syndicate beginning after the day of this information release.

Clarification concerning the liability of insurance companies to the tax on capital

Insurance companies governed by the *Act respecting insurance* do not pay tax on capital under Part IV of the *Taxation Act* but, under Part VI, they pay a tax on capital calculated on the basis of the premiums they collect.

The tax legislation will be amended so that, for the purposes of Parts IV and VI of the *Taxation Act*, an insurance company is defined as an "insurer" as understood in the *Act respecting insurance*.

This amendment will apply regarding a taxation year beginning after the day of this information release.

Change to the refundable tax credit for losses

In general, Québec tax legislation allows a corporation that incurs a business loss to convert it, at the rate of 5.75%, into a refundable tax credit, up to a ceiling equal to three times its tax on capital payable for the year. Any balance remaining because of the ceiling can be carried forward for the next seven years.

Certain corporations, in calculating their paid-up capital for the purposes of the tax on capital, do not include certain deductions solely to increase their tax on capital so as to increase, by the same token, their refundable tax credit for losses.

To prevent such manoeuvres, the tax legislation will be amended so that a corporation will be denied any part of the payment of such tax credit that can be reasonably considered attributable to an increase in the tax on capital resulting from its election not to deduct an amount otherwise allowable as a deduction in calculating the corporation's paid-up capital for a taxation year.

This change will apply to a taxation year of a corporation ending after the day of this information release.

Liability to the compensatory tax on financial institutions

Since July 1, 1992, financial institutions in Québec are liable to a compensatory tax. This tax was instituted to maintain a constant tax burden on such institutions following the reform of the Québec sales tax, given that they would benefit from input tax refunds. In general, the tax is calculated notably on the basis of the wages paid by a financial institution to an employee who reports for work at a place of business of the institution in Québec.

Changes have recently been announced regarding the application of the *Act respecting the Régie de l'assurance-maladie du Québec* to clarify the rules on liability to tax when an employee reports for work sometimes at a place of business of his employer in Québec and at other times at a place of business outside Québec.(1) In general, in such a situation, all the wages paid to the employee for such pay period must be subject to tax under the Act, unless the employee reports for work during such period mainly at a place of business of his employer outside of Québec, in which case there is no liability to tax.

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(1) Information Bulletin 95-5, September 8, 1995.

In order to standardize the tax legislation, changes similar to those made to the *Act respecting the Régie de l'assurance-maladie du Québec* will also be made to the compensatory tax on financial institutions, and will apply retroactively, i.e. since the inception of the compensatory tax. However, they will not apply to cases pending before the courts on August 9, 1995, nor to notices of objection filed with the Minister of Revenue no later than such date, if the method of calculation of the compensatory tax has been contested no later than such date in these cases or notices and the objection is based on points covered by these changes.

Land transfer duties

The *Land Transfer Duties Act* requires any person who does not reside in Canada and who acquires land in Québec to pay to the Minister of Revenue an amount equal to 33% of the value of the consideration. However, provision is made for exemptions for, among others, certain cases of land transfers within the same corporate group.

This Act will be amended so that these exemptions also apply to land transfers between a transferor which is a corporation and a transferee which is one of its third or lower level subsidiaries or, conversely, between a transferor which is such a subsidiary and a transferee which is a corporation holding shares in the subsidiary by means of three more levels of subsidiaries.

For the purposes of this measure, a subsidiary is understood as a corporation of which 90% or more of the issued shares with full voting rights are owned by another corporation.

This measure will apply to any land transfer made after the day of this information release.

MEASURES CONCERNING THE QUÉBEC SALES TAX (QST) AND THE ROAD USE TAX

Increase in the rate of the partial QST rebates granted to hospital authorities

Many of the measures announced in the last Budget Speech had an impact on institutions of the health and social services network. In this context, to keep these institutions' financial situation constant, the rate of partial QST rebates granted to hospital authorities was raised to 51.5% effective May 10, 1995.

Following the review of the impact of the reform of the QST on institutions of the health and social services network, the rate of the partial QST rebate granted to hospital authorities is increased from 51.5% to 70%. This increase is retroactive. It applies as of the day following the day of the Budget Speech.

However, given that over the next few years this measure will enable institutions of the health and social services network to generate savings on their debt service, the rate will be set at 66% as of April 1, 1997, 60% as of April 1, 2000, 55% as of April 1, 2003 and 51.5% as of April 1, 2006.

Postponement of the application of the heavy vehicle road use tax

In the Budget Speech of May 9, 1995, the Québec government announced the introduction of a heavy vehicle road use tax to take effect April 1, 1996. This measure was designed to improve the competitive position of Québec carriers compared to their American competitors by introducing a two-tier system similar to the one in the United States where carriers are liable to pay registration duties to the various states as well as a heavy vehicle use tax to the federal government.

To facilitate interprovincial trade, the Québec government wanted the other provinces to follow Québec's lead by introducing a two-tier system similar or identical to the one in Québec. Initiatives were taken in this sense and provincial Ministers of Transport reached a consensus to apply such a system throughout Canada in 1997.

In this context, Québec has decided to postpone the application of the heavy vehicle road use tax to April 1, 1997.