



**SUBMISSION TO THE
HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE**

**ON BEHALF OF
FINANCIAL EXECUTIVES INTERNATIONAL - CANADA (“FEI”)**

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**September 6, 2005
For October 31, 2005**

SUBMISSION TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

EXECUTIVE SUMMARY

The Tax Policy Task Force of Financial Executives International - Canada is pleased to submit its comments to the House of Commons Standing Committee on Finance during the 2005-06 pre-budget consultation period. In summary, the submission discusses the following three proposals:

1. repeal of the half-year CCA rule for environmentally friendly capital investments,
2. introduction of a corporate group tax reporting system in Canada, and
3. establishment of a Centre for Workplace Continuing Education and Training

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 the 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 tax revenues.

These proposals, with supporting arguments, are developed in some detail in the submission, with additional commentary related to their fiscal impact.

We ask that the Standing Committee examine these proposals and consider them in your report following the conclusion of the pre-budget consultation process. We would be pleased to meet with the Standing Committee to discuss our recommendations in detail.

September 6, 2005

Massimo Paletti, MP
Chairperson
Standing Committee on Finance
House of Commons
Ottawa, ON
K1A 0A6

Dear Sir

Please accept this submission on behalf of the Tax Policy Task Force of Financial Executives International - Canada (the "FEI Committee"). FEI Canada is a professional association of Canada's senior financial executives. With 11 chapters across Canada and approximately 1,700 members. Together, the members of FEI Canada and FEI United States represent 8,000 of North America's leading and most influential corporations. The following are the views of the FEI Canada Tax Policy Task Force and do not necessarily reflect the views of FEI members at large.

The FEI Canada Task Force 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.

Our brief focuses on three key issues:

- 1. A modest, but beneficial, enhancement of the CCA rules related to environmentally friendly capital investments.**
- 2. A proposal to implement a Canadian group tax reporting system.**
- 3. A proposal to establish a private sector Centre for Continuing Education and Training, to be financed by tax-preferred contributions from Canadian taxpayers.**

Each proposal is offered to stimulate discussion and debate. We do not expect immediate action on the second proposal in the forthcoming budget. Rather we seek the Standing Committee's endorsement of this proposal as a worthwhile initiative by referencing it in your report as an idea for timely implementation. The first and third proposals are recommended for immediate budget implementation.

The environmental equipment CCA improvement and the group reporting proposals, and to a lesser extent, the Education and Training Centre and CCA proposal, 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.

Much work remains to be done with respect to implementation details and costing of these proposals. At this time, we do not have access to the data required to project the near term tax yield impact. We can, however, provide some informed commentary on their potential fiscal impact. By lending your support, we believe the appropriate fiscal implications will be developed within Finance.

1. ENHANCED CCA TREATMENT OF ENVIRONMENTALLY FRIENDLY INVESTMENTS

Budget 2005 established new and enhanced CCA rates for certain environmentally friendly capital investments. Currently, CCA is available only on one-half of all net additions to a CCA class in the acquisition year. The FEI Task Force recommends that this restriction be repealed for all environmentally friendly acquisitions, thereby allowing full CCA relief in the year of acquisition and thus enabling Canadian businesses to assist the government reach its Kyoto commitments, at a minimal cost.

2. CORPORATE GROUP TAX REPORTING

A corporate group comprises corporations owned and controlled by the same shareholder or group of shareholders. Corporate groups exist in many sectors of the Canadian economy for a multitude of business and legal/regulatory reasons. In addition to public corporations, many owner-managed businesses are organized as corporate groups. In many cases, it is neither possible nor advisable to re-organize into one corporate entity.

Canadian corporations are taxed on an individual entity basis. Consequently, it is not possible for corporations to **directly** transfer unclaimed tax attributes (i.e., losses, deductions or credits) to another group member. Losses of a group member, for example, can only be offset against prior or subsequent profits of the corporation which incurred the loss. While many corporations can access trapped tax attributes via the current rules, many cannot. In these circumstances, group cash flow is impaired, growth potential is stunted, the effect of tax incentives based on taxability is reduced, and the domestic and international competitiveness of Canadian corporations is diminished. Conceivably, losses for a given year may not be utilized due to the limits placed on the number of carryover years (currently three years back and ten years forward). In other situations, corporations may engage in relatively complicated tax planning strategies in order to access the losses of a group member. Sometimes these strategies achieve their objective. Often they do not. In either case, corporations spend a great deal of time and money implementing these tax strategies, resulting in less focus on the business performance and high costs of implementation.

The most comprehensive recent study of the taxation of Canadian businesses was conducted by the Technical Committee on Business Taxation, chaired by Prof. Jack Mintz (commonly referred to as the Mintz Committee), which reported in 1997. For 1993, the most recent data available to Mintz, unclaimed tax attributes of Canadian corporations amounted to \$119 billion. The federal tax value of these unused attributes was estimated at \$31B, more than three times the \$9.8B paid in corporate income taxes for 1993. Mintz noted that the above amounts vary considerably across sectors. The FEI Task Force has no reason to believe that the current situation is dramatically different than it was a decade ago.

In light of the non-productive costs and competitive inefficiencies encountered by corporations attempting to gain access to trapped tax attributes, the FEI Task Force believes that group tax reporting is both a fair and simple solution to the problems. Group tax reporting would restore equity between single-entity corporations and corporate groups, and enhance the competitive position of group companies.

Governments in virtually all other industrialized countries allow group tax reporting, either by consolidation of group members' tax affairs (in the U.S. and the European Union), a loss transfer system (in Britain and Ireland), or a subvention system (in Scandinavia).

Policy-makers may have design and implementation concerns related to group tax reporting. For example, perceived complexity in drafting new tax rules, the presumption that the tax yield could decline, provincial concerns about the allocation of taxable income and revenue loss, and fear of abuse, are ongoing concerns when new tax measures are proposed. However, the normative taxation principles of equity, neutrality and efficiency require that the tax burden of a corporate tax group parallel that of a single-entity corporation.

Several years ago, our then FEI taxation committee surveyed our membership (80% of whom reported that their employer was a member of a corporate group) to determine their views on this issue. Perhaps the current situation can be summarized by the words of two respondents. One noted that, "Strategies have resulted in financial results and positions that do not make business sense." Another wrote, "It is just too expensive to let tax losses go unused in one subsidiary while paying taxes in another."

A brief summary of the major conclusions of the survey follows:

1. 95% indicated support for some form of group tax reporting.
2. 82% of those supporting the concept advocated either a consolidation or a loss transfer system.
3. 71% indicated their corporations had utilized the available loss carryover provisions to offset losses against prior or future profits.
4. 16% reported that their corporation had incurred losses which had expired because they could not be utilized within the available years.
5. Whereas 61% of respondents indicated that members of their in-house tax department spent under 500 annual hours on strategies designed to utilize tax 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.
6. 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 tax loss utilization.
7. 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 did indicate 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 structural efficiency.

A. Fairness

1. Is fairness compromised by the present corporate tax system?
2. Is it equitable that a corporate group is not taxed on the same basis as a single-entity corporation, or that a non-taxpaying firm cannot use the same incentives as a tax-paying firm?

If the answer to question 1 is “Yes”, in the absence of an overwhelming rationale to the contrary, group tax reporting is called for. From an operational perspective, group reporting makes corporations operating as subsidiaries comparable with corporations constituted as one entity. The corporate group would be taxed on the same basis as a single-entity corporation.

With regard to question 2, one must ask whether tax incentives are rate reductions (not a basis for group tax reporting) or subsidies (a basis for group tax reporting). Because firms with losses do not currently pay tax, the inability to file group tax returns diminishes or eliminates the value of tax incentives based on taxability. Therefore, to the extent that tax losses exceed taxable incomes, tax incentives are wasted. Currently, one group member may have access to a tax incentive which it cannot use, while another is taxable. Consequently the impact of the incentive is reduced, deferred or lost entirely.

Group tax reporting allows all firms to use tax incentives immediately. The improved response to government incentives stems from the removal of the uncertainty as to the tax effects of specific expenditures. Tax credits and non-capital losses that arise due to the tax incentives would be available to other group members to reduce overall taxes payable.

B. Level Playing Field

Tax differentials create competitive advantages or disadvantages. Because of the resulting equal tax treatment of single entities and corporate groups, the playing field for businesses organized as corporate groups as opposed to divisions under one overall corporate umbrella is leveled. Group reporting would achieve the same net taxable position as that of divisions whose taxable incomes and losses are netted. The tax differential provided by the current legislation would no longer be a factor and business units would be able to concentrate on becoming more efficient and competitive without being concerned with the legal form of their business.

To the extent that international competitors obtain group relief, the absence of group reporting places Canadian corporations at a competitive disadvantage. The playing field would also be leveled for Canadian corporate groups competing against corporate groups from the U.S. and Europe. Canadian corporations would, therefore, be more competitive in today's global market.

Competition is also enhanced because:

- Growing companies, which often incur start-up losses, are able to compete on a more equal footing with established firms.
- Firms would be more inclined, and find it less costly, to enter profitable, and exit unprofitable, sectors of the economy.
- Reported income is smoothed, especially of firms in high risk industries which experience volatile earnings flows.
- The deferred tax benefit is received earlier, rather than on a discounted basis in a later year.
- Loss companies will not incur a 100% penalty for expired losses.

C. Market Efficiency

In a neutral tax system tax rules do not distort investment or consumer decisions or interfere in otherwise efficient markets. Consequently, decisions are made for their commercial or business logic, rather than because of a tax advantage. Non-neutral decisions reduce productive efficiency and create excess burden.

Strategies designed to access trapped tax attributes, or reallocating resources to avoid a tax or attain a tax benefit, create excess burden to the extent that total costs exceed total benefits to the economy. Generally the resources consumed are not put to productive economic use (the benefit of which is of a

different nature than the private benefit to the corporation resulting from a successful tax strategy). Group reporting would increase market efficiency by reducing the impact of the corporation tax on economic decision-making, and negate the expenditures which lead to excess burden as corporations could access the tax attributes directly rather than indirectly.

D. Risk-taking

Because Canadian firms cannot report on a group basis, investment and risk-taking is discouraged, as the full extent of the loss is borne by investors. Because group reporting supports start-up businesses, provides more incentive for risky propositions, and effectively results in the sharing of the loss between the corporation and government, more investment and entrepreneurial activity is encouraged.

E. Consistency

Consistency is enhanced in that:

- Start-up corporate losses generate an offset or refund, similar to an unincorporated individual's ability to deduct losses against other income in the year incurred.
- There would be no difference in the effective tax rates of taxpaying and non-taxpaying firms over time.
- Symmetry is improved because profits are fully taxable and losses are offset or refunded.

F. Investment

There would be an immediate reduction of cash outflows for payment of corporation income taxes. The incremental cash available to the group could be used to invest in new capital projects or an expansion of existing facilities, both of which would create employment and assist the overall economy. The additional cash could also be used to retire debt and reduce the corporate group's overall interest expense, which in turn would increase profits and make the corporate group more competitive and financially sound.

G Other Benefits

1. Group reporting decreases the number of abusive tax avoidance cases wherein intra-group transactions are entered into solely to access trapped tax attributes.
2. The current rules encourage mergers and acquisitions, an outcome which may not be universally desirable from a public policy perspective. Group reporting reduces the degree of corporate concentration.
3. Many corporations spend a considerable amount of time and effort structuring transactions with no other purpose than receipt of a tax benefit. Accounting, legal and management staff invest time and effort structuring transactions that effectively transfer losses from one corporate entity to another. The cost of planning and implementing many of these transactions would be eliminated by group reporting.
4. Loss carry forwards create budget instability. With regard to forecasting corporate tax yields, Finance cannot accurately predict the extent to which prior or subsequent losses will be claimed. The current indirect method of transferring losses and deductions thus causes instability in predicting and achieving tax yields. Once a steady state position has been attained, group reporting would improve Finance's ability to predict future corporate tax revenues.
5. Tax-induced structures may not be the most appropriate from a business perspective. Currently, corporate structures are often adjusted and re-adjusted solely for tax purposes. A group reporting provision would improve the freedom of business to structure its corporate affairs based on business or commercial concerns and less for tax reasons.

Summary

It would be incorrect to assume that large corporations would be the principal beneficiaries of group tax reporting, as there are many corporate groups within the small and medium size corporate sector. These groups form for the same reasons as large corporate groups, and they incur the same costs and lost tax attributes as large corporations. Although the dollars involved are obviously lower, they are dollars critical to the long-term stability of the owner-managed sector. In addition, family planning and financing imperatives often dictate formation of a corporate group. Many of these corporations may not have in-house tax expertise to engage in strategies such as amalgamations and wind-ups, or it is only available at an exorbitant cost. Expired losses are particularly costly to this sector.

Start-up firms often incur losses, which is not to say that they are necessarily inefficient or unsuccessful. Does the failure to provide immediate relief for losses represent a bias against newly incorporated and/or risky ventures vis-à-vis large diversified corporations? The inability to file group returns makes it more difficult for small firms to undertake risky investments, thus discourages start-ups and standalone investments. Group reporting encourages more investment by risky firms because it reduces barriers to raising capital financing.

A group reporting system would permit the immediate utilization of intra-group attributes in this sector, which would improve their cash flow position and eliminate costly tax advisory costs which could be more effectively utilized if retained within the group.

While the FEI Task Force strongly supports corporate group tax reporting, we are not unaware of the philosophical, revenue and technical problems associated with this proposal. We are also aware of the potential impact such a proposal would have on the fiscal position of the provinces and for minority shareholders.

Finance would be concerned that immediate implementation would lead to a significant reduction in tax revenues. However, although a revenue loss would undoubtedly occur in the short-term, is it a logical conclusion in the long-term? If a corporation which incurs a loss eventually uses the tax attribute, the effect of group reporting is only a speed-up of its utilization. The tax loss is, therefore, primarily a timing issue rather than an absolute loss of revenue, and can be mitigated by a phase-in process. Over time the only revenue loss would result from claiming losses that would have expired under the current system, plus the present value impact of the earlier deduction or utilization of the attribute. Ignoring the timing difference, the net revenue effect would be zero, assuming all attributes are claimed in the existing carryover period.

A policy which is neutral at the federal level may negatively affect one or more provinces. The provinces are largely revenue, not philosophy, driven, as they are concerned with a potentially permanent revenue loss, whereas the federal government deals only with the timing of the revenue impact. Among the provincial governments there would be winners and losers on a firm by firm analysis. For example, in the absence of compensating adjustments, Province "A"'s tax revenue falls as a result of an attribute transfer from a loss company in Province "B" to a profitable company in Province "A", creating a net shifting of tax revenues. Should the loss company later become taxable, Province "B" realizes a windfall gain. Whether the lost revenue can be recouped from another corporation's transfer of a tax attribute from Province "A" to Province "B" is an empirical question which can only be resolved by an analysis of the composition of each province's corporate tax base and yield. However, Province "B" is likely to benefit from transfers in the opposite direction. Furthermore, the current rules provide numerous examples of intra-province income allocation which is detrimental to one or more provinces.

To curtail potential abuse, careful development of a group reporting system would curtail overly-aggressive tax planning strategies. Should all else fail, the CRA has the GAAR to rely on.

The FEI Task Force requests that the Standing Committee take this proposal into consideration as it contemplates revisions to the taxation of business income and of corporations. In conjunction with organizations such as FEI, we are confident that a simple group tax reporting system can be developed

which not only improves the existing tax system, but which will alleviate the concerns raised by those who look upon such a system negatively.

In conclusion, please note the words of another of our respondents. He or she indicated that, should a group tax reporting proposal be initiated in Canada, “CFOs could focus on the business rather than setting up complicated tax structures to achieve the same end as if they were located in the U.S.”

3. THE CENTRE FOR CONTINUING WORKPLACE TRAINING AND EDUCATION

Governments have traditionally extolled the virtues of life-long learning and re-training. While the current government supports education and training in many ways, The FEI Task Force believes that there is need for one more important initiative. The identification, acquisition and delivery of quality workplace related continuing education programs are both time-consuming and expensive. Many corporations are not aware of the courses that are available. Those corporations and unincorporated small businesses which are experience difficulties securing training and updating courses tailored for their employees’ specific needs. For many educational institutions the cost of developing and maintaining one-off specialized courses or programs is prohibitively expensive. Providers of training programs often experience significant up-front costs developing courses for one-time clients. Thus many providers fail to respond to the market’s need for new course materials. These problems are exacerbated because Canada lacks a readily accessible centralized database of previously developed programs.

The FEI Task Force urges the Standing Committee to assist the private sector in establishing a Centre for Continuing Workplace Training and Education (preferably at a university or leading community college), which would be designed to serve the continuing education needs of Canadian business and workers.

The Centre would:

- (a) develop a data base that:
 - (i) catalogues all available training and continuing education courses and programs, and
 - (ii) includes a registry of institutions and individuals engaged in the delivery of training and continuing education courses and programs,
- (b) regularly survey Canadian businesses and workers to determine their training and continuing education needs,
- (c) commission experienced educators, managers and professionals to develop relevant courses and programs,
- (d) make course and program materials available to Canadian businesses and learning institutions,
- (e) publish a regular newsletter for distribution to all stakeholders, and
- (f) organize an annual conference/educational fair bringing together interested parties from across the country.

A Centre which serves as a clearing-house for job training and continuing education materials would go a long way to resolving many of the currently experienced difficulties of both employers and employees seeking training and job-related education.

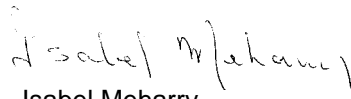
In addition to conference fees (and possibly an annual membership fee), the Centre could be financed by deductible donations from businesses and funds received from individuals who would receive a tax credit for their contribution (a "Registered Training Fund"). Other than an infusion of initial capital, and perhaps an annual subsidy, the Centre should be a self-financing facility.

Thank you for allowing the FEI Task Force to submit our brief. We trust that you will consider our points seriously and include them in your forthcoming Report.

Yours truly,



Barry Gorman
Chair
Tax Policy Task Force
Financial Executives International – Canada



Isabel Meharry
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