So, first of all, we have reference to amounts included in income from business or property, and then there is a reference to the deductions permitted in computing income from business or property. What we are chopping off from the first reference is an exception to deductions. We are removing that reference to subsection 20(7), which must mean that this is a tidying up process, as mentioned by the minister, in the list of 39 clauses of Bill C-170 that are not included in the ways and means motion. The reason I have taken so long to draw this to the attention of the committee is that the act is so complicated. I cannot overemphasize the care that one has to exercise in examining all of these particular provisions because they have cross-references. But in short, why the change?

Mr. Turner (Ottawa-Carleton): Mr. Chairman, as the hon. gentleman realizes, this is a technical amendment. It will delete reference to subsection 20(7) presently in subparagraph 12(1)(e)(ii). The reference to subsection 20(7) is redundant since it is previously mentioned in subparagraph 12(1)(e)(i). It is just a redundancy that we are eliminating without any policy consequences.

Clause agreed to.

On clause 3—*Obligation issued at discount.*

Mr. Lambert (Edmonton West): Mr. Chairman, May I ask the minister why the change? Is it merely an error? I recall that Bill C-259 had the date June 17 or June 18, and this was the wrong day. Is that all it is?

Mr. Turner (Ottawa-Carleton): Yes, Mr. Chairman. This is another technical amendment to ensure that bonds and other obligations issued on June 18, 1971, the date of the former budget, are covered by this subsection. This date was inadvertently missed in the existing provisions.

Clause agreed to.

On clause 4.

Mr. Lambert (Edmonton West): Mr. Chairman, I think I should make it clear at this point that you had better keep looking down my way when you call clauses since I have many questions to ask. At some point we must have an explanation on the record from the minister of every change that we are making. There need not be a long elaboration, but I think that both the House and the general public are entitled to know why these changes are being made in the act. There is no other way for the public to be acquainted with these problems. Those reasons may be commented on by outsiders at some later date. However, this is the only way we will have an Income Tax Act which makes any sense.

• (1610)

Mr. Turner (Ottawa-Carleton): I am agreeable to that procedure, Sir, but I would intend to follow it with the understanding of the committee that I give a brief explanation of every clause as we come to it. If members of the committee are not satisfied with the explanation or wish a further explanation I will rise again. I might say that the hon. member for Edmonton West knows that whatever I say is not binding on the court in any event. It will be the wording of the clause which counts. I mean my words will not be binding on the court in respect of a determination of the meaning of a particular section or subsection. Subsection 18(4) of the present act provides that where a corporation's debt equity ratio exceeds three to one, that is to say where the ratio of debt to equity is larger than three to one in terms of dollar value, the excess debt will be regarded as equity and an appropriate part of the interest will be treated as a non-deductible expense.

This is the thin capitalization rule, and is used to prevent corporations so arranging their financial affairs that they artificially arrange their debt-equity ratio so as to have a good deal of their equity in debt and deduct the interest on it rather than have it as a non-deductible expense. Paragraph 18(4)(a)(ii) requires the equity portion of the formula to be calculated at the beginning of a corporation's taxation year. This creates a hardship for newly incorporated and expanding corporations. The amendment, in effect, permits the taxpayer to determine the equity by reference to the paid-up capital at either the beginning or end of the year. This is primarily a benefit to smaller companies which would not want to duplicate their accounting unnecessarily.

Mr. Lambert (Edmonton West): Mr. Chairman, I am just wondering whether the insistence by the government on this debt-equity ratio is not going to work a much greater hardship on small businesses and those just starting-out. I am not worried about the bigger established corporations. I am wondering, in this so-called neutrality approach to the act, what the effect will be. I have known many companies in the past which had perhaps $50,000 worth of assets. Two or three individuals would decide to incorporate the business. They would be in partnership and would have anywhere from $25,000 to $50,000. There is no question that this many shares will be issued as their contributions and that they are going to issue the necessary shares to themselves for the carrying on and establishment of a corporate entity because this very definitely, shall we say, affects their future operations with regard to the shares.

In setting up an obligation by the company to the individual shareholders concerning their major contribution, frankly I would suggest to the minister that he is being overly severe on small business. Whether it is at the beginning of the fiscal year or at the end matters little insofar as these businesses are concerned. I think what the minister is forgetting is that interest is being charged to the company expense account. If the business should be a small business, likely it is being taxed at the lower rate. Remember that as soon as it is charged up to the company's account, it is deemed to have been received by the shareholder whose marginal rate quite conceivably may be considerably higher. Therefore, why limit the structure to Canadian business if there is no way that the public is being cheated, since these are private companies. Why make it so difficult?

I am looking also at certain provisions which did exist in the province of Alberta of no-share qualifications for directors. Where there is a very small issue of shares, maybe three or five, for small businesses, why have this insistence on that particular rule? This is where I think the minister is doing a disservice to the smaller and newer businesses.