December 16, 2011

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

Dear Minister Flaherty,

Financial Executives International Canada (FEI Canada) is respectfully submitting the following recommendations as part of the 2012 pre-budget consultation. Consistent with prior years, this submission has been prepared by the Taxation Sub-Committee of the Issues and Policy Advisory Committee of FEI Canada. FEI Canada is an organization representing 2,000 senior financial executives and it appreciates the need for budget measures that support both economic growth and a balanced budget.

Canada faces an uncertain economic future in the near term. The European debt crisis could slow or halt our economic growth. If not Europe, the United States' uncertain recovery also could negatively impact our economy as our neighbours to the south enter their presidential election year. The path ahead has its challenges and a prudent course through the upcoming turbulent and uncertain economic waters will have to be skillfully and thoughtfully charted out.

FEI Canada has long advocated for:

(a) government policies which stimulate economic growth, enhance competition and productivity, and increase employment;

(b) responsible fiscal management;

(c) accountability and transparency with respect to government taxation and spending; and

(d) tax policies which support the above and/or tax legislation which eliminates unintended inconsistencies and anomalies in the tax system.

For the 2012 Budget, FEI Canada would like to see a budget with the following attributes:

1. Canada should demonstrate fiscal prudence and responsibility to provide a solid fiscal platform to build a strong economy that can compete internationally;

2. Canada should encourage the free flow of financial and labour capital to encourage investment in our country;

3. Canada should encourage and support innovation of new ideas that culminate in new products and services offered both domestically and abroad by Canadian companies;

4. Canada should reduce the complexity of businesses' dealings with the government, particularly in the tax system, to support improvements in productivity; and

5. Canada should encourage and support Canadians to improve their individual financial positions, during both their working and retirement years.

FEI Canada believes that its budget recommendations will be mutually beneficial for the government, Canadian business and Canadians as a whole and are in line with the objectives of suggesting budget initiatives with net cost neutrality. With this in mind, FEI Canada's budget recommendations are set out below for your consideration.

1) Fiscal Platform

FEI Canada's recommendations are designed to provide a sound fiscal platform for the Canadian economy including:

a) Implement planned corporate tax reductions, until the target federal corporate tax rate of 15% is reached, and encourage the provinces to migrate towards a common provincial corporate income tax rate of 10%;

b) Create a National Securities Regulator;

c) Support and encourage efforts by all provinces to reduce inter-provincial trade and labour barriers;

d) Continue to encourage the federal and provincial harmonization of the tax system.

Corporate Income Tax Rate

The government's adherence to the reduction of the federal Canadian corporate tax rate system has made Canada a very attractive nation for domestic and foreign investment. Further, allowing Canadian companies to retain earnings in the form of lower taxes has provided direct stimulus to existing Canadian companies supporting their fiscal health and slowed layoffs as an alternative means to improving cash flow. FEI Canada believes that retaining jobs during this current economic climate is important and, therefore, the federal government should continue to maintain the federal corporate tax rate at 15%.

Different provincial corporate income tax rates are confusing to foreign investors and encourage what the provinces refer to as provincial income shifting. Much of these concerns would be eliminated if the provinces worked towards establishing common corporate income tax rates. Currently, British Columbia, Alberta, Ontario and New Brunswick either are currently or are planning to move towards a 10% provincial corporate income tax rate. The output from these provinces represents approximately 68% of the total Canadian GDP. If Quebec were to move its corporate tax rate back to 10% from the current 11.9% (Quebec had been 8.9%), there would be harmonization of the tax rate in provinces representing approximately 89% of the total Canadian GDP. Naturally, it would be desirable for all provinces to have a uniform corporate tax rate.

National Regulator and Provincial Barriers

Much has been said on the introduction of a national securities regulator and the elimination of provincial barriers. These initiatives continue to be a positive measure that would support confidence and productivity in our country.

Harmonization

FEI Canada is pleased the Quebec Sales Tax and the Goods and Services Tax has been substantially harmonized. As noted above, increased harmonization improves understanding of the Canadian corporate landscape for foreign investors. Harmonization of taxes reduces administration and costs for both government and industry and should continue to be encouraged in all areas where there are similar federal and provincial taxes such as income taxes, sales taxes and environmental taxes.

2) Free Flow of Capital

FEI Canada's recommendations, which are designed to encourage the free flow of capital, include:

a) Eliminate withholding taxes on dividends with the United States and with major trading and investing partners;

b) Provide the same Scientific Research and Experimental Development ("SR&ED") benefits for public and private corporations.

Withholding Taxes

Similar to FEI Canada's comments in its pre-budget submission last year, withholding taxes constitute a barrier to the free flow of capital. Within the European Union, the EU parent-subsidiary eliminates withholding taxes. The United States, a major source and recipient of investment capital for Canadian businesses, has negotiated a zero withholding tax rate under many of its treaties for dividend payments since 2003. FEI Canada believes that Canada should strive to eliminate or phase out withholding taxes on the payment of dividends with the United States similar to the removal of withholding tax on interest.

Withholding taxes on dividends also creates a bias for debt financing in Canada which can create issues regarding the thin capitalization rules for many foreign-controlled Canadian companies, as well as generally adding to the cost of raising equity versus debt. The elimination of withholding taxes on dividends would greatly improve the ability of Canadian companies to attract foreign capital and compete with other jurisdictions. FEI Canada recommends that withholding taxes should be eliminated on dividends with other major trading and investing partners where such a removal would be mutually beneficial to Canadian foreign trade.

SR&ED

Smaller Canadian companies that are either growing or are in their start-up phase should get as much encouragement as possible. The ownership status (public versus private) should not be a criterion for receiving different tax credit enhancements. The SR&ED program or any innovation program should not discourage smaller Canadian companies from seeking public funds to fund their research activities in Canada, but should encourage both domestic and foreign investors to provide capital investment for vital SR&ED or innovation projects performed and realized in Canada.

3) Innovation

FEI Canada recommendations to support innovation in Canada include:

a) Support programs that encourage investment and spending on innovation in Canada;

b) Support innovation costs from cradle to grave or from the onset of an innovative idea to the commercialization of that idea.

Innovation Investment & Spending

FEI Canada recognizes that innovation plays a significant role in achieving a strong and sustainable economy. Canada needs economic and taxation policies that encourage and facilitate innovation.

There are various ways to accomplish this. Businesses which are just taking flight may have more difficulty getting access to credit than most. To address this, FEI Canada supports the introduction of tax credits for investors in innovation and for those who help finance corporations to grow beyond the research stage (e.g. commercialization activities).

The SR&ED tax credit program was developed many years ago and has served Canada well until now. In order to continue to be effective, FEI Canada believes the program needs to be improved further.

As noted above, FEI Canada believes that there should be a uniform treatment for public and private companies. The uniformity permits the government to introduce legislation that would allow companies engaged in innovation to issue flow-through shares that could operate similar to the flow-through share programs that exist in the oil and gas and mining industries. Similar to how the flow-through share program has encouraged exploration and development of Canada's natural resources, so too could flow-through shares be issued to support innovation across all industries. Innovation flow-through shares would renounce qualifying SR&ED or innovation expenditures and any related tax credits to investors investing in these companies. Such a program would encourage private investment in Canadian innovation and would not be an incremental cost to the government since this program only represents transferring deductions and credits from one taxpayer to another.

Innovation Costs

FEI Canada recommends that the current SR&ED program should be expanded so that all activities related to development and commercialization of a product or processes are eligible activities. Activities such as market research or data collection, business development and quality assurance are necessary in order to gain valuable insights from customers and other parties so that the ultimate product or service is commercially viable. Commercial viability, in fact, should be tied into the criteria for a project to qualify for the expanded SR&ED expenditures incurred in Canada and not only the scientific research results or technological advancement of the project since it is the commercial viability that ultimately creates jobs, generates tax revenue and spawns additional innovation. The availability of tax credits for the commercialization and development of products can be tied to the sale of product from a Canadian company to ensure that the tax credits are recovered through additional tax revenues generated from the sale of the ideas or products.

4) Reducing Complexity

FEI Canada recommendations to simplify the Canadian taxation system include:

a) Establish a task force to undertake a review of the Federal Income Tax Act;

b) Implement a loss transfer system with the view of introducing consolidated corporate income tax returns;

c) Implement legislation that would allow and require a mandatory process to encourage settlement during field audits to reduce ongoing tax disputes;

d) Allow consolidated GST/HST tax return filings within a related group of entities.

Review of the Income Tax Act.

FEI Canada recommends that the Ministry of Finance continue reviewing the Canadian Federal Income Tax Act (the Act). Some important reviews have been undertaken recently and we recommend that, in addition to some of the specific areas under review, a task force should be established to undertake a more comprehensive review of the Act. Keeping the goal of reducing federal costs in mind, FEI Canada recommends that the Act be thoroughly reviewed with the objective of reducing complexity, in particular, those aspects of the Act which (a) do not lead to economic efficiency, growth and/or increased competitiveness, (b) create excessive compliance costs vis-à-vis their policy objectives (the proliferation of CCA classes, e.g.), (c) are inconsistent with the characteristics of a simple tax system, and/or (d) result in unnecessary duplication.

The review should include a comprehensive and careful examination of every tax provision designed to incent a particular industry. Tax incentives should be timely, targeted and temporary. The stated objective of the tax provision should be measured against the cost of the initiative, in order to determine whether it is yielding the intended benefit. If the provision is found to be no longer achieving its purpose, its elimination will help narrow the budget deficit and reduce complexity in the Act. Legislated sunset rules would also help to control the growth of non-efficient tax expenditures.

There have already been a number of recommendations made to the Federal Government on how to make Canada's tax system more competitive while achieving more simplicity. For example, the Advisory Panel on Canada's System of International Taxation in their document of December, 2008 entitled Enhancing Canada's International Tax Advantage made a number of recommendations for which the Government has yet to act on. These recommendations should be included in the task force recommendations for immediate implementation.

Following our 2010 and 2011 testimony to the Standing Committee on Finance, we are pleased to note that the December 2011 report of the committee includes the following recommendation:

> "***The federal government convene an expert panel to review, modernize and simplify the federal corporate tax system.***"

FEI Canada would be pleased to participate in this expert panel or assist the government in any manner to achieve this worthwhile endeavour.

<u>Loss Transfer System</u>
FEI Canada agrees with the government's comments in a previous consultation paper on the taxation of corporate groups that "an efficient tax system also contributes to providing a more competitive environment for business…" and that "it may be possible to further enhance competitiveness by improving the efficiency of the tax system with respect to the treatment of corporate groups".[1]

[1] Canada: Department of Finance. "The Taxation of Corporate Groups: Consultation Paper". November 2010, p. 2.

The current strategies for transferring losses are neither effective nor efficient. Under the current rules, to utilize losses taxpayers undergo complex and costly planning transactions that add no value to the Canadian economy as a whole. Smaller taxpayers usually do not have the expertise or financing to implement costly tax loss utilization techniques. Certain corporations operate their business divisions in separate legal entities for valid business reasons or regulatory reasons. Divisions operating within the same entity, however, have the ability to offset tax losses from unprofitable divisions against taxable income from profitable divisions which creates inequitable advantages among taxpayers.

In addition, under the current system, the acceptance of the use of tax loss strategies by the Canada Revenue Agency is not always certain. This uncertainty increases the risk to taxpayers of incorrectly reporting their tax obligations to the government and to external financial statement users as well as increasing the potential for costly tax audit disputes. Providing a legislative framework to transfer losses would improve the clarity, predictability and fairness of the tax system for all taxpayers and the government.

FEI Canada acknowledges that the immediate need is to implement a form of tax loss utilization within corporate groups. This should be a priority in the current budget. However, FEI Canada believes that the tax system should transition towards the filing of one consolidated tax return in an effort to further reduce tax administration. A consolidated tax return appropriately recognizes the broader economic corporate group as the taxpayer.

It is understood that a more in-depth analysis is required before a consolidated tax reporting system can be implemented. As such, FEI Canada believes that any tax loss utilization system adopted should be designed so that it may operate within the current tax reporting system and a future consolidated tax reporting system. For further details, please see FEI Canada's comments on the Department of Finance's consultation paper on the Taxation of Corporate Groups, dated 18 March, 2011, which can be found at http://www.feicanada.org/page/news/comment.

Mandatory Settlement Process

Tax simplification will ultimately reduce the burden of tax administration for CRA and Finance thereby reducing government costs and contribute to balancing the budget. Similarly, streamlining the tax audit process and resolution of tax disputes will again reduce costs for the government. Tax disputes have increased significantly over the past decade because the CRA has a mandate to reassess rather than to resolve. For instance, notices of objection (or "intakes") filed by taxpayers increased 88% between 2005/06 and 2009/10; the overall caseload (or "inventory" of cases) increased during the same time period by 126%.[2] These levels of increases are neither efficient nor affordable and clearly call out for immediate change.

FEI Canada recommends that the federal government introduce legislation that would allow and require a mandatory process to encourage settlement as part of the field audit. Mandatory settlement meetings currently are undertaken at the Tax Court level with the view of settling cases out of court. Encouraging the settlement of an issue at the field audit level will reduce the number of files that filter through the objection and appeals process over a number of years and will save resources for both the government and taxpayers (especially for smaller taxpayers where financial resources are scarce). The Canada Revenue Agency ("CRA") currently reports the statistic "Tax Earned by Audit" or TEBA for its measure of audit effectiveness. This reporting method should be changed to one that supports the settlement rather than only the reassessment of audit issues.

GST/HST Consolidated Filing

Each legal entity within a corporate group is required to file a separate GST/HST return. Often corporate groups have a centralized accounts payable function that pays funds on behalf of all companies in the corporate group and recovers the payments from the members incurring the expense. The corporate group would then record and report GST/HST paid by the corporate group on numerous GST/HST returns for each entity that also are separately paid and subject to audit. The process is both costly and inefficient for both government and taxpayers.

An election should be available to allow corporate groups to report GST/HST on a consolidated basis. Consolidated reporting may be limited to those companies engaged exclusively in commercial activities. Consolidated reporting would substantially reduce the number of returns that need to be processed by the CRA. Further, consolidated reporting elections would identify related parties to tax auditors eliminating the multiple audits of companies within the same corporate group. This measure would not result in any lost revenue to the CRA and reduce costs of administering the GST/HST system.

[2] Lévesque, Anne-Marie. LLL; Paul Lynch, CA and Carman R. McNary, Q.C. "Tax Dispute Resolution -- Is There a Better way?" Presentation to the 2010 Annual Tax Conference, Canadian Tax Foundation. Vancouver, November 30, 2010.

Retirement Planning and Individual Tax Measures

FEI Canada recommendations related to retirement planning and individual tax matters include:

a) Expenses incurred for the Pooled Retirement Pension Plan ("PRPP") should be deductible by corporations and individuals;

b) Registered Pension Plans ("RPP") receipts should be eligible for transfer to an individual's or spousal RRSP;

c) The amount of the eligible death benefit payment should be increased from $10,000 to $25,000;

d) Payments to employees to cover the cost of treatment of a life threatening disease not covered by a provincial health care program should not be considered a taxable benefit for the first $25,000 of costs per year.

PRPPs

Costs incurred by corporations or individuals to establish, contribute or administer PRPPs should be deductible.

RPP

Participation in a defined RPP reduces RRSP contribution room and results in payments from the plan immediately upon retirement. In a defined contribution plan, payments are made to the individual's RRSP which are available to be withdrawn by the individual at a timing of his or her choosing. In some cases, pension amounts are not immediately required in the case where the individual returns to work or both spouses are alive and are collecting their pension payments. Allowing RPP payments to be contributed to the individual's personal or spousal RRSP provides a means for retirees to continue to save for later in their retirement and for after the death of one spouse when the RPP survivor payments are normally halved.

Death Benefits

Often the death of employee is under extremely unfortunate circumstances and leads to financial hardship to the employee's family. Under the current rules, the amount of a death benefit that can be paid to a family tax free is $10,000. This amount has remained unchanged for a number of years while the cost of funeral and other living expenses has increased over the same period of time. FEI Canada recommends that this amount be increased to $25,000 to encourage corporate support of families during these difficult times.

Health Costs

There are very few people who do not know someone who has had a family member suffer from cancer or some other life threatening disease. Sometimes not all the costs of treatment are covered by a provincial health program or the family has to incur additional housing costs to reside near their family member undergoing treatment in an urban centre. FEI Canada recommends that employees not be assessed a taxable benefit for corporate support of treatment for life threatening diseases or related family accommodation costs up to $25,000 per year. Such a program will encourage companies to support and/or encourage additional fundraising for families who are faced with this situation.

Conclusion

FEI Canada believes that Canada is in a very fortunate position compared to other nations and believes that the sustainability of this position is predicated on continued economic and job growth. The Canadian standard of living and the social programs we have become accustomed to cannot be sustained without prudent fiscal planning and declining deficit and debt levels at both the government and individual family levels. FEI Canada believes that the recommendations presented support these objectives and offer the support to the government to ensure Canada continues forward on a strong economic foundation for future generations to come.

Respectfully submitted,

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