

Income Tax Act

uses excess funds to purchase portfolio securities rather than to pay dividends or to expand the business. This is quite the thing. All sorts of businesses must have reserves set aside for a rainy day. Management would be most imprudent if having some spare cash it did not pay dividends which would attract taxation or did not engage in unwanted or unneeded business expansion, if it did not put it aside in securities investments lasting longer than a year. However, those are ineligible investments and the returns thereon will be taxed as non-business income. On one hand, it will push the total income toward the \$400,000 ceiling but they have to deduct it from the otherwise income of the company in order to qualify for the lower rate.

Ineligible investments under the bill are defined as being all property acquired after 1971 that are not used to produce income from an active business. However, excluded from the term ineligible investments are bank deposits and bonds. I presume government bonds will qualify as eligible investments because they are government bonds. However, if they are bonds, for example, of some electric utility company they would become passive income not in the ordinary course of business and therefore would be disqualified.

The Chairman: Order, please. It being six o'clock, I do now leave the chair.

At six o'clock the committee took recess.

AFTER RECESS

The committee resumed at 8 p.m.

The Deputy Chairman: Order. When the committee rose at six o'clock the hon. member for Edmonton West had the floor on sections 82 to 85, 89, 112, 121 to 125, 129, 143 and 181 to 197.

Mr. Lambert (Edmonton West): Before the dinner hour I was discussing the effect of sections 188 and 189 on ineligible investments. I think the dinner hour came at a fortunate moment because I had the impression I was treading on shaky ground in arriving at my definition as to what might be eligible investments. When I said that government bonds might qualify but not those of an electric utility I found I was not completely right. Neither would qualify if the maturity of the issue exceeded one year.

I find it extraordinary that a company having funds in excess of its day to day working capital requirements should encounter such a restriction. The size of the reserves might still be well within the sum necessary for the prudent and efficient management of the company's affairs, yet the only thing it is permitted to do with this money is keep it on deposit with a chartered bank or a trust company or buy short-term issues. On no account must companies invest in anything which reaches maturity after one year. So, for example, investment in long-term bonds, which the government has a great desire to encourage, is forbidden. Let us consider which ones are eligible.

any bond, debenture, mortgage, hypothec, note or other similar obligation

(A) of or guaranteed by the government of Canada,

(B) of the government of a province or an agent thereof,

(C) of a municipality in Canada or a municipal or public body performing a function of government in Canada,

(D) of a corporation, commission or association not less than 90 per cent of the shares or capital of which is owned by Her Majesty in right of a province or by a Canadian municipality, or of a subsidiary wholly-owned corporation—

Strangely enough, companies cannot invest, in these circumstances, in any obligations, even the Canada Development Corporation. One of the bright stars which is very much in the government's eye at the present time is on a muted note. It blows its trumpet about projecting some life into that otherwise moribund body. I would have bet last June that this was to be a non-starter. I still think it will be a non-starter, notwithstanding the fact that some people have got together to form the board. In any event, the obligations of the Canada Development Corporation do not qualify under this particular section. All investments are required to be subject to the one principal requirement that they mature not later than one year after the date of issue of the obligation.

• (8:10 p.m.)

Then there are a number of other ways whereby money can be invested, but I am surprised this limitation has been put on this sort of investment. I should like to know what is the difference between interest on a treasury note and that on a Dominion of Canada medium-term bond. Perhaps the parliamentary secretary can tell the committee why this disabling restriction was applied at this particular point.

Where there is an ineligible investment, a special tax will be levied equal to 25 per cent of twice the cost of the investment or 25 per cent of the corporation's—this is another new term—"preferred rate amount" minus the net amount on which it has previously paid tax under this provision. The definition of "preferred rate amount" in section 189(4)(c) once again is complex, but normally it would be amounts on which the corporation had previously claimed the small business deduction minus an allowance for dividends paid. I apologize for the language, but this is pure Greek. Then there is a comment which reads as follows:

Perhaps an indication of the complexity of some of these terms, their computation and their inter-relationship is the fact that the bill as drafted appears to extend eligibility for the small business deduction by the simple expedient of making ineligible investments and subsequently disposing of them. This unintended benefit will obviously be removed prior to enactment into law.

It will be very interesting to see how quickly the appropriate amendment will be made if this is something that has winnowed its way through the gate and escaped attention. Business might have been able to do something about it on an interim basis, but as long as you qualify by certain dates you will be all right. The comment continues:

The thrust of the intended procedure is to ensure that the 25 per cent small business deduction is available only where the funds are used to expand the business or have been brought to personal tax by dividend distribution. The corporation can no longer be used to shelter excess funds from personal tax unless the excess