(1) Clause 36 proposes to add subsection 112(2.2) to the Act which would deny any deduction in respect of dividends on shares acquired after October 23, 1979 if a financial institution is or may be required to acquire the shares at any time or provide any form of guarantee, security or covenant providing protection with respect to such shares.

Your Committee is aware of several instances where banks, in anticipation of amendments to the *Bank Act*, have caused their subsidiaries to issue preferred shares to the public. In the event the Bank Act is amended to allow banks to issue preferred shares, such banks will exchange their preferred shares for the preferred shares of their subsidiaries. Pending such exchange, the banks have given certain protective covenants with respect to the preferred shares of their subsidiaries. The effect of the amendments proposed by Clause 36 would be to deny any deduction to taxpayers acquiring shares with such protective covenants after October 23, 1979 with respect to dividends received thereon.

(2) Subclause 66(7) of the Bill defines a term preferred share. Subparagraph (*a*)(i) of the definition defines a term preferred share to include those shares that may be redeemed, acquired or cancelled or their paid-up capital reduced within 10 years of the date of their issue.

The effect of this provision would be to include financial institutions from investing in the "put" market. That is to say, they could not acquire options which give the holder thereof the right to oblige a third party to acquire shares from them at a determined price. Your Committee sees no reason why financial institutions should be precluded from investing in the put market for shares listed on prescribed stock exchanges.

(3) Subparagraph (*a*)(iii) of the definition defines a term preferred share to include any share whereby the issuing corporation or any other person may be required to redeem, cancel or acquire the share within 10 years of issue, unless it is pursuant to a requirement of the corporation to redeem, acquire or cancel annually not more than 5% of the shares of the class. Your Committee is aware that many such requirements incorporate a cumulative feature. That is to say, if a corporation is unable to acquire any shares in any year, it may cumulate its right to acquire the shares in succeeding years. It is understood that the Department of National Revenue takes the position that this subparagraph, as drafted, provides for cumulative purchases. Your Committee is not confident that this is the better interpretation. It is recommended that the word "annually" on line 50 of page 96 of the Bill be replaced with the phrase "in respect of any year" in order to provide more clearly for a cumulative feature.

(4) Your Committee can envision an anomalous situation arising from the drafting of subparagraphs (i) and (ii). That is to say, should a share redeemable within 10 years of its issue remain outstanding after 10 years from its issue, it will still qualify as a term preferred share. It is recommended these subparagraphs be amended to limit the application of the definition to the first 10 years from the date of a share's issue.

(5) Subparagraph (*a*)(iii) includes in the definition of a term preferred share shares issued after November 16, 1978 if the issuing corporation or any other person provides or may be required to provide any form of covenant "providing protection with respect to the share". Such expression is clearly too broad. If a financial institution were to acquire a share issued after November 16, 1978 with one or more of the usual covenants attaching to preferred shares, it would not be permitted a deduction for dividends received on the share. The following are examples of standard covenants applying to preferred shares:

(*a*) the corporation will not issue shares ranking in priority to or *pari passu* with the share without the holder's consent;

(*b*) no dividends will be paid on common shares unless all arrears of dividends on preferred shares have been paid;

(*c*) holders of preferred shares may vote in the event of arrears of dividends.

Such covenants provide protection with respect to preferred shares but should not disqualify financial institutions from being entitled to deduct dividends from their income.

(6) Financial institutions owning shares acquired in the ordinary course of business and giving them control or the contingent right to acquire control of the issuing corporation will not be entitled to deduct dividends received on such shares (subsection 112(2.1) as proposed by Clause 36 and paragraph (*b*) of the definition of a term preferred share as proposed by subclause 66). Your Committee has several concerns with respect to these provisions. Firstly, it is concerned with the use of the expression "ordinary course of business". It is difficult to define what constitutes "ordinary course of business" for financial institutions. Banks and other financial institutions regularly invest their surplus funds and such activity could well be considered to be "in the ordinary course of business". Similarly, shares acquired by a venture capital division or subsidiary of a financial institution could be considered to be "acquired in the ordinary course of business" of that division or subsidiary. Such activities should not disallow the dividend deduction available to a financial institution. Secondly, your Committee can conceive of instances where financial institutions might invest either alone or together with one or more other financial institutions in shares which might, inadvertently or not, give them a contingent right to acquire control, such as in the case of failure to pay dividends for a specified period.

(7) Your Committee feels that paragraph (*g*) and subparagraph (*h*)(i) are too broad as drafted. As presented in the Bill, any minor amendment to an "established agreement" (defined to mean an agreement made before November 17, 1978 to issue a share) or any agreement relating to such share might change the share's status to a term preferred share.

(8) Subparagraph (*h*)(ii) of the definition provides that if the owner of a share could at any time after November 16, 1978 require, either alone or together with others, the redemption, acquisition, cancellation, conversion or reduction of the paid-up capital of the share (except on a default) unless the