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REPORT

to the

MINISTER OF FINANCE

by

THE SPECIAL COMMITTEE

on

CORPORATE TAXATION

1961

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TO: The Honourable Donald M. Fleming, P.C., Q.C.,
Minister of Finance,
Ottawa, Ontario.

We, the Members of the Special Committee on Corporate Taxation appointed pursuant to Order-in-Council P. C. 1960-1356, dated October 1, 1960, to advise on certain problems connected with corporate taxation which were set forth in detail in the "terms of reference" as follows:-

"1. to consider the various provisions of the Income Tax Act relating to the taxation, as personal income or otherwise, of amounts that are distributed or are available for distribution out of the earnings of corporations;

2. to determine the extent to which these provisions have given rise to anomalies and inequities in taxation, have made unduly complex the arrangements governing business organization, have imposed barriers to the creation of new businesses and the reorganization of existing businesses and have encouraged the adoption of artificial devices and arrangements to avoid taxation;

3. to study the comparable provisions of the tax laws of other countries;

4. to recommend changes which may achieve greater simplicity and overcome any anomalies, inequities or deficiencies it finds in the present law without substantial loss of revenue;

5. to recommend appropriate changes in the taxation of personal corporations, in the light of recommendations made under the previous paragraph; and

6. in connection with the above subjects, to recommend any methods by which the income tax laws in question might be reformulated, in the national interest, so as to give greater encouragement to the Canadian ownership of Canadian industry."

SUBMIT TO YOU THE FOLLOWING REPORT:

SUMMARY OF FINDINGS AND RECOMMENDATIONS

We have reviewed the present provisions of the Income Tax Act relating to corporate distributions in Canada and their historical background. We have considered the general effect of such provisions upon the Revenue and upon corporate enterprise and shareholders. We have studied the comparable provisions of the tax laws of other countries. These matters are dealt with more fully hereunder.

As a result of these investigations, we have found that:-

1. The amount of tax actually collected from Canadian resident individuals in respect of dividends received from Canadian corporations, based upon the latest statistics available (1958), is estimated to be less than $50,000,000 per annum;

2. The amount of tax on accumulated corporate earnings for the 1959 filing year actually collected in respect of the special tax of 15% under Section 105 has been tabulated by the Department of National Revenue as $5,643,766;

3. The present numerous complex provisions of the Income Tax Act respecting corporate distributions, in spite of many amendments, have not effectively prevented in many cases avoidance by individuals of the tax payable on the ultimate distribution of accumulated corporate earnings;

4. There are in fact many anomalies, inequities and deficiencies in the taxation of corporate and individual taxpayers arising out of these provisions;

5. These provisions also tend to encourage excessive accumulation of corporate earnings;

6. The taxation at graduated rates upon ultimate distribution of these accumulations continues to be a serious problem for many shareholders of closely-held corporations and their estates who are often forced to liquidate their holdings or resort to artificial devices to avoid the impact of this ultimate taxation;

7. On the other hand, similar problems are not created when investments by Canadian individuals are made in listed shares of public corporations, with the result that individual investors are not sufficiently encouraged to start new corporate ventures;

8. Freedom and flexibility of corporate organization are unduly restrained by the many provisions already referred to which affect indiscriminately all corporations, both closely-held and widely-held, without due regard to the requirements of efficient business organization;

9. The special tax concessions made from time to time in the past to reduce the effect of the graduated rates in an effort to solve the above problems have not prevented the continuing accumulation of corporate earnings and have not actually produced substantial revenues.

Therefore, in the opinion of the Committee, a new approach to the problem of the taxation of corporate distributions is necessary and desirable from the point of view of the Government and the Taxpayer.

The Recommendations of the Committee may be summarized as follows:

1. The basic recommendation is to impose, in lieu of the present method of taxation of dividends, a flat Shareholders Tax of 15% to be withheld by the corporation on any distribution or deemed distribution of accumulated corporate earnings to all shareholders by Canadian taxable corporations (hereinafter called "Canadian Dividends").

   In the case of corporate shareholders, the Shareholders Tax is payable only on the first distribution and thereafter no further tax is to be paid by Canadian resident corporate shareholders in respect thereto.

   The Shareholders Tax withheld is deemed to be on account of the 15% non-resident tax on dividends under Part III of the Income Tax Act.

2. In order to recognize the present favourable tax treatment accorded to Canadian resident individual shareholders with taxable incomes up to $10,000, a refund of the 15% Shareholders Tax would be granted to such individuals.

3. The Designated Surplus provisions in Section 28 and the special taxes in Sections 47(4), 105, 105A, 105B and 105C would be repealed and Section 81, dealing with distributions by way of "deemed dividends", would be amended to include the provisions of present Section 8 and to cover devices for "disappearance" of surpluses that may remain.

4. In the event that it is considered desirable as a matter of policy that the Shareholders Tax be increased on a limited progressive basis, the upward limits of such increased taxes should range from 15% to 40%.

5. Transitional provisions will be necessary to preserve for a reasonable time all present rights respecting the distribution of existing surpluses tax-free to corporate shareholders. The right to elect to pay the 15% tax under Section 105 in order to convert undistributed income to a tax-paid basis will also be preserved for a limited period.

6. As an incentive to certain Canadian corporations to distribute their earnings to Canadian resident shareholders, a special tax abatement shall be allowed to such corporations of a percentage of Canadian Dividends paid to such shareholders out of its earnings after December 31, 1960. The rate of abatement shall be reviewed annually, with a suggested rate of 10% for 1961.

7. The provisions respecting personal corporations would be repealed.

REVIEW OF PROVISIONS RELATING TO CORPORATE DISTRIBUTIONS

"Reference 1 - to consider the various provisions of the Income Tax Act relating to the taxation, as personal income or otherwise, of amounts that are distributed or are available for distribution out of the earnings of corporations."

HISTORICAL BACKGROUND

The Ives Commission Report

It is convenient to refer to the last official public enquiry which touches upon the matters referred to this Committee under its terms of reference, namely, The Royal Commission on Taxation of Annuities and Family Corporations, otherwise known as The Ives Commission. This Commission reported on March 29, 1945. While the concern of The Ives Commission in this respect was restricted to the problem of the tax liability on accumulated earned surpluses of so-called "private corporations or closely-held corporations", the many representations and problems considered by them also concerned this Committee. Their final Summary of Recommendations respecting this part of their enquiry was as follows:

"1. That the companies to which these recommendations apply be those which, in general, come within the definition of a private company as provided in the Dominion Companies Act.

2. That capitalization or distribution of surpluses earned prior to the end of the 1939 fiscal year be permitted on payment of a special tax by the company, which will approximate the tax that would have been paid by the shareholders had the surplus been distributed year by hear as earned.

3. That to accomplish this objective a graduated rate of tax be applied to the amount of the distribution or capitalization made or accruing to each shareholder - the minimum rate being 15% on amounts up to $25,000, and the maximum being 33% on amounts in excess of $400,000 to any one shareholder.

4. That permission to capitalize or distribute such surpluses be available for a period of two years from the date that the plan is made law.

5. That the refundable portion of excess profits tax be made available to apply in part payment of the special tax.

6. That on the re-organization of a private company which involves a change in beneficial ownership, or on the winding-up or discontinuance of business of any such company, the undistributed income which is deemed to be the payment of a dividend under the present law be reduced by an amount equal to 20% of the income after tax earned in the 1940 and subsequent taxation years."

As a result of the recommendations, Part XVIII containing Sections 94 to 97 was added to the Income War Tax Act in 1945 to provide the mechanics by which the recommendations of The Ives Commission were substantially adopted with respect to earned surpluses accumulated up to the end of the 1939 fiscal period. No attempt was made at that time to deal by legislation with earned surpluses accumulated after that date and specifically the 20% retention proposal in Recommendation No. 6 was not accepted.

Election to pay 15% Tax

In 1950, the Government of the day decided to introduce further legislation to deal with accumulated as well as future surpluses. Under this legislation earned surpluses accumulated to the end of the 1949 taxation year were to be

dealt with in much the same way as earned surpluses up to the end of the 1939 fiscal period under Part XVIII of the Income War Tax Act, except that the tax payable by the closely-held corporation was a flat 15% and capitalization of the resulting tax-paid undistributed income was mandatory to achieve tax freedom for the receiving shareholder. As for future surpluses, there was introduced what was thought to be a continuing solution by permitting the capitalization tax-free to the shareholders (at a 15% tax cost to the company) of an amount of undistributed income equal to dividends paid after 1949. The then Minister of Finance in his Budget Speech of March 28, 1950, said by way of explanation of this measure:

> "If the proposed legislation did no more than take care of past surpluses a new problem with respect to the future would immediately start developing. I think it desirable, therefore, that the present legislation should provide a comprehensive solution to the problem as a whole rather than merely deal in ad hoc fashion with the past."

Introduction of Designated Surplus concept

On May 10, 1950, the Designated Surplus concept was introduced. The effect was to tax at full corporate rates the distribution of accumulated surpluses of corporations whose control was acquired by another corporation after that date. To the extent that a controlled closely-held corporation had tax-paid undistributed income on hand such a distribution remained tax-free.

In 1951, the right to elect to pay the 15% tax was extended to other than closely-held corporations, but, except in respect of surpluses at the end of 1949 taxation year, was

withdrawn from a corporation which was a "subsidiary controlled corporation." The effect of this amendment was that, in the case of the acquisition of control after 1949, no portion of Designated Surplus representing earnings accumulated since the 1949 taxation year could be distributed by way of dividends or otherwise to a controlling corporation at a tax cost of only 15%.

Additional Special Taxes

While the Designated Surplus provisions in the main froze pre-control surpluses, other erosions of undistributed income continued so that various special tax provisions were introduced into the Act as follows:

1. A 20% or 30% tax on premiums paid by a company on any redemption or acquisition of its preferred shares, now under Section 105A (1953);
2. A 15% or 20% tax on distributions of Designated Surplus to exempt taxpayers, non-residents and securities dealers, Section 105B (1955); and
3. A 20% tax in respect of certain statutory amalgamations resulting in the effective disappearance or reduction of undistributed income, Section 105C (1959 and 1960).

Dividend Tax Credit

In 1949, provision was made for an allowance to Canadian resident individual shareholders of a credit against taxes otherwise payable of 10% of dividends received from Canadian taxable corporations. The credit was limited to the amount of tax payable in respect of such dividends. In 1953, the credit

was increased to 20%, subject to the same limitation. However, in 1957, this limitation was removed.

SUMMARY OF PRESENT LEGISLATION

We set out hereunder the principal provisions in the Income Tax Act of Canada affecting the distribution and retention of profits earned by corporations in Canada and a brief outline of their purpose. The tax payable by corporations is 21% on taxable income not exceeding $35,000 and 50% on any amount in excess thereof.

Provisions relating to cash distributions

S. 6 (1) (a)	- Amounts received as dividends included in income
S. 6 (1) (g)	- Amounts received as premiums on redemption of shares before April 30, 1953, included in income
S. 11 (2)	- Shareholder's allowance for depletion
S. 28 (1)	- Inter-corporate dividends tax-free in certain cases
S. 28 (2)	- Inter-corporate dividends taxable in certain cases
S. 38	- 20% dividend tax credit for Canadian resident individuals
S. 47 (4) (5)	- 25% withholding tax on dividends received by brokers in certain circumstances
S. 63	- Dividends received by trusts and estates

Provisions relating to "deemed" distributions and other benefits to shareholders

S. 8 (1)	- Benefits to shareholders included in income
S. 8 (2)	- Loans to shareholders taxed as deemed dividends without tax credit

S. 8 (3)	-	Interest on income debentures deemed a dividend
S. 11 (1) (da)	-	Repayment of loan by shareholder under S. 8(2) deductible from income
S. 24	-	Securities or rights in satisfaction of dividends
S. 67-68	-	Deemed distribution of income to shareholders of personal corporations
S. 81-82	-	"Distributions" resulting from reorganizations, winding-up, capitalizations, etc., deemed to be dividends

Special provisions and taxes on benefits and distributions to shareholders

S. 31 (2)	-	Distributions to non-resident shareholder employees in certain cases taxed as ordinary income
S. 32 (3)	-	4% surtax on investment income from non-Canadian sources
S. 105	-	15% tax on undistributed income subject to certain conditions
S. 105A	-	20% or 30% tax on premiums on redemption or acquisition of preferred stock
S. 105B	-	15% or 20% tax in respect of dividends paid out of Designated Surplus to specified persons
S. 105C	-	20% tax in respect of certain undistributed income following statutory amalgamations

EFFECTS OF PRESENT LEGISLATION

> "Reference 2 - to determine the extent to which these provisions have given rise to anomalies and inequities in taxation, have made unduly complex the arrangements governing business organization, have imposed barriers to the creation of new businesses and the reorganization of existing businesses and have encouraged the adoption of artificial devices and arrangements to avoid taxation."

The cumulative effect of the annual revisions of income tax legislation, particularly those which were intended to deal with special situations, has been to complicate the tax structure and to introduce a variety of rates.

The following partial tabulation of rates (in which are included Old Age Security Tax unless otherwise noted) which are involved in the earning of business income in corporate form and the distribution of such income will serve to illustrate this point.

Rates relating to cash distributions

(i)	Dividends received by resident individuals from foreign or non-taxable corporations	14% - 84% *
(ii)	Dividends received by resident individuals from Canadian resident taxable corporations	14% - 80% * less 20% of dividend
(iii)	Dividends received by Canadian resident taxable corporations from foreign or non-taxable corporations	21% & 50% **
(iv)	Dividends received by Canadian resident taxable corporations from Canadian resident taxable corporations	exempt

(v)	Dividends received by Canadian resident taxable corporations out of designated surplus of a controlled Canadian resident taxable corporation	21% & 50% **
(vi)	Dividends paid to non-resident individuals and corporations	15%
(vii)	Dividends paid to non-resident individuals and corporations under a tax treaty	exempt - 15%

* To the 80% and 84% rates should be added $90 - Old Age Security Tax. 4% investment surtax included where applicable.

** Included in taxable income: at 21% up to $35,000 and 50% on excess

Rates relating to other distributions

(viii)	Various corporate actions which constitute payment of a deemed dividend	as above (i) - (vii)
(ix)	A stock dividend or other capitalization (but not a cash dividend) paid out of capital surplus after having paid appropriate taxes on any undistributed income on hand	exempt
(x)	Benefits under Section 8(1) to Canadian resident shareholders of Canadian resident corporations	14% - 80% *
(xi)	Such benefits if to non-resident shareholders	15%

* To the 80% rate should be added $90 - Old Age Security Tax

Special Tax rates payable by payer corporations

(xii)	"Distribution" of 1949 surpluses (105(1))	15%
(xiii)	"Distribution" of post 1949 surpluses (105(2)) equivalent to dividends paid	15%

(xiv)	"Distribution" by way of premium paid on redemption or acquisition by a corporation of its preferred stock (105A)	20% or 30%
(xv)	"Distribution" out of Designated Surplus to a non-resident corporation (105B)	15%
(xvi)	And if to an exempt person (105B)	15%
(xvii)	And if to a trader or dealer in securities (105B)	20%
(xviii)	"Distribution" resulting from statutory amalgamation (105C)	20%

The foregoing tabulation gives effect to the Budget resolutions introduced by the Minister of Finance on December 20, 1960.

The above sets out the principal rates although there are other special taxpayers for which different rates or treatment are applicable such as trusts and estates, foreign business corporations, non-resident-owned investment corporations, investment companies, life insurance companies, public utilities, co-operatives and non-taxable entities including charities, pension trusts, personal corporations, etc. It is evident that the hopeful words of the Minister of Finance in his Budget Speech of March 28, 1950, quoted above, have not been fulfilled. The procession of "ad hoc" solutions has in the last decade continued unabated.

Election to pay 15% Tax

In 1950, when the right of election to pay a special 15% tax on undistributed income was introduced, it was thought that a settlement of tax liability on 1949 undistributed income on this basis would be accomplished. Thereafter it was expected that the corporation would adopt a regular dividend policy so that it could qualify for continuing elections to pay the 15%

tax on amounts equal to the dividends paid. In fact many corporations found that the 15% tax on their 1949 undistributed income was too great a burden unless there was an immediate and substantial benefit to be gained for their shareholders. Accordingly, such corporations could not elect under the continuing phase of the plan even if their subsequent dividend policy would have qualified them to do so. Further, those corporations which had elected and paid the tax on their 1949 undistributed income or were incorporated after 1949 did not necessarily elect or could elect to pay the special tax of 15% because of one or more of the following reasons:

1. The tax cost to the shareholders at graduated rates of dividend payments in order to qualify for the election was a deterrent in many cases;

2. The 20% Dividend Tax Credit had removed to a large degree the incentive to pay the 15% tax which would otherwise have been present; and

3. There were other ways of distributing undistributed income without tax by resorting to the many devices developed throughout the decade in spite of continuous efforts by the administration to defeat these attempts to avoid taxation.

Accordingly, this concession has not solved the problem of continuing accumulations of corporate earnings.

Designated Surplus

The effect of the Designated Surplus provisions, described above, was to tax at full corporate rates all dividends paid out of pre-control period accumulated earnings. These provisions were obviously intended to prevent the application of the proceeds of tax-free inter-corporate dividends in payment for the shares of the controlled corporation. It was also intended to prevent the vendor of the shares from obtaining

the benefits of a distribution of earnings without tax. Therefore, unless these provisions could be avoided when one corporation acquired control of another after May 10, 1950, the pre-control surplus was effectively frozen.

The compelling urge to avoid the Designated Surplus problem is illustrated by some of the more obvious devices employed without regard to the business realities other than tax considerations:

1. The cutting off of normal inter-corporate cash flow to avoid tax.

2. The 50-50 split between companies acquiring a subsidiary company to avoid control and consequent designation of surplus under Section 28(2) and the tax under Section 105B.

3. The creation of non-voting stock to be acquired by a corporation in order to avoid the acquisition of control with the same results as in No. 2 above.

4. The use of holding companies solely as a buffer to prevent future designation of surplus.

5. The statutory amalgamation to free designated surplus in the hands of the resulting corporation as permitted under Section 105C without tax and to avoid designation of surplus under Section 28(2).

In actual practice there are many variations and combinations of these devices.

Even when a Designated Surplus has arisen, the controlling corporation can avoid the tax effects by many unnatural arrangements of the business activity and the capital structure of the controlled corporation such as:

1. Transfer of business by way of sale or rental of assets to the controlling corporation, leaving Designated Surplus recorded on the inactive controlled corporation's books;

2. Purchase of assets from controlling corporation, thereby transferring cash to the controlling corporation to pay off acquisition or other debt; and

3. Erosion of Designated Surplus by excessive management and other charges by the controlling corporation and by other artificial methods.

A direct result of these complex provisions designed to prevent the escape or erosion of undistributed income without tax is to inhibit normal economic organization and re-organization of Canadian business, both large and small, both private and public.

Additional Special Taxes

As indicated above, Sections 105A, 105B and 105C were designed to collect various special taxes at rates of 15%, 20% or 30%, as the case may be, upon the actual or deemed distribution or realization of corporate earnings by means of the various methods described in these sections.

These special taxes are in lieu of the graduated rates otherwise payable by individuals and by way of additional taxes payable by corporations in respect of such distributions or deemed distributions.

With respect to Section 105A, a premium paid upon the redemption or acquisition of preferred shares was considered to be in effect a distribution of corporate earnings. The tax imposed is a flat rate of 20% of premiums not in excess of 10% and 30% of premiums over 10%. This tax is payable regardless of the amount of undistributed income on hand of the corporation,

if any. Therefore, the underlying principle justifying the imposition of tax was not carried forward completely into the legislation in that capital repayments by way of premiums are also taxed. At the same time, where undistributed income existed, it can always be distributed at a maximum cost of 20% because any amount of undistributed income can be distributed by the issue and immediate redemption of a sufficient amount of preferred shares carrying a 10% premium equal to the amount of the proposed distribution.

Section 105B taxes are applicable only when Designated Surplus is distributed to entities which would not be effectively subject to tax. The provisions of Section 105B apply where a resident corporation is "controlled" by a non-resident corporation or a person exempt from tax or a trader or dealer in securities. Because such control can result through ownership of less than 100% of the shares, the special tax under this section will be payable by the payer corporation even where payments out of Designated Surplus are made to resident taxable corporations or individuals. The result is that the undistributed income of the corporation is subject to the special 20% or 15% tax under Section 105B, and the balance actually distributed to the minority Canadian resident individual shareholders is subject to further tax at graduated rates.

The special tax rate on Designated Surplus distributions where the Canadian resident corporation is controlled by a securities dealer is 20%, as opposed to 15% where the corporation is controlled by a non-resident corporation or an exempt entity, except a personal corporation. While the underlying

intention in Section 105B is to collect a flat tax in the special circumstances described therein, in fact, the devices referred to above under the heading "Designated Surplus" are equally available to taxpayers who wish to avoid these special taxes.

Section 105C recognizes the principle that no tax penalties should be levied on the distribution of earnings from one corporation to another unless such earnings effectively "disappear" for tax purposes, in which case a flat tax of 20% is levied on the amount of "disappearance". The measure of the "disappearance" is the reduction of the undistributed income to less than the "net asset value" (excepting goodwill) of the recipient corporation. However, the actual application of the principle in Section 105C is limited to a few cases where a statutory amalgamation is possible under Provincial Company law. All other mergers and reorganizations, however accomplished, with the same economic effects are denied the application of this principle.

Dividend Tax Credit

Before 1957, the dividend tax credit of 10%, and subsequently 20%, was limited to the tax actually payable by the Canadian resident individual on the dividend he received from Canadian taxable corporations. However, pursuant to the 1957 amendments, this limitation was removed so that the 20% credit applied regardless of the tax payable in respect of the dividend. The reason given for the change was to remove the need for taxpayers with small incomes calculating their tax both with and without their dividends included. The effect was to reduce the tax otherwise payable on income from other sources

in the case of many taxpayers. For example, under the present rates, an individual in the first bracket of taxable income of $1,000 subject to 11% tax (excluding Old Age Security Tax) receives an additional tax credit amounting to 9% of these dividends. This additional abatement is available only to an individual who has income made up of dividends and other income. Consequently, an individual in this bracket with dividend income only is limited to a credit of 11% instead of 20%.

The effect of the 9% tax credit is illustrated as follows:

	TAX PAYABLE
$1,000 Taxable Income	$110.00
Appropriated as follows:	
$900 Taxable Income	$ 99.00
100 Dividends from Canadian taxable companies	11.00
$1,000	110.00
Less: Tax Credit of 20% of $100	20.00
	$ 90.00

The difference between the tax payable of $11.00 on $100 of dividends, and the tax credit of $20.00 on same is $9.00, which has been applied to reduce the tax payable on the other income.

Benefits to shareholders

Section 8, Subsections (1) and (2) of the Act, tax certain benefits to shareholders either as ordinary income or as a deemed dividend. These provisions apply regardless of the amount of undistributed income, if any, in the hands of the corporation.

In the case of benefits under Subsection (1), which are taxed as ordinary income, no dividend tax credit is permitted to the individual shareholders, and in the case of corporate shareholders, such benefits are taxed at full corporate rates.

Subsection (2) applies to loans to shareholders which are treated as deemed dividends except for the instances referred to in the subsection. However, no dividend tax credit is permitted to individual shareholders, but upon the repayment of the loan, a deduction is permitted from income equal to the amount of the repayment. Moreover, this deduction is limited to the taxpayer's other income in that year only. In the case of corporate taxpayers, the deemed dividend will be taxed to the recipient corporation if it is paid out of Designated Surplus. If it is not paid out of Designated Surplus, the deemed dividend is received by the recipient corporation tax-free, but the amount is added to its undistributed income. The deemed dividend is not deductible from the undistributed income of the payer corporation. Subsequent repayment of the loan by the corporation does not reduce its undistributed income.

The foregoing examples of the many anomalies and inequities arise out of the attempt to collect a tax on the distribution of corporate earnings. No consistent principle is apparent in these complex provisions other than this attempt to collect such tax or to apply prohibitive tax rates to counteract the avoidance of the graduated rates of tax.

<u>Amount of tax collected</u>

We have estimated that the amount of tax actually collected annually from Canadian resident individuals in respect of dividends received from Canadian corporations based upon the present rate structure and present pattern of distribution of corporate earnings is less than $50,000,000. Our estimate is based on the information available for the most recent year, namely, the taxation year 1958, which is published in "1960 Taxation Statistics" prepared by the Department of National Revenue, together with additional information obtained from other Government sources.

The total amount of tax actually collected in respect of the special tax of 15% under Section 105 was $5,643,766 in the filing year 1959 as tabulated by the Department of National Revenue. There are no statistics available tabulating the taxes collected annually under Sections 105A, 105B and 105C. The special nature of these taxes is such that their application is erratic and unpredictable. We would, however, estimate that Sections 105A, 105B and 105C are not likely to raise any significant amount of tax because of this limited application.

We have not been able to ascertain the amount of tax collected on dividends paid out of Designated Surplus defined in Section 28(2) but in view of the prohibitive effective rate it is unlikely that any significant amount of tax has been collected.

TAX LAWS OF OTHER COUNTRIES

"Reference 3 - to study the comparable provisions of the tax laws of other countries."

We have studied in a general way the tax laws of some of the countries of comparable economic development to that of Canada with particular emphasis on thos matters within the scope of the work of this Committee.

In our survey of these laws we have found that although the problem of the taxation of corporate earnings exists in all these countries, the approach in each differs widely. To a large extent the differences are inherent in the tax system which has evolved in each country. The approach has been further conditioned by the objectives sought to be achieved by fiscal means from time to time by each of them.

The tax systems of the countries studied recognize certain general principles:

1. All impose a tax oncorporations as separate taxable entities;

2. All impose a tax on the distribution of corporate earnings to individual shareholders;

3. Most acknowledge the special nature of corporate distributions of profits already subject to tax, and various tax concessions are granted to individual shareholders; and

4. Many grant incentives to encourage the distribution of corporate earnings, or impose penalties to discourage their undue accumulation.

We illustrate the variety of the different approaches to the taxation of corporate distributions hereunder:

1. In such countries as the United Kingdom, Australia, South Africa and Italy, a portion of the tax initially paid by the corporation in respect of its profits is deemed to have been paid for the shareholder who applies the same against his personal tax, if any.

2. In France, there is found a combination of a withholding tax on dividends, plus a further tax, if applicable, at graduated rates.

3. In some countries, dividends received by individual shareholders are to a greater or lesser extent excluded from the computation of gross income. The deduction may be absolute as in the case of the $50 exemption in the United States, or a percentage of dividends such as the 15% allowed in Finland.

4. The United States grants an allowance against taxes of 4% of dividends received by individuals over the $50 exemption previously mentioned.

5. In the United States and in the United Kingdom, there are special penalties for undue accumulation of surpluses by closely-held corporations.

6. In some countries there are tax incentives for specific purposes. In West Germany, the basic corporate tax rate on retained profits is 51%, and on distributed profits it is 15%. Similar incentives, but with more limited scope are found in Sweden and France. At the same time other countries, such as Belgium, tax distributed profits at a higher rate than retained profits.

Since systems of taxation grow out of the history and economic and cultural development of each country, each is peculiar to its own environment and peoples. While the broad general principles may be universal, the Canadian solution must be found in Canadian experience.

SUGGESTIONS FROM VARIOUS SOURCES RELATING TO DISTRIBUTIONS BY CANADIAN CORPORATIONS

Many suggestions relating to the problems of distributions by Canadian corporations have been made recently by interested parties. We mention the principal suggestions hereunder and indicate briefly why we were of the view that these suggestions did not provide a satisfactory solution to the problems referred to us under our terms of reference.

Exempt dividends received by Canadian resident persons from taxpaying Canadian resident corporations with compensation to the Revenue by an increase of 1% or 2% in the general corporate tax rate

This suggestion would exempt shareholders completely from tax on the dividend form of income, a principle which the Committee could not support. Moreover, a general increase in corporate tax in lieu of any tax on dividends has the undesirable effect of taxing earnings indiscriminately whether distributed or retained, and increasing the gap in the rates of taxation between the partnership and corporate forms of carrying on business. We are also of the view that an increase in the general corporate rate of tax for the purpose of freeing dividends from tax is not desirable at this time. There is a substantial body of opinion, which we share, that believes that an unduly high rate of tax on corporate profits has an adverse effect on business expansion at home or on the position of Canadian business in export markets.

Increase the dividend tax credit to approximate the higher (50%) corporate tax rate

The effect of this suggestion is the virtual abolition of tax on dividends without compensation to the Revenue. Furthermore, if the principle underlying the dividend tax credit is to reimburse the shareholder for corporate tax paid on earnings distributed, the credit should be related to the actual federal tax borne by the corporation. A flat rate of dividend tax credit of general application does not meet this test. The effective rate of corporation tax varies as between large and small corporations and as between corporations which do business in certain provinces levying their own corporate income taxes and in foreign countries and those who do not.

Free Designated Surplus after a period of years

This suggestion does not solve the particular problem created by Designated Surplus because it merely delays the removal of an undesirable feature of the present legislation. Reference has already been made to this matter in this Report.

Impose a tax on the vendor of shares equal to his portion of Undistributed Income in certain circumstances

The essence of this suggestion appears to be the taxation of undistributed income of a closely-held corporation on any sale of its shares by a controlling shareholder to the extent of the undistributed income attributable to such shares. This carries the concept of Designated Surplus one step further than at present in that tax will be imposed even if there is

no actual distribution. Under the Designated Surplus provisions no tax is imposed until there is a distribution out of such surplus. This suggestion would impose a tax whether or not there is an actual distribution. Accordingly, there is a penalty on bona fide sales of shares in which the use of the corporation's own accumulated earnings to provide the purchase price is not a factor.

Furthermore, there would be unwarranted discriminatory treatment as between investors in closely-held and in widely-held corporations as well as between controlling and minority shareholders.

For the above reasons, we cannot support this suggestion.

Tax the payer corporation at the rate of 15% on Designated Surplus which effectively disappears for tax purposes

The principle of imposing a tax on the "disappearance" of surplus has already been accepted in Section 105C. This suggestion is an extension of this principle to Designated Surplus and may solve that problem provided that "disappearance" can be effectively defined. However, while this suggestion permits distribution out of Designated Surplus in bona fide cases, the use of artficial devices to avoid designation is not prevented.

Extend the principle of Section 105

In view of the limited application of the election privilege under Section 105(1) and (2) to pay the special 15%

tax thereunder and the problems already described above under the heading "Election to Pay 15% Tax", it has been suggested that any corporation, whether a subsidiary or not, be permitted at any time to elect to pay the special tax on any amount of its undistributed income including designated surplus. The effect of thus creating tax-paid undistributed income by the payment of the 15% tax would be to permit the capitalization of such tax-paid undistributed income and the subsequent distribution of all or part thereof without tax.

As the present 20% dividend tax credit provision exempts a large proportion of individual shareholders of widely-held corporations, this suggestion would mainly benefit closely-held corporations and their shareholders.

As the purpose of Section 105 was to encourage final settlement of tax liability in respect of accumulating corporate earnings, particularly of closely-held corporations, the Committee is of the opinion that the removal of the impediments mentioned previously in this Report would restore the usefulness of the legislation to that originally contemplated.

For these reasons, in the opinion of the Committee, this suggestion merits further consideration in the absence of the more far reaching solution recommended by this Committee hereunder.

RECOMMENDATIONS

> "Reference 4 - to recommend changes which may achieve greater simplicity and overcome any anomalies, inequities or deficiencies it finds in the present law without substantial loss of revenue."
>
> "Reference 5 - to recommend appropriate changes in the taxation of personal corporations, in the light of recommendations made under the previous paragraph; and
>
> Reference 6 - in connection with the above subjects, to recommend any methods by which the income tax laws in question might be reformulated, in the national interest, so as to give greater encouragement to the Canadian ownership of Canadian industry."

The Committee is of the opinion that a new approach to the taxation of the distribution of corporate earnings is necessary and desirable. As has been previously shown in this Report, the Revenue has not received substantial amounts from the present graduated rate structure applicable to dividends and the special taxes under Sections 105, 105A, 105B and 105C. The provisions made from time to time to ensure that the Revenue received such tax in due course have actually produced revenue of slightly in excess of $50,000,000 per annum. We feel that the ultimate cost to the Canadian tax-paying public of the administrative efforts to enforce these provisions have been out of proportion to the amount of taxes actually collected. We recognize that the enforcement of existing tax laws cannot be relaxed on the grounds of cost. However, it is obvious that in an attempt to control avoidance, the law should not be permitted to become so complex that the cost of its administration is unrealistic.

The Committee is of the view that under the present method of taxation, freedom and flexibility of corporate organizations have been unduly restrained for both widely-held and closely-held corporations without regard to the requirements of efficient business enterprise. The special tax concessions made from time to time to reduce the impact of the graduated rates of taxation on corporate distributions have not provided an effective and continuing solution.

The problem affects both closely-held and widely-held corporations, but in different ways. In the case of the closely-held corporations, the continued accumulation of earnings to which is attached a contingent tax liability at graduated rates poses a serious problem for the shareholders and their estates. The widely-held corporations are only concerned if they have one or more subsidiaries whose accumulated earnings are, or can become, designated. The shareholders of a widely-held public corporation whose shares are listed on a recognized stock exchange are in a different position from those in closely-held corporations because the listed shares may normally be sold without tax liability at a price which reflects their interest in the accumulated earnings. It might therefore be claimed that any solution should differentiate between these two classes of corporations. Experience has shown, however, that any attempt to provide a satisfactory statutory definition of either of these broad groups has never been entirely successful. This follows from the variety and complexity of business organizations in which no all-inclusive definition can equitably cover every situation. Therefore, we have attempted to find a solution which, in so far as possible, will meet the needs of

both classes.

The tests the Committee has set for itself in coming to a new approach are summarized as follows:

1. That any recommendation to be made should be as simple as possible from a technical point of view;

2. That administrative ease and protection to the Revenue should be as great as possible;

3. That the proper and necessary retention of earnings for use in the business should not be prevented;

4. That the maximum distribution of corporate earnings, consistent with proper retention, should be encouraged;

5. That any recommendation to be made should be directed towards encouraging greater Canadian ownership of Canadian industry; and

6. That, consistent with the foregoing objectives, any recommendation to be made should be as equitable as possible.

With these tests in mind, the Committee recommends that in lieu of the present complex provisions and rates, there will be a uniform rate of a Shareholders Tax on dividends of 15% withheld at the source. In the event that it is considered desirable as a matter of policy that the Shareholders Tax be increased on a limited progressive basis, we indicate the limits of such increased tax in order to maintain the effectiveness of our recommendations. We also recommend a distribution incentive allowance be granted on an annual basis to certain Canadian corporations for dividends paid to Canadians out of earnings after December 31, 1960.

The detailed recommendations and the explanations thereunder are as follows:

Shareholders Tax

1. All shareholders receiving from Canadian "taxable corporations" (as presently defined in Section 38(2)) dividends, including "deemed dividends", shall pay a Shareholders Tax of 15% on the amount of such dividends, after deducting depletion allowances, if any, herein called "Canadian Dividends", and the payer corporation shall withhold therefrom the said tax and remit the same to the Receiver General of Canada on behalf of the shareholder. This tax is payable on the gross amount of Canadian Dividends without deduction for interest or other carrying charges.

We believe that in principle a flat rate withholding tax on corporate distributions is the practical answer to the problems under consideration by this Committee. Because corporate profits are now taxed at rates which are not truly progressive but distributions of profit are subject to a second tax at steeply graduated personal rates, it is inevitable in our view that shareholders will attempt to avoid the full burden of the second tax. This applies to a greater or lesser degree to all corporations whether closely-held or widely-held.

The theory of the progressive rates of tax must, in our opinion, be discarded or substantially modified for corporate distributions by both closely-held and widely-held corporations in the interests of a sounder and more efficient and effective overall tax system in Canada. We have outlined in this Report many of the anomalies and inequities arising out of the present system of attempting to marry the two opposite

concepts of taxation, namely, the flat rate principle inherent in the taxation of corporate earnings and the graduated rates applicable to the subsequent distribution of such earnings.

The basic idea in this proposal is therefore to impose a flat withholding tax, and as such, is simple in conception and application. It is self-evident that a withholding tax facilitates collection and offers greater protection to the Revenue. According to the most recent statistics available, there appears to be some $150 millions of dividend payments to persons who were not required to file returns or, being so required, failed to report such dividends. To the extent that any part of this amount should have been so reported for tax purposes, the withholding tax will ensure more effective assessment and collection.

We feel that the rate of Shareholders Tax should be fixed at 15%, because it has already been established as a principal rate for corporate distributions under the special taxes already referred to and for the purpose of non-resident taxation. The uniform rate for residents and non-residents simplifies corporate administration.

It is our view that if our recommendations are adopted, the tax avoidance practices reviewed in this Report would be substantially eliminated. As a consequence, we recommend that the special taxes provided in Sections 47(4), 105, 105A, 105B and 105C, and the Designated Surplus provisions in Section 28, all be repealed and that Section Section 81, which sets out the situations constituting deemed dividends,

be retained and expanded to cover benefits and loans in Section 8, and the "disappearance of surpluses now subject to tax under Sections 105A, 105B and 105C. We have prepared a summary analysis of the principal sections in the Act affected by our recommendations, together with suggestions as to the changes required. This analysis appears as an Appendix annexed to this Report.

Distribution of earnings to Canadian shareholders may be made in cash at a uniform tax cost so that the present graduated rates of tax on dividends, one of the chief causes for reluctance to distribute, are eliminated, subject to any modification of the Shareholders Tax mentioned hereunder. To the extent that a corporation wishes to declare a stock dividend, it may do so at any time provided that 85% of the total dividend is payable by the issue of shares and the balance of 15%, being the Shareholders Tax, is payable in cash and remitted to the Receiver General of Canada.

The Shareholders Tax applies to the exempt persons listed in Section 62 of the Act. It is the opinion of the Committee that generally no concession should be made with respect to these persons having in mind the special tax treatment already enjoyed by them and the universal character of the proposed Shareholders Tax. However, considering the continuing need to encourage charitable activities in the community, it may be desirable to grant refunds of Shareholders Tax to those entities described in Section 62(1)(e), (f) and (g). If the refund is extended to these entities, we recommend that for non-profit corporations and trusts under paragraphs (f) and (g) the right to a refund be withdrawn if such corporation or trust holds more than a 10% interest in the corporation.

Intercorporate dividends

2. The Shareholders Tax of 15% shall be deemed to have been withheld in respect of any payment of a Canadian Dividend out of the shareholder's portion of the payer corporation's tax-paid undistributed income as of the time of the payment of such dividend. Therefore, no further withholding tax will be payable in respect of the amount of such dividend. Tax-paid undistributed income of a corporation shall mean the aggregate of the tax-paid undistributed income of the corporation as presently defined by Section 82(1)(b) and net Canadian Dividends received.

The Shareholders Tax applies to Canadian Dividends received by other Canadian corporations, but re-distribution of such Canadian Dividends is not subject to a further 15% withholding tax. The receiving corporation will include such Canadian Dividends, less the 15% tax withheld, in its tax-paid undistributed income. Therefore, the freedom from tax of intercorporate dividends is preserved to the extent that the receiving corporation pays out such Canadian Dividends to its own shareholders. In such case, there is in effect a prepayment of the 15% Shareholders Tax for the ultimate shareholder. This may tend to encourage more prompt re-distribution of such dividends.

Canadian Dividends otherwise exempt

3. Canadian Dividends shall be excluded from the computation of taxable income of Canadian resident persons for income tax purposes. The dividend tax credit provided in Section 38 shall be repealed.

The Shareholders Tax of 15%, subject to possible modification thereof as indicated hereunder, is intended to be in full, complete and final settlement of tax liability in

respect of corporate distributions by way of Canadian Dividends to Canadian resident shareholders. This has the effect of removing such dividends from the present graduated tax structure and of recognizing the special tax character of distributions of corporate earnings already subject to tax in the hands of the corporation. The anomalies referred to above with respect to the effect of the present 20% tax credit will be removed.

Refund or Tax Credit

4. A refund of Shareholders Tax of 15% of Canadian Dividends received by Canadian resident individuals shall be allowed to individuals having an aggregate of taxable income (as re-defined) and Canadian Dividends not exceeding $10,000;

Alternatively,

If it is considered desirable to maintain the present special privileged position of such individuals who because of the 20% Dividend Tax Credit have an additional credit against taxes on their other income, it would then be necessary that the refund or tax credit referred to above be increased from 15% to 20%. However, in such case, the refund should be limited to the aggregate of Shareholders Tax and the tax otherwise payable in respect of taxable income (as re-defined).

The Shareholders Tax is applicable to all Canadian Dividends paid. The effect would be to tax a large group of Canadian individual shareholders who are now wholly or partially exempted from tax by reason of the 20% Dividend Tax Credit. The 15% refund recommendation is designed to recognize in part the present favourable tax treatment for this group. We are of the view that no new tax burden should be imposed on this group which might have the effect, directly or indirectly,

of discouraging them from continuing to invest or acquiring new investment in Canadian industry.

No refund will be made to the unincorporated entities described in Section 62 or their members, subject to our observations regarding charitable entities.

The refund should not extend to trusts or entities under Section 63 taxed as such but the individual beneficiary's right to a refund upon distribution will be preserved as if he had received the Canadian Dividend directly.

Therefore, the Committee feels justified in modifying its basic recommendation of a 15% flat Shareholders Tax by providing for a refund or tax credit of such tax within certain income tax brackets. The taxable income bracket under $10,000 was chosen by the Committee because of the existing situation. It should be noted that the present 20% credit applies only against taxes otherwise payable and no direct refund is permitted. Our recommendation contemplates an actual refund of the 15% tax withheld to the extent that there is not other tax payable.

The Committee is not in favour of extending the refund or tax credit to the present rate of 20%. Such extension can only be justified on the ground that this additional tax advantage already exists.

Modification of Shareholders Tax

5. If it is considered desirable to introduce a limited degree of progressiveness into our recommendations, the 15% Shareholders Tax might be modified as follows:

BRACKET (AGGREGATE OF TAXABLE INCOME AS RE-DEFINED PLUS CANADIAN DIVIDENDS)	RATE ON PORTION OF "CANADIAN DIVIDEND CONTENT IN EACH BRACKET"
Under $10,000	Nil
$10,000 to $25,000	15%
$25,000 to $90,000	25%
$90,000 to $400,000	30%
Over $400,000	40%

"Canadian Dividend Content in each Bracket" means the amount of Canadian Dividends in addition to taxable income (as re-defined), if any, in the bracket.

15% of Canadian Dividends shall be withheld by the corporation as hereinbefore recommended and applied on account of the above tax and the remaining amount (if any), shall be paid by the shareholder.

We adhere to the basic principle that the Shareholders Tax should be fixed at a flat rate of 15%. However, if it is considered desirable as a matter of policy to modify the flat rate to introduce a limited degree of progressiveness, the above rates are the maximum rates which we could recommend. If these rates are exceeded, the problems that our recommendations are designed to remove will continue. Even the above rates will invite, in some degree, resort to devices to avoid these taxes. We believe that it is preferable for a system of tax to be introduced which would ensure actual collection of a fixed tax at source in a reasonable amount instead of a system which imposes a highly graduated tax in theory, but which fails to yield the expected revenue. The foregoing rates are also

the maximum rates which can be justified in the light of the present tax cost of corporate distributions under the methods now expressly condoned or encouraged by the Act.

We emphasize that the 15% Shareholders Tax is a levy on the gross amount of dividends without deduction for interest or other carrying charges and, therefore, to this extent is not comparable to tax payable according to the present rate structure. However, if a limited degree of progressiveness is to be introduced then it may be necessary to permit the deduction from Canadian Dividends of such interest or other carrying charges.

Pre-1961 Undistributed Income

6. The transfer of undistributed income between corporations shall be permitted within a reasonable time to be fixed with respect to undistributed income at the end of the 1960 taxation year on the basis of the present provisions of the Act to the extent applicable to such corporations on the date of the implementation of these recommendations.

   Similarly, the right to elect to pay the special tax of 15% under Section 105 shall also be continued for such reasonable time to be fixed on the basis of the present provisions of the Act to the extent applicable on the date of the implementation of these recommendations.

   Distributions by cash dividend or otherwise of tax-paid undistributed income arising out of the application of the present provisions of the Act shall not be subject to further tax.

The purpose of the transitional provisions is to enable corporations to review their position and to take the

necessary steps to make such adjustments as may be desirable on the present basis within a limited time to be fixed. The effect of this recommendation is that any corporation which is now in a position to receive tax-free dividends from another corporation with respect to surpluses accumulated up to the end of the 1960 taxation year will continue to have this right for the transitional period without being subject to the 15% Shareholders Tax.

Corporations which were entitled to elect to pay the special 15% tax in respect of any part of their undistributed income will be permitted to do so for such limited time. This recommendation for the continuance of the right to pay the Section 105 tax of 15% is necessary only in the event that provision is made for an increase in the rates of Shareholders Tax over 15%.

The intent is to ensure that upon the implementation of these recommendations any vested rights under the present law shall be continued for a reasonable time and to prevent the new legislation from having any retroactive taxing effect.

Withholding Tax on Non-Residents

7. The Shareholders Tax withheld shall be deemed to be on account of the 15% non-resident tax under Section 106(1)(a) of the Act.

A uniform withholding tax of 15% for residents and non-residents results from these recommendations. In the case of non-residents no deductions from dividends will be allowed. One effect of such a universal application of the withholding

principle is that it will no longer be possible to avoid the payment of the 15% withholding tax in respect of dividends paid by Canadian corporations to such non-residents.

Distribution Incentive Allowance

8. As an incentive to certain Canadian taxable corporations to distribute their earnings to Canadian resident shareholders, a special tax abatement shall be allowed to such a corporation equal to a percentage of Canadian Dividends paid by it to them out of its earnings subsequent to December 31, 1960, (excluding Canadian Dividends and exempt income received and dividends or other distributions received under the transitional provisions). The rate of abatement shall be reviewed annually, with a suggested rate of 10% for 1961.

Aside from necessary retention of corporate earnings for the purpose of business expansion and development, the directors of closely-held corporations are often discouraged from adopting a policy of maximum dividend disbursement because of the present highly graduated tax rates applicable to individuals. While the Committee is of the opinion that its recommendations respecting the 15% Shareholders Tax will tend to solve this problem, some closely-held corporations may still postpone distribution. In the case of widely-held corporations, some direct advantage to the corporation itself may be necessary to encourage maximum distributions. Therefore, it would seem desirable for both closely-held and widely-held Canadian corporations that an effective incentive to distribute should be granted in the form of the corporate tax abatement recommended.

A corporation under this recommendation would be entitled to a tax refund in respect of any abatement to which

it became entitled during a year in which it had no income tax to pay. As the abatement may be claimed only for payments to Canadian residents, no abatement will be allowed in respect of dividends paid to a non-resident shareholder.

In the case of a Canadian addressee who is the agent of a non-resident, it is recommended that provision be made requiring the Canadian addressee to notify, in prescribed form, the corporation that he is agent of a non-resident, and if such agent fails to do so, he be subjected to a penalty equal to 15% of the net dividend actually received after deduction of the 15% Shareholders Tax. For this purpose a non-resident-owned investment corporation will be deemed to be an agent for a non-resident.

In the case of dividends paid out of tax-paid undistributed income to non-residents, it is recommended that Recommendations Nos. 2 and 7 be modified so that the 15% Shareholders Tax shall be payable. This is to prevent the benefit of the abatement provisions from flowing to non-residents through one or more Canadian resident corporations. It should be noted in this connection that if the corporation has moved undistributed income up under the transitional provisions, this would have been done on a tax-free basis.

The abatement provisions should be on an annual basis so that the amount of the allowance can be reviewed and adjusted, if necessary, for the degree of incentive appropriate for each year.

There are certain corporations for which no tax incentive to distribute will be allowed. These are the investment companies under Section 69 and the non-resident-owned investment corporations under Section 70. In addition, it will be necessary for provision to be made so that any corporation whose principal business is that of investment will not be entitled to abatement.

Personal Corporations

9. In the light of the recommendations made above, the provisions relating to personal corporations shall be repealed.

The new approach to the taxation of corporate distributions will make the retention of the personal corporation concept no longer necessary. Our recommendations provide for a 15% withholding tax on all Canadian Dividends whether the shareholder is an individual or a corporation. Therefore, there is no further tax to be paid in respect of such dividend. To the extent that the 15% Shareholders Tax is modified for individual shareholders in certain brackets, the receipt of Canadian Dividends by an investment holding corporation can have the effect of postponing the payment of any additional Shareholders Tax. We are of the opinion that this possible effect does not justify the retention of the acknowledged highly artificial and complex provisions considered necessary for the enforcement of the personal corporation concept.

With respect to income other than Canadian Dividends received by investment holding corporations, the corporate rates of tax will be payable and the distribution of the

earnings will be subject to the Shareholders Tax.

The repeal of Sections 67 and 68 should have effect for the taxation year commencing after the date of the implementation of the Committee's other recommendations and subsequent taxation years. Up to the commencement of such taxation year, as a transitional provision personal corporations under the present legislation shall continue to be treated as such so that their income will be deemed to be distributed and taxed to the shareholders on the last day of their current taxation year on the following basis. Income, including dividends, received by the corporation before the implementation date will be taxed on the same basis as under the present legislation. Income, including Canadian Dividends, received by the corporation after the implementation date will be taxed in accordance with the new legislation.

It is well known that the personal corporation provisions contain a large number of anomalies and inequities which often lend themselves to many abuses. Therefore, this recommendation simplifies the Canadian Income Tax Act by removing another of the more troublesome and complicated provisions of the Act.

CONCLUSION

The Summary of the Findings upon which this Committee has based its Recommendations and a Summary of the Recommendations themselves are set out at the beginning of this Report.

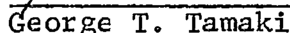
In adopting a new approach to the taxation of corporate distributions we have proposed two basic concepts for the Canadian income tax system: first, a withholding tax on corporate distributions and second, an incentive allowance for distributions to Canadian residents. We are of the belief that the implementation of our recommendations will materially aid in the development of the Canadian economy. While it is impossible to forecast with any degree of certainty the effect on the Revenue of any new system of taxation designed to change the present pattern of corporate distributions, we are of the opinion that our recommendations can be implemented without substantial loss of revenue.

RESPECTFULLY SUBMITTED,

R. Bredin Stapells

A. Emile Beauvais

Harold P. Herington



George T. Tamaki

March 21, 1961

APPENDIX

SUMMARY OF PRINCIPAL SECTIONS AFFECTED BY RECOMMENDATIONS, TOGETHER WITH SUGGESTIONS AS TO CHANGES REQUIRED

We set hereunder the principal sections of the Income Tax Act which are affected by the recommendations of the Committee, together with some suggestions as to the nature of the changes required:

Section of Income Tax Act	Suggested Change
6 (1) (a) (i)	Exclude "Canadian Dividends" to be defined
6 (1) (i)	Repeal
8 (1)	Repeal and treat benefit as deemed dividend under S. 81
8 (2)	Repeal and treat benefit as deemed dividend under S. 81
8 (3)	Repeal and transfer to S. 81
11 (1) (da)	Repeal, - but add repayment to corporation's tax-paid undistributed income
11 (2)	Amend regulations to provide for allowance in respect of "Canadian Dividends"
12 (1) (f)	Amend to delete reference to "personal corporation"
26 (2)	Amend to add "Canadian Dividends" to income of spouse
28 (1) (a)	Repeal
28 (1) (c)	Repeal
28 (2)	Repeal
28 (3)	Repeal
28 (4)	Repeal

APPENDIX (Cont'd)

Section of Income Tax Act	Suggested Change
28 (5)	Repeal
28 (6)	Repeal
28 (7)	Repeal
28 (8)	Repeal
28 (9a)	Repeal
28 (9b)	Repeal
28 (11)	Retain but extend to reduce loss, if any, on securities by Canadian Dividends received in respect thereof
28 (12)	Repeal
32 (8)	Amend to provide for addition of "Canadian Dividends" to income of dependant
38 (1)	Repeal
38 (2)	Repeal
38 (3)	Repeal
38 (4)	Repeal
47 (4)	Amend to exclude "Canadian Dividends"
62 (1) (f)	Amend to include net "Canadian Dividends" in income
62 (1) (g)	Amend to include net "Canadian Dividends" in income
63 (11)	Repeal and substitute provision confirming refund or additional tax, as the case may be, for Canadian Dividends received from a trust or estate
65	Amend to exclude payments of "Canadian Dividends"
67	Repeal

APPENDIX (Cont'd)

Section of Income Tax Act	Suggested Change
68	Repeal
79 (6a)	Repeal
79 (6b)	Repeal
81	Amend to add to deemed dividend provisions, situations presently covered by Sections 8(1), 8(2), 8(3), 105A, 105B and 105C
81 (5)	Amend to extend to S. 8, "deemed distributions"
82 (1) (a) (iv)	Amend to reduce deduction of capital loss in respect of shares to amount of "Canadian Dividends" received so as to prevent such loss from being applied against purchasing company's undistributed income
82 (6)	Amend to provide for discontinuance of personal corporation status
105	Repeal, and substitute new Part II incorporating provisions relating to Shareholders Tax and Abatement Allowance
105A	Repeal
105B	Repeal
105C	Repeal
111	Amend to delete reference to "personal corporations"
117 (1) (i)	Amend to add "Canadian Dividends" to income of dependant
139 (1) (o)	Amend to exclude reference to S. 28(2)
139 (1) (ad)	Repeal
139 (1) (au)	Amend to extend to inter-corporate dividends
139 (1) (ba)	Amend to include Shareholders Tax and to delete reference to present Parts II, IIA, IIB and Part IIC