Canadian Tax Highlights

Editor: Vivien Morgan, LL.B.

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Fire and Rain

The TCC's decision in *Safety Boss* confirms that Revenue should not substitute its own judgment for the taxpayer's in determining the reasonableness of a bonus or fee. Reasonableness, ultimately a question of fact, is determined by reference to the nature of the payee's contribution and to the amount that an arm's-length party would pay in similar circumstances.

Safety Boss (SB), essentially a one-man company, was in the business of oilfield firefighting and capping blowout oil and gas wells. Miller, its president and 99 percent shareholder, was an oilfield fighter with significant experience, particularly in the Middle East, and had developed skills and a personal reputation worldwide for dealing with the most serious oil fires. On the basis of Miller's expertise, SB obtained a contract with the Kuwaiti government to extinguish the oilwell fires expected to be set by retreating Iraqi troops in the Gulf War. SB's success in extinguishing those fires was attributed to Miller's leadership, expertise, and innovative techniques.

In June 1991, Miller had incorporated a Bermudan corporation, SBIL. He went non-resident himself on August 2. On August 30, the day before its year-end, SB declared (and later deducted) a $3 million bonus to Miller, who then resigned as SB's president and director and entered into an exclusive employment contract with SBIL. In turn, SBIL contracted with SB to provide firefighting services and to make Miller's services available. SB deducted the $1,973,333 fee paid to SBIL for its services from September 1 to November 14, 1991, when the Kuwaiti fires were extinguished. Miller reported $2.5 million of the $3 million bonus he received from SB, apparently on the ground that the remaining $500,000 was attributable to the period after he went non-resident. Revenue disallowed SB's deduction for all but $67,500 of the $500,000 non-resident portion of the bonus and for all but $126,000 of the $1.97 million fee to SBIL, on the basis that the excess amounts were not reasonable within the meaning of subsection 69(2).

The court said that there was no readily apparent difference between the concepts in section 67 and those in subsection 69(2). It would be inappropriate, the court said, for Revenue to determine the reasonable portion of the $3 million bonus based on whether it was taxable in Canada. Furthermore, determining reasonableness by reference to a salary paid to another employee was a flawed approach because it did not take into account Miller's rainmaking and technical skills. Although Revenue's policy is not determinative, the court said, it is "sometimes useful to look at [it], particularly where the assessment . . . is a departure from a beneficial and sensible practice." That policy was not to challenge the reasonableness of a bonus paid to a principal shareholder if the profits were "attributable to [his] special knowhow, connections or entrepreneurial skills." Furthermore, the amounts paid to Miller could not be said to be unreasonable because the Kuwaiti government, clearly an arm's-length party, in fact paid more for what were essentially Miller's services. In a footnote, the court said that it had "with some difficulty resisted the temptation to comment on what Mr. Miller received in comparison to what presidents of large public corporations or baseball and basketball players get paid."

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In This Issue

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Rental Losses Deductible

The TCC recently found for the taxpayers in *Stremler* and *Jones*, which were heard together as test cases for other investors in a residential condominium tax shelter marketed in the late 1980s and early 1990s. The TCC found that the taxpayers' condos were adventures in the nature of trade and that rental losses incurred before resale were currently deductible. A news release issued by the taxpayers' representatives indicates that Revenue will not appeal.

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The taxpayers testified that they purchased condo units in hopes of resale at substantial profits and thought they could earn rental income to offset costs in the interim. The taxpayers were not estopped from claiming that the units were inventory, because their characterization of the units as capital on their tax returns was a statement of law, not fact, and a representation of law is not grounds for estoppel. The TCC accepted that their primary motive in purchasing was resale and said they had a reasonable expectation of profit therefrom, but not from rental income. The units were found to be inventory and thus the taxpayers must calculate their income from business under subsection 10(1.01): the SCC in *Friesen* held that real estate held in an adventure in the nature of trade is inventory.

The timing of deductibility for the associated carrying costs was more problematic. Such costs are capitalized for subsection 10(1) inventory. But the TCC said that inventory held in an adventure in the nature of trade must be valued at the cost for which it was acquired, thus precluding capitalization. Following the SCC in *Canderel*, which established the most accurate picture of a taxpayer's income for the year as the guide to calculating profits, the TCC favoured current deductibility. Although this result may not reflect the intention of Parliament's quick reaction to *Friesen*, the court said that it was correct on the basis of the wording of subsection 10(1.01) and the statutory scheme of section 10.

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FSC Fight

Recently the World Trade Organization ruled that the US foreign sales corporation (FSC) tax program is an illegal subsidy. The US Treasury secretary said that the United States will not abandon the program and will pursue negotiations to avoid EU retaliation. The FSC program was created in 1984 to level the playing field between US exporters and European manufacturers that were obtaining tax rebates for EU export sales. FSCs are integral to competitive financing for US outbound leases, and US-based arrangers within the structured finance industry are watching the outcome closely. The market is still robust owing to the assumption that appropriate grandfathering will be granted in the event of changes to the economics of this type of structure.

FSC structures are designed to provide an incentive for US products that qualify as export property—generally, property that is predominantly US-manufactured and that will be used by the purchaser outside the United States. Complex measurement rules determine whether the property qualifies as export property and for FSC benefits. Of the two basic FSC structures, an ownership FSC is more commonly used in financing big-ticket equipment such as aircraft. The key steps to establishing an ownership FSC that acts as lessor commence with a taxable US entity organizing a special purpose corporation (SPC) to borrow funds and serve as FSC's owner. Typically, US Taxco contributes 13 to 15 percent of the aircraft's cost as common share equity to SPC. SPC borrows the balance of the funds from US lending institutions that purchase SPC-issued notes secured only by FSC stock. No security interest in the aircraft is granted. SPC then forms FSC with nominal capital, and SPC purchases the equipment and contributes it to FSC for FSC stock. SPC has been clearly segregated as the borrower of funds. FSC leases the equipment to an arm's-length foreign lessee.

Among other criteria, a corporation may elect to be a FSC if it was organized under the laws of a US possession or certain foreign countries that have an acceptable exchange-of-information agreement with the United States, such as Barbados or the US Virgin Islands. Because the non-US lessee generally enters into triple net leases for use predominantly outside the United States, the FSC's income as lessor is subject only to the "home country" low foreign tax rate and not to US tax. Thirty percent of the dividends FSC pays out of its taxable income—gross rents less depreciation and other costs—are exempt from US tax. Typically, all of FSC's cash flow is dividended out to allow SPC to service its debt. The 70 percent balance is taxable to SPC under subpart F, at an effective US rate of about 24 percent (70% × 35%). The benefit of the FSC structure materializes when SPC is consolidated with US Taxco: SPC's interest expense generates a tax loss that US Taxco can use to shelter its income otherwise taxable at 35 percent. Some of this tax incentive is shared with the non-US lessee via a lower rent.

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Ah, Sweet Simplicity!

The impending switch in federal-provincial tax collection agreements—allowing provincial personal income tax rates as a percentage of taxable income—will subtly change the future of the personal income tax system in Canada. This year's federal budget showed that such a change freed Finance to redesign the federal rate structure, which in turn will prompt the provinces to reexamine their own rate structures. The table shows the main 1999 rates to facilitate seeing the real changes in store for provincial taxpayers and their advisers.

1999 Personal Income Tax Rates

	As % of federal	First bracket	Second bracket	Top bracket	Top marginal rate
Basic federal rates		17.0	26.0	29.0	30.9
Provincial rates					
Nfld.	69.0	11.7	17.9	20.0	22.0
PEI	58.5	9.9	15.2	17.0	18.7
NS	57.5	9.8	15.0	16.7	18.3
NB	60.0	10.2	15.6	17.4	18.8
Que.[a]		20.1	23.1	26.1	26.1
Ont.	39.5	6.7	10.3	11.5	17.9
Man.	48.5	8.2	12.6	14.1	18.1
Sask.	48.0	8.2	12.5	13.9	19.4
Alta.	44.0	7.5	11.4	12.8	14.3
BC	49.5	8.4	12.9	14.4	21.4
Yukon	50.0	8.5	13.0	14.5	15.2
NWT	45.0	7.7	11.7	13.1	13.1
Nunavut	45.0	7.7	11.7	13.1	13.1

[a] See note in text on Quebec federal rates.

Federal tax rates in Quebec are 16.5 percent lower than in other provinces, reflecting the abatement for opting out: effective federal rates were 14.5, 22.1, 24.7, and 26.6 percent in 1999. Most provinces have some form of low-income tax relief, and their surtaxes and flat taxes cut in at varying income levels. Full details on the 1999 systems are available in the 1999 edition of *Finances of the Nation*, published recently by the Foundation. Space constraints prohibit showing all possible provincial rates here. The provinces' reaction to their newfound freedom is impossible to predict, but their budgets will probably reveal details. Alberta will change to a single-rate system, with the 11 percent provincial tax starting at no less than $11,000, when it officially de-links. Other provinces will no doubt try to maintain existing tax collection levels despite federal cuts. Certainly all will re-examine the role of the personal income tax system in raising revenue and adjusting for economic disparities.

Revenue will continue to collect federal and provincial personal income tax (except in Quebec), which means one return and one cheque. All will apply their rates to the same tax base, leading to a high degree of uniformity and implying simplified tax planning and compliance. With luck, it will be some time before the provinces begin to yearn for their own definitions of taxable income.

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Same-Sex Couples' Tax Relief

Changes in a bill tabled on February 11, 2000 mean that same-sex couples will soon be treated the same under tax law as opposite-sex common law couples. Amendments to the Income Tax and Customs and Excise Tax acts and the ITARs extend benefits and obligations of opposite-sex common law couples to all couples who cohabit in a conjugal relationship for at least one year.

According to Revenue's question-and-answer package, the proposals are effective for 2001 and subsequent taxation years. For tax years 1998-2000, same-sex partners may jointly elect such treatment in a written request made by April 30, 2001 (or by June 15, 2001 if at least one partner is self-employed). The letter must be signed by both partners, and must include their names and social insurance numbers. Eligible same-sex couples must assess whether they will benefit from the election, bearing in mind that some credits are based on family income and that deductions such as child-care expenses must be claimed by the lower-income partner. Eligible same-sex partners may claim the spousal amount and combine charitable donations and medical expenses. Credits transferable to a spouse are also encompassed, including the age amount, the disability credit, the pension credit, and tuition and education credits. RRSP rules are also affected: for example, same-sex partners may contribute to spousal RRSPs. On the other hand, income-splitting arrangements in place may be neutralized.

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CP Back to TCC

The FCA has remitted the *CP* case back to the TCC "to make such factual and legal determinations as [Judge Bonner] considers necessary solely with respect to [GAAR]." The FCA said that it wished to have confidence that the necessary fact findings were made, and because of GAAR's complexity the FCA should act in an appellate capacity rather than making its own findings of fact from the record.

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US AMT Overrides Treaty

The recent US Tax Court decision in *Pekar* confirms that a US citizen living in Canada may suffer double taxation because of the US alternative minimum tax (AMT). An AMT liability arises for the amount in excess of the year's regular tax liability. Foreign taxes are only creditable against 90 percent of AMT, leaving a US citizen with only Canadian-source income with at least 10 percent of AMT to pay after a foreign tax credit (FTC) for the generally higher Canadian tax. *Pekar* indicates that the relief from double taxation in the Canada-US treaty probably does not override the AMT limitation.

Pekar involved a US citizen who emigrated to Germany; he filed US tax returns without considering AMT. An IRS audit determined an AMT for 1995—when the taxpayer resided in both Germany and the United Kingdom—and the 90 percent AMT limit applied. The court concluded that the AMT limitation did not violate the US treaties with Germany and the United Kingdom, which both state that the allowable FTC is "subject to the limitation of the law of the United States." The court ruled that the provisions of the US-Germany treaty were consistent with the 90 percent AMT limitation and therefore did not override it even though the treaty took effect after the Code section's enactment. The Canada-US tax treaty contains similar language.

US citizens working in Canada or other high-tax countries may be subject to double taxation, although FTCs eliminate all or most of their regular tax liability. AMT may be recoverable in a later year as a credit against an individual's regular tax in excess of AMT—for example, when the individual repatriates and earns US income. Alternatively, earning US-source income subject to regular tax may both allow recovery of AMT previously paid and avoid future double taxation, but for some individuals there may be no recoverability and future double taxation may be unavoidable. (US tax may be creditable in Canada; Revenue has issued guidance on creditability.) Congress has seen many proposals to modify or eliminate AMT; relief may be a long time coming.

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Budget's International Changes

The federal budget includes corporate tax rate reductions for non-manufacturing and non-resource sectors. However, proposals in the international area are tightening.

Existing thin capitalization rules disallow interest paid by a Canco to a specified non-resident on indebtedness that exceeds three times equity. For tax years beginning after 2000, the debt-equity ratio is reduced to 2:1; that ratio is generally calculated on a monthly average basis; and the rules are extended to third-party loans that are guaranteed or secured by a specified non-resident. The inclusion of guaranteed debt is controversial and could disrupt many normal commercial financing arrangements. For example, Canco's borrowing costs may be significantly higher without a parent company's guarantee. The lack of grandfathering is particularly troubling: under the terms of its debt, Canco may be prevented from refinancing or may face financial penalties for doing so. Consultations to be initiated will explore extending the thin cap rules to other arrangements, including borrowings by partnerships, trusts, and branches, and "debt substitutes" such as certain types of leases. The budget also proposes to repeal the non-resident-owned investment corporation (NRO) regime. Existing NROs will retain that status until the end of their last taxation year beginning before 2003, but, except for arrangements entered into in writing before budget day, they may not issue new shares except by way of reorganization or increase debt levels to finance new investments.

A complex series of proposals on weak currency borrowings addresses the SCC's decision in *Shell*. If the proceeds of foreign currency debt are converted to a different currency before they are used to earn income and if the interest rate exceeds by more than two percentage points the rate on equivalent borrowing in the currency actually used, then only the notional interest on the equivalent debt is deductible. Any foreign exchange gain or loss realized on debt repayment is adjusted by the disallowed interest, and any foreign exchange gain or loss on debt repayment or on settlement of any related hedge is treated as ordinary income. The proposal does not apply to a corporation if its principal business is the lending of money or if the borrowing is $500,000 or less. The measure applies from July 1, 2000 to indebtedness incurred after February 27, 2000.

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Dividends to Capital Gains

The February 28, 2000 federal budget proposes to reduce the capital gains inclusion rate for all taxpayers from three-fourths to two-thirds for dispositions occurring on or after that date, generally reducing the top rate on capital gains by approximately 4 percent. The applicable corporate income tax rate on capital gains thus moves closer to the part IV tax rate of 33⅓ percent generally imposed on the private company recipient of dividend income from non-connected payers. An individual's top marginal tax rate on capital gains is reduced to slightly below that of dividends in all provinces: tax advisers will now be looking to convert individuals' dividends into capital gains.

The inclusion rate for goodwill apparently remains unchanged. Furthermore, the budget did not suggest increasing the 25 percent relief threshold for estates under the stop-loss rules that reflect the previous non-taxable portion (25 percent) of capital gains. Taxpayers who disposed of appreciated capital property in 2000 before budget day will be disappointed to learn that the reduced capital gains inclusion rate does not apply unless the gain's recognition can be deferred through the reserve mechanism or a rollover. Of course, those who sold losers in that period scored on the cutoff date.

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A Trust Menagerie

A surprisingly large number of trusts are defined for income tax purposes either legislatively or by common usage.

■ **Alter ego trust.** Contained in December 17, 1999 proposals (the proposals). An inter vivos trust created by a taxpayer who has attained age 65; he or she is entitled to receive all trust income for life, and no one else may use trust income or capital. Property may be rolled in and is generally deemed disposed of at death.

■ **Bare trust.** The trustee has no significant powers or responsibilities and can take no action regarding trust property without instructions from the beneficiaries. Revenue says that the trustee merely holds legal title to the trust property and acts as an agent for the beneficiaries; the settlor is the sole beneficiary, and the property may revert at any time. In the proposals, bare trusts will be ignored under the Act.

■ **Blind trust.** Used to avoid conflict of interest in the discharge of duties. The Conflict of Interest and Post-Employment Code for Public Office Holders requires a public office holder, on taking office, to divest himself or herself of certain assets or place them in a blind trust. Trustees generally have complete discretion to deal with the trust assets, but they cannot disclose their nature or composition to the settlor or someone else on his behalf. An inbound transfer is proposed to be a rollover generally, flowing through the settlor's ACB or cost amount.

■ **Charitable purpose trust.** An exception to the common law rule that a purpose trust is invalid: such a trust may also enjoy favourable tax treatment as a charitable foundation registered as a charity for tax purposes. The common law definition of "charitable purposes" is based on voluntary or altruistic gifts to third parties and requires an objectively measurable and socially useful public benefit available to a sizable sector of the population—relief of poverty, advancement of education, advancement of religion, and other purposes that will continue to evolve with social developments.

■ **Commercial trust.** An informal term for a trust that is not a personal trust—that is, units or interests are bought and sold—or a trust that carries on a business. The top marginal rate applies on all undistributed income of non-personal trusts. The trust may also be taxed on distributions to designated persons such as non-residents or tax-exempts.

■ **Discretionary trust.** An informal term referring to the trustees' discretionary power to distribute income and/or capital to beneficiaries; the discretion is not only as to timing.

■ **Henson trust.** In Ontario, a disabled person with income or assets over prescribed limits (currently $5,000) loses public benefits and services. A beneficial interest in a discretionary trust is not counted, only actual distributions.

■ **Health and welfare trust.** Defined in IT-85R2 as an employer-funded trust established to provide certain health and welfare benefits for employees—a group sickness or accident plan, private health services plan,

SHOE *by Jeff MacNelly*

group term life insurance policy, or any combination thereof. Employer contributions are deductible but not included in employees' income. Plan benefits other than for wage loss replacement and plan-paid premiums for group term life insurance are not taxable.

■ **Immigration trust.** A non-resident trust with a Canadian-resident settlor and beneficiary; taxed on worldwide income or its FAPI is attributed to beneficiaries unless at the end of any trust taxation year the settlor was not a Canadian resident for 60 months or more. Such trusts are routinely used by permanent immigrants to obtain a five-year tax exemption on undistributed investment income, which may be later distributed tax-free.

■ **Inter vivos trust.** Not created on or after and as a consequence of an individual's death. Taxed at the highest marginal rate.

■ **Joint spousal trusts.** Proposed for an individual aged 65 or more. Income is earned solely for the benefit of the trust's creator and his or her spouse, and no one else can receive such income or capital during their lifetimes. Property may be rolled in; a deemed disposition follows the death of the survivor for property subject to the 21-year rule.

■ **Mutual fund trust.**

■ **Non-discretionary trust.** All interests vested indefeasibly at the start of the trust's taxation year. Discretion may lie as to the timing of payment.

■ **Non-resident trust.** Trust residence is generally considered to reflect the residence of the trustee(s) who controls and manages the trust.

■ **Personal trust.** No beneficial interest was acquired for consideration payable to the trust or its contributor. One person, or two or more related persons, may contribute property. Proposals exclude unit trusts.

■ **Pre-71 inter vivos trust.** A non-mutual-fund trust created before and resident in Canada since June 18, 1971; has not received gifts since; has not since owed an amount to or guaranteed by a person not at arm's length with its beneficiaries; and did not carry on an active business in the year. Proposals prohibit receipt of legal ownership of property from another trust taxed at top marginal rate only. Graduated rates apply.

■ **Post-71 spousal trust.** The proposed definition is similar to the current definition of "spousal trust": income is earned solely for the benefit of the trust creator's spouse, and no one else can receive such income or capital during the spouse's lifetime. Property may be rolled in and deemed disposed of at the spouse's death.

■ **Pre-72 spousal trust.** A transitional measure on the introduction of the 21-year deemed disposition rule.

■ **Real estate investment trust (REIT).** Owns, maintains, and manages real property; since 1994, usually a closed-end mutual fund trust. REIT units are generally redeemable only on fund dissolution, allowing investment in real estate to earn rents and capital appreciation, but offer liquidity because units must be publicly traded and widely held. REIT units qualify as RRSP, RRIF, and DPSP investments.

■ **Resident trust.**

■ **Revocable trust.** An express power to revoke the trust is reserved at the outset; such power is not implicit in a broad power to amend, per the SCC in *Schmidt*. Revenue uses the term for a subsection 75(2) trust, under which property may revert to the contributor or persons determined by him or her, or the disposal of property requires his or her consent; attribution applies while the contributor is resident.

■ **Tainted spousal trust.** A testamentary trust in favour of a spouse that is not a spousal trust because, for example, someone else may receive income. Payment of certain testamentary debts does not taint the balance of trust property. Revenue says that provincial trust-variation legislation cannot purify the trust to qualify for a rollover from the deceased, nor can an agreement or undertaking by the trustees. Disclaimers, releases, or surrenders or a court order under dependant-relief legislation may purify the trust.

■ **Testamentary trust.** Arises on and as a consequence of an individual's death; may lose status if other property is contributed. May have an off-calendar year-end. Taxed at graduated rates.

■ **Unit trust.** An inter vivos trust in which each beneficiary's interest is described by reference to trust units. Either the units are retractable or the fund is listed on a prescribed exchange and invests in real estate or holds wide-ranging prescribed investments; proposals allow the trust to satisfy one or the other of the latter criteria at different times.

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IRS on Trust Protectors

The IRS recently released a field service advice (FSA) that casts light on how it views the effect of protector powers on grantor trust status.

US citizens and residents may minimize US income and estate tax exposure by way of trusts. For example, a Canadian resident planning a US move can insulate property from US estate tax by transferring it to a properly structured trust; generally more difficult and aggressive planning may defer or avoid tax on the property income. US citizens in Canada can use a trust to insulate property from estate tax. To minimize US gift tax, only low-value property—such as shares in high-tech companies in their infancy—may be transferred, or else instalment sales utilized. Trusts can also minimize income tax exposure under the various US anti-deferral tax regimes—controlled foreign corporations (CFCs), passive foreign investment companies, and foreign personal holding companies—applicable to shares of Canadian or other non-US corporations held by US persons.

The FSA involved a US citizen who was the protector and a beneficiary—but not, he said, the grantor—of foreign trusts that owned foreign company shares. As protector, he could approve or veto virtually all the trustees' actions, but he could not vest any trust income or capital in himself, his creditors, his heirs, or his estate or its creditors, and he had no incidents of ownership in the capital or income. The IRS said that such powers did not cause the individual to be considered a trust owner under the grantor trust rules: they were not trust ownership powers (Code section 673-9). But as beneficiary he was considered an indirect owner of the shares, which tipped the balance of share ownership in favour of US persons, thus rendering the corporations CFCs. The individual's share interests were valued at 100 percent of share value, not an actuarial portion that assigned a value to the remainder interest.

If the individual had been a grantor in addition to having protector powers, he would likely be considered an owner of the trusts under grantor trust rules. The individual's representation that he was not a grantor—that he had not directly or indirectly made any gratuitous transfers to the trusts—was emphasized as critical to the FSA holding. Further scrutiny in the audit context would be necessary, the FSA cautioned: the nominal funding by the third party who had established the trusts did not appear adequate to finance the subsequent share investment. The FSA also warned that the individual could be a grantor if he made subsequent gratuitous transfers to the trust, if the nominal settlor was deemed to have acted as his agent in creating or funding the trust, or if any property contributed to the trust originated with him. This warning may be relevant to Canadian freeze transactions if third-party nominees settle trusts that subscribe for new common growth shares. If property is transferred to trusts through intermediaries, including non-resident alien spouses, a sale, not a gift, to the intermediary may reduce the risk of grantor status. In the FSA, all trust income was to be paid to the individual for life, which avoided the difficult issue of how to attribute beneficial interests in discretionary trusts for CFC purposes. Practitioners still await IRS views in this area.

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Lease Termination Payments

Ontario has long considered that settlement payments made on a lease termination or breach are subject to Ontario PST, a conclusion that the lessee in *Extendicare* has managed to convince the Ontario Court of Appeal is incorrect. It is not yet known whether the Crown will seek leave to appeal to the SCC, which may be difficult to obtain in any event.

The Court of Appeal viewed the liquidated damages clause as allowing the lessor to collect as damages amounts that would have been payable if the lease had not been breached; it rejected the Crown's argument that the lessee's breach did not end its obligation to make payment and that the settlement "could reasonably be considered rental payments under the lease." The court cited SCC cases to conclude that a repudiated contract is terminated; payments made to forestall legal action arising from the breach are not rent. Furthermore, the payments are not subject to PST because they were not related to consumption or use of tangible personal property: the equipment was in fact repossessed. The payments were not made for tangible personal property, but rather to ward off a potential lawsuit. Nor were the payments rent, "anchored in notions of regularity of payments and continuation of the [lessor-lessee] relationship." In fact, the legislative history indicated an intention to link the tax payable and the lessee's use of the property. The court was assisted by a concession extracted from the Crown to the effect that a court-awarded damages payment would not have been taxable, although it seemed clear that the court would have arrived at the same conclusion in any event. The court concluded that the "payments were made in the context of a termination of all relationships (contractual and litigation) between the parties, not in the context of a continuing lease," and were thus not within the legislative scheme. Such reasoning suggests that even mutually negotiated termination payments aimed at ending an existing lease may escape PST; Ontario's position that purchase exemption certificates cannot be accepted from a lessee that wishes to exercise its purchase option on assets for resale to a third party may also warrant review.

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Foreign Tax News

Treaties

In April 2000, Canada begins treaty negotiations with the Mongolian People's Republic; Finance has requested comments from parties concerned.

CANADIAN TAX *Highlights*

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For a list of Canada's tax treaties currently in force, signed, or under negotiation, visit Finance's Web site or call the Foundation's library.

OECD

On March 3, 2000, the OECD issued a second draft of the model treaty commentary on permanent establishments in the context of e-commerce. Comments should be submitted before June 15, 2000. Final guidelines will be issued in September, thus providing more time to study comments and the issues. The revised draft responds to comments, including whether human intervention is required vis-à-vis control and operation of automated equipment, and if so, where, how, and by whom.

The Committee on Fiscal Affairs is examining means to help small economies avoid harmful tax practices.

United States

The IRS extended the effective date of final regs on withholding on US-source income paid to foreign persons to payments made after 2000 (originally applicable to payments after 1998). (See TDs 8856 and 8734. For summaries and full details, contact the Foundation's library.)

United Kingdom

A government report prepared for the 2000 budget says that billions of pounds sterling are lost annually to the informal economy. Incentives to encourage participation in the legitimate economy, new penalties (including potential prosecution of all tax evasion), and new investigative powers are proposed.

Czech Republic

Incentives to encourage new investment provide income tax relief for 10 years for newly established entities (5 years for existing entities). Breach of certain conditions requires full repayment of benefits.

Budgets 2000

South Africa changes from a source-based to worldwide taxation for residents, effective 2001-2002; foreign dividends are taxed immediately; capital gains are taxed effective April 1, 2001. A new 15 percent tax rate is introduced on the first ZAR100,000 for small business corporations. Personal tax brackets are raised and the marginal rate is lowered. The maximum tax on trusts is reduced to 42 percent. In **India**, foreign institutional investors may increase equity in Indian companies to 40 percent; minimum government ownership in national banks is reduced to 33 percent, and their 2 percent interest tax is abolished. Tax authorities are no longer responsible for registration and regulation of venture capital funds. The surcharge on non-corporate taxpayers with total income over INR150,000 rises to 15 percent, bumping the marginal rate from 33 to 34.5 percent; the senior citizens' tax rebate rises to 15 percent. The tax holiday for new industries in depressed areas is extended two years. The domestic corporate dividend-distribution tax doubles to 22 percent. **Latvia**'s budget includes a 25 percent withholding on all income to non-resident individuals, including artists and athletes, and a 25 percent tax on individuals' interest income from foreign banks. New rules for companies engaged in the exploration and exploitation of natural resources include new rates and rules for calculating depreciation of certain assets used in such activities and longer loss-carryforward periods. Withholding on enterprise residents of no- or low-tax jurisdictions is tightened. Excise taxes are increased on alcoholic beverages and introduced on non-alcoholic beverages such as coffee and mineral water.

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CTF WEB SITE

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http://www.ctf.ca

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ABORIGINAL TAX POLICY CONFERENCE
May 31-June 1, Saskatoon

Check the Web site for full program details.

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