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Chair

Mr. James Rajotte

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● (0850)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call this meeting to order.

This is meeting 107 of the Standing Committee on Finance.

Our orders of the day, pursuant to Standing Order 108(2), are the subject matter of Bill C-48, An Act to amend the Income Tax Act, the Excise Tax Act, the Federal-Provincial Fiscal Arrangements Act, the First Nations Goods and Services Tax Act and related legislation.

Colleagues, this bill is still before the House as we speak, so this is considered a pre-study of this bill and of the subject matter.

We have with us here today officials from the Department of Finance. We want to welcome you all to the committee.

Colleagues, as you know, it's a fairly large, substantive piece of legislation we're dealing with, so I did ask members to indicate which sections or which parts of the bill they wanted to focus on.

My understanding is that members want to focus on two parts in particular: part 3, dealing with foreign affiliates, upstream loans, and consequent definitions; and part 5, on restrictive covenants, charitable donations, gift and contributions, reporting of tax avoidance transactions, specified leasing property rules, shares issued for consideration for property or services, and real estate investment trusts.

The way I'm proposing that we proceed is we use our normal question rounds. Therefore, I will start with the official opposition, back to the government, to the Liberal Party, and back to the government for the first round.

The officials are prepared for a question and answer session.

[*Translation*]

We will start with Ms. Nash.

[*English*]

Ms. Peggy Nash (Parkdale—High Park, NDP): Thank you.

Welcome to the officials. It's great to see you here at the finance committee again.

My first question is a process question.

The last time a technical tax bill was passed was back in 2001, and the Auditor General raised concerns about the slow pace of making these technical changes.

The Chair: A point of order, Mr. Brison?

Hon. Scott Brison (Kings—Hants, Lib.): I'm sorry to interrupt, Peggy, but I just thought it would be helpful for a public who may be observing or listening to this or, ultimately, potentially reading it, if there were an overview of sections prior to us launching into questions. It might make it more user-friendly, from a citizen engagement perspective and their capacity to understand this. It is frequently the case that we would hear from public servants a little bit of an overview, in terms of intentions of the legislation.

The Chair: Okay.

On this point of order, Ms. Glover.

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Mr. Chair.

I appreciate what Mr. Brison is saying, and I understand he'd like to facilitate this for people who might be viewing. But, really, the function of today is to try to get through the sections that we, as parliamentarians, need to vote on. We had discussed how important it was to try to get through this, which is why the binders were available ahead of time.

There is information for the public available. Consultations on these have been released multiple times, and in the interest of time, I believe committee had agreed this was the best way to proceed because we want to get to the questions that will help us to make our decision, as parliamentarians, when it come time to vote.

Being that it is a bill that's 1,000 pages, being that there has been enormous consultation back more than 10 years, it's imperative that we allow those who have questions to ask those questions, and we thought this was the best way to proceed.

I'd love to hear from my NDP colleagues, but I would hate to see us not have enough time, and we do have other studies to get to. I really want to get to an income inequality study and I'd hate to see us have to add some more meetings because we didn't get through the questions we have.

Thanks.

The Chair: Okay.

On this, I have Mr. Jean and Ms. Nash. If we could briefly make our points, then I'll move on.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

I just don't think it's fair to ask the officials to come up with a speech in 10 seconds. If Mr. Brison wanted that to happen, he should have anticipated wanting that before the meeting, because we knew the format of it, and they could have prepared appropriately. I just don't think it's fair to them.

The Chair: Okay, thank you.

Ms. Nash, on this point.

Ms. Peggy Nash: I appreciate we have a lot of work to get through. I'd like to propose a compromise, which is we just ask one of the officials to spend two minutes explaining what it is we're reviewing in this committee so that anyone who is tuning in today to the finance committee can understand the nature of our discussions.

Is that acceptable to everyone?

The Chair: The challenge is that the committee instructed me that we will have two hours with officials to cover this bill. That is what the committee instructed me, as the chair, to do.

Looking at this bill, if you have officials speak to each section of the bill we will not get to members' questions within those two hours.

Order.

In the interest of time, I ask members to focus, and I don't want to have a situation where we don't get to members' questions. I'm looking at the officials, but my sense is if we start doing introductions for sections of the bill we will not get through members' questions and then we will have to either not get to our questions or add meetings.

I operated under how the subcommittee and the committee instructed me to organize this, so if they wished to organize it a different way, they should have told me that prior to the beginning of this meeting.

Ms. Nash.

● (0855)

Ms. Peggy Nash: Why don't I just use my first question to ask the officials to make sure of this?

The Chair: That would be extremely helpful.

Ms. Peggy Nash: In the interest of moving things along, perhaps one of the officials can just describe for us, in as brief a way as possible, the nature of this overall technical tax bill and then specifically part 3 that we are examining first of all, very briefly, please.

Mr. Ted Cook (Senior Legislative Chief, Tax Legislation Division, Tax Policy Branch, Department of Finance): Certainly. With respect to the bill, probably the best way to provide an overview is to just briefly go through the parts.

Part 1 of the bill relates to non-resident trusts and foreign investment entities, or offshore investment funds. This is, in some sense, a carry-over of measures that were first introduced in the House back in 2006 and 2007, as part of prior Bill C-10. They have been significantly revised as a result of an announcement in budget 2010 and subject to further consultation after budget 2010.

If there are particular questions, perhaps we can deal with them separately.

Parts 2 and 3 deal with amendments to the foreign affiliate and foreign accrual property income regime of Canada. It's a regime dealing with income earned by subsidiaries, loosely speaking, of corporations and other taxpayers resident in Canada. My colleague, Mr. Porter will speak to part 3. I think he can give a bit of an overview of Canada's foreign affiliate system and how the hybrid surplus rules, which are encapsulated in part 3, function. These measures were not part of Bill C-10 so this would be the first time they have been before the House.

Part 4 contains bijuralism measures, which are measures that make amendments to the Income Tax Act to make sure that it properly reflects both common law and civil code concepts mostly with respect to property and property rights. These are amendments that were included in Bill C-10. They are the result of a Department of Justice study.

Part 5 is the major portion of the bill. It contains the remaining portions of Bill C-10, which were introduced in Parliament, as I mentioned, in 2006 and 2007 and died on the order paper both times.

As well, I would note that part 5 includes a number of additional measures—and we may get a chance to speak to them if I can anticipate another question from Ms. Nash—that relate to technical packages that the Department of Finance has released post-2007-08, partly in response to the Auditor General's report. Obviously the decision to release technical packages and include them in the bill is the Minister of Finance's, but the Department of Finance has been working on preparing technical packages.

It also includes a number of previously announced measures, both measures that were included in budget 2010, such as foreign tax credit generator measures, rules with respect to specified leasing properties, SIFT loss conversions and trading—and again, maybe we can speak to those more directly—and a number of miscellaneous previously announced measures.

Part 5 also contains three unannounced measures, very small, relating to income allocation for airlines, short-term residents in Canada and departure tax, and also a measure related to labour-sponsored venture capital corporations.

Parts 6 and 7 relate to GST and federal-provincial arrangements with respect to taxes.

Finally, part 8 just provides coordinating amendments that were necessary because the bill was tabled at the same time that there was a budget implementation act before the House.

That's just a very brief overview of the contents of the bill.

● (0900)

Ms. Peggy Nash: Thank you.

I understand my five minutes are up.

The Chair: Your five minutes are up. We will have plenty of time to return to you though.

We'll go to Ms. Glover, please.

Mrs. Shelly Glover: Thank you, Mr. Chair.

I want to thank our witnesses for the hard work that's been put into this very thorough bill.

We heard, through pre-budget consultations and through other meetings, several times from certified general accountants associations, etc., about the grey pages. I'm just wondering does anyone here have a copy of the code that actually illustrates the grey pages?

Mr. Ted Cook: We did bring a copy of the act.

Mrs. Shelly Glover: For purposes of clarity—

Mr. Ted Cook: So that's the Income Tax Act.

Mrs. Shelly Glover: —tell us how this technical tax bill affects that code and how it clears up those grey pages. And in addition, could you tell us how frustrating it has been for those who have to use that book and whether this technical tax bill will alleviate the challenges that they've had dealing with this? Just describe for us what the challenges would have been.

Mr. Ted Cook: I guess there are two parts to your question. One is about the extent to which the bill will clean up the grey pages in the act. I think the answer is substantially or all, or almost all, of the grey pages in the act with this bill will be cleaned up.

Mrs. Shelly Glover: How many grey pages are there?

Mr. Ted Cook: I would have no idea as to the number, but if you flip randomly through the act—

Mrs. Shelly Glover: Is there any way you could show it to us?

Mr. Ted Cook: Okay.

There's the act, and if you flip randomly through it—although here's a page without it—generally there are grey pages. They are probably at least 50% of the pages in the act are grey, maybe.

Mrs. Shelly Glover: And the grey pages are exactly what?

Mr. Ted Cook: The grey pages will be composed of two things. One is draft legislation that has been released that is not enacted yet. As well, grey pages will be comfort letters where the Department of Finance has indicated to taxpayers that they intend to recommend to the Minister of Finance a particular change.

Mrs. Shelly Glover: So continue with the rest of the question.

Mr. Ted Cook: With respect to compliance with the Income Tax Act, as I think most of the committee members are aware, we encourage taxpayers to rely on draft legislation. We encourage the CRA to administer based on draft legislation, but taxpayers do have a choice—so there is that question—as to whether they comply with the proposed legislation or the legislation in the act, which may create issues down the road. And I guess for a lot of companies there is an issue in the sense that for financial statement purposes before this bill was tabled in the House they would very often take one position for tax purposes but be required to reflect something else for financial statement purposes, that is the law as it stands as opposed to proposed legislation.

Mrs. Shelly Glover: That's confusing.

Now with the technical tax bill, what happens to those grey pages? Are we adding more grey pages or are those going to become white pages? Will the code get bigger as a result of this bill?

Mr. Ted Cook: The short answer is the grey pages will disappear. As to whether this book will actually get thinner, the book won't get any thinner because the way the publishers do it is they show the history of the act. Part of this thickness is just indexing and shows what the act was with respect to prior periods. You will never see the Income Tax Act actually get thinner in terms of the commercial publisher.

Mrs. Shelly Glover: Okay.

And the grey pages...it's really reflective of what we've got here. It's not that we're really adding to the code, we're just turning those grey pages white.

Mr. Ted Cook: In terms of what is in the Income Tax Act, what commercial publishers put out, there won't be any additional paper. Obviously in terms of what the actual law is, to the extent that we add a section or something like that, the act itself will grow. But in terms of whether we're adding 1,000 pages to the act, you have to replicate an entire provision to make perhaps the smallest changes within it.

Mrs. Shelly Glover: But most of what we're doing has already been addressed in the code and we're just making sure that it's now legislated.

Mr. Ted Cook: If you're talking about the grey pages, in terms of what's not been previously announced, there are very minimal changes in terms of income tax.

● (0905)

Mrs. Shelly Glover: Thank you.

The Chair: Thank you, Ms. Glover.

Mr. Brison, please.

Hon. Scott Brison: Thank you very much for appearing before us here. First, what's the fiscal impact of the measures in Bill C-48?

Mr. Ted Cook: In terms of the fiscal measures contained in Bill C-48, the measures by and large are what the Department of Finance considers integrity measures. Those are measures that protect the functioning of the Income Tax Act as intended. With respect to comfort letters or technical changes, those are things that do not affect the policy framework of the provisions.

The short answer is that, in the bill that is before the committee today, it does not represent either an increase or decrease in revenue, in terms of the fiscal framework.

Hon. Scott Brison: So these are all housekeeping measures, as opposed to policy changes, are they?

Mr. Ted Cook: In terms of what constitutes a policy measure, obviously, as I indicated in my overview, part 5 does contain some budget 2010 measures with respect to specified leasing of property and foreign tax credit generators. In terms of whether they are purely housekeeping, they are to support the existing functioning of the Income Tax Act.

As well, part 1 contains measures with respect to non-resident trusts and foreign investment entities that were first introduced in budget 1999 and were included in Bill C-33 and Bill C-10.

Hon. Scott Brison: It's difficult to understand how these would not have an impact on the fiscal framework. Some of them are quasi-policy changes. If you could clarify that all these changes are revenue neutral, that would be helpful.

Mr. Shawn Porter (Director, Tax Legislation, Department of Finance): Perhaps, Mr. Brison, I could pick up what Mr. Cook said around integrity measures. It is not to say that all the measures are merely housekeeping. They are very important. If they're not enacted, there would be significant revenue loss, but that doesn't mean that when you introduce them they're a policy change. They're an integrity measure to support the existing policy choices that are reflected in the act.

Another observation to make is that these proposed measures have now, for several years, been administered by the CRA as though they are law. Many taxpayers have either paid tax in accordance with the proposed measure or, to the extent it was an integrity measure, they've modified their behaviour and they've ceased and desisted in the kind of planning that was being undertaken that would have otherwise eroded the revenue line.

Hon. Scott Brison: In terms of the changes to the foreign affiliate system, how does our approach differ from that of the U.K. or the U.S., for instance, and to what extent does this increase the difference or bring us closer to their approaches?

Mr. Shawn Porter: We only have a couple of hours this morning.

Hon. Scott Brison: I remember when I was young and taking tax at university and writing open-book exams with the tax code. Nobody wants to go back there.

Mr. Shawn Porter: In the major measures in part 3, there are a lot of what you could characterize as housekeeping measures in the foreign affiliate changes as well. Most of the changes are accommodating, streamlining, simplifying, relieving, and clarifying. The ones that get all the attention, and we're sure the members want to chat further about this morning, involve hybrid surplus and upstream loans. Those are the more significant changes.

Mr. Brison, I will get to your question, but just to provide the necessary context to answer it, the Canadian international tax system, as it relates to certain kinds of income earned through foreign affiliates of corporations in Canada—corporations in Canada, when they're exploiting markets elsewhere in the world, often invest and do that through foreign affiliates—this is a subject matter that involves how Canada taxes that foreign income, be it active business income, passive income, or what have you.

Since the Canadian system was introduced in the 1970s, we've had a component of that foreign income be subject to what we would call a deferral and credit system. That is, the income can be earned offshore and Canada doesn't tax it currently, but it goes into a pool of earnings that the system refers to as taxable surplus, and when the taxable surplus is repatriated to Canada—and it may be repatriated in the same year that it is earned or it may not be repatriated for 30 years—the Canadian system will then impose a residual tax, a top-up tax, to reflect the difference, if there is any, an excess of the Canadian corporate tax rate over the tax borne by those earnings offshore. Therefore, if you earned active income in a jurisdiction that imposed tax at a 5% rate, Canada wouldn't tax it, provided it was active when you earned it, generally speaking. However, when it's repatriated to Canada, we would impose tax on it that would increase the burden to roughly the 25% to 30% rate when you include provincial taxes.

● (0910)

The Chair: Just finish up briefly, please.

Mr. Shawn Porter: As a final word, and I'm sure we'll have an opportunity to come back to this, suffice it to say that the upstream loan rule was an attempt to avoid the residual tax. The residual tax was only imposed when a foreign affiliate distributed a dividend to the shareholder in Canada. If the foreign affiliate made an upstream loan to the shareholder in Canada, which has the same economic effect, then the rule didn't have applications. The upstream loan rule will essentially treat that as a dividend, and then subject to potential —

The Chair: Thank you.

Thank you, Mr. Brison.

Mr. Hoback, please.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Mr. Chair.

I thank everybody for coming here this morning.

I really don't have a lot of questions, but there's one area, in definitions, where you could help me out. You talked a little bit about comfort letters and what they are. Maybe you could define what they are, and the processes used in getting a comfort letter.

I know that Mr. Brison maybe would like to receive a comfort letter somewhere down the road from the Government of Canada.

Hon. Scott Brison: I get a lot of discomfort letters.

Voices: Oh, oh!

Mr. Randy Hoback: Well, I think we can give you a comfort one, maybe, from Revenue Canada.

Perhaps you could give us the definition of what a comfort letter is, what it entails; what you would have to do to get a comfort letter; if there's a backlog in receiving these comfort letters; and what the impact would be, after this legislation goes through, in terms of whether or not we'd be sending out more of these comfort letters.

Mr. Ted Cook: Comfort letters are letters that are issued by the Department of Finance generally to taxpayers. The situation they contemplate is that an individual or other taxpayer is faced with a transaction usually that they would like to undertake, or a particular tax situation. When they look at it, and the CRA looks at it, they come to the conclusion that in fact the transaction the taxpayer wants to undertake doesn't work under the Income Tax Act.

In some cases, the taxpayer will change their transaction, or they may come to the Department of Finance and say, “Well, what we want to do is completely in line with the policy of the provisions of the Income Tax Act”—essentially, you have perhaps a situation that wasn't contemplated at the time the initial act was drafted—“and will you provide us a comfort letter?”

The comfort letter request comes to our division, the tax legislation division of the Tax Policy Branch, and we analyze the situation technically with respect to the act and also the surrounding policy for the provision. If we find that it is in fact within the policy of the act, officials of the Department of Finance may issue a comfort letter.

What a comfort letter does is it indicates our willingness to recommend to the Minister of Finance that a particular change be made to the Income Tax Act, and this particular change usually will have effect as of the transaction date or the date of receipt of the comfort letter. What we can provide is a recommendation. Taxpayers are generally willing to order their affairs based on comfort letters, and the CRA is generally willing to administer based on comfort letters.

The comfort letter process works reasonably well. Of course, it ultimately depends on the subsequent enactment of the changes that were alluded to in the comfort letter. Obviously at some point down the road, for people to sort of maintain faith in the system, it's necessary that those comfort letters be enacted.

We continue to issue comfort letters. We perhaps do it less often than we had in prior years, but we continue to issue comfort letters, and will do so into the foreseeable future.

Sorry, if there's another minute, I think you had also asked about the backlog.

● (0915)

Mr. Randy Hoback: It was about the impact of Bill C-48, plus the backlog.

Mr. Ted Cook: I think in terms of the backlog of comfort letters, if I can maybe step back a bit, obviously the Auditor General reviewed the Department of Finance, and particularly our area, back in 2009, and made two recommendations: that we introduce a better system for monitoring technical amendments and that we develop a plan for implementing dealing with this backlog; and—to the minister—the release of smaller packages of technical amendments.

I think we can say that we've done so. In fact Bill C-48 before you has the amendments that were contained in at least two technical amendment packages that were released for comment in 2010 and 2011.

The Auditor General found that there were approximately 250 comfort letters that needed enactment. In terms of the comfort letters that are sort of still outstanding in the backlog, I would note that we did release a technical package back in December. As it stands now, between that technical package and the amendments that are contained in Bill C-48, fewer than 25 comfort letters have not been released in terms of draft legislation at this point.

The Chair: Thank you, Mr. Hoback.

Ms. Nash, go ahead, please.

Ms. Peggy Nash: Thank you.

I just want to pick up on the technical tax changes, because it's been a number of years since we've passed a technical tax bill. It's my understanding the last one was passed back in 2001. Is that correct?

Mr. Ted Cook: That is correct. Obviously technical amendments were then tabled in the House again in 2006 and 2007 but unfortunately were not passed.

Ms. Peggy Nash: Okay. Now, the Auditor General raised concerns about the slow pace. We're glad to see that this bill has come forward. It's quite a lengthy bill. It's close to 1,000 pages, so we're looking at quite a big document, and that's because there are a lot of changes that we need to deal with. You're talking about wanting to make this process faster. Is there going to be any attempt on the part of the government to, on a more regular basis, update the technical tax changes? I assume you would agree it's not desirable that there be a 13-year gap between technical tax bills. Maybe you can just tell me what the ideal timeframe would be from your perspective.

Mr. Ted Cook: In terms of the ideal timeframe, whether to introduce a bill and the contents of that bill, and the frequency of introducing technical amendments are obviously decisions—and I think both the public accounts committee and the Auditor General have recognized this—ultimately made by the government. Within the control or ambit of the Department of Finance are the kinds of things I've talked about in terms of preparing packages of technical amendments that would put the government in a position to pursue its priorities as appropriate.

Since the Auditor General's report, with respect to general miscellaneous technical amendments, we have recommended and have released packages of technical amendments—in November 2010, October 2011, and December 2011. So in terms of the Department of Finance's response, I think we've been working hard to deal with technical amendments and to put the government in a position to ensure that it won't be another 13 years.

Ms. Peggy Nash: Right. Now in terms of the number of these technical amendments, the Auditor General said back in 2009, which was during this 12-year period, that there were at least 400 outstanding technical tax changes that hadn't been legislated at that point. How many of those technical tax changes would you say are being dealt with in this particular bill?

● (0920)

Mr. Ted Cook: In terms of the Auditor General's comments, I think it's a difficult question, as far as what an amendment is and how broad it is. Part 1 makes amendments to non-resident trusts and foreign investment entities. The question is whether there are two amendments or 100. I think perhaps the focus has been rightly on comfort letters, because those are amendments whereby the Department of Finance has publicly stated to taxpayers that it intends to recommend a certain change.

Ms. Peggy Nash: How many comfort letters would be outstanding and how many technical changes would be outstanding even following the adoption of this bill, if it is subsequently adopted?

Mr. Ted Cook: I'll just answer briefly, Mr. Chair.

The Auditor General found 400 amendments in total, 250 of which were comfort letters. In terms of what is contained in Bill C-48, after you take out Bill C-48, there are probably fewer than 50 comfort letters.

We also did a release in December 2012 that addressed another 20 to 25 comfort letters. They are out in draft. That leaves approximately 20 to 25 comfort letters that are unaddressed, and I would say that some of those are even comfort letters we've issued this year. Some are older comfort letters, because we've addressed them by theme and by what makes sense. I won't say that we're just dealing with the ones that have been issued in the last year or two, but by the same token, we're sort of in the ballpark of having addressed really the great majority of the comfort letters.

The Chair: Thank you, Ms. Nash.

Mr. Adler, please go ahead.

Mr. Mark Adler (York Centre, CPC): Thank you, Chair.

You indicated earlier that there was a previous incarnation of this bill under a previous Parliament that died with the dissolution of the Parliament. How different is this bill from that one, would you say?

An hon. member: Introduced by us.

Mr. Mark Adler: Introduced by us, yes.

Mr. Ted Cook: Just in terms of overview, part 1 has measures with respect to non-resident trusts and foreign investment entities. There were measures with respect to those in Bill C-10. The Senate committee hearings highlighted a number of specific concerns with those measures. They've been significantly revamped as a result and subject to consultation after budget 2010.

Parts 2 and 3, with respect to foreign affiliates and what we had talked about with respect to a hybrid surplus, are all new from former Bill C-10.

The bijuralism amendments contained in part 4 were contained in Bill C-10.

Part 5 represented the majority of old Bill C-10. It has those amendments to the extent that we haven't found a spot for them, perhaps, in a budget bill earlier, plus certain budget 2010 measures that have not been enacted yet, as well as sort of a list of previously announced measures, and the additional technical amendments that I have just been alluding to.

Parts 6 and 7 were not included in Bill C-10.

Mr. Mark Adler: Clearly, these changes are going to have implications for both taxpayers and tax professionals.

You indicated earlier that there were consultations that took place. Could you talk a bit about those consultations, how extensive they were and what kind of feedback you received during the course of these consultations?

Mr. Ted Cook: On the general responses, aside from a few income tax measures—I'm just talking about the income tax side—there's been an opportunity for consultation. The amount of specific consultation will depend on the measure. In terms of the non-resident trusts and foreign investment entity measures, they have a history that goes back to 1999. There have been a number of releases. It was considered by the Senate committee. It was again released in 2010. It was also subject to review by a panel of tax practitioners. That measure has been through quite a bit of consultation.

On other measures, if they were part of old Bill C-10, then, obviously, there's a consultation process that occurred with respect to Bill C-10. With respect to the technical amendments that were released post-2009, they would have just the consultation period that applied when the initial draft legislation was released, which is normally a general release of the legislation and an invitation for comment.

● (0925)

Mr. Mark Adler: Clearly, there were extensive consultations undertaken.

Mr. Ted Cook: As I indicated, there's been consultation on the vast, vast majority of the measures included.

Mr. Mark Adler: During the course of these consultations, was the feedback on what you were proposing positive within the tax community?

Mr. Ted Cook: In terms of feedback, certainly the Senate committee and some of the witnesses before the Senate committee expressed concerns with respect to the specific aspects of the measures that are now included in part 1, so we've worked to address that.

We've talked about integrity measures. Obviously, integrity measures aren't always well accepted by some parts of the tax community. In overall terms, though, if I were to use a word as to how the tax community has reacted to this bill, it's “relief”.

Mr. Shawn Porter: I would just add, with respect to parts 2 and 3, the two international parts, part 2 was originally introduced in December 2009. There were consultations, it was re-released in August 2010, and it has generally been well received. There were no further sources of noise with respect to the measures introduced in that package.

On part 3, which involved hybrid surplus and upstream loans, originally released in August 2011, we received a number of comments, particularly around hybrid surplus and upstream loans, and so there were significant consultations. What has been re-released for the first time in Bill C-48 are amendments, further changes as a result of those consultations, to the upstream loan rules in particular, which, in the main, have been well received by the tax community.

The Chair: Thank you, Mr. Adler.

[*Translation*]

Mr. Caron, you have the floor.

Mr. Guy Caron (Rimouski-Neigette—Témiscouata—Les Basques, NDP): I have two questions. The second one is for Mr. Harnish. So I will give him time to move up to the table while I ask the first question.

My question has to do with the process. If we go by the Auditor General's report in 2009, the agency was developing an electronic database that was supposed to be implemented at the end of 2009. Where are we in that regard?

[*English*]

Mr. Ted Cook: I'll respond to that question. In terms of the Auditor General's report, there are two parts to it. I'm talking about the recommendations just with respect to the Department of Finance.

One was to develop a comprehensive database and continue to use it for processing technical amendments. In fact, we did. We internally developed a database. The database has been completed. The database is used to log comfort letters and other technical amendments.

The database and our implementation of it, and in fact our implementation of the Auditor General's recommendations, were subject to a Department of Finance internal audit in the 2011-12 taxation year. That internal audit, which included things like cross-checking our entries in the database and making suggestions in terms of how we can manage the database, found that our view that we had fully implemented the Auditor General's recommendations was substantiated, and, with respect to dealing with the backlog—this is back before we had additional releases of technical amendments—that we had substantially implemented the other recommendations.

I guess what I'd say is that since we received the Auditor General's report and made our response to it, certainly it has been my brief—and certainly senior management has been very clear—to take the recommendations seriously and deal with them. We do have a database in place. We do track our comfort letters. We have a good handle on that. That's why I can talk about the number of comfort letters.

In terms of how many entries there are in the database, there are a lot. Now we're using it for blue-sky potential issues. We try to use it for our forward planning, so it's I think—

● (0930)

[*Translation*]

Mr. Guy Caron: I have a technical question on clause 195 of the bill, which deals with restrictive covenants. I would like to put things in context by mentioning a decision of the Federal Court of Appeal. When there is a restrictive covenant between two businesses, the Court of Appeal held that the inflow of capital was not taxable.

Following that decision, John Manley, the finance minister at the time, issued a comfort letter stating that the legislative amendments in question would mean that the amount to be received under a restrictive covenant would be normal income for tax purposes, subject to the exception described further on. That comfort letter was included in the technical amendments that were published in 2004, and, if I am not mistaken, in 2006 and 2007.

However, Bill C-48 says quite the opposite. Basically, it says that income derived from restrictive covenants is no longer taxable.

Mr. Harnish, I am asking you to join us at the table because your signature was on the comfort letter as well as Mr. Manley's. In a nutshell, why was all goodwill in restrictive covenants excluded, when the intention seemed to be not to exclude it?

[*English*]

Mr. Kerry Harnish (Special Advisor, Domestic Corporations and Resource Income, Department of Finance): I'm not sure what you're referring to in “excluded from the clause”. The main clause in the provision provides that if you receive an amount for a restrictive covenant, that will be taxable as income.

The provision does have exceptions for when the covenant is given in the context of the sale of a business, including assets or shares. When there's a sale of a business or shares of a company, the provisions provide that the value of the covenant can be included in the proceeds received for the shares. That would result if the provisions complied with capital gain treatment.

The general thrust of the measure is that if you were to provide a restrictive covenant in the context of a sale of a business, the receipts or the value that relates to the covenant would receive capital gain treatment to the extent that it relates to share sale or asset sale. However, if there were no asset sale or no share sale, the value of the receipts would generally be included in the income as taxable income.

Mr. Guy Caron: A very quick yes or no answer...?

The Chair: Yes.

[*Translation*]

Mr. Guy Caron: In your opinion, does the content of clause 195 that I have just mentioned correspond to the comfort letter that you and Mr. Manley signed in 2003?

[*English*]

Mr. Kerry Harnish: I'm not familiar with the comfort letter you're referring to, you would have to bring that to my attention. I don't generally sign comfort letters. That's not my role at the Department of Finance. Other people would be responsible for that. There was a press release back in 2003.

[*Translation*]

Mr. Guy Caron: I am sorry; it was the media release that you co-signed, not the comfort letter.

[*English*]

Mr. Kerry Harnish: It's quite possible my name was on that press release.

[*Translation*]

Mr. Guy Caron: Thank you.

[*English*]

The Chair: Mr. Jean, please, for your round.

Mr. Brian Jean: Thank you, Mr. Chair.

I'm interested in a couple of things.

First, it appears that some of these amendments, obviously all technical in nature, have been some time in coming forward. Would that be fair to say? It's been years and years, with recommendations from the industry saying some changes should be made.

Mr. Ted Cook: I think the first release of technical amendments contained in this bill probably goes back to December 2002.

Mr. Brian Jean: In particular, you mentioned the anti-avoidance rules to prevent taxpayers from making upstream loans from foreign affiliates. What's the purpose of these upstream loan amendments in general?

Mr. Shawn Porter: In effect, it is for the Canadian resident corporation that owns shares in a foreign affiliate, which has earned surplus and is now at a stage where it's repatriating it to Canada. If it makes an upstream loan that remains outstanding to its Canadian corporate parent indefinitely, then the effect and the intent of the upstream loan rule is to treat it as a dividend distribution and the tax consequences follow from that. The exception to that is if the upstream loan is relatively short term, i.e., is repaid within a two-year period, then the tax policy and the rules would respect the loan as a loan.

Usually the tax consequences are to impose additional Canadian tax at that time to reflect the fact that the Canadian tax rate exceeds the foreign tax burden on the earnings that were repatriated. However, in circumstances where the reason for the upstream loan is driven by foreign tax and commercial implications and not Canadian tax planning, and there is underlying exempt surplus in the system, then the effect of the rule would be to treat the upstream loan, if it remained outstanding for more than two years, as a dividend distribution. There would be offsetting deductions, just as there are in the case of any Canadian multinational. When they receive exempt surplus back from their foreign affiliates, we don't impose any additional tax on that.

● (0935)

Mr. Brian Jean: So, in essence, it's to avoid what otherwise would be taxable dividends that are not fully offset by deductions under section 113.

Mr. Shawn Porter: That's correct.

Mr. Brian Jean: I see there are two time periods for those transitional relief loans. My understanding is that it's a new rule to collapse back-to-back loans into a new exemption loan between affiliates. Is that fair to say?

Mr. Shawn Porter: There may be two questions in that.

In the August 2011 release, essentially any upstream loan in place at that time was deemed to have been made in August 2011, giving those taxpayers essentially a two-year window to restructure their affairs, to repay the loan, to do whatever to take themselves out of the effect of the rule.

Mr. Brian Jean: If they hadn't repaid it by that time, it has another two years in there, to 2016, doesn't it? Then it automatically deems back to 2014 if it's not paid within that period of time.

Mr. Shawn Porter: Yes, but I have a couple of clarifications on that point.

As a result of the consultations, a number of firms and organizations indicated that two years was an insufficient runway to complete the restructuring. Some of these loans have been in place for a number of years and it wouldn't be that easy to arrange for the refinancing.

One of the significant amendments between the August 2011 release and what's in Bill C-48 is that essentially a five-year runway was provided. To tie that into the dates, taxpayers have until August 2016 to clean up the loans in place in August 2011. The mechanism that was used was to say that in August 2014, we'll deem those loans to have been made, and that starts the two-year clock, which in effect takes the restructuring or the grace period up to August 2016.

Mr. Brian Jean: That certainly seems reasonable.

The final question I have for you is on distributions from a foreign affiliate and the qualifying return of capital election. Could you explain that in more detail? It got a little fuzzy there near the end.

Mr. Shawn Porter: This is, in the main, a very well-received measure. There are all sorts of legal complexities given the different types of corporate law that one encounters in a range of foreign jurisdictions. As to whether money that comes out is a return of capital, is a return of something that Canadian corporate law would regard as paid-up capital or legal stated capital, or whether it's divided, these private law determinations are necessary as a prerequisite to applying Canadian tax rules.

Therefore, simplifying rules were introduced generally to say that most distributions out of a foreign affiliate, other than something that is expressly return of capital, or something that comes out in the course of dissolution, is a dividend. That is one simplifying point. Then with respect to returns of capital, provisions have been made to enable Canadian taxpayers to get at their investment first, before they would have to bring back surplus pools, without any underlying tax attached to them.

Generally speaking, what comes out of a foreign affiliate is exempt surplus. Then taxable surplus comes. Taxable surplus pool is the one that could result in additional Canadian tax on repatriation. Once you've exhausted those pools, you're then into a notional pool of pre-acquisition surplus, which is essentially return of your capital.

These rules now facilitate an ability to elect to skip over the taxable surplus pool or the new hybrid surplus pool. That is a relieving and taxpayer-friendly provision. Those pools would usually result in residual Canadian tax being paid. That residual Canadian tax can be deferred further by making an election to get at a qualifying return of capital, to essentially get at the shareholder's investment first, ahead of the low-taxed surplus pools.

● (0940)

The Chair: Thank you, Mr. Porter and Mr. Jean.

We'll go to Mr. Côté, please.

[*Translation*]

Mr. Raymond Côté (Beauport—Limoilou, NDP): Thank you, Mr. Chair.

To follow up on my colleague Guy Caron's comments about the goodwill amount, let me remind you about the GlaxoSmithKline affair. Determining the intangibles that might be part of the value of a licence agreement potentially has a number of implications. There are things like guaranteed access to new products, the right to be supplied with raw materials and bulk products, support for commercialization, technical assistance for establishing new lines, and so on. Those things cannot necessarily be calculated in terms of the costs and the profits brought in by the product in question.

Do you feel that factoring in the goodwill amount as part of a company's eligible capital creates a precedent? Evaluating the value of a brand, its intangible value, that is, could let businesses get away with not paying taxes.

[*English*]

Mr. Shawn Porter: The reference to the recent Supreme Court decision in GlaxoSmithKline is outside the scope of Bill C-48. It is a recent decision. It concerns transfer pricing. The decision of the court was to refer the case back to the tax court for reconsideration, given direction that the Supreme Court had given. However, it has nothing to do with the subject matter of Bill C-48.

[*Translation*]

Mr. Raymond Côté: Okay.

Let me move to another subject, gifts and contributions.

Once more, there might be a lack of clarity here. We see the terms "market value", "fair market value" and "fair value". Of course, it is always difficult to know what that is. I understand the need for some flexibility, but the ambiguous terms and the inherent complexity of it all may lead to errors and incorrect interpretations, whether deliberate or not.

With donated works of art, for example, how can we be assured that the principles are observed and that the value of the gift corresponds to the actual value of the item?

[*English*]

Mr. Ted Cook: I think what you're referring to is that there are some amendments in Bill C-48 that relate to charitable donations. Certainly it had come to the attention of the Department of Finance and the CRA that people were engaging in schemes where works of art or other articles would be purchased at one price, they would receive evaluation that the work of art was worth another price, and then donate it to a charity claiming a charitable donation for the appraised value of the work of art.

The charitable donation measure in Bill C-48 will be addressed by my colleague, Ed Short, who is chief of the personal and general income tax section.

Mr. Edward Short (Senior Chief, Business, Property and Personal Income, Department of Finance): The first point is that the term "fair market value" is used throughout the Income Tax Act. It's a question of fact as to what the market value of something is. It's generally speaking the amount that a willing buyer and seller will negotiate in an open market. There's nothing in the Income Tax Act that defines what this is, but it's essential that we use this term in various places to try to determine a valuation where there's not an exchange of cash. In the context of gifts, people can be allowed a tax credit for an individual if they make a donation, and the tax credit will be based on the fair market value of the property that's been transferred to the charity.

There are some difficulties in deciding what the value of a property is. There have been court cases that have gone different ways in the context of some of these tax shelter schemes. In some cases, there's been past jurisprudence where the courts have accepted the valuation that's been given by an appraiser to, for instance, a group of artwork that's been purchased at a low cost and then has been appraised at a high value and then donated. There have been others where the courts have gone the other way and said that the value of that artwork, in the cases in particular, is the bulk price that was paid by the promoter or arranged by the promoter.

Now there are provisions, as Ted has mentioned, in this bill, which try to address some of the schemes to take some of the guesswork out. What they do is say that if you are involved in a gifting arrangement, then if you make a gift within three years of a property that you've acquired for the purpose of making a gift of it, then the fair market value will be deemed to be the amount that you paid. That's one of the measures that's in the bill in respect of gifting arrangements.

● (0945)

The Chair: Thank you.

We'll go to Mr. Van Kesteren, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Chair.

Thank you all for being here. It's not the first time you've been here and probably not the last time you'll be here either.

When I look at the book, it's pretty intimidating, I must say. I don't know if you can give me an answer to this, but what proportion of taxpayers would be affected by this? The average person probably is not going to be affected by this, is he?

Mr. Ted Cook: Yes, it is a difficult question to address. Do you mean by the bill itself?

Mr. Dave Van Kesteren: Yes.

Mr. Ted Cook: Certainly parts 1, 2 and 3 are aimed at particular taxpayer groups. Bijuralism, theoretically to the extent that you're reflecting both legal traditions in Canada, would have broad application.

We've just been talking about charitable donations. The flip side of the measures that my colleague has just spoken about is there are measures that allow split receipting, so that if you receive some benefit, like you attend a dinner or receive a golf game as part of your charitable donation, rather than having the donation rejected because you've received some benefit in respect of it, you can receive a receipt and make a charitable donation for that part. So that could be a broad application.

Mr. Dave Van Kesteren: Okay.

We keep getting calls to simplify the tax system. We've got to simplify. This looks like we're getting into this thing even deeper. Is this a move toward simplification? It's certainly a move toward job creation. I can see a lot of tax lawyers probably are pretty excited about this new bill, and anybody else in the tax business. Is it a move toward simplification?

Mr. Ted Cook: That question can be addressed at many different levels. As I indicated earlier, in terms of having draft legislation that has not been enacted, it makes life more difficult for both taxpayers and the CRA, for example, because they may file their tax returns based on the draft legislation but, for financial statement purposes, be required to reflect the law as it stands and perhaps make a note. In terms of compliance, this would make life simpler for people.

Mr. Dave Van Kesteren: Is it the first step toward simplification? We need to clear up these areas and now we can start to simplify—would that be a fair assessment?

Mr. Ted Cook: In terms of the implications of this bill, it has certainly represented a significant overhang in terms of the Department of Finance's work. This bill required a lot of work, and each iteration of it has required maintenance and checking and things like that. Certainly those are resources that are available for other things.

In terms of simplification, when we draft now, we try to adhere to modern drafting standards provided by the Department of Justice, and when we open up provisions, we try to clarify the law where we can. But I think the Canadian tax system has indicated a preference for precision, and precision necessitates a certain amount of complexity in the act.

● (0950)

Mr. Dave Van Kesteren: My constituents might come to me and say, “Dave, did you read that bill? I see you got that bill passed”. I didn't read it, and if I did read it, I probably would fall asleep in the first chapter if I got that far, and I probably wouldn't understand too much of it. I think that's probably indicative of most people in this place. We're passing a bill that has implications and an effect on people. How can I go back to my constituents and say this is the right thing? Maybe you could help the committee with that.

Mr. Ted Cook: I certainly read it.

Mr. Dave Van Kesteren: I know you did.

Mr. Ted Cook: For parts of it, this is the third time this bill has been before Parliament. It's consistent with the policy. The consultations have been undertaken in respect of the vast majority of it. In terms of how the tax system and tax law interact with individual taxpayers, certainly the CRA provides guidance. Tax law is ultimately reduced by the CRA and by the community at large into more digestible bits for people.

Mr. Dave Van Kesteren: Do you work in conjunction with, say, the OECD and organizations like that when you formulate this?

Mr. Ted Cook: Certainly within the tax legislation division, tax policy branch, we have strong connections with the OECD, and various people within the branch are members of various committees. Some of the committees are chaired by CRA representatives. So certainly we're tied in to the OECD, at minimum.

The Chair: Thank you, Mr. Van Kesteren.

Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you, Mr. Chair.

I'm very, very pleased to see this technical tax act moving forward. I know at our pre-budget consultations that I've been part of for the last couple of years, it is a frequent request that we have, so I think it's going to be a welcome bill for many of our stakeholders.

In terms of our current study, you probably are aware that we're doing a study on tax evasion, and I wonder if you could talk about the areas in this bill that are very complementary to moving forward on tax evasion and the offshore tax havens and how they actually link very nicely with some of the work we're doing.

Mr. Ted Cook: Perhaps I'll just outline a few areas and then pass it to various colleagues who can speak to the specific parts.

Obviously I would say part 1 relates to non-resident trusts and foreign investment entities. Parts 2 and 3 relate to foreign affiliates, and certainly we've already talked about that. Part 5 does have measures that relate to international taxation. I guess the one that springs most readily to mind is the measure related to foreign tax credit generators, which is a budget 2010 measure designed to prevent taxpayers from entering into plans to artificially generate foreign tax credits in a way we feel is inappropriate, by way of taking advantage of differences in law between various jurisdictions.

I'll pass it first to my colleague Grant Nash, who might speak briefly about part 1.

The Chair: Mr. Nash.

Mr. Grant Nash (Senior Tax Policy Officer, Business Income Tax, Department of Finance): Good morning, members, Mr. Chair.

Thanks for your question, Ms. McLeod.

In the simplest of terms, it's possible to reduce Canadian tax by interposing a foreign intermediary between a source of income and a taxpayer. Since the 1970s, the Income Tax Act has contained rules that seek to respond to that to ensure that an appropriate amount of Canadian tax is paid.

Part 1 of Bill C-48 modifies those rules to ensure that they continue to apply appropriately, particularly in the context of circumstances involving a non-resident trust as the foreign intermediary.

● (0955)

Mrs. Cathy McLeod: Thank you. I think what I'm hearing is that certainly in the last number of years we are really taking some significant action towards closing some of those loopholes that did exist. Is that a fair comment to make?

Mr. Grant Nash: Certainly in the case of what part 1 is seeking to accomplish, it responds to concerns with respect to the ability of the existing rules to give full effect to their objectives.

Mrs. Cathy McLeod: Great. For my next question, we talked about the grey to white, but you indicated that there are a few areas that actually were not grey sections. Could you specifically talk about those sections that are new to this particular act?

Mr. Ted Cook: In terms of the income tax side, I think what you're talking about are the new measures where there has not been a consultation as yet, prior to introducing the bill. There are three areas where there are new measures that were not previously announced.

One relates to one I was personally responsible for in terms of preparing the legislation, departure tax and short-term residents of Canada. The Income Tax Act imposes a departure tax, if you will, a tax when people leave Canada and they are deemed to have disposed of most of their properties and to pay tax accordingly. There are rules that excuse certain people from this tax if they are just short-term residents of Canada. So if you've just come into Canada, you're perhaps an American who comes up to work in Canada and you leave Canada within five years, we don't feel it's appropriate to impose the departure tax at that point.

The rule requires that you own the same property. Some people were caught up in an issue where they came into Canada and during that five-year period, the company went through a reorganization and as a result they had a different share than they started out with. But economically they're the same. So a comfort letter was issued in the early 2000s that we thought that was an anomaly and that an amendment would be made to the act, and that's contained in Bill C-48.

The two other measures relate to the allocation of income to provinces by airlines and also some changes with respect to LSVCCs. I think my colleague Davine Roach can just provide a very brief summary of the airline measure.

Ms. Davine Roach (Senior Chief, Domestic Corporations and Resource Income, Department of Finance): Sure, thank you. With respect to the airline change, under the Income Tax Act there's a provision that allocates corporate taxable income amongst the provinces based on certain formula. In the case of airlines, it was on air miles flown.

Now the formula doesn't work in terms of allocating to the provinces airline miles flown over the territorial waters, which includes the Bay of Fundy and Hudson Bay. All this amendment is doing is ensuring that all the airline miles flown in Canada including over territorial waters are appropriately allocated to provinces.

The Chair: Thank you, Ms. McLeod.

We're going to Mr. Rankin, please.

Mr. Murray Rankin (Victoria, NDP): Thank you, Mr. Chair.

And thank you, witnesses, for attending this morning.

I'd like to focus in on part 5 a little bit further, if I could, and pick on something that I think Mr. Cook referred to just recently in response to Ms. McLeod, and that is the issue of foreign tax credit generators for international tax avoidance.

My question is, how is it working? How is it intended to work? And what is the fiscal impact expected to be?

Mr. Ted Cook: Perhaps I'll provide just a bit of explanation.

Foreign tax credit generators seek to create foreign tax credits for Canadian taxpayers by taking advantages of differences in the way tax laws work in Canada and in other jurisdictions, for example, the United States. We tax on the legal substance in the form of what a taxpayer does. The U.S. generally taxes based on the economic form of what the taxpayer has done. What this does is it allows taxpayers to set up situations where, for example, for Canadian tax purposes, a Canadian taxpayer might own a partnership interest in the U.S., but because of the series of transactions that have been entered into under the U.S. economic substance approach, that property, that partnership interest, might be considered to be owned by someone else for U.S. tax purposes, with the result that, arguably for Canadian tax purposes, you have an interest in a partnership and you should get a foreign tax credit for the tax paid by that partnership.

But for U.S. tax purposes, what they see is an interest in a partnership that's owned by a U.S. resident, and a U.S. resident makes payment of interest, which is exempt from U.S. withholding, for U.S. purposes. The result is you can get results that you can't get in a straightforward way. You get a foreign tax credit in Canada and the U.S. company gets a deduction.

In terms of the impact, which I think is what you're asking, this is an integrity measure. Again, this is just something where the CRA identified these schemes and we took action to stop them. Individual transactions that were identified could run to the tens and maybe hundreds of millions of dollars with respect to the income at play. But in terms of what's actually booked for fiscal revenue, there is no fiscal cost associated with it.

And as to how it's working, we don't have any intelligence that it's not.

● (1000)

Mr. Murray Rankin: All right.

I understand that one of the concerns in part 5 is to provide greater information on tax avoidance, generate more information about what are called avoidance transactions, transactions designed to get a tax benefit. They all must now be reported, and I understand even if the transaction is not necessarily abusive, there has to be some sort of reporting mechanism for such transactions, if I have that right. And then a red flag might go up if this abuse...an additional reporting is required.

That sounds like a fairly intrusive type of arrangement, for very good reason, to get at tax avoidance. Can you comment on whether my summary is more or less accurate; and how they are working in practice, these additional reporting measures for tax avoidance?

Mr. Ted Cook: Again, I'll pass that to my colleague Ed Short, who's got carriage of that particular file.

One thing I will note, and Ed can correct me if I'm wrong, is that because this requires an actual reporting requirement, the CRA isn't able to require the reporting by taxpayers until this bill is actually passed. Is that correct, Mr. Short?

Mr. Edward Short: Yes, that's right.

Your description of the proposal is not exactly correct. It's about half correct. It is true that it requires the reporting of what we call an avoidance transaction. It's defined in the tax law. But it's only a reporting of that avoidance transaction if also there are two out of three hallmarks present—what we call hallmarks.

Just first, on what an avoidance transaction is, an avoidance transaction is not necessarily something that's abusive. An abusive avoidance transaction would be subject to the general anti-avoidance rule. That requires another step for the CRA to reassess, that is, the CRA would have to show that the transaction or series of transactions actually represents an abuse of the tax law. This rule for reporting applies just for simple avoidance, if you want to call it that.

What is an avoidance transaction? It is one where the purpose of the transaction is more for tax than for any other purpose, and it could involve a series of transactions where there may be a commercial purpose to the series of transactions. But if there is a transaction in the series and the purpose of that transaction in the series is not for a commercial purpose but it is for a tax purpose—that is, the purpose is to receive a tax benefit—then the whole series will be considered to be an avoidance transaction. So that's the first thing. To be an avoidance transaction, you didn't do this as much for commercial purposes as you did it to lower your taxes.

The second thing is the hallmarks—two out of three hallmarks. And what's a hallmark? It's a set of circumstances under which—

The Chair: Just briefly.

● (1005)

Mr. Edward Short: To put it briefly, where there's smoke, there's fire. There are factors that seem to exist, things like tax advisers who charge contingent fees. Who would do that? That is, it's contingent on the tax benefit. So that's one hallmark.

Contractual protection, that is a guarantee. “Even if this transaction doesn't work, the CRA challenges it, don't worry, we will guarantee you your tax benefit, we'll pay it for you.” That is the second one.

Another is confidential protection. “You're not allowed to disclose the details of this to anybody.”

Two out of three, and now you have to report.

The Chair: Thank you, Mr. Rankin.

I'm going to take the next round. I wanted to touch upon two issues in budget 2010 dealing with SIFTs and dealing with section 116, both of which were in the appendix to the budget.

My first question would be, why is the most interesting part of the budget always the appendix?

Voices: Oh, oh!

The Chair: First of all, I'd like to get an explanation—I don't know if it's you, Mr. Cook, or someone else dealing with these two sections—why the changes were made with respect to taxable Canadian property in section 116.

Mr. Ted Cook: In terms of how this relates to the budget 2010 measure, the actual main measure, if you will, with respect to budget 2010 and taxable Canadian property, has actually been implemented as part of one of the budget implementation acts. With respect to what's in this bill, it's sort of a tweak of an issue that has been identified to us.

With respect to budget 2010, in order to reduce reporting requirements for non-residents engaging in transactions that don't result in any Canadian tax, what we did was amend the definition of taxable Canadian property to accord with, essentially, our rights to tax under our tax treaties. As a general matter, if there's a tax treaty, if it assigns or denies Canada's right to tax, regardless of what the act says, you go with the treaty.

What was happening was people were having obligations to file paperwork with the CRA, even though there would be no tax. Our way of dealing with that was to amend the definition of taxable Canadian property.

The specific amendment in this bill simply deals with the situation where it's kind of whether or not we have a look-through rule. You have a corporation, you're trying to decide whether its got taxable Canadian property, well, if it owns another corporation, do you look through to the underlying property or do you just look at whether that corporation's shares are taxable Canadian property?

The Chair: The question as it relates to process is, would it be that the measures are implemented in a budget implementation act, and there's just something that's unforeseen at that time? Something pops up and therefore the department then responds to that. Is that the reason why this amendment is in this particular bill?

Mr. Ted Cook: That's exactly right with respect to that particular change. We were implementing the 2010 measure, and it was brought to our attention that there was this little inconsistency in terms of the operation of the rule.

The Chair: Is it the same with respect to process, with respect to the specified investment flow-through trust? Is it that an issue arose that was not foreseen initially, and therefore this is why this change is being made?

Mr. Ted Cook: It is. The measures you have before you are in terms of the foreign tax credit generator or specified leasing property. Those are the implementation of the budget measures. It's not that those measures have been previously passed, and these are changes to them.

The Chair: My understanding, and please correct me if I'm not correct on this, is that the changes made in 2006.... There were obviously changes made with respect to income trust generally, and this issue was not foreseen at the time those changes were made. Am I correct in my understanding of that?

Mr. Ted Cook: Now I understand your question.

With respect to that, certainly when the SIFT rules were introduced, there was a provision that SIFT trusts and partnerships, if you will, needed to convert out of SIFT form by the end of 2010 or 2011—

The Chair: They had a four-year period.

Mr. Ted Cook: Or they would be subject to a SIFT tax. The expectation was that most of those SIFTs would convert rather than be subject to the SIFT tax.

What we found, in terms of converting, was that the SIFT trusts and partnerships were looking for loss corporations to amalgamate with rather than just creating a new corporation or something. They were trying to find—

● (1010)

The Chair: For taxable purposes they were looking for loss corporations.

Mr. Ted Cook: Absolutely, to continue sheltering the income going into the future.

The existing rules with respect to losses had contemplated largely the situation of, “we already have rules in the act to deal with that but they deal with corporation-corporation transactions not trust-corporation transactions”.

The Chair: Okay. Just a final question, and it may be outside of the scope of the bill, but my understanding was that for the trust it was four years and there was a certain percentage allocated per year at which they could grow, but in fact what Finance did is allow 100% growth within a one-year period. That change, if I recall, was actually announced by the minister in the House in response to a question, but has that change actually been legislated?

Mr. Ted Cook: I'll pass it to my colleague Grant Nash, who was more involved with the SIFT, but what you're referring to, I believe, is the normal growth guidelines, so when we implemented the SIFT rules, recognizing that SIFTs were in place, there was a certain expectation that they would continue to operate.

The Chair: Because the original guidelines were actually amended, if I'm correct on that.

Mr. Nash?

Mr. Grant Nash: You are correct, Mr. Chair. That amendment, given the nature of how the guidelines were incorporated into the act, didn't strictly speaking occur in legislative form. But, in effect, the SIFT regime has been fully enacted to the extent that it can be, except for the SIFT loss trading rules that are contained in this bill.

The Chair: Okay. I appreciate that. Thank you very much.

We'll go to Mr. Brison now, please.

Hon. Scott Brison: Thank you very much, Mr. Chair.

I have a question. You mentioned before that a portion or a big part of Bill C-48 was before Parliament twice before in Bill C-33 and Bill C-10. Both Bill C-33 and Bill C-10 had been studied in the past by the House and sent to the Senate.

There have been concerns we had heard about Bill C-10 with respect to the film tax credit. Those changes that had been proposed to the film tax credit aren't included in Bill C-48. What were the areas of concern that were identified in Bill C-10 and how were they modified or left out of Bill C-48?

Mr. Ted Cook: You're quite right, the film or video production tax credit was at issue before the Senate in Bill C-10 primarily, I understand, with respect to the public policy test that was related to the credit at that time, a proposed a public policy test.

I'm going to pass it to Ed Short to explain what's happened with respect to that aspect of the credit since then.

Mr. Edward Short: The rules that were in Bill C-10 were rules to simplify the calculation of the film tax credit for Canadian films and they were the product of a couple of years of consultations with the film industry around 2003. The rules were announced in 2003.

In Bill C-10, in the Senate, the film industry expressed concern with what's called the public policy test. It gave discretion to the Minister of Revenue to deny the credit if in the view of the minister the funding of a film would be inconsistent with public policy. In the latest release of the legislation for this bill—maybe it wasn't the latest but I think it was in July 2010—the film rules were left out. The rest of the rules were not controversial, but just the same all of the proposed film rules were left out of the bill and the government indicated in a news release that it did intend to go forward with the rest of the rules without the public policy test at a future time.

Hon. Scott Brison: So it was the Senate's diligence that resulted in that change ultimately. That's a reminder of the benefit of our hard-working Senate from time to time as to changing legislation, improving it, and removing unintended consequences.

I have a quick question on the change in upstream loan rules. Other than tax avoidance, is there any other reason why one would transfer to an upstream loan, or patriate or bring to Canada funds through an upstream loan, as opposed to a dividend? Is there any other reason besides tax reasons?

● (1015)

Mr. Shawn Porter: There are other reasons. For the purposes of this discussion, we are focusing on Canadian tax reasons. There may well be foreign tax reasons why the distribution would take the form of an upstream loan instead of a dividend. There could also be foreign corporate law or other commercial restrictions on that foreign affiliate that preclude it from making a dividend distribution so it has to make a distribution in some other form.

So—and I touched on this a moment ago—the rules accommodate that practical reality in those circumstances where there isn't any Canadian tax policy issue or tax mischief issue. The rules will operate to allow offsetting deductions for what would otherwise be deemed income inclusion under these new upstream loan rules. In effect, in those circumstances, if there is no Canadian tax planning, there will be adequate underlying tax paid surplus or adjusted cost bases that will provide a full offset, so those rules would have no practical application.

Hon. Scott Brison: Some jurisdictions would not allow dividends to be paid outside of the country. Is that accurate?

Mr. Shawn Porter: A common example would be a U.S. subsidiary of a Canadian company. If it paid a dividend, in all likelihood there would be a 5% withholding tax under the treaty, assuming Canada owned more than 10% of the voting shares of the company that paid the dividend. In order to avoid that 5% U.S. withholding tax, which Canada does not give a credit for, often the U.S. company might make a loan up instead and pay U.S. tax on imputed income on that loan. At today's interest rates that would be a much smaller tax toll charge than paying the U.S. withholding tax would be.

Hon. Scott Brison: Thank you.

The Chair: I'll go to Ms. Glover, please.

Mrs. Shelly Glover: Thank you, Mr. Chair.

I want to go back to something that Mr. Cook said a little while ago on the whole idea of there not being consultation. I don't want anybody to light their hair on fire so we need to delve into that and explain exactly why, because these are very minor amendments that were made. So I want to give you an opportunity to explain them.

Ms. Roach, you may as well start, because you've already explained the formula, which is actually going to benefit the provinces. Why was there no consultation on the formula with regard to the allocation for airlines?

Ms. Davine Roach: I would say it's one of those integrity measures. It was fairly obvious to everyone that this was just a technicality in the formula. The intention was always clear. One would think that really no consultation would be necessary. However, that being said, it was released in October 2012 and we have heard from no one, and they would certainly know who to call if they had issues. I think it's just one of those things that are very obvious to everybody in the private sector and otherwise.

Mrs. Shelly Glover: And I can't imagine any province saying, "No, don't give me more".

Ms. Davine Roach: Absolutely.

Mrs. Shelly Glover: If it benefits them, I would think they'd welcome the change.

Regarding the others, Mr. Cook, could you address why those are minor in detail as well and didn't require any extensive...?

Mr. Ted Cook: With respect to the short-term resident measure I was talking to, in fact it was released by way of comfort letters, so it's relieving to the taxpayer. In fact, we just kind of wedged it into the bill because we actually received a letter from a lawyer representing one of the affected people who had posted security with the CRA. I think they had posted security in the order of $5 million or $7 million and they were asking us to take action as quickly as we could so they could access the funds, but because it was posted with the CRA.... the CRA administers the act, but there are certain things it cannot do on the basis of draft legislation. It couldn't release posted security in this case, so it couldn't cut a cheque. It can't require the kind of anti-avoidance reporting that we've talked about, requiring taxpayers to provide additional information.

Then, with respect to the third measure, relating to labour-sponsored venture capital corporations, I'll just pass that to Mr. Short.

● (1020)

Mrs. Shelly Glover: It was a relieving measure that was obviously intended to make life easier, but again as a minor detail there really has been no indication of anyone saying, "Oh, don't give us extra. Don't fix this for us".

Mr. Ted Cook: Certainly, as Ms. Roach mentioned, on those measures as well, we haven't heard anything negative since the bill was released in October as a notice of ways and means.

Mrs. Shelly Glover: Mr. Short?

Mr. Edward Short: Yes. The labour-sponsored venture capital corporation measures were asked for by people in the sector. They're there because of the withdrawal of the LSVCC credit in Ontario that caused liquidity problems.

With regard to these measures, all they do is implement what was requested by people within the sector, to turn off some penalties if those corporations want to wind down, and otherwise help them deal with their liquidity issues. They were relieving measures. They were not policy changes.

Again, we haven't heard anything from the industry since then.

Mrs. Shelly Glover: I just wanted to give you an opportunity to explain those.

Thanks.

[*Translation*]

The Chair: Mr. Caron, over to you.

Mr. Guy Caron: This bill has almost 1,000 pages. So it is difficult to ask all the questions we have. That is why we are focusing on two or three specific aspects. You will receive written questions from us and we would like all the committee to get written answers.

I would like to go back to a matter that Mr. Côté brought up when we were talking about clause 248, which amends the tax credit for charitable donations. We are always talking about terms that are defined, or more or less defined to allow for flexibility, such as "market value", "fair market value" and "fair value". You explained a little about the objective of this clause.

Could you tell me how it might apply in a specific situation? I am referring to an article published in the *Vancouver Sun* at the end of January. It deals with the purchase by groups of investors of some little statues attributed to Michelangelo. They were donated to the Museum of Vancouver, a museum that has no mandate to display historical artifacts of that kind. Quite the contrary, given that it is not a major museum.

The investors claimed that an appraisal, conducted anonymously, put the value of the sculptures at about $30 million. There were 18 of them. So the Museum of Vancouver issued tax receipts for $30 million, which provided the investors with a tax credit of about $13 million.

But Sotheby's, which has expertise in appraisals, puts the value of the terra cotta sculptures at between $200,000 and $300,000. So, from $30 million, we are now at $300,000, which makes a huge difference in the tax credit.

How would the amendment in clause 248 about tax credits for charitable donations deal with a situation like that? There are strong suspicions in this case that the donation of cultural property was being used for inappropriate tax purposes.

[*English*]

Mr. Ted Cook: By way of opening response, I think we can talk to the nature of the amendment. But in terms of specific transaction and specific taxpayers and specific charity, whether the CRA may be looking at something or not—

[*Translation*]

Mr. Guy Caron: Let me ask the question more precisely.

In what way could the flexibility provided by not defining the terms "market value", "fair market value" and "fair value" more closely leave the door open to situations of this kind?

[*English*]

Mr. Ted Cook: By way of opening remark, the concept of fair market value is not defined in the act. It is certainly one of the foundational concepts used in the Income Tax Act and it has been subject to quite a bit of jurisprudence.

When you're looking at drafting an income tax act, you can either rely on jurisprudence as it develops or try to specify....

● (1025)

[*Translation*]

Mr. Guy Caron: I have another question.

Mr. Short mentioned that various court cases have been a little contradictory, have gone different ways. How can the case law really help you?

What do you say, Mr. Short?

[*English*]

Mr. Edward Short: On any individual case it is a question of fact as to what the value of the property is. I'm not familiar with the example that you've given, and I guess I couldn't comment on it anyway, being a specific case, but in general, what I can tell you about donations of certified cultural property is that they're not covered by these rules that are in Bill C-48. The rule that I mentioned before—that is to deem the fair market value for the gifting provisions to be equal to the cost if you acquired it within the last three years—does not apply to certified cultural property. The reason that it does not is because two things have to happen, and the government is involved in the process.

The Cultural Property Export Review Board will certify, first, that this is a property that's of cultural importance to Canada. The second thing is that the board has to also certify the appraised value of that property. Those are checks and balances that, because they exist within that system, it would be considered perhaps inappropriate to have a policy to then reduce the amount of the value of those gifts for tax purposes back down to the cost.

The point to start from is that when somebody gives up something of value, even if they bought it at a lower price, still when they give that property up, the expectation is that they could have sold it and received, in that example you gave, they would say $30 million. Is it really $30 million, or is it $200,000? That's a question of fact, and for that you need experts in the field to be able to appraise that. In this case, as I say, the cultural board is responsible for making sure that those values are accurate, so it's for that reason that we don't feel that the tax rules in Bill C-48 need to or should apply to that process.

The Chair: Okay, thank you.

We'll go to Mr. Jean, please.

Mr. Brian Jean: Thank you, Mr. Chair.

I have very quick question on something that Mr. Van Kesteren brought up.

Mr. Cook, I thought I'd heard you describe a new amendment in relation to gifts in kind for charity purposes. If I'm wrong on this, just tell me. My understanding is somebody, for example, gives a gift of a condominium, let's say a vacation property, to a charity and they auction that off, which is very popular where I come from in Fort McMurray. They auction it off for $5,000, let's say. Even though the value might be $6,000, the $5,000 can be used as a charity donation. Is that correct, or is there some sort of change?

Mr. Ted Cook: I'll pass that over to Mr. Short, but I think what I was responding to with Mr. Van Kesteren was the notion that some of the rules in here allow for what is generally called split receipting. It's not so much you give something and what's the value of it and it's auctioned off or something like that, it's when you make a donation and as part of making that donation, you might get something of ancillary value, like—

Mr. Brian Jean: Gifts in kind, of labour or—

Mr. Ted Cook: The most common examples are if you attend a charity dinner, you get the dinner. If you go to a charity golf tournament, you get the value of the round of golf. Those are probably the simplest examples—and I'm going to pass it to Mr. Short to correct me.

Mr. Edward Short: I'm sorry, it's just the opposite. Say you pay $150 for a round of golf and the green fee is $50, you'll get a charitable receipt for $100.

Now I'm not sure that we're talking about the same thing. Yes, there are rules in there to deal with that. That is, there are rules that will allow the charity to issue a receipt for $100 in that example, but that didn't sound like the same thing that you were asking about. There are also rules, which Monsieur Côté was asking about, that suggest that if you have purchased a property within the last three years and then you make a donation, then your fair market value will not exceed, for tax purposes, whatever you paid for it.

● (1030)

Mr. Brian Jean: Within that three-year period. If it's within three years, you mean?

Mr. Edward Short: That's right. That goes to the idea that you're supposed to get recognition for tax purposes for the amount by which you were impoverished. That is, how much did you really give up to the charity?

Mr. Brian Jean: But would that be fair in the case of, for instance, an increase in property of 10% per year in the third year? Can you actually argue the case and come up with a fair market value or an appraisal for the new value? For instance, if you paid $300,000 for the property you donated in year 3, but the property's now worth $400,000 and you get an actual qualified appraiser to come in to give you an appraisal saying that.

Mr. Edward Short: The new rule will override that.

Mr. Brian Jean: Okay.

What about in my particular example, which seems very popular in most of the charities that I as a politician attend? People give gifts in kind—for instance, a condominium, a property value that's worth maybe two weeks in Hawaii. They give that, and the value there is $5,000. It's sold at the auction for $5,000 or $4,000, whatever the case may be.

Will that person receive a receipt for the amount that the charity actually receives?

Mr. Edward Short: You're saying it's the charity that's auctioning it off?

Mr. Brian Jean: Yes. The person donates it and the charity—

Mr. Edward Short: The person will not get a receipt for that, because they have acquired the right to use that condo. They paid $6,000 for it. The CRA would apply these rules, saying that they feel you got fair market value consideration when you auctioned that off.

Now, if—

Mr. Brian Jean: But the money only goes to the charity. It doesn't go to the person who actually owns the condominium.

Mr. Edward Short: Well, if somebody else has donated the time share—

Mr. Brian Jean: Yes.

Mr. Edward Short: —that person will get a donation credit based on whatever the value was of that....

Mr. Brian Jean: Of...paid by the....

Mr. Edward Short: Yes—which again is a question of fact.

Mr. Brian Jean: Thank you.

The Chair: Thank you, Mr. Jean.

Monsieur Côté.

[*Translation*]

Mr. Raymond Côté: Thank you, Mr. Chair.

I would like to go back to the goodwill amount. Clause 195 of Bill C-48 makes an addition to section 56.4. In it, several terms are defined, including "restrictive covenant" and "goodwill amount", which have some implications. I am specifically thinking of industries that are based on the principles of intellectual property. That is why I gave the GlaxoSmithKline example earlier.

According to the definition, the goodwill amount is included "in computing the cumulative eligible capital of the business carried on by the taxpayer through a permanent establishment located in Canada". At the end of the definition of the term "goodwill amount", it says the definition is used in applying new subsection 56.4(7), where the question of restrictive covenants potentially comes up.

With industries based on the principle of intellectual property, are the tax consequences of these technical amendments clearly understood?

[*English*]

Mr. Ted Cook: I'll pass that over to Kerry Harnish to speak to restrictive covenants.

Mr. Kerry Harnish: The restrictive covenant measures, as was previously mentioned, are directed at a couple of Federal Court of Appeal cases. We would view them as integrity measures.

The question that comes up is that when the restrictive covenant was given, the taxpayer, based on the cases, would take the position that the value of the covenant was not taxable. So the portion of a share sale, for example, that was related to the value of the covenant would become non-taxable.

That could have significant revenue implications, because it could arise on any sale of any business asset. As you can imagine, across the economy there would be a lot of sales in a given year. But in terms of the particular amounts for the particular sales, we'd not be able to come up with a firm figure on that, because that depends upon the Canada Revenue Agency finding the particular transactions under audit. The Canada Revenue Agency, of course, in the particular two cases that came up on appeal, found the particular transactions, reassessed the particular transactions, and the courts indicated that they thought the values were not taxable.

So these measures come back to that situation, and we say, look, that's not an appropriate tax policy result to have the particular value not subject to tax. The measures are meant to impose the tax. The risk to Treasury would be significant, but what's the particular revenue saving on it? It would be next to impossible to determine that.

● (1035)

[*Translation*]

Mr. Raymond Côté: But I would like to know if that will be enough to cover what you described. I do not want to over-dramatize things, but I am thinking about the Google case in Europe, for example. The government is considering developing a tax policy for intellectual property and for patents to deal with these kinds of challenges, but I am not convinced that the definitions, as they stand, are going to prevent the consequences I am afraid of. I am even afraid that the government may be painting itself into a corner, if you see what I mean.

[*English*]

Mr. Kerry Harnish: Yes, but what I would say on that subject is that these measures are focused on a particular type of transaction, which is the sale of a business and the sale of its assets. In the context of those sales, what was occurring, for example, was that the vendor would agree not to compete with the buyer's business and would take value.

I think what you're referring to is a broader issue with respect to transactions related to copyright and transfer pricing. Copyright is actual property, under the law, whereas a restrictive covenant was found by the Federal Court of Appeal not to be property.

With respect to transfer pricing, these measures are not about it. That would be a different issue, and I'd have to turn back to Mr. Cook.

The Chair: Mr. Cook, would you like to comment on this?

Mr. Ted Cook: We have been talking about restrictive covenants because I think your concern was the intellectual property aspect and generally the issue of intangibles. You also referred to GlaxoSmithKline and Google, which have obviously been in the news, and probably to Starbucks in the U.K.—those types of situations. What you're probably talking about is something broader, frankly, than what we have in Bill C-48.

We have a set of transfer pricing rules in the Income Tax Act. Of course, concern has been flagged in some other jurisdictions—most recently in the U.K., and they've had some hearings.

Even when you have a developed transfer pricing system in place, does it provide enough scope for multinational corporations to order their affairs, particularly with respect to intangibles? You can take an intangible and by its nature can put it in any jurisdiction in the world that you wish to, and by way of support through transfer pricing studies, you develop expenses and such things to reduce your taxable income significantly.

I would say that while it's somewhat related, really what you're talking about is transfer pricing and how robust Canada's rules are with respect to intellectual property.

[*Translation*]

Mr. Raymond Côté: Okay.

Thank you.

[*English*]

The Chair: Thank you.

We have about seven minutes left. I have a couple of questions, and then we'll go to Mr. Rankin for his final round.

I want to follow up on the discussion with respect to process.

Mr. Cook, prior to 2001, were technical tax bills done on an annual basis? You mentioned the technical tax packages in recent years. Are they prepared on an annual basis by the department, or roughly annually?

Mr. Ted Cook: I think "roughly annually" is the way it has worked out. As I'm sure you and committee members are aware, we're heavily implicated in the development of the federal budget and all the legislation related to it. For a significant portion of the year, we don't really focus on a lot of other things. So far it has worked out to be roughly annually, but it's really more a question that when packages are ready we will recommend them for release to the minister.

With respect to the first part of your question, I might stand to be corrected by my colleagues, but I think there have been a couple of times in the past when the government has indicated a desire to move toward annual technical bills. But I don't think, if you look at the historical record, that there's been a long period during which annual technical bills have been introduced in Parliament. There was probably a period when we did two or three in a span of four years or something like that, but if you look at the last 20 to 25 years, I don't think there has been a significant period during which they have been introduced annually.

The Chair: As you know, we're heading toward a budget in March—presumably the latter part of March. With respect to the timing of technical tax packages, is the fall the best time for the department for their release, simply because of the budget cycle that you follow?

● (1040)

Mr. Ted Cook: There is a sort of lockdown period at some time on both sides of the budget, when physically our resources are not there. It has rather worked out to the fall, but I wouldn't say that.... Our senior management is very interested in moving forward with additional technical packages, and so I don't think we're targeting the fall; we're targeting whenever we can apply the resources and get them ready and release them.

But certainly, going for more than a year without our recommending a release would not be....

The Chair: Just to give us a sense in terms of responding to items that come up, if you use comfort letters as an example, has there been a dramatic increase or just a slow increase in the number of comfort letters that have needed to be responded to in the last, say, 10 or 15 years?

Mr. Ted Cook: When you say "needed to be responded to", do you mean in terms of comfort letters that we've issued?

The Chair: Yes...comfort letters.

Mr. Ted Cook: Maybe Mr. Porter has a better sense than I do, but I would say we've issued fewer comfort letters per year in the last few years than we did probably in the early 2000s.

The Chair: Was it because there have been fewer items that have needed to be addressed? Is that correct?

Mr. Ted Cook: It's partly so. It's a bit in the eye of the beholder. Now we're actually trying to do the technical releases and deal with things in the draft releases as they come up. It's partly the number of requests. It's partly how willing the Department of Finance is to issue. Obviously, the more you satisfy the more there's an appetite. The relationship between taxpayers and the CRA in terms of how provisions are interpreted....

The Chair: Okay, I appreciate that.

Mr. Rankin, we have a few minutes here.

Mr. Murray Rankin: This is a question for Mr. Porter because intriguingly you talked about the upstream loans rule a bit and then tantalized us with the hybrid surplus part, but I don't think we gave you enough time to talk about it. As I understand it, the upstream loans rule basically closes a loophole and deals with treating loans as dividends for tax purposes, and that's, I think, excellent in terms of closing loopholes and hopefully acquiring more money for the Canadian taxpayer, this residual top-up tax that you talked about.

So tell us a bit more about hybrid surplus. What is the fiscal impact of the changes in Bill C-48that respect the hybrid surplus rules?

Mr. Shawn Porter: I will just speak to the measure. Generally, when you have an exemption system and you recognize foreign earnings and you put them in an exempt surplus bucket such that they can be repatriated to the home country—in our case, Canada—without any further tax, you have to have protective measures in the system to avoid transactions that manufacture or fabricate exempt surplus in circumstances where there has really been no underlying surplus.

One of the mechanisms prior to hybrid surplus that may have been available to Canadian-based companies to do that would be when a foreign affiliate that is a holding company—so the holding company is owned by the Canadian parent and the holding company owns shares of other foreign affiliates below it—could sell the shares of the lower tier foreign affiliate to another company in the group, so there's no economic realization of gain outside of the group. That kind of transaction would create...to the extent there was a capital gain, mirroring the fact that we only tax half of the capital gains domestically. We put half of the capital gain in exempt surplus and half of the capital gain in taxable surplus. But provided the shares of the underlying affiliate are involved in an act of business only, we don't tax that gain currently. We will only tax that pool upon repatriation.

There's a couple of things at issue here. It's not really the case that there's been an amount of surplus created equal to the amount of the capital gain. There has, as a matter of form because there's been a real internal transfer, but there hasn't been a real realization by that corporate group, outside of the group, for cash proceeds. That's just one example of the potential to manufacture surplus, so that half of that gain, then—if there was cash available elsewhere in the group—could now be repatriated to Canada without any further tax.

The hybrid surplus concept bolts the taxable and the tax-free portion of that gain together, and if there is no underlying foreign tax related to the capital gain—and usually there is not because that holding company is in a jurisdiction that doesn't pay tax—then effectively now repatriating any amount out of the hybrid surplus pool will result in some level of additional residual Canadian tax. But you can't take the step of just creating an exempt surplus pool to the extent of one-half of that capital gain.

● (1045)

Mr. Murray Rankin: That's excellent. Thank you very much.

The Chair: Thank you, Mr. Rankin.

On behalf of the committee, I want to thank all of our officials for being here today. We will continue our discussion of this bill on Tuesday. Thank you so much for providing information.

I understand some members may have some written questions they wish to submit to the department officials. If they can do that through me as the chair and through the clerk, we will certainly endeavour to get the answers for all the committee members.

Thank you.

The meeting is adjourned.