



## **Proposed Amendments to Streamline the Functional Currency Tax Reporting Rules**

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On November 10<sup>th</sup>, further to its promise earlier this year, the Department of Finance released draft legislative proposals to amend the functional currency tax reporting rules, which are contained in section 261 of the *Income Tax Act* (Canada) the ("Tax Act"). These rules are relevant to and can impact Canadian businesses which report financial results in a foreign currency or which have foreign affiliates.

Within a scheme of detailed rules, section 261 of the Tax Act provides an elective exception to the general rule that amounts (i.e., income, taxable income, etc.) which must be determined under the Tax Act must be determined in Canadian dollars. The proposed legislation is intended to incorporate changes that the Department of Finance announced in June 2008 in response to certain technical and practical issues with the current functional currency rules. The proposed changes announced by the Department of Finance include:

- revising the definition of "functional currency" to address concerns regarding the practical application of the current definition, and specifically, removing the requirement that a taxpayer continue to have the foreign currency qualify as its functional currency in all years subsequent to making an election; and
- amending how the foreign exchange rate calculations are made in respect of assets and debt obligations to ensure that such amounts are reported similarly.

The election deadline to opt out of the Canadian dollar tax reporting regime and instead report amounts in a qualifying foreign currency has been extended by the Department of Finance, in certain circumstances, to December 15, 2008. The intention behind the extension is to give taxpayers the opportunity to review the proposed legislation before they decide to elect into the functional currency regime. The extended deadline is helpful especially since further changes that were not previously announced have been incorporated into the proposed legislation. The following is a brief description of these additional changes.

### **1. Similar Election Filing Deadline for all Eligible Taxpayers.**

The functional currency tax reporting regime will apply to all taxation years that end on or after the day that is six months after the day on which the election is filed by an eligible taxpayer. Generally, a taxpayer is eligible to make the election if it is a corporation that is resident in Canada. Unlike the current rule, the proposed rules provide for similar election filing deadlines for all eligible corporations, whether they are newly incorporated or newly amalgamated.

### **2. Application of Functional Currency Regime to Corporate Partners.**

The proposed legislation includes rules that apply to a corporate taxpayer that elects to be a functional currency reporter and is or becomes a partner of a partnership. Generally, the proposed rules would impute the functional currency of the corporate partner, and any of its changes in tax currency reporting, to a partnership for purposes of computing functional currency amounts of the corporate partner.

### **3. Instalment Payments, Interest and Penalties and Functional Currency Reporting.**

A set of rules in the proposed legislation outlines how amounts that are payable under the Tax Act should be determined for functional currency reporters. The rules specifically address how instalment payments and the remainder of taxes payable are to be computed for functional currency tax years. The rules also provide that taxes payable for a year by a functional currency reporter are to be determined in Canadian dollars. The Canadian dollar amount is to be determined by converting amounts expressed in the elected functional currency of the taxpayer into the relevant Canadian dollar spot rate for the taxpayer's balance-due day. As a result, the Canadian dollar value of interest and penalties based on taxes payable can easily be determined.

4. **Mergers, Amalgamations, Wind-ups and Functional Currency Reporting.**

The proposed amendments to section 261 of the Tax Act provide for a comprehensive set of rules that deal with corporate reorganizations. With respect to wind-ups, the rules generally accord the tax reporting currency of the subsidiary with that of the parent where the subsidiary and the parent have different tax reporting currencies. Similarly, the rules also accord the tax reporting currency for a predecessor corporation with that of a new corporation in respect of an amalgamation. These sets of rules are both subject to override by a more detailed anti-avoidance provision that is also included in the proposed amendments. In addition, the proposed rules in respect of mergers are formulated so as to ensure the application of the proposed anti-avoidance provisions to mergers, where appropriate.

The proposed changes, if adopted, would simplify the application of the existing functional currency tax reporting rules and expand the availability of the election to opt into the functional currency regime. These improvements may make it more advantageous for a Canadian corporation engaged in international business to become a functional currency reporter.

*This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.*

*If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.*

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