Presentation to the House of Commons Finance Committee on Income Trusts
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The income trust tax plan removes tax advantages, and where there are tax advantages there is indisputable government revenue leakage.

If there were no tax advantages, there would not be this aggressive income trust lobby to reverse the income trust tax plan. If corporations had less combined business and personal taxes then, income trusts would be rushing to convert back to corporations to achieve these relative tax advantages.

If there were no tax advantages, there would not have been the $22 billion drop in market capitalization of business and energy trusts post the October 31, 2006 announcment of the new income trust tax plan.

I agree with Finance Canada not including the impact of the present value of net government revenues on income trusts versus corporations owned in tax deferred plans. It did not do so, since the Minister of Finance has a duty to manage the government budget today.

Nonetheless, if tax deferred revenues were to be taken into account, the $500 million government revenue leakage estimated by Finance Canada would be substantially higher.

I find there is a substantial tax deferred loss from owning income trusts versus corporations in the tax deferred accounts, as set out in my Research Report, "Investment Trusts Versus Corporations - Investment Valuation and Government Revenues in Tax Deferred Plans", which was submitted to the Finance Committee last week by Art Field, President of the National Pensioners & Senior Citizens Federation. My estimate of PV tax deferred loss is $98 for every $1000 invested. The loss occurs due to the government not collecting business taxes from income trusts annually, whereas it would do so from corporations owned in tax deferred accounts. I use a discount rate of 8.5%, a 10 year holding period and an average corporate tax rate of 24% and an average personal tax rate of 39%, which are about the same rates used by Finance Canada, Yves Fortin and Dennis Bruce.

I do not agree with the expert witness testimony of Dennis Bruce of HDR/HLB Decision Economics that there is an overstatement of the tax leakage by $125 million due to a deferred tax gain from ownership of income trusts in tax deferred accounts. I do not agree with either Yves Fortin's or Gordon Tait's conclusion that there is no government tax leakage from the tax deferred accounts. George Kesteven appears to be relying on these experts when he says that the tax leakage estimate is grossly exaggerated. Brent Fullard weighs in too on the false tax leakage argument because Finance Canada ignores the $9 billion of taxes being collected on $52 billion of retirement income.

There is insufficient time to critique the methodology of each of the industry's expert witnesses on government tax leakage from tax deferred plans. Generally, they all have the same problem of answering the wrong question. They are answering the question of whether the present value of taxes collected from owning income trusts in tax deferred accounts in the future is more than the business taxes foregone today when a corporation converts to an income trust. The right question to ask is whether the present value of taxes collected from income trusts owned in tax deferred plans is less than the present value of taxes from corporations owned in tax deferred plans. This question defines what tax parity between income trusts and corporations is all about. There is a definitive tax leakage from tax deferred plans because the government is not collecting business taxes annually from the income trusts owned, whereas it is doing so from corporations owned in tax deferred plans.

A related issue is the claim by the noted experts plus Kevin Dancey of the CICA and Dirk Lever of RBC Dominion that there is double taxation on corporation dividends and income trusts distributions post 2011. I do not agree that there is net double taxation of dividends after taking into account the large tax benefits from the upfront tax deduction for RRSP contributions and the deferral of taxes on investment income earned within the tax deferred accounts. The PV of an investment in a corporation within an RRSP is higher than the same one in a taxable account, since the RRSP structural benefits offset the loss of the preferential tax treatment on dividends within RRSP. Income trusts have a tax advantage over corporations in tax deferred plans, which is eliminated by the income trusts tax plan. The two business structures now have parity within tax deferred plans and neither experience net double taxation within tax deferred plans due to the inherent tax benefits within the structure of these plans.

I wish to contest the conclusions concerning U.S. Master Limited Partnerships made by Brent Fullard of CAITI, George Kesteven of CAIT, Gordon Kerr of the Coalition of Energy Trusts and Cameron Renkes of BMO Capital Markets. Unfortunately, the Canadian income trusts lobby has got its two arguments on MLPs wrong. (1) Americans retirees owning MLPs will not be treated better than Canadian retirees owning income trusts; (2) U.S. MLPs do not have a competitive advantage causing them to be the source for more American ownership of Canadian businesses.

For the most part, Americans owning U.S. MLPs are taxed in the same manner as Canadians owning income trusts after the new tax plan. Americans owning MLPs in taxable accounts pay full personal income tax rates just like Canadians owning income trusts in taxable accounts do. Americans owning MLPs in IRAs have the essentially the same treatment as Canadian owning income trusts in RRSPs after the new tax. Dianne Besunder, a spokeswoman for the IRS 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."

The MLP i-units that Cameron Renkes argues give relative tax advantage for tax deferred accounts in the U.S. have been used only a few times.  They look like tax avoidance schemes that have not been the subject of any IRS advance tax ruling.  The i-units avoid the special tax payable for MLPs owned in tax deferred accounts by foregoing the cash distributions and taking additional i-units instead. This makes the i-units an inferior security for investors in terms of the certainty of receiving cash distributions.  There is forced reinvestment of distributions and possible illiquidity in the secondary markets. The investor protection features are extremely inferior, such as no voting rights and limited recourse for management changes in the terms of the i-units.

The big tax loophole being closed by Canada is that Americans owning Canadian income trusts had their distributions treated as qualified foreign property getting a preferential 15% dividend tax rate, which was a strong tax advantage for them to own Canadian income trusts over their own MLPs and REITs.   Even the U.S. IRS would eventually figure out that it was losing over US $350 million of American government revenues annually. Unless it was America's intent to subsidize Americans purchasing Canadian oil & gas assets, the IRS would likely prefer to raise more government revenues and stop the preference for Americans buying Canadian energy trusts over the same oil & gas assets in the United States.

The new Canadian income trusts plan actually makes it more likely that Canadians can own their own oil and gas resources than the status quo.  The Coalition of Energy Trusts has got their argument on MLPs now being able to takeover the Canadian energy trust industry backwards.