The Joint Committee on Taxation of
The Canadian Bar Association
and
The Canadian Institute of Chartered Accountants

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Standing Senate Committee on Banking, Trade and Commerce

Presentation of the Joint CBA/CICA Taxation Committee on Bill C-10
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Speaking Notes for

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Co-Chair, Joint CICA/CBA Taxation Committee
Bruce Harris, Co-Chair, Joint CICA/CBA Taxation Committee

Thank you Mr. Chair and Honourable Senators. We are pleased to appear before the Committee today at your request.

We are here as co-chairs of the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants. My name is Paul Tamaki. I am a partner of the law firm of Blake, Cassels & Graydon LLP. Bruce Harris is a tax partner of accounting firm, PricewaterhouseCoopers LLP.

The Joint Committee on Taxation is made up of tax accountants and tax lawyers, who are members of the Canadian Institute of Chartered Accountants or the Canadian Bar Association. There are approximately 11 members from each profession.

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 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 Legislation Division of the Tax Policy Branch.

Bill C-10 has a long history. Part 1 contains the non-resident trust and foreign investment entity provisions. This first appeared as draft legislation in 2000. Part 2 contains so-called technical amendments to the Income Tax Act. Part 3 relates to bijuralism, a concept which the Canadian

Bar Association certainly supports in principle, and which as far as we know is non-controversial.

Our comments focus largely on Part 1.

The Joint Committee has written 12 letters and submissions on the non-resident trust 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 their overall complexity and the concern that taxpayers would have difficulty comprehending and complying with them.

Our submissions have included most of the matters raised by previous witnesses before this Committee. We have had several meetings and conversations with Finance officials to discuss these provisions. A number of our recommendations are reflected in the legislation. Other concerns have not been resolved. We have continued to meet with Finance officials to discuss our concerns, most recently on April 1 of this year.

We would like to highlight two points from our latest discussions with Finance officials. We discussed two aspects of the non-resident trust legislation: first, the application of the NRT rules to legitimate investments in offshore commercial trusts; and second, the application of the provision to so-called dual-resident trusts.

You have heard a number of submissions as to why tax-exempt pension funds require an exemption from the application of the NRT provisions. You have heard the existing provisions described as "unworkable." We understand that representatives of the pension funds have received comfort letters which appear to satisfy their concerns. Taxable investors and tax exempts that are not covered by the comfort letter may have the same legitimate reasons for wanting to make the same international investments, namely diversification and enhanced returns on investment. However, the same NRT tax issues that created problems for the tax-exempt entities also apply to these investors. We can see the benefit of a targeted provision which allows tax-exempts to avoid having to deal with the NRT provisions. However, if Bill C-10 is problematic for these tax exempts, it is equally problematic for other investors.

In our recent discussions with Finance officials, we discussed possible ways to address our concerns. The problem here is reflected in your Committee's exchanges with Finance officials when they appeared on December 12. The Department of Finance is concerned about a type of tax planning where certain taxpayers were transferring property to offshore trusts in a manner where future appreciation of the property was not taxed in Canada even though the funds eventually came back to a Canadian. An example of this is an international estate freeze whereby the future growth in a family business corporation is transferred to a trust that is not taxable in Canada.

Finance agrees that there should be an exemption for legitimate investments in foreign commercial trusts. This is the intended purpose of the exemption in paragraph (h) of the definition of "exempt foreign trust." This is one of the matters that Mr. Marley spoke about when he appeared before your Committee on May 15th. The concern we have with the wording of that exemption is that international investments are typically structured to suit the widest possible group of investors and to provide flexibility as to 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 these 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 a broad discretion in structuring underlying investments of the fund. Some of these underlying structures could offend the technical language of the exemption for commercial trusts in the NRT rules, even though it is quite unreasonable to think that the fund could be used to carry out an international estate freeze. If there is any risk that the fund will be a NRT and the fund is aware of the risk, the fund would probably not permit investment by Canadians. Even worse, if the fund is not aware of the risk and has Canadian investors, the fund and its Canadian investors can be ``exposed to very significant Canadian tax.

We have brought these concerns to Finance's attention. We believe that they understand our concerns. However, apart from their comfort letters to the tax exempt pension funds, they have not given us any indication that they agree that further modifications should be made. This is because of their primary concern that any changes could allow these entities to be used to carry out international estate freezes. The result is that Bill C-10 does not go far enough to make the provision workable for investing in these offshore commercial trusts.

Another area we have discussed with 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 potential double taxation. Mr. Gagnon discussed this when he appeared before you in December. We have discussed this double taxation matter with Finance. Finance is concerned 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 double taxation issue in some cases.

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. Some are favourable to the taxpayer. The Joint Committee has also made submissions on many of these technical amendments. For your information, we have tabled that correspondence as well. As with most of our submissions, some points have been addressed, others have not. Nevertheless, we will continue our discussions with Finance officials in an effort to make the Income Tax Act more workable, more understandable and fairer.

Thank you very much for asking us to speak to you about these matters today. We would be pleased to answer your questions.

Yours truly,

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