

Income Tax Act

Mr. Stevens: Dealing with clause 32, the minister has referred to the effect of clause 42, which is consequential upon the passage of clause 32, if it does pass. The minister has left the inference that somehow or other the point that I was raising concerning the payment of dividends from small businesses to a corporation and then out to an individual is not covered. The minister has left the inference that the effect of clause 42 would be to permit that payment of a dividend through the corporate chain. As I understand it, clause 42 simply facilitates the payment of the dividend, but there is no credit left with the small business corporation respecting their cumulative dividend account.

Mr. Chrétien: Mr. Chairman, I think it is exactly as the hon. member has concluded; the transfer of money can be made under clause 42. But when transferred to that type of corporation, the income of the corporation, up to \$750,000 is affected in a different fashion.

Mr. Stevens: Mr. Chairman, that is just my point. What they have done is that they have set up—and we endorsed it as hon. members will recall—a special provision with respect to small businesses, giving them the privilege to have a relatively low income tax on \$150,000 per year to a cumulative amount of \$750,000. To the extent that they pay dividends out, they can credit those dividends against the cumulative \$750,000 account. The thrust of this section is to take away the dividend credit provision if the dividend is paid to a corporation.

The point I am trying to make, Mr. Chairman, is that surely this is a backward step. When we become analytical as to where the dividends are being paid from the small business corporation, we are automatically, by that restriction, curbing the amount of capital small businesses will have available to them in future. My point is simply that when something appears to be working, when there is some flow of capital coming into small businesses, why is that now being killed by saying that, in the event that small business pays a dividend to the corporation that put up the capital, we are going to take away the cumulative effect of the over-all provision that we have said is available to small business? It is just the reverse of the situation that one would normally expect if we want to encourage venture capital in this country to go into small businesses in order to give them a shot in the arm.

I will ask the minister once again—I see he is anxious to reply. What is the rationale in killing off this type of activity when apparently it has been working a little better than the government expected?

Mr. Chrétien: Mr. Chairman, I explained that clause 42 facilitated the flow through of the dividends. But what I explained in the earlier written note that I gave the committee is that it is possible with the present system for companies having the proper set-up to receive the preferential rate of taxes that goes to small companies not up to the amount of \$750,000 of cumulative profit, but up to \$7.5 million. You can do that by using the rules. A clever person with lawyers and so on and a very complex system could have not only \$750,000 of taxes paid at the lower level, the preferential level, but have it

[Mr. Stevens.]

accumulated up to \$7.5 million. For that reason, it would be unacceptable for us not to move when we see a potential loophole like this. The hon. member should congratulate my officials for being able to forecast that loophole. If we had not forecast it, he would be the first in a few years from now to say we had not done our job properly.

● (1552)

What we are trying to do here is help small business. We do not want to create the situation where there is a loophole for big business. In order to give some further explanation of a more technical nature, may I have permission to read this text. To correct this situation, the amendments provide that dividends on non-control holdings that are exempt from part IV tax will not reduce the payer's cumulative deduction account. This ensures that, to the extent the part IV tax is not paid, the payor corporation's small business deduction entitlement is limited to \$750,000. A consequential amendment to part IV permits the receiving corporation to elect to pay the part IV tax on otherwise exempt dividends. In this manner the payor corporation's cumulative deduction account is reduced, its small business entitlement is refreshed, and the part IV tax serves to ensure that an appropriate rate of corporate tax is paid on surplus retained in the corporate sector.

In structural terms, the amendment to subsection 125(6) modifies the definition of "cumulative deduction account" to provide that those dividends paid after April 10, 1978 to non-controlling private corporations owning more than 10 per cent of the payer's voting stock do not reduce the payor corporation's cumulative deduction account. Subsection 125(7) provides an exception to this general rule for dividends on which the recipient private corporation elected to pay the part IV tax.

Mr. Stevens: Mr. Chairman, I think I have made the point. The minister has read what the officials have given him as an explanation. He obviously does not understand the thrust of the clause. He simply has to read what he is handed.

Mr. Chrétien: Mr. Chairman, if we were to give prizes in this House, the hon. member would receive the prize as the one who throws around more cheap shots than anyone else. I will explain it in French.

[Translation]

Let us take nine companies . . . As it is too technical for them in English I will explain it half in French and half in *joual* and perhaps they will understand. Mr. Chairman, if nine companies decide to merge, they could control only 11 per cent of all shares, and with these nine different companies controlling 11 per cent, they would be able to get the preferential tax rate of this little company, abusing the system. In other words, those companies with interests in the small company could manage things so that this small company would declare a maximum profit of \$7,500,000 to avoid the rate applied to bigger corporations. In my mind, Mr. Chairman, there is a real danger of people abusing the advantage which we are