Proceedings of the Standing Senate Committee on Banking, Trade and Commerce

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The Standing Senate Committee on Banking, Trade and Commerce, to which was referred Bill C-10, An Act to amend the Income Tax Act, including amendments in relation to foreign investment entities and non-resident trusts, and to provide for the bijural expression of the provisions of that act, met this day at 4:06 p.m. to give consideration to the bill.

Senator W. David Angus (*Chair*) in the chair.

[*Français*]

The Chair: Honourable senators, good afternoon. I am calling to order this meeting of the Standing Senate Committee on Banking, Trade and Commerce. My name is David Angus. I am the chair of the committee and am from Quebec. Also here today are Senator Goldstein, the Deputy Chair, from Quebec; Senator Fox from Quebec; Senator Meighen from Ontario; Senator Tkachuk from Saskatchewan; Senator Eyton from Ontario; Senator Harb from Ontario; Senator Ringuette from New Brunswick; Senator Massicotte from Quebec; and Senator Jaffer from British Columbia.

We are on the CPAC Network and on the worldwide webcast. Good afternoon to everyone. We are convened to continue our study on Bill C-10, which needs no further description at this time.

Senator Tkachuk: Mr. Ruby I want to go back to the point that I tried to make last week. I am concerned about further delays on this bill. I have my suspicions about the process, in particular, the one followed by the film industry. As you and others know, the industry only seemed to become aware of this problem when the Conservatives started administering the draft legislation, even though the film and video production tax guidelines are clear and can be read on page 80.

Public interest consideration has been on the books, but Mr. Chair, our government has been accused of having an agenda as we have all heard. Our government is accused of creating a ``regime of censorship'' in the words of one witness, and we have even listened to a priest, religious groups and from witnesses from Western Canada.

If you will excuse me, I will lift my knuckles from the floor. We have a vibrant film industry in Western Canada. Even Mr. Gross said that he received exceptional financing from the Conservative government in Alberta.

While I do not agree this bill will cause censorship or self-censorship, the case that the opponents to the bill have been making is their business case, not their freedom of speech case. They indicate that the legislation is causing uncertainty. That is the premise on which they are building their business case; that the legislation is bad for business and bad for acquiring financial support or funding.

We may be leaving here next week.

The Chair: Are you saying Parliament may rise?

Senator Tkachuk: I do not know for sure. No one knows these things for sure and they are always quite exceptional. However, I have been here for 15 years and the feeling I have, and I think others have, is that we will be out of here next week unless something drastic happens.

If that occurs, this bill will not be dealt with. It will be sitting there in limbo, creating huge business uncertainty for the industry in Western Canada and all over the country.

The fact that we are not going to clause-by-clause consideration is causing me a lot of problems. The fact that we do not have amendments from the opposition, which has been extending the length of these hearings, is going to cause a real problem for the film industry.

I would like to know when the steering committee will decide on a day that we can do clause-by-clause consideration especially if we can leave here and get it passed and dealt with in the Senate Chamber before we leave. That is all I have to say. I just wanted to represent the business interests of Western Canadian filmmakers, who I think would not want this bill sitting out there in limbo.

The Chair: I want to be sure I understand what you were asking for. Let us say we were going to clause-by-clause consideration right now. What difference does it make whether it is this week or next week or the week after, if, as you say, we are all out of here?

Senator Tkachuk: If we had dealt with clause-by-clause when we first wanted to, this would have been dealt with. Failing that, we could go to clause-by-clause tomorrow after the mayors leave, and deal with the bill and the amendments that the Liberals are looking at. At least we can deal with them, see if we can come to an agreement with them, get the bill into the Senate and get it into the House of Commons while it is still here.

Senator Harb: I appreciate the valid point my colleague has raised. Maybe we have heard enough from the film industry. Some have said that their concern is how this legislation will affect their business, but others have said this proposed legislation amounts to self-censorship, and puts a chill through the industry and so on.

We have heard from the different elements of the industry, and I totally agree that perhaps we have heard enough from the writers, artists and producers. However, there are other important components to this bill, such as the non- resident trust. As well, Caisse Desjardins appeared before this committee not long ago, telling us about the tremendous implication that this bill will have on them in the absence of some sort of assurances or amendments.

If you will recall, we were prepared to deal with this bill back in the fall. When we asked the department whether there are any controversies in the bill that should be brought to the attention of the committee, we were told that there were not. Suddenly, we had the first bombshell, to the tune of $900 million, by the organization that represents trust and non-resident trusts. That is $900 million a year, according to those groups.

Then we had the caisse populaire bring to our attention that it is hundreds of millions in terms of the impact of this proposed legislation. Frankly, I do not know whom else the 450-odd pages in this omnibus bill will affect.

I would say to my colleagues, yes, when we run out of witnesses on the other elements of the bill, such as the non- residents, as well as the caisse populaire concerns, and when the department comes back, it will be important for the steering committee to sit down and make a serious game plan. The steering committee will have to determine how to proceed with it in order to respond to the needs of our

constituents. I totally agree with my colleague.

Senator Ringuette: The issue that is being discussed is a matter of process. We have an important witness before us. Just like in previous meetings, where there were some issues that should have been dealt with in a different matter, I would like to proceed with hearing and questioning the witness. In that way, we can further our discussions on this bill.

If there is a question — and I would tend to agree with Senator Harb — this is a question that should be first dealt with at the steering committee level.

The Chair: Are you finished? Did you have something to say in response?

Senator Tkachuk: We have some common cause. We do not agree but that is a discussion we need to have rather quickly.

The Chair: Let me say two things. Senator Ringuette, it may be process but there are certain realities. I want to say that I convened a meeting of the steering committee at the end of April, with a view to finding out when we would have clause-by-clause consideration of this bill. I am only one on a committee of three. I was outvoted and told that there would be 16 more witnesses. That is when things started to go a little off the rails. This is the only forum in which everyone can know what is going on. That is why it did get out and was ventilated, quite properly, by the whole committee. We have a problem.

The other thing I wanted to say is that I was very troubled — as I think all of us were last meeting when the Desjardins people appeared before the committee. I read all the material and the sections and received a briefing from people in the Department of Finance and in the minister's office.

I find that in fact, it is not a problem. Regarding the Desjardins Group, there is a window until 2010. It was by design; the *Thibault* case was pending and there were issues. However, there are no problems for the Desjardins Group in the bill as drafted as long as the government proceeds to resolve them within that time frame.

I have suggested that all concerned senators should get a briefing. I have asked Mr. Ernewein and his colleagues to be available to you in particular, Senator Fox, as you mentioned to a senior minister of the Crown that you have certain concerns.

We are all concerned, if, indeed, what they said is a problem. You will hear and you will decide.

Senator Fox: Why will not the officials come back and tell us that?

The Chair: I have asked them to come back; they will come on Thursday. All of this is to say that we should all be a little careful about jumping to conclusions.

The only reason they came is because it was obvious we would be hearing 16 witnesses. The steering committee voted two to one to have them; I voted to have no more witnesses and go to clause-by-clause on May 1, which was the original hoped-for plan of the committee. It is all history now. Senator Tkachuk has made a point.

Senator Meighen: Did you say the officials were coming a week tomorrow?

The Chair: We are scheduling them for next Thursday. I think we are now at a point maybe when the steering committee can have a productive meeting and ventilate the issues. However, I reserve my right as chair to bring these issues before the committee. If they cannot be resolved properly at the steering committee, the whole committee should have some insight.

Mr. Ruby, I do not know when your appointment to the Senate will come down, or how your election campaign is going, but at least you have a little bit more insight as to what is in store for you.

Senator Goldstein: Having heard what you have just heard, you might not accept an appointment.

Senator Eyton: At the least, he should get an attendance fee for sitting through that.

The Chair: We try our best to give sober second thought to some of the legislation. We are dealing here with this document, as you know. You are a renowned and competent tax lawyer with an international reputation, so you are probably one of the few Canadians who actually can understand what is in this darn thing.

The House of Commons did not have a look at it, we are told. We have been wrestling, mere mortals that we are, as your senators, to try to give sober second thought to it. We have gotten ourselves into all kinds of wrangles; all we want to do is to do the right thing.

If you have something that you feel will assist us in that task, we are delighted you are here. If you feel it is just redundant, as I know you might feel, then you will say so as well. We are interested in hearing you and we thank you for coming down here today.

Stephen Ruby, Senior partner, Davies Ward Phillips & Vineberg LLP, as an individual: Thank you. I am pleased to be here and to have the opportunity to address you on certain aspects of Bill C-10. By way of introduction, I am a senior partner of the firm of Davies Ward Phillips & Vineberg. I practice in its Toronto office. I am currently a Governor of the Canadian Tax Foundation. I have previously been co-chair of the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. I am a former president of the Canadian branch of the International Fiscal Association, and I am a former special adviser to the Senior Assistant Deputy Minister of Finance. Over the years, my practice has included domestic and international corporate tax planning, including mergers and acquisitions, family and personal tax planning, as well as tax litigation. I want to speak to this committee today, however, as a tax professional about certain aspects of Bill C-10 that I find troublesome. In this regard, I note that I am appearing before this committee in my personal capacity and not as a representative of my firm or of any organization or constituency, such that the remarks that I make to you today are my own personal views.

The Chair: I am glad you said that, because I think it makes you more credible than if you were here on behalf of a particular client or an interest group. We will be very interested in what you have to say.

Mr. Ruby: Thank you. In reading the transcripts of certain of this committee's hearings on Bill C-10, I have noticed that there has been some discussion concerning the efficacy and legality of so-called ``comfort letters'' issued by the Department of Finance. Comfort letters address unintended legislative technical deficiencies and anomalies, as well as tax policy issues, that are bought to the attention of Finance by members of the tax community. They act as a stop-gap measure during the sometimes protracted period that transpires until legislation can be introduced to remediate the particular problem. Because of the technical complexity of our tax legislation, such problems arise frequently. Although comfort letters are not legally binding on the government and in substance are only expressions of intent on the part of the Department of Finance that certain changes will be recommended to the Minister of Finance, they are nevertheless given and taken in good faith, and significant transactions are completed on the strength of these comfort letters.

But for the comfort letter process, the practice of tax in this country would suffer serious and debilitating disruptions and many transactions would grind to a halt because of the absence of assurance that certain problems will be fixed. Therefore, it should be recognized and acknowledged

that even though the comfort letter process is not ideal and has no formal recognition, given the time-consuming Canadian process of developing tax legislation, the comfort letter process is critical to the ongoing smooth working of Canada's tax system, and I, for one, strongly endorse it.

The Chair: I hope I speak for my colleagues. You have just raised an important and interesting matter, because you will have read in the transcripts that some of us are aware of jurisprudence that talks about their unenforceability. However, the people from the Department of Finance have told us time and again that it is a good process, not perfect but useful in terms of fairness for the fisc and the taxpayer. You are saying that you are in favour of them. It is an archaic system maybe, and unenforceable as the courts say they are, they still seem to work satisfactorily and nobody invokes the unenforceability.

Mr. Ruby: That is right. They have great utility, and they are important. They are an integral part of our tax system. At least, that is the way it has developed over many years.

I appreciate that Bill C-10 is an omnibus bill that contains numerous relieving amendments that the tax community has been anxiously awaiting for quite some time. On the other hand, this bill contains some seriously flawed legislation concerning non-resident trusts, which I will refer to NRTs, foreign investment entities, which we call FIEs, and provisions respecting restrictive covenants. In particular, in my view, each of these amendments is so fundamentally flawed as to warrant serious consideration being given to not enacting this bill until that legislation is removed from it.

This comment should not be interpreted as suggesting that I do not recognize the concerns in the non-resident area, the foreign investment entity area and the restrictive covenant area that the Department of Finance is attempting to address with the proposed legislation. I am in full agreement with the department that there are serious concerns in each of these areas. However, in each case, the legislation in Bill C-10 that is intended to address these concerns has design flaws that are of a fundamental nature rather than just technical anomalies. These flaws can only be fixed by reformulating the conceptual approach to the concerns raised in these areas.

I will now detail certain of my concerns to you in each of these areas. I appreciate, by the way, that not all practitioners will agree with me. However, from conversations that I have had with my partners and numerous practitioners over the several years that this particular legislation has been in the making, I believe that my comments are consistent with the views of many.

The old and current existing legislation of the offshore trust rules applied where a trust resident in a foreign jurisdiction and having a Canadian resident beneficiary received property from a Canadian resident who was related to the Canadian resident beneficiary. You had the three elements: The Canadian resident contributor, you had the offshore trust, and you had the Canadian resident beneficiary. The concern was that money would be funnelled from Canada into the offshore trust; the income on those funds would be accumulated in that offshore trust, and then be repatriated back to Canada to the Canadians resident beneficiary tax-free. In these circumstances, Canada sought to tax the passive investment income of the trust on the theory that the transferred property in substance had not left Canada. The Department of Finance and the Canada Revenue Agency perceived that Canadians were circumventing the application of these rules and sought to strengthen them with the new NRT rules.

I submit that the design of the new NRT rules is fundamentally flawed for the following reasons. First, I should make the general comment that these rules are vastly more complicated than their predecessors. The rule as proposed is too broad because it deems the foreign trust, other than certain exempt trusts, to be resident in Canada where a Canadian resident has made a contribution to the trust, regardless of the fact that the trust does not have any Canadian resident beneficiaries. Where there are

no Canadian resident beneficiaries, there is no avoidance of Canadian tax because the income is not being accumulated for and ultimately repatriated to a Canadian resident.

Second, the rule is disproportionate, in that a nominal contribution to a trust by a Canadian resident will result in the trust's worldwide income, including active business income, which was not taxed under the old rules, being subject to Canadian tax. Therefore, a $100 contribution to a foreign trust having assets of $50 million will subject the income on the entire $50 million to Canadian tax and not just the income on the $100 contribution.

Third, the rule violates what we call transactional neutrality. This can be best explained by an example. A Canadian resident parent has two children resident in the U.S. The Canadian parent gifts $100,000 to one child outright and $100,000 to a U.S. resident trust for the other child, for non-tax reasons.

The Chair: Non-tax reasons being because it is a younger child or something?

Mr. Ruby: You may want asset protection. The trust is subject to tax by Canada on its worldwide income, is required to file a Canadian tax return, and is required to withhold and remit Canadian tax on income distributions to the child, whereas the gift to the other child and the income derived therefrom is not subject to Canadian tax at all.

This rule is unique and no other jurisdiction taxes on this basis. If other jurisdictions adopted this approach, no tax system would function properly. For example, assume that countries X, Y and Z adopted the Canadian rule and that a trust resident in the U.S. received contributions from persons resident in Canada and each of countries X, Y and Z. The U.S., Canada and countries X, Y and Z would each claim taxing jurisdiction on the trust's worldwide income, resulting in an intractable taxing dilemma. I think that is the litmus test that somehow proves to me that there is something fundamentally wrong with this rule.

The consequences of this rule are penal, because the NRT rules make the Canadian resident contributor and the Canadian resident beneficiaries of a non-resident trust jointly and severally liable with the trustees of the trust for the Canadian taxes of the trust. The liability of Canadian contributors is limited to an amount equal to their contributions to the trust if and only if these contributions do not exceed the greater of $10,000 and 10 per cent of all contributions to the trust. In short, the liability of a Canadian contributor to a trust is unlimited where he contributes $150,000 to a trust in respect of which the aggregate contributions are $1 million, in other words, he exceeds the 10 per cent limit, then his exposure is unlimited. Canadian resident beneficiaries, on the other hand, are liable for the Canadian taxes of the trust to the extent of the distributions made to them by the trust.

Canadian jurisprudence provides that unless there is a clear authority in the trust indenture to pay foreign taxes or there is a treaty requiring such payment, Canadian trustees of a Canadian trust are not empowered to use the assets of the trust to pay foreign taxes. Moreover, if personal assets of the trustees are used to pay the foreign taxes imposed upon the trust, the trustees cannot recover such taxes from the trust or from its beneficiaries. This derives from the long-established so-called ``revenue rule'' that one sovereign state will not enforce the tax laws of another sovereign state. The rule preventing trustees from paying foreign taxes, unless specifically authorized or compelled, appears to be the law as well of Australia, Scotland, South Africa, the United States and England. My point is that it does not behoove Canada to enact laws that would be unenforceable in Canada and yet expect compliance by trustees in foreign jurisdictions having the same prohibitions.

The position of the Canada Revenue Agency, CRA, is that a trust that is deemed to be resident in Canada under the NRT rules is a resident of Canada for the purposes of Canada's tax treaties because it

is resident in Canada by reason of one of the enumerated criteria in paragraph 1 of Article IV, the residence article, of Canada's tax treaties. In the view of CRA, the so-called tiebreaker rules generally will not be applied. By ``tiebreaker rule,'' I am referring to competent authority procedure.

The CRA has said they will not negotiate with the other country's competent authority with respect to the residence of the trust. They flatly refuse to negotiate it. They think that the deeming rule deems the trust to be resident in Canada and that is the end of it.

There are numerous instances of potential circumstances that would result in double taxation because of this rule. Indeed, where a trust is actually resident in a high-tax jurisdiction, double taxation will frequently arise. For example, assume that a U.S. person contributes $1 million to a U.S. trust having a U.S. resident beneficiary, to which a Canadian resident has also made a contribution. Under the U.S. Internal Revenue Code, the income from the $1 million will be attributed to and taxed in the hands of the U.S. contributor. The same income will also be taxed by Canada, but the U.S. tax paid by the U.S. contributor will not be creditable against the Canadian tax payable by the trust because the U.S. tax will not have been paid by the trust, but by a different person, namely, the U.S. contributor.

The Chair: Would the same rule apply to some other jurisdiction?

Mr. Ruby: If some other jurisdiction had an attribution rule similar to the U.S., and a number of jurisdictions do.

Also consider a trust that is taxable in the U.S. and owns a corporation that is a FIE — and I will come to speak to the FIE rules — under Canadian tax law. The trust will have imputed income under the FIE rules for Canadian tax purposes, but such income does not arise under the U.S. Internal Revenue Code. Accordingly, the trust will pay tax to Canada in respect of the FIE income but will not obtain a foreign tax credit for the U.S. tax paid by the FIE in respect of its actual income. When the FIE pays the FIE income as a dividend to the trust, it will be taxable by the U.S. but not by Canada, so we have timing mismatches in terms of credits.

As has been pointed out previously to the committee, foreign tax credits for individuals are limited to 15 per cent, with the balance of the foreign tax only being deductible. Accordingly, whenever the income of the trust is taxed by a high-tax jurisdiction, there will necessarily be double taxation of the trust's income.

The complexity of the NRT rules is staggering, and such complexity not only results in noncompliance and unenforceability but, in my view, it brings the rule of law into disrepute. It is difficult to rationalize why a trust that is resident in a high-tax jurisdiction, whose income is taxable by that jurisdiction, either in the hands of its trustees or in the hands of its beneficiaries who are resident in that jurisdiction, should be subject to rigorous and costly compliance with the NRT rules.

The exemption provided for commercial trusts is extremely complex and, in many cases, either too uncertain or simply ineffective. This will interfere with Canadian investment and legitimate business vehicles that have no tax avoidance motive of any kind and will limit Canadian investors' ability to participate in international transactions.

It is difficult to understand why non-taxable entities, other than tax-exempt pension plans, are not entitled to the same exemption as has been proposed for tax-exempt pension plans.

The Chair: On the NRT rules, I take it you are not here on the specific issue of whether non-resident trusts based in the United States should be exempted, as was discussed back in the 1998 Budget. The new NRT rules in this bill are even more complicated than the previous rules that they are amending

and they lead to unintended consequences. I think I understand your position; is that correct?

Mr. Ruby: That is correct. In 1999, I believe the U.S. was going to be exempted, and that was dropped.

The Chair: That is a matter of policy. The government can do that if they want. However, in terms of the actual policy that they purport to implement with this legislation, you are saying it is flawed and unworkable, or words to that effect. That is what interests this committee.

If the government wants to go with a flawed policy, that is their business and the people will talk to them about that. In terms of the actual law, there is an important distinction.

Mr. Ruby: Senator Angus, my view is that no amount of tinkering can fix these rules because they are conceptually flawed. The approach is flawed and that is what I was trying to elicit with all of these comments and anomalies that come up when you examine and review the rules.

The Chair: In other words, there is not another way to go. You are not proposing an amendment. The government is apparently trying to accomplish something, according to the minister who appeared before us, in terms of stopping leakage, through either tax evasion and/or money laundering, which seem to be the big policy objectives. You are not suggesting an amendment; you are saying you just cannot do this.

Mr. Ruby: I am suggesting that the approach reflected by these rules is fundamentally flawed and that a different approach to address the concerns of the Department of Finance must be or should be adopted.

I will now address some of the anomalies that I believe occur with respect to and under the FIE rules. The FIE rules are intended to address the situation of Canadian residents transferring passive investment income offshore to non- resident entities, including non-resident corporations and non-resident trusts that are not caught by the NRT rules, whose passive investment income is not otherwise subject to tax by Canada on a current basis.

A non-resident entity will be a FIE, in very general terms, if either more than one half of the book value of its assets consists of passive investments or if its principal undertaking is an investment business, in each case as specifically defined by the FIE legislation.

The FIE rules contain complicated definitions of when a FIE is carrying on an investment business and various methods of computing the book value of the assets of a FIE. The design of the new FIE rules is also fundamentally flawed, for the following reasons: For many non-resident entities, the book value method cannot be applied because the accounting standards used by these entities are unacceptable under the FIE rules. The FIE rules apply on an entity basis. By that I mean that they effectively tax the Canadian taxpayer's share of all of the income of the FIE and not just the passive investment income of the FIE. They tax active business income, as well as passive income, even though they were intended and designed, we think, to tax passive investment income that has been moved offshore.

The rules treat the FIE as a portfolio investment, so that there is no foreign tax credit for any foreign tax paid by the FIE on its income that is indirectly taxed in Canada under the default regime rule of the FIE rules. This is particularly harsh where the Canadian taxpayer is taxed on imputed income and has not received a cash distribution with which to pay the tax.

The FIE rules are exceedingly complex and difficult to interpret and understand. In particular, much of the language used is impenetrable, rendering compliance highly uncertain since rules that are opaque necessarily breed non- compliance. As Mr. Patrick Marley pointed out in his testimony before this committee on May 15, the definition of ``tracked interest'' in the FIE rules is remarkable for its

opaqueness and that is only one example.

The FIE rules provide that every non-resident entity is deemed to be a FIE unless the taxpayer can establish otherwise. This reverse onus imposes a heavy and costly compliance burden on Canadians in respect of non-resident entities in which the Canadian holds a minority interest. In addition, whether a non-resident entity is a FIE is an annual determination.

Given these and other factors such as, in particular, the inability to obtain relevant information, compliance will be impossible for most Canadians. In the case of most Canadian resident taxpayers, it will be a ``catch me if you can'' attitude.

The practical consequences are likely to be significantly increased compliance costs for Canadian corporate taxpayers who were not the target of this legislation in the first place and noncompliance, whether voluntary or involuntary, by others because the rules are impenetrably complex.

Lastly, I would like to address restrictive covenants as Mr. Patrick Marley raised them when he testified before the committee.

The proposed rules will serve to discourage intergenerational transfers of family-owned Canadian businesses because the family members will be taxed more harshly than if the sale was to an arm's-length purchaser. For example, if a father-in-law sells his shares in an operating company to his son-in-law for full value, but gives his son-in-law a covenant not to compete, the value of the non-compete covenant will be included in the father-in-law's income notwithstanding that the entire purchase price was allocated to the shares. Instead, if the father-in-law had sold his shares to an arm's-length purchaser with a covenant not to compete, no amount would be included in the father-in- law's income in respect of the covenant. The rules need serious revision in order not to discourage intra-family sales.

The Chair: Thank you. You have mentioned your curriculum vitae summarily and that you are a senior partner in the firm of Davies Ward Phillips & Vineberg. Have you worked as a special adviser to the senior Assistant Deputy Minister of Finance?

Mr. Ruby: That is correct.

The Chair: This was on a contract?

Mr. Ruby: Yes.

The Chair: You were seconded?

Mr. Ruby: I was seconded. I was initially working for David Dodge in 1990 and 1991. He asked me to come down and assist the department for a year and a half. I worked at the department four days per week.

The Chair: Therefore, you know whereof you speak in terms of the comfort letters and the processes followed in trying to put this fiscal legislation together?

Mr. Ruby: Yes.

The Chair: You also know how to make the system work.

Mr. Ruby: I think that is a fair statement.

Senator Massicotte: I have heard and read your presentation. Obviously, there are some very technical problems with the bill. We have heard this comment from many people and presume it is accurate.

The question is what we do with this. You are saying there is no repair, we cannot deal with it. We

should take it out and start from scratch. What part of the proposed bill would you take out?

Mr. Ruby: Take out the non-resident trust rules, the foreign investment entity rules and the restrictive covenant rules in clause 56.4. As I said initially, I think there are concerns in this area. I would recommend a consultative committee be struck in the same manner as for international tax. That committee should study these issues and attempt to reformulate a better and different approach to solving the problems.

I do not think that in any of these areas mere tinkering and tweaking will correct what I perceive to be the significant problems, only some of which I have highlighted today.

Senator Massicotte: The Department of Finance advised us that they have consulted with people in the industry to get to this point. Obviously, in your opinion they did not do a good enough job.

It looks like they have done what you have said. Why did they come to this conclusion, if it is not good enough? How should the process be different?

Mr. Ruby: I am talking about the fundamental approach, the underlying theme of this legislation. In part, I played a role when I was co-chair of the joint committee in negotiating some of the changes to this legislation. I was an integral part of that on behalf of the joint committee as Mr. Tamaki will no doubt tell you when he gives his testimony.

I am suggesting to this committee that the problem has gone this far for so long because nobody went back and suggested maybe the whole approach is wrong. Instead, we are trying to fix this and fix that. I am trying to convey that maybe we should go back and look at how we have formulated our conceptual approach to solving these issues.

Senator Eyton: Mr. Ruby, we have heard many of the criticisms you have expressed and we have heard from many bodies that have a direct and professional interest in the issues you are addressing. They include the Joint Committee on Taxation, Stikeman Elliot, Withers LLP, the Society of Trust and Estate Practitioners in Canada, Credit Union Central in Manitoba, the Ontario Municipal Employees Retirement System, et cetera.

I think all of them shared your concerns, but all of those bodies recommended precise amendments. I do not recall anyone who has come in, as you have done and said throw it all out on these issues and start all over again. Could you explain that to me?

Mr. Ruby: I cannot speak for those organizations and bodies. I come here without any special interest that I am protecting. I am talking about the legislation as a practitioner. I find the language in the bill impenetrable and extremely complicated. As I have said many times, I think the basic problem-solving approach to these problems can only be remedied by going back and revisiting how we thought we would solve these problems.

We got on a track where a certain primary approach was adopted to each of these problems. Then that was expanded, but we never went back and revisited why we have all these problems. Maybe something is wrong with what we did in the first place. Maybe that is why we have all these problems. I may be an outlier in terms of my recommendation, but that is my view.

Senator Massicotte: I am not surprised with your answer. You realize that every tax adviser says that about nearly every amendment to the Income Tax Act. They say it is too complicated and not workable. However, let us say it is adopted and you are stuck with it. It appears that smart people like you are able to finds ways around it and protect their clients from an abusive result.

Is that possible in this case? What would you do if it became law? Would you not find a solution to it?

Mr. Ruby: Many people think that tax advisers, tax lawyers and tax accountants spend their days looking for loopholes. I happen to think it is a myth. Nothing could be further from the truth. We spend our days looking for potholes. What I mean by that is the act is so complicated, many potential mistakes can be made and you can fall into traps. If we want to do a commercial or family deal, we spend a lot of time trying to ensure that we do not fall into a trap. These rules are drafted so broadly and the ambit is so wide that you can easily fall into a trap. You should understand; we do not spend our time looking for loopholes. I am trying to say that it is important that these rules be reformulated.

Senator Massicotte: There is nothing you would do as an adviser to avoid pitfalls? There is obviously a lot of merit to the bill, right? There is obviously a problem. You acknowledge that.

Mr. Ruby: I acknowledge that, absolutely.

Senator Massicotte: There is no mechanism you would find as an adviser to avoid the pitfalls, as you say, that are in this act?

Mr. Ruby: I think there may very well be different approaches that will solve the problem. I have not spent a great deal of time thinking about that. If a consultative committee was struck and you had some smart guys on that committee, they could revamp the approach to these problems and address the concerns in a more efficacious manner, where the results would not be as onerous as they are now and perhaps the legislation would not be as complicated.

Senator Massicotte: You come here speaking on your own behalf and not on behalf of your firm. That is interesting and I appreciate that. Relative to your opinion, are you aware whether the other tax experts in Canada would share your opinion and conclusion?

Mr. Ruby: I have every reason to believe that most practitioners share my concern with the complexity, incomprehensibility and breadth of the ambit of these provisions. They are anti-avoidance provisions and I believe most practitioners would agree with me when I say they do and can interfere with bona fide commercial and family planning that is not intended for tax avoidance purposes.

Senator Massicotte: Would they agree with you that you should avoid those and start from scratch? I do not know how many pages the bill is, but I think there is only one page left after eliminating all the things you said we should eliminate.

Mr. Ruby: I cannot answer that because I have not asked any of them what their views are with respect to how we would fix the problems.

The Chair: If I may, my supplementary would be on this very point. In the meantime, would we just go along with the status quo? Do you think that would not cause a big problem?

Mr. Ruby: Not in my view. We have lived with the other provisions in this omnibus bill for a long time. It would be very nice to have them enacted but, in my view, if enacting those amendments means we have to enact the non-resident trust and the FIE legislation and the restrictive covenant legislation, I would give serious consideration before I would do that.

Senator Massicotte: Is the general anti-avoidance rule, GAAR, not good enough as it is?

Mr. Ruby: Evidently, in the view of the Department of Finance, the GAAR is not good enough; otherwise, they would not need this legislation.

Senator Massicotte: In your opinion, is it good enough?

Mr. Ruby: I will pass on that question, senator. That is a very tough question.

Senator Harb: Thank you very much for your excellent presentation. You brought up quite a few interesting points. If a non-resident trust, for example, is in the United States and it is taxed in the U.S. jurisdiction, you are saying it should not be subject to double taxation. However, if it is the subject of double taxation in Canada, the investment community screams and the individual who is double taxed as a result will also scream. What happens to a European investor who also has an investment in that fund? He would find himself in a trap as well, would he not?

Mr. Ruby: Yes; if there was a contribution made to that fund and it was not an exempt trust; if a contribution was made by a Canadian resident, the worldwide income of that fund would be subject to tax by Canada.

Senator Harb: That would be grounds for legal action, would you think?

Mr. Ruby: What legal action would you recommend?

Senator Harb: As a tax lawyer? I am a British citizen of sorts, why are you taxing me?

Mr. Ruby: I mentioned that the CRA refuses to negotiate the residence of these trusts with our treaty partners. In my view, that is a bit of a breach of the letter and spirit of treaties. That is why we have treaties, but that is the position that they have adopted. That kind of a negotiation, to determine who has taxing jurisdiction, is what treaties are for.

Senator Harb: Is it your view that this particular part of the legislation is exempt from the double taxation? Is it explicitly exempt? If not, one will say you cannot double tax an individual as long as you have a treaty. If you do not have a treaty, go ahead and do it. In the case of a non-resident trust that is in the U.S., you have to make up your mind; you either tax it here or in the U.S.

Mr. Ruby: Canada takes the view that even if it is taxable in the U.S., it is nevertheless contemporaneously taxable in Canada. They said they will give a tax credit for the U.S. tax. There are problems with that because there are so many permutations and combinations of double tax that can arise that you would have to go to competent authority every time.

Senator Harb: Registered pension funds are an investment that is not taxable until you start to draw on them. Is it your view that will also be trapped in the process if this particular aspect of the bill goes through?

Mr. Ruby: Their concern was they were getting trapped with the potential liability because if they were a resident contributor, they might be liable for the taxes of the trust.

Senator Harb: Did you make any representation to the Department of Finance? They appeared before us and they are aware of the fact that there are issues with the proposed legislation. We gave them some time then, around Christmas, to go and deal with the investment community to develop some kind of a game plan. Have you have a chance to communicate with them somehow to express your views, as you have done here. They are a very reasonable bunch and I am sure they would be very receptive to a reasonable suggestion such as you made to us today.

Mr. Ruby: Since I gave up the chair of the joint committee, I have had conversations from time to time with officials at the Department of Finance but they have been informal — just in corridors and things like that. I have expressed my views briefly to them but not in a formal way.

Senator Meighen: Often it seems to me that rule-makers are wont to create more problems when they set out to rectify the initial problem. Instead of being faced with one or two problems, you end up being

faced with five or six. I wonder if that is not what we are dealing with here.

In that connection, you said that there is a problem and you recognize that. The department set out to rectify it. How severe is the problem that exists now under the current legislation? Is it widespread, in your view, or is it limited?

When you are answering, could you also weave into that the distinction between so-called high tax jurisdiction and low tax? I can understand if we are worried about people fleeing to tax havens that shall remain nameless. However, when we are dealing with western European countries and the United States, I thought the interrelationship was pretty well established over the years and that very few people were playing one-off against the other or abusing the system in terms of that particular area of the world. However, if you are dealing with a tax haven, I understand. With that confused question, could you give a clear answer?

Mr. Ruby: I do think this is an example of where you have a problem, and the solution is more difficult and creates more problems than the initial problem that you sought to solve. The definition of a high tax jurisdiction would be countries like the United Kingdom, the United States and most members of the European Union — generally speaking, countries with which Canada has entered into a double-tax treaty. That is a general statement; not every country we have done that with has high tax rates but most of them do.

Senator Meighen: Where is the problem? Is it with non-high tax jurisdictions, in your view, or with all jurisdictions?

Mr. Ruby: I would have exempted high-tax jurisdictions from these rules. How much more revenue will Canada get? The other question you asked me is how widespread is this? I do not know. I do not have the statistics for how much tax is being avoided or lost. Some Department of Finance officials have indicated to me that it is extensive. I have no way of verifying that. I do not doubt it. It might very well be true, but certainly Canada would not get in a high tax jurisdiction. The marginal extra tax we get would depend on the comparative tax rates between Canada and the foreign tax jurisdiction. If the foreign tax jurisdiction had rates comparable to Canada's and there was full credit and we did not have all these double tax problems, then the marginal revenue that would be raised by the fisc would be insignificant. However, in low tax jurisdictions, it would be significant.

Senator Meighen: Is there, in your tax world, an uncontroversial definition of high tax and low tax? If we set out a list of countries that we would exempt, as you suggested, because they are a high tax jurisdiction, would it create a lot of controversy because we included country X but not country Y?

Mr. Ruby: Someone's definition of comparable could be 5 per cent, and someone else could tolerate a spread of 25 per cent. It depends on your take. That is a difficult question for me to answer. Some countries have international tax systems where they have anti-avoidance rules that apply to foreign subsidiaries. They have black list and white list countries or, in the case of New Zealand, grey list countries. These are countries that are exempted from these anti- avoidance rules because they are considered to have tax rates that are comparable to the home country's jurisdiction. Other countries have done this in international tax. They have exempted certain countries because they feel their tax rates are sufficiently high and sophisticated in terms of computing the base. It is not just the rate. It is the effective tax rate and the base is computed as well as the rate. It is a tough question. Other countries have done this.

Senator Meighen: In your view, if these provisions are enacted, what about Canadian residents who set up, as you referred to in the earlier part of your presentation, a non-resident trust for the benefit of

their children resident in the United States. Now they will be taxed even though the children are resident in the United States and not in Canada. What would they do to avoid that?

Mr. Ruby: They will have to go to competent authority in Canada and say, ``I am double taxed, and I expect Canada to give me some relief."

Senator Meighen: And hope for the best?

Mr. Ruby: And hope for the best. I think Canada might very well offer them some relief, but they do not have any right to it. You have no legal right to it in the sense that you have a right to sue for that relief. It is up to the competent authority.

Senator Meighen: I suppose that if you did not want to take any risk, you would become a non-resident?

Mr. Ruby: Or you would not do it. These rules interfere with family planning that has no tax avoidance motive and no tax avoidance intent because of the breadth of these rules. That is why I think the rules require reformulation. I do not think the tax system should interfere with legitimate business concerns or family planning concerns.

Senator Goldstein: Mr. Ruby, thank you for coming and for your enlightening remarks, which we all appreciate.

We find ourselves in a curious and difficult position. On the one hand, we all know by now that legislation, not this specific legislation but legislation like this, has been drafted and been kicked around for almost ten years now. It has de facto been presented to us pretty much for the first time in the past year or so, which causes some of us to consider that perhaps the problems that this legislation seeks to avoid are not as acute as would require bad legislation to be passed into force. If the department has not done a hell of a lot about it for eight, nine or ten years, it cannot be something that is imminent.

On the other hand, we equally find ourselves in the position as a Senate to want to avoid interfering to the extent reasonably possible with policy decisions that are made by the government of the day. We may or may not agree with the policy decisions, but the policy decisions properly belong to the government of the day. If the Canadian people find those policy decisions unacceptable, they know how to vote, and they vote well.

The second problem we have is that there is a general reluctance, certainly on my part and on the part of many others around this table and elsewhere, to have the Senate interfere with tax legislation.

We recognize that some parts of this bill are good. For instance, the film industry is anxious to have most of the provisions dealing with film tax credits put into place because they clarify many problems that the film industry has encountered.

Given all that, and recognizing that the perfect is the enemy of the good, if we could adopt Senator Meighen's approach insofar as foreign trusts are concerned, or non-Canadian trusts, and distinguish between high tax and low tax countries by way of an amendment; and if we could equally amend the areas dealing with the taxation of restrictive covenants of all kinds and limit it to the usual restrictive covenant, which is a business-related activity; while it is not the best alternative, do you think that the tax community and Canadians in the context of what I have just put to you could and should be able to live with what they have in the moment? Do you think Canadians could live with those amendments, and hope that the government will continue to look at this, as it should, and bring amendments, as it undoubtedly will?

Mr. Ruby: That is a tough question to answer in a universal sense, because I agree with you that those patches would be very helpful, both in the restrictive covenant area and the non-resident trust area. I would assume you would recommend something similar for the FIE area.

Senator Goldstein: Yes.

Mr. Ruby: Those amendments that restrict the ambit and scope of the legislation that pertains to those areas are helpful. That would be my second choice. That would not be my first choice, because there is a concern that once you make those amendments, then this legislation will not be revisited for quite some time. The fundamental problems will remain, but they will be more contained, so yes, I would endorse what you recommend. If you could properly restrict and narrow the focus these rules and get the impenetrable language out of there, it would be helpful.

Senator Massicotte: We have heard testimony from the Caisse Populaire on the personal side with the proposed legislation that one would not be able to withdraw from RRSPs given the nature of the entity they represent. We heard a summary from our chair. Are you aware of this problem?

Mr. Ruby: No, I have not studied this problem.

The Chair: Are there any further questions for Mr. Ruby? Sir, you can see we are very interested in what you have had to say. I think Senator Goldstein might have gotten close it. ``Perfection is the enemy of the good.'' We will do our best. Could we call you if we need some clarification on any of your ideas?

Mr. Ruby: Yes.

The Chair: You have painted with a bit of a broad brush, unfortunately, and therefore it is not too easy to accept your proposals.

Mr. Ruby: My proposals are broad because they go to what I believe are the fundamental problems with the legislation and why, in part, we have such complicated, incomprehensible rules. We started out with an approach that I think is flawed and then we have to shore it up.

The Chair: Thank you.

Honourable senators, we are very pleased to have before us two well-known experts in the field of fiscal matters. In particular, we welcome Mr. Paul K. Tamaki, Chair of the National Taxation Law Section of the Canadian Bar Association and Co-Chair of the Canadian Institute of Chartered Accountants and Canadian Bar Association Joint Committee on Taxation. I was fortunate to be a partner of Mr. Tamaki's late father, George Tamaki, who was a legend in Canadian tax law matters. I am told that the nut does not fall that far from the tree and that Paul has followed brilliantly in his father's footsteps. It is a privilege to have you before us today, sir, as well as Bruce Harris, who is also well known in this field, who is an eminent member of the CA profession. He is Co-Chair of the Canadian Institute of chartered Accountants/Canadian Bar Association Joint Committee on Taxation.

You two gentlemen work together as co-chairs of this very important committee. We appreciate your coming here as we are hopefully winding down our hearings on this massive piece of legislation that has caused much-perplexed afterthought by all of us. We are trying to do it in a sober way.

Paul K. Tamaki, Chair, National Taxation Law Section, Canadian Bar Association, and Co-Chair, Canadian Institute of Chartered Accountants/Canadian Bar Association, Joint Committee on Taxation: Thank you, Mr. Chair and honourable senators. We are very pleased to appear before the committee today at your invitation.

We are here, as the chair has said, as co-chairs of the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. I am a partner at the law firm of Blake, Cassels & Graydon LLP in Toronto and my friend Bruce Harris is a partner in the accounting firm of PriceWaterhouseCoopers LLP.

The joint committee is made up of tax accountants and tax lawyers who are members of the CICA and the Canadian Bar Association. There are approximately 11 members from each profession so there are approximately 22 in total.

Bruce Harris, Co-Chair, Canadian Institute of Chartered Accountants/Canadian Bar Association, Joint Committee on Taxation: The primary objective of the joint committee is to have income tax legislation that is workable, understandable and fair. We address drafting issues, not matters of overall tax policy. We do not represent a particular group of taxpayers. We provide technical comments on proposed amendments to the Income Tax Act and raise technical concerns in existing legislation. For the most part, our input is by way of written submissions and meetings with the Department of Finance or the Canada Revenue Agency. These submissions are public. We would like to say for the record that we enjoy an open working relationship with the Department of Finance and, in particular, the officials with the Legislative Division of the Tax Policy Branch.

Bill C-10 has a long history. Part 1 contains the non-resident trusts and foreign investment entity rules. This first appeared in draft legislation in 2000. Part 2 contains the so-called technical amendments to the Income Tax Act. Part 3 relates to bijuralism, a concept that the Canadian Bar Association certainly supports in principle and that, as far as we know, is non-controversial. Our comments today focus largely on Part 1.

The joint committee has written 12 letters and submissions on the non-resident trusts and foreign investment entity proposals since 2000, including eight extensive submissions to the Department of Finance on various versions of the draft legislation. We have provided the chair with a copy of these submissions. They are highly technical and we do not intend to take you through them, but they do give you an idea of the effort our committee has devoted to these proposals.

One of our committee's first comments on the legislation was the overall complexity and the concern that taxpayers would have difficulty in comprehending and complying with it. Our submissions have included most of the matters raised by previous witnesses before this committee.

We have had several meetings and conversations with Department of Finance officials to discuss these provisions. A number of our recommendations are reflected in Bill C-10. Other concerns have not yet been resolved. We have continued to meet with finance officials to discuss our concerns. Our most recent meeting was on April 1, 2008.

Mr. Tamaki: We would like to highlight two points in our latest discussion with finance officials on the non-resident trust legislation. First is the application of the NRT rules to legitimate investments in offshore commercial trusts. Second is the application of these provisions to so-called dual resident trusts.

You have heard a number of submissions why tax exempt pension funds require an exemption from the application of the non-resident trust rules. You have heard their representatives describe these rules as unworkable. We understand that representatives of the pension funds have received comfort letters which appear to satisfy their concerns.

We think taxable investors and tax exempts who are not covered by the comfort letter have the same legitimate reasons for wanting to make the same international investments, namely diversification and

enhanced returns on their investment. However, the same NRT tax issue that has created problems for the tax exempt entities also apply to these investors.

We can see the benefit of a targeted exemption that allows tax exempt investors to avoid having to deal with the NRT provisions entirely. However, if Bill C-10 is problematic for those tax exempt investors, it is equally problematic for other investors.

In our discussions with the Department of Finance officials, we discussed possible ways to address our concerns. I think the problem is reflected in your committee's exchanges with the department's officials when they appeared in December.

The Department of Finance is concerned about a type of tax planning whereby certain taxpayers are transferring property to offshore trusts in a manner in which future income or appreciation from the property is not taxed in Canada even though the funds make their way back to a Canadian. An example of this is the so-called ``international estate freeze'' whereby the future growth in a family business corporation is transferred to a foreign trust that is not taxable in Canada.

The Department of Finance agrees that there should be an exemption for legitimate investments in foreign commercial trusts. That is the intended purpose of the exemption in paragraph (*h*) of the definition of ``exempt foreign trust'' in subsection 94(1). This is one of the matters that Mr. Marley spoke about before your committee in May.

The concern we have with the wording of the current exemption is that international investments are typically structured to suit the widest group of investors and to provide flexibility regarding the type of investment structures that the fund can use around the world. Canadian investors form a relatively small part of the potential investors in the funds. As a result, it is not surprising that most investment funds are not structured with the Canadian tax laws in mind.

In particular, many foreign funds give the fund administrator broad discretion in structuring underlying investments in the fund. Some of these underlying structures could offend the technical language of the exemption for commercial trusts in paragraph (*h*) of the definition of ``exempt foreign trust'' in subsection 94(1).

These possible structures created by the foreign funds could be problematic although it is unreasonable to think that the fund could be used to carry out an international estate freeze. If there is a risk that the fund will be an NRT and the fund is aware of the risk, the fund will probably not permit Canadian investors. Even worse, if the fund is not aware of the risk and has Canadian investors, the fund and its investors may be exposed to a very significant tax.

We have brought these concerns to the Department of Finance's attention and we believe they understand our concerns. However, apart from their comfort letters issued to the exempt funds, they have not given us any indication that they agree further modifications should be made. Their primary concern is that any changes to allow investments by other entities could be used to facilitate international estate freezes. The result is that Bill C-10 does not go far enough to make the provisions workable for these investors in offshore commercial trusts.

Mr. Harris: Another area we have discussed with the Department of Finance officials is the application of the rules to dual resident trusts. These are trusts that are potentially taxable in two countries. For example, a trust may be subject to tax as a resident of the United States because that is where the trust assets are administered. The same trust may be deemed to be resident in Canada and subject to Canadian tax on its worldwide income under the NRT rules, simply because a Canadian has contributed property to the trust.

This can lead to Canadian taxation of bona fide family trust arrangements and can lead to double taxation. Mr. Charles Gagnon of Stikeman Elliott discussed this when he appeared before you in December. We discussed these matters with the Finance Department. Their concern is that not taxing the trust would open the door to international estate freezes or similar plans that would allow Canadians to avoid tax. Our concern is that the proposed rules do not adequately address the dual resident trust tax issues that can arise from legitimate family arrangements.

Part 2 of Bill C-10 is so-called ``technical amendments'' to the Income Tax Act. Many of these changes first appeared in draft form in December 2002. Some are purely technical in nature and some are favourable to the taxpayer. The joint committee has also made submissions on many of these amendments. For your information, we have tabled that as part of our submission.

The Chair: Have you provided it to our clerk?

Mr. Harris: Yes.

Mr. Tamaki: It is that brick you see in front of your clerk.

Mr. Harris: As with most of our submissions, some points have been addressed and others have not. Nevertheless, we will continue our discussions with Department of Finance officials in an effort to make the Income Tax Act more workable, more understandable and fairer.

The Chair: Thank you gentlemen for your thoughtful presentation on this very complicated subject. For the record, since you have mentioned Part 3 of the act, the issue of bijuralism is not something we have brought to our attention by others. You say you agree with the concept. I understand that is has to do with uniformity of law in Canada, et cetera. For the record, could you outline the concept and what it means to you?

Mr. Tamaki: I am afraid there is not much more that I can say. The reason we said it was that the Canadian Bar Association agrees with it for the record. Unfortunately, it is not an area with which the joint committee has had to deal. Although we deal with technical matters, this is quite technical and has not raised any tax issues in and of itself. We can see the need for it and the Canadian Bar Association agrees with it in principle, but I do not have any more to say on the matter.

Mr. Harris: I have nothing further to say on the subject.

Senator Massicotte: I have read your presentation. You raised the issue of comfort letters and why some investors would get protection and not others. Why only foreign exempt institutions?

You have met with the Department of Finance and they have not made the amendments although you think they understood the issue. Can you speculate whether it is because they do not see this as an issue or is it strictly a political timing issue?

Mr. Tamaki: The basic concern is that they are concerned with international estate freezes, to give a short-form name to it. I think they see our concerns but they are worried that if they make changes it opens up the door to these estate freezes.

I believe there is a middle ground that can be achieved, where we satisfy everyone's concerns. Unfortunately, I am not sure they agree with it. At this point, they certainly have not made any indication that they think so much of the other concerns that they are willing to seriously deal with it. That is not to say they will not. Even if this bill passes, we, as the joint committee, will continue to press them on matters that we feel need attention.

Mr. Harris: I agree with Mr. Tamaki's comments. My sense from when we met with them was that

they acknowledged our concern but that their prime concern was these international freezes — trying to ensure that you could not circumvent the rules they were trying to draft if they narrowed their scope.

Senator Massicotte: Are these international freezes current today? Is there a problem? Are people avoiding paying what they consider the proper share of tax by these international estate freezes?

Mr. Harris: I would say that in the last number of years while these rules have been outstanding, given the expectation that they would be enacted some day — because they have been around in draft form since 2000 — I would be surprised if any international estate freezes have taken place since that time.

Senator Massicotte: Is that because of the threat of this legislation coming on?

Mr. Harris: Yes.

Senator Massicotte: In your own practice, have you seen any international tax estate freezes?

Mr. Harris: No.

Mr. Tamaki: I have not seen any at all.

Senator Massicotte: They are obviously giving comfort letters, which means they are proposing amendments to come. With the institutional investor, I guess they will be amending the definition of ``exempt.'' Is that how they will get there?

Mr. Tamaki: I think that is correct.

Senator Massicotte: You are saying that exemption should also apply to bona fide investors who are not trying to avoid taxes but being creative in dealing with their succession or other family issues.

Mr. Tamaki: I am not sure that everyone needs the same exemption that the pension funds have asked for and apparently have been promised. I would guess for taxables, there may be other concerns that the Department of Finance feels need to be addressed.

Senator Massicotte: How would you address your issue? What amendment would you propose?

Mr. Tamaki: That is a difficult question. I do not want to get too much into the complexities of the amendment of the rules, but I guess some of these complexities have been spoken to by other witnesses. However, there are two types of exemptions for commercial investments in foreign trusts. One is for what you might call widely held foreign trusts, which have more than 150 beneficiaries.

They are problematic for the tax exempts and, therefore, also for the taxables. We think fairly targeted amendments can be made to make the provisions much more workable — nothing is perfect, but much more workable — for regular investors.

The other exclusion, which deals with funds with under 150 beneficiaries, is a much more difficult exemption to comply with. I could make a recommendation to cure the issue from the point of view of the taxable investors, but I would expect that the Department of Finance would say if you do that, you open the door to international estate freezes.

Senator Massicotte: The previous witness said this is so faulty, difficult to comprehend and unwieldy, we should eliminate it completely and start from scratch, using a more macro-approach, saying what is my objective and how do I get there. Do you share those views?

Mr. Harris: Our view — and I will let Mr. Tamaki speak on his account — is we think target amendments on the NRT side would be appropriate.

Senator Massicotte: How about the FIE?

Mr. Harris: It is a complex piece of legislation. My perspective is that targeted amendments would be necessary. That is my view. I will say that on a number of occasions, I have had colleagues speak to me and they say that these rules are so complicated that they have difficulty trying to figure out what they mean.

Senator Massicotte: You would not scrap them, you would try to fix the problem, is that right?

Mr. Harris: My perspective would be to try to fix the areas that cause the uncertainty, yes.

Senator Massicotte: Obviously, a starting point is that the Department of Finance does not think GAAR is adequate. In other words, there are still some interpretation problems and therefore there is a need for legislation. Do you agree with that objective — or do you think it was completely unnecessary?

Mr. Harris: GAAR is a very broad rule. In the shifting sands of how courts, including the Supreme Court of Canada, will interpret legislation, I think that the Department of Finance, as well as the tax experts, have difficulty trying to grapple with when something is subject to GAAR and when not. I cannot speak for the Department of Finance, but I suspect they felt it was necessary to put these amendments in because of some uncertainty as to whether GAAR would apply to those types of arrangements in all cases.

Senator Massicotte: Obviously, there is a concern. Last week, we had witnesses on the RRSP side. I do not know if you are aware of the issue, but the caisse populaire, given the legislation in Quebec, is cooperative. The opinion they expressed is the legislation, as proposed, would not permit RRSP investors to withdraw funds from their RRSPs. Are you aware of that and do you share that opinion?

Mr. Harris: I first became aware of it in reading the minutes of last week. I do not believe our committee has addressed that issue in recent times. I would have to go back and check whether they looked at before, but I do not believe so.

Senator Massicotte: Is it because you do not agree with the opinion?

Mr. Harris: We have not studied the issue.

Mr. Tamaki: That is correct. We were not aware of that issue.

Senator Jaffer: If I understood, you responded to Senator Massicotte by saying there should be targeted amendments. The earlier witness made suggestions that there be a consultative committee to look at it. Were you thinking of doing it through a committee or how were you thinking of the targeted amendments?

Mr. Harris: I was not really thinking of the process of how to make those targeted amendments. That would be one alternative. Our committee will continue to work with the Department of Finance to try to make the rules, as we see, fairer and easier for taxpayers to comply with. I had not decided in my own mind whether we needed a separate committee. It is something that perhaps could be considered. I would not discard it.

Mr. Tamaki: I heard Mr. Ruby say, in essence, that he would like to scrap the whole thing and start with a clean sheet of paper. I do not think there is any question that we would end up with more than one sheet of paper after the exercise is over. I am not convinced that result would be that much better than what we have. We certainly hope so.

In terms of targeted amendments, Mr. Harris and I are thinking about amendments to the exclusions from the system. If we could have clearer amendments as to when you are in and when you are out, that

would be very useful. We would hope that most people would be out and the only ones who would be in are those who are actually doing the things the Department of Finance is offended by.

There is discussion about GAAR. Perhaps that is the answer — perhaps not GAAR, but some anti-avoidance rule that would make people reluctant to do the transactions if they were concerned that the anti-avoidance rule applies.

As far as a consultative committee is concerned, I think that would be a good idea if not simply to table the problems that we are having with this legislation and the problems that the Department of Finance perceives with the existing legislation and the abuses they see. If we all understand those things and have that communication, then I think there is a much better chance they will come up with legislation that we can all live with.

Senator Meighen: Senator Massicotte and Senator Jaffer have asked pretty well the questions I wanted to ask, but for my clarification, is there a consultative committee in existence? Is there an ongoing dialogue with the department, or is it ad hoc?

Mr. Tamaki: I think the consultative committee referred to was one established by the Minister of Finance to deal with international tax issues. As I understand it, it is focused primarily on business issues, how the international tax system can be fixed, or to address business issues, issues for Canadian businesses investing abroad or foreign businesses investing in Canada. In the consultative paper issued by the advisory panel, they suggest that this area that we are talking about, non-resident trusts and foreign investment entities, has more to do with personal investment than business, so at the moment they do not feel it is part of their mandate.

Senator Meighen: Am I to understand, then, that there is no ongoing consultative body that interacts with Department of Finance officials who may say, ``Look, we are having a problem with non-resident trusts, and we think there is an awful lot of leakage here, and people are taking advantage of low-tax jurisdictions, so we want to fix it. Can we work together to come up with some proposals to do that?" That does not happen?

Mr. Tamaki: There is not an ongoing committee. There is our committee, the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. If the government feels it has a problem and sends out draft legislation or even a paper and asks for comments, we would certainly comment on it. It is more responding to requests for comments. If we see a technical issue in the existing legislation that we feel should be fixed, then we would send a submission off to them.

There is not an ongoing dialogue on basic policy issues, because we are more of a technical committee. I do not know, but I would expect that the Department of Finance officials consult personally with as many people as they can, but I do not think there is anything on a formal basis.

Senator Meighen: Gentlemen, we can reject this bill, we can adopt this bill, we can amend this bill, or we can adopt it with observations. We have heard evidence, and indeed we have heard it from the chair, that there is a good deal in this bill that is very worthwhile. I do not know if you have read that. I confess I have not. However, I am told that there are some measures that are devoutly to be wished for. As you can see, we are caught in a dilemma. I want to make myself clear. Your evidence is to the effect that targeted amendments would be helpful, that the letter of comfort might be expanded to cover those things not covered, but that it is not worth throwing the baby out with the bath water and defeating this bill. Is that your evidence?

Mr. Tamaki: I do not think we are saying that. We have actually thought about this quite a bit in terms

of how to respond to that question.

Senator Meighen: So have we.

Mr. Tamaki: Let me try to respond. I am not sure, at the end of the day, whether we will answer your question. If not, you can ask me again. It is clearly a very difficult question for us to answer. It is not one that has been focused on by our committee. To some extent, you are getting the views of the two of us. Nonetheless, I think it is fair to say that ordinarily our committee advocates that legislation be enacted as soon as possible simply to give taxpayers clarity on their position, and delays in enacting legislation have implications, including accounting presentation concerns.

With respect to Bill C-10, you have heard from numerous people. Some members of the tax committee have argued for a complete rewriting of the bill on the basis that it is unworkable. Others say that targeted amendments could be made to fix it. Others say, ``Pass it, because we are interested in other areas, and we are anxious to get the other areas in the legislation.'' Amongst our members, you will find all these views represented. In our view, there are flaws with the bill, and we have discussed two of them today, and others have mentioned them as well. At the same time, we have not had a technical amendments bill passed since 2002, and many of the proposed amendments have been outstanding for just too long. We recognize that if this bill is not passed, a pipeline of materials within the Department of Finance is further delayed. Those would be reasons to pass the bill.

As far as the flaws are concerned, although we think that some of them can eventually be fixed by further discussions that our committee and others may have with the Department of Finance, the department has not given us any indication that it agrees that changes are necessary and that they will ultimately make changes that are appropriate. If these flaws are a concern, then I do not think we can recommend that you pass the bill, if the flaws were the only concern. Once this legislation leaves the Senate, we have and you have no assurance that these flaws will be fixed. By the same token, I think it is up to senators to decide whether the benefits to taxpayers of passing the bill outweigh the problem of having flawed legislation.

Senator Meighen: Thank you, Mr. Tamaki. That is very helpful. I am pleased to see you anticipated that question. Good counsel always does.

To what extent would a broader comfort letter or other comfort letters allay your concerns?

Mr. Tamaki: I have read the comfort letter that was given to the pension funds. I have not studied it closely. It is quite specific as to the changes they will make in the sense that it says how the words will be changed. If we could have that level of comfort, it would be quite comforting. You have to evaluate the words and decide whether they give you comfort or not.

Mr. Harris: This would be harder to draft, I would expect. It was targeted and specific for the pension funds. It might be more difficult to capture the wording.

Senator Massicotte: I am not sure I understood your answer to Senator Meighen's questions. You have a choice to either approve the bill as it is or refuse it completely. I know about wish lists and comfort letters and so on. I did not understand your answer. Do you recommend to pass it or not pass it?

Mr. Tamaki: We did not answer that question. We said it is your job to evaluate the benefits to taxpayers of passing the bill versus the problem of passing the bill with its flaws.

Senator Massicotte: I appreciate that, but you are the expert. You know the consequences and the content of the bill. In your best opinion, what do you think?

Mr. Tamaki: It is not my job, with respect, to weigh the benefits of this legislation to various taxpayers against the problems of flawed legislation. There are many, including myself, who have no investments in foreign trusts and to whom it does not matter whether you pass the bill or not.

Senator Massicotte: Mr. Harris, do you agree with that answer, or do you wish to be more specific?

Mr. Harris: It is hard to say with the various competing interests that you have to weigh here, and that is the problem, I suspect, you have. There are competing interests. Some provisions in this bill need to be passed. It is hard for us to say that by delaying the bill, those interests should be set aside.

Senator Massicotte: That is real life.

Mr. Harris: That is fair. They have been waiting for some of these provisions since 2002. Would another delay matter that much to them? It is hard for me to answer that question.

Senator Massicotte: If I fast-forward the answer, let us say the bill is passed as is. Given your expertise and the issues involved, is there an alternative solution for your clients that within a year or two we find the industry developed some method of structure to avoid the problems we are worried about?

Mr. Harris: My sense is probably not. In fact, these rules have been effective, as I think you know, since January 1, 2007, generally; in a sense, taxpayers have been living with these rules for a year and a half now already.

I know of transactions that have nothing to do with the avoidance issue that the Department of Finance is concerned about. When we look at these rules and there is a trust offshore for some foreign, non-tax reason, it interferes with the process, as Mr. Ruby said. As a consequence, the usual reaction is to try to figure out a solution. My personal experience is that at the end they have to do the transaction some other way, not including a trust.

Senator Massicotte: And have they found a way?

Mr. Harris: It may not be ideal for the foreign jurisdiction, for whatever reasons.

Senator Massicotte: Do they satisfy the commercial interests of the transaction?

Mr. Harris: I cannot say they satisfy their commercial interests the way they would like.

Senator Massicotte: I appreciate that.

Mr. Harris: It does create real problems. The jurisdictions have trouble understanding why these laws are so complicated and difficult to deal with, when they recognize there is no Canadian avoidance involved.

Mr. Tamaki: No one has to invest his or her money in a foreign commercial trust. Many would like to because of diversification and returns, but they do not have to. The pension funds would like to because of the reason they put forward. The result is that if we pass the bill as is, and taking into account the comfort letter, I think you will find that only pension funds will make investments in these foreign funds. That will be to the detriment of those who would like to do it. However, the world will not end. Some people will get less, not as good a return or not as good diversification as they would like. The selection of investments in which they can invest will be reduced. They will still be able to invest in foreign corporations. They will be caught by the FIE rules perhaps, in which case they will have to deal with that. If those FIE rules are too complex for them, they will not make that investment either. I think what is happening is that we are narrowing the available investment choices for the people who have the money to invest.

Senator Goldstein: Gentlemen, thank you very much for your enlightening comments. As you can see, we are all grappling with the best possible way we can deal with this legislation, in the interest of all Canadians.

If we were to add all tax-exempts not-for-profits — universities and hospitals, for instance, all of which have funds like the pension funds but are not at the moment taxable funds to the comfort letter by proposing a change to the legislation; if we were to do a fix as well for the FIEs; if we were to deal with the restrictive covenant issue, a relatively simple fix; and if we were to deal with the problems that the Desjardins Group has raised, assuming we could find a way to deal with those four issues — and setting aside the other matter which has exercised us so greatly — would you be prone to say to us, if that is what you are going to do, that it is not the best solution, but it is not the worst solution?

Mr. Harris: It would solve some of the issues we have discussed. It does not deal with taxable persons who might invest in these types of structures.

Senator Goldstein: That is certainly true.

Mr. Harris: It does not address the dual resident trust issues. Conceptually, why should a taxable entity be treated any differently than a tax-exempt university or pension? Conceptually, you would say it should be treated the same. Likewise, the issue of the dual resident trusts is something we and others have mentioned should be looked at as well. What you said goes some way to dealing with some of the issues raised but does not go the complete way.

Senator Goldstein: We are trying to grapple with this and we are having a tough time, as you can see. Thank you very much.

The previous witness, Mr. Ruby, pointed out to us that in his view, in his experience, if we were to suggest three, four or five fixes and pass the legislation back to the Senate subject to those fixes, and if the House of Commons were to adopt the fixes, then the likelihood would be that this legislation would not be revisited by the department for years and years, in order to deal with the other things that would be fixed. Is that your experience as well?

Mr. Tamaki: It would seem to me that it depends on what fixes you are talking about. If you are talking about the fix of repealing Part 1, if that is your fix, then you can be sure something will come back. However, if you are talking about a fix that will exempt only certain taxable pension funds from the NRT rules, that will not solve the problem for everyone else. As I keep saying, there is no assurance that that problem, that flaw, if you believe it is a flaw, will be fixed.

Senator Goldstein: We will be hearing from the universities next week. I can only assume they will want to be included.

Mr. Tamaki: I expect that is right.

Senator Ringuette: It seems that we are constantly faced with a leaking house. One year it is the basement and the next year it is the roof. We are doing that over and over again. Canadians have been promised revised, simplified, fairer tax legislation for all Canadians and we are still living in the house that leaks at both ends.

In your review of Bill C-10, have you identified retroactivity provisions? For instance, Mr. Harris, you mentioned earlier in your comments that rules that were put in place a year and a half ago find themselves in this legislation. I am assuming this legislation is retroactive to the rules that were put in place a year and a half ago.

Mr. Harris: I think the proper term is retrospective, in the sense that once these rules are enacted, they generally apply starting January 1, 2007. What I was commenting on is if they were enacted tomorrow, it could affect transactions that took place starting January 1, 2007. As a consequence, as transactions take place, advisers are aware that these draft rules are outstanding and you have to take them into account in looking at a transaction, with the expectation that they could very well become law based on the form that they are in.

Senator Goldstein: It is not unusual for a bill of this nature to determine a target date. We all talk about how terrible retroactivity is in legislation and specifically in tax legislation. However, where you have a piece of legislation that contains a retroactivity clause, but it has been known to the profession for a year or more, are you shocked by that? I, frankly, am not.

Mr. Harris: No, it is common. When the Minister of Finance presents his budget, at times there is notice of ways and means and shortly thereafter is the legislation. That legislation is very often effective at four o'clock on the day of the budget or the next day. This is not uncommon.

Senator Goldstein: You would live with that part?

Mr. Harris: Yes.

Mr. Tamaki: I should point out that it is not all bad. Many of these technical amendments were requested by taxpayers to cure defects in the legislation.

For the most part, those defects would be cured from the time they existed, although it may not even have been known. I have not looked at it, but I am sure much of this legislation is retroactive to an earlier date. That is primarily because it is in favour of the taxpayer.

The Chair: I have taken the liberty of looking through the compendium of correspondence with the Department of Finance and with this committee that goes back to before 2000. It corroborates what you have stated.

Many of the things you, on behalf of the tax paying public, have asked for purport to be implemented in this bill. If the bill is thrown out — to use Senator Meighen's phrase — it is throwing out the baby with the bathwater. Is that not true?

Mr. Tamaki: I think that is true. However, I agree with the way Mr. Ruby described the comfort letter system. It would apply in the same way to these technical amendments which are largely in Part 2. The tax community assumes the bill will eventually be passed. If the bill does not pass, I do not think that we will all say that is awful because all these promises have been broken. By the same token, there are other comfort letters that have not reached bill form yet that we are waiting to see. We understand that we may not see them until this bill is passed.

The Chair: You can see that you have this committee's attention. It is evident that men of your, Mr. Ruby's, Mr. Marley's and others expertise in the field have come here and have told us basically the same things.

However, none of you have come with specific targeted amendments or a draft of another type of comfort letter that would deal with the NRT rules, the FIE provisions or the restrictive covenants. Therefore, this is a hypothetical question to you gentlemen. You may not have had time to come today with proposed amendments.

This bill has been with this committee since November 27. If Parliament rises for the summer within the period that we all think it will, it simply will not pass under any scenario before the summer. Would

you or people that you work with be able to write something concrete over the course of the summer?

You know why I am asking this, gentlemen. We are doing our best, but we are not experts. You say, on the one hand, that it is our job, but we are creating a forum and we are trying to provide an opportunity to highlight the flaws and to use our judgment weighing the evidence. It is clear that the experts in the field are not comfortable with this bill for the reasons you have said, but no one has given us the concrete solution.

We have asked Department of Finance Canada and they say no it is okay the way it is and the stakeholders know about it. The Minister of Finance says it is his policy to have the NRT and the FIE situation dealt with aggressively.

Therefore, the amendments will not be forthcoming from the department or from the legislator unless we make some suggestions based on the evidence. I am wondering how we get the concrete solutions. It is an option we have over the summer to hire some of you people to come in here to work with us to determine the concrete solutions. The other thing is to go ahead based on what the minister and his officials have told us. We have tried to address the pension situation and there is a letter of comfort. The bill could pass. We have another part of the act that you have not talked about that sounds to us like a case has been made to make amendments and amendments will be put forward. However, we do not have suggested amendments on these critical tax matters.

Mr. Tamaki: Let me try to answer that.

If we had the time and the resources, we could come up with suggested amendments to the legislation. However, I expect the Department of Finance Canada would reject them. As much as I know you would like to see suggested amendments, I am not sure that we want to spend the time developing something that the Department of Finance Canada will reject. We would like to develop something that would work for everyone and that would be acceptable to the Department of Finance as well.

If the Department of Finance officials had an incentive, instructions or guidance from the minister or perhaps from the Senate about what they would like to see, we could work out something together. However, I do not think it can be done unilaterally by us. We need to know what they are concerned about so we can try to address that in any changes we make. Part of it is that we have to convince them that the changes we are making are not detrimental to them or that they can deal with them.

The Chair: I put the question to you, Mr. Tamaki, and you answered it. You said that the time it would take to do it and the anticipated negative response to the fruits of our efforts make it not worth doing. Therefore, it is over to you, Senator Angus and committee, good luck to you. Is that fair?

Mr. Tamaki: I do not think so. I am not sure how this happens, but if Department of Finance officials could be convinced that the legislation is flawed, then we could work with them to fix those flaws.

The Chair: Are you saying that thus far, despite your best efforts, you have not convinced them to that end?

Mr. Tamaki: I do not think we have.

Mr. Harris: No, I do not believe we have.

Senator Goldstein: I have a hypothesis and I do not know whether it would be supported by anyone in this committee.

Hypothetically, if we were to say to the Department of Finance that these are our concerns and this is what we think should be changed. Please consult with the Joint Committee on Taxation — I do not

really care who they consult with frankly — and come up with amendments that you may not like but that would satisfy the professionals because we are unable to deal with the bill as it now stands. Do you think that would incite them to work with you?

Mr. Harris: They take their instructions from the minister.

Senator Goldstein: Of course they take the instructions from the minister. I tried to ask the question gently.

Do you think the department and the minister would be willing to allow them to work with you that way during the course of the early summer so that we could see something well before we reconvene?

Mr. Harris: I do not know how we can speak on behalf of their office.

Mr. Tamaki: I do not know how to answer that question. We cannot force them to negotiate with us.

Senator Goldstein: I know you cannot.

The Chair: First, thank you for being here. We are putting this hypothesis to you. We are perplexed and you are perplexed. There are various ways forward and you have outlined four options.

Talk about it among yourselves — perhaps Mr. Ruby and Mr. Marley and some of the others — and if you come up with some suggestions, let us know. We will make a suggestion to the ministry that they should talk to you; so for that part of the negotiation, there will at least be another side to talk to. I think we can assure you of that.

Mr. Tamaki: I guess the thought that comes to mind is Mr. Ruby's suggestion that this question be put before the advisory committee. Then we may be able to get more information about what the concerns are on both sides. That information would be useful to develop a solution to the impasse.

The Chair: On behalf of all of the members of this committee, thank you both very much — and your members, whoever participated in this excellent work — for coming and adding to our confusion about a very difficult subject. It was very helpful, though, so thank you.

Gentlemen, tomorrow, unfortunately, I have a personal commitment. I will not be able to attend our meeting at 10:45. The deputy chair will be in the chair.

We originally were going to hear, for our two-hour period, a panel of three mayors — the mayors of Halifax, Toronto and Montreal. We have just been advised the mayor of Halifax has opted out. Therefore, there will be the two mayors. The committee will start at 10:45, and that will be it.

It should be an hour-long presentation. If there are any questions, the steering committee will try to meet. I have made suggestions to the deputy chair and he will talk to the other member, Senator Moore. We will try to meet on Monday or Tuesday and have some news for you at the beginning of next week as to what we suggest.

You can see that this thing is getting bigger and more complicated. Any wisdom that any of you could bring to the chair would be deeply appreciated. We are all trying to get to the same end and do our job as sober second thinkers. At the same time, we do not want to unduly or for the wrong reasons impede this legislation.

Senator Tkachuk: It is important to note that despite some of the concerns of the witnesses, we could pass this bill with the observations necessary to clean up some of these problems. They claim that they are already working under the provisions of the bill in certain cases for the year 2007. The longer the delay, the more worrisome it becomes and people will not know what they are working under.

My view would be that if we could find an observation that we could attach, asking the department to go back to the drawing board on key issues we have identified — or even include a little report from some of the witnesses that have come forward, like this group and others — we could get them working on it and ask them to bring amendments to the bill. We can do that.

The Chair: Thank you, we will take that under advisement. We will deliberate. We have a number of options and that is one of them. It is important that we check to see if Minister of Finance's office is talking to these witnesses. That would be the easiest way, if they could negotiate a settlement, but if they will not talk to them, I have a problem with that.

Senator Tkachuk: Mr. Tamaki said something interesting. He said ``we could do some amendments, but we believe they will not accept them."

The Chair: These Tamakis tend to pretend they are negative, but they are very positive underneath; they are inscrutable.

Mr. Tamaki: The only point I was trying to make is that what concerns both of us is a matter for full and frank discussion with the Minister of Finance. If you asked us to come up with an amendment, we could do that. We could say, just repeal the whole thing. That would be a simple amendment and that would quite possibly satisfy us, but that would not satisfy the Minister of Finance, and that is really a nonstarter.

The Chair: In any event, senators, that is the state of play. Thank you again, witnesses, and thank you, senators. We will get there one day.

The committee adjourned.