

Trust tax plan produces tax parity

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Brent Fullard of the Canadian Association of Income Trust Investors is wrong to think Ottawa's trust tax threatens to sell out Canada. The U.S. tax treatment of Master Limited Partnerships (MLPs) is not more favourable than Canadian treatment of trusts would be under the tax plan. Moreover, Americans owning Canadian trusts have a very strong and probably unintended U.S.-made tax incentive to hold them.

Ottawa's tax plan creates tax parity between trusts and corporations in Canada. As Bank of Canada governor David Dodge says, we need tax parity to ensure the proper allocation of capital to its best uses without biases caused by tax. The new tax plan not only achieves tax parity within Canada but, oddly enough, it also achieves tax parity within the U.S. and between the U.S. and Canada at the same time.

With the strong American tax incentive to buy Canadian income trusts removed by the tax plan, Canadian individuals and energy corporations will be on an equal footing with American individuals, energy corporations and MLPs for the purchase of Canadian energy trusts, without tax incentives giving any one group an advantage in ownership. The 10% refundable income trust tax plan proposed by the federal Liberal party does not achieve tax parity and attempts to retain a strong tax incentive for American ownership of Canadian income trusts.

Canada should not be seeking to protect Canadian sovereignty over our own energy resources by artificially lifting Canadian energy trust unit prices above their fair values through tax advantages and loose securities regulation. Canadian seniors and other unsophisticated retail investors eventually bear the long-term capital losses associated with a deceptive cash yield policy designed to inflate unit prices and to indirectly deter foreign takeovers. The status quo and the Liberal 10% refundable tax plan are clearly not protecting Canadian sovereignty.

There is already substantial American, if not majority American, ownership of energy trusts today due to income trusts having tax incentives for both Canadians and Americans.

Americans owning MLPs in taxable accounts pay full personal income tax rates, just as Canadians owning income trusts in taxable accounts do now. Americans owning MLPs in Individual Retirement Accounts (IRAs) have essentially the same treatment as Canadians owning income trusts in RRSPs after the new tax. Dianne Besunder, a spokeswoman for the Internal Revenue Service in New York, says: "A business held inside an IRA -- because it avoids year-to-year taxation -- is considered to have an unfair advantage. The IRS therefore taxes shareholder income that would otherwise not have been taxed."

American investors have their distributions from Canadian income trusts treated as "qualified dividends" from an "eligible foreign corporation." These receive a special U.S. federal dividend tax rate of 15% rather than the U.S. personal income tax rate of about 30% (plus there is additional state income taxes averaging 8%). The American owners of U.S. MLPs and U.S. REITs have their distributions treated as income, so they are treated at a disadvantage relative to the American owners of Canadian income trusts. Unless the U.S. government explicitly seeks higher American ownership of Canada's energy industry, this appears to be an unintended U.S. tax incentive for Americans to buy Canadian trusts.

Ottawa's tax plan for trusts removes the U.S. tax incentive by collecting business taxes from the Canadian income trusts. Then the combined Canadian business tax and the U.S. dividend tax puts the American owner on essentially the same footing as a Canadian owner in a taxable account, paying combined Canadian business tax and Canadian dividend tax.

What people are forgetting in the debate on the new tax is that the U.S. government could just as easily have eliminated its own tax incentive, creating the same adverse impact on Canadian income trust prices.

The IRS could rationally define the Canadian distributions to be income, just as they are defined in Canada and just as they are defined for U.S. MLPs and REITs. The IRS could determine either tax avoidance by the Canadian income trusts, or change the U.S. tax law to remove its unintended strong tax incentive for Americans to buy Canadian income trusts.

Canadian income trusts usually disclose that there has been no U.S. IRS advance ruling, nor a written legal opinion received on Canadian income trust distributions being treated as "eligible dividends" from "eligible foreign corporations" in the United States.

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