Paragraph 155. Computation of income for tax purposes.

The Committee was disturbed to learn that a Canadian manufacturing company, the subsidiary of a United States parent, was able to incorporate a Canadian subsidiary company to carry on business in foreign markets which, because it does not carry on business in Canada, is not taxable in Canada. The Committee is glad to know that it is no longer possible to incorporate such a subsidiary with tax-exempt status in Canada and that any company incorporated in Canada after April 1965 is deemed to be resident in Canada and is taxable.

The Committee was also deeply concerned to learn that in the case under consideration, the Canadian manufacturing company which made a gross profit of 79% on the 30% of its production which was sold in Canada, made a gross profit of only 9% on the 70% of its production which was sold to its Canadian tax-exempt subsidiary. The Committee does not believe that differences of volume as between its several customers can justify such a difference in its rate of gross profit.

The Department explained that in the case of a non arm's length transaction it was required to judge whether the prices were right by reference to the fair market value. In this case it was almost impossible to find a case where dealings at arm's length were identical with the case under consideration. The Committee was not impressed with the departmental witness' statement that a very lucrative foreign market, which had nothing to do with the manufacture of goods in Canada, should have no bearing on the profits of the Canadian manufacturing company. The Committee is of the opinion that all the income enjoyed by a Canadian company from Canadian production should be subject to Canadian income tax.

The Committee appreciates the Department's difficulty in establishing a fair market value in the circumstances described and suggests that consideration be given to strengthening the Department's hand by providing that in the absence of any evidence to the contrary, the fair market value is no less than the value at which any arm's length transactions are taking place, regardless of whether they are identical transactions to those which are not at arm's length. While the Committee feels that in the administration of the tax laws the individual taxpayer is usually given the benefit of any doubt, it also feels that there should be a closer scrutiny made of companies, when a company has at its disposal a non-taxpaying subsidiary enabling it to adjust selling prices and therefore the proportion of its profits which are subject to tax.

The Committee is concerned that there may be many other companies incorporated in Canada prior to April 1965 which are not deemed to be resident here and therefore not taxable in Canada. It feels that particular attention should be paid by the Department to transactions with these companies which are not at arm's length insofar as other Canadian companies are concerned. A non-resident tax-free status is not now available to other taxpayers and it should be the responsibility of the Department to ensure that this special privilege is not abused.

Paragraph 157. Income tax owing by non-residents.

Treasury Board Vote 7c of Appropriation Act No. 1, 1968, 1967-68, c. 34, authorized the deletion from the accounts of certain debts due to Her Majesty aggregating $19 million. Of this amount, $16.8 million represented uncollectable income tax, of which $5.2 million was owing by 267 taxpayers from whom collection could not be effected because they are no longer resident in Canada.