

December 8, 2010

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 pleased to submit the following recommendations as part of the 2011 pre-budget consultation. This submission has been prepared by the Taxation Sub-Committee of the Issues and Policy Advisory Committee of FEI Canada. As an organization representing more than 2,000 senior Canadian financial executives, FEI Canada is acutely aware of the challenge of dealing with Canada's competing economic priorities as preparation continues for the forthcoming budget.

Canada's economic and fiscal picture is very different from that of a year ago. During the 2010 Budget consultation period, the unemployment rate was rising rapidly, economic growth was stagnant, Canadian corporations were experiencing significant challenges raising required capital, and bankruptcies were increasing.

Whether the recession is now over is a matter of debate amongst economists. What is clear is that employment is trending upwards and the rate of bankruptcy and large-scale layoffs has lessened. The financial sector has weathered the storm, slightly battered, but is still the envy of the world. We are progressing towards a very much needed national securities regulator.

Government has done its part with the fiscal management tools at its disposal. In prior pre-budget submissions, FEI Canada has advocated the "triple T principle" of government intervention, that is, that they be timely, targeted, and temporary. Examples of such beneficial targeted spending would be investments in technology incubators and public-private partnerships which foster the commercialization of ideas developed by university researchers. It is now time for the private sector to step to the plate and continue Canada's progress towards a state of economic and fiscal stability, to be followed soon thereafter by sustainable economic growth and prosperity.

Alas, the deficit dragon, an outcome of the economic downturn, has grown large and is a serious concern to many. FEI Canada believes that the major concern of government in the near term is to demonstrate the same leadership qualities demonstrated by those who developed and carried out the stimulus program. Government should now focus on managing the deficit with the view to restoring fiscal balance on or before its fiscal 2015 target.

FEI Canada has long advocated:

- (a) government policies which stimulate economic growth, enhance competition and productivity, and increase employment,
- (b) responsible financial 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.

FEI Canada believes the following principles should form the basis of Budget 2011:

- 1) The focus should be on deficit reduction and maintaining good fiscal management to ensure that the Canadian economy will be able to withstand future downturns. Policies should allow free market forces to lead the recovery, allowing the government to concentrate on rebalancing the books.
- 2) Enhancing productivity is critical to ensure global competitiveness. Given the Canadian dollar move towards parity with the US currency, this issue can no longer be ignored.
- 3) Economic recovery will be fostered by investment policies, and enhanced access to credit and capital markets. Furthermore, Canada must support growth of a digital and knowledge-based economy by facilitating investments that will provide employment for generations to come.
- 4) Budget proposals should not add to the complexity of the tax system or the compliance burden of taxpayers. The tax system should be reviewed with the objective of simplifying tax reporting. As demonstrated in a recent Canadian Financial Executives Research Foundation (CFERF) research study, senior Canadian financial executives identified expansion of the taxation system and immediate regulatory and compliance issues as major concerns that are unproductive for the Canadian economy.

- 5) Policy initiatives should be prudent and incremental in nature, appropriate to Canada's relatively stable economic and financial situation, and benefit all Canadian taxpayers.
- 6) To the extent possible, initiatives should be revenue neutral over the short to medium-term or the legislated period of the initiative.
- 7) The tax system should provide Canadians with more flexible retirement planning opportunities.

Pursuant to the above principles, FEI Canada recommends that your Department consider the taxation initiatives set out below for inclusion in Budget 2011. We strongly believe these will achieve our mutual objectives of providing a framework for sustained economic recovery, enhancing the competitiveness of the Canadian economy, focusing incentives on capital acquisitions which improve productivity, and improving the standard of living of all Canadians.

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.

CORPORATE ACCESS TO CAPITAL AND CASH FLOW

As noted in a prior FEI Canada submission to the House of Commons Standing Committee on Finance (FINA) on credit availability on March 31, 2009, Canadian corporations experienced severe problems during the financial crisis in accessing capital on reasonable terms. In many cases, capital was prohibitively expensive, resulting in either excessive interest charges if debt was taken on, or a decision to forgo new financing due to the cost. In the former case, cash flow suffered. In the latter case, expansion or modernization plans were curtailed, resulting in less economic growth than desirable for a growing economy. Consequently, job reductions occurred, corporations continued production with ageing plants and equipment, and corporate cash flows suffered.

As stated above, FEI Canada believes it is time for the corporate sector to complete the economic renewal process started by your government. A tax system which fosters new investment enhances the competitiveness of Canadian businesses both nationally and internationally, and enables Canadian corporations to comfortably increase their employment levels is vital to achieving this imperative. The course should be stayed on planned corporate tax rate reductions to maintain or increase corporate confidence, since if the economy is healthy, deficit reduction should be an automatic by-product through an increase in the taxation base. Our objective is not just too incrementally

enhance the existing corporate sector, but to make Canada the “go to” jurisdiction for Canadian and international capital.

To increase the capital pool available to, and cash flow within, Canadian businesses, and to support the economy as Canada moves out of recession, FEI Canada recommends that the government:

- (a) Maintain the scheduled corporate income tax rate reductions.**
- (b) Continue progress towards creation of a National Securities Regulator.**
- (c) Encourage initial funding of Canadian technological companies, especially those engaged in innovative research and development.**
- (d) Support and encourage efforts by all provinces to reduce inter-provincial trade and labour barriers.**

Well-designed tax policies can efficiently expand the overall capital pool, decrease the after-tax cost of financing, and result in an increased flow of capital to otherwise worthy, but risky, businesses. FEI Canada believes government policy should focus on increasing the capital pool available to venture capital funded businesses, entrepreneurial activity and start-ups, as properly financed profitable operations of this nature provide a significant potential for economic growth and increased employment. Tax policies which assist displaced workers start a new business would provide additional capital to assist individuals who wish to create new businesses.

Withholding Taxes

Withholding taxes constitute a barrier to the free flow of capital. Within the European Union, the EU parent-subsidiary eliminates withholding taxes on dividends on cross-border payments within corporate groups. The U.S., 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 withholding taxes on the payment of dividends.

Withholding taxes on dividends create a bias for debt financing in Canada which can create issues regarding 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 effectively with other jurisdictions.

In order to provide the required incentive, FEI Canada recommends that Finance Canada work with its treaty partners to reduce or eliminate the withholding tax on dividend payments to non-Canadians.

Elimination of the withholding taxes will ensure that Canadian businesses can access global capital markets at the lowest possible cost. There is a strong link between elimination of withholding taxes on dividends and increased foreign direct investment and the free flow of capital.

Research and Development

Innovation is critical to Canada's future competitiveness, growth and productivity. According to the June, 2008 final report of the Competition Policy Review Panel, "innovation and technological leadership can make the difference between success and failure in the global marketplace".

Investment tax credits for research and development, an effective source of collateral, should be enhanced for both public and private corporations.

SIMPLIFICATION

FEI Canada believes that the time has come to consider a focused review with an objective of simplifying the *Income Tax Act*. The *Income Tax Act* has grown over the last 93 years from 10 pages to over 2000 pages with smaller print. To ensure continued economic growth as the private and public sectors cautiously manage out of the deepest economic downturn since the Great Depression, both sectors must undertake measures that improve productively and reduce costs in the upcoming years. Simplification of the *Income Tax Act* would further this objective.

Simplification as an objective refers to the reduction or elimination of unwarranted complexity, inconsistencies or anomalies in the *Income Tax Act*. Simplification would result in reduced compliance and administration costs, fewer appeals and court cases, and increased compliance with the provisions of the Act. Simplification will allow Canadian businesses and individuals to devote more resources to growing the economy. Fewer resources will be consumed attempting to understand and comply with the often bewildering provisions of the *Income Tax Act*. While FEI Canada believes that a degree of complexity is necessary to tailor preferences to their intended targets and to prevent unwarranted abuse, unnecessary complexity hinders economic development and job creation as resources are used to grapple with this complexity rather than deployed to benefit the economy. As well, this complexity promotes a competitive disadvantage for smaller businesses that have fewer resources to navigate our often convoluted tax system.

Following FEI Canada's October 2010 presentation to FINA's pre-budget consultation hearings, we promised to provide further comments on the need for tax simplification. FEI Canada has now done this, and the letter enclosed as Appendix A calls for simplicity improvements to the clarity and predictability of the *Income Tax Act* and we elaborate on how this can best be achieved.

FEI Canada fully supports the government's recently announced public consultations on the Taxation of Corporate Groups to consider a consolidated group tax return or loss transfer system. FEI Canada believes that the simplification of corporate tax reporting is an encouraging first step in the tax simplification of the Income Tax Act and would be pleased to participate with Finance Canada in this project.

Hence, FEI Canada requests that a task force be established to provide recommendations for the simplification of the Income Tax Act.

RETIREMENT PLANNING

That Canada's population is ageing is a well-known demographic development. Furthermore, because of the recent recession and market meltdown, current and prospective pensioners have seen their retirement savings diminish in value. Many must now consider extending their employment or face a reduction in their retirement consumption. Consequently, to the extent that potential retirees remain employed, job prospects for new entrants to the labour force are reduced. Government could also face increased demands for enhanced government provided pensions to address the expected decline in self-provided retirement savings.

We note that 11 million workers (60% of the Canadian workforce), the majority of whom are in the private sector, have no pension plan. An increasing number of Canadians who have pension plans are no longer active members of their plans due to labour market adjustments and the generally more mobile nature of the workforce. The pension gap between public and private sector workers is one such concern. It is essential that these individuals not be disadvantaged vis-à-vis employees actively enrolled in registered pension plans. Furthermore, only 6.3 million Canadians have registered retirement savings plans. The majority of these have not contributed the maximum permissible.

To address this situation, FEI Canada recommends that:

- (a) A 125% super deduction should be provided on the first \$5,000 of RRSP contributions to provide an added incentive for Canadians to focus on retirement savings.**
- (b) The annual contribution limit of Tax Free Savings Accounts should be increased from \$5,000 to \$10,000**
- (c) RRSP contribution limits should be increased from 18% to 25% of earned income to allow individuals to provide for adequate retirement income. The cap on contributions into corporate pension plans should be proportionately increased.**

- (d) **The mandatory date for cutting off contributions to the CPP for those not yet eligible for the maximum pension payments, contributing to RRSPs, and converting RRSPs to RRIFs, should be electively extended to the age of 75.**
- (e) **A mechanism should be introduced to enhance plan mobility for workers who change their employment.**

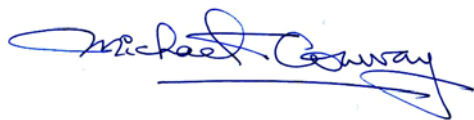
These measures will add flexibility to the employment opportunities of older workers and will greatly enhance their retirement planning.

Finally, FEI Canada suggests that the federal government work with its provincial colleagues to expand these provisions to provincially regulated pension plans where necessary, and those discussions commence with the view to establishing a national pension regulator similar to the proposed national securities regulator.

CONCLUSION

Canada is in a unique position to secure sustainable economic renewal following the recent economic turnaround, while keeping in mind the long-term stability of government finances. We thank you for the opportunity to present FEI Canada's recommendations on the 2011 budget. This submission has provided reasoned recommendations on increasing the pool of investment capital and retirement planning, and has alluded to a forthcoming submission related to Income Tax Act simplification. FEI Canada believes that if the above initiatives are included in Budget 2011, our mutual objective of restoring the economic health of Canadian business will be achieved. We look forward to continuing to work the government to ensure that Canada maintains the highest levels of competitiveness and economic growth from which all Canadians will benefit.

Respectfully submitted,



Michael Conway, CA, ICD.D
Chief Executive and National President
Financial Executives International Canada



Barry Gorman, PhD, CA, TEP
Chair, Taxation Committee
Financial Executives International
Canada

**APPENDIX A:
TAX SIMPLIFICATION**

December 8, 2010

**Mr. James Rajotte, M.P.
Chair, Standing Committee on Finance
House of Commons
Ottawa, Canada
K1A 0A6**

Dear Mr. Rajotte,

Financial Executives International Canada (FEI Canada), on behalf of the Taxation Sub-Committee of our Issues and Policy Advisory Committee, is pleased to follow up on our letter to you following FEI Canada's October 4, 2010 presentation to the House of Commons Standing Committee on Finance (FINA)'s pre-budget consultations. Specifically, as promised, we are pleased to provide you with additional thoughts on our proposal to simplify the *Income Tax Act*.

INTRODUCTION

The Supreme Court of Canada has indicated that taxpayers should have tax rules that are understandable, predictable and fair. Further, the Canada Revenue Agency has commented that clear and concise tax rules help to prevent aggressive tax planning. Since the *Income War Tax Act* received royal assent on September 20, 1917, tax legislation has grown from approximately 10 pages to well over 2000 pages with smaller print!

An enormous amount of legislation has been amassed over the last 93 years, as provision after provision has been added by successive governments attempting to create a fair tax system that is responsive to the economic priorities of the day. However, while attempting to strive for fairness, the principles of clarity and predictability appear to have been given lesser consideration.

FEI Canada believes that the time has come to consider a focused review of the tax system so that it may become more understandable (i.e., clear) and predictable, with reduced administration, while maintaining revenue neutrality. The timing seems appropriate not only considering the government's initiative to review a consolidated tax system, but also considering the fact that much-needed corporate tax rate reductions over the past decade have lessened the significance of many legislative measures. Furthermore, with the impact of the economic downturn on corporate and government resources and the concurrent increasing of the value of the Canadian dollar against the currencies of major competitors, the imperative to increase corporate productivity has never been more crucial for our country.

SIMPLIFICATION PRINCIPLES

Although this letter is by no means an attempt to cover all aspects of a simplification process, FEI Canada would like to offer some thoughts on the principles that would form the foundation of such an initiative.

1) Clarity

a) Consolidation

Consolidation refers to the combining of a number of provisions or reporting obligations. FEI Canada is in full support of a consolidated/group income tax return system. Additional measures of consolidation could include allowing consolidated GST return filings within a corporate group, rationalizing/reducing the number of capital cost allowance classes and permitting the consolidation of various multi-year deductions that require extensive tracking, such as financing costs which these should be deductible in the year the cost is incurred rather than over 5 years.

With regards to personal income tax returns, allowing or requiring joint/consolidated personal tax returns would not only reduce the number of returns, but also would increase the fairness of this system by eliminating what are perceived as income splitting opportunities available only to the wealthy.

b) Elimination

Efficiencies can be gained by the elimination of those provisions or exceptions that are redundant, irrelevant or immaterial. For example, there is a growing international trend to reduce withholding tax on dividends to support the international flow of capital. The elimination of withholding taxes will enhance the benefits of investing in Canada while reducing this withholding and reporting obligation. Another example relates to how the 50% add back of meals and entertainment expenses operates. These general rules, as well as a number of other provisions, have a number of exceptions. Although exceptions have certain policy initiatives, exceptions add complexity to provisions and could be removed without a significant shift in revenues.

c) Reduction

Reducing administration is a key ingredient of a simplification review. One has to question the value of certain reporting asked of taxpayers. For example, an inactive corporation which may be held for a future transaction should have a one page tax filing that declares that the company is inactive and has no revenue rather than having to file a comprehensive corporate tax return. Also, a major step to simplification would be to allow companies below a certain threshold of

income and/or assets to file their taxes based on accounting income with only a few minor adjustments.

d) Organization

As the Income Tax Act has grown over the years, its general organization has greatly deteriorated. FEI Canada recommends that a general reorganization of the Income Tax Act be undertaken. A first priority should be to improve the indexing and cross-referencing on sections of the Income Tax Act. This initiative would make it easier to carry out key word searches on tax applications and would likely be more amenable to digital interrogation. The second measure in this regard might be to create separate tax acts for corporate and personal income taxes. The acts would then be more appropriately organized similar to other pieces of legislations with a definition section usually at the beginning of the legislation with charging provisions set out in the legislation and measures supporting the charging provisions set out in the regulations. These steps alone would make the Income Tax Act more user friendly and save an enormous amount of time for both tax practitioners and auditors alike.

2) Predictability

a) Intention

A significant, but important, measure to improve predictability of the tax outcome would be to set out the clear policy intention of each provision in the Income Tax Act. Clear intention would improve both compliance by taxpayers and enforcement by the government.

b) Clarification

There are many sections in tax legislation that have words that lead to different interpretation and tax disputes. Interpretative legislation should be replaced, where practical, with bright line tests. For instance, the terms “all or substantially all” and “principally” have been interpreted by the courts to mean 90% and 50% respectively. These percentages could be introduced in the legislation to make clear the on-side test that is to be applied in the particular circumstance. Further, bright line tests should be codified for other terms that have been interpreted over the years in the courts, such as employee versus independent contractor. These types of measures will add to the accuracy of tax reporting, be more consistent, provide clearer audit guidelines and reduced audit disputes.

c) Completion

Over the years, both the private and public sector tax practitioners have identified various “holes” in the legislation. These are sometimes addressed by Finance Canada issuing a Comfort Letter stating the intended result, but are sometimes not addressed at all. These “holes” must not only be cleaned up with amending legislation, but also there needs to be a mechanism for the continuous improvement of the legislation on a timely basis which would mean no later than once per year.

3) Administration

In addition to the increase in complexity of tax legislation, FEI Canada members have also experienced an increase in the complexity and thus administration of the audit and dispute resolution process. To put this matter into context, the number of Notices of Objection has increased 88% from the 2005-2006 fiscal year to the 2009-2010 fiscal year and 24% in the last year alone.¹

The primary reason for these alarming facts results from the fact that the Canada Revenue Agency measures itself based on “tax earned by audit” (TEBA), which is calculated as the total tax reassessments divided by the number of audits. The problem with this statistic is that it does not take into account the ultimate dollar resolution of the dispute and therefore, the audit mandate is to reassess the greatest amount of tax dollars. This mandate results in unnecessary resources and costs to resolve audit disputes with the Tax Appeals branch or with the Tax Court. The current process does not prompt continuous improvements, nor enhanced productivity of resources.

The resolution is clear. Rather than mandate tax auditors to reassess, mandate tax auditors to resolve or settle audits. In the United States, IRS auditors are directed to resolve disputes without litigation. Simply put, an organizational cultural change must be introduced within the Canada Revenue Agency with the utmost urgency to reduce the time and resources by both the government and taxpayers to resolve audit disputes.

¹ **Tax Dispute Resolution: Is There a Better Way?** Presentation by Anne-Marie Lévesque, Assistant Commissioner, Appeals Branch, Canada Revenue Agency. Paul Lynch, CA and Carman R. McNary, QC, to the Canadian Tax Foundation’s 2010 Annual Tax Conference

CONCLUSION

During the economic crisis, Canada's financial sector became the envy of the modernized world. It is now time to strive for the same goal in our tax system and administration.

FEI Canada requests that a task force be established to provide recommendations for the simplification of the Income Tax Act. FEI Canada members are ready to assist in this action plan.

Respectfully submitted,

A handwritten signature in blue ink that reads "Michael Conway". The signature is fluid and cursive, with a horizontal line underneath the name.

Michael Conway, CA, ICD.D
Chief Executive and National President
Financial Executives International Canada

A handwritten signature in blue ink that reads "Barry Gorman". The signature is fluid and cursive.

Barry Gorman, PhD, CA, TEP
Chair, Taxation Committee
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