Third Session—Twenty-fourth Parliament
1960

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING COMMITTEE

ON

BANKING AND COMMERCE

To whom was referred the Bill C-68, An Act to amend the Income Tax Act.

The Honourable SALTER A. HAYDEN, *Chairman*

THURSDAY, JUNE 30, 1960

No. 1

WITNESSES:

Mr. E. R. Irwin, Director, Taxation Division, Department of Finance; Mr. J. F. Harmer, Assistant Director, Assessment Branch, Mr. D. R. Pook, Chief Technical Officer and Mr. E. S. MacLatchy, Assistant Director, Legal Division, of the Department of National Revenue.

THE QUEEN'S PRINTER AND CONTROLLER OF STATIONERY
OTTAWA, 1960

23440-1—1

THE STANDING COMMITTEE ON

BANKING AND COMMERCE

The Honourable Salter Adrian Hayden, Chairman

The Honourable Senators

*Aseltine	Gershaw	Paterson
Baird	Golding	Pouliot
Beaubien	Gouin	Power
Bois	Haig	Pratt
Bouffard	Hardy	Quinn
Brunt	Hayden	Reid
Burchill	Horner	Robertson
Campbell	Howard	Roebuck
Connolly	Hugessen	Taylor
(*Ottawa West*)	Isnor	(*Norfolk*)
Crerar	Kinley	Thorvaldson
Croll	Lambert	Turgeon
Davies	Leonard	Vaillancourt
Dessureault	*Macdonald	Vien
Emerson	McDonald	Wall
Euler	McKeen	White
Farquhar	McLean	Wilson
Farris	Monette	Woodrow—50.

Ex officio member.

(Quorum 9)

ORDER OF REFERENCE

Extract from the Minutes of Proceedings of the Senate.

WEDNESDAY, June 29, 1960.

"Pursuant to the Order of the Day, the Senate resumed the adjourned debate on the motion of the Honourable Senator Thorvaldson, seconded by the Honourable Senator Pearson, for second reading of the Bill C-68, intituled: "An Act to amend the Income Tax Act".

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Thorvaldson moved, seconded by the Honourable Senator Buchanan, that the Bill be referred to the Standing Committee on Banking and Commerce.

The question being put on the motion, it was—

Resolved in the affirmative."

J. F. MacNEILL,
Clerk of the Senate.

23440-1—1½

MINUTES OF PROCEEDINGS

THURSDAY, June 30, 1960.

Pursuant to adjournment and notice the Standing Committee on Banking and Commerce met this day at 10.00 a.m.

Present: The Honourable Senators: Hayden, *Chairman*; Aseltine, Beaubien, Brunt, Croll, Dessureault, Euler, Gershaw, Golding, Haig, Lambert, Leonard, Macdonald, McKeen, Pratt, Thorvaldson, Turgeon, Vaillancourt, Wall and Woodrow—20.

In attendance: Mr. E. R. Hopkins, Law Clerk and Parliamentary Counsel and the Official Reporters of the Senate.

Bill C-68, An Act to amend the Income Tax Act, was read and considered.

Mr. E. R. Irwin, Director, Taxation Division, Department of Finance, Mr. J. F. Harmer, Assistant Director, Assessment Branch, Mr. D. R. Pook, Chief Technical Officer and Mr. E. S. MacLatchy, Assistant Director, Legal Division, of the Department of National Revenue, were heard in explanation of the Bill.

On motion of the Honourable Senator Brunt, seconded by the Honourable Senator Turgeon, it was Resolved to report recommending that authority be granted for the printing of 800 copies in English and 200 copies in French of their proceedings on the said Bill.

Clauses 1 to 17 were carried.

Subclauses 2, 3 and 4 of clause 18 were carried.

Clauses 19 to 32 were carried.

Subclauses 1 to 4 and 6 of clause 33 were carried.

At 1.15 p.m. further consideration of the Bill was adjourned until 10.00 a.m., Wednesday, July 6th, 1960.

Attest.

A. Fortier,
Clerk of the Committee.

THE SENATE

STANDING COMMITTEE ON BANKING AND COMMERCE

EVIDENCE

OTTAWA, Thursday, June 30, 1960.

The Standing Committee on Banking and Commerce, to which was referred Bill C-68, an Act to amend the Income Tax Act, met this day at 10 a.m.

Senator Salter A. Hayden in the Chair.

The CHAIRMAN: Gentlemen, we have a quorum. We have one bill before us this morning, C-68, an Act to amend the Income Tax Act. As witnesses we have Mr. F. R. Irwin, Director, Taxation Division, Department of Finance; Mr. J. F. Harmer, Assistant Director, Assessment Branch, Department of National Revenue; Mr. D. R. Pook, Chief Technical Officer, Department of National Revenue, and Mr. E. S. MacLatchy, Assistant Director, Legal Division, Department of National Revenue.

Since it is impossible to look through the whole bill and find a principle that is running through it except the principle of levying taxes, and there is no use discussing that so I would suggest we deal with the bill clause by clause.

Hon. SENATORS: Agreed.

The CHAIRMAN: These four representatives I named will sort out among themselves who is going to give the answer on the particular clauses as we go along. If you have any questions, you just ask them and somehow we will get the answer for you.

Clause 1—Estate Tax and Succession Duties applicable to certain property.

This deals with the question we discussed yesterday about getting a credit on annual payments under a pension instead of some element of estate tax and succession duty that may have been included in the valuation of the benefit originally. Would you care to give an explanation in as few or as many words as you would like, Mr. Irwin, if you are the one who is going to do it?

Mr. IRWIN: Mr. Chairman, this amendment provides that a taxpayer who receives a pension, a death benefit or an annuity under a registered retirement savings plan may deduct a certain portion thereof for income tax purposes on account of the estate tax or succession duty that may have been paid on the value of that particular property.

The method outlined in the amendment is first to determine the estate tax applicable to the property and the succession duty, if any, that may reasonably be attributed to the property. You calculate the percentage which the aggregate of these taxes is of the property.

The CHAIRMAN: The value of the property.

Mr. IRWIN: Is of the value of the property. This percentage is the amount that may be deducted from income for income tax purposes.

The CHAIRMAN: In each year.

Mr. IRWIN: It may, of course, be a single payment.

The CHAIRMAN: Yes.

SENATOR BRUNT: Give us an example of that.

Mr. IRWIN: A simple example would be where there was an estate, say, of $100,000 of which 50 per cent was comprised of the present value of a pension continuing to a widow. The Estate Tax Act in section 58(4) defines the part of any tax payable under that act that is applicable to property passing on death.

Senator BRUNT: Just let us take arbitrary figures and apply them to the example. I think that is the easiest way.

The CHAIRMAN: What amount of estate tax would you apply there?

Mr. IRWIN: You might say the estate tax was $6,000. We would look first to section 58(4) of the Estate Tax Act and determine the amount of the estate tax that is applicable to the pension. That would be $6,000 over the aggregate net value of the property.

Senator BRUNT: No, we have a succession duty in here.

The CHAIRMAN: Let us assume it is Ontario.

Mr. IRWIN: All right. Suppose there is also a succession duty of $1,000 for a total of $7,000. You take the aggregate of the taxes applicable to the property, which I suggested was $100,000, to give a rate of 7 per cent.

The CHAIRMAN: No. Wait a minute. It is the $7,000 over the value of the benefit; so it would be $7,000 over fifty, wouldn't it? You are only ascribing 50 per cent of this estate as being the value of the pension benefit.

Mr. IRWIN: I must refer you back to the words under (A). You determine first the estate tax that is applicable to the property and the succession duty that is applicable to the property and take the aggregate of this over the property.

The CHAIRMAN: Over the value of the property. You put a value of $50,000 on that.

Mr. IRWIN: If you assume that the taxes applicable to the pension are $7,000, yes.

The CHAIRMAN: It would be seven-fiftieths of whatever the annual payment is. Let us assume there is an annual payment of, say, $2,500.

Senator BRUNT: Make it $2,800.

The CHAIRMAN: All right, a $2,800 annual payment. So it would be seven-fiftieths of $2,800.

Mr. IRWIN: The $7,000 is the total of the estate tax and the succession duty applicable to this property?

The CHAIRMAN: Yes.

Senator BRUNT: And you put that over fifty.

Mr. IRWIN: Over the value of the property to arrive at a percentage and that is the percentage which may be deducted from the annual payment or the benefit if it happens to be a single payment.

Senator BRUNT: Let us get it clear. The $7,000 is put over $50,000?

The CHAIRMAN: That's right, over the value of the benefit.

Senator BRUNT: Is that right, Mr. Irwin?

Mr. IRWIN: Yes.

The CHAIRMAN: That is what the statute says. On the example we have it would work out that slightly under $400 would be deducted from what would otherwise be paid with respect to the annual payment if we assume the annual payment to be $2,800. It would be seven-fiftieths of that. It would be slightly under $400.

Senator BRUNT: It would give you $392 on which no income tax would be paid.

The CHAIRMAN: Instead of returning $2,800 you would return $2,800 less $392 as income for that year. That is correct, is it not, Mr. Irwin?

Mr. IRWIN: Yes, sir.

The CHAIRMAN: And if there was a lump sum payment you would, of course, just apply the fraction in the lump sum.

Mr. IRWIN: Yes.

The CHAIRMAN: This goes part way in meeting the situation we tried to deal with two years ago, as you will recall, Mr. Irwin, in an amendment to the Estate Tax Act which was before us at that time. I say part way because by the time this clause which we are now dealing with starts to operate the estate would have already paid estate tax and succession duty on the value of the benefit, which valuation included the income tax element in the benefit. Is that not right?

Mr. IRWIN: Yes.

The CHAIRMAN: So it has not resolved the problem but possibly we are making progress.

Mr. IRWIN: There are two ways, of course, this can be handled, the estate tax approach or the income tax approach. The Government, after a good deal of study on this matter, decided upon the income tax approach.

The CHAIRMAN: Yes, and it is part of our responsibility if we think it does not go far enough to comment on the distance it goes and to point out that the road is still open ahead for further improvement.

Senator MACDONALD: It will affect just the income for 1960 and the future?

The CHAIRMAN: Yes, in subclause (2) of clause 1 it is provided that it applies to 1960. Subclause (2) says:

> (2) This section is applicable to the 1960 and subsequent taxation years in the case of any benefit received upon or after the death of a predecessor whose death occurred after 1958.

The CHAIRMAN: What was the date of the coming into force of the Estate Tax Act?

Senator ASELTINE: January 1, 1959.

The CHAIRMAN: January 1, 1959. So it only deals with any benefits that have accrued since the coming into force of the Estate Tax Act, but not retroactively. The first time it will be reflected will be in 1960. There will not be any benefit in 1959 if there was a payment. That is right.

Is this section clear now? Shall we carry it?

Hon. SENATORS: Carried.

The CHAIRMAN: Clause 2, Mr. Irwin?

Mr. IRWIN: Clause 2 is to prevent the taxpayer having the benefit of both section 15 and section 37. Both these sections deal with what a taxpayer, who is a member of a partnership or a proprietor of a business, may do in certain circumstances where he may find that more than twelve months income is bunched into one income tax return.

The CHAIRMAN: Have you an illustration of that? I have been studying both those sections, and I must say I was not too clear as to what the result was.

Mr. IRWIN: Section 15 of the Income Tax Act requires that an individual who is a member of a partnership must include in his income for a calendar year the income of the partenership earned during the fiscal period that ended in the calendar year. Suppose an individual is a member of a partnership whose fiscal period ends on, say, January 31, 1960, for 1960 he must

include in income the income of that fiscal period that ends in the calendar year. Now, it might happen that the partnership was wound up on say July 31, and that would mean the fiscal period of the partnership will end on July 31 and he would have two fiscal periods ending in 1960 and would have to include 18 months income in his return for 1960. This would happen if it were not for the provisions of section 15 which permit him to elect to have the fiscal period end at the time it would have ended had the partnership not been wound up.

Senator BRUNT: He puts nine months into the next year?

The CHAIRMAN: No, the whole thing after January 31.

Mr. IRWIN: If he makes that election.

Senator BRUNT: It goes into the subsequent year?

The CHAIRMAN: That is right.

Mr. IRWIN: All clause 2 says is that he may not use section 15 if in the year the partnership is wound up he can use section 37 which gives him certain other reliefs, which we will come to later in this bill because that section is being amended as well.

The CHAIRMAN: Let us now bring in section 37, subsection (2) which appears on page 7 of the bill.

Mr. IRWIN: Section 37 of the Income Tax Act is designed to deal with situations where the taxpayer might have to include more than twelve months income in one taxation year. This could arise, for example, where a proprietor of a business sells his business and thereby ends its fiscal period and then takes employment. He might have income in the year both from the fiscal period of his business that ended in the calendar year and then from the employment for the remainder of the year. Section 37 permits a proration of the income so that that part of his income which is attributable or which might be attributed to more than is activities during the year is taxed at an average effective rate. It is designed to alleviate the impact of our graduated rate schedule on income being bunched into one year. Clause 10, subclause (2), provided by this bill, extends this relieving provision to cover a number of other situations where more than twelve months income may be bunched into one year. For example, when a taxpayer withdraws from a partnership and becomes a proprietor of a business.

The CHAIRMAN: Let us assume he withdraws from a partnership on March 1 and he becomes a proprietor of another business in April. What is there there by the time he reaches the end of the year against which he would require relief?

Mr. HARMER: The only case in which he would require relief there, Mr. Chairman, is if the proprietorship on which he embarked in April had a fiscal period ending before the end of that calendar year.

The CHAIRMAN: He would start off with this condition, that you are going to have a fiscal period of several operations ending in the same year?

Mr. HARMER: That is right.

The CHAIRMAN: That is the basis for it, and then this section would come into operation and relieve on some apportionment or some prorating basis, is that right?

Mr. HARMER: That is right.

Senator BRUNT: A partnership or a proprietorship might have a fiscal year that coincided with the calendar year.

The CHAIRMAN: Of course, if you did that then your first year of the proprietorship would be less than twelve months and the combination of your

operation in a partnership and in a proprietorship in all would only encompass twelve months, so there would not be any case for relief under this section, would there?

Mr. IRWIN: Not in the example you have outlined.

The CHAIRMAN: Any other questions on this?

Senator BRUNT: No.

The CHAIRMAN: Shall section 10 carry as well as section 2?

Some HON. SENATORS: Carried.

The CHAIRMAN: Section 3 is another one of the depreciation sections. I think it is quite straightforward reading, Mr. Irwin, but would you give an explanation of it?

Mr. IRWIN: Subclause (2) deals with the transfer of depreciable property from one prescribed class to another. The regulations prescribed under the authority of the Income Tax Act provide for dividing assets into about eighteen classes with a rate of capital cost allowance for each class. It sometimes happens that a taxpayer thinks an asset falls under one class, when, in fact, it should fall under another class, and when this is discovered he wants to make a change; or the Minister of National Revenue may, on examining a return, find that a taxpayer has regarded an asset as falling in the wrong class and may direct him to reclassify it. This clause provides rules to take care of these circumstances.

The CHAIRMAN: Yes, for whatever the reason for the change in classification. It may be at the request of the minister, or it may be that the taxpayer himself has misclassified the property and wants to shift it another class; is that right?

Mr. IRWIN: Or the classification of assets may be changed by regulation.

The CHAIRMAN: So in all those events you have taken care of it by this amendment. I assume in practice you were doing it, anyway.

Mr. HARMER: Yes.

The CHAIRMAN: Yes, this is just giving statutory effect to something that was good and workable in practice. Does subsection (1) of section 3 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Subsection (2) of section 3 deals with the situation in a bankrupt estate.

Mr. IRWIN: Not a bankrupt estate but a bankrupt corporation. It provides that a trustee in bankrupty may claim a capital cost allowance on an amount equal to the undepreciated capital cost of the assets of the bankrupt corporation at the time immediately before the corporation became bankrupt.

The CHAIRMAN: Does subsection (2) carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Subsection (3) on page 4 deals with the time of coming into force of these subsections that you have explained?

Mr. IRWIN: Yes, sir.

The CHAIRMAN: Does subsection 3 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 4?

Mr. IRWIN: Section 4 deals with family assistance payments. New Canadians receive family assistance payments in respect of their children for the first year in Canada. This is the period, you will recall, during which they do not receive family allowance payments. This amendment provides that children in respect of whom family assistance is paid shall be classed for

income tax purposes as if they are children eligible for family allowances, and the deduction that may be claimed for them will be $250 instead of $500.

Senator THORVALDSON: Mr. Irwin, is there no way in which this legislation can be made permanent? This section is in the amending act every year. Is there no way in which you can legislate once and for all in regard to this subject-matter?

Mr. IRWIN: This has to be annual legislation because the payment to the children of new Canadians is authorized by the annual Appropriation Act. It is under the estimates of the Department of Citizenship and Immigration. Now, it would be possible for this to be made permanent by amending the Family Allowances Act or by some other act of Parliament providing for these family assistance payments, but Parliament has not done so.

Senator BRUNT: In other words, if they do not set up an appropriation in any year you would not have this in?

Mr. IRWIN: That is so.

The CHAIRMAN: Does section 4 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 5 deals with the increase in the deduction of medical expenses.

Senator ASELTINE: I think that is quite clear.

The CHAIRMAN: Yes. I think so. Does section 5 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 6, Mr. Irwin?

Mr. IRWIN: Section 6 deals with the calculation of the income of a non-resident, and subclause (1) is intended to make it clear that the income of a non-resident from employment in Canada or a business carried on in Canada shall be computed by reference only to his income from Canada.

The CHAIRMAN: Is there any difference, Mr. Irwin, between the new language which appears in section 6 as to meaning, and the language which is presently in the statute?

Mr. IRWIN: There was intended to be, sir.

Senator BRUNT: Would you explain what it is?

Mr. IRWIN: The words that are now to be used, I think, must be examined in the light of the new wording found in clause 33 where income from a source or a particular place is defined. The objective here is to make sure that in computing the income of a non-resident we shall look only to his income from a source or from a particular activity.

The CHAIRMAN: But when you talk about a part of a man's income which may be reasonably attributed to duties performed by him in Canada or to a business carried on by him in Canada, and you say his income from all duties performed by him in Canada and all businesses carried on by him in Canada—if you put those two sentences down and write your answer at the end of each as being so much the answers would be the same to each line, would they not?

Mr. HARMER: Can I try to explain that, Mr. Chairman?

The CHAIRMAN: Certainly.

Mr. HARMER: I think the difference occurs where there may be a loss from one source, and income from the other. Under the old wording of section 31 it could be that the man ended up with an income from one source of $10,000, and a loss of $10,000 from another source, so that he had no income. Therefore, you cannot apportion anything between the two

countries, whereas under the new wording of section 31 the intention is to look at the income from the source in the particular country which may end up with us being able to tax $10,000 in Canada and saying the whole $10,000 loss was from the United States where, in fact, it occurred.

The CHAIRMAN: That is not the question I am asking. Yes, I am beginning to—

Mr. HARMER: The old section 31 said "such part of his income", and if he had no income there would be no part of it allocatable to Canada.

The CHAIRMAN: Suppose you have a resident carrying on, say, two proprietorships in Canada so that he personally is liable for tax. He has a profit from one and a loss from the other. What you are saying is that by this change in the wording in section 6 of the bill, plus the change in the definition in section 33 of the bill, you might be able to attribute the loss of some business operations of his to the States so that it would not be brought into Canadian calculations at all? Is that what you say?

Mr. HARMER: No, I did not intend to say that, sir. What I meant was that he might have two businesses, one of them being, in fact, in the United States and one, in fact, being in Canada; and, in fact, in the United States he lost money, and, in fact, in Canada he made money. Under the old law his income from all sources is the net of those two amounts, and if it comes to nil or less than nil there would be nothing to allocate to Canada notwithstanding the fact that he had, in fact, made money from his Canadian business.

The CHAIRMAN: Wait a minute, now. This section that you are proposing to amend deals with the taxable income of non-residents.

Mr. HARMER: In Canada.

The CHAIRMAN: Yes.

Mr. HARMER: Nevertheless, a non-resident is the same as any other person. His income has to be calculated as being from all sources, and this is the section which says how much of that income from all sources Canada can tax.

The CHAIRMAN: Well, Mr. Harmer, with respect to a non-resident of Canada who is carrying on a business in Canada and who is also carrying on a business in the United States, are you suggesting that he could attempt to relate his business operations and losses in the States to his operation in Canada?

Mr. HARMER: In practice, sir, I do not think this is happening, but in law we were afraid that someone could raise this argument, and the purpose of this amendment is to prevent him from so doing.

The CHAIRMAN: He might have an operation in Canada and an operation of the same kind of business in the United States. Then, to the extent that one impinged on the other in the sense of head office expenses, and so on, wherever the head office was, you are then concerned with the Canada-United States convention, are you not?

Mr. HARMER: Yes.

The CHAIRMAN: I am entitled to bring it into expenses. Are you sure there isn't something more we are missing, Mr. Irwin?

Senator BRUNT: You are very suspicious.

The CHAIRMAN: Yes. That seems so simple that it is hardly worth while covering by the change.

Senator MACDONALD: I think the witness' remark that it has no such intention, should be recorded.

Senator THORVALDSON: Has anyone challenged the previous section?

Mr. HARMER: Only indirectly because of this International Pipeline case. This arises out of that case. The Justice Department in studying it thought

that, although it was not dealing with section 31, the reasons were equally applicable in the case of a non-resident earning income in Canada, and felt that if we were going to have to fix up the Income Tax Act to overcome that decision, it would have to be done in respect of that income.

The CHAIRMAN: But it was not a question of determining taxable income of a non-resident.

Mr. HARMER: No.

The CHAIRMAN: You were determining the taxable income of a resident.

Mr. HARMER: Yes. But Justice felt it would be equally applicable in the case of a non-resident.

The CHAIRMAN: We have had this provision—section 6 refers to subsection 1 (*a*) of section 31 of the act—in the statute for a few years.

Mr. IRWIN: Yes.

The CHAIRMAN: Has there been any difficulty in administering it?

Mr. HARMER: Not that I know of.

The CHAIRMAN: Has any question been raised by anyone of the possibility that you will have the difficulties you envisage, and which you give as the reason for the change?

Mr. HARMER: Not in an actual case, no.

Senator THORVALDSON: I must say, Mr. Chairman, I rather prefer the language of the amendment. I think it is more concise.

The CHAIRMAN: It might be. If I had seen that language before it was put in the bill, I would have preferred it, but I do not like changing to language one is not accustomed to, unless there is a reason for the change.

Senator THORVALDSON: I agree. However, I think this language is more clear-cut than the old section.

The CHAIRMAN: I don't wish to be wearisome, but could we get a short statement on the record as to what this amendment does and what situation it covers that the present language does not cover?

Senator BRUNT: This will be very hypothetical.

The CHAIRMAN: It has got to be, because they tell us they have never had a case in practice.

Mr. IRWIN: Mr. Chairman, I know you would not want us to undertake to defend legislation. Our role of course is to try to explain it.

The CHAIRMAN: I did not ask you to defend it; I just ask you to explain it.

Mr. IRWIN: This is a case, I think, where we hope to amend the law before difficulties arise, not afterwards.

The CHAIRMAN: You tell me what is the difficulty that you perceive so clearly ahead that you think you should amend before it happens.

Senator BRUNT: Could you give us an example of where you might benefit by it?

Mr. IRWIN: I don't think I can add anything to what Mr. Harmer has said.

The CHAIRMAN: It seems to me Mr. Harmer's is a reverse case.

Mr. HARMER: Mr. Chairman, the explanatory notes on subclauses 1 and 2 refer to the same kind of case that I was stating as an example. It says that the amendments provide that the income of a non-resident from employment in Canada or a business carried on in Canada shall be computed by reference only to income from Canada not by reference to the world income of the non-resident.

In my example the world income would have been nil.

Senator McKEEN: Are there cases now where foreign companies are using profits they make in Canada as an offset against losses in a foreign country?

Mr. HARMER: Not to my knowledge, senator.

Senator McKEEN: Would you allow it?

Mr. HARMER: No. But we were afraid if we had disallowed that, and were taken to court, under the present wording of the law it could very well be that we would lose the case.

The CHAIRMAN: You have authority over expenses that may be the subject matter of deductions against earnings, and you may disallow any part of expenses which you think are not properly referable to the earning of that income, or that are in excess of what is reasonable. Is that not correct?

Mr. HARMER: Yes sir. But these are not expenses in the normal sense; they are losses from another business.

Senator CROLL: Is not the important word here "all"? They are inserting the words "from all" and "and all businesses". That seems to me to be stating it more firmly.

The CHAIRMAN: I don't see, Senator Croll, any difference between saying "from all duties performed by him", and "may reasonably be attributed to duties performed by him".

Senator CROLL: What appeals to me is the word "all"; that seems a more inclusive word than the words used in the present section. It made a difference to me when I read it, but I waited to hear what others had to say. As I say, I thought this was a firmer way of putting it, and much more conclusive. Since they are trying to attain the same objective, it seems to me that we ought to give them the words if they think they will do the job they want done.

The CHAIRMAN: The only thought I have in mind there is from my experience in the past we should get an explanation of the purpose for changes when they are made without actual cases, because situations may arise in the future, not thought of now, and we may provide something in legislation that was not intended to apply to that new situation; but if we have it in the law it is there, and it becomes applicable. Therefore, I want to know everything they had in mind when they proposed this change in language.

Senator THORVALDSON: Following what Senator Croll has said, I think you can have a good look at the draftsmanship. The previous section says:

> "The part of his income for the year that may reasonably be attributed to the duties performed by him in Canada..."

There is an element of discretion there. Somebody is going to have to determine something about what the income was—that is part of the law. I want to limit discretion wherever I can. From my point of view it seems to me that the amendment is absolutely clear and concise, and simply says that his income for the year from all duties performed and so on, is taxable. I do think that there is a real benefit in the draftsmanship of the amendment.

The CHAIRMAN: I still think that if a non-resident operating in Canada a business and is also operating a business in the United States and if he is being paid a salary by one or the other of these businesses, the question arises as to the apportionment of that salary as between the operation that he does in Canada and that which he does in the United States, and I say that question is still to be resolved under the change as it would have under the present language. If a man has these two businesses and is drawing a salary from one of $25,000 a year, and he works for both, the problem of the apportionment of that income would still have to be determined. There would have to be an adjustment made and under this amendment the department would not be able to allow the apportionment.

Senator THORVALDSON: In the final analysis the apportionment comes to a decision of the courts namely that if a man challenges the correctness of what

is stated to be his income, of course he has the same right to challenge that as anything else, and the court will eventually decide.

Senator McKEEN: Mr. Chairman, I am wondering if there is anything in this that allows an adjustment as between the taxes a man has to pay who is in business in Canada and in the United States such as the capital profits tax which is not charged in Canada. As I understand, there is no offset against the capital profits tax collected in United States as regards taxes paid in Canada on that portion of the income coming from capital profits because there is no tax collected on that portion of the income in Canada and so as I understand, regardless of taxes paid in Canada by an American resident in Canada, there is no allowance made on the tax they collected in the United States as capital profits.

The CHAIRMAN: If he is working in Canada he does not have to account in the United States for personal earnings in Canada.

Senator McKEEN: But it is being done.

The CHAIRMAN: It does not have to be done. He does not pay any tax in the United States on the operation he has in Canada. He does on all other income.

Senator McKEEN: Yes, but what about the profits on sales of property and things like that?

The CHAIRMAN: Well, it is the long arm of the United States that takes care of that, but on personal earnings, no.

We are getting far afield on this. Mr. Irwin, is there anything more you have to offer by way of explanation as to why this change was made, from what Mr. Harmer has offered?

Mr. IRWIN: No.

The CHAIRMAN: Subsection (2) of section 6. This is a further amendment defining what a loss is. What have you to say about that, Mr. Irwin?

Mr. IRWIN: I think we have already dealt with that.

The CHAIRMAN: Shall the subsection carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Subsection (3) of section 6 deals only with when it comes into force.

Shall the subsection carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Section 7. Would you care to give an explanation in relation to section 7, Mr. Irwin?

Mr. IRWIN: Section 7 deals with the calculation of investment income. It is necessary to calculate investment income because it bears an additional 4 per cent surtax. The Income Tax Act defines investment income by first laying down the rules for the calculation of earned income and providing that everything that is not earned income shall be investment income. As a result of this it is necessary to provide that every deduction from income shall also be a deduction from earned income as otherwise the deduction would go to reduce the investment income and thereby reduce the investment surtax. The act provides under paragraph (u) that certain amounts taken from a pension plan and transferred to another pension plan may be deducted from income and under paragraph (v) that certain amounts may be deducted from income on account of estate tax or succession duty.

The CHAIRMAN: We have dealt with that in section 1?

Mr. IRWIN: Yes. This amendment provides that those two deductions shall be regarded as coming off earned income.

Senator BRUNT: You made the statement, Mr. Irwin, that earned income was fully defined under the act and everything else was then classed as investment income. Is that correct?

Mr. IRWIN: Yes.

Senator BRUNT: Then you define rent as earned income?

Mr. IRWIN: Yes.

The CHAIRMAN: Yes, it is.

Shall section 7 carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Section 8. That section seems to speak for itself.

Shall section 8 carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Section 9. Mr. Irwin, have you anything to offer on this?

Mr. IRWIN: This is intended to prevent a taxpayer benefiting under two sections. The act permits a taxpayer to make certain deductions, as I have just mentioned, when he transfers money from one pension plan to another, or he may be allowed to make certain deductions on account of estate taxes that have been paid on a pension benefit. This amendment will prevent him from taking a corresponding amount of income and having it taxed at special rates provided by section 36 of the Income Tax Act.

Senator BRUNT: Have you run into a case that made this amendment necessary?

Mr. IRWIN: I am not sure whether there were any cases but it seemed to us that this is the sort of thing that should not happen.

Senator EULER: Mr. Chairman, might I refer to a statement made by Senator Brunt. I think he said that rent is regarded as earned income.

The CHAIRMAN: Yes.

Senator EULER: It is not investment income?

The CHAIRMAN: That is right, it is not.

Senator BRUNT: You pay no surtax on rent.

The CHAIRMAN: In this section 9, Mr. Harmer, have you run into any situation where there was an attempt to get a double benefit?

Mr. HARMER: No, Mr. Chairman, we have not, because the section already prevented the double benefit in respect of deductions previously allowed under section 11 (1) (u), and in this year the only change is to add (v).

The CHAIRMAN: Shall section 9 carry?

Hon. SENATORS: Agreed.

Senator MACDONALD: Mr. Chairman, might I revert to the question raised by Senator Euler. Senator Euler is surprised that there is not a surtax on rent. Might I ask the officials of the department if a return is filed and the person filing the return is not aware of the fact that rents are considered as earned income does the department peruse the return and if it notices an error has been made does it advise the taxpayer of that?

Senator ASELTINE: The forms are very, very clear.

Senator MACDONALD: The forms may be clear, but if someone makes a mistake, and a mistake of that kind could run into considerable money, does the department inform the taxpayer that he has made this mistake?

The CHAIRMAN: Mr. Harmer, will you answer that?

Senator EULER: Well, they have never done it. I have paid surtax on rents all along. I suppose I am entitled to a refund over the years. I never knew that.

The CHAIRMAN: Mr. Harmer can give an answer to your question.

Mr. HARMER: Mr. Chairman, my answer is that we make every effort to catch such mistakes and to correct them but from what Senator Euler says apparently we have not been completely successful.

The CHAIRMAN: Shall section 10 carry? We have already passed section 10.

We come now to section 11 on page 8, which deals with the rules for determining when one corporation is associated with another. Would you care to lead the explanation, Mr. Irwin?

Mr. IRWIN: The proposed amendment will replace the present 70 per cent ownership rule with a rule related to control of corporations. The Government felt this change was necessary because it has been found that companies can be split up under the 70 per cent ownership rule in such a way that control of the new companies—and a large part of their income—remains in the hands of the owners of the original company. In this way the split-up companies obtain the benefit of the lower rate on the first $25,000, and what is really a large business which should pay a rate of 50 per cent on all profits in excess of $25,000 so arranges its affairs that all its profits are taxed at only 21 per cent.

The CHAIRMAN: Let us take an illustration. We start out with two companies under the present law and you have a share allocation of, say, 69 per cent and 31 per cent, so that you have got a man in one company holding 69 per cent of the shares in the company or he holds 31 per cent of the shares. Under the present law wouldn't those two companies still be associated companies?

Mr. HARMER: It depends on who owns the other 69 per cent of the second company.

The CHAIRMAN: Let us assume they are at arm's length.

Mr. HARMER: They are not associated companies under the present law.

The CHAIRMAN: They are not associated companies under the present law, but under the proposed amendments they would still not be controlled companies, isn't that right?

Mr. HARMER: That is right.

The CHAIRMAN: The control may be recognized at 51 per cent so you are reducing the 70 per cent to 51 per cent, isn't that right?

Mr. HARMER: In effect.

The CHAIRMAN: Would you attempt to reduce it further, Mr. Irwin, in line with what is recognized on the street as being effective control as opposed to majority holding of shares?

Mr. IRWIN: Our legal advisers informed us, Mr. Chairman, that the courts have interpreted control to mean over 50 per cent, and the Department of National Revenue would have great difficulty in proving that there was control if there was less than that amount of ownership, even though it might be generally understood that a smaller shareholding did give the effective control. The interpretation of the present law will, of course, be determined by the Department of National Revenue.

The CHAIRMAN: What I think we are entitled to get at this time is what is your concept of control, for you have used the words "control" and "controlled". Now, in using them what do you intend it to cover in relation to holdings of shares? Anything over 50 per cent? Who is going to answer that?

Senator CROLL: Didn't Mr. Irwin say that they considered better than 50 per cent as control, and they were relying upon what they considered a legal position which bound them, and said that the effective control to which you have reference may exist but not legally in their minds.

The CHAIRMAN: He didn't put it that way, at least it did not seem to me he did. That is why I put the specific question, which was that in using the word controlled in this section 11 is it intended to cover any situation where shares are held by one person to the extent of more than 50 per cent? Is that what you mean by control or controlled?

Mr. IRWIN: May I answer it this way? It is not anticipated that this amendment will be used to regard companies as associated where the control may be effective control because of the ownership of a large block of shares which may fall well below 50 per cent.

The CHAIRMAN: That is just begging the question too because then you are saying it is a matter of degree how much below 50 per cent the large block may be. I just wanted a very simple statement. If the block is less than 50 per cent is it your intention in enacting this clause to apply the rules in this control clause to such a situation?

Mr. HARMER: Perhaps I could try to answer that, Mr. Chairman. Your original question, as I understood it, contained only the word "owned" as to 51 per cent or more, but I do not think it was our intention to limit control to cases where ownership involved 51 per cent or more. Instead, what I think the section is intended to do is to look at what you might call control of the shares either by ownership or by the existence of a voting trust or an option to acquire the shares on certain conditions or something of that nature, but apart from the play with respect to that word "owned" then I think my answer would be yes to your question, that this was our intention, to look at 51 per cent control of shares but not necessarily 51 per cent ownership.

The CHAIRMAN: No, but there would have to be at least a block of 50 representing over 50 per cent of the issued voting shares before the question of control would arise.

Mr. HARMER: That is right.

The CHAIRMAN: And that block might be by virtue of ownership or voting trust or by some other fashion.

Mr. HARMER: Yes.

Senator BRUNT: Is there any reason why you don't define control?

Mr. HARMER: We were told by the draftsmen that that had been so well done by the courts, Senator Brunt, that it would be redundant to put it in the law.

Senator BRUNT: Oh, I have heard that so often.

The CHAIRMAN: The Companies Act defines a subsidiary company as being 51 per cent of whose shares are held by another company, so I suppose you would regard a subsidiary company as a controlled company?

Mr. HARMER: Yes.

The CHAIRMAN: And is that the definition which you would rely on?

Mr. HARMER: No, sir. I think we rely on the whole jurisprudence, whatever that consists of; I am not an expert on it.

The CHAIRMAN: You have to define "control" in the statutes in relation to a particular situation. It should not be too difficult to define "control" in another situation, should it?

Senator BRUNT: Before we leave this, and I give an example, are those all control companies?

Mr. HARMER: Mr. Pook is examining that, sir.

Senator CROLL: We have no idea what the example is.

Senator BRUNT: I will give it, if the senators want to take it down. I think you have to get the formula before you.

Senator CROLL: All right, go ahead.

Senator BRUNT: You take "W" company. 29 per cent of the stock is owned by "A", 20 per cent by "B", 21 per cent by "C", 30 per cent by "D"; that ends that company. The next company is "X" company. 26 per cent of the stock is owned by "C", 20 per cent by "D", 30 per cent by "E", 19 per cent by "F"; that ends that company. "Y" company. One per cent by "D", 20 per cent by "E", 30 per cent by "F", 20 per cent by "G", 29 per cent by "H"; that ends that company. The last company is "Z" company. 20 per cent by "F", 31 per cent by "H", 20 per cent by "I", and 29 per cent by "J". There are your four companies. They are all related companies.

Senator ASELTINE: Why would they be?

Mr. POOK: Assuming that all of the shareholders that have been mentioned are dealing at arms' length with each other and not related persons, it would be my opinion that none of these companies are associated.

Senator BRUNT: "W" and "X" are associated because C and D control both of them, don't they?

Mr. POOK: C and D could control both of them, but there seems to be no reason to assume that they do.

The CHAIRMAN: But if they are at arms' length how do you assume they will work together?

Senator BRUNT: I am very happy if they are not associated, as a matter of fact. I do not want to enlarge this definition.

The CHAIRMAN: No, but you put the proposition and the witness has given his answer. I do not think it is any part of our job to argue him out of his answer.

Senator LAMBERT: From the practical point of view what if the basis of control is over 50 per cent?

The CHAIRMAN: What I understand the witness to say, Senator Lambert, is that control as used in this section encompasses more than the ownership of over 50 per cent of the shares. You may control over 50 per cent by a voting trust, and that would bring it within this section 11 of the bill in just the same fashion, and that may account for the reason you have the exception on the next page, that is, that where a bank, for instance, might take transfer to itself or to a trustee of a majority of the issued shares of a company to safeguard an investment that is already made, that is not regarded as control so as to make the bank and the industrial company associated companies. Is that not right, Mr. Harmer?

Mr. HARMER: Yes, sir.

Senator LAMBERT: Then what does legal ownership mean?

The CHAIRMAN: It does not say legal ownership in the section, but uses the word "control" and "controlled", and you can control by ownership or control by agreement.

Senator LAMBERT: I see your point all right, but I think from the point of view of taxation the terms are practically synonymous.

Senator PRATT: Mr. Chairman, to bring this matter down to a concrete example. Take a company that has probably 50 shareholders. Supposing the company is going behind, its outlook is not too good, and some one goes in and perhaps gets a 51 per cent control, yet there may be anywhere from 20 to 50 other shareholders. Simply because that man goes in and takes over and gets control of the earnings of that business, for the purpose of this basic taxation are those earnings in effect to be pooled with earnings that that man may have from other corporations, in which he does have actual control of the shares, and so on? What about the minority shareholders? There are

numbers of instances, I am sure, that have come to light in the application of this at the 70 per cent rate that probably would not have notice to bring it down to a bare 51 per cent, and you are going to have any number of instances—

The CHAIRMAN: But you have to add another bracket, Senator, before the section starts to operate. That is, you have to start up another company. Otherwise, the question of associated companies cannot arise. If there is only one company, the problem of control does not arise.

Senator PRATT: Yes, but an individual may already have a company which he controls, and he may get 51 per cent interest in another company; then that other company does not stand on its own with respect to this taxation, and the earnings of the other interests the man has are brought into relationship one with the other.

The CHAIRMAN: Yes. Of course, there are provisions in the act at the present time under which the associated companies may share in the lower rate of tax on the first $25,000. They have to agree on the proportions that each will take or the minister will fix it.

Senator PRATT: But they should not be regarded as associated companies when there is no interlocking relationship in trade, and so forth, and when they are separate entities and the one has no relationship with the other.

Senator LAMBERT: The companies would be owned by the same man.

Senator PRATT: Yes. If the man is going to control the business he would have to take 51 per cent control in order to do so.

The CHAIRMAN: The principle is this, that we have a general corporate rate of tax that applies to all companies. Now, we are going to give some benefit to some sections and give them a lower rate of tax on earnings up to $25,000. I mean, if we are going to have that difference in rate, which is substantial, then the Government as a matter of policy has laid down certain rules as to the situations in which they can apply; because I think when this change first came in there were a tremendous number of new companies formed and there was a subdivision of operations so that as many as possible would get the benefit of the 25 per cent. Well, I do not suppose as a matter of Government policy it was intended to make the benefit of that lower rate available indiscriminatory, and they have laid down rules. Of course, once you lay down rules somebody's toes are going to be stepped on somewhere along the line. You cannot legislate for individual cases.

Senator PRATT: Can it be envisaged that companies could be set up separately, and make separate returns without at the same time having to go to all the expense of setting up a separate company? That does not seem reasonable.

Senator LEONARD: Am I not correct in saying that the present act is beneficial in the case that has been cited, that the second company is able to pay taxes which are less than it would pay when the two companies were under separate ownership. The only purpose of the act is to prevent that operation being carried on a second, third and fourth time, and to prevent what are really artificial divisions of the original two companies.

Senator PRATT: Where there is an intention, surely, to avoid taxation there should be some provision whereby the authorities can prevent it.

The CHAIRMAN: I do not think Senator Leonard's application is correct because you start off with each and every company being entitled to the lower rate on the first $25,000 of income. If you put two of those companies which are entitled to that together then they are splitting up one amount of $25,000, so there is a disadvantage. It lies in the hands of those people, when they

know what the law is and what the rules of the game are, to play the game according to the rules and to get the benefit of the $25,000. Shall this section carry?

Hon. SENATORS: Carried.

The CHAIRMAN: There is the saving provision. I think we have already talked about that. Are you satisfied that that is clear enough in the illustration I gave of the bank?

Senator BRUNT: Yes.

Hon. SENATORS: Carried.

The CHAIRMAN: The next section is section 12. I think section 12 is clear. We have had legislation dealing with some aspects of this before us already. It is with respect to the credit for corporation tax, 10 per cent in Quebec and 9 per cent in Ontario; is not that right, Mr. Irwin?

Mr. IRWIN: The general abatement is nine percentage points. This amendment provides for this to be increased to ten percentage points in a province that enters into an arrangement under which it pays university grants itself and does not receive grants to universities from the federal Government.

The CHAIRMAN: We had this before when we were dealing with the Quebec grants a short time ago.

Senator BRUNT: Yes. It only relates to Ontario and Quebec, I think?

The CHAIRMAN: Does that section carry?

Hon. SENATORS: Carried.

The CHAIRMAN: What have you to say about section 13, Mr. Irwin? This deals with those foreign rules that are applicable to all taxpayers in relation to foreign tax deductions. Again we have a change in language in this. I am awfully curious to know why the change is made. I think at the bottom of page 10 you have the words "any income or profits tax", and I think in the present statute it reads "the tax". Can you explain to me why the change is made? Is there anything intended to be covered by the change of language that is not covered by the present words "the tax"?

Mr. IRWIN: This section, as you have stated, deals with the calculation of credits for foreign taxes, and the most important change that is made here will make less restrictive the rules for calculating foreign tax credits by withdrawing the present rule that income in respect of which the credit is computed must have been taxed in both the foreign country and in Canada. In keeping with that change in rules for computation of tax it has been necessary to change the wording.

The CHAIRMAN: Wait a minute, now. You said that this change in section 13 would do away with the requirement that the income must be taxed in both places. Is that what I understood you to say?

Mr. IRWIN: That is correct.

The CHAIRMAN: Well, there is an exception in this definition.

Mr. IRWIN: Yes, there are exceptions.

The CHAIRMAN: If a Canadian company or an individual received dividends form a company in the United States, more than 25 per cent of the stock of which is owned in Canada by another Canadian company, the Canadian company will receive those dividends free of any Canadian tax; is that right?

Mr. IRWIN: Yes.

The CHAIRMAN: Therefore, when I started to talk about foreign tax credits, as I understand it on reading this, I do not get any credit for withholding tax in the United States on those dividends which are not subject to tax in Canada?

Mr. IRWIN: Yes, dividends which are not taxable in Canada are excluded from this calculation.

The CHAIRMAN: When you said this change is in the rule that income had to be taxed in both countries before you can get a foreign tax credit—that still is the rule, is it not?

Mr. HARMER: Perhaps I could try to explain this by the use of an example. Under the present law an individual in Canada who receives a dividend from the United States, of say, $100 on which 15 per cent tax was deducted at the source might, in Canada, have carrying charges to offset against that dividend of, say, $50. In effect, therefore, his income from that foreign source subject to Canadian tax would only be the $100 less the $50 carrying charges, or $50 net, on which he would pay Canadian tax. Presently we have been saying that his foreign tax credit would have to be related to only that part of the income which bore tax in Canada. In other words, although he paid 15 per cent of the gross dividend of $100 we would only allow him 15 per cent of the net of $50 which he was going to pay tax on in Canada. The effect of this amendment would be to allow him the full 15 per cent of the $100 which he received, even though in Canada he would only be paying tax on $50. I think Mr. Irwin's statement that the income did not have to be taxed in both countries is correct because we are not taxing in Canada the part that is offset by the carrying charges.

The CHAIRMAN: Supposing a man had borrowed money to make the investment in the United States from which he got this income of $100. Suppose he borrowed the money in Canada, and makes an interest deduction from the income which wipes out the income so far as Canada is concerned. Do you say in those circumstances by virtue of this amendment, that he would get the full credit for the withholding tax in the United States?

Mr. HARMER: There are two parts to that allowance for foreign tax credit in this section. One of them is the one we have been talking about, which has relation to the tax actually paid in a foreign country; but there is a second limitation governed by the effective rate of the Canadian tax paid. It is only the lesser of those two amounts that he gets. In the example you gave this second limitation would come into effect, I would think.

The CHAIRMAN: It might or might not. Let us assume that the rate of tax which he would pay in Canada would be in excess of 15 per cent, even after he deducted his interest from income in the United States. Would he then be entitled to deduct the full amount of the withholding tax.

Mr. HARMER: I don't quite understand how much income he is left with in Canada, in your example.

The CHAIRMAN: I am assuming he got $100-worth of income by way of dividends from the United States, and $15 withholding tax. When he comes to Canada he has additional income in Canada, he has expenses and he has interest he paid on money he borrowed to buy that stock in the United States. Let us assume that when he is figuring his Canadian tax, even though he took a credit for the interest and therefore offset the $100 of income in the United States—

Mr. HARMER: To the full extent?

The CHAIRMAN: Yes, to the full extent—he still pays a rate of tax in Canada that is greater than 15 per cent.

Mr. HARMER: But he would not be paying any tax on this, because there was no income left after this deduction. So, he would get no deduction.

The CHAIRMAN: He would get no deductions?

Mr. HARMER: That is right.

The CHAIRMAN: But you do put in a separate package the U.S. income that comes in, and you would be proposing to offset against it the interest that he paid on borrowed money to acquire that asset in the United States, is that right?

Mr. HARMER: Yes.

The CHAIRMAN: That is not the present practice.

Mr. HARMER: My understanding is that is the present practice.

Senator LAMBERT: That is a hypothetical case. An example of $100 hardly leads you anywhere, without considering the total amount of income the taxpayer might receive. What bracket is he in?

Mr. HARMER: Let us say he is in the 50 per cent bracket. In that case he would still get his 15 per cent, even though he was in the 50 per cent bracket.

Senator BRUNT: The opinion has been expressed that under these amendments, now that capital gains tax has been imposed in the United States, that now can be taken off. Is that correct?

Mr. HARMER: I think, senator, under this wording of any income or profits tax, it is true that a capital gains tax would come in under the first part of the calculation. Whether it would in fact be allowed would depend on the second part of the calculation, which is still dependent on the effective Canadian rate on the Canadian income.

Senator BRUNT: Could you give us an example where the capital gains tax might be allowed, and another example where it might not be allowed?

Mr. HARMER: If, for instance, the taxpayer we are speaking of had nothing but capital gains in the United States, then the effect would be that he would get no deductions against his Canadian tax, because there was no income from that source taxed in Canada. Therefore, under paragraph (b) there would be no allowance. But if he has besides his capital gains on which he paid a capital gains tax in the United States, any income subject to say 15 per cent income tax, then the two taxes would be lumped together for the purpose of paragraph (a) of section 41, but it would be limited to the effective Canadian rate on the income taxed in Canada; and if, for instance, he was in the 50 per cent bracket in Canada, the effect of having paid the capital gains tax would be to give him more than the 15 per cent he paid on the income which is so taxed in Canada.

The CHAIRMAN: May I try to re-state that proposition? The capital gains tax is 25 per cent.

Senator BRUNT: Take it on the basis of holding the securities for more than six months.

The CHAIRMAN: I receive moneys from that source which do not enter into my Canadian tax calculation at all, but I have income in Canada, the receipt of which is to put me in the 50 per cent bracket in Canada. Now, I still can't bring in the 25 per cent, if I have no other foreign income; I have to have other foreign income that is subject to tax in the United States. If I have other foreign income which is subject to a withholding tax of 15 per cent, and my overall rate in Canada is 50 per cent, would I be able to deduct the sum total of capital gains and withholding tax paid in the United States, or would I be limited only to the withholding tax?

Mr. HARMER: Could I get back to my original example of $100. Let us say he had two $100 items in the United States, one of which was subject to 25 per cent capital gains tax, and the other was subject to 15 per cent ordinary withholding. In effect, he has paid $40 tax during the year. But in Canada his income is only $100 because we don't tax the $100 capital gains.

Now, he has an effective rate in Canada of 50 per cent which means his tax on that in Canada would be $50. The allowance in this case would be the lesser of the two, which is $40, a combination of the two taxes in the United States, or $50, which is the effective rate of the tax on the $100 taxable in Canada.

In that case he would get the full capital gain tax.

Senator BRUNT: But if he were in the 20 per cent bracket—?

Mr. HARMER: He would get only 5 per cent.

Senator BRUNT: He would get $20 instead of $40?

Mr. HARMER: Yes.

The CHAIRMAN: The moral is that the people who are making capital gains in the United States and have substantial income in Canada, should also acquire income in the United States from other sources if they want to get any benefit from the combination of the capital gains tax and withholding tax in the United States on their Canadian income.

Senator ASELTINE: That would be the usual situation. I do not think there would be very many cases where persons would have only a capital gains tax, and no other.

The CHAIRMAN: I don't know how often it would happen.

Senator BRUNT: I disagree with the chairman's statement, because one income tax return a year is enough to file.

The CHAIRMAN: I was curious, in view of that philosophy, what your interest was in learning how this applied, if you are going to confine yourself to Canadian investments completely.

We have covered everything in relation to section 13.

Senator ASELTINE: Carried.

The CHAIRMAN: Section 14. That seems to be a straightforward section. Do you care to add anything to it Mr. Irwin?

Mr. IRWIN: This is mainly technical. The underlined words have been added for clarification. When the section of the act referred to was first enacted, the section 14 referred to had no subsections. Since that time a subsection has been added to it. It was necessary to have this clarification.

Hon. SENATORS: Carried.

The CHAIRMAN: Section 15.

Senator BRUNT: This one should be amended. This has to do with the four-year period.

The CHAIRMAN: Yes. As I understand it—and Mr. Irwin can correct me if I am wrong—this makes the four-year period run not only from the assessment, if an assessment is made, but also from what we have been calling a nil assessment.

Mr. IRWIN: That is right.

The CHAIRMAN: Heretofore the approach was that, having regard to the Okalta case which was decided in the Supreme Court of Canada some years ago, a nil assessment was not an assessment, no time was running until there was an assessment. I understand, particularly in the case of some oil companies, it looked as though there might be a long time, perhaps as much as five or ten years, when everything would be in suspense because they had no taxable income.

Now it is crystallized, and the four years runs from the date of a nil assessment. Is that right?

Senator BRUNT: Well, if there is any doubt as to the date would you take the date of mailing?

Mr. IRWIN: Yes, this makes it clear that your four-year period starts from date of mailing.

The CHAIRMAN: There is also a provision here which you might explain, about a taxpayer filing a waiver to stop the running of the four years. That must be where he is going to get some benefit and cannot accomplish it within the four-year period. Is that right?

Mr. IRWIN: As I understand the situation, Mr. Chairman, there may be discussions going on between the minister and the taxpayer as the four-year period during which the minister may re-assess is drawing to a close, and the taxpayer may not want to have a re-assessment until he has had a chance to fully document his case, but as the law stands at present the minister has no alternative but to re-assess during the four-year period or lose all right to do so. This permits the taxpayer to waive the four-year limit so that he can document his case fully.

Senator BRUNT: And do away with arbitrary assessments?

The CHAIRMAN: Shall the section carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Section 16. This is one section that to me is very intriguing, and if you can qualify the situation I would appreciate it very much. I was trying to find out what the difference was between, "knowingly or under circumstances amounting to gross negligence" in section 16 of the bill as against, "wilfully in any manner evaded or attempted to evade payment of taxes" in section 56 of the act.

What are the yardsticks for determining when it is wilful evasion as against knowingly or under circumstances amounting to gross negligence?

Mr. HARMER: Mr. Chairman, my understanding is that there is no difference between "wilfully" and "knowingly."

The CHAIRMAN: I did not think there was.

Mr. HARMER: There is, though, I think, an additional change in the section by the addition of these words, "under circumstances amounting to gross negligence".

The CHAIRMAN: Yes, but they are disjunctive, didn't you notice that? If he knowingly does something under section 16 he can be assessed a penalty of 25 per cent, or if under circumstances amounting to gross negligence—as I say, it is disjunctive. You have 'wilfully' in clause 16 and 'wilfully' in section 56 of the act.

Senator CROLL: Mr. Chairman, it may be on the strict interpretation of the language, but is not the effect of this section to give the department some discretion in cases where they felt they were doing a gross injustice and they had to put it under the fraud section whereas as a matter of fact they were not quite sure that there was fraud and and this gives them an out. It may be a border-line case and if they feel that they must assess the full penalty the only thing they can do is to impose a 50 per cent penalty.

The CHAIRMAN: It is not 50 per cent, it is 25 per cent to 50 per cent. The range is 25 to 50 per cent.

Senator CROLL: Yes, I appreciate that. I see I am wrong on that.

The CHAIRMAN: On the question of fraud, it strikes me that if a person knowingly does what is set out in section 16 that is just as much a fraud as a person who wilfully does something under section 56 of the statute, as it stands at the present time.

Mr. HARMER: That is right.

The CHAIRMAN: I am not trying to make it difficult, but what I am trying to do is to find out what there is different in this bill, and what kind of situation are you intending to reach.

Mr. HARMER: I think the section is wider by the addition of the words "or under circumstances amounting to gross negligence" and for this reason we believe there will be more cases caught under this section than were under the old section 56. Secondly, the change, as you have already mentioned, is in the amount of the penalty which has been altered from a discretionary penalty of somewhere between 25 and 50 per cent to a flat 25 per cent. This is something we, as administrators, desired because we felt that we do not like being in the position of judge, jury and executioner, and we thought that there should be a penalty that applied if the circumstances warranted it, and we should not be asked to judge whether it should be greater or smaller.

Senator BRUNT: But you are going to still have to do that.

Mr. HARMER: Not in amount.

Senator BRUNT: No, but in percentage, 25 per cent to 50 per cent where there has been evasion.

Mr. HARMER: The intention there is that section 56 which now becomes subsection (1) was being left in the law merely to take care of cases where offences had occurred up to the time this became law but which would not be caught by us for say, three, four, five or more years. This new section can only be applied in respect of offences occurring after the date it becomes law, and this would be the only operating section after the time when other offences that have occurred up to that date have all been caught up to.

Senator CROLL: Then we should welcome it?

The CHAIRMAN: I welcome it.

The saving clause on top of page 14 is only this, that they cannot proceed against you under both subsections. That is all it says. The sort of thing I understood Mr. Harmer to say was that as of when the present section 56 has run its course in relation to any cases that are afterwards discovered in relation to the period down to the time when this section becomes law and that will be the end of it.

Senator BRUNT: It is not.

The CHAIRMAN: I cannot find it in the act.

Senator CROLL: Now, administratively he says that will be the end of it.

Mr. HARMER: I think it is a little more than administratively. My understanding of the way this will operate is this, that as we mentioned before, "knowingly" in the new section and "wilfully" in the old are the same thing and therefore if you can get a person under new subsection (2) because he knowingly did something then this subsection 3 says you can penalize him under (2), and you cannot penalize him under (1).

The CHAIRMAN: Subsection (2) of section 16, on the next page may be the one that does it. It says, "(2) This section is applicable in respect of any statement or omission in any return, certificate, statement or answer filed or made after the coming into force of this section." It says that this section is applicable but it does not say that the other one is inapplicable.

Mr. HARMER: I think the paragraph ahead of that makes it inapplicable because you can penalize them on offences occurring after this becomes law, and the paragraph at the top of page 14 says you cannot penalize him under the other.

The CHAIRMAN: It seems to me you still have the choice. I am very happy, and I would welcome the idea that the present section 56 is going to lapse

after you have dealt with all the cases that might arise in the period down to this date. If that is the intention I think it should be more clearly stated in the statute.

Senator THORVALDSON: Can you give an example? Can you give me an example of the difference between wilfully and, say, where there is an element of gross negligence? I find it very difficult to know what is involved in gross negligence when it comes to an income tax return.

Mr. HARMER: I would find it very difficult to give you an example of an actual case, senator, but the theory is this. At the present time we are told that in order to prove a man has wilfully attempted to evade tax you have to have all the kinds of proof you could use in a criminal court to support a criminal charge.

Senator BRUNT: There has to be *mens rea.*

Mr. HARMER: Yes. Whereas we think this gross negligence does not go quite as far as wilfully. We are not sure how much short of that it falls, but we don't think it is going to be quite as difficult to prove in court. There are, as one honourable senator mentioned earlier, some cases which are borderline. A reasonable person in our department, let us say, might feel there has been evasion or an attempt at it but he just cannot obtain the kind of proof he would need to support a criminal prosecution.

Senator THORVALDSON: I can easily understand the meaning of gross negligence when it comes to automobile accident cases, and so on, but I find it very difficult to apply to income tax matters.

Senator BRUNT: You will be able to cite these automobile cases as precedents.

Senator THORVALDSON: For instance, would it be gross negligence if I simply had my income tax matters looked after by my secretary and I just signed the return and did not bother to verify things in it myself? Would that be considered negligence or gross negligence?

Mr. HARMER: I can only give my personal views on that. In the example you have stated if you signed your return saying that your income was only $1,000 for the year and you knew very well it was several times that amount, I would think that would be gross negligence.

Senator THORVALDSON: I recognize that, but I was thinking of where I had negligently delegated authority or I was probably innocent of that knowledge. In a case like you have suggested, it would be outright evasion.

Senator BRUNT: This will be the section you will use on all returns commencing with the current year?

Mr. HARMER: Unfortunately there will be a year in which some offences will be under the old and some under the new, for this will come into effect in the middle of the year.

The CHAIRMAN: If the intention is that in the future as and from the date that this section becomes law that only subsection (2) in this bill will apply to these situations, if they said this section is the only section that is applicable in respect of any statement after the coming into force—"filed or made after the coming into force,"—that would, of course, make it absolutely clear.

Senator BRUNT: I presume there would be no objection to that amendment.

The CHAIRMAN: I only raised that to crystallize the issue.

Senator LAMBERT: It is clear now.

The CHAIRMAN: I don't want the taxing bill to force something suddenly when you have not had a chance to study. As a matter of fact, I think if the departmental officers affirmed that after this section becomes law should any

situations arise in relation to any filing or any statement made in a return after that date will be subject only to subsection (2) of section 16 and not to the old section 56, I think we would be satisfied with that.

Senator BRUNT: We would be quite prepared to accept that.

Mr. HARMER: That is our intention, and we were told by the draftsmen of the Department of Justice that this is what the subsection accomplishes.

Senator BRUNT: Of course, we don't always agree with the Department of Justice with regard to the drafting of bills.

The CHAIRMAN: Shall clause 16 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Clause 17 is very simple. We dealt with it yesterday. It is clear. Shall it carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Clause 18 deals with the proceeds of distribution. Have you a word to say about that, Mr. Irwin?

Mr. IRWIN: Subclause (1) of clause 18 deals with depreciable property in the hands of an estate or trust. It provides that if such property, on which capital cost allowances have been taken, is distributed to the beneficiary the distribution shall be treated for tax purposes as a sale.

Senator BRUNT: Would you give us an example with figures?

The CHAIRMAN: You mean for purposes of recapture the asset would have to be valued at its then market value or at its depreciated cost?

Mr. HARMER: At its then market value.

Senator BRUNT: In other words, if the property was worth $20,000 and depreciated down to $10,000 the transfer would be at $20,000?

The CHAIRMAN: That's right, and if there is any incidence of recapture somebody has to pay.

Senator BRUNT: Somebody would be nailed for $10,000.

The CHAIRMAN: Yes. Is that correct, Mr. Irwin?

Mr. IRWIN: As I understand the example.

Mr. HARMER: If they had already claimed this $10,000 as capital cost allowance in computing income in prior years.

Senator BRUNT: But this deals with trust transfer.

Mr. HARMER: But the trust had, in this example, been using the property to earn income.

Senator BRUNT: That's right.

Mr. HARMER: And while it was so doing it was claiming capital cost allowance on, say, $20,000 or whatever the fair market value was at the time the trust acquired it, and then by this process it had written it down to $10,000 and then distributed it to beneficiaries—

Senator BRUNT: It is turned over to beneficiaries in accordance with a provision in the will.

Mr. HARMER: At that time the fair market value was still $20,000, so in fact it had not depreciated at all so that the $20,000 would be treated as though received as the sale price and the $10,000 allowed as depreciation in prior years would be recaptured.

Senator BRUNT: You would attach the trust and not the beneficiary receiving it?

Mr. HARMER: This gets a little complicated.

Senator BRUNT: I would think so.

Mr. HARMER: The trustee is taxable on whatever income is left in his hands but not on what is distributed to the beneficiaries. Whether you can determine by these means income to beneficiaries that is only notional income, I am not too sure. Maybe MacLatchy has some ideas on this.

Senator BRUNT: Let us take an example where a trust company is the executor of a will and a trustee of an estate. It is an office building that is concerned and the will provides that the income is to be paid to the widow for so long as she shall survive the testator and on her death the building shall be conveyed to her son. The building is worth $100,000. The trustee takes the capital cost allowance over the years, say, of $50,000. Then on the death of the widow the building is transferred to the son. Let us say there is no argument about the building being worth $100,000. When the transfer takes place who pays the tax on the $50,000 that has been written off, and do you charge it all up in one year? Is it payable by the trustee? Is it payable by the widow's estate or is it payable by the son who now receives the building?

The CHAIRMAN: It is the vendor of the property who has got the benefit of the write-offs and therefore it is the vendor of the property who pays the tax.

Mr. HARMER: My understanding is that the trustees would be liable for the tax on $50,000.

The CHAIRMAN: What have you been doing in practice up to the present time in a situation of this kind? Have you been applying the rule?

Senator BRUNT: What it means is that anything they set up for capital cost allowances they will have to retain it in either good trustee investments or cash until they dispose of all these assets. Is there any safety provision, supposing they did not take any capital cost allowances and the building was worth actually less than was taken into the estate tax?

Mr. HARMER: It would get the difference.

Senator BRUNT: What about the difference in that case?

Mr. HARMER: It would get that difference in computing the income of the trust.

Senator BRUNT: Oh, but the trust is being wound up.

Mr. HARMER: But it may not do them any good.

The CHAIRMAN: They are entitled to it, but it may not be of any value. Have you come up with an answer yet, Mr. Harmer?

Mr. HARMER: No. I wonder if we could come back to it later.

The CHAIRMAN: Yes. That is subsection (1), and we are dealing with section 18.

What have you to say about subsection 2, Mr. Irwin?

Mr. IRWIN: Subsection (2) is a technical amendment which corrects an oversight in the 1958 bill. Section 8(1) of the Income Tax Act provides that if a shareholder receives a loan from a corporation he shall be deemed to have received a dividend from the corporation. The law was amended in 1958 to provide that he would not be deemed to receive income if he repaid the loan.

Senator BRUNT: Within the year?

Mr. IRWIN: Yes, that is right, there was a time limit. At the same time, the dividend tax credit which the shareholder could have received in respect of that deemed-to-be-received dividend was withdrawn. We forgot, in amending the bill in 1958, to make a corresponding change in section 63(11)(a), and it is being done now.

Senator BRUNT: May I ask one simple question? Is this beneficial to the taxpayer?

Mr. IRWIN: No, sir.

The CHAIRMAN: No, it is not. Carried?

Hon. SENATORS: Carried.

The CHAIRMAN: Subsection (3).

Mr. IRWIN: Subclause (3) is consequential upon the change being made to the provisions for calculating foreign tax credits.

The CHAIRMAN: It makes the same rules applicable?

Mr. IRWIN: Yes, sir.

The CHAIRMAN: Does subclause (3) carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Subclause (4), on the top of page 15?

Mr. IRWIN: This is also consequential upon the change with respect to foreign tax credits.

The CHAIRMAN: Does subclause (4) carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Subclause (5) just deals with the coming into force of the section. (Carried)

So we have carried all the subsections of section 18, except one.

Now, section 19 deals with personal corporations. Have you a brief explanation of that, Mr. Irwin?

Mr. IRWIN: Subclause (1) is simply a clarification of wording, and it is along the lines of the change I have just referred to in connection with section 63(11)(a).

The CHAIRMAN: If a personal corporation has an income from foreign holdings and they come into the personal corporation and are not distributed, the person whose personal corporation it is, is going to be taxable on that income, in any event. Is that right?

Mr. IRWIN: That is subclause (2).

The CHAIRMAN: Yes.

Mr. IRWIN: Subclause (1) deals with the dividend tax credit. Subclause (2) deals with the calculation of the foreign tax credit.

The CHAIRMAN: Yes. Does that carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Subsection (3) is just the coming into force. (Carried)

Section 20 is simply a change in the rate. That is on investment companies, is it not?

Mr. IRWIN: Yes, sir. This is relieving. This is a change that was overlooked in the 1959 bill.

(Carried)

The CHAIRMAN: Section 21. This is not relieving; this is providing that a non-resident owner company cannot claim depletion allowance, is it not?

Mr. IRWIN: That is correct, sir.

The CHAIRMAN: Where they may operate an oil well. The reason for that, I take it, is that they enjoy a special rate of tax?

Mr. IRWIN: Yes, sir.

The CHAIRMAN: And therefore there is little in the way of deductions that are allowed?

Mr. IRWIN: Yes, sir. If the non-resident shareholder received these dividends from a Canadian oil or mining company, or royalties from an oil operation directly, he would not get the depletion allowance, and I believe the

Government felt he should not get the depletion allowance if he received this income indirectly through a non-resident owned investment corporation.

—Section 21 carried.

The CHAIRMAN: Section 22?

Mr. IRWIN: This is a relieving amendment. Section 81(a) of the act provides that where a corporation has increased its paid up capital in any way other than in accordance with certain stated exceptions, the corporation shall be deemed to have capitalized undistributed income and this would give rise to shareholders being deemed to have received a dividend. This amendment makes it clear that a reduction of liabilities of a company with a corresponding increase in its paid-up capital, as for example the conversion of debentures into stock, shall not be deemed to be a capitalization of undistributed income.

The CHAIRMAN: Subsection (2)?

Mr. IRWIN: That is part of the amendment I have just explained.

The CHAIRMAN: Very well. Does section 22 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Would you just tell us about section 23?

Mr. IRWIN: This is also a relieving section. Section 105C of the act, which is referred to in this amendment, imposes a tax on new corporations formed by amalgamation in those cases where part or all of the undistributed income of a predecessor corporation has been drained off in the process of amalgamation. This amendment provides that in computing any undistributed income of the new corporation that has resulted from the amalgamation a deduction will be allowed of the amount of income on which tax has been paid under section 105C.

The CHAIRMAN: When you say "drained off" do you mean the physical operations that are required to withdraw that underdistributed income?

Mr. IRWIN: Yes, section 105C provides for a tax in certain cases.

The CHAIRMAN: That is right.

Mr. IRWIN: It is thought that if at some future time the department is calculating the undistributed income of that corporation it should receive credit for the fact that it has already paid tax in respect of a certain amount of undistributed income.

The CHAIRMAN: Yes, one of the corporations going into the amalgamation may have taken advantage of section 105C and paid its tax and created a preferred stock, and then there is the amalgamation. In those circumstances, if it has created a preferred stock, that may disappear in the amalgamation.

Mr. IRWIN: This particular amendment does not relate to what goes on before you have the new company formed as a result of an amalgamation. It only looks at the new company which has been formed by the amalgamation and provides a certain rule to be followed in computing the undistributed income of that new corporation.

The CHAIRMAN: Does this section carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 24 simply permits a deduction of drilling and exploration costs for rock salt and potash deposits?

Senator BRUNT: It relates to a couple of new minerals.

Mr. IRWIN: Companies whose business is mining for potash or salt by conventional mining methods have had the right to deduct exploration expenses, but not all companies follow conventional mining methods and therefore did not qualify.

The CHAIRMAN: Does subsection (1) of section 24 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: What is the significance of subsection (2)?

Mr. IRWIN: Subclause (2) merely adds the word "exclusively" in two places to make doubly sure that only shares of the capital stock can be used as consideration in this kind of re-organization.

The CHAIRMAN: Shall this subsection carry?

Hon. SENATORS: Carried.

The CHAIRMAN: What have you to say about section 25, Mr. Irwin?

Mr. IRWIN: Section 25 deals with the situation where a person has been carrying on business in Canada and computing his income by what is generally known as the cash method. In such circumstances he does not take into account any accounts receivable or the proceeds from the sale of inventory until they are actually received. It might happen that a person who is carrying on business in this way and who had built up some accounts receivable ceased to be a Canadian resident. Under the existing law it would not be possible to bring those accounts into income. This provides that they may be valued and included in the income for the last year in which the individual resided in Canada.

Senator BRUNT: In the last year? You just take all of the accounts receivable and put them into his income?

The CHAIRMAN: They have to be valued.

Senator BRUNT: Yes, after a proper allowance is made for bad and doubtful ones.

The CHAIRMAN: Yes.

Senator BRUNT: And the same with respect to the inventory?

The CHAIRMAN: Yes.

Senator BRUNT: There is no averaging?

Mr. IRWIN: There are provisions for averaging, I believe, in connection with section 85F, and they would apply here.

Senator BRUNT: They would not be disturbed?

Mr. IRWIN: No.

The CHAIRMAN: Does section 25 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 26?

Mr. IRWIN: Subclause (1) is consequential upon the amendment dealing with transfers of—

Senator BRUNT: Does this deal with transfers between classes of depreciable property?

Mr. IRWIN: This subclause (1) is consequential upon that amendment.

The CHAIRMAN: Does subsection (1) of section 26 carry?

Hon. SENATORS: Carried.

The CHAIRMAN: What about subsection (2)?

Mr. IRWIN: The law permits a taxpayer to make a deduction for bad debts, but it provides that if in a subsequent year he recovers any of the bad debts this recovery must be taken into income. This amendment will provide that a new corporation that results from an amalgamation will have to take into income any recovered bad debts that have been deducted by a predecessor corporation.

The CHAIRMAN: Does subsection (2) carry?

Hon. SENATORS: Carried.

The CHAIRMAN: What about subsection (3) at the top of page 19?

Mr. IRWIN: This also refers to a new corporation that has been formed as a result of an amalgamation. It permits the new corporation that results from the amalgamation to set up a reserve in respect of uncollected proceeds of sales made by the predecessor corporation on the same basis as the predecessor corporation could have established that reserve.

The CHAIRMAN: Yes, it can proceed and deal with bad debts and reserves on the same basis as though there had been a continuity in the corporate operations?

Mr. IRWIN: That is its purpose.

The CHAIRMAN: Does that subsection carry?

Hon. SENATORS: Carried.

The CHAIRMAN: Section 27 simply provides for another member of the Tax Appeal Board; is not that right?

Mr. IRWIN: Yes, sir.

Hon. SENATORS: Carried.

The CHAIRMAN: What have you to say about section 28, Mr. Irwin?

Mr. IRWIN: Subclause (1) is relieving. It refers to the special tax imposed by section 105C, and the amendment is intended to make it clear that the amount upon which tax is payable will not be increased by the tax itself. The calculation of the tax under section 105C depends upon the difference between assets and liabilities. One might argue that the tax is itself a liability, and if this were the case the tax would increase the amount upon which the tax is payable, which would in turn increase the liability, which would in turn increase the tax, and so on. This is intended to make it clear that that will not be—

Senator BRUNT: Can you give us a simple example of that?

Let us assume the assets are $100,000 and the liabilities $50,000, and the tax applied on the difference of $50,000 would in this case be $10,000. One might argue that the tax is a liability, therefore the liabilities are $60,000.

Senator BRUNT: Yes, $60,000. And it comes down to $40,000, and 20 per cent would be $8,000. That I like.

Mr. IRWIN: I am sorry. It is the difference between the net assets and the surplus. If you increase the liabilities you reduce the net assets. My example was wrong.

Senator BRUNT: I would just like to understand it clearly. Could you give us a simple example?

The CHAIRMAN: Take the same one. If the net assets are $100,000 and the surplus is $250,000, the difference is $150,000, and you would pay 20 per cent of that. Is that not right?

Mr. IRWIN: That is right.

Senator BRUNT: That would be $30,000.

The CHAIRMAN: Yes. Whereas, if you put the tax in as a liability your net assets would be less. The difference between the net assets and the undistributed income would be more, and your 20 per cent on a greater amount would produce more tax.

Senator BRUNT: Yes—clear as mud.

The CHAIRMAN: Carried. We have been talking about subsection (1) of section 28.

What about subsection (2) of that section, Mr. Irwin?

Mr. IRWIN: Subsection 2 is meant to plug a loophole. It refers again to this special tax that is imposed under section 105C, and it provides that in computing the liabilities of this new corporation for the purposes of arriving at the base on which the tax should be applied all shares of the new corporation, other than common shares, shall be deemed to be liabilities.

The CHAIRMAN: The effect of that is of course to reduce the net assets, is that not so?

Mr. IRWIN: That is right, and to increase the base on which the tax would apply.

The CHAIRMAN: What is the principle behind that? Is it to prevent the dilation of undistributed income by creating more common shares? It would simply mean that people would create more common shares, wouldn't they?

Mr. IRWIN: It was found that the amalgamation of two companies could be used to extract undistributed income in a tax-free form. Section 105C was inserted last year to impose a tax of 20 per cent in the circumstances in which this occurred. It was found that the amendment passed last year did not cover all the situations.

The CHAIRMAN: They would create preferred shares and after an amalgamation would redeem them.

Mr. IRWIN: Yes.

The CHAIRMAN: You are plugging that loophole now. Well, it was a nice run while it lasted.

Subsection (2) of section 28, carried.

Subsection (3) deals with only the date of coming into force. Carried.

Section 29. Apparently sections 29 and 30 should be considered together. These sections, as I think I indicated yesterday, deal with withholding tax in three different categories. One category is, if an agent receives money that is payable to a non-resident he has an obligation to withhold, and if he does not withhold and has to pay it himself, he has the right to demand payment from the non-resident. Those are two classes?

Mr. IRWIN: Yes sir.

The CHAIRMAN: That is, he has to pay the withholding tax if he receives the money; even though he has paid it himself for the person entitled to the money, he has an obligation to pay X dollars.

Senator ASELTINE: Has that not always been the law?

The CHAIRMAN: I thought it was.

Mr. HARMER: The way the law was, objections were made that although the agent was liable to pay, he had no means of recovering it from the person he represented.

Senator ASELTINE: How is he going to recover?

Senator BRUNT: He can take it out of other moneys that come in.

Senator ASELTINE: He might not have any other money.

The CHAIRMAN: Then he would have to sue for it.

Mr. HARMER: I don't think we can help you there, senator.

The CHAIRMAN: Section 30 is a very ameliorating one. Heretofore, if you had a duty to withhold you were liable for 100 per cent of the withholding tax. Now the penalty is 10 per cent.

Senator BRUNT: Let us pass it.

The CHAIRMAN: Carried.

Section 31 simply provides for a penalty. This is a technical section.

Mr. IRWIN: Yes. It provides for the continuation of the present rule that a person who has been convicted under section 132 may not also be required to pay a penalty under clause 56 (1) for the same offence.

Senator BRUNT: Carried.

The CHAIRMAN: In practice you actually observe that, don't you?

Mr. HARMER: This is going to be a change.

The CHAIRMAN: I have heard it announced at times, if we prosecute we won't exact the civil penalty as well.

Mr. HARMER: This has been the case, but with this change from the old 25 to 50 per cent to a new flat 25 per cent, the thought is that we want to be able to penalize as well as prosecute in cases where the offence is vicious enough to warrant it; and we want to be able to do that after prosecution, not before, as was the case in the past.

The CHAIRMAN: Under this amendment you could only do it before any information was laid.

Mr. HARMER: Only under subsection (1) of section 56, not under subsection (2), which is the new penalty.

The CHAIRMAN: Under section 31, if you are going to impose a penalty you must impose it before the information is laid.

Mr. HARMER: If we impose that penalty under the old 56 (1), yes, but if we impose it under the new 56 (2), which is a flat 25 per cent, we do not have to do it before prosecution.

Senator BRUNT: You could do it at any time, either before or after.

Mr. HARMER: That is right.

The CHAIRMAN: What I do not like here is reference to section 56 (1), because we just had a statement from Mr. Harmer to the effect that, after this bill becomes law, subsection (1) of section 56 would apply only in circumstances that arose down to the date of the passage of the bill. Here we are giving power to continue to apply subsection (1) where there has been a conviction or proceedings leading to conviction. But if you are going to apply it, you must do so before you lay the information. It looks to me as if you are keeping a stick in both hands.

Mr. HARMER: No, that is not the intention. This is in the law now, in respect of the present penalty under section 56, which becomes 56 (1). The intention is to continue this provision until section 56 (1) runs out and then this will have no further effect.

The CHAIRMAN: Since we accepted Mr. Harmer's statement on the first part of this I am sure we are prepared to accept it on the second part, that there is a limited period of application.

Shall the section carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Section 32.

Senator BRUNT: I think we have dealt with section 32 already.

The CHAIRMAN: Section 32 is in addition to section 15, it is of the same ilk I would think. Is that right, Mr. Irwin? It deals with the mailing date?

Mr. IRWIN: That is correct.

The CHAIRMAN: And it provides for the exception in case of appeals that have already been taken.

Mr. IRWIN: Yes, it provides a rule for determining the date of mailing and for determining the date when an assessment, which includes a re-assessment, shall be deemed to be made.

The CHAIRMAN: Shall the section carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Now, section 33 really covers a lot of pages, so much so that I made the suggestion to some people, not publicly of course, that I thought possibly we should enact as law what appears on the righthand side of the page because the explanations in some sections seemed to be very succinct and less difficult to interpret than what appears on the lefthand side.

Let us deal with subsection (1) of section 33.

Mr. IRWIN: This subsection deals with the definition of death benefits. It does three things: It substitutes a reference to employee's salary, wages and other remuneration in place of the present words which refer only to remuneration. This is intended to add a reference to the employee's basic remuneration, to his salary and wages, to make it a little more definite. The second thing it does is provide that where an employee dies without leaving a widow the exemption shall be apportioned among the beneficiaries in proportion to the amount received. This replaces the present rule which leaves it to the minister to decide who shall get the exemption. And thirdly, it covers the situation where an employee may receive a death benefit in respect of more than one office or employment.

The CHAIRMAN: Then you dealt with them as if each one was the only one?

Mr. IRWIN: Yes.

The CHAIRMAN: I mean you do not total them.

Mr. IRWIN: That is correct. He cannot have the full exemption in respect of each of them.

The CHAIRMAN: How would it work out if supposing you had two death benefits—let us assume one was $5,000 and the other was $15,000—from different sources? How would you apply the provisions of this amendment to that situation?

Mr. IRWIN: This involves an interpretation of the words; I would rather refer it to the national revenue people here.

Mr. POOK: I am not clear on the example you gave. The exemption is $10,000.

The CHAIRMAN: Let us put them, one at $3,000 and the other at $5,000.

Mr. POOK: Those are the death benefits?

The CHAIRMAN: Yes, from two different sources.

Mr. POOK: If the employee's remuneration came from two different sources the exemption is proportioned in proportion to the amount of salary he got from his employers. The proportion of the $10,000 is allowed.

The CHAIRMAN: Of course there are so many factors that you would have to put down in order to operate the formula, I can see the difficulty in that.

Mr. HARMER: To make it nice and simple, if the income from each employer was $5,000 in the last year of employment, they would add to $10,000, and then he got a death benefit from each one of $6,000, it would be that $5,000 exemption against each $6,000 death benefit.

The CHAIRMAN: That is all in subsection (1). Shall the subsection carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Subsection (2).

Shall it carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Subsection (3), is to repeal the section 139 (1) (az). Are we concerned about that repeal Mr. Irwin?

Mr. IRWIN: This repeals the definition of income from a source. This is being dealt with in a new section.

The CHAIRMAN: Shall the subsection carry?

Hon. SENATORS: Agreed.

The CHAIRMAN: Subsection (4) of section 33. This has so many complicated references in it I wonder if you can tell us in a few words what it is intended to do?

Mr. IRWIN: It merely adds the underlined words. This particular subsection of section 139 provides a definition of the expression "tax payable under Part I," or "tax payable under Part II," and it is necessary to add this reference to Part IIC.

The CHAIRMAN: Now we come to a section that requires some discussion, subsection (5) of section 33 which purports to amend section 139. There is no question but that this revision is for the purpose of dealing with the decision in the Interprovincial Pipeline case. Is that right?

Mr. IRWIN: That is right.

Senator BRUNT: That is admitted. That is what it is about.

The CHAIRMAN: The principle involved, as I understand it, is that the effect of rewriting this definition is so as to be able to attribute to income received from abroad or from another country expenses which were actually incurred in Canada.

Mr. IRWIN: Yes, the Income Tax Act provides a number of deductions in computing income. It is sometimes necessary to compute income from a particular source or from a particular activity and this is intended to make clear that amounts which are deducted in computing income may be allocated or used in computing income from a particular activity or source.

The CHAIRMAN: That is a generalization, but if we look at this in the light of the Interprovincial Pipeline case I think we can get a clearer understanding of what you are doing because in the Interprovincial Pipeline case the company borrowed money in Canada and it had a liability to pay interest on the bonds that were issued in Canada. Is that not right?

Mr. IRWIN: I believe so.

The CHAIRMAN: And they established a subsidiary company in the United States to construct and hold the part of the pipe line that was constructed in the United States, and the Canadian company lent money to the American company and charged interest on that loan, and the American company bought treasury bills in the United States and received income from that source.

Now, if this subsection (5) were law in relation to those facts then the Interprovincial Pipeline would have got no credit for the withholding tax withheld by the United States on the interest that was paid to the Canadian company for the money loaned to the American company. Is that right?

Mr. HARMER: Yes, sir.

The CHAIRMAN: I find something difficult in that principle to accept. The Canadian company borrows money in Canada and there is an obligation to pay interest, so that is a deductible charge of the Canadian company. The Canadian company turns around and puts that money to work in the United States and earns income on that money in the United States. Income comes to it in Canada but less a withholding tax in the other country. What you are in effect saying here is that that interest paid in Canada on the money that was borrowed in Canada and loaned to the American company is a deductible charge or, as the language in this definition says, "It may be reasonably regarded as wholly applicable to that source." In other words, you are saying that the interest paid in Canada may reasonably be regarded as being applicable to the interest received from the United States, and since it was at least equal to that amount there was no income from the United States, even if the United States collected a withholding tax.

Mr. IRWIN: Yes, sir, for Canadian tax purposes there is no income from the United States. The costs of earning the income are equal to the income.

The CHAIRMAN: What I am trying to figure out is where is this going to stop. The Interprovincial case happened to involve interest but it could involve promotional expenses in Canada. I could conceive that it might even involve indirect charges.

Senator BRUNT: We will just have to wait and see.

The CHAIRMAN: What is the view of the department in presenting this amendment as to the scope of the words "such deductions as may reasonably be regarded as wholly applicable to that source"? What is the intended scope of that in that allocation?

Mr. HARMER: What ever is reasonable in the circumstances.

Senator BRUNT: It will be all-embracing.

Senator LAMBERT: Discretionary authority is introduced?

Mr. HARMER: No, this is something we have to take a view on and then we have to be prepared to support it in the courts and if the courts say that we were unreasonable in allocating certain expenses to certain income then we cannot make the assessment stick.

The CHAIRMAN: Let us test that reasonableness on the facts of the Interprovincial Pipeline case in the allocation of the interest paid in Canada against the interest earned in the United States. Let us bring forward a reasonable man in those circumstances.

Mr. HARMER: To us, sir, it seems eminently reasonable to say that if a company has no money of its own and has to go out and borrow money which it invests some place else, it is surely reasonable to say the interest it pays on what it borrows should be offset against the interest it receives on the investment of that borrowed money.

Senator BRUNT: Without regard to the tax it has to pay on the interest it received?

Mr. HARMER: The tax is the result of this. If, in fact, by having made what we think is a reasonable allocation it turns out there is no net income coming into Canada and therefore no Canadian tax payable, then we do not see why we should allow a foreign tax against the Canadian tax on some other kind of income when in fact we get no tax on the income taxed in the United States.

The CHAIRMAN: Let us say I borrowed the money to put it to work and I happened to put it to work in the United States and it cost me something there to put it to work, and when you say my cost of the money in Canada is going to be deducted from the earnings of that money in the United States but I am not going to be allowed the cost that I am subjected to in the United States in the use of that money there, then I am puzzled. That is the thing that puzzles me.

Senator BRUNT: There is this further fact that I think should be looked at. Because of this subsidiary company in the United States which operates a pipe line, the overall profit is increased.

The CHAIRMAN: That's right. The pipe line would be inoperable, I would think.

Senator BRUNT: They have to operate certain facilities in Superior, Wisconsin, but the overall profit is increased and our taxing authorities are quite happy to tax the increase on the profit. You want the best of everything.

Mr. IRWIN: No, the dividends would come back tax free.

The CHAIRMAN: Yes.

Senator LAMBERT: Does this taxing provision apply now to only one case?

Senator BRUNT: Only one case has come up so far.

Senator LAMBERT: That is the reason for it? It is a net being spread at the sight of the bird that you want to catch.

The CHAIRMAN: No, you can't catch this bird. This was in 1950-54 and the case went through the courts and the Supreme Court of Canada held that the withholding tax was a proper deduction. Now, you have a change in the law inspired by the Interprovincial Pipeline case but this would be applicable to any such case which would occur in the future. They cannot go back and undo the Interprovincial Pipeline case.

Senator LAMBERT: No, but as a matter of fact there is no other corporation to which this clause would apply at the moment?

The CHAIRMAN: I don't know. It could very well be.

Senator BRUNT: It doesn't have to be a pipe line company.

The CHAIRMAN: No. This would apply in any case where you borrowed money in Canada and used it for the purpose of earning income in the United States.

Senator BRUNT: That's right.

The CHAIRMAN: And I am sure there are lots of those cases.

Senator LAMBERT: With respect to the Interprovincial Pipeline Company the money was not borrowed from the people of Canada except for a very small percentage of it. You know that because you will remember the bill coming through here.

The CHAIRMAN: Yes.

Senator LAMBERT: It seems to me that when you use the income tax law of Canada—it isn't the first time it has been done—to introduce clauses that are applicable to one particular case and not to a broad number, you are coming fairly close to *ex parte* deliberation and concentration. I wonder if it does not have some reaction on the development of the country, that is all. This particular corporation certainly had a great deal to do with the development of the natural resources of Alberta.

Mr. HARMER: Senator, the intention is certainly not to limit the application of this amendment to one company or even to all companies doing business outside the country. It has very wide application in many instances. In any case, where you have to determine income from a source either from Canada or abroad or income from a particular business, or anything like that.

Senator LAMBERT: The effect of such taxation can reach a point where it can discourage any further development of that kind. That is the point I am trying to bring out.

Senator BRUNT: I come back to the other point. I realize dividends paid by the parent company may be taxable, but I maintain that because that pipe line is in the United States, profits of the Canadian company are increasing.

The CHAIRMAN: Oh, yes.

Senator BRUNT: Regardless of dividends coming from the United States or not, you tax those increased profits.

Senator MCKEEN: On the other hand, when that money from the company goes to Canadian shareholders it is taxed.

The CHAIRMAN: Yes.

Senator LEONARD: Is there any infringement on the reciprocity treaty?

The CHAIRMAN: At the moment I am concerned with the U.S.-Canadian tax convention. This is something that marks a change in our income tax law

and therefore a change in relation to the basis on which our U.S.-Canadian tax convention was entered into. Now, the thing I am not prepared to say is, I doubt if it stultifies the convention; but if you started to apply the convention you might have to apply it on the basis of the law as it was when the convention was entered into, rather than this amendment. If you want to have the amendment within the scope of the convention you would have to have a supplementary convention.

Senator LEONARD: What does Mr. Irwin say?

Mr. IRWIN: Mr. Chairman, I do not think this interferes with our convention. I might add we don't regard this as a change in law but rather as putting down in words what we thought the law always provided.

The CHAIRMAN: Yes, except that the court said that it didn't.

Mr. IRWIN: Yes.

The CHAIRMAN: So that we have to proceed by the income tax of Canada which is part of that tax convention and is based on a state of law, not what you thought it was, but what the court said it was.

Senator BRUNT: Have any studies been made of the convention with respect to tying in this amendment? Has anybody really looked at the convention?

Mr. IRWIN: We do not think that it will affect the convention adversely. For example, Article 15 of the convention says, "As far as may be in accordance with the provisions of the Income Tax Act, Canada agrees to allow a tax credit", and so on.

The CHAIRMAN: That is the act as it was at the time.

Senator BRUNT: At the time.

The CHAIRMAN: Yes, not in relation to any change.

Senator BRUNT: Surely that would be interpreted as applying to the act as it existed at that time?

Mr. IRWIN: Not in this case.

Senator BRUNT: And according to the courts this company was entitled to the 15 per cent tax deduction which was made.

Mr. IRWIN: No, sir. When we want to, if you will, freeze a provision of the Income Tax Act as it stands at the time of the agreement, the agreement must say so.

The CHAIRMAN: The point is that where the convention is at variance with the Income Tax Act as it exists, the convention governs?

Mr. IRWIN: Oh, yes.

The CHAIRMAN: Well, if you make subsequent changes, are you suggesting that they apply to the convention? That is not the thing that bothers me as much as this factor. For instance, if you have a Canadian company that carries on branch operations in the States, and elsewhere, I can see a variety of fields where you may find expenses attributable on this formula to the U.S. branch operations that are not the type of expense that can enter into the calculation of U.S. tax for the purposes of the operations there, and I am going to get a burden of tax greater than the sum total of the taxes should be with the credits that I should get. I am thinking of indirect expenses, and the convention covers indirect expenses, and both countries recognize those things. With branch operations from Toronto and the United States, or some other country, you might find a portion of head office expense attributable to the branch operations in the States greater than what the company thinks is proper and greater than what they can charge against those operations in the States, and yet that would only be applied for the purposes of the formula, and if instead

of branch operations it happens to be a subsidiary company I can see all kinds of difficulties, both convention-wise and in relation to the extent to which this new doctrine may be applied in attributing expenses to a certain source of income—I can see all kinds of problems; and my interest is not an interest of saying "No", my interest is one of trying to simplify it.

Senator ASELTINE: I think we should pass it and see what happens.

The CHAIRMAN: Oh, well, of course, if we are going to just adopt the principle of passing a measure to see what happens we do not need to sit here for three hours.

Senator BRUNT: I think the present section with regard to associated companies is going to lead to all kinds of trouble.

Senator LAMBERT: Is it not true that in the case of the interprovincial corporation the subsidiary companies are represented in different States through which that line was obligated to pass when they were going to build the line, to incorporate a company with a separate subsidiary company in Michigan and—

The CHAIRMAN: No. They used the Delaware company, and it went through all the different States from Wisconsin right down to Sarnia.

Senator LAMBERT: Is it one separate corporation?

The CHAIRMAN: One separate corporation.

Senator LAMBERT: The point I want to make is that that interprovincial line would never have been built when it was if it had not been for the projecting of it through the western States to Port Huron.

The CHAIRMAN: No, the cost would have been too great.

Senator LAMBERT: Well, I know that, and the capitalization was borne pretty largely by the United States; but from the point of view of developing an industry in Alberta and bringing whatever benefit there has been from that province, building the line through those States, which now gives distributing facilities to certain American consumers, was an essential feature of it. I am not complaining about getting revenue, if it is possible to do so, but my purpose is to check on future developments of that kind, because I think that is the important aspect of this.

The CHAIRMAN: I can understand the application of this section to interest, as in the interprovincial pipe line situation, and possibly the theory was that my cost in money should be tied in to the income that I received from its use, and certainly that would be a sound principle if the whole operation was in Canada. The only thing that complicates it is because I borrowed the money in Canada and incurred a cost, and then I used the money in the States and earned some revenue, but also incurred some costs. Now, I am not getting the full cost of the money against the income in the sense that I am not getting any benefit from the withholding tax in the States. That is the only element there. The deduction is clear—it is interest—but when I am faced with a sentence which says "such deductions as may reasonably be regarded as wholly applicable", then I do not know what that is.

Senator BRUNT: Where do we end up?

The CHAIRMAN: I do not know. When it is interest I understand, but when it is made to be such as can be reasonably regarded then I—

Senator LEONARD: Mr. Chairman, is it clear that the taxpayer's income is from a source outside of Canada?

The CHAIRMAN: When it says "in a particular place" that may be in any place.

Senator LEONARD: What does Mr. Irwin say?

Mr. HARMER: The section is not limited to taxpayers having income from outside Canada.

Senator LEONARD: It applies to a Canadian taxpayer's income from sources within or without Canada?

Mr. HARMER: Yes.

Senator LEONARD: Then, it goes very much further than the Income Tax Resolution, does it not?

Senator BRUNT: Has somebody a copy of the resolution?

The CHAIRMAN: It is on the opposite page.

Senator LEONARD: The resolution says: "... and in computing income from sources outside Canada ...".

Mr. HARMER: Yes "... for the purpose of calculating the foreign tax credit ...".

Senator LEONARD: Have you a rule with respect to foreign income sources without Canada?

The CHAIRMAN: I feel dissatisfied with the section because I cannot put any boundaries on it. It does go further than the budget resolution which we have had time to consider. "From a particular place" may mean any place within or without Canada.

Senator BRUNT: Mr. Chairman, in the resolution it says the rules must specify the deductions. There is no specifying of the deductions.

Senator LEONARD: It is confined to two classes, the income of a non-resident person from a business or employment in Canada, and in computing income from sources outside of Canada for the purpose of calculating foreign tax credits allowed to a person resident in Canada, but as to a taxpayer in Canada a resolution deals only with the computing of income from sources outside of Canada for the purpose of computing tax.

The CHAIRMAN: My suggestion on this is that we should stand this section for further discussion.

Senator BRUNT: I agree. We have this other one to come back to, in any event.

The CHAIRMAN: Shall we go back to section 18?

Senator BRUNT: No, let it stand. It is now one o'clock.

The CHAIRMAN: Then, we will stand subsection (1) of section 18, and subsections (5) and (6) of section 33 for further discussion. Do I have the usual motion to print 800 copies of the proceedings in English and 200 copies in French?

Senator BRUNT: I so move.

The CHAIRMAN: All the sections except subsection (1) of section 18, and subsections (5) and (6) of section 33 have been carried.

Senator LEONARD: And subsection (5) of section 18 should stand also.

The CHAIRMAN: Yes, we are standing subsections (1) and (5) of section 18, and subsections (5) and (6) of section 33. All the others have been carried.

Senator BRUNT: When we come back we will limit the discussion to those four subsections.

The CHAIRMAN: Yes. The Committee can now rise and report progress.

Whereupon the meeting was adjourned.