Canadian Tax Highlights

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Third-Party Gross Negligence

In both GST and income tax assessments, a gross negligence penalty can be assessed if specific statutory preconditions are satisfied. Persons must knowingly, or in circumstances amounting to gross negligence, make, participate in, assent to, or acquiesce in the making of a false statement or omission relating to their tax obligations. The penalty is calculated as a percentage of the amount attributable to the false statement or omission—for example, taxes underpaid or recoveries overclaimed. In *Findlay*, the FCA overturned a gross negligence penalty that Revenue had levied on a taxpayer who had relied on a third party to prepare his income tax return.

Findlay involved a sole proprietor who rolled his business to a corporation in 1991, resulting in some capital gains. However, the taxpayer was "under the impression that very little tax would result," apparently because it was intended that a capital gains exemption would be claimed. The taxpayer used the third party that had prepared both his business accounts and his personal income tax returns for a number of years to prepare the income tax returns for the new company, the section 85 election for the asset transfer, and the taxpayer's personal return for the 1991 taxation year. The capital gains arising on the asset transfer were omitted from the personal return that the taxpayer read, signed, and filed. Revenue assessed a gross negligence penalty, taking the position that the nonreporting of the capital gain was due to gross negligence, and also disallowed any capital gains deduction on the same basis (subsection 110.6(6)). At the objection stage, Revenue said that the taxpayer did not exercise "proper and clear judgment" and that the use of a third party to prepare the return did not diminish his responsibility to file an accurate tax return.

The issue before the FCA was whether the facts warranted a gross negligence penalty. The legislation renders the taxpayer liable for the penalty, not the agent acting on his behalf. The court referred to *Udell*, which held that in order to attribute an agent's gross negligence to a taxpayer, there must be an element of knowledge on the taxpayer's part and an acceptance of the agent's act or omission. The court also referred to *Venne*, in which the taxpayer, without any review, signed and filed returns prepared by a bookkeeper; certain income was undeclared. *Venne* held that the taxpayer was negligent in failing to review the returns and supervise the bookkeeper, but the Crown had not established the existence of gross negligence, a greater degree of neglect than simply a failure to use reasonable care. The FCA in *Findlay* adopted *Venne*'s definition of gross negligence: a high degree of negligence tantamount to an intentional act, essentially an indifference as to whether the law is complied with.

Although the TCC in *Findlay* had found that the Crown did not establish that the taxpayer knowingly "participated in, assented to or acquiesced in" the tax preparer's actions, it concluded that those actions amounted to gross negligence and attributed that negligence to the taxpayer. The FCA concluded that the tax preparer's negligence could not be attributed to the taxpayer without a finding of gross negligence on the taxpayer's part. To find otherwise shifted the onus to the taxpayer to establish that he was not responsible for the tax preparer's gross negligence. (For income tax purposes, the onus of proof on an appeal expressly rests with Revenue to establish the facts justifying the assessment of a gross negligence penalty. For GST purposes, there is no express rule to this effect, but the TCC has held on several occasions that the onus is on Revenue—for example, in *Alex Excavating* and *897366 Ontario Limited*.)

Findlay gives clear and concise directions on what is required for Revenue to establish gross negligence and provides guidance on how the penalty might be challenged when third parties are involved. For example, in an income tax or GST context, a taxpayer may argue that the gross negligence of a third party it relied

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on cannot be attributed to the taxpayer if there was no knowledge or acceptance of the third party's actions. Furthermore, gross negligence requires not just mere carelessness or neglect, but rather conduct that amounts to wilful indifference, a critical requirement that is not always present in cases in which Revenue levies a gross negligence penalty.

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Collecting Foreign Tax

The third protocol to the Canada-US treaty introduced article XXVIA, a collection assistance rule that enables one state to request the assistance of the other (the requested state) in collecting its tax debts. The rule's retroactivity led the FCTD in *Chua* to conclude that the article was unconstitutional and thus of no force and effect.

Historically, Canada refused to allow a foreign state to enforce its tax debt claims in Canada. In *Harden*, the SCC provided one reason for the courts' refusal to enforce foreign tax judgments: "[T]hat the enforcement of a claim for taxes is but an extension of the sovereign power which imposed the taxes, and an assertion of sovereign authority by one state within the territory of another . . . is (treaty or convention apart) contrary to all concepts of independent sovereignties." The FCTD noted that Canada now has collection assistance agreements with the United States and the Netherlands. The United States initiated talks to include the article in the protocol because out of an estimated 2.3 million US citizens living abroad in 1990, fewer than 250,000 filed returns, but insisted on an exemption for individuals who were citizens in the other country at the time the tax debt was incurred.

Ms Chua became a permanent resident in Canada in 1977 and a citizen in October 1990. In the early 1980s, while living in Canada, Ms Chua purchased a residential vacation property in Hawaii. She disposed of it in 1986. Some of the withholding tax she remitted to the IRS was refunded, but in 1991—when Ms Chua was a Canadian citizen—the IRS reassessed for about $275,000 in tax, interest, and penalties. She did not contest the assessment because the law in Canada at that time made foreign tax debts uncollectible here. The third protocol was signed and came into force in 1995, and in 1996 Revenue advised Ms Chua that it had accepted an IRS request for assistance in collecting the tax debt. The only reason why the third protocol's article XXVIA could be used against Ms Chua was that the rule was purported to have retroactive operation to November 1985 (10 years before it came into force) to a time when Ms Chua was not a Canadian citizen and thus not saved by the exemption for citizens of the requested state.

The FCTD rejected some of Ms Chua's submissions, but ultimately agreed that the retroactive effect of article XXVIA discriminated in several ways against a new Canadian citizen compared with longstanding citizens. The applicant's human dignity was affected because so-called convention citizens—persons caught in tax squabbles ...th the IRS between 1985 and 1995 who might have neglected to pursue their rights because of the then current law regarding foreign tax collection—were treated as having "[fewer] rights than all other Canadian citizens." Retroactivity deprived convention citizens of fundamental justice because "no fair notice" of the third protocol was given when the applicant could have resorted to the US courts. Furthermore, the applicant's property in Canada was put at risk of seizure, a risk that was not borne by a longstanding citizen. The applicant's reliance on well-established common law principles caused her to relinquish her rights to challenge the IRS assessment, and the retroactive application of article XXVIA made her vulnerable to breaches of procedural and substantive justice. Consequently, the FCTD concluded that the article violated section 15(1) of the Charter.

Chua may not be so much a section 15 case as an example of the steps a court may take to remedy fundamental breaches of procedural and substantive justice. The court reacted mainly to the unfairness of the retroactivity of article XXVIA: a section 7 or 8 argument might just as easily have prevailed. The court was careful to limit the scope of its decision to those who were not citizens when the claim arose but who were citizens at the time the assessment was forwarded. "It would not apply to a person who became a Canadian citizen after November 9, 1995 . . . [or] to a person who became a citizen" thereafter or to someone whose rights of appeal against an IRS assessment had not then expired. "This case . . . concerns discrimination between one group of Canadian citizens and all other[s]."

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Treaty Emigration Changes

On September 18, Finance announced that the Canadian and US treaty negotiators have agreed in principle to certain changes to the Canada-US treaty. The changes are designed to make the system fairer by limiting the potential for double taxation of individuals moving from one country to another and by clarifying a rule that arguably allows corporate tax avoidance. If ratified, the changes will apply as of the date of the release. Other "important" treaty changes are expected under the negotiations that are currently under way, but the negotiators agreed that the particular changes announced were important for international mobility and should take effect immediately.

For corporations, the changes clarify the treaty's effect on a company's residence on its continuance from one country to another. Apparently it came to the attention of US tax authorities that the treaty's continuance provisions could be used to avoid taxes. For example, a US corporation planning to sell its US sub's shares at a gain arguably could escape US tax thereon if it first continued into Nova Scotia. Nova Scotia corporate law is unique in that it permits the continuation of a foreign entity without requiring the termination of entity status under the foreign law. Article IV(3) of the treaty deems the US parent to be a Canadian resident. When the sub's shares are sold, no taxable gain is reported from a US perspective if the shares do not derive their value principally from real property. The US parent suffers no Canadian tax because the adjusted cost base of the shares was stepped up to FMV at the time of continuation. Other planning arrangements have also come to the negotiators' attention, the tax results of which depended upon the attainment of dual residence status. Such plans were considered by the negotiators to be "inconsistent" with the treaty's intent: it was "not contemplated that the continuance provision be used to avoid taxes in this manner." Accordingly, the revised provision will clarify that a corporation incorporated in one country and continued in another is still treated as a resident of the first country unless internal law no longer treats it as such. In the example above, the US parent would not be entitled to treaty benefits except as agreed upon by the two countries' competent authorities.

Changes were also announced for individuals who emigrate to the other country: they may choose to be treated as having disposed of and reacquired property held by them at the time at its then FMV, with a view to eliminating taxation in the destination country on any pre-emigration gain. This resolves a particular problem that has plagued Canadian emigrants to the United States, because Canada taxes accrued gains on emigration and the United States does not allow a step-up on immigration. Canadian negotiators have been agitating for such a change for some time; the appropriate situation has finally arisen to permit its inclusion in the negotiated package. If the property is real estate situated in the destination country, appropriate crediting applies.

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ALBERTA'S SINGLE-RATE TAX

On January 1, 2001, Alberta residents will pay significantly less in personal income tax, reflecting an overall tax cut of 25 percent accompanying the newly introduced provincial single-rate tax. According to an article by Melville McMillan of the University of Alberta (to appear in the forthcoming issue of the *Canadian Tax Journal*), the tax cuts obscure the fact that the new rate structure shifts the burden of personal income tax from low- to mid-income taxpayers, leaving unchanged the share of high-income taxpayers.

The single 10.5 percent rate applied directly to federally defined taxable income means a sizable reduction in the marginal tax rate for those in the top income bracket under the federal system. Middle-bracket Alberta taxpayers will see some reduction in their marginal tax rate relative to the 1999 system but no change from the system outlined in the 2000 federal budget. Those at the bottom end of the income scale will see their tax burden drop dramatically because of a generous new $12,900 personal exemption and an additional $12,900 for a spouse or spousal equivalent that eliminates an estimated 132,000 low-income taxpayers from the tax rolls. The rest of the existing federal nonrefundable credits, valued at 10.5 percent, are also reflected in the new provincial system.

The accompanying table, abstracted from Professor McMillan's article, shows that the tax reductions for those with incomes of $30,000 or less is paid for entirely by those earning $30,000 to $100,000. Taxpayers with higher incomes contribute nothing to the tax cuts offered to low-income Albertans because their proportionate share of the overall, albeit diminished, tax burden remains unaltered. Despite smaller tax bills, single individuals and two-earner families bear the most significant increase in their share of the much reduced total income tax collections; the share of single-earner families is reduced the most. McMillan compares the single-rate system with multi-rate systems that collect the same revenues to show that a more progressive income tax system might well produce the same economic benefits stemming from the tax cut without shifting the responsibility to the average taxpayer.

Alberta Personal Tax Shares Under Current and Single-Rate Tax Systems

Income levels	Current	Single-rate
Under $30,000	13.3	8.0
$30,000 to $100,000	59.0	64.1
Over $100,000	27.8	27.8

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OECD VIRTUAL REDRAFT

On September 1, 2000, the OECD issued a second draft report on the characterization of e-business income. Principal changes include the following.

■ A consensus has been reached that downloaded software (including updates and add-ons) and application service provider (ASP) licence fees are business profits for treaty purposes. Paragraphs 14 to 14.2 in the model treaty's commentary to article 12 are now fully endorsed for transactions involving software, but not for other types of downloaded electronic products such as exclusive or other high-value data.

■ The redraft adds a more detailed discussion of the factors distinguishing the supply of knowhow from the performance of services generating article 12 royalty income and business profits, respectively. The redraft notes that knowhow is an asset that already exists and is not created out of a particular contractual relationship. There is also now a broader consensus that the medium for delivery of services is generally not relevant: for example, the characterization of income from a service of preparing a report or developing software is not altered by its electronic delivery.

■ A relevant treaty's royalty definition may refer to "payments for the use of, or the right to use, industrial, commercial or scientific equipment." The redraft clarifies that in such cases payments for limited-duration software and other digital licences should be treated as royalties (1) if the digital product is provided on a tangible medium (CD-ROM or diskette); (2) if, when the tangible medium is no longer being used, it must be returned to the supplier; and (3) if the product is to be used for a business purpose. Personal use (such as for a computer game or the enjoyment of music) is not an industrial, commercial, or scientific use.

■ Payments for downloaded digital products that are not obtained in a tangible medium are now considered not "for the use of, or the right to use, industrial, commercial or scientific equipment."

■ The redraft promises further review of whether application-hosting services or customer support provided over a network are technical services under a treaty that allows source taxation of such services.

■ The redraft says that a new category of e-business income—carriage fees—paid to a Web site or network operator by a content provider for the privilege of having his content displayed is analogous to the income earned from content-acquisition transactions and is business profits.

The redraft's emerging broader consensus is encouraging. Comments from interested parties on the first draft, some of which are in the redraft, are said to overwhelmingly support the majority positions. The technical advisory group will meet once more this fall to complete their final report for the Committee on Fiscal Affairs by year-end.

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US REORGS

Recent IRS regs deal with the continuity of interest (COI) required to qualify a corporate acquisition as a rollover: the target's shareholders must receive as consideration a specified amount of the acquiring company's stock. The new regs address the effect of preacquisition redemptions and distributions and should be considered when planning for cross-border acquisitions.

Whether it is USco acquiring Canco or vice versa, generally several tests must be met before the acquisition is a rollover for US tax purposes. If Canco acquires a US Targetco, the form of the transaction determines the qualifying tests. In a straight share-for-share exchange, the Targetco shareholders can generally receive only Canco voting shares as consideration. Cash consideration may be used if the acquisition is structured as a merger; Canco establishes a wholly owned US Subco to merge at closing into the US Targetco, or vice versa. US Subco must be a US corporation because only US companies can merge. Canco capitalizes US Subco with the acquisition consideration (the appropriate mix of cash and Canco shares) to be distributed to the US Targetco shareholders in the merger. The end result is the functional equivalent of a straight share-for-share exchange—Canco has all the US Targetco shares and the former Targetco shareholders receive the acquisition consideration (stock and cash) from US Subco in the merger. In addition, the merger structure allows Canco to put intercompany debt in US Targetco, opening up an avenue to repatriate US profits to Canada free of US withholding tax: Canco capitalizes US Subco with debt, and pushes it into US Targetco via the merger. If US Subco is merged into US Targetco—a reverse merger—Targetco shareholders may receive up to 20 percent of the total consideration in cash and other non-share consideration. In a forward merger of Targetco into US Subco, US Targetco shareholders may receive up to 50 percent non-share consideration. But forward mergers are generally less preferable and more cumbersome from a corporate perspective because they entail such complications as the transfer of ownership of all the assets of Targetco, an operating company, with the attendant third-party consents for financing documents, leases, contracts, etc., and the transfer of registrations for ownership of patents, trademarks, etc.

If a particular US shareholder of US Targetco owns at least 5 percent of Canco after the acquisition, additional US tax filings are required for a rollover. Depending on the acquisition structure, Canco may need to acquire substantially all of US Targetco's assets, restricting pre-acquisition sales or redemptions of substantial portions of those assets.

When USco acquires Canco, a rollover for US tax purposes may be desirable if, for example, some of Targetco's shareholders are US citizens. Such an acquisition generally must be a straight share-for-share exchange: both entities in a merger must be US companies. Thus Canadian Targetco shareholders generally cannot receive cash or other consideration except USco voting stock. This requirement may be difficult or impossible to satisfy if the acquisition is structured as an exchangeable share transaction to qualify for a Canadian tax rollover.

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FIE Draft Under Pressure

The 1999 federal budget changes to the taxation of non-resident trusts and foreign investment entities (FIEs) were modified in November 1999, and massive draft legislation was released on June 22, 2000. (See "Foreign Investment Entities," *Canadian Tax Highlights*, July 25, 2000, at 49.) Following intense pressure from the financial, business, and tax communities, a September 7, 2000 Finance release announced an extension of consultations, a delay in implementation, and certain technical modifications.

The consultation period is extended from September 1, 2000 to December 31, 2000, and implementation is delayed one year to taxation years beginning after 2001. In response to submissions received, the release also includes certain proposed changes to the FIE rules. US "regulated investment companies" are excluded from the rules, and Finance will explore whether other foreign-based funds should be exempt. The FIE rules do not apply to determine cost amount for RPP and RRSP foreign content limits. Stock options of a foreign parent company are not subject to the rules. The two-thirds inclusion rate for "deferral amounts" under the mark-to-market regime applies to capital property, even if it was acquired after June 22, 2000; however, the 100 percent inclusion rate still applies to appreciation in value beyond the deferral amount once the rules are in effect.

A non-resident entity is generally an FIE if the carrying value of its investment property exceeds 50 percent of total assets. The investment-property definition excludes certain limited properties used in prescribed businesses. Finance will review the concept of carrying value and consider alternative concepts. (Carrying value is the amount relevant under accounting principles substantially similar to Canadian GAAP.) The investment-business definition excludes a business of purchasing and developing property such as computer software for sale or licence, but no exemptions are proposed for other businesses or for publicly traded foreign corporations structured as holding companies, which by definition carry on an investment business. For the purposes of determining carrying value on a lookthrough basis, technical changes are proposed to the concept of significant interest, which is essentially the ownership of at least 25 percent, by votes and value, by one non-resident entity in another.

The new release reacts to certain anomalies brought to Finance's attention, but not to others such as the interaction of the foreign affiliate and FIE regimes. The policy rationale underpinning the package is uncertain and may require a wholesale reconstruction to more properly focus on the intended target—avoidance of

SHOE ***by Jeff MacNelly***

tax by high-income individuals through investment in foreign-based funds.

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Exchangeable Shares and FIEs

The new foreign investment entity (FIE) rules proposed in the 1999 federal budget to replace the troubled offshore investment fund rules may apply inappropriately and pose concerns for cross-border acquisitions using exchangeable shares. Recent changes from Finance promise relief, but many structural weaknesses still plague the rules.

A non-resident corporation (Forco) cannot directly acquire a Canco in a share-for-share exchange and obtain a rollover for Canadian tax purposes for Canco's shareholders. Exchangeable shares effect a rollover and leave Forco holding all the shares in Canco or its successor, except for the exchangeable shares held by Canco's former shareholders. The exchangeable shares and related agreements together provide Canco's former shareholders with the same rights and economic interests as Forco shares would: because they are generally exchangeable for Forco shares, each shareholder arguably has a "participating interest" or option to acquire Forco shares under the FIE rules. Finance is considering an amendment to this express effect, and also to the effect that an exchangeable share will be treated as if it were the share for which it can be exchanged.

The problems created by the draft FIE rules are not limited to their application to exchangeable shares. For example, many exchangeable-share transactions involve non-resident high-tech corporations that acquire their Canadian counterparts. Such corporations are more likely than manufacturing companies to be FIEs: they generally invest less in bricks and mortar, and the tangible business properties they do own have much higher rates of depreciation and thus lower carrying values, which increase the chance that more than 50 percent of the company's carrying value is in investment properties. An exemption for shares of a corporation that are widely held, actively traded on a regular basis, and listed on a prescribed exchange applies if the corporation's principal business is not an investment business, but does not assist a private corporation. Finance's latest release may save a high-tech corporation that derives income from the licensing of intellectual property it has developed or acquired from investment business status, but it cannot save a public high-tech company with significant cash reserves. Intense market interest enables high-tech corporations to raise additional financing or capital relatively easily, but if those additional funds are not invested within the prescribed grace period the corporation may be considered an FIE. If such a corporation earns income on its cash reserves and, as is often the case, loses money on its high-tech business while developing new technologies, Revenue may argue that its principal business is earning income from cash reserves.

The draft FIE rules may hinder exchangeable-share transactions because the tax consequences of the rules' implementation may be unpalatable to Canadian residents holding exchangeable shares. It will be early 2001 before Finance clarifies its schedule for a revised draft reflecting changes made to date and, one hopes, changes yet to come.

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Shares from Options Clarified

An announcement in Revenue's *Income Tax Technical News* no. 19 (June 2000) seemed to indicate that an employee who acquired shares under a stock option plan and then immediately sold them could specifically track those shares without averaging their ACBs with other employer company shares and could also add the related section 7 benefit to the unaveraged cost. (See "Tracking Shares from Options," *Canadian Tax Highlights*, July 25, 2000, at 53-54.) A numeric example in a recent technical interpretation indicates that the actual cost, but not the benefit, must be averaged.

	Old policy	New policy
ACB		
200 shares × $20/share	$4,000	$4,000
Prorated paragraph 53(1)(j) benefit (200/300 × $3,000)	2,000	—
Full paragraph 53(1)(j) benefit	—	3,000
	$6,000	$7,000
Proceeds (200 shares × $40/share)	$8,000	$8,000
ACB	(6,000)	(7,000)
Capital gain	$2,000	$1,000

The TI clarifies that if the employee already owns shares of the company when the options are exercised, Revenue's new policy allows the related taxable employment benefit to be added to the cost of only the specific shares acquired under the option and immediately sold: the benefit is not averaged over the cost of all identical properties. Assume that an individual owns 100 shares of Publico with an ACB of $1,000 ($10 per share) and then acquires 200 more such shares under a stock option plan for $5,000 ($25 per share). The average "actual cost" of all 300 shares is $20 per share. On the same day, the individual sells the 200 shares at $40 per share, resulting in a taxable employment benefit of $3,000 [($40 FMV − $25 exercise price) × 200 shares]. Under the old policy, the employment benefit was averaged over the ACB of all the shares then held, not just the most recent acquisition, adding only $15 to each of the 300 shares held. Revenue's new policy allows specific identification of the shares acquired as the ones sold under option—if certain conditions are met—so that the entire related employment benefit attaches only to the ACB of those 200 shares. But because the shares' actual cost—the option price ex employment benefit—is still averaged with the cost of all identical properties then held, a large difference in the actual aggregate cost of old and newly acquired shares may result in a substantial capital gain on the disposition. As a result, planning techniques to separate the ownership of two pools of shares and avoid averaging should still be considered.

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Non-Compete Covenants

In 1999, the IRS issued a technical advice memorandum (TAM) stating that payment for a covenant not to compete in the United States was US-source income subject to 30 percent domestic withholding. On the facts, a US corporation paid a Swiss corporation, a former shareholder, for a covenant not to compete in North America. The Swiss corporation did not have a US permanent establishment (PE) or any other investment in US operations.

The IRS agreed that income from business profits not attributable to a US PE is exempt from US income tax under the US-Switzerland treaty. The taxpayer argued that the payment was business profits because it was in lieu of US business profits that it otherwise could earn or because it was a commercial settlement arising from its business operations. The TAM concluded that a payment for refraining from business activity cannot be characterized as business profits.

The next issue was whether the income was subject to withholding as fixed or determinable annual or periodical income (FDAPI) not effectively connected with the conduct of a US trade or business. The TAM stated that the payment was FDAPI, citing the *Korfund* case. That case held that the right to do business in the United States was US-situs property, and that payments for agreeing to refrain from exercising that right were considered derived from the use of that property in the United States. Furthermore, the TAM concluded that the payment did not fit the treaty definition of royalties and thus was not eligible for a reduced (zero) rate of withholding. The treaty definition of royalties enumerates specific examples that the TAM concluded were income from the use or disposition of intellectual property; the final catch-all phrase, "and other like property or rights," must therefore be read ejusdem generis and cannot be construed to refer to items that are not similar to the specifically enumerated items. The TAM concluded that royalties from intellectual property are not similar to payments under non-compete agreements, which "involve inaction or forbearance of income producing activity." As a result, the portion of the payment attributable to agreeing not to compete in the United States was subject to the 30 percent domestic withholding.

This TAM is contrary to a 1983 IRS ruling that held similar income to be business profits that were treaty-exempt because they were not attributable to a US PE. The ruling reasoned that a payment in lieu of income took on the same character as the forgone amount: thus, a payment in lieu of doing business has the same character as the business activity itself. Interestingly, the ruling also relied on *Korfund* to conclude that such an in-lieu-of payment was US-source, but did not allude to the case's conclusion that the right was a property right. Although the correctness of the TAM may be debatable, its potential application is far-reaching. A non-compete agreement between two entities located anywhere in the world could be considered subject to US withholding if the geographic territory includes the United States, regardless of whether the recipient ever engaged in business activity there.

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Administration Roundup

Partnership information returns. If a partnership is exempt from filing and files no return, Revenue can make a determination regarding the partnership income beyond the three-year assessment period. It may be prudent to file even if a partnership is exempt from doing so, because filing starts the statute-barred clock and protects partners from a potentially unlimited reassessment period. A partnership is exempt from filing, for example, if it has five or fewer members throughout its whole fiscal period and no member is another partnership. If such a partnership voluntarily files a return after the usual due date, a recent letter

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from Revenue's Rulings Directorate indicates that late-filing penalties do not apply, because the minister exercised his statutory authority and waived the requirement to file prescribed forms for such a partnership and others enumerated in *Information Circular* 89-5R, paragraph 11.

Ontario and holdbacks receivable. Ontario Finance is apparently working on a bulletin to confirm that taxpayers may no longer exclude holdbacks receivable and uncertified progress billings from the calculation of Ontario paid-up capital for taxation years ending after October 30, 1998. This change, intended to parallel the federal large corporations tax treatment of holdbacks receivable, was announced in Ontario's 1998 budget.

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FOREIGN TAX NEWS

Treaties

Canadian and US treaty negotiators agreed in principle on the changes set out above in "Treaty Emigration Changes."

The treaty with Uzbekistan entered into force on September 14, 2000, effective for withholding purposes on amounts paid or credited after 2000, and for other taxes for taxation years beginning thereafter.

Canada

The OECD 2000 Economic Survey of Canada describes the Canadian economy as robust and recommends that initiatives in tax reform proceed, including preferential treatment of industries that extract non-renewable resources. The survey suggests that Canada expand its commitment to tax relief in order to establish a more favourable position among other OECD countries, which generally have lower tax burdens, particularly for businesses.

Germany

The first draft of tax reform proposals promises radical changes, including a flat 25 percent rate—30 to 40 percent currently—for residents and non-residents, and the exemption of corporate capital gains on shares with a minimum one-year holding period. Individuals' capital gains on shares continue to be taxable if they are business property, but only at a 50 percent inclusion rate if held for more than one year. New thin cap rules reduce the debt-to-equity ratio from 3:1 to 1.5:1 (from 9:1 to 3:1 for holding companies). The step-up in asset values on corporate acquisitions is to be eliminated.

Money Laundering

US Deputy Treasury Secretary Stuart E. Eizenstat, addressing the Anti-Corruption Summit 2000 in Arlington, Virginia, said that US laws are not strong enough to fight tax evasion and money laundering; substantial initiatives are being blocked in Congress. The "name-and-shame" tactics of the Paris-based Financial Action Task Force against money-laundering havens that were uncooperative with international efforts have produced encouraging results.

Spain and Mexico signed a mutual administrative assistance treaty to combat money laundering, agreeing to exchange information when their respective competent authorities suspect that funds involved in international transactions are related to illegal activities.

The criminalization of the bribery of foreign officials is targeted by the OECD's Anti-Bribery Convention, signed by 23 nations. The remaining 7 member countries' signing may be impeded by the interest deductibility of bribes in several European countries, including France.

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