

Income Tax Act

can he deal with the following situation? We know that this applies generally across Canada, where we have so many subsidiaries of foreign firms operating in this country. How can he guarantee that there is not an overloading on to the books of the Canadian subsidiary of the cost of research conducted by the organization as a whole? Let us assume, for argument's sake, that there are five plants or subsidiaries in the United States and one or perhaps two in Canada, and that they have research facilities. The cost should be apportioned out over the whole organization, but because of the various profit positions of the company a business decision is made that because the Canadian operations have been highly successful a higher proportion of the cost of research for that year shall be charged on the books, which means merely making a bookkeeping entry; whether it be a branch or a controlled subsidiary it is a matter of book entries, and therefore flexible.

I agree with the minister that a taxpayer in Canada who is deriving benefit from research should pay his fair share and regard it as an expense of doing business. But what control has he—this may be a matter for the Department of National Revenue—over seeing that what is being charged for is a fair price for research properly attributable to the operations of a Canadian subsidiary?

Mr. Gordon: Of course, Mr. Chairman, this is a broad question which applies to a lot of other charges made by parents to subsidiaries, quite apart from the question of charges for research. It makes the problems of the Department of National Revenue that much more difficult, as my hon. friend from Digby-Annapolis-Kings knows very well. There is the difficulty of knowing whether the subsidiary company is paying too much for the goods it buys. There is also the question of all kinds of intercompany charges that the officials of the Department of National Revenue have to examine very carefully. In the last analysis the assessors of the Department of National Revenue must be satisfied that charges of all kinds—and there are many other charges which are made besides those for research—made by parent companies to their subsidiaries are reasonable and that they are not being used to transfer profits, free of withholding tax and free of income tax in Canada, from such subsidiaries to the parents.

I think the article in the Canada-United States reciprocal tax convention dealing with this matter is article IV which deals with "diversion of profits to a parent corporation." It is one of the things which the assessors must look into company by company and case by case; but I can assure my hon. friend that as far as I know there is no more difficulty in

doing this in the case of research expenditures than in a wide variety of other intercompany charges.

Clause agreed to.

On clause 16—*Sale of accounts receivable.*

Mr. Nowlan: Would the minister explain what is the reason for clause 16? It simply amends the former section to include the sale of obligations in the money lending business. Was there some particular case which arose which made this clause necessary. What is the background to it?

Mr. Gordon: This was one of those things which was taken pretty seriously by the joint committee of the Canadian Bar Association and the Canadian Chartered Accountants Association. They thought there was a loophole here, or if not a loophole then an omission, and they felt very strongly that it should be coopered up. I was convinced that there was something in it; it did not seem too serious so we thought we should go along with it.

Clause agreed to.

Clauses 17 and 18 agreed to.

On clause 19.

Mr. Nowlan: Would the minister just explain the meaning of clause 19?

Mr. Gordon: The provision being repealed provided a special 5 per cent tax on increased dividends to prevent companies which did not intend to acquire a degree of Canadian ownership paying extra dividends before the end of 1964 in anticipation of the coming into force of the 20 per cent non-resident withholding tax on January 1, 1965. Any company which may have paid the tax imposed under part IID will be eligible for a refund.

Mr. Monteith: I am assuming that the minister admits that he was not correct in bringing forward the increase to 20 per cent in last year's income tax amendment.

Mr. Gordon: On the contrary, Mr. Chairman. As I explained before, the only reason for reducing the amount from 20 per cent to 15 per cent is the changes in the rates of tax in the United States. After all, we are all agreed now, I think, that this carrot and stick business introduced some time ago by my hon. friend opposite in connection with research charges is something for the past.

Mr. Martineau: Does that mean, Mr. Chairman, that the fiscal policy of the government will depend in large measure on what is being done below the border?

Mr. Gordon: Certainly not, Mr. Chairman.