

(a) to ensure that the N.R.O. was in fact beneficially owned by foreigners, not by Canadians masked by a veil of foreign corporations and/or trusts;

(b) a situation where some of the N.R.O. shareholders lived in a treaty country and some did not.

To guard against the possible improper use of N.R.O.s by Canadians and to meet the problem of joint ownership in treaty and non-treaty jurisdictions, **we recommend the election required for a Canadian company to be taxed as an N.R.O. be subject to the applicant's satisfying the Minister of National Revenue as to the facts of the residence of the owners.**

We further recommend that consideration be given to expanding the source of income rules for qualification as an N.R.O. in order to make it possible for at least some foreign business corporations to become N.R.O.s and thereby be able to continue their presence in Canada.

THIN CAPITALIZATION

White Paper Proposal

6.42

Proposed to restrict deductibility of non-arm's length interest where ratio of shareholder debt to equity exceeds three to one.

Comment

Although paragraphs 6.41 and 6.42 of the White Paper are not explicit on the point, it is our understanding that the "thin capitalization" rules are intended to apply only to Canadian corporations which are owned by non-residents. Assuming this conclusion to be correct, we again are sympathetic to the problem which has prompted the Government to suggest these rules, but we are doubtful about the feasibility of the proposed solution. As the White Paper observes, other countries have experimented with similar type of legislation with only modest degrees of success and at a considerable cost in terms of both complexity and interference with normal commercial activity.

Submissions to the Committee on this proposal pointed out that it was not sufficiently detailed to permit of useful criticism, which will have to await the appearance of draft legislation.

Recommendation

We approve the objective of the proposal. However, we recommend that the government proceed to the legislative drafting stage, but be prepared to reconsider the proposal if sufficient valid criticism of its workability is received at that time.