Canadian Tax Highlights

Editor: Vivien Morgan, LL.B.

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Third-Party Penalties: Consultations

Bill C-25, which included the third-party civil penalties proposed in the 1999 federal budget, received royal assent on June 29, 2000.

The minister of national revenue has undertaken to apply the penalty fairly, impartially, and only when warranted, by involving the tax community in developing the agency's administrative guidelines for the penalty's application. While the overall consultation and guideline development process is being managed by the Audit Directorate of the Compliance Programs Branch (formerly the Verification, Enforcement and Compliance Research Branch), Bob Beith, former ADM of the Appeals Branch, has been engaged to lead the external consultations. Following internal consultations and preparatory work, the agency plans to meet with interested practitioner groups to cover a wide range of issues, including the criteria for applying the penalty, the approval process, the notification process, and evidentiary documentation. A Web site notice will invite input generally. The agency invites all interested parties to participate in the consultative process by making their views known to their professional association or directly to the agency.

The guidelines will appear as an IC and may include examples of the penalty's application in addition to those in budget and draft legislation documents. A draft will be circulated to consulting parties before being finalized. No penalties will be imposed until consultations are complete and the guidelines are in place. Final guidelines are expected by December 31, 2000. Furthermore, as promised by the minister, no penalty will be imposed without the approval of a headquarters committee in order to ensure fair and consistent application. The minister is also committed to periodically updating the tax community on the agency's experience in applying the penalty; annual updates at practitioner events such as the Foundation's annual conference will provide an opportunity for discourse with practitioners.

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Foreign Investment Entities

On June 22, 2000, Finance released a sprawling 180 pages of draft legislation and explanatory notes on non-resident trusts and foreign investment entities (FIEs) based on February 1999 budget proposals. The draft legislation is byzantine, and the FIE proposals extend well beyond foreign investment funds: they will affect various corporate joint venture structures and other ordinary-course transactions.

Canadian taxpayers face annual taxation if they or controlled foreign affiliates (CFAs) hold an interest in an FIE, a non-resident entity that owns investment properties with carrying value exceeding 50 percent of total assets. Carrying value is computed under Canadian GAAP or under substantially similar accounting principles if a balance sheet is distributed within three months. The investor is taxed on the annual FMV increase in its interest in the FIE (mark-to-market regime) or, if the investor files a timely election and has adequate information to comply, on its proportionate share of the FIE's after-tax income (accrual regime). The election may avoid taxation on unrealized gains, but the requirements—including the recomputation of the FIE's income under Canadian tax rules—render few taxpayers eligible. The rules apply, with or without a tax-avoidance motive, for taxation years starting after 2000. Individuals (other than trusts) resident in Canada for less than five years are exempt.

The investment property definition is broad and includes currency, real estate, resource properties, and derivative financial products (even if used or held in an active business), and shares of corporations and interests in partnerships and trusts. The breadth of the definition is particularly troubling in the high-tech industry, where cash may overwhelm the balance sheet, and for entities in many other business sectors where real estate exceeds 50 percent of assets. Lookthrough rules apply if the entity

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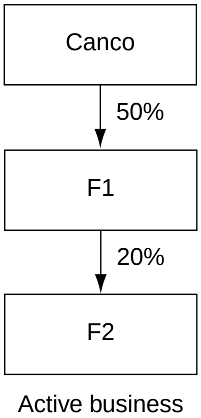
owns 25 percent or more of votes and value of a corporation (or of the value of a partnership or non-discretionary trust): the entity includes its ownership interest in the underlying assets for the 50 percent carrying-value test. Thus a non-resident entity holding 25 percent or more of votes and value of a foreign corporation with active business assets should not be an FIE. In addition, an irrevocable election to avoid FIE status and treat an entity as a CFA may be made by a taxpayer who, inter alia, directly or indirectly owns 10 percent or more of votes and value. However, the rule as drafted will apply in few situations. Consider a joint venture in which Canco owns 50 percent of F1, a foreign affiliate holdco that owns 20 percent of F2, a foreign affiliate carrying on an active business. Although Canco has an indirect interest of 10 percent of votes and value in F2, F1 has an investment business. Thus Canco cannot elect that either F1 or F2 be treated as a CFA: F1 is thus an FIE and Canco's interest in F1 is taxed on a mark-to-market or accrual basis.



An investor is not taxed if the FIE is an "exempt interest," including shares of a corporation that are publicly listed and actively traded, if the corporation meets certain business activity or asset tests. This exemption is intended to eliminate the requirement to apply the 50 percent carrying-value test annually, but foreign holdcos may have difficulty meeting the activity and asset tests. The legislation treats a right to acquire an interest as an interest in an entity, thereby introducing other uncertainties. For example, a number of exchangeable share transactions have already been impeded by concerns that, if the foreign corporation is an FIE, Canadian exchangeable-share holders may be taxable under the mark-to-market regime. Finance has requested comments by September 1, 2000, but taxpayers and their advisers may be grappling with the rules for many months or years.

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US Estate Tax Repeal

A brew of US presidential campaign politics and tax policy is escalating controversy over US gift and estate taxes. The House of Representatives passed, by a purportedly veto-proof majority, the Death Tax Elimination Act of 2000, for phase-in over 10 years, but a presidential veto has been promised; the Senate will probably have debated the bill by the week of July 10. In a campaign address, Vice-President Gore announced that he would eliminate estate taxes for most family farms and small businesses. Estate plans in process should consider a possible repeal, particularly if irrevocable inter vivos transfers are contemplated. And an extended phase-in may expose any repeal to subsequent reversal as the political and economic environment changes.

Estates of US citizens or domiciliaries are subject to US estate tax based on the FMV of worldwide assets. Others are taxed on the basis of FMV of US-situs property (such as real estate and shares in US corporations), with a US domestic law exemption of US$60,000 for non-domiciliaries, equal to a US$13,000 tax credit. A Canada-US treaty protocol may provide a larger credit, a prorated portion of the US$675,000 exemption enjoyed by US citizens or domiciliaries, US$1,000,000 in 2006. The tax is imposed at graduated rates, generally up to 55 percent on amounts over US$3,000,000. The basis of property included in a decedent's gross estate is stepped up for income tax purposes; thus a beneficiary or the estate is not subject to income tax on the property's sale if its FMV has not increased since the death. The proposed Death Tax Elimination Act reduces the graduated tax rates incrementally; repeal is complete for estates of decedents who die after 2009. Basis step-up rules also change: the decedent's basis generally flows through to the beneficiary. Canadian estates would see potentially lower death taxes in the phase-in period and thereafter would focus on coordinating the timing of Canadian gains tax and US income tax to avoid a mismatch.

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Details, Details, Details!

Revenue's Web site now has full details of personal income tax statistics for the 1997 tax year for the country as a whole and for each province. All tables can easily be downloaded by anyone familiar with spreadsheets; more detail is available than in the now defunct "green book" hard copy.

Some details are fascinating. For example, taxpayers with incomes under $50,000—81 percent of all taxpayers in the country—account for 56 percent of assessed income. The table shows that they accounted for 62 percent of all taxpayers with taxable dividends and 63 percent of capital gains recipients, and 21 and 19 percent, respectively, of all such income and gains. (Such dividends and capital gains are in addition to those received indirectly through pension plans or RRSPs.) Ten percent (1.2 million) of taxpayers in that income range reported dividends, showing an average of $1,820 each. About 1.0 million or 9 percent of all taxpayers in that income range reported capital gains averaging $2,200. Taxpayers with incomes over $150,000 accounted for 1 percent of all taxpayers, 10 percent of all income, 18 percent of federal tax, and 22 percent of provincial tax; they accounted for 44 percent of all dividends and 52 percent of all capital gains.

Percentage Distribution of Dividend and Capital Gain Income, 1997 Taxation Year

	Taxable dividends		Taxable capital gains	
	Number of taxpayers	Amount	Number of taxpayers	Amount
Under $25,000	23.6	3.7	26.1	6.4
$25,000 to $50,000	38.1	17.1	36.9	12.2
$50,000 to $80,000	23.4	16.8	21.9	12.8
$80,000 to $100,000	5.5	7.0	5.3	6.2
$100,000 to $150,000	4.8	11.4	4.9	10.1
$150,000 and over	4.6	44.1	4.9	52.3
Total	100.0	100.0	100.0	100.0

The details of taxpayers and their income and tax positions provide useful statistics for anyone interested in the impact of the tax system on Canadians and the national economy. The numbers are also valuable indicators of the economic life of individual Canadians and of the nation as a whole. The prevalence of dividends and capital gains at relatively low income levels underscores the importance of the special tax treatment accorded such income and the extent to which share ownership extends to a significant proportion of the total population.

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New Reasonableness Test?

A recent Revenue technical interpretation (TI) says that its longstanding administrative policy relating to the deductibility of bonuses paid to a corporation's owner-manager does not apply if the payer corporation's shares are held indirectly through a holdco or trust. No analysis is provided; it is not clear whether assessing practice has changed or whether the specific shareholding structure raised concerns. The result is clear: an owner-manager may now suffer double tax on a bonus.

In the case of active business income, Canada's corporate tax system attempts to integrate the corporate-shareholder levels of tax for a CCPC's first $200,000 of income: income over that small business limit is only partially integrated. To avoid an effective rate exceeding 60 percent if earnings are dividended out, bonuses that are reasonable may reduce corporate taxable income to $200,000. They are then taxed in the recipient's hands only. Revenue has allowed a full deduction without a determination of reasonableness for a bonus paid to a principal shareholder active in the business's management, if corporate policy is to declare bonuses of profits attributable to the recipient's special knowhow, connections, or entrepreneurial skill. Although the policy is a relieving measure, Revenue has tended to apply it restrictively, and not, for example, to intercorporate management fees even if Opco's entrepreneur is the sole shareholder of Holdco. Revenue appears concerned about multiple access to the small business deduction or undue tax deferral from payments between corporations with staggered year-ends.

The new TI deals with an opco owned by individual A and two holdcos, each in turn owned by a discretionary family trust (FT). Each of individuals B and C was a capital beneficiary (with his spouse) of an FT, and the respective spouse and children were income beneficiaries. B and C managed Opco, which paid them bonuses equal to their family's indirect interest in Opco's earnings. Revenue disavowed its bonus policy even though B and C otherwise met policy requirements and their indirect shareholding interests in Opco in theory could have been turned tax-free into direct interests. It is not clear why direct shareholding should be a precondition: the bonus was paid directly to the entrepreneur and left no room for deferral or income splitting. Furthermore, it is not clear whether the requisite direct shareholding must meet a substantive financial or economic threshold and whether existing tiered corporate structures in place for tax and non-tax reasons must be restructured. The TI also suggests that comparisons with similar businesses of like size are helpful, but such comparisons may in fact mislead without details of shareholdings.

The TI's facts-and-circumstances test for determining a bonus's reasonableness offers little practical guidance compared with the previous policy's bright-line test. A huge penalty is exacted for any error: non-deductibility can result in an effective combined corporate and personal rate of up to 90 percent, forcing the entrepreneur to accept the lesser evil of partial integration at 60 percent. The good news is that the recent TCC decision in *Safety Boss* indicates that the direct shareholding test may not be critical. (See "Fire and Rain," *Canadian Tax Highlights*, March 28, 2000, at 17.) The TCC said that, on the facts, the owner-manager as sole proprietor would have earned all the bonus and the fact of incorporation should not affect reasonableness. Revenue's position may not ultimately win the day, but it is hoped that it clarifies the direct shareholding requirement and minimizes interim uncertainty.

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Virtual Indecision

The OECD technical advisory group (TAG) considering e-business income characterization recently issued a consultative draft—including a minority view, in some cases—for finalization by year-end. Most of the TAG majority and unanimous positions will be greeted favourably by businesses and their advisers: 23 of 26 activities are considered to generate business income for treaty purposes.

The TAG viewed revenue as royalties, not business profits, if the electronic client obtains the right to exploit the copyright or if the Internet is the transfer medium for certain technical information. In cases where a minority view arose, it may reflect member country disagreement with new model convention royalty commentary that ignores the media used and looks to the nature of rights transferred. (See "OECD on E-Business," *Canadian Tax Highlights*, November 23, 1999, at 81.) For example, the minority focuses on the medium used for the information or code (downloaded software is considered royalty income) contrary to the principle of tax neutrality and the revised royalty commentary. The minority also considers income to be a royalty if earned on certain types of information delivery and short-term licensing arrangements such as application service providers. There is no Canadian TAG member and no indication whether Canada supports the majority or the minority view.

The lack of consensus is a concern. Taxpayers using the Internet to transact in electronic products and services are potentially subject to withholding tax in countries that view the revenue as royalties; other countries will treat the revenue as business income, which enjoys the higher tax threshold of profits attributable to a permanent establishment. Canadians who transact may only gain partial relief under our foreign tax credit system. Furthermore, a business with a home country that considers the income to be business profits may be unwilling to transact in a foreign jurisdiction that favours the royalty view and imposes withholding tax. The so-called digital divide may widen if residents of such jurisdictions are thus denied access to certain Web-based services and products.

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	OECD TAG characterization of income		
	Unanimous or majority view		Minority view (if applicable)
E-business	Business profits	Other	Royalty
E-order processing of tangible products (1)	✓		
E-ordering and downloading of digital products:			
— Not for copyright exploitation (2)	✓		✓
— For copyright exploitation (3)		Royalty	✓
Updates and add-ons: (4)			
— Delivered on tangible medium	✓		
— Delivered electronically	✓		✓
Limited duration software and other digital information licences (5):			
— Delivered on tangible medium	✓		
— Delivered electronically	✓		✓
Single-use software or other digital product (6)		Service or royalty	
Application hosting:			
— Separate licence (7)	✓		
— Bundled contract (8)	✓		✓
Application service provider (ASP) (9)	✓		✓
ASP licence fees (10)	✓		✓
Web site hosting (11)	✓		
Software maintenance (12)		Mixed contracts	
Data warehousing (13)	✓		
Customer support over a computer network (14)	✓		✓[a]
Data retrieval (15)	✓		✓
Delivery of high-value data (16)	✓		✓
Advertising (17)	✓		
E-access to professional advice (18)	✓		
Technical information (19)		Royalty	
Information delivery (20)	✓		✓
Subscription-based interactive Web access (21)	✓		
Online shopping portals (22)	✓		
Online auctions (23)	✓		
Sales referral programs (24)	✓		
Content acquisition transactions (25):			
— Right to display copyrighted material		Royalty	
— Creation of new content	✓		
Streamed (real-time) Web broadcasting (26)	✓		

Note: Numbering of items corresponds to the TAG report. [a] Only if electronic downloading and copying of technical documentation on a non-temporary medium is a substantial part of the consideration for the payment, not just information downloaded solely for viewing purposes.

Not Connected

A recent decision of the TCC in *Olsen* will surprise many tax practitioners. The court found that the special definition of "control" in part IV did not apply to another part IV definition when it was incorporated by reference into a part I dividend-stripping rule. Tax planners may wish to consider the decision in the context of the enhanced capital gains exemption: the section 110.6 definition of "qualified small business corporation share" uses the same definition of "connected."

At issue was the meaning of "connected" for the purposes of section 84.1, which applies if a resident individual transfers shares to a non-arm's-length purchaser that is then connected with the subject corporation. If section 84.1 applies, the vendor may be deemed to have received a dividend rather than a capital gain, which in Mr. Olsen's case was a tax-free receipt because of the enhanced capital gains exemption. To determine whether the purchaser and subject corporation are connected after the sale, section 84.1 incorporates the definition of "connected" in subsection 186(4) in part IV. Generally, the definition of "connected" states that two corporations are connected if, inter alia, one controls the other. A separate definition of "control" in subsection 186(2) applies "for the purposes of . . . Part [IV]" and views as a unit all shares held by persons not at arm's length with the would-be controlling corporation. In an earlier release, Revenue concluded that the part IV definition of "control" applied to the part IV definition of "connected" when it was incorporated into section 84.1. The TCC disagreed. In particular, the court focused on the fact that section 84.1 refers only to subsection 186(4), whereas a former version of section 84.1 specifically referred to the term "control" as defined in subsection 186(2). The court said that it would have been simple to continue that reference and its removal was significant. (It should be noted, however, that the post-sale test in the earlier section 84.1 was one of control and not connectedness, thus dictating a direct reference to the definition of "control" in part IV and obviating a reference to subsection 186(4).) The court also noted the preamble of the definition of "control," "for the purposes of . . . Part [IV]," and said that the definition was restricted to transactions under the purview of part IV, which imposes a special tax on intercorporate dividends.

The TCC said that the rules of interpretation favoured the taxpayer and quoted a passage from the SCC in *Notre Dame de Bon-Secours*: "In the past, resort was often made to the maxim that an ambiguity in a taxing provision is resolved in the taxpayer's favour. . . . Now an ambiguity is usually resolved openly by reference to legislative intent." The SCC also said that "a legislative provision should be given a strict or liberal interpretation depending on the purpose underlying it." At the time there were concerns that this latter passage was a step back to the old approach of interpreting in accordance with whether a provision was taxing or exempting in nature. In fact, the TCC in *Olsen* went on to say that "[s]ection 84.1 is an anti-avoidance provision and penal in nature. It should be strictly interpreted."

The TCC concluded that there was a gap in the legislation and it was unclear whether subsection 186(2) should be referred to. At the very least, the TCC said, there is a reasonable doubt not totally resolved by the ordinary rules of interpretation, and Mr. Olsen was entitled to the residual presumption in favour of the taxpayer.

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Tracking Shares from Options

Revenue's latest *Income Tax Technical News* (ITTN) takes a new position on partial dispositions from a pool of

SHOE *by Jeff MacNelly*

identical properties that includes shares acquired under section 7 options (no. 19, June 16, 2000). Employees benefit if they already own their employer's shares when they exercise such options for a same-day sale.

Previously, Revenue said that the adjusted cost bases (ACBs) of the newly acquired and previously held shares were averaged. An immediate resale of the newly acquired shares meant that the proceeds often exceeded the averaged ACB, creating a sometimes substantial capital gain on top of any section 7 employment benefit. Revenue now accepts that if it seems "obvious" that newly acquired shares were disposed of, they may be so identified for the purposes of computing any capital gain. To support specific identification, the ITTN requires a demonstrable correlation between the acquisition and disposition—for example, if the number of shares acquired under the option equals the number disposed of immediately after the option's exercise. In such a case, only the ACB of the shares acquired under the option is relevant for computing any capital gain or loss. A Revenue official confirmed that this result should also follow if the individual sells only enough shares to generate cash equal to the tax on the employment benefit.

Revenue's new interpretation does not apply if the individual acquires additional shares before disposing of the shares acquired under the option. Thus, under an appropriate stock option agreement, the employee may choose to receive cash in lieu of shares on the option's exercise. Revenue's longstanding administrative position treats such a receipt as a stock option benefit rather than ordinary employment income, and the employer may deduct the payout because no shares were issued. Existing stock option plans should be reviewed and new plans drafted to ensure tax-effectiveness for both parties. Alternatively, transfers of stock options to a trust or other non-arm's-length taxpayer may be appropriate if, for example, an employee plans to sell only some shares acquired to cover the tax liability on the option's exercise: segregating the remaining shares avoids ACB averaging. ITTN no. 19 also confirms Revenue's conclusion that GAAR does not apply to such arrangements.

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Ontario Bonus Depletion

The 2000 Ontario budget proposed a 30 percent bonus depletion deduction for qualifying grass-roots Canadian exploration expense (CEE) incurred in Ontario, a measure that may enhance the popularity of flowthrough share financing in the province. During the summer, consultation with interested stakeholders will explore issues such as the scope of the program and the definitions of qualifying grass-roots CEE, eligible participants (all principal business corporations or just junior mining exploration companies?), and eligible investors. The final rules are expected to generally parallel federal rules.

A flowthrough share is a prudent investment only if an investor's return exceeds the net funds invested after tax. Expenditures that the corporation funds with subscription proceeds and renounces in favour of the investor are counterpointed by the flowthrough shares' deemed nil ACB. If the shares are capital property to the investor, the entire sale proceeds are a capital gain: the capital gain election for Canadian securities is not available. Proposals to modify personal tax rates and the capital gains inclusion rate also affect the investor's return and thus the effectiveness of this vehicle as a financing tool for mining companies seeking to raise exploration funds. Subsequent changes in the shares' market value are also relevant. If a flowthrough share investment will generate tax deductions that reduce regular income taxes below the AMT threshold, the cost of either paying AMT or foregoing a tax deduction must be taken into account. The tables reflect the tax deduction and at-risk capital of an Ontario investor in the highest marginal tax bracket whose $1,000 investment in flowthrough shares is reflected in $1,000 CEE incurred in Ontario and renounced in the investor's favour by the principal business corporation issuing the flowthrough shares. The tables show the impact of a matching federal 30 percent bonus depletion and of the existing federal CEE rules.

Impact of the Proposals on a Flowthrough Share Investment

Federal Matching Ontario

Time period	(A) Investment and CEE deduction	Total deductions available	Tax rate[a]	(B)[b] Tax savings	(A – B) After-tax cost of investment
	$	$	%	$	$
Pre-budget					
1999	1,000	1,000	48.75	488	512
2000	1,000	1,300	47.86	622	378
2001	1,000	1,300	47.57	618	382

No Federal Matching

Time period	CEE Ontario deduction	Federal deduction	Tax rate[a]	(B)[b] Tax savings	($1,000 – B) After-tax cost of investment
	$	$	%	$	$
Pre-budget					
1999	1,000	1,000	48.75	488	512
2000	1,300	1,000	47.86	531	469
2001	1,300	1,000	47.57	528	472

[a] Blended rate: Ontario—62.00%; federal—66.67%. [b] Ontario only for 30% depletion. Federal 30.88%, Ontario 17.87% pre-budget; federal 30.45% 2000, and 30.16% 2001.

It is hoped that Ontario's final rule mirrors the federal mining exploration deletion deduction (MEDA), phased out after 1989. Without a matching federal deduction, an investor's at-risk capital drops only by 8 percent, a move that the brokerage community seems to think is insufficient to activate investor interest in flowthrough share financings: matching along the lines of MEDA drops an investor's at-risk capital an additional 19 to 27 percent for CEE incurred in Ontario. The mining industry would prefer a matching 30 percent bonus federal deduction for qualifying CEE incurred in any province to encourage the exploitation of the best exploration plays, not just projects located in tax-friendly jurisdictions.

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Holdco Further Enfeebled

Government revenues are generally rising faster than the economy as a whole, and personal disposable incomes are languishing in comparison with US statistics: the political and economic rationales for significant personal and corporate tax cuts are compelling. The federal government has only just joined the provincial trend to lower basic personal income tax rates, but the combined effect of various provincial measures, the elimination of the 3 percent federal general surtax, and the phaseout of the 5 percent high-income surtax continues to diminish the allure of earning investment income though a holdco rather than personally.

A number of provinces cut small business tax rates aggressively in the past few years, but the general corporate rates applicable to investment income earned by a CCPC were stable until Ontario's 2000 budget reduced its general corporate rate from 15.5 percent to 14.5 percent effective May 2, 2000, to 14.0 percent on January 1, 2001, and to 8.0 percent by 2005. Earning investment income through a CCPC taxable in Ontario only may become tax-advantageous.

The 2000 federal budget reduced the capital gains inclusion rate from three-quarters to two-thirds, but changed neither the general federal corporate rate on investment income nor the 4 percent federal corporate surtax. We understand that every province and territory has adopted this new capital gains inclusion rate for dispositions after February 27, 2000. To increase Ontario's competitiveness and ensure a tax system conducive to investment and savings, its 2000 budget proposes a capital gains inclusion rate of 50 percent for all taxpayers by 2004.

As in 1999, tax deferrals for interest income or capital gains exist only in Newfoundland. The top personal marginal tax rate on dividend income in a majority of jurisdictions is lower than the federal part IV tax rate, creating a negative tax deferral. To avoid trapped RDTOH in the corporation and to achieve the lowest overall combined tax in such jurisdictions, when a capital gain is realized it may be prudent to maximize the dividend refund rather than the capital dividend. The table shows that earning investment income in a corporation in 2000 creates a tax cost of approximately 2.0 to 3.0 percent for interest income and two-thirds of that amount for capital gains. A significantly larger tax cost arises if a CCPC earns capital gains dividends from a mutual fund trust. (See "Mutual Fund Disintegration," *Canadian Tax Highlights*, April 25, 2000, at 30-31.) As in earlier years, strictly on rates, an individual will prefer to earn investment income person-

Income Tax Payable on $10,000 of Investment Income Earned Through a Corporation and Directly Year Ending December 31, 2000

	Ontario	Quebec	BC
		dollars	
Portfolio dividends			
Corporate tax	3,333	3,333	3,333
Refundable tax	(3,333)	(3,333)	(3,333)
Individual tax on dividend	3,232	3,504	3,461
Combined tax	3,232	3,504	3,461
Individual tax	3,232	3,504	3,461
Tax cost with Holdco	—	—	—
Tax deferral with Holdco	(101)	171	128
Capital gains			
Corporate tax	3,375	3,480	3,486
Refundable tax	(1,646)	(1,593)	(1,590)
Individual tax on dividend	1,596	1,675	1,651
Combined tax	3,325	3,562	3,547
Individual tax	3,191	3,378	3,417
Tax cost with Holdco	134	184	130
Tax deferral with Holdco	(184)	(102)	(69)
Interest			
Corporate tax	5,062	5,219	5,229
Refundable tax	(2,469)	(2,391)	(2,386)
Individual tax on dividend	2,394	2,513	2,477
Combined tax	4,987	5,341	5,320
Individual tax	4,786	5,067	5,126
Tax cost with Holdco	201	274	194
Tax deferral with Holdco	(276)	(152)	(103)

Note: The figures assume that (1) the individual is taxed at the top marginal tax rate, (2) the capital gains are realized after February 27, 2000 and qualify for the 66⅔% inclusion rate, (3) the capital gains deductions for qualifying small business corporation shares or qualified farm property are not available, and (4) the taxable dividend paid is the net after-tax amount less any capital dividend. Further, it is assumed that the 1.60% Quebec Youth Fund surtax is enacted as planned.

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ally, not through a corporation, but numerous other factors must be considered. (See "Victim of Lower Rates?" *Canadian Tax Highlights*, August 17, 1999, at 61-2.)

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Administration Update

Ontario interactive digital media tax credit (OIDMTC). Introduced in Ontario's 1998 budget and expanded in the 2000 budget, the program officially opened only when administrative procedures for processing applications were established on June 7, 2000. The OIDMTC is a refundable credit equal to 20 percent of eligible Ontario labour expenditures incurred by a qualifying corporation to create eligible interactive digital media products in Ontario. Eligible costs are generally incurred by the artists engaged in creating multimedia content such as text, sound, and images, not the engineers and technicians who created the foundation technology. Eligible Canadian corporations—Canadian or foreign-owned—develop eligible products at a permanent establishment in Ontario, have annual gross revenues and total assets not exceeding $20 million and $10 million respectively, and file an Ontario corporate tax return. Eligible products—for example, video games—use text, audio, and video in a manner that facilitates the user's interaction with the product.

Revenue's SR & ED dispute resolution guidelines. New guidelines for resolving SR & ED tax credit claimants' concerns about SR & ED reviews include Revenue's conditions for a second review of a claim. The policy outlines procedures for claimants to follow to dispute the technical reviewer's findings or complain about the conduct of a review.

Voluntary disclosure IC. Revenue released new *Information Circular* 00-1 on the voluntary disclosure program, replacing IC 85-1R2. Taxpayers who voluntarily disclose previously unreported or misreported tax or customs information must pay tax and duties owing, plus interest, but Revenue can provide relief from penalties and prosecution. Revenue says the program now offers a standard policy for clients who want to make voluntary disclosure. Clients are defined as taxpayers, exporters, travellers, employers, GST/HST registrants, and benefit recipients as well as client representatives and agents. A client may seek advice and information anonymously from a Revenue agent to help prepare for a voluntary disclosure. Revenue says these recent enhancements have increased taxpayers' use of the program.

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Foreign Tax News

Tax Treaties

Legislation containing new treaties between Canada and Kyrgyzstan, Lebanon, Algeria, Bulgaria, Portugal, Uzbekistan, Jordan, and Luxembourg, and a protocol with Japan, received royal assent.

OECD

OECD ministerial meetings opened in Paris with increased economic globalization and strengthened tax harmonization as the primary goal. A report on harmful tax competition and tax havens listed 47 "potentially harmful" OECD member state tax regimes and 35 non-member jurisdictions that meet the OECD criteria for a tax haven, including the US Virgin Islands and Jersey. The OECD will develop guidelines to determine whether the member country practices are harmful in fact; members are committed to the elimination of such practices by April 2003. Listed tax haven countries have one year to commit to the elimination of harmful tax practices before 2006; otherwise, sanctions will be imposed.

Australia

A new tax system took effect July 1, reducing personal income taxes by A$12 billion and the corporate tax rate from 36 to 30 percent. The new GST at a 10 percent rate promises first-year revenues of $24.21 billion; many businesses and consumers are concerned about the impact on prices.

Carol Mohammed
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CTF Web Site

Canadian Tax Highlights is on the CTF Web site:
http://www.ctf.ca

UPCOMING CONFERENCES

52d ANNUAL TAX CONFERENCE

September 24-27, Toronto

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