

NO.: **IT-458R2**

DATE: May 31, 2000

SUBJECT: INCOME TAX ACT
Canadian-Controlled Private Corporation

REFERENCE: The definition of “Canadian-controlled private corporation” in subsection 125(7) (also the definitions of “Canadian corporation,” “private corporation,” and “public corporation” in subsections 89(1) and 248(1), subsections 125(1), 251(5), 256(5.1), 256(6) of the *Income Tax Act* and sections 3200, 3201 and 6700 of the *Income Tax Regulations*)

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This bulletin cancels and replaces Interpretation Bulletin IT-458R dated May 31, 1991.

Summary

This bulletin explains the meaning of a Canadian-controlled private corporation (CCPC) and the requirements that must be met for a corporation to be a CCPC. The appendix to this bulletin provides examples of situations which illustrate whether corporations meet the requirements to be considered a CCPC. A CCPC is a special type of private corporation that is also a Canadian corporation. In order to qualify as a CCPC it must not be controlled, directly or indirectly in any manner whatever, by public corporations, non-residents or a combination of the two.

In many respects, it is advantageous for a corporation and its shareholders that the corporation qualify as a CCPC. Some of these advantages, which are primarily designed to assist small businesses, include:

- access to the small business deduction;
- an additional month to pay the balance of taxes payable under Parts I, I.3, VI and VI.1 for the year;
- enhanced investment tax credits, which may be fully refundable, for their qualified expenditures on scientific research and experimental development;
- shareholder entitlement to the capital gains exemption on the disposition of qualified small business corporation shares; and
- deferral of an employee’s taxable benefit arising from the exercise of stock options granted by a CCPC.

In many of these situations it is necessary that the corporation be a CCPC throughout the particular taxation year. Consequently, the advantages of CCPC status may not be available in the year a corporation becomes or ceases to be a CCPC. Furthermore, certain of these advantages may be restricted or unavailable if the CCPC is part of an associated group (see the current version of IT-64, *Corporations: Association and Control – After 1988*).

For more information on the advantages of CCPC status, please refer to the current versions of interpretation bulletins:

IT-73	<i>The Small Business Deduction</i>
IT-113	<i>Benefits to Employees – Stock Options</i>
IT-151	<i>Scientific Research and Experimental Development Expenditures</i>

Discussion and Interpretation

¶1. A CCPC is defined in subsection 125(7). Under the opening words of this definition, a corporation must be a Canadian corporation and a private corporation as those terms are defined under subsection 89(1). A corporation resident in Canada that has a class of shares listed on a prescribed stock exchange in Canada is not considered to be a private corporation and, therefore, cannot be considered to be a CCPC. In addition, under paragraph (c) of the definition of a CCPC, a corporation that has a class of shares listed on a foreign stock exchange listed in section 3201 of the Regulations, will be prevented from qualifying as a CCPC after 1995. The current version of IT-391, *Status of Corporations*, discusses the meaning of private and public corporations for the purposes of the Act. Paragraph (a) of the definition of a CCPC provides that the corporation must not be “controlled, directly or indirectly in any manner whatever” (see ¶8) by one or more non-resident persons (non-residents), one or more public corporations (other than a prescribed venture capital corporation within the meaning of section 6700 of the Regulations), or any combination of non-residents and public corporations. The control test referred to in the definition of CCPC envisages situations where over 50% of the shares of a corporation are owned by one or more non-residents or by one or more public corporations regardless of whether or not a controlling group can be identified. To that end, paragraph (b) of the definition of a CCPC clarifies that, after 1995, a corporation is prevented from being a CCPC if the corporation would, if each share of the capital stock of a corporation that is owned by a non-resident person or a public corporation (other than a prescribed venture capital corporation) were owned by a particular person, be controlled by that particular person.

¶2. It is not necessary that a corporation be controlled by Canadian residents, private corporations or a combination thereof, in order to qualify as a CCPC. For example, if an individual resident in Canada controls 50% of the voting rights of the shares of a Canadian corporation that is a private corporation, normally, no other person or group of persons (i.e. public corporations and/or non-residents) would control the corporation for purposes of the definition of a

CCPC under subsection 125(7). However, this would not be the case if control by non-residents or public corporations exists as a result of holding a right as described in paragraph 251(5)(b) and discussed in ¶s 5 or 6, or because of the existence of *de facto* control by non-residents or public corporations as described in subsection 256(5.1) and discussed in ¶8. See Example 1.

¶3. If a Canadian corporation is controlled by another corporation resident in Canada, which is itself controlled by a non-resident or by a public corporation, the Canadian corporation cannot qualify as a CCPC because it is indirectly controlled by a non-resident or a public corporation. Also, if the corporation is controlled by a non-resident corporation that is itself controlled by a CCPC, it will not qualify as a CCPC because it is directly controlled by a non-resident corporation. See Examples 2, 3 and 4.

Note: If draft legislation released on November 30, 1999, is enacted as currently proposed, new subsection 256(6.1) of the Act—introduced in response to the decision of the Federal Court of Appeal in Parthenon Investments Ltd. v. The Queen, 97 D.T.C. 5343, [1997] 3 C.T.C. 152—will apply to specify, for greater certainty, that a corporation may be controlled simultaneously by persons or groups at more than one level above it in a corporate chain. Proposed paragraph 256(6.1)(a) specifies that, where a subsidiary would be controlled by its parent if the parent were not itself controlled by any other person or group, the subsidiary is considered to be controlled both by the parent and by the person or group that controls the parent. Proposed paragraph 256(6.1)(b) is a rule of similar effect that applies where the subject corporation would be controlled by a group (the “first-tier group”) if no member of the first-tier group were itself controlled by a third party. In that case, the subject corporation is considered to be controlled both by the first-tier group, and by any higher-tier group, either the member or a person or group by whom the member is controlled. If one person controls all members of the first-tier group, that person would constitute a higher-tier group.

Proposed subsection 256(6.2) of the Act specifies that the rule regarding simultaneous control in new subsection 256(6.1) also applies to the concept of de facto control.

¶4. A corporation can become, or cease to be, a CCPC if control changes or the status of the parties who control the corporation changes. For example, a Canadian corporation that would be a CCPC (except for the fact that it is controlled by non-residents) will become a CCPC if a sufficient number of shareholders become residents of Canada so that not more than 50% of the voting rights of the shares are controlled by non-residents. This is so, whether the shareholders actually become residents of Canada or are deemed under paragraph 250(1)(a) to have been resident in Canada throughout the year. Similarly, if a sufficient number of Canadian resident shareholders of a CCPC become non-residents so that non-residents control more than 50% of

the voting rights of the shares, the corporation will cease to be a CCPC.

¶ 5. Paragraph 251(5)(b) provides special rules in determining whether or not a corporation qualifies as a CCPC. Subparagraph 251(5)(b)(i) provides that if, at any time, a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire, shares of the capital stock of a corporation, or to control the voting rights of such shares, that person is deemed to have the same position in relation to the control of the corporation as if that person owned the shares at that time. For example, if a public corporation or non-resident acquires an option to purchase more than 50% of the voting shares of what would otherwise be a CCPC, the public corporation or non-resident is deemed, by virtue of subparagraph 251(5)(b)(i), to control the corporation. This would cause the corporation to lose its status as a CCPC. See Example 5.

¶ 6. Subparagraph 251(5)(b)(ii) provides that if, at any time, a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to cause a corporation to redeem, acquire, or cancel any shares of its capital stock owned by other shareholders, that person is deemed to have the same position in relation to control of the corporation as if the shares were redeemed, acquired, or cancelled by the corporation at that time. Thus, this subparagraph may also apply to deny status as a CCPC if a public corporation or non-resident has a “right” pursuant to subparagraph 251(5)(b)(ii).

Under subparagraph 251(5)(b)(iii), if, at any time after April 26, 1995, a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to, or to acquire or control, voting rights in respect of shares of the capital stock of a corporation, that person is deemed to have the same position in relation to the control of the corporation as if that person could exercise the voting rights at that time.

Subparagraph 251(5)(b)(iv) provides that if, at any time after April 26, 1995, a person has a right under a contract, in equity or otherwise, either immediately or in the future and either absolutely or contingently, to cause the reduction of voting rights in respect of shares of the capital stock of a corporation that are owned by other shareholders, that person would be deemed to have the same position in relation to the control of the corporation as if the voting rights were so reduced at that time.

¶ 7. There are exceptions to the rules in paragraph 251(5)(b). The provisions of paragraph 251(5)(b) will not apply if one or more of the rights described therein are not exercisable until the death, bankruptcy or permanent disability of an individual. Thus, paragraph 251(5)(b) does not apply if a person has a right, for example, to acquire shares under a survivorship agreement.

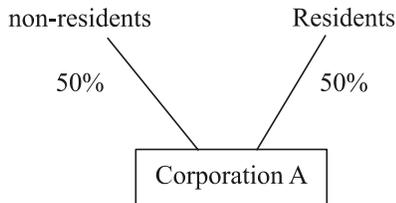
¶ 8. The concept of control of a corporation is paramount in determining whether the corporation is a CCPC. The word “control” is not defined in the Act. The term control usually contemplates the right of control that rests in ownership of such a number of shares as carries with it the right to a majority of the votes in the election of the board of directors. Such control is commonly referred to as *de jure* control. However, the expression “controlled, directly or indirectly in any manner whatever” (see ¶ 1) that is found in the definition of a CCPC has an extended meaning for purposes of the Act by virtue of subsection 256(5.1). Under subsection 256(5.1), a corporation is considered to be controlled, directly or indirectly in any manner whatever, by another corporation, a person or a group of persons (the “controller”) if the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation (*de facto* control). In order to determine whether or not there exists such influence that, if exercised, would result in control of a corporation, it would be necessary to review all of the facts in each situation. An example of *de facto* control might be a situation in which a person held a significant portion, but less than 50%, of the voting control of a corporation and the balance was widely dispersed among many employees of the corporation or was held by persons who could reasonably be considered to act in respect of the corporation in accordance with his or her wishes. An exception to the rules in subsection 256(5.1) is provided when the corporation and the controller are dealing at arm’s length and the controller’s influence is derived from an agreement or arrangement such as a franchise, license, lease, distribution, supply or management agreement, the main purpose of which is to govern the relationship between the parties regarding the manner in which a business carried on by the corporation is to be conducted. For a more detailed discussion of the meaning of “control,” see the current version of IT-64, *Corporations: Association and Control – After 1988*.

¶ 9. If the provisions of subsection 256(6) are met, a corporation that controls, directly or indirectly in any manner whatever another corporation at a particular time will be deemed not to control that corporation at that time. This particular provision may have application when, for example, a manufacturing corporation which is a public corporation or a corporation controlled by non-residents, establishes distributorships in Canada. This is usually effected by creating a corporation in such a manner that the Canadian operator or distributor will not acquire actual control of it until certain financial obligations to the manufacturer are met. When all of the provisions of subsection 256(6) are met, the newly created corporation will be a CCPC from the time of incorporation if the other conditions of the definition of a CCPC under subsection 125(7) are met.

Appendix

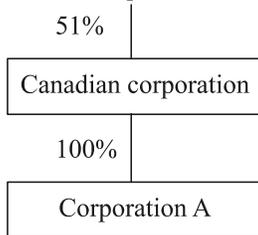
The purpose of the following examples is to indicate when a corporation is controlled, directly or indirectly in any manner whatever, by one or more non-resident persons, one or more public corporations (other than prescribed venture capital corporations) or by a combination thereof. It is assumed that the other criteria of the definition of a CCPC under subsection 125(7) are met. Unless otherwise indicated, percentages shown indicate the percentage of the voting shares held in the corporation by the particular person or group of persons.

1. Public corporations and/or non-residents

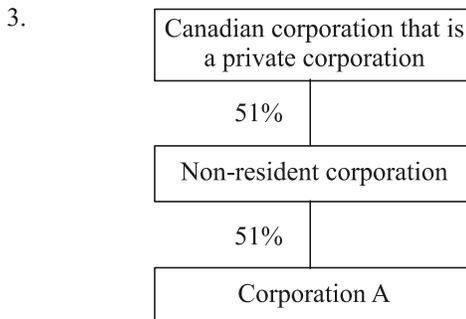


Corporation A is a CCPC because it is not controlled by non-residents, public corporations or a combination of non-residents and public corporations. The above result assumes that control does not exist by virtue of the holding of a right under paragraph 251(5)(b) or by the existence of *de facto* control under subsection 256(5.1).

2. Non-residents and/or Public corporations

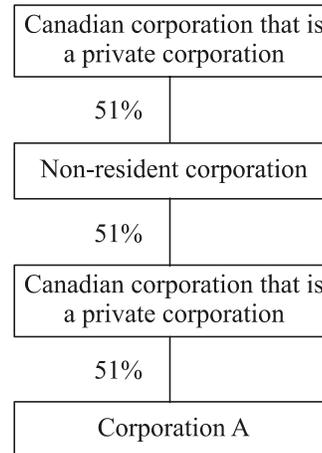


Corporation A is not a CCPC because it is indirectly controlled by non-residents and/or public corporations.



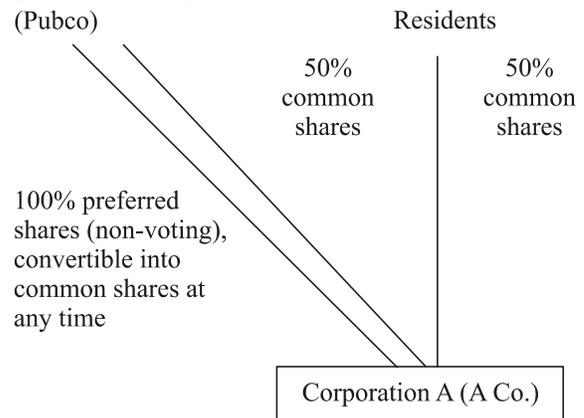
Corporation A is not a CCPC because it is directly controlled by a non-resident corporation. The fact that the non-resident corporation is itself directly controlled by a Canadian corporation that is a private corporation is not relevant.

- 4.

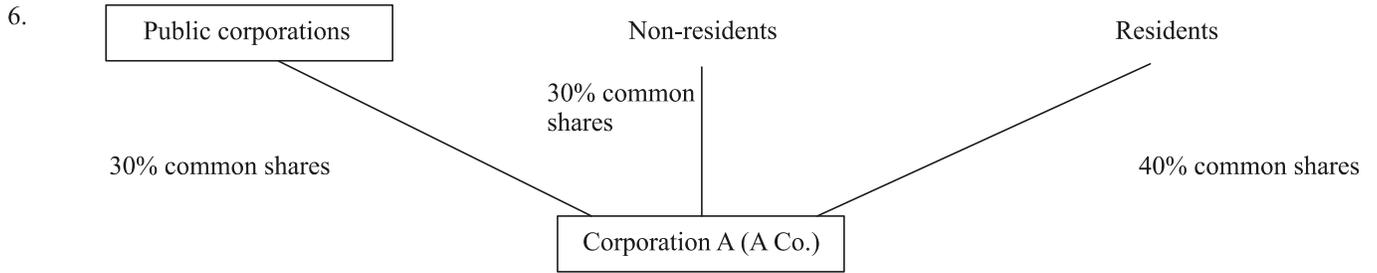


Corporation A is not a CCPC because it is indirectly controlled by a non-resident corporation. The fact that Corporation A is controlled both directly and indirectly by Canadian corporations that are private corporations does not negate the fact that it is also indirectly controlled by a non-resident corporation for purposes of the definition of a CCPC.

5. Public corporation and/or Non-residents (Pubco)

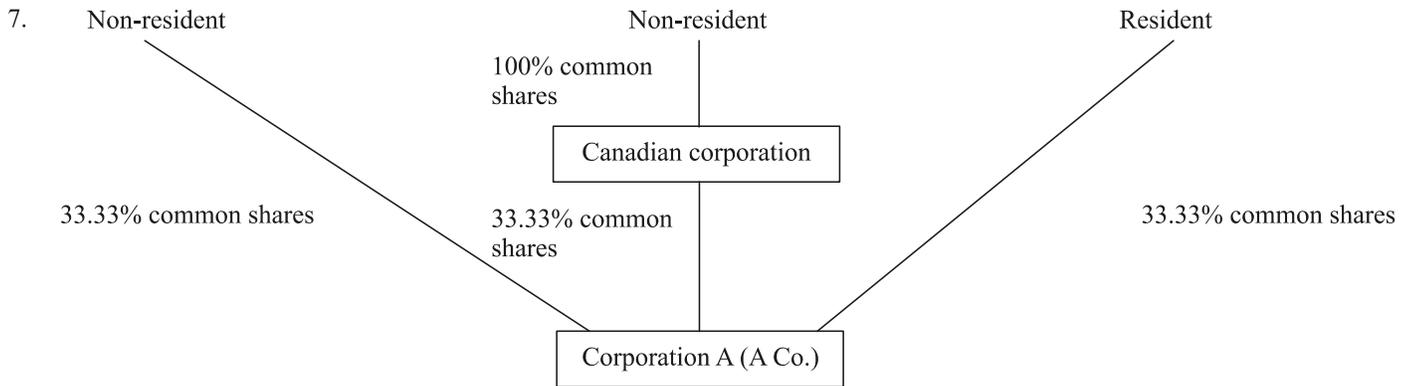


A Co. is not a CCPC because of the “right” of Pubco to convert its preferred shares to common shares. This right places Pubco in the same position, in relation to control of A Co., as if it owned the A Co. common shares to which the preferred shares are convertible by reason of subparagraph 251(5)(b)(i). Therefore, since Pubco owns 50% of the common shares and has the right to acquire additional common shares that, when taken together with the common shares it already owns, aggregate more than 50% of the total common shares issued and outstanding of A Co., Pubco is considered to control A Co.



Although the shares of A Co. are widely dispersed among public corporations and non-residents that are likely not acting together to exercise control of A Co., A Co. is not a CCPC. This is because if the shares of A Co.'s capital stock

that are owned by the non-residents and by the public corporation were owned by the same person, A Co. would be controlled by that person.



A Co. is not a CCPC because if the shares of its capital stock and of the capital stock of Canadian corporation that are

owned by non-residents were owned by the same person, that person would control A Co.

Explanation of Changes

Introduction

The purpose of the *Explanation of Changes* is to give the reasons for the revisions to an interpretation bulletin. It outlines revisions that we have made as a result of changes to the law, as well as changes reflecting new or revised interpretations.

Overview

This bulletin deals with the definition of “Canadian-controlled private corporation” (CCPC) in subsection 125(7). It discusses the conditions that a corporation must meet to be considered to be a CCPC and provides examples that show whether these conditions are met. We have revised this bulletin to reflect the amendments to the Act as enacted by S.C. 1994, c. 7, Schedule II (1991 c. 49—formerly Bill C-18) and S.C. 1998 c. 19 (formerly Bill C-28). Draft legislation released November 30, 1999 is reflected in an italicized note following ¶ 3.

Legislative and Other Changes

Throughout the bulletin, we have made minor changes for clarification or readability purposes. We have also eliminated previous transitional provisions that were no longer relevant.

The discussion of the small business deduction has been consolidated in the *Summary* so that the *Discussion and Interpretation* portion of the bulletin only discusses the requirements for a corporation to be considered a CCPC. In addition, we have expanded the *Summary* to outline some of the other advantages that may be available to a CCPC and its shareholders.

¶ 1 has been revised to include a reference to IT-391, *Status of Corporations*, for more information on the meaning of private and public corporations. We have also revised this paragraph to discuss changes to the legislation applicable after 1995 that amend the definition of a CCPC to exclude a corporation whose shares are listed on a foreign stock exchange. The amendment also clarifies that a corporation will not be considered to be a CCPC if it would, if each share of the capital stock of a corporation that is owned by a non-resident person or a public corporation

(other than a prescribed venture capital corporation) were owned by a particular person, be controlled by that particular person.

An italicized note has been added to ¶ 3 to reflect draft legislation released on November 30, 1999, which specifies that a corporation may be controlled simultaneously by persons or groups at more than one level above it in a corporate chain.

¶ 4 has been revised to clarify that the provisions of paragraph 250(1)(a) that deem a person to be a resident of Canada throughout a particular taxation year, may affect a corporation’s status as a CCPC.

New ¶s 6 and 7 were formerly the second and third paragraphs of former ¶ 6. We have revised ¶ 6 to discuss the amendments that introduce new subparagraphs 251(5)(b)(iii) and (iv). These subparagraphs provide that two additional kinds of rights would place their holder in the same position in relation to the control of the corporation as if the rights were exercised.

New ¶ 7 has been revised to reflect the amendment to paragraph 251(5)(b) which extended the scope of the exception in this paragraph to include, in addition to contractual rights, equitable rights and other rights not yet exercisable because their exercise is contingent upon the death, bankruptcy or permanent disability of an individual.

New ¶s 8 and 9 are former ¶ 8 and 7 respectively. New ¶ 8 was expanded to complete the discussion on the concepts of *de jure* and *de facto* control. We have also explained that it is a question of fact as to whether there exists influence that, if exercised, would result in control of the corporation.

We have added two new examples to the Appendix. The first one we added illustrates the situation where a corporation is not a CCPC because the corporation would, if the shares of its capital stock that are owned by non-residents and by public corporation were owned by the same person, be controlled by that person. The last example of the Appendix illustrates the situation where a corporation is not a CCPC because the corporation would, if the shares of the capital stock of any corporation that are owned by non-residents and by public corporations were owned by the same person, be controlled by that person.

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