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Current Management Issues in Canadian Corporate Taxation

CFERF Executive Research Report

July 2010

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Acknowledgements

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Executive Summary

The Canadian corporate tax environment has become increasingly complex. In addition to the issues surrounding compliance and regulation, over the next year many senior finance executives in Canadian companies will be grappling with the tax implications of adopting the International Financial Reporting Standards (IFRS) and Harmonized Sales Taxes (HST). Meanwhile, the issue of effective tax management has come under scrutiny in private and public companies alike, as the current economic environment increases the pressure on the finance function to find savings through reducing costs and increasing efficiencies in every area of their company. Finance and executives are overwhelmed with issues of compliance. For many companies, particularly those who operate in multiple jurisdictions in Canada and abroad, managing the tax function has become an arduous task, characterized by uncertainty in regulation and the increased risk of audit.

Against this backdrop, this study examines the current, salient issues in tax management in Canada. More specifically, it seeks to determine what areas of corporate tax management are the most complex and whether or not these areas are likely to grow in complexity over time. The overwhelming theme that emerged throughout the study was that the complexity of tax issues forced most tax managers to focus on compliance and audit, as opposed to strategic tax planning. More companies considered the issue of transfer pricing as either complex or very complex as compared to any other area of tax. IFRS and HST posed additional problems surrounding the uncertainty of future tax positions, the costs of compliance, and the increased risk of audit.

Regulatory changes were considered to be the single largest contributor to complexity and uncertainty in the tax system and are not likely to get any simpler going forward. Many executives were concerned about how the tax system will evolve, particularly with respect to the broadening of the HST base and environmental taxes and levies. The aggressiveness of the Canada Revenue Agency, specifically in their information requirements, was also a major issue.

Respondents evaluate what tax management strategies have been most successful, and which ones have under-delivered on their value proposition. A wide variety of strategies have been employed to help tax managers improve the effectiveness of their tax management function. Most companies have implemented improvement strategies related to increasing the efficiency of routine processes (58.6%), followed by improving talent management and retention (45.7%), and improving systems for storing, analyzing and retrieving data (37%). However, for a large number of companies, many of these strategies did not deliver on their expected value. More specifically, while almost 60% of companies attempted to improve routine processes, only 45.7% thought these initiatives delivered the best value for money.

The report outlines how Canadian companies plan to improve their tax management strategies and processes in the future. Going forward, executives will continue to look for improvements in their tax management capabilities and many will be seeking to hire new staff, increase their training efforts, and increase the use of external consultants. Technology also continues to provide improvement opportunities; however, the quality of the information feeding those systems is critical. Communication and cooperation with the controllership function will help ensure that the tax department gets what it needs to do its job. To this end, the Chief Financial Officer (CFO) can play a critical role in championing the view that effective tax management both creates and preserves value for the company.

From this research, finance and tax executives will gain an understanding of how other Canadian companies have approached strategic tax planning, compliance management, tax automation, and other tax management issues to promote overall corporate objectives.

Current Management Issues in Canadian Corporate Taxation was prepared by the Canadian Financial Executives Research Foundation in cooperation with its research sponsor, Ryan. The study is based upon a survey of 162 senior finance executives from across the country and the results of a research forum that was held in Toronto on February 18, 2010.

Research Methodology

Current Management Issues in Canadian Corporate Taxation was prepared by the Canadian Financial Executives Research Foundation (CFERF) and sponsored by Ryan. It encompasses both the results of a survey of senior financial executives from public and private companies across Canada, as well as the insights obtained through an Executive Research Forum held in Toronto on February 18, 2010. One hundred sixty two surveys were completed between November 9 and December 4, 2009.

Survey results were compiled and analyzed on the basis of industry classification, whether the company was public or private, and size based on revenue. Respondents were also categorized by position title. The second phase of the research methodology included capturing the feedback from senior financial executives who took part in the half-day executive research forum. The purpose of the forum was to allow for open dialogue between company experts who were provided with specific questions prior to the forum. A broad variety of Canadian industries were represented, including: energy, consumer products, pharmaceuticals, retail distribution, agriculture and food products, telecommunications, and insurance.

Survey Demographics

A total of 162 surveys were completed by finance executives. Roughly 30% were completed by CFOs, followed by Tax Managers (13.6%), VPs Finance (12.3%), and Directors of Tax (9.9%). The results mainly reflect the views of executives working for Canadian business enterprises, as opposed to foreign owned subsidiaries, Crown corporations or not for profits, with a weighting towards privately-held companies. Roughly 40% worked for Canadian private companies, and 28% worked for Canadian public companies. Over half of all respondents reported that their companies were based in Ontario (51.2%), and the bulk of the remainder was located in Alberta (17.3%) and B.C. (14.8%). Most of the companies reported that Canada was their primary market (71.4%).

Respondents were also asked to identify themselves according to 20 large Standard Industrial Classification (SIC) Groupings. The largest number of respondents came from the finance and insurance sector (16.7%), followed by manufacturing (14.8%), and wholesale trade (11.7%). The remainder was widely disbursed across other industry groups.

Over half of the companies represented in our sample had annual revenues of less than $500 million (56.1%) reflecting the relative weighting towards private companies. Of the larger companies represented 18.5% had revenues between $500 million and $999 million and 13% had revenues between $1 billion and $4.9 billion.

See appendix A for further demographic details.

Company Profiles

Canadian companies have complex legal and tax structures and our survey results reflect this landscape. Over half of the executives responding to our survey (53.7%) indicated that their company consisted of one to nine legal entities, 16% stated there were 10 to 20 affiliated legal entities, and roughly 30% reported more than 20 legal entities related to their corporation. At the same time, most companies operated in more than one domestic tax jurisdiction (70%), and 16% operated in more than 10 international tax jurisdictions. Of those who operated internationally, significantly more managed the international tax administrative duties from Canada (39.5%) than those who didn't (26.3%).

More than half of the respondents did not have a separate tax function (51.2%). One out of every four companies indicated that their CFO of VP Finance handled tax issues (12.3%), as compared to 17.3% of companies who had a director of tax or 10.5% who had a tax manager with primary responsibility for corporate taxation issues. Private companies were somewhat more likely to have their CFOs as the company's tax manager (32.8%) compared to public companies (23.9%). Similarly, smaller companies, which also tend to be private, were less likely to have a separate tax function. Only one of the 36 companies represented in this study with revenues of less than $49 million had a separate tax manager. The vast majority of respondents devoted their tax management resources toward compliance (80.2%). This compares to 14.2% who said they spent most of their resources on tax planning.

Evolving Tax System

INCREASING COMPLEXITIES

Survey respondents provided their views on a wide range of corporate tax issues. They commented on how complex these issues are now and are likely to be in the coming two years, and how the management of these issues will potentially change within their companies. We see from Table 1 (page 5) that many areas of corporate tax present complex issues to Canadian companies; however, the issue of transfer pricing is more likely to pose difficulties than any other single tax issue. Of the executives who reported that transfer pricing was an issue (117), an overwhelming majority (78%) agreed that the tax implications of transfer pricing were either complex or very complex. Similarly, a large majority of executives felt that foreign income taxes posed either complex or very complex management issues, as did non-routine events from regulations governing major transactions. Managing federal corporate income tax was also considered either complex or very complex by a majority of respondents as was IFRS conversion and navigating the federal/provincial tax structures.

We also see that relatively more companies who had a separate tax function felt that these areas were either complex or very complex to manage compared to companies whose finance executives were responsible for managing these issues. This speaks not only to the level of complexity of tax issues in larger firms who are more likely to have separate tax functions, and operate under more complex legal and corporate structures, but also to the depth of understanding of the tax issues and amount of time that could be devoted by finance staff to managing them.

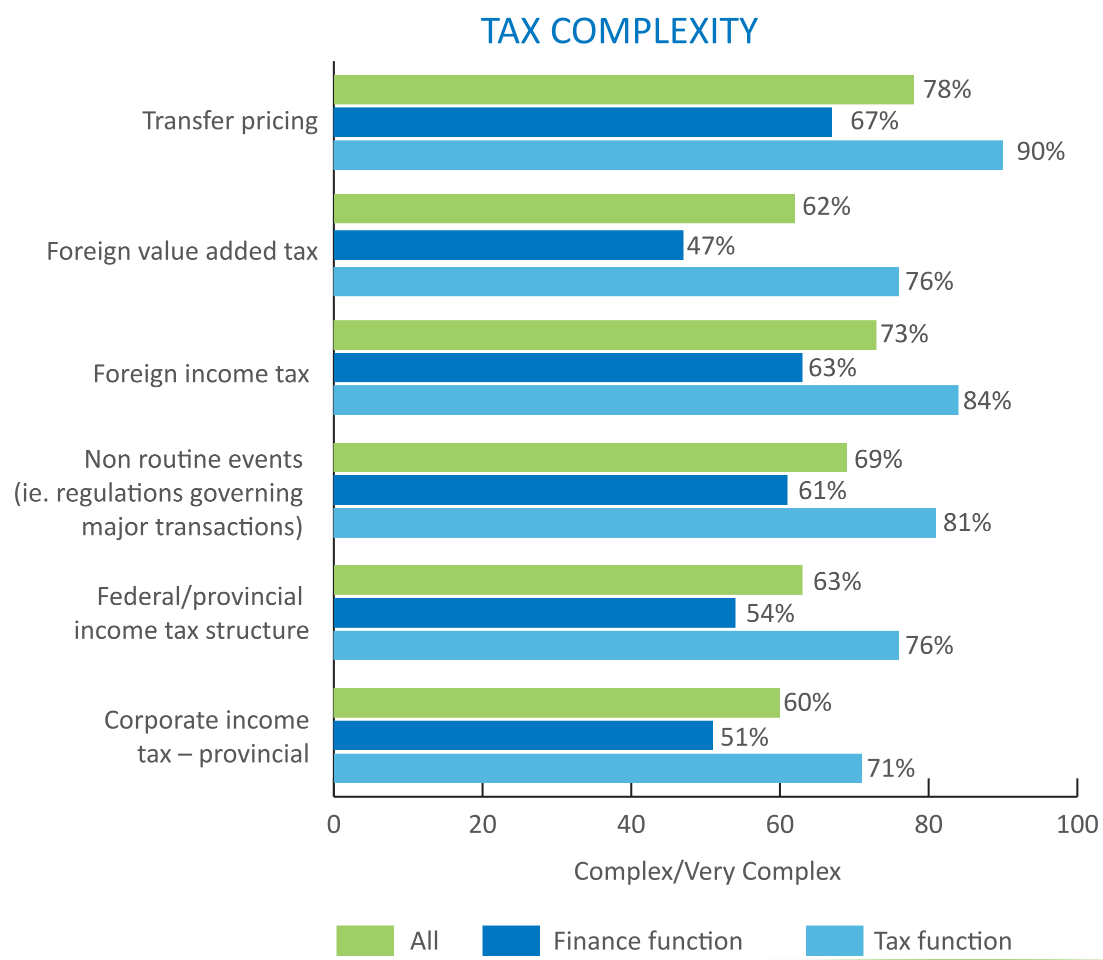


TABLE 1. TAX COMPLEXITY

ISSUES RATED COMPLEX/VERY COMPLEX*

	All	Finance function**	Tax function***
Transfer pricing	78%	67%	90%
Foreign income taxes	73%	63%	84%
Non routine events (i.e. Regulations governing major transactions)	69%	61%	81%
Corporate income tax- federal	66%	56%	61%
IFRS conversion	65%	61%	70%
Federal/provincial income tax structure	63%	54%	76%
Foreign value added tax	62%	47%	76%
Corporate income tax – provincial	60%	51%	71%
Tax technology	50%	43%	59%
Harmonized sales tax	50%	48%	55%
Non-consolidated taxation	48%	36%	62%
Carbon Tax	47%	52%	41%
Internal Control Compliance	45%	37%	56%
PST	42%	39%	50%
Tax sparing agreements	36%	24%	37%
Excise duties	36%	36%	36%
Environmental levies	34%	32%	36%
Tax on dividend income	33%	26%	45%
Payroll and benefits tax	31%	25%	42%
GST	31%	24%	42%
Tax on property income	27%	18%	38%
Canadian crown royalty	26%	28%	25%
Capital gains tax	24%	21%	29%

* Percentage of respondents that indicated that the issue was either complex or very complex to manage
** Companies where tax management is handled by finance
*** Companies that had a separate tax function or separate internal tax management specialist

Regardless of whether companies are private or public, or whether they have an internal tax department or a lone CFO managing their tax functions, compliance is the number one issue that consumes tax management resources, with strategic tax planning a distant second.

DIVISION OF TAX MANAGEMENT RESOURCES BETWEEN TAX COMPLIANCE AND TAX PLANNING

Respondents	Compliance	Planning	Don't know
All	80.2%	14.2%	5.6%
Private	81.3%	12.5%	6.3%
Public	76.1%	21.7%	2.2%
Finance function*	81.2%	13.9%	5%
Tax function**	78.7%	14.8%	6.6%

* Companies where tax management is handled by finance
** Companies that had a separate tax function or separate internal tax management specialist

When asked how the corporate tax environment was likely to evolve over the next two years, most finance executives agreed that the tax system was not going to get any simpler. For each tax area we explored, the complexity of the issues involved was expected to stay relatively the same or increase over the next two years. The only area where executives expected a decrease in the level of complexity was with respect to provincial sales tax, with roughly 27% indicating that PST would become either somewhat or much less complex over the next two years. At the same time, 37% expected the issue of the harmonized sales tax to become more complicated during the period. Similarly, a relatively large number of executives (43%) believed that tax issues under IFRS would be more complex in the next two years than they are now. This view was also held by many with respect to transfer pricing (39%), foreign income taxes (36%), environmental levies (27%), changes in non-routine events (28%), the federal/provincial corporate income tax structure (25%) and issues surrounding internal control compliance as it relates to tax (22%).

Although most executives were able to make predictions on how they viewed the tax system unfolding in the next two years, there were several areas where many executives simply didn't know. For example, while just over half of respondents thought that the complexity of carbon taxation in Canada was either going to stay relatively the same or increase over the next two years, roughly 40% of individuals had no idea how things would unfold. Similarly, 28% of respondents couldn't predict how environmental levies were likely to change. A level of uncertainty also surrounded the tax treatment of foreign income with 40% of executives who traded internationally indicating that they couldn't predict the future complexity of tax sparing agreements. Another 23% said that they didn't know what direction foreign value added tax was going.

FOREIGN SALES TAX JURISDICTION ISSUES AT TELUS

We have customers, for example a bank, who will want to go into China, Korea, or some other country. We can be in that country fairly easily by just installing a few pieces of equipment and providing telecom services. But we're finding that the tax rules for telecom in these foreign jurisdictions are not that clear, particularly in terms of what constitutes permanent establishments in these jurisdictions. While there are tax treaties and generally understood rules for income tax, on the value added side that's not necessarily the case. They may tax you based upon where the recipient of the service receives the benefit rather than, as in Canada, on where the party that delivers the benefit resides. You may solve your income tax problem but still have a foreign value added tax problem. Going into the United States, for example, is a real mess from a sales tax perspective. Not only does each state have different rules, but you could also have municipalities within the state that have their own rules on the sales tax, user taxes and various other kinds of taxes. In order to manage this, we're converting our systems, and I presently have five people focused just on international tax.

– Tim McGillicuddy, VP Taxation, TELUS

CHANGING REGULATIONS AND COMPLIANCE REQUIREMENTS

IFRS

With the mandatory adoption of IFRS in 2011, Canadian public companies are grappling with the tax implications of moving to a new accounting standard. According to Peter Effer, VP Taxation at Shoppers Drug Mart, implementing IFRS from a tax perspective highlights the need to have close collaboration between the controllership and tax departments. Says Effer, because of the reconciliation issues that arise with IFRS, particularly with respect to the area of fixed assets, "... you become critically aware of the importance of that collaboration and cooperation."

Complexities arising due to IFRS also surround the preparedness of the CRA. According to Tom Evans, Chief Agent at GE Employers Reassurance Corp., "My worry is that the Department of Finance Tax Policy and CRA are way behind in terms of IFRS and what that will mean when we start reporting under that standard." Says Evans, "If they're not up-to-speed, by 2011 there could be some serious glitches coming out in the future as a result." Therefore, training of government tax policy and administration personnel is critical. According to Peter Effer, the biggest issue that CRA has with IFRS is the training of their auditors, because IFRS is not required for every corporation. Says Effer, "You have Canadian Generally Accepted Accounting Principles (GAAP) for a number of the smaller enterprises and IFRS for the public companies. Technically, Shoppers Drug Mart Corporation is the public company, and that's the only company that has to be IFRS compliant. The legal entities within the group don't have to be IFRS compliant. This situation, which is being considered by the CRA, would result in a significant reconciliation between the audited public consolidated financial statements prepared in accordance with IFRS and the individual legal entity statements prepared under Canadian GAAP used to file corporate tax returns. CRA auditors will have to be well-versed on the differences between the accounting principles. I think from this standpoint, there are going to be problems."

HST

Most financial executives agree that the HST will bring both short term costs as well as yield long term benefits. Over the next six to eight months, the main challenges associated with the HST are related to:

- the cost of systems implementation;
- making sure that the tax is calculated accurately and properly disclosed on invoices;
- the corresponding increased financial risk associated with errors;
- potentially increased audit risk with respect to Input Tax Credits (ITC);
- increased training expense;
- the potential negative impact on customer perception, particularly in rate regulated industries.

HST PROCESSING

While in the long run HST is expected to reduce commodity tax risk, near term expenses associated with conversion can be significant for many companies. As Tim McGillicuddy, VP Taxation at TELUS explains, "Presently TELUS has experienced a range of tax audit assessments, between 10 and 20 million dollars a year because our systems just don't handle the PST properly. So, that risk is going to go away." However, says McGillicuddy, the implementation of the HST is going to be very expensive. "For us,it looks like it will cost on the order of $10 million dollars just to implement it." At the same time, other risks emerge surrounding accuracy of processing. As Peter Effer, VP Taxation at Shopper's Drug Mart explains, "In some cases, there has been a shift of risk from PST to HST, but it's not to the same degree. For example, CRA can reassess a company for not charging tax correctly. When the recipient company could claim an input tax credit that would not cause a net loss to the CRA purse, CRA can issue what is called a 'wash transaction' penalty for non-compliance. The wash transaction penalty is equal to 4% of the tax that should have been charged. Under GST, 4% of 5% is 0.2%. However, under HST, 4% of 13% is 0.52%. The financial risk of tax errors just increased."

> "Life would be easier if we had either one tax rate in all the provinces and all the provinces were harmonized, or…consolidated tax reporting. It should be one or the other."
>
> – Peter Effer, VP Taxation, Shoppers Drug Mart

Critical Challenges Facing Tax Departments

Tax and Finance executives considered regulatory changes to be the single largest contributor to the complexity of the Canadian tax system, and many finance executives believe that most areas of corporate income tax will likely remain as complex in the future as they are today. Going forward, the adoption of IFRS will bring new issues to tax management in public companies as they attempt to meet the 2011 adoption deadline, and little is known about the potential impact on the bottom line. At the same time, taxation surrounding foreign operations will continue to be complex for many companies. Likewise, the action of foreign governments remains uncertain as does the evolution of environmental regulations/levies and carbon taxes.

When asked about the significant challenges that will likely present themselves in 2010 and 2011, time, budget and resource constraints (39.6 %) were the most common. This was followed by increased tax complexity due to increased overseas business (38.1%). Responding to new developments in tax law was seen by many companies as only a moderate challenge (59.1%), as was increased regulatory compliance (56.5%), and scarcity of talent (59.1%).

WHAT'S KEEPING YOUR TAX FUNCTION UP AT NIGHT?

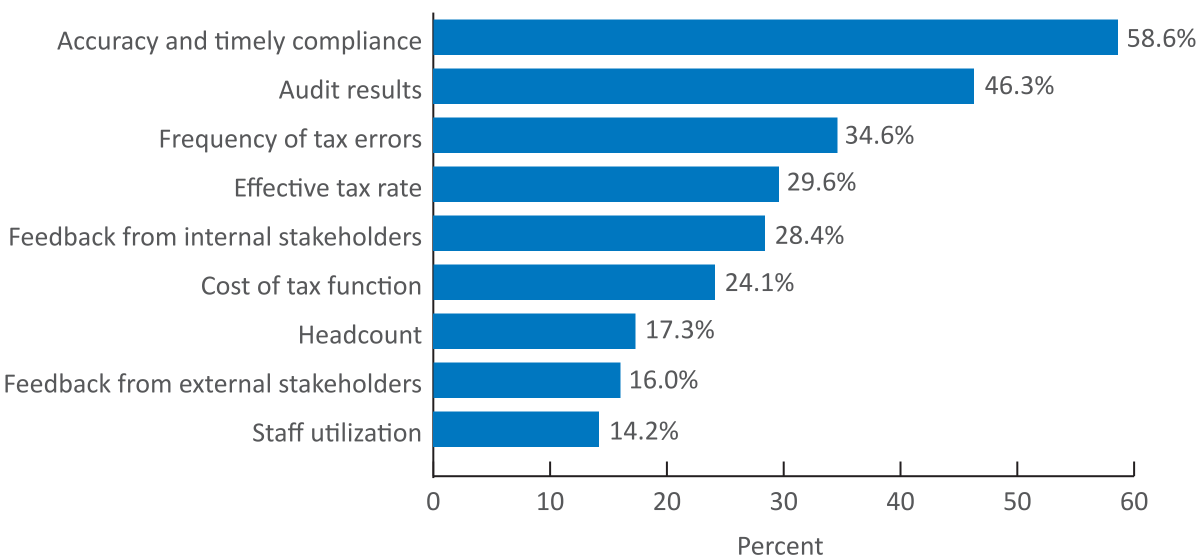
- Stability and predictability of tax regulation and tax policy trends
- Lack of resources and support from upper management
- IFRS conversion
- Ongoing CRA audits – more aggressive tax authorities with more resources compared to limited internal resources to deal with such audits
- Getting through previous years' tax audits when many staff in the financial organization has turned over since the year under audit
- Managing complex corporate structures, diversity of jurisdictions, and related tax impacts
- Transfer pricing regulations and compliance – both domestic and international
- Preparing an accurate tax provision on a timely basis each quarter
- HST implementation and implications
- Moving beyond a task focus to become a key decision support activity
- Obtaining sufficient technical advice and data to support financial compliance and decision making
- Tax effective structuring for merger and acquisition activity
- Calculation of federal income tax
- Limitations of accounting system
- Manual processes and lack of cross functional teams
- Convincing CRA and the Internal Revenue Service (IRS) to use eXtensible Business Reporting Language (XBRL)

TAX FUNCTION EFFECTIVENESS

In general most financial executives felt that the tax function in their companies was effectively integrated with the rest of the finance function (71%), and that it had a high degree of credibility (67.2%). However, fewer executives were likely to agree that their tax function could access timely and accurate information for decision making (58.6%), had adequate resources (51.8%), could attract and retain qualified tax professionals (45.7%), or that it played a prominent role in decision making (43.9%).

Historically, most companies have measured the effectiveness of their tax function mainly on the basis of quantitative results. Our survey supports this view showing that the most common indicators today are accuracy and timely compliance (58.6%), audit results (46.3%), frequency of tax errors (34.6%), and a company's effective tax rate (29.6%). Companies were less likely to consider the costs of tax management in their assessment of overall effectiveness, with roughly one in four (24.1%) indicating that they use cost as a measure of performance. Measures that were the least likely to form part of a tax management evaluation were head count (17.3%), feedback from external stakeholders (16%), and staff utilization (14.2%). Although staff utilization was the least common indicator of tax management success, staffing issues due to resource constraints are likely to pose a serious risk to corporate tax managers in the next two years.

WHICH OF THE FOLLOWING MEASURES DOES YOUR COMPANY USE TO EVALUATE THE PERFORMANCE OF ITS TAX FUNCTION/MANAGEMENT?



CUSTOMER PERCEPTION

Many companies are also concerned about the impact of the HST on customer perceptions. For example at Enbridge Gas, the main challenge surrounds managing customer expectations. According to Bill Ross, VP Finance and Information technology (IT), "The issue basically boils down to how you deal with a customer's expectation that your input costs may to be lower, and therefore, how this may impact the sales price of your product." Enzo Baldan, Manager of Tax Services at Enbridge further explains, "In the business that we're in, there's always an issue with how the customer will interpret the tax, particularly on services that traditionally have not received the provincial component of the HST. We're dealing with how to communicate that effectively to our customers."

Meanwhile, other companies are concerned that increased disclosure of the ITC to customers could also result in competitive issues. Tim McGillicuddy of TELUS says, "We found on the restricted ITC part, there really is no requirement to disclose what portion is restricted and what's not. From our perspective, we actually see it as a competitive issue. If our competitors provide more information on their bills than we do, then there could be an attraction for customers to go with them. So, we're very aware of that as well."

MINIMIZING THE RISK OF HST ERRORS THROUGH FOCUSED MANAGEMENT AT SHOPPERS DRUG MART

"It's really important that you have good documentation for the ITC restrictions because you can guarantee that the tax auditors will zero in on this particular area. It's not just about getting something into an account. You also must create good backup at the time the transaction occurred. We are handling the recording of the restricted ITCs outside of the normal invoice payables function. In other words, we are leaving the normal accounts payable process alone, which makes sense in my mind, since we have to report the gross ITCs in any event. Off to the side, we are developing a separate system process to determine the restricted ITCs for each accounting period that can be run, stored on a file and retained for future audits. In this manner, we should be able to report effectively and reduce the risk of error."

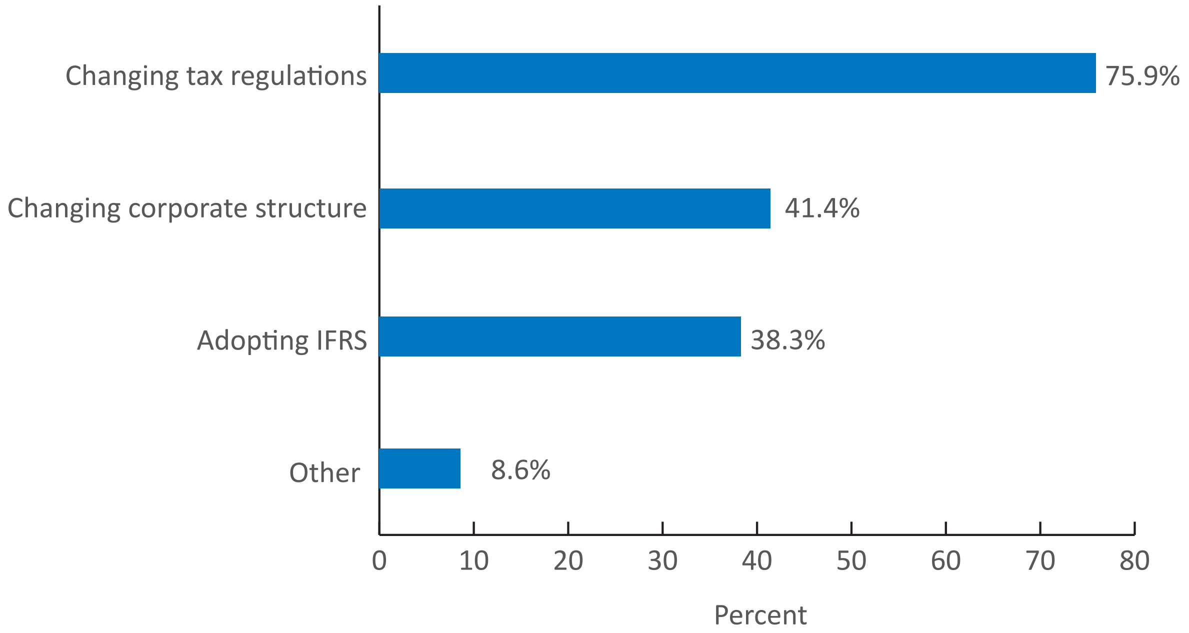
– Peter Effer, VP Taxation, Shoppers Drug Mart

TAX SYSTEM UNCERTAINTY

Corporate risk surrounding tax is expected to increase over the next two years as a result of government deficits and the potential upward pressure on the GST; the expected broadening of the base on the HST; continued difficulties surrounding tax audits and the CRA's increasing demands for information; outstanding technical amendments causing reporting uncertainty around tax reserves; and the direction of environmental taxes and levies.

The vast majority of survey respondents attributed the primary reasons for increased management complexity of tax issues to changes in tax regulations (75.9%). Other reasons included changing corporate structure (41.4%) and the adoption of IFRS (38.3%). Others mentioned more attention from the CRA, more aggressive tax collection and how the CRA administers tax law.

WHAT ARE THE PRIMARY REASONS FOR INCREASED MANAGEMENT COMPLEXITY OF THE TAX ISSUES IN YOUR ORGANIZATION?



AUDIT SCRUTINY

While most financial executives believe that their companies were doing a good job managing tax compliance and tax audits, future changes to tax policy and interpretation and the actions of the CRA were also major causes for concern. First, with growing federal and provincial deficits, the stability of the current corporate tax regime is called into question. According to Tom Evans, Chief Agent at GE Employers Reassurance Corp., companies in all sectors are worried that recent government fiscal policy will eventually have negative impacts on corporate profits. Evans says, "I think business leaders are concerned, given that all the governments are running deficits right now, that any pre-stated tax reductions are probably in peril." Evans also points to the potential for the HST base to broaden, posing specific risks to certain sectors. "In terms of its implementation of HST," says Evans, "the government seems to be broadening the net. I think there are perceived fat cows out there – easy money grabs – and other financial services firms are also quite concerned that we're going to be targets."

At the same time, many executives believe that the CRA tax audits are likely to pose more management challenges going forward. "What I'm really concerned about," says Tim McGillicuddy, VP Taxation at TELUS, "is the increasing aggressiveness of the Canada Revenue Agency with respect to their stance on what information they're entitled to." McGillicuddy said, "You're required to deliver any kind of information that's developed on a particular type of transaction, whether it be in the form of email or otherwise. If they issue a formal "requirement" for this information, you have to go through a process of upturning everything within your organization to find out who has had anything to do with a particular transaction and what kind of documentation they have. It's quite onerous on the organization to do this, and the CRA is issuing more and more of such "requirements" in regular audit situations. Furthermore, says McGillicuddy, "they're asking for deferred tax working papers, which really has nothing to do with the calculation of the income taxes themselves, but rather they're just trying to find out what we think our exposures are, which I don't think is appropriate."

> "When you're trying to determine what your tax provision is for financial statement purposes, it's difficult to give certainty around the tax expense line in the financial statements when you have a number of tax technical amendments that are not finalized."
>
> – Peter Effer, VP Taxation, Shoppers Drug Mart

In addition, companies continue to struggle with tax audits that span a period of time where information simply may not be available. According to Enzo Baldan, Manager of Tax Services at Enbridge Gas, "Going back a number of years to find documentation is a challenge at the best of times, and to meet a CRA information requirement is even worse. The ability to access information going back a period of time is further challenged by business decisions surrounding corporate reorganizations. These reorganizations have an impact on record retention, mergers and acquisition activity that may result in the loss of individuals with specific knowledge related to a tax decision, or simply individuals losing track of records over a period of time." Says Tim McGillicuddy, VP Tax at Telus, "We find that just the ongoing reorganizations within the corporation impacts record retention. The loss of jobs etc. either resulting in records being destroyed or retained off-site. But, if you haven't retained the master list of what's in which box, even though you've retained the records, it's just as bad as not having them."

ENVIRONMENTAL TAXES AND LEVIES

Environmental taxation is one of the most unpredictable areas of corporate tax policy today, yet it is likely to have some of the most profound impacts on companies across the country. Adding to the uncertainty around what companies can expect from the federal and provincial finance authorities, environmental taxes are also being charged in the form of "levies" by other ministries and governmental departments. This suggests even less uniformity across provinces and threatens to inject further complexity into the Canadian tax system as a whole. Says Enzo Baldan, Manager of Tax Services at Enbridge Gas Distribution Inc., "The problem with the environmental taxes and levies is quite new, so we really don't know which direction governments are going to go, what they are planning to tax, or how they plan to raise it. We may run into the same problem that we have with provincial sales taxes, namely different criteria and different bases, that will ultimately have a significant impact on the resourcing needed to manage such taxes."

According to Bill Ross, VP Finance and IT at Enbridge, the term "levy" alone adds a level of confusion to the tax system by reducing the transparency of the charge to the ultimate consumer. Ross says, "I think this raises an interesting point. Is the term levy being applied to hide the opportunity to raise another tax?" For example, explains Ross, "For example, this summer the Ontario Ministry of Energy will impose a charge on utility companies in an effort to finance government sponsored renewable energy products. So, the question is, is it a tax? Is it a levy? Is it something that's hidden in the purchase price? All these levies or taxes will ultimately have to be defined."

Some suggest that by its very nature, a levy is a tax, but one that's not being raised in the traditional way on the basis of revenues or transactions. But rather, it is a front-loaded, high-risk tax that is independent of output or demand. As Enzo Baldan explains, "It's a tax, but a tax that's not being raised in the normal way of doing business that traditionally taxes profits or transactions, but rather an up-front tax." Says Baldan, "By changing the common methodology, you're putting more risk onto our departments. The risk of non-payment becomes ours if the consumer shifts their purchasing decisions as a result. Also, there's a great deal of uncertainty around how this will be collected and reported. How do we explain to the consumers that this is a new levy, a new tax that the government doesn't want to talk about? This will mean more headaches for us."

Prospective Tax Strategies

In order to better manage the tax issues facing their firms, companies have turned to a wide range of strategies designed to reduce time and resources, as well as improve the overall capabilities of their tax management staff. While cost management is not a primary measure of tax department performance in most companies, budget and resource constraints are one of the leading risk factors for effective tax management today. Over the next two years, many executives expect to have to do more with the resources they currently have. However, companies that are in a financial position to devote new resources towards increasing the effectiveness of their tax function/management will mainly be spending more on training of internal staff, hiring new talent, and increasing the use of external consultants.

"HOW WILL YOUR COMPANY ATTEMPT TO OVERCOME CURRENT CHALLENGES OR IMPROVE UPON TAX ADMINISTRATION/MANAGEMENT?"

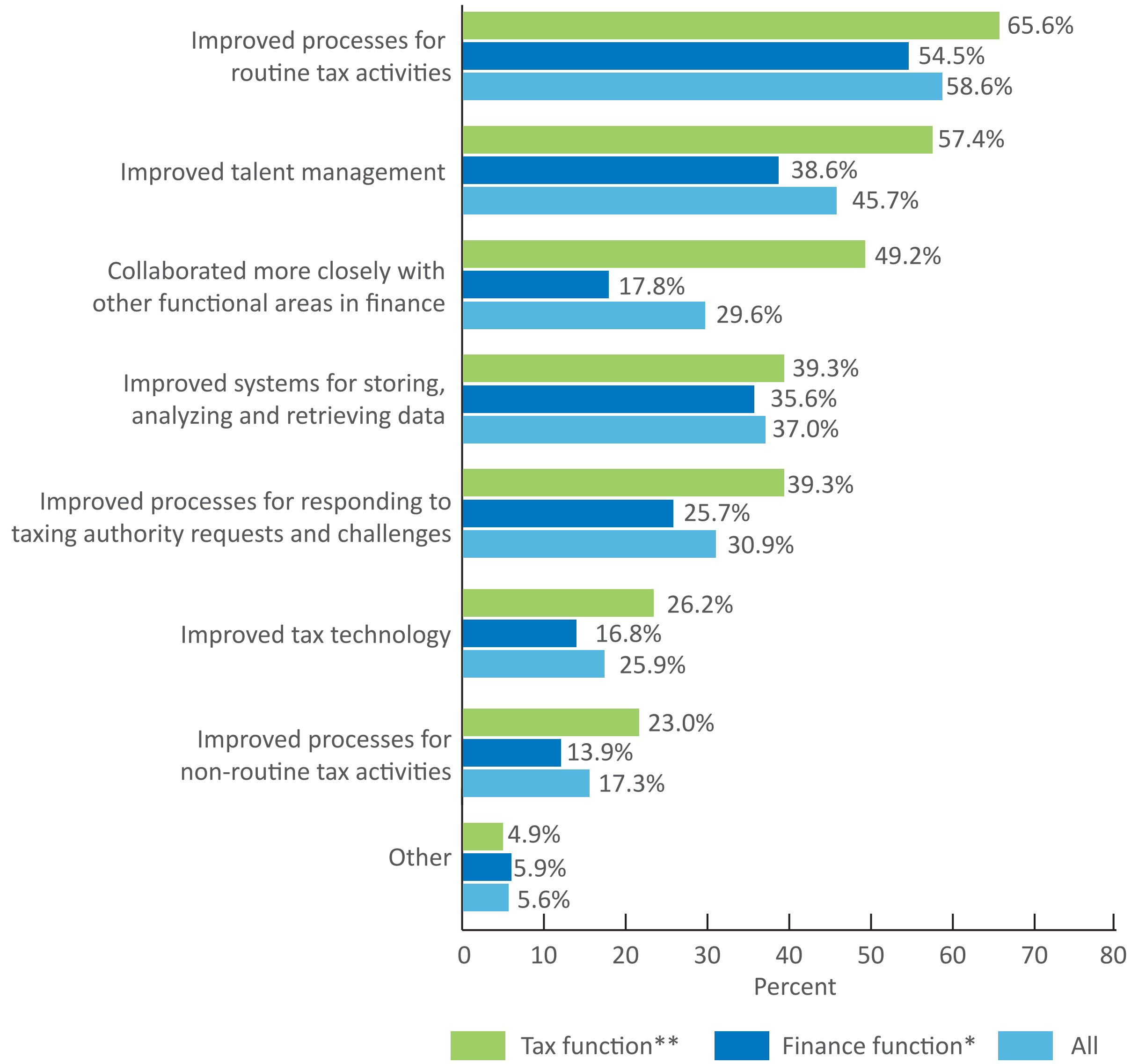
TOP FIVE RESPONSES

1. Increase training and development
2. Increase human resource capacity through new hires
3. Hire external consultants
4. Do more with the same amount of resources
5. Improve tax planning, analysis and control

To determine what strategies are most common and how effective they have been in meeting their objectives, respondents were asked to indicate what they've done over the past three to five years and which of these efforts provided the best results. Our survey shows that the most common strategy among companies has been attempting to improve simple tax operations. Of the eight strategy options provided (see Table 2), almost 59% of finance executives reported that they have implemented initiatives to improve the management of routine activities (i.e. tax returns, tax determinations, and payments). This was followed by efforts to improve talent management (recruiting, training, etc.) (45.7%), improving systems for storing, analyzing and retrieving data (37%), improving processes for responding to tax authority requests and challenges (30.9%), collaborating more closely with other functional areas in finance (i.e. audit) (29.6%), and improving tax technology (25.9%). Non-routine complex tax issues involving acquisitions, divestitures, and repatriation were the less likely to lend themselves to process improvements.

Not surprisingly, larger companies with full-time, dedicated resources for tax management and/or separate tax departments were more likely to have implemented these improvements than smaller companies where the finance function was a responsible for tax. Most notably, while increasing training and staff development efforts were crucial to companies, smaller companies were less likely to have devoted resources in this way to improve tax management in their firms.

WHAT HAVE YOU IMPLEMENTED OVER THE PAST THREE TO FIVE YEARS TO ENHANCE THE EFFECTIVENESS OF MANAGING THE TAXATION ISSUES FOR YOUR COMPANY?



* Companies where tax management fell under the purview of a financial executive.

** Companies that had a separate tax function or at least a separate internal tax management specialist

When asked if these strategies provided the expected value for their organizations, results show that not all companies received the best outcomes from their improvement initiatives. More specifically, while 58.6% of companies attempted to improve strategies for routine tax activities, only 45.7% said that it provided the best value. Similarly, 37% of finance executives reported that they implemented new systems for storing, analyzing and retrieving data, while just under one quarter (23.5%) felt that these improvements provided the best value-for-money outcomes.

TABLE 2. TAX MANAGEMENT STRATEGY

	Implementing strategy	Strategy provided best value	Strategy needs improvement
Routine tax activities	58.6%	45.7%	19.4%
Talent Management	45.7%	43.8%	17.0%
Systems for storing, analyzing, retrieving data	37.0%	23.5%	33.5%
Responding to tax authority requests and challenges	30.9%	21.6%	14.0%
Closer collaboration with finance (i.e. audit)	29.6%	24.7%	19.2%
Improved tax technology	25.9%	21.0%	39.4%
Non-routine tax activities	17.3%	11.7%	23.4%
Other	5.6%	4.9%	n/a

Some companies felt that the best way to improve their tax management process was to take more internal control over process improvement, while others found efficiencies and control improvements through outsourcing routine functions, particularly for transaction tax reviews.

At GE Employers Reassurance Corp., Tom Evans, Chief Agent explains that an initiative to improve the tax management processes resulted in bringing some of their outsourced tax functions back in-house, which better enabled them to understand the link between investment strategies, accounting and financial reporting, and tax planning and compliance. Evans says, "We've had a real push to examine and change a lot of the processes that were being followed. Previously, we were entirely outsourced. We've brought some of that in-house again, and that has enabled us to better understand what the tax specialists need to prepare the tax returns from an accounting perspective. Further, because we do special reporting of investments for tax purposes, having a better understanding of that has allowed us to make the whole process much more efficient, and essentially save some money doing it, not only in fees, but in terms of absolute tax dollars."

However, other companies are finding that a successful way to improve the management of their tax function has been to leverage external service providers. As Peter Effer, VP Taxation at Shoppers Drug Mart explains, "Although it seems like a plug for third-party organizations, when you're dealing with a transaction tax, there's so much room for error. When you use external review consultants to verify your results, it provides a control function for the purposes of signing-off your year-end audited statements. It ultimately gives you some comfort that you're managing your risk properly." Similarly, at Lilydale, says Jeff Gresham, VP and CFO, "On transaction tax and audit efforts, we've used a couple of different service providers to do thorough reviews of our systems and filings. Over the last three or four years we've been very much comforted by that sort of granular review process, really establishing that there were not significant errors in our practices surrounding commodity taxation."

ACHIEVING TOTAL TAX COMPETENCY

So how are companies planning to overcome challenges or improve upon tax administration/management going forward? Many will look to increase internal human resource capacity by hiring new tax specialists. Others will focus on internal training to improve upon the current talent in the firm as well as increase the use of external consultants. Many executives also indicated that they were going to place greater emphasis on tax planning, improving administrative processes and utilizing internal teams more effectively. Others said that, due to the economic climate, they would simply have to do more with the same resources and work longer hours. One respondent indicated that they would try to persuade the CRA to adopt standard business reporting using XBRL suggesting that "this will save my business and others a great deal of time and money."

With the dominant focus of tax management being on compliance, other areas falling under the purview of the tax department or CFO, are often managed in an ad hoc way. Our study reveals that one out of every three finance executives sees that their companies need to improve their track record when it comes to allocating resources between compliance initiatives and tax planning and analysis. One in four felt that identifying savings opportunities, evaluating the impact of IFRS conversion, and participating in tax planning and policy needed improvement. Similarly, just over 20% saw room for improvement in mitigating business risks.

Despite weaknesses in certain areas, companies across the board are also doing things right. Not surprisingly, when it came to complying with tax laws, over 60% of all respondents felt that they were doing either a good or excellent job of managing this issue. Similarly, many executives felt that they did a good or excellent job of performing a tax audit defense (51.1%), considering tax consequences of major transactions (49.3%), avoiding tax-related errors in financial statements (49%), and complying with new accounting rules (47.3%).

However, results varied dramatically between companies that had a separate tax function and those that didn't. For those that did, the most notable differences lie in their success in managing the more strategic issues related to tax, specifically identifying savings opportunities, tax planning, and making sure that resources are adequately shifted between compliance and planning when necessary (see Table 3). Shifting resources between tax compliance and planning, however, was still seen as a weakness by more companies than any other area of tax management, regardless of whether the firm had a dedicated tax function or if their tax issues were managed by the CFO. Again, this confirms that in companies of all sizes, compliance is the single largest drain on resources when it comes to the tax management activities, negatively impacting the organization's ability to focus on more strategic tax planning and management initiatives.

TABLE 3. HOW WELL IS YOUR TAX FUNCTION PERFORMING?

	Good	Average	Needs improvement	Don't know
Complying with tax regulations	62.6%	21.5%	15.2%	.6%
Finance function*	53%	27.5%	18.3%	-
Tax function**	78.3%	11.6%	10%	-
Performing tax audit defense	51.1%	21.9%	18.9%	8%
Finance function *	37.9%	25.3%	25.3%	11.3%
Tax function**	68.9%	17.2%	10.3%	3.4%
Considering tax consequences of major transactions	49.3%	28.4%	20.2%	2%
Finance function*	39.3%	31.4%	26.9%	2.2%
Tax function**	64%	23.7%	10.1%	1.6%
Avoiding tax related errors in financial statements	49%	32.3%	16.7%	1.5%
Finance function*	45.2%	32.6%	18.9%	3.1%
Tax function**	55%	31.6%	13.3%	-
Complying with new accounting rules	47.3%	37.8%	13.5%	1.4%
Finance function*	39.7%	39.7%	19.3%	-
Tax function**	58.3%	35%	5%	-
Mitigating business risks associated with tax	41.6%	33.8%	22.7%	1.9%
Finance function*	34.0%	35.1%	28.7%	2.1%
Tax function**	53.3%	31.6%	13.3%	1.6%
Identifying savings opportunities	41.5%	32.7%	25.1%	.6%
Finance function*	29.2%	37.3%	32%	-
Tax function**	61.6%	25%	13.3%	-
Participating in tax planning	41.5%	31.6%	25%	2%
Finance function *	33.6%	32.6%	31.5%	2.1%
Tax function**	53.3%	30%	15%	1.6%
Reallocating resources from tax compliance to tax planning	28.2%	37%	33.3%	1.5%
Finance function*	19.2%	39.7%	38.4%	3.1%
Tax function**	40.3%	33.3%	26.3%	-
Contributing to non-tax regulatory compliance (NI-52-109/111)	22.3%	42.1%	14.3%	21.4%
Finance function*	21.1%	42.2%	18.3%	18.3%
Tax function**	23.6%	41.8%	9%	25.4%

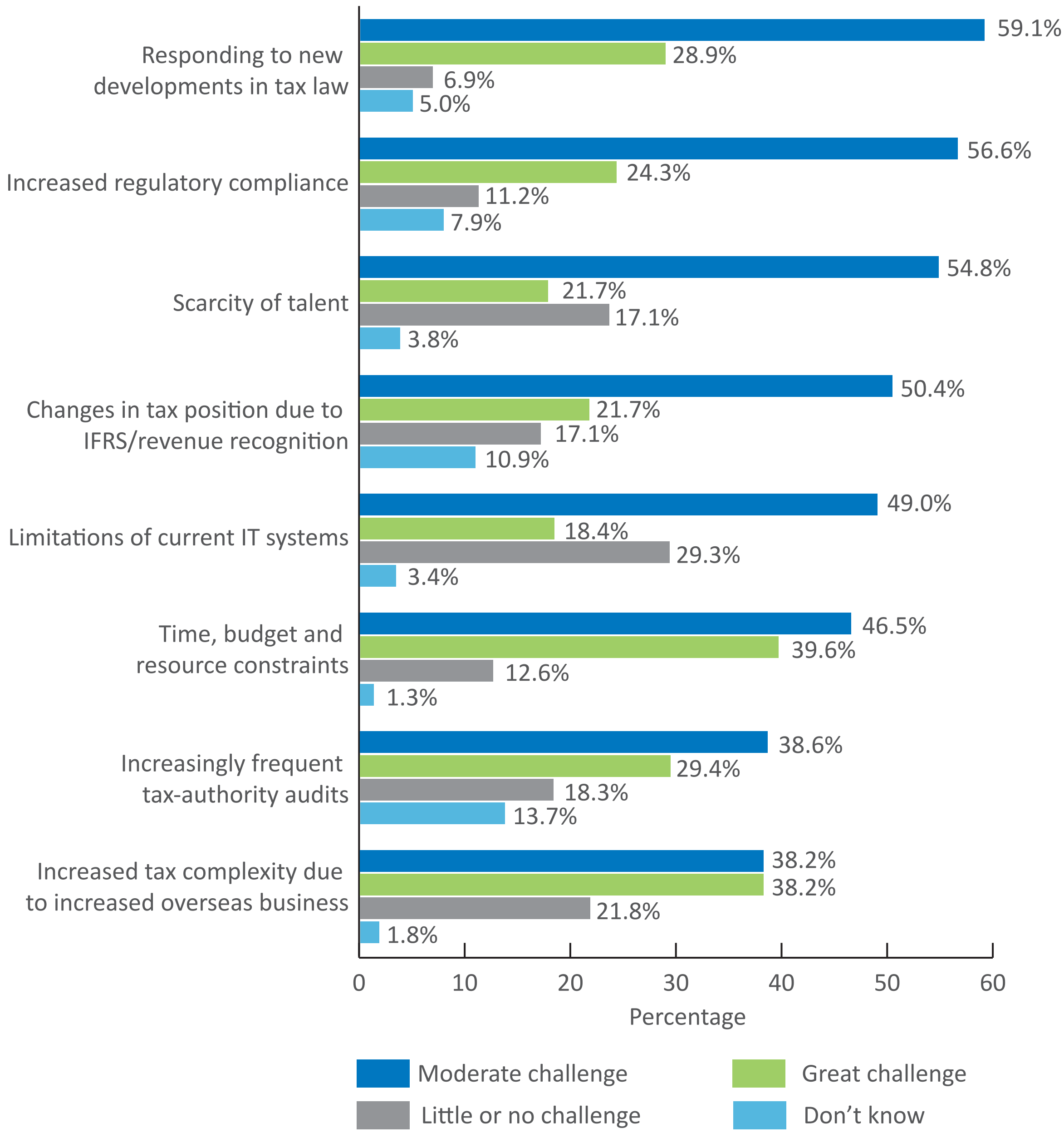
* Companies where tax management is handled by finance
** Companies that had a separate tax function or separate internal tax management specialist

THE TAX PLANNING CONTINUUM AT TELUS

"At TELUS, we view compliance and planning as a continuum, particularly in the area of income tax. There's a form of planning that occurs in compliance activities because there are positions that you can take based upon what happens with the transactions. We take a lot of time in terms of preparing our tax returns, because we take pride in the notion that we can effectively be a profit centre. Because each transaction is different, you can take tax positions in your returns that can be favourable or unfavourable to the company as the case may be. We start with that, and in the course of preparing the returns, we identify those positions, what our exposures are, what the likelihood of being attacked on the positions might be, and that flows into the provision. Of course we also deal with plans around mergers and acquisitions (M&A) transactions or other large kinds of transactions. We identify issues where the tax laws seem to adversely affect the corporation and that feeds into what kind of advocacy positions we take with governments. So, we view it as a continuum, and we have our planners actually involved in the compliance process itself."

– Tim McGillicuddy, VP Taxation, TELUS

IN YOUR OPINION, HOW MUCH OF A CHALLENGE WILL THE FOLLOWING ITEMS LIKELY PRESENT TO YOUR COMPANY OVER THE NEXT TWO YEARS?



EFFECTIVE MANAGEMENT IS A FUNCTION OF RESOURCES

"There are three things that make a tax department successful – resources, good input information from accounting, and timely involvement of the tax group in other business departments. If you're constrained from a resource standpoint, you're going to have difficulty allocating time to develop and execute planning ideas. For tax reporting, if you have good cooperation with your accounting group, which we have at Shoppers, you can make your tax reporting function more efficient. Make no mistake, it is the responsibility of the tax department to go to the accounting people and clearly articulate their needs, but it is the accounting department which has ownership of the general ledger (G/L) and needs to set up the accounting systems to support tax reporting. You can then use technology to improve the tax function, which is typically very manual. In a nutshell, it's just basic teamwork between tax and accounting groups, but this teamwork must be encouraged from the top to drive overall finance department efficiency. I think timely involvement of the tax group in other business departments speaks for itself. The better the planning up front, the more efficient the exercise. In my opinion, that holds true for any department in a company, not just a tax group."

– Peter Effer, VP Taxation Shoppers Drug Mart

OUTSOURCING AND TRAINING

Companies that outsource procurement and payroll may be particularly vulnerable to increased financial risk due to processing and coding errors. Natalie Yunes, Tax Manager at Bayer Inc. comments how outsourcing can expose the company to additional risk and impact staff training. Yunes says, "I expect that we will have a number of issues training staff, both on accounts payable and on the procurement end. The reason is because our accounts payable is outsourced, and I fully expect that they will miss half of the Ontario and British Columbia (BC) components of the recoverable HST. Consequently, I will have to put in a lot of effort in-house to solve that or have a consultant come in and recover those. At the same time, I have to set up a liability for the things that we have recovered that we shouldn't have. Also, because the tax base is widening, I will also have to retrain my procurement department to actually be able to put in the correct tax code into their purchase order so that the invoices are properly matched. This will likely be an ongoing expense item."

TAX AUTOMATION

Tax management, including compliance, accounting, and reporting, is burdened with manual processes, according to most tax and finance executives (54.9%), and almost one third (31.5%) felt that they weren't taking good advantage of IT as it relates to tax management. Many finance executives felt that tax management technology can be an effective tool for improving the overall management of the tax function; however, they also agreed that it will only be as effective as the information that feeds it.

According to Peter Effer, VP Taxation at Shoppers Drug Mart, tax management would ultimately be improved by having better accounting systems to provide more accurate input data. Effer says, "You could then use technology to improve the tax function, but it's not the tax function itself where you would start." Other companies have high hopes for the power of integrated tax technology, but warn that multiple systems issues can create roadblocks to effective implementation. "The dream is that we can get tax provision software that would be able to extract all the information we need into a model that we can tweak to our needs and then flow into the tax return," says Enzo Baldan, Manager Tax Services at Enbridge Gas Distribution. "That would solve a lot of our problems. Right now," says Enzo, "we're running into multiple systems problems, and we have to identify the various interfaces and the impacts of pulling information from one system into another. What we do in one system has major ramifications on how information flows into another and hits us in terms of total cost. This information flow between multiple systems has been a major issue for us in the current implementation of the HST."

Finance executives also stress the importance of careful planning when applying technology solutions to the tax function. Jeff Gresham, VP and CFO of Lilydale, says, "We're in the throws of implementing a new ERP system across the organization. We've looked at the system in terms of how it can improve our compliance both with commodity taxes and transaction taxes, particularly on imported equipment. We've also looked into preparing not only internal accounting entries on a routine monthly basis, but also into feeding tax returns and other filing requirements. That requires planning and ensuring the supports are there on a routine basis to get the information required."

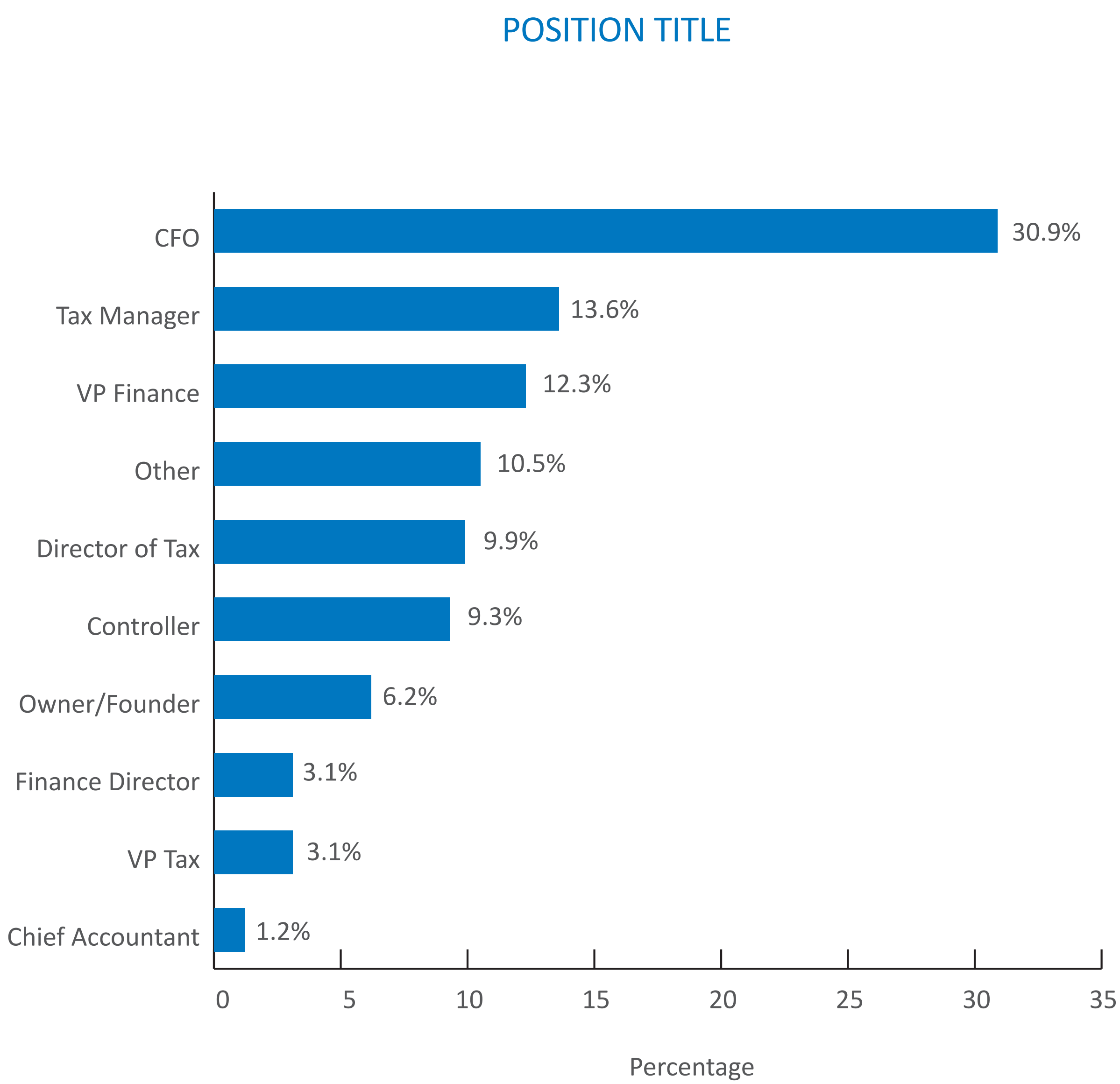
Conclusion

This study has revealed that finance executives generally believe that many aspects of the Canadian tax system will continue to increase in complexity over the next two years, posing increasing challenges to effective tax management and putting more strain on already scarce resources. The two most pressing issues surrounding tax management in Canada are the adoption of the IFRS in public companies and the implementation of the HST. However, we also know that the level of complexity around transfer pricing is an ongoing concern for many companies, as are other issues surrounding operating in multiple tax jurisdictions and countries. In addition, many executives were concerned about how the Canadian tax system would evolve given the current state of federal and provincial budgets, the potential for widening the tax base, and the future of environmental taxes and levies originating from different federal and provincial ministries. As such, changing regulations are seen to be the number one reason executives see the Canadian tax system increasing in complexity in the future.

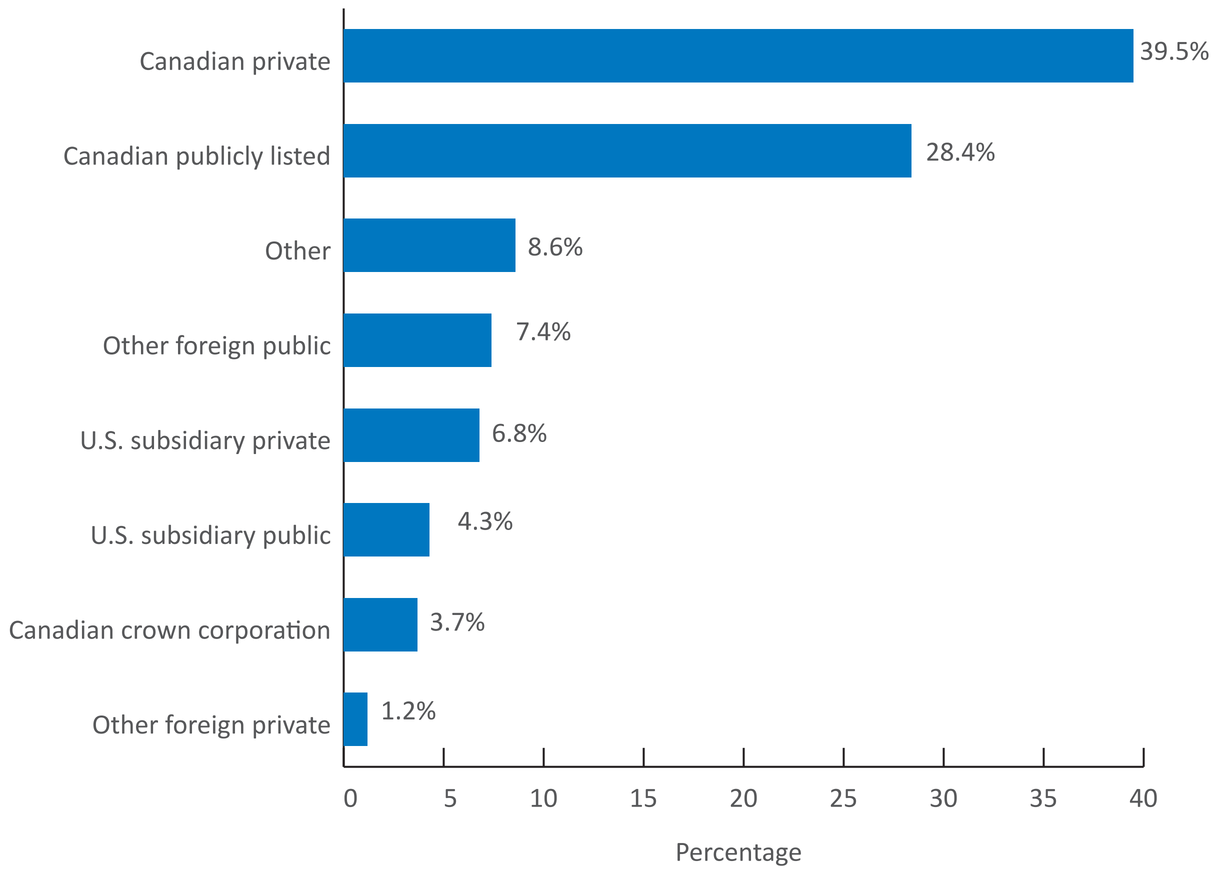
In order to manage over the next two years, tax and finance executives are planning on increasing their human resource capabilities through hiring, increased training, and hiring external consultants. However, many are also concerned that they will simply have to do more with the same level of resources they're working with today, particularly for small companies without a dedicated tax function or professional internal tax manager. To date, strategies for improving the efficiency of tax management have mainly focused on process improvement, focusing on more routine tax functions surrounding compliance. As a result, managing compliance requirements has been the single biggest draw on tax management resources. Tax planning, although generally seen as a very important part of a company's tax management strategy, wasn't afforded the resources many thought it deserved.

We've also shown that going forward, many executives have high hopes for improvements in tax management technology, however, they also realize that in order to take advantage of technology improvements, the information provided by the accounting department has to be appropriate and accessible. To this end, tax and finance executives believe that tax must work in close cooperation with the controllership function, and that the CFO should act as a champion for the tax management function, recognizing its important role in creating and preserving value in the company. Careful consideration of hiring a skilled tax consultant to manage and validate the tax positions and strategies implemented can help reduce risk and uncertainty while strategically positioning tax within the organization.

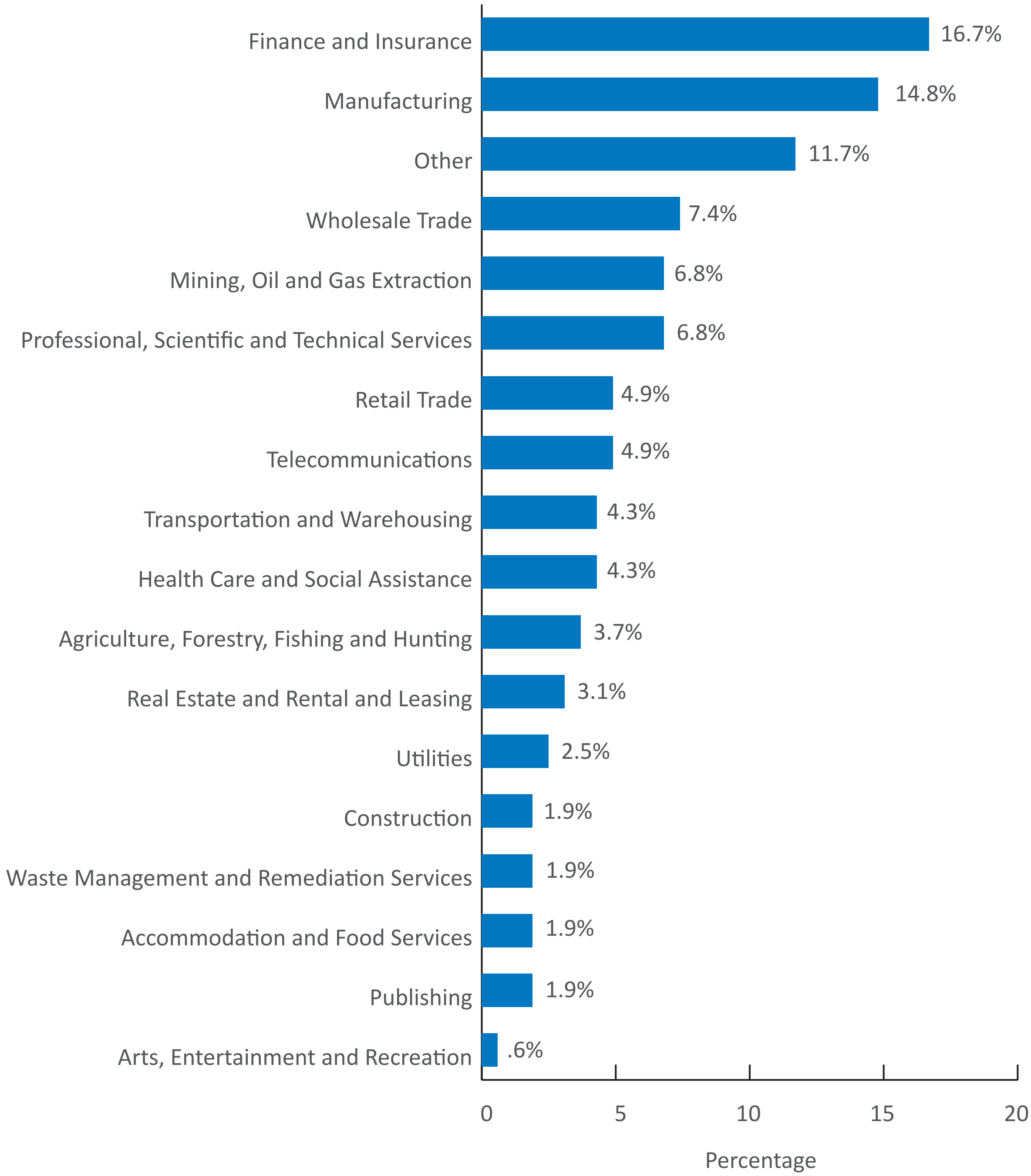
Appendix A – Survey Demographics



CORPORATE STRUCTURE

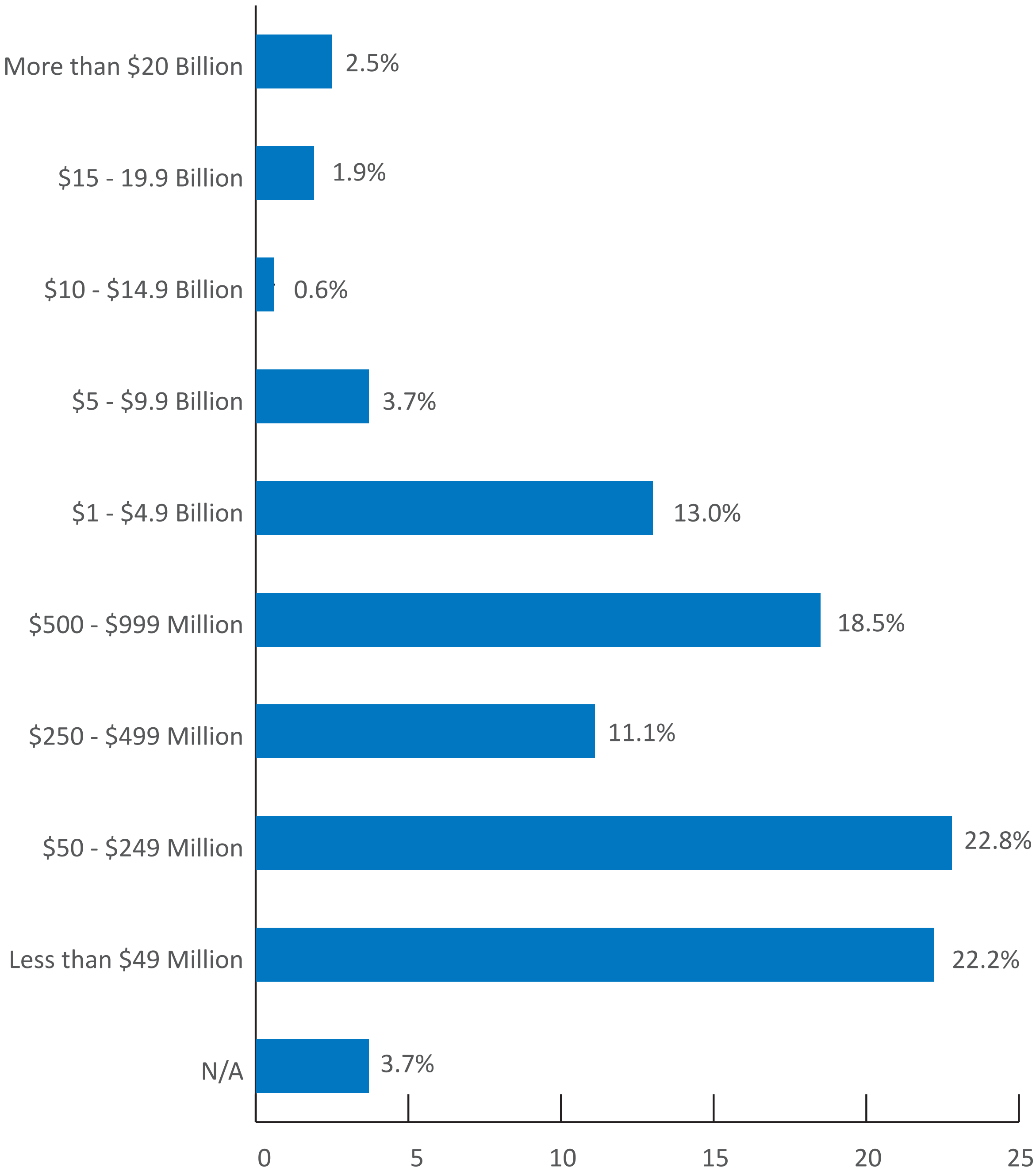


INDUSTRY

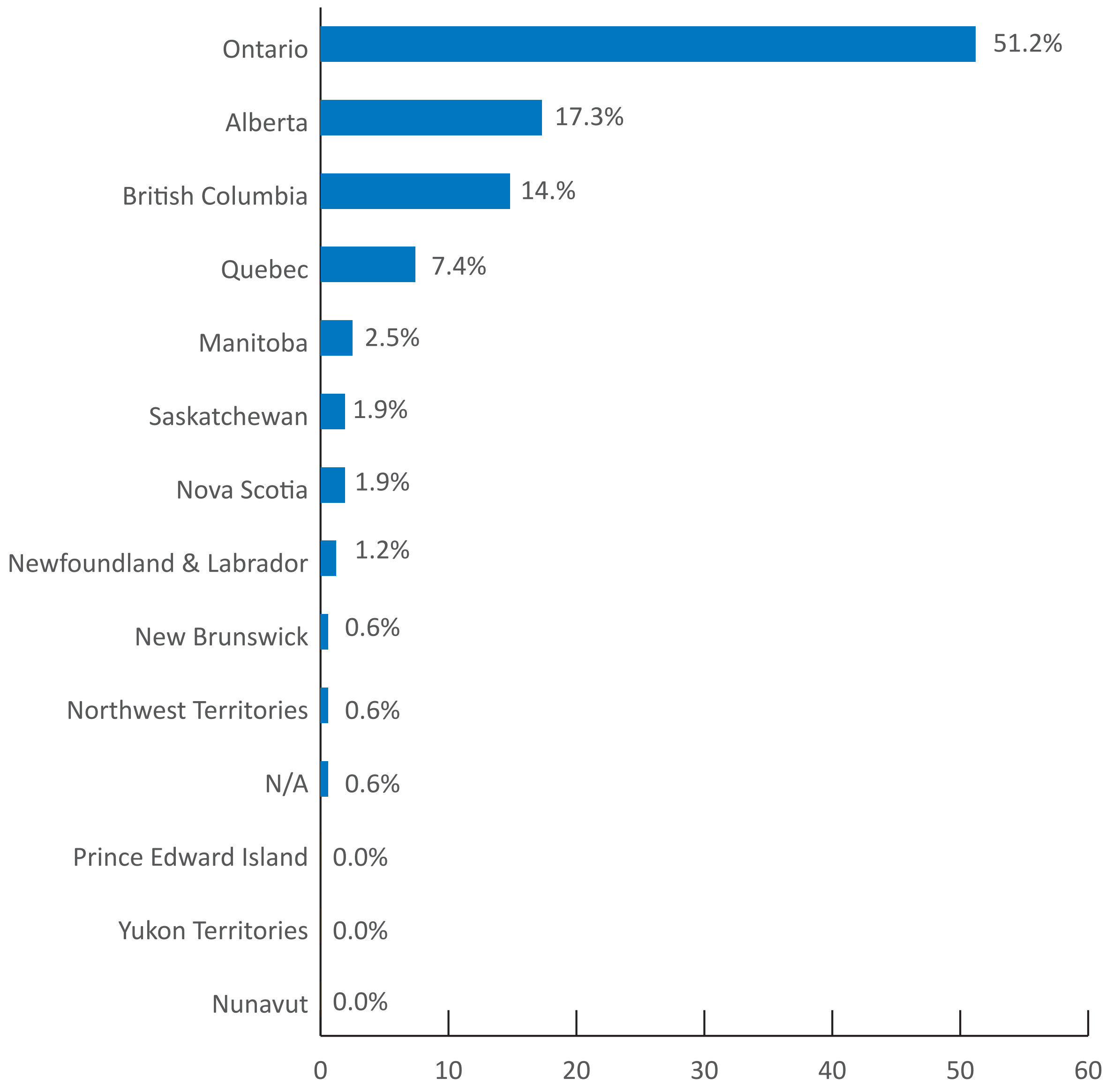


Finance and Insurance
16.7%
Manufacturing
14.8%
Other
11.7%
Wholesale Trade
7.4%
Mining, Oil and Gas Extraction
6.8%
Professional, Scientific and Technical Services
6.8%
Retail Trade
4.9%
Telecommunications
4.9%
Transportation and Warehousing
4.3%
Health Care and Social Assistance
4.3%
Agriculture, Forestry, Fishing and Hunting
3.7%
Real Estate and Rental and Leasing
3.1%
Utilities
2.5%
Construction
1.9%
Waste Management and Remediation Services
1.9%
Accommodation and Food Services
1.9%
Publishing
1.9%
Arts, Entertainment and Recreation
.6%
0
5
10
15
20
Percentage

ANNUAL REVENUE



HEADQUARTER LOCATION



Appendix B – Forum Participants

Forum Chair	William Hewitt, CFERF Trustee, Chair - FEI Canada's Issues and Policy Advisory Committee
Moderators	Garry Round, Managing Principal, Canadian Operations, Ryan ULC
	Ramona Dzinkowski, Executive Director CFERF
Participants	Enzo Baldan, Manager Tax Services, Enbridge Gas Distribution Inc.
	Peter Effer, VP Taxation, Shoppers Drug Mart Corporation
	Tom Evans, Chief Agent, GE Employers Reassurance Corp.
	Jeff Gresham, VP and Chief Financial Officer, Lilydale Inc.
	Nancy Lala, Chief Financial Officer, About Communications
	Carol Lyons, Controller, Liquor Control Board of Ontario
	Tim McGillicuddy, VP Taxation, TELUS
	Brendan Moore, Principal, Ryan Property Tax Services ULC
	Bill Ross, VP Finance and IT, Enbridge Gas Distribution Inc.
	Natalie Yunes, Tax Manager, Bayer Inc.
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