The impact of Sub Part F type rules would be to shift the liability for the tax from the foreign corporation to a taxpayer within Canada's taxing jurisdiction, both in theory and in fact.

(ii) Sub Part F type rules may be more desirable than tougher enforcement of residence rules, because the former would snare only passive income, leaving commercial income outside the scope of Canadian tax until repatriation.

In the same vein we suggest that the government narrow its area of concern from that of "passive" income to that of "diverted" income, because we believe the former concept to be unnecessarily broad. In other words, we suggest that investment type income which is derived as yield from surplus cash of a bona fide foreign business operation should be regarded as being qualitatively different from yield of Canadian capital or assets deliberately diverted offshore to avoid tax rather than for a business purpose.

(b) While the Government has not elaborated upon the details of its proposals in this area, Government witnesses have stated that they are confident that rules can be developed in this area which are significantly simpler and more effective than the Sub Part F rules in the United States.

Be that as it may, we are still left with the concern that the objective may not be worth the price which must be paid to accomplish it. The continued use of tax havens to effect tax avoidance is obviously undesirable, but unfortunately the Government has not indicated to us the magnitude of the problem, in terms of either dollars or taxpayers. Similarly, Government witnesses have not indicated whether or to what extent a system of mandatory reporting of interests in foreign corporations, trusts, etc. coupled with enforcement of the present law, would mitigate the problem. This Committee would consider it a retrogressive step if legislation were to be enacted which, in order to deal with a small problem, introduced serious obstacles to the bona fide international business activities of Canadians.

We note that the proposal for a general withholding tax rate of 25% for flows to resident or non-treaty countries would provide a partial barrier to diverting income from Canada, as would vigorous enforcement of the fair market value pricing rules now in the tax law.

If the tax avoidance problem remains serious enough to warrant pursuing and the combination of higher withholding tax and the present "fair market value rules" are not sufficient—as the government's proposals must lead us to believe—there appear to be only two choices available to cope with it. These are tougher enforcement of the existing residence rules or the introduction of ministerial discretion by which certain types of passive or diverted income could be deemed to be currently taxable by Canada in the hands of Canadian shareholders. As we have suggested previously, tougher enforcement of the residence rules across the board would affect bona fide foreign business operations as well as passive or diverted income —which we consider an undesirable result.