



February 9, 2007

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").

As senior finance executives, the COMMITTEE understands the importance of prudent and disciplined fiscal management. We applaud your government's commitment to planned federal debt reduction and reasoned program spending. We note especially your commitments to continue lowering the federal debt by \$3 billion per year and to eliminate Canada's total government net debt within a generation, and goals of achieving a debt to GDP ratio of 25% by 2013 and building a more competitive business environment.

Unstructured increases in program and overall government spending have plagued Canada for many years. The COMMITTEE is encouraged by the initiatives taken by your government in the past year to introduce more structure and discipline to government spending. By maintaining the rate of growth in program spending below the rate of GDP growth over the medium term, Canadians will be assured that wasteful spending will be reduced and a greater percentage of spending will be dedicated to the many worthwhile programs deemed essential. Introduction of a new Expenditure Management System will further add to the confidence of Canadians that their hard earned tax dollars will be prudently spent on essential programs.

Additionally, the COMMITTEE strongly endorses your government's adherence to tax policies based on core principles, especially your commitment to reduce personal and corporate taxes. With projected surpluses exceeding \$18.6 billion to 2012, continued reduction in Canadians' tax burden will stimulate the economy, increase the well-being of ordinary Canadians, create a more attractive investment climate, and encourage businesses to hire more employees.

## **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 improve Canada's environmental performance, (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 (i) sustainable given the healthy forecast federal surplus position, (ii) revenue neutral over the near to medium term, or (iii) 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 continue efforts to simply the tax system, and remove unintended anomalies, inconsistencies, and impediments from the 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, impediments imposed by those rules, and the additional costs incurred by Canadian businesses because of these rules.

## **1. CORPORATE TAX RATES**

The COMMITTEE applauds your government for eliminating the large corporations' tax and the surtax, as well as the planned reductions in the basic corporate tax rate. However, we believe further reductions are required in order to encourage business capital expansion in Canada and to remain competitive with international corporate rates. For example, Ireland has experienced a dramatic increase in its corporate sector following the slashing of its corporate rate to 12.5%. Other European countries are also implementing rate reduction policies.

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 tax rates which are competitive with U.S. and international rates. Excessively high corporate tax rates stifle capital formation. Canadian corporate rates are not conducive to investment in this country. As noted in a recent C.D. Howe Institute report, "Canada has the sixth highest effective tax rate on capital investment among 36 industrialized and leading developing countries, as well as the eighth highest effective tax rate on capital when a further 45 developing countries are included in the comparison".

**The COMMITTEE recommends that the currently scheduled rate reductions be adjusted such that the eventual corporate rate is reduced to 15% by 2011.**

Enactment of these measures will assist your government in fulfilling its commitment to establish in Canada the lowest rate on new business investment in the G7.

## **2. INCOME TRUSTS**

As a result of the changes to the dividend taxation rules, the perceived imbalance between the taxation of dividends from large corporations and distributions from income trusts has largely been resolved. The COMMITTEE is somewhat sympathetic to the rationale underlying the October 31, 2006 announcement of the proposed tax on distributions from income trusts. As a consequence of these proposals, many income trusts are likely to revert to corporate status prior to the 2011 date at which the distributions tax will become effective. As the income trust sector moves on, we believe a number of issues remain to be resolved.

- The COMMITTEE is puzzled by the exemption granted REITs from the distribution tax rules announced on October 31, 2006. Why are REITs exempt, whereas energy trusts

are not? Surely a “greater public interest” case cannot be made for REITs than for trusts in the energy sector.

**The COMMITTEE recommends that your department publish a more definitive statement clarifying the rationale for taxing the energy sector but not the rental property sector, or exempt energy trusts from the distribution tax.**

- According to informal discussions with CRA officials, the Agency expects that income trusts reconverting to the corporate form will, pursuant to IT-143R3, treat the costs of re-conversion as eligible capital expenditures. This seems unduly harsh, given that such re-conversions will be the consequence of a totally unexpected policy announcement.

**As a matter of equity, and to cushion the financial impact of a re-conversion from a trust to a corporation, the COMMITTEE recommends that all costs of re-conversion from an income trust to the corporate form be immediately deductible in the year incurred.**

### 3. ENVIRONMENTALLY FRIENDLY CAPITAL INVESTMENTS

To provide incentives for the acquisition of environmentally friendly capital investment, the COMMITTEE proposes the following.

- **The half-year CCA rule should be eliminated for environmentally friendly capital equipment.**

Currently, CCA is available only on one-half of all net additions to a CCA class in the acquisition year. This proposal, by allowing full CCA relief in the acquisition year, will enable Canadian businesses to assist the government reach its environmental objectives, 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 resources. Alternatively, designated sectors, for example, natural resources or manufacturing, or investments which achieve desirable outcomes, pollution abatement, for example, could be targeted.

- Following the 2006 budget example, which placed certain investments in cogeneration systems in an accelerated CCA class, **further efforts should be made to identify additional investments which could be similarly assigned a higher CCA rate. Capital acquisitions which contribute to the manufacture of more energy efficient motor vehicles are a potential example.**

### 4. 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. Sales tax rates vary from

province to province. Differences exist between the PST and GST tax base in some provinces. Sales tax registrants are burdened by unnecessary compliance costs as they must submit sales tax returns to two or more taxing authorities.

Various studies have indicated the need to remove or reduce provincial sales taxes. 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 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.**

## 5. 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 19.5% of Canadian tax filers report annual income between \$40,000 and \$70,000 (Income Statistics, 2006). 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 65% 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).**

## 6. WITHHOLDING ON INTEREST AND DIVIDENDS

Capital formation is a critical component of economic development and growth. Without significant infusions of new capital, economic development is hampered, critically needed maintenance and renewal is delayed, productivity is impaired, and employment levels are lower than is optimal. Unfortunately, Canadian capital pools are, and always have been, insufficient to satisfy the constant need for new investment capital. Consequently, Canada has historically relied on foreign investors to provide the capital not available from Canadian sources.

Given the globalization of economic activity and capital formation, where international investors can place investments anywhere in the world relatively quickly and easily, government must provide additional incentives to lure mobile capital to invest in Canada.

**In order to provide the required incentive, the COMMITTEE recommends that Finance work with its treaty partners to reduce or eliminate the withholding tax on arm's**

**length interest and dividend payments to non-Canadians, and on non-arm's length interest and dividend payments to taxpayers subject to the Canada-U.S. treaty.**

## **7. CORPORATE GROUP TAX REPORTING**

In spite of the introduction of the 20-year loss carry forward period, Canadian corporations will continue to experience cash flow problems as they are unable to offset profits in one group member with losses in another.

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 indicated that significant time and money is spent developing mechanisms to ultimately accomplish the equivalent of group wide reporting.

**The COMMITTEE recommends that, 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.**

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.

## **8. PERSONAL TAXATION THRESHOLDS**

In spite of recent budget initiatives, the tax burden imposed on individual Canadians is still too high, especially compared to the tax burden in many other countries. In addition, Canada's current and expected budgetary surplus provides an opportunity to return unnecessarily high personal taxes to hard-working Canadians. Increased personal disposable income is either saved or consumed. Additional savings enhance the overall financial well-being of Canadians. **To the extent that decreased income taxes result in increased consumption, a portion of the lost income tax yield is recouped by consumption taxes.** Furthermore, increased consumption leads to more revenue for Canadian businesses, especially hard-pressed small and medium-sized corporations, increasing their cash flow and potential to employ additional employees.

The 2006 personal income thresholds are \$36,378, \$72,756 and \$118,285. 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.

To reduce the tax burden on lower and middle income Canadians, and to create an after-tax position for managers and professionals more comparable with the U.S., the COMMITTEE recommends the following personal tax change, which builds upon the beneficial tax reductions introduced in Budget 2006.

- **Income thresholds for the personal income tax should increase to roughly \$45,500, \$91,000 and \$148,000, which are approximately 125% of the 2006 amounts.**

Implementation of this proposal will fulfill your government's commitment to reduce personal taxes, and will ensure a fairer tax system and one which will attract and retain highly skilled workers.

## **9. RETIREMENT PLANNING**

Canada's population is aging, and will continue to do so for the next fifteen to twenty years. The number of retired individuals is increasing rapidly. Consequently, the percentage of 30 to 65 year old individuals is declining relative to the 65 and over age group. Canadians are also living longer. Many older Canadians are choosing to maintain their employment, either for income or work-related satisfaction reasons, beyond the normal retirement age. In addition, many employers require older workers to maintain their productive capacity. The retirement rules, therefore, should be adjusted to take these changes into account.

The COMMITTEE recommends the following measures to address needs of seniors as they move beyond the normal retirement age.

- **To allow individuals to provide for adequate retirement income:**
  - **RRSP contribution limits should be increased from 18% to 25% of earned income, and**
  - **the maximum age for contributions to an RRSP should be, on an elective basis, raised to 73 from 69.**

The latter proposal would require consequent to the rules related to the conversion of an RRSP to a RRIF. Taxpayers could be allowed to defer the transfer until age 73. Alternatively, the transfer could take place at any time between the ages of 69 and 73.

## **10. WORKPLACE TRAINING**

Governments have traditionally extolled the virtues of life-long learning and re-training. Canadian workplaces require highly skilled and trained individuals to increase the productivity of Canadian businesses. To augment in-house training programs, and the skills developed by Canadian technical and vocational educational institutions (skills development which will be greatly enhanced by several measures introduced in Budget 2006), the COMMITTEE recommends that your government consider the following two proposals:

- **A deduction for personally acquired training and development.**

- **Establishment of 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 businesses and workers. Further details related to this proposal were contained in our letter of March 6, 2006, or can be obtained on request.**

These proposals would fulfill your government's commitment to invest in education and training programs which will provide incentives for Canadians to excel in the workplace.

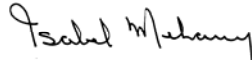
## CONCLUSION

As outlined in this brief, fiscal discipline and aggressive debt reduction, federal spending increases less than GDP 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 2007 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 and 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 1,900 members.

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 these areas.

The remarks 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.