

## Securities and Mergers & Acquisitions Bulletin

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Fasken Martineau DuMoulin LLP

### Department of Finance launches consultations on income trusts

On September 8, 2005, the Department of Finance issued its much anticipated consultation paper (the “Consultation Paper”) on tax and other issues related to publicly listed income trusts and limited partnerships. The Consultation Paper, which can be found on the web at <http://www.fin.gc.ca/news05/05055e.html> launches the consultation process promised by the Federal Government in the 2005 Budget in response to the continued growth of income trusts in Canada.

The Consultation Paper focuses on the tax and economic efficiency implications of flow-through entities, or FTEs, and whether the current tax system is appropriate or should be modified in response to the increasing prevalence of FTEs. The Department of Finance estimates that the use of FTEs resulted in federal tax revenues being \$300 million lower in 2004 than they would have been if FTEs were structured as corporations, but the Department of Finance acknowledges that this estimate is very sensitive to certain key assumptions including the proportion of FTEs held by tax-exempt investors. The Consultation Paper also reviews the taxation of FTEs in the United States, the United Kingdom and Australia and notes that, with certain limited exceptions, FTEs are taxed as corporations in those countries.

In addition to the effect of FTEs on tax revenues, the Department of Finance also is seeking input with respect to the impact of FTEs on economic efficiency. In particular, the Consultation Paper asks whether the preferential tax treatment afforded to FTEs distorts structuring and investment decisions thereby reducing economic efficiency.

#### Scope of Consultations

Specifically, the Department of Finance is seeking input on a number of key questions, including:

1. Does the tax advantage of FTEs relative to public corporations have a significant impact on how businesses are organized in Canada?
2. Have FTEs had a significant impact on tax revenues? Is there potential for revenue losses to grow in the years to come?
3. What impacts are FTEs having on investment decisions and the allocation of capital in Canada? Is the overall impact on the economy positive or negative?
4. Given the important role tax exempt investors play in Canadian capital markets, and could play in the FTE market, what impact could this have on government revenues and economic efficiency?

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5. Overall are there public policy concerns about FTEs and how the tax system influences their existence, and if so, what actions should be considered to address these concerns?

The Consultation Paper does not raise any new issues or policy concerns nor does it include any specific proposals. A number of policy responses are offered for consideration, however, including possibly limiting the deduction of interest expenses by operating entities, taxing FTEs in a manner similar to corporations or better integrating the personal and corporate income tax system.

## Consultation Framework

Interested parties may make written submissions to the Department of Finance on or before December 31, 2005. Additionally, the Canadian Tax Foundation will be hosting symposiums as another vehicle for public input.

For further information or assistance in making a submission, please contact:

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