

# Flaherty drops bomb on income trusts

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OTTAWA — Federal Finance Minister Jim Flaherty has announced tough new rules designed to curb the growing corporate move toward income trusts.

Mr. Flaherty says the trend is worrying, and if left unchecked could shift billions of dollars of the tax burden onto individuals and away from corporations.

“This trend has now moved into the core of our industrial and knowledge-based economy,” Mr. Flaherty said at a surprise news conference late Tuesday, shortly after financial markets had closed.

“It is a trend that has caused me growing concern. If corporations don't pay their share of taxes, this tax burden will shift onto the shoulders of hardworking individuals and their families.”

The minister said the move toward income trusts has been so swift and dramatic that it threatens Canada's economy, as well as government priorities such as health care and tax relief.

“Left unchecked, such corporate decisions would result in billions of dollars in less revenue for the federal government to invest in the priorities of Canadians,” Mr. Flaherty said.

There have been \$70-billion worth of corporate conversions to income trusts announced in 2006 alone, including Telus Corp., and BCE Inc., which announced its plans on Oct. 11.

However, when pressed on the impact of the changes, Mr. Flaherty said the new rules would apply to the two communications giants, since neither has yet completed their conversion to income trusts.

“BCE and Telus will not be able to become income trusts and have the tax benefits that are currently available,” he said. “Does that make it clear?”

Canada has about 250 trusts — worth about \$200-billion — in real estate, oil and gas, telecom, industrial, food processing and manufacturing sectors. They have become a popular investment vehicle but can be risky investments if business conditions deteriorate and companies are forced to cut payments.

The proposed rules would apply a new tax on the money distributed to shareholders by newly formed income trusts. Existing income trusts would be given a four-year transition period, ending in 2011, that would allow them to adjust to the new rules.

Meanwhile, corporate income taxes would be cut by 2011 to remove some of the market incentives to forming income trusts.

William Holland, chief executive officer of mutual fund company CI Financial Income Fund said Tuesday evening that it's "incredibly irresponsible" for the government to make any changes at all after saying the rules on trusts would be left alone.

"They shouldn't make any changes. They said they were going to leave income trusts alone. Well, they're not leaving them alone. That's the problem.

"Companies like ours have made a long-term strategic change because of what they said. We tried for three years to (convert into an income trust) and they changed the rules three times. And then, finally, we converted when they said they'd leave them alone."

Mr. Holland said the government's actions are like those of a third-world country.

"This just highlights the ridiculous nature of the present state of government in Canada," he said.

"Changing rules on a quarterly basis like that is really almost like an emerging market, like a third-world market economy."

As part of his wide-ranging tax reform plan Tuesday, Mr. Flaherty also announced that the government would:

- Increase the Age Credit Amount for seniors by \$1,000, to \$5,066 from \$4,066, retroactive to Jan. 1, 2006, affecting low- and middle-income seniors.

- Allow income splitting among pensioners, giving tax relief to retired seniors and encouraging others to save for their retirement.

"We will permit income splitting for pensioners beginning in 2007," Mr. Flaherty said. "This will significantly enhance the incentives to save and invest for family retirement security."

Independent MP Garth Turner, a longtime advocate of income splitting who was tossed from the Tory caucus, predicted last week that such a measure could mean a tax break worth up to \$301-million for two million seniors.

Retired couples can now split Canada and Quebec pension payments, but can't split other income, such as retirement funds and company pensions. That concentrates income in the hands of the higher earning spouse, with the resulting higher tax bite.

Mr. Flaherty said all the tax measures he announced late Tuesday would cost the federal government about \$1.24-billion annually by 2011, when they all come into effect.

Earlier this month, the federal New Democrats complained about recent high-profile income-trust conversions, warning that the trusts could threaten Canada's social programs.

Mr. Flaherty also hinted strongly Tuesday that the Conservative government would cut personal income taxes, although he wouldn't provide details.