JOSEPH J. OLIVER
PRESIDENT AND CHIEF EXECUTIVE OFFICER

February 2, 2004

The Honourable Ralph Goodale, P.C., M.P.
Minister of Finance
L'Esplanade Laurier
140 O'Connor Street
Ottawa, Ontario
K1A 0G5

Dear Minister:

Re: Draft Legislation Regarding the Deductibility of Interest and Other Expenses

The Investment Dealers Association of Canada (the IDA) is pleased to respond to the Department's October 31, 2003 request for comments on the draft legislation regarding the deductibility of interest and other expenses.

The IDA has serious concerns with the draft legislation. If it is enacted, we believe that it will threaten the current well-established practice of borrowing to invest in common shares, a very significant source of liquidity in our equity capital markets. Even though the Department states in its press release that it is not the intention of the draft legislation to disallow or interfere with this practice, our professional advisors have informed us that the draft legislation cannot be interpreted to apply in this way. Thus, we believe that the draft legislation will inevitably harm this area of the capital markets, with unintended consequences for investors and issuers. We set out below the reasons for our concerns and offer an alternative approach which we believe will have less negative impacts on the capital markets, while meeting your requirements for objectivity.

The draft legislation clearly states the conditions under which interest expense will be deductible for tax purposes. Specifically, the draft legislation requires that an investor must have a reasonable expectation of a cumulative profit, not including capital gains, from the particular investment. In the vast majority of cases where an investor borrows to invest in common shares, the investor will not be able over expected holding periods to meet the proposed cumulative profit requirement. The implied assurance from the Department that CCRA will favourably interpret the law in these cases is not, in our view, acceptable. We are concerned that CCRA would be legally bound to administer the law as written, and that investors would be best advised under these conditions to make their investment decisions on the assumption that interest costs are not deductible.

The difficulty in meeting the proposed cumulative profit requirement arises from the fact that dividend yields on common stocks, if they pay dividends, are generally well below the borrowing rates on investment loans. The average dividend yield on TSX-listed stocks is currently approximately 1.5%,

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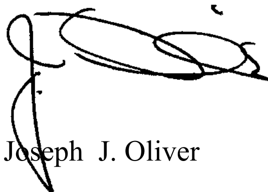
while the borrowing rates paid on margin accounts at our member firms average around prime plus 1.5% – a differential currently of over 4%. The only way an investor could have a reasonable expectation of a cumulative profit under these conditions would be if the investor were to hold the investment for a sufficient period of time such that, through growth of the company, the cumulative dividend eventually exceeded the cumulative interest paid. The Investment Funds Institute of Canada calculates that at a dividend rate of 1.7% and a stock price growth rate of 7% (which is the average annual growth rate of the TSE Composite Index over the last 20 years), it would take a holding period of 25 years to realize a cumulative profit. Investor holding periods for stocks in Canada generally average less than 5 years, although they obviously vary according as to the class of investor.

The potential impact on Canada's capital markets is significant. Investor borrowings facilitated through IDA member firms as reflected by outstanding debits in client margin accounts currently total over $7 billion. Most of these borrowings support portfolios that rely heavily on growth through capital gains. Denying interest deductibility for interest expense on these positions would dry up if not eliminate a good portion of this liquidity. The net result would be diminished access to capital for Canadian issuers, particularly for non dividend-paying, growth companies which rely almost exclusively on the promise of growth to attract and retain investors. The IDA, in its 2004 Federal pre-budget submission, has recommended a number of tax measures to improve capital formation and access to capital for the critical small business sector of the Canadian economy. The proposed legislation would operate in the opposite direction by limiting the availability of capital to growth companies, and would hamper Canadian innovation and productivity in the process.

In summary, the proposed amendments to the rules governing the deductibility of interest expense are potentially very damaging to Canada's capital markets and the Canadian economy. Thus, we strongly urge the government not to proceed with the proposed amendments. However, if the government believes changes are necessary (something which is not clear to us based on the materials published by the government), we propose that the government adopt a test based on an expectation of net profits where net profits are defined to include capital gains. This test would more closely mirror the economic rationale that underlies an investor's choice in borrowing to invest than the government's proposed test, and would be consistent with the accepted practice of preferential tax treatment for capital gains.

This issue is of fundamental importance to Canadian investors and issuers. We thank you for providing us with an opportunity to comment on the proposed legislation, and look forward to discussing our views with you and your officials at the earliest opportunity.

Sincerely,



Joseph J. Oliver

cc: Kevin Lynch, Deputy Minister of Finance