6.75 The White Paper views the prescribed recovery rate as a mechanism for eliminating the deferral of tax. The proposed new provisioning rules, however, would retain the possibility of tax deferral even when applied precisely as intended. Under the new rules, financial institutions will continue to be entitled to deductions for anticipated rather than actual loan losses. Deductions for future losses, even if correctly anticipated, yield reductions in reported income before the income loss actually occurs. In effect, therefore, they represent a form of tax deferral and should not be permitted under a tax system which accounts for income and losses as they accrue.

6.76 20. **We recommend that deductions for loan losses be permitted only when it is determined that the loans are partially or totally uncollectible.** In other words, except as provided in paragraph 6.78 below, we recommend that financial institutions no longer be permitted to claim deductions for expected future losses. Loan losses should be deductible only as they occur.

6.77 The advantages of this approach are that: a) in the tax treatment of bad debts, it places financial institutions in a similar position to non-financial firms; b) it is fairly straightforward - it maintains the present system of deductions for bad debts; and c) it provides an appropriate measure of economic income as the basis of taxation.

6.78 **21.** In order to minimize the effect of the proposal on smaller, regional institutions, we would retain the possibility of accumulating small amounts of tax deductible reserves on the basis of a standard formula. Specifically, **we recommend that financial institutions be permitted to accumulate tax deductible reserves up to one percent of the first $100 million of eligible assets.** Since reserves are provided in recognition of the risk of loss associated with a portfolio, the definition of eligible assets should exclude securities bearing little or no risk.

6.79 **22. To ease transition into the new system for providing reserves, we recommend that existing reserves that would not be allowed under the new system be brought into income in equal amounts over a seven-year period.**

- *Life Insurance Companies*

6.80 The White Paper makes a number of recommendations designed: a) to restrict excessive reserve deductions allowed to the life insurance industry, and b) to