Kill Bill: Is C-10 on the Ropes?

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One year ago, I wrote an open letter in this newsletter to Finance Minister Flaherty, direct from a Maui windsurfing beach, inviting Mr. Flaherty ("Jim") to come to the beach for a chat. And what more appropriate topic of conversation can there be than international tax, particularly the foreign investment entity (FIE) and non-resident trust proposals then in Bill C-33 - now Bill C-10**[1]**?

While the article was entitled "Mr. Flaherty, Tear Down These Rules"**[2]**, I ended rather respectfully, requesting that he might "make some changes to these proposals". I cited as an example, the plight of a beneficiary of a non-resident estate (or trust), who could have to pay tax based on an interest factor applied to the estate's entire asset base, even though he or she may receive only pennies from the estate – and another FIE proposal, requiring a person who comes to Canada with a foreign life insurance policy to revalue the policy each year and pay tax on its increase. (Doesn't *everyone* have the information and expertise to do this?)

As most readers are aware, Bill C-10 has been in a legislative limbo for many months. Having passed through the House of Commons, the Bill found its way to the Standing Senate Committee on Banking, Trade and Commerce and has been there for all of 2008, with no signs of passage in sight. This level of review from a body that has traditionally rubber-stamped legislation is likely unprecedented.**[3]**

Fatal Detraction?

In the meantime, some other extraordinary events have taken place. First, when the Committee commenced its hearings in December of 2007, STEP representative Robin McKnight criticized the proposals as "unduly complicated and . . . fatally flawed". Then there was an impromptu groundswell of e-mails in January. Starting with a few practitioners complaining about the international component of Bill C-10, the distribution list got longer and longer, swelling to 200 or so participants, consisting of many or most the leading Canadian practitioners in international personal tax planning. The culmination of this process was a letter to Senator David Angus, the Chairman of the Standing Committee**[4]** - endorsed by dozens of leading tax advisors – criticizing the non-resident trust and FIE proposals as "fundamentally unsound", "virtually impossible to comprehend", and asking that these proposals be stripped from Bill C-10 for further consideration.

Since that time, to a large extent, the torch has been carried by three tax lawyers from Davies Ward Phillips & Vineberg. In late January, Nat Boidman wrote about the non-resident trust and FIE proposals in an op-ed piece appearing in the National Post**[5]**, labeling them "unnecessary, unworkable and excessive". On May 1st, Michael Kandev wrote a similar piece**[6]** adding a third troublesome area, the restrictive covenant proposals, citing their complexity, inappropriate broad scope and punitive effect. The article stated that the outcry from practitioners "received only a luke warm reaction from officials at the Department," and that pleas for revisions were ignored.

A month later, another senior tax partner from DWPV, Steve Ruby**[7]**, was called to testify before the Standing Committee. Mr. Ruby called for the Senate to kill the non-resident trust, FIE, and restrictive covenant proposals**[8]**. Citing them as "fundamentally flawed", Mr. Ruby testified that they "can only be fixed by reformulating the conceptual approach to the concerns raised in these areas". While Mr. Ruby did not purport to speak for his partners, a day later at the annual STEP conference in Toronto, Nat Boidman endorsed Mr. Ruby's testimony, and cited a "disconnect" between what Finance says it's doing in press releases on the subject and what it is actually doing in the legislation. To literally adhere to the rules, Mr. Boidman observed, "the FIE proposals can require a small investor in a Fortune 500 company, to hire a forest of advisors"**[9]** in order to show that the investment is not caught by the rules.**[10]**

As a result of these efforts, where we stand – a year after my Maui article – is that there is a real possibility that wholesale changes to Bill C-10 may occur. The Committee has indicated that it will not pass the tax content of the Bill as is, and has asked the Department of Finance and tax practitioners' representatives to work something out.

Drop 'em a Line

So guess where I am? But this time, I am not writing to Mr. Flaherty. I am asking you to write.

I want you to tell Mr. Flaherty that the non-resident trust, FIE and restrictive covenant proposals are seriously flawed and should be scrapped. Tell him that you agree with Michael Kandev that the controversy surrounding Bill C-10 has also exposed some fundamental issues with the process of making Canadian tax laws. Tell him that the Department of Finance Tax Policy Branch should be reorganized to ensure that Canadians are taxed pursuant to clear, fair and well designed tax laws.

If you join in this effort, there is a real possibility that the problematic provisions in Bill C-10 could be substantially changed or even killed.

Mr. Flaherty's e-mail is: jflaherty@fin.gc.ca.**[11]** Senator Angus can be copied at his e-mail: anguswd@sen.parl.gc.ca.**[12]**

If this effort meets with success, we will be particularly indebted to the three DWPV tax practitioners - who have showed that their principles are more important to them than a cushy relationship with Finance.

Special thanks to Nathan Boidman.

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[1] In case you didn't read the article, the analogy is that Canadians are outnumbered both as windsurfers and businesspeople. In the latter case, we don't need complex and punitive international tax rules holding us back.

[2] *Tax Notes* No. 535, August 2007.

[3] Although much of the fuss has been over "Censorgate" in respect of film funding, rather than arcane tax proposals.

[4] Addressed to Senator W. David Angus, Chairman of the Sanding Committee, by Paul LeBreux, January 28, 2008.

[5] "Offshore excess; Bill C-10 will hit onshore investments, as well as offshore" National Post, January 29, 2008.

[6] Also in the National Post: "Wake-up To Tax Laws", May 1st, 2008.

[7] Testimony before the Standing Senate Committee on Banking, Trade and Commerce, June 4th.

[8] In a letter to the Finance Minister dated March 8th, 2007, The Tax Executives Institute made the same recommendation.

[9] Canadian and U.S. tax lawyers, securities lawyers, tax accountants, forensic accountants, business valuators, stock brokerage advisors - and psychiatrists, due to tests relating to the investor's motive for acquiring the investment.

[10] It should be remembered that, as a general rule, unless an investment in a foreign entity fits specifically into an exemption, it is a FIE, with the typical result that there is deemed income based on prescribed interest rates as applied to the "designated cost" of the FIE. While a major exemption is usually available for controlled foreign affiliates, anything else — most "co-ventures", for example — must be scrutinized carefully, even if they are active-business-related, and therefore might fit into the major exemptions offered for this type of investment.

[11] Mr. Flaherty's mailing address is:

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