

October 18, 2005

The Honourable Ralph Goodale, 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.) 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 35 senior financial executives representing a broad cross-section 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 members of IPAC and do not necessarily represent the views of all FEI Canada members.

THE COMMITTEE members understand the importance of sound, prudent financial planning. We, therefore, applaud your government's fiscal and debt management achievements (eight consecutive budget surpluses, culminating in the modest surplus projected in Budget 2005 for fiscal 2004-05, projected surpluses to fiscal 2009-10, and a reduction in the national debt of approximately \$65 billion since 1997-98), which continues Mr. Martin's deficit and debt reduction policies. These accomplishments will place Canada's economy in a sound financial position as we proceed through the early years of the new millennium. THE COMMITTEE believes that your government should not waiver from the path of fiscal discipline, a 2004 Throne Speech commitment, and sound financial management, as espoused in Budget 2005.

THE COMMITTEE encourages a balanced approach of tax reductions and debt repayment, within agreed parameters. To achieve fiscal flexibility, it is critically important that we pay down the deficit 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 current commitment to use the annual Contingency Reserve to pay down the debt, and in a more transparent and effective manner than as currently contained in the proposed Surplus Allocation Act. 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 COMMITTEE notes that the federal debt is projected to be lowered to 38.8% of GDP in fiscal 2004-05, an aggressive strategy such as THE COMMITTEE suggests should result in the government attaining the 2004 Throne Speech's 25% debt-to-GDP ratio within 10 years target, a target reaffirmed in Budget 2005.

THE COMMITTEE notes the extraordinary growth in federal fiscal spending plans and that this growth is made possible by the projected increase in revenues from taxation. THE COMMITTEE would have preferred the government find the monies to fund its initiatives without increasing spending levels (through reductions in other programs), and to reduce taxes to a more appreciable extent. The future balanced budgets are at risk should the 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 this spending plan and working towards both lower spending and lower taxes.

We also note the government-wide expenditure review, under the leadership of the Honourable John McCallum, under which \$11 billion in savings will be achieved over the next 5 years, and the reported review of the public sector complement. 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, a policy in line with your government's 2004 Throne Speech commitment "not to spend itself into deficit".

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 2004 Fiscal and Economic Update projected short and medium term budget surpluses, after providing funding for the intergovernmental health accord, the framework for equalization and Territorial Formula Financing, and provision for the Contingency Reserve, of approximately \$29.5 billion over six years. We note your comment that, in order to accomplish the goals of the 2004 Throne Speech, "*an ambitious agenda must be founded upon a robust, competitive and innovative economy – growing and thriving in a knowledge-based technology-driven and highly skilled world.*" In addition, we note you indicated that, "*[W]e must also improve Canada's competitiveness*", in part, "*by maintaining Canada's competitive tax system*". The proposals to follow will contribute to the attainment of the goals of that agenda.

THE COMMITTEE also 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, your government is committed to improving the environment, both in Canada and around the globe. Themes of the Throne Speech included 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, and applauds the Budget 2005 enhancement of CCA rates for certain environmentally friendly capital investments.

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.

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.
- (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.

CENTRE FOR CONTINUING WORKPLACE TRAINING AND EDUCATION

A Centre for Continuing Workplace Training and Education should be established.

Along with the government's Workplace Skills Strategy, this initiative would enable businesses of all sizes to access high quality continuing education programs tailored to their individual needs, thus enhancing the employment-related skills of Canadian labour and improving the productivity of the economy. The Centre would:

- (a) develop a database 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.

ENVIRONMENTALLY FRIENDLY CAPITAL INVESTMENTS

To provide an incentive for the acquisition of environmentally friendly capital investment, the half-year CCA rule should be eliminated for environmentally friendly capital equipment.

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 (to conform to the thrust of the 2004 Throne Speech). Alternatively, designated sectors (for example, natural resources or manufacturing), or investments which achieve desirable outcomes (pollution abatement, for example), could be targeted.

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 current amounts.

MINIMUM TAX THRESHOLD

When the personal minimum tax was introduced in 1986, the threshold was set at \$40,000. In spite of inflation induced increases in income since 1986, 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).

RETIREMENT SAVINGS

Past government policy decisions have emphasized the need for Canadians to save for retirement, thus reducing their future dependence on government programs. In addition, the retirement savings rules gather various retirement plans into a common taxability basket via the Pension Adjustment mechanism. Our view is that these policies should continue, augmented by an additional objective of ensuring that RRSPs attain parity with defined benefit pension plans.

We note that an increasing number of Canadians are no longer members of registered pension plans due to labour market adjustments and the generally more mobile nature of the workforce. It is essential that these individuals not be disadvantaged vis-à-vis employees enrolled in registered pension plans.

Furthermore, many members of defined benefit plans are disadvantaged because of the relatively small Pension Adjustment Reversal available when they leave their plans (often not a choice of their own making). Many such individuals would have been better off in a defined contribution plan or personally saving for retirement via an RRSP. It should be government policy that a more level playing field exist when taxpayers move their retirement savings between a defined benefit plan, a defined contribution plan, and an RRSP.

THE COMMITTEE recommends that:

- (a) Tax deductible limits for registered pension plans be increased.
- (b) The Pension Adjustment Reversal threshold be increased, preferably to the amount of the transfer between pension or retirement plans.
- (c) New rules be developed which would enable corporations to contribute more to their pension plans than is currently permitted.

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, and as echoed by Industry Minister David Emerson, 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.

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.

THE COMMITTEE recommends that the federal government work with its provincial colleagues towards greater harmonization of the provincial sales taxes with the GST.

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.

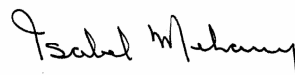
CONCLUSION

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 and are consistent with the 2004 Throne Speech commitment to “contribute to real progress for Canadians”. We strongly urge your government to consider these measures and implement them in the next 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