

On section 7: lease-option, higher purchase, etc.

The CHAIRMAN: May we have an explanation of this, please, Dr. Eaton?

Dr. EATON: Section 7 extends the existing provision in our law—which is section 18, I believe. The present law deals only with movable property. This broadens out to cover all property other than property used in farming. The substance of the section is this, that where there is a lease-option agreement, for purposes of income tax the lessee is deemed to be the owner of the property, and accordingly is entitled to depreciation on the property. Now the problem that gave rise to the need for this amendment is the case where very short term leases were entered into with nominal purchase price as an option. The result of that would be that the taxpayer could pay these so-called rentals annually, say for five years, and at the end of five years acquire the property for a nominal sum. The effect of that is that he would have written off through the medium of rent practically the whole of the cost of that property, and then would be the owner of it; whereas the person who purchases outright has to write the property off in the ordinary orderly manner of depreciation. But for this amendment a person could, by paying rent, very high rent, rent in excess of use value, for property, get the whole property written off in five years, whereas with ordinary depreciation rates he might not get it written off for twenty-five or thirty years. The other feature is that in these agreements the taxpayer may not merely be purchasing depreciable assets; he may be purchasing land, which is included also in the property being purchased. There is no write-off depreciation or amortization in the case of land. Where land is included in these lease-option agreements, the taxpayer gets an undue benefit as compared with other property of taxpayers under the law. So this is to take care of the short-term lease options. Where the lease option is in fact for a long term, it may be that under this the taxpayer will get a higher annual deduction than he would get had he been on the ordinary rental basis.

Hon. Mr. HAIG: How do you arrive at that under the wording?

Dr. EATON: Under the diminishing balance principle, sir, the rate is about double.

Hon. Mr. HAIG: Is not this put in to get at people who, for instance, bought road machinery?

Dr. EATON: I believe that was the origin of it in the days of E.P.T.; but since that time it is quite common for companies to sell realty and then purchase it back, or enter into a lease-option agreement with an option to purchase back.

Hon. Mr. DUTREMPLAY: It would not be a sale, if it is a rent.

Dr. EATON: It is deemed to be a sale for income tax purposes.

Hon. Mr. HAYDEN: If there is a repurchase.

Dr. EATON: Yes.

Hon. Mr. HAIG: Is not the real argument this. Say road machinery cost \$30,000, the purchaser was to pay so much a year as rent, and he had an option at the end of the time to purchase the machine and be allowed credits for the amount paid in the meantime. You found it necessary to grant exemptions on this as expense in the current year. It is to get over that?

Dr. EATON: Yes.

Hon. Mr. HAIG: I had one such case.

The CHAIRMAN: That takes all of section 7. You agree to pass all section 7?

Dr. EATON: It all deals with the same topic, sir.

The section was agreed to.