

March 6, 2006

The Honourable James Flaherty, P.C., M.P.  
Minister of Finance  
Department of Finance Canada  
140 O'Connor Street  
Ottawa, Ontario K1A 0G5

Dear Honourable Minister,

Please accept this letter on behalf of the Tax Policy Committee of the Issues and Policy Advisory Committee of Financial Executives International Canada (Hereinafter referred to as THE COMMITTEE.).

THE COMMITTEE members understand the importance of sound, prudent financial planning. We recognize the current federal budget surplus position and the opportunities and challenges this presents. THE COMMITTEE believes that your government should not waiver from the path of fiscal discipline, and encourages a balanced approach of spending, tax reductions and debt repayment, within agreed parameters. To achieve fiscal flexibility, it is critically important that we pay down the accumulated federal debt so as not to saddle future generations with past and current spending programs. An aggressive repayment schedule should be incorporated in future budgets. THE COMMITTEE urges your department to consider expanding debt reduction beyond the prior policy of using the annual Contingency Reserve to pay down the debt, in a more transparent and effective manner. For example, if projected revenues prior to decisions related to new last minute spending initiatives exceed previously committed expenditures by x%, debt repayment should be increased by a pre-determined amount of at least x%. Although the federal debt/GDP ratio has been reduced, an aggressive strategy such as THE COMMITTEE suggests should result in the government attaining an even more desirable debt/GDP ratio in the coming years.

THE COMMITTEE notes the extraordinary growth in federal fiscal spending over the past number of years, and that this growth is made possible by the projected increase in revenues from taxation. THE COMMITTEE would prefer that the government find the monies to fund new initiatives without increasing spending levels (through reductions in other programs), and reduce taxes to a more appreciable extent to stimulate the economy. Future balanced budgets are at risk should projected economic growth falter and taxation revenues fall below planned levels. THE COMMITTEE urges the federal government to reduce its fiscal role in the Canadian economy by reassessing spending plans and working towards both lower spending and lower taxes.

We do not encourage further growth in federal government program spending. Our belief is that if there is a surplus of x% in a given year, it should be government policy that program spending increase by no more than a predetermined amount less than x%. While we recognize that there are urgent needs which must be addressed, in our view, these needs can be met by reallocating currently committed funds.

Canada has many natural attributes, but in a competitive world, we must foster a business environment that encourages investment and capital accumulation to ensure the growth of the economy and opportunities for future generations. We compete head to head with productive capacity in the USA, particularly given NAFTA. Thus, we must ensure that our taxation regime is competitive with the U.S.

We must also ensure that simplification of the tax system continues, within a framework which has due regard for preservation of the tax yield, ensures fair treatment of all taxpayers, and guards against unwarranted abuse.

THE COMMITTEE espouses the attainment of a more competitive economy, both domestically and internationally. A more competitive economy means more than "a level playing field" and more than a lower taxed business sector, although both are important components. Competitiveness also encompasses public policies which promote strategically important industries or sectors, match incentives

provided by other countries, contribute to the development of a technologically skilled labour force, permit corporations of all sizes to access new technology in a rapidly changing technological world, establish capital cost amortization rates appropriate for the new technological environment, and ensure the availability of financing at appropriate rates.

As a signatory to the Kyoto Accord, the government is committed to improving the environment, both in Canada and around the globe, through the pursuit of greater productivity, investment in people, a competitive tax system which promotes economic growth, improving the commercialization of environmental technologies, and attaining sustainable development. Capital investment is a key to attaining these goals. THE COMMITTEE believes that your government can spur capital investment by directing initiatives to capital investment which demonstrates a positive impact on the economy and the environment.

## BUDGET PROPOSALS

THE COMMITTEE recommends that your Department consider the following taxation initiatives for inclusion in the forthcoming budget. We strongly believe these will achieve our mutual objective of enhancing the competitiveness of the Canadian economy.

These proposals address some of the key taxation and education issues of concern to FEI's membership. If implemented they would (i) assist Canadian corporations and the government as they endeavor to meet Kyoto commitments, (ii) enhance the domestic and international competitiveness of Canadian corporations, (iii) improve the cash flow of many Canadian corporations, thus enabling firms of all sizes to reinvest more after-tax funds in capital and productivity enhancements, and (iv) alleviate a pressing problem related to the acquisition of timely and cost-effective continuing education by Canadian corporations and their employees. Furthermore, these targeted initiatives are either revenue neutral over the near to medium term or are relatively negligible in terms of foregone tax revenues.

In presenting these proposals, please note that THE COMMITTEE believes it is the duty of government to remove unintended anomalies, inconsistencies, and impediments from the tax system, especially those which do not serve a tax policy purpose.

These proposals were developed following consultations with our members. We have, therefore, benefited from the insights provided by taxpayers intimately familiar with the current tax rules, the impediments imposed by those rules, and the additional costs incurred by Canadian businesses because of these rules.

### 1. CORPORATE GROUP TAX REPORTING

**Following comprehensive study and consultation, and incorporating a lengthy phase-in period, a loss transfer or tax consolidation system should be introduced which would allow Canadian corporations to directly access the unused tax attributes of other members of a commonly owned corporate group.**

Most developed economies that directly compete with Canada for capital, including the United States (tax consolidation), the United Kingdom (loss transfer), and the expanded European Union, currently have tax systems that allow group-wide tax reporting. In addition, such measures would greatly simplify Canadian taxation practices. Prior FEIC research (a survey of FEIC members) indicated that significant time and money is spent developing mechanisms to ultimately accomplish the equivalent of group wide reporting. A brief summary of the major conclusions of the research findings follows:

- (a) 95% indicated support for some form of group reporting.
- (b) 82% of those supporting the concept advocated either consolidation or a loss transfer system.

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- (c) 71% indicated their corporations had utilized the available loss carry over provisions to offset losses against prior or future profits.
- (d) 16% reported that their corporation had incurred losses which had expired because they could not be utilized within the available years.
- (e) Whereas 61% of respondents indicated that members of their in-house tax department spent under 500 annual hours on strategies designed to utilize losses within the corporation or by another corporate member, 7% indicated between 500 and 1,000 hours, and a further 7% over 1,000 hours.
- (f) 71% reported that their corporation spent under \$500,000 annually on related tax planning. Four respondents indicated that in excess of \$500,000 was spent annually attempting to achieve inter-group loss utilization.

While it is not our intention in this submission to propose specific technical provisions for a group reporting proposal (much time and thought is required before detailed specifics could be proposed), the survey indicated overwhelming support for the following broad parameters of a group reporting system:

- (a) The system should be initiated by an annual election of the corporation, filed in prescribed form.
- (b) Participating corporations should be in any line of business.
- (c) Group reporting should be available for all unclaimed attributes.
- (d) Group reporting should be available against all forms of corporate income.
- (e) Attributes not utilized in a given year should be available, at the option of the corporation, in future years.

Group tax reporting offers many benefits to the Canadian economy. It enhances fairness, competitiveness, neutrality, investment, consistency and cash flow; reduces abuse, unnecessary corporate concentration, and costly and inefficient corporate expenditures; and improves budget projections and corporate structure efficiency. Group reporting would extend these benefits to all corporate sectors, including the small and medium size sector, where tax efficiency, combined with financing and family planning, are critical concerns.

## 2. ENVIRONMENTALLY FRIENDLY CAPITAL INVESTMENTS

Currently, capital cost allowance (CCA) is available only on one-half of all net additions to a CCA class in the acquisition year. To provide an incentive for the acquisition of environmentally friendly capital investment, **THE COMMITTEE proposes that the half-year CCA rule should be eliminated for environmentally friendly capital equipment**, thereby allowing full CCA relief in the acquisition year. This measure would enable Canadian businesses to assist the government reach its Kyoto commitments, at minimal cost.

To effectively target this initiative, careful definition of the term “environmentally friendly” will be required. Ideally, all investments that supplant less efficient plant and equipment should qualify. Should this prove administratively unfeasible, qualifying investments could, for example, be restricted to energy efficient acquisitions or those which utilize renewable energy sources. Alternatively, designated sectors (for example, natural resources or manufacturing), or investments which achieve desirable outcomes (pollution abatement, for example), could be targeted.

### 3. INCREASED PERSONAL INCOME TAX THRESHOLDS

The 2005 personal income thresholds are \$35,595, \$71,190 and \$115,739. The comparable top threshold in the U.S., our most important trading partner, is approximately C\$350,000. While the debate over the “brain drain” can generate conflicting conclusions, it is unquestionable that mobile taxpayers (a group which includes senior and middle managers and executives/professionals), are influenced in their employment location decisions by the impact of taxation on their income.

**In order to create an after-tax position for managers and professionals more comparable with the U.S., income thresholds for the personal income tax should increase to roughly \$44,500, \$89,000 and \$144,500, which are approximately 1.25% of the 2005 amounts.**

### 4. MINIMUM TAX THRESHOLD

When the personal minimum tax was introduced in 1986, the threshold was set at \$40,000. In spite of increases in income since 1986, especially inflation induced increases, the threshold for the personal minimum tax has been maintained at \$40,000. While this amount may have met the policy objectives of the measure when it was introduced, it clearly is inappropriate at a time when approximately 17% of Canadian tax filers report annual income between \$40,000 and \$65,000 (*Income Statistics, 2004*). Many individuals, for whom the measure was never intended, may now be caught by the minimum tax rules because of the relatively low threshold.

The CPI has increased approximately 63% since introduction of the minimum tax. Had the threshold been indexed since its inception, the threshold would now be approximately \$65,000.

**In order to restore a comparable balance between incomes and the minimum tax threshold, the threshold should be raised to \$65,000 (indexed).**

### 5. CORPORATE TAX RATES

Capital investment is essential to sustain economic and employment growth, and generally increase the standard of living of ordinary Canadians. Investment is stimulated by attractive domestic after-tax returns and by tax rates which are competitive with U.S. rates. Excessively high corporate tax rates stifle capital formation. As noted in a recent C.D. Howe Institute report, Canadian corporate rates are not conducive to investment in this country. The C.D. Howe report indicated that Canada ranks second highest of 36 industrialized and developing countries in terms of effective tax rates on investment, a significant determinant of our productivity gap vis-à-vis the U.S.

**To encourage business capital expansion in Canada and to remain competitive with U.S. rates:**

- (a) **the corporate tax rate reductions contained in Budget 2005 should be reinstated,**
- (b) **effective corporate income tax rates should be reduced even further than as currently scheduled,**
- (c) **even though the corporate surtax has been eliminated from all sectors on January 1, 2008, consideration should be given to immediately eliminating the surtax from selected sectors, and**
- (d) **elimination of the Large Corporations Tax should be accelerated.**

## 6. HARMONIZATION

Many Canadian corporations transact business in two or more provinces. The larger corporations do so in all ten provinces and one or more territories. Various studies have indicated the need to remove or reduce provincial sales taxes. In addition, differences exist between the PST and GST tax base in some provinces. Whereas sales tax jurisdiction rests with the provinces, the federal government is responsible for administering the GST. Greater harmonization of the GST with provincial sales taxes would enhance competition, reduce red tape, and reduce compliance and administration costs as taxpayers and government would only have to deal with one sales tax authority.

Echoing the comments of the recent report of the Saskatchewan Business Tax Reform Committee, **THE COMMITTEE recommends that the federal government work with its provincial colleagues towards greater harmonization of the provincial sales taxes with the GST.**

## 7. TAXATION OF DIVIDEND INCOME

The double taxation of dividend income is a significant issue when corporations contemplate investment decisions and dividend policies. Due to excessively high corporate rates, many corporations have converted to Income Trusts. Others are considering doing so. An end to the double taxation mechanism would enable corporations to base their investment strategies on sound business principles rather than seeking favourable tax rates as their dominant investment decision criteria.

**THE COMMITTEE recommends that, in conjunction with reduced corporate rates, the dividend tax credit mechanism be adjusted to achieve after-tax balance between different forms of investment and ensure a seamless transfer of corporation dividend distributions to shareholders.**

## 8. ELECTION CAMPAIGN PROPOSALS

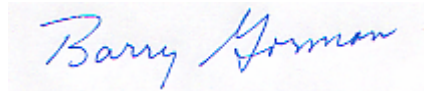
Following study of your party's tax-related election promises which apply to our membership, **THE COMMITTEE urges the government to proceed as rapidly as possible with the following measures.**

- (a) **Removal of taxation on listed securities which are donated to charities.**
- (b) **Following a period of time required to carefully eliminate unintended anomalies in the legislation, the proposal to defer taxation on the disposition of capital properties held for more than six months.**
- (c) **Reduction of the small business tax rate to 11%, and an increase in the Annual Business Limit to \$400,000.**
- (d) **The tax credits for wages of eligible employees.**
- (e) **The \$500 deduction for employee's tools.**
- (f) **The proposal to provide \$1,000 apprenticeship grants.**

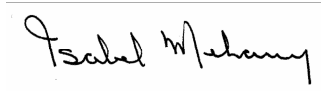
## CONCLUSION

As outlined in this brief, fiscal discipline and aggressive debt reduction, federal spending increases less than revenue growth, a competitive tax regime, continued simplification of the tax system, targeted tax incentives, and a more competitive, environmentally friendly and growing economy are fundamental tenets of THE COMMITTEE. We believe the tax measures we have proposed conform to these principles. We strongly urge your government to consider these measures and implement them in the spring 2006 budget. THE COMMITTEE stands ready to assist the government in fulfilling our mutual objectives.

Sincerely,



Barry Gorman  
Chair, Tax Task Force  
Issues and Policy Advisory Committee  
FEI Canada



Isabel Meharry  
President & CEO  
FEI Canada

## About FEI Canada

FEI Canada is an all-industry professional association for senior financial executives, with eleven chapters across Canada and more than 1,700 members. Membership is generally restricted to senior financial officers of medium to large corporations, as well as senior financial officers in public sector organizations.

The Issues and Policy Advisory Committee (IPAC) is one of two national advocacy committees of FEI Canada. IPAC comprises more than 30 senior financial executives representing a broad cross-section of the FEI membership and of the Canadian economy who have volunteered their time, experience and knowledge to consider and recommend action on a range of topics of interest to Canadian business and governmental agencies. The current composition of IPAC is formulated to address the following areas: corporate governance, capital markets, tax policy, pensions, internal controls and public sector accountability. In addition to advocacy, IPAC is devoted to improving the awareness and educational implications of the issues it addresses, and is focused on continually improving the areas it addresses.

The remarks contained in this submission are made by the members of IPAC and do not necessarily represent the views of all FEI Canada members or its Board.