20 December 2012

The Honourable James Flaherty, P.C., M.P.
Minister of Finance
Department of Finance Canada
Ottawa, Canada
K1A 0G5

Dear Minister Flaherty:

Financial Executives International Canada (FEI Canada) is pleased to present its recommendations as part of the 2013 pre-budget consultation. FEI Canada is an organization representing 1,800 senior financial executives through various chapters across Canada. This submission has been prepared by the Taxation Sub-Committee of the Issues and Policy Advisory Committee of FEI Canada.

EXECUTIVE SUMMARY

Last year, FEI Canada noted the concern of the European debt crisis and the slow economic recovery. To date, little has changed on these international fronts which are reflected in the very modest economic forecasts by the Bank of Canada, stated in its October 23, 2012 and confirmed in its December 4, 2012 statement on interest rate, as 2.2% in 2012, 2.3% in 2013 and 2.4% in 2014. The precarious problems facing the global economy challenge the ability to accurately predict long-term economic conditions. As such, the following recommendations of FEI Canada support providing a firm foundation for economic stability and growth both by the public and private sector:

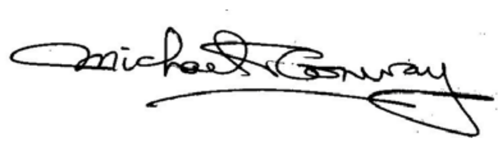
1. **Recovery & Growth** - Stay the course and continue to view balancing the budget a priority. The evidence is clear from Europe that sustained deficits leads to a lack of international confidence and slow economic growth. The foundation of the Canadian economy must be based on a system that does not spend more than it earns and supported by strong national financial systems including a strong national securities regulator, the free flow of capital and a harmonized tax system.

2. **Job Creation** - Provide a platform for strong job creation and growth. This platform should create new jobs by transforming innovative ideas from development to commercialization through innovation funding from private and public sources and enabled through focused training in areas where skills shortages have been identified.

3. **Demographic Change** - Establish a framework to address the needs and realize the benefits of our aging population. FEI Canada recommends that the government develop and articulate a national framework that addresses the key issues facing the elderly, being retirement income, health care and home care.

4. **Productivity** - Continue to encourage and promote productivity. Establish an expert panel or a Royal Commission, with significant representation of senior financial executives working with Canadian businesses, to undertake a comprehensive review of the Federal Income Tax Act with the objective of reducing its complexity. Implement a loss transfer system within corporate groups, and establish a mandatory tax dispute settlement process. Furthermore, with the rapidly changing environment, Canada must be flexible to change and support the retraining of its citizens as economic activity shifts from one sector to another and as citizens move into and out of the workforce. In this regard, the federal government must encourage the provinces to support the elimination of inter-provincial trade barriers to allow and encourage Canadians to seek employment throughout Canada as economic activity shifts from one province to another.

Sincerely,



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

Peter Effer CA
Chair, Taxation Committee
Financial Executives International
Canada

FEI CANADA RECOMMENDATIONS

RECOVERY & GROWTH

Balance the budget: The government should retain its objective to balance the budget in the near term. That being said, the goal of balancing the budget should not cause the country to slip into a prolonged recession as it has in Europe. FEI Canada encourages the government to continue its project cost review. If, however, additional revenues are required, FEI Canada suggests that they come in the form of an increase in the rate of Good and Services Tax, which is the form of tax that is most favoured by economists, balanced with a reduction in personal income tax to a lesser extent.

Withholding taxes: Withholding taxes constitute a barrier to the free flow of capital and discourage investment. Similar to FEI Canada's comments in its pre-budget submission last year, FEI Canada believes that Canada should strive to eliminate or phase out withholding taxes on the payment of dividends between Canada and the United States and other major trading partners to encourage investment capital for Canadian businesses. Such a measure is consistent with the removal of withholding tax on interest paid to the United States introduced in prior years. The United States has negotiated a zero withholding tax rate under many of its treaties for dividend payments since 2003 and within the European Union, the EU parent-subsidiary eliminates withholding taxes.

Tax harmonization: Harmonization improves the understanding of the Canadian corporate landscape for foreign investors and reduces administration and costs for both government and industry. Harmonization 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.

Provincial income tax rates: 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 were encouraged to work towards establishing common corporate income tax rate. Such an alignment would be a good first step towards the introduction of consolidated tax reporting.

JOB CREATION

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.

Smaller Canadian companies that are either growing or are in their start-up phase should get as much support as possible. 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. The ownership status (public versus private) should not be a criterion for receiving different tax credit enhancements.

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.

In addition to the above, FEI Canada believes that innovation requires a long term outlook. The federal budget of 2012 introduced considerable uncertainty regarding support for innovation by reducing generally-available SR&ED incentives. In their place, direct support programs of an uncertain nature and amount were suggested. FEI Canada supports the restoration of SR&ED incentives, in particular those related to capital expenditures and the use of proxy calculations. FEI Canada would welcome clarity related to the grant process announced in last year's budget and would recommend that the government review process not be slow or vague.

To balance the costs of the program, a size test could be introduced which reduces the availability of the tax credit as a company grows and SR&ED becomes more of a general operating costs in nature. The tax credit, however, should not be reduced to zero to ensure that all businesses continue to be motivated to innovate. Exceptions to this general rule could be considered for companies where SR&ED activities form a material portion of their operations or where a company establishes a centre in Canada for international based SR&ED. These exceptions would ensure that Canada continues to maintain existing jobs and attracts new jobs and minds in the field of SR&ED.

Complementing the above, FEI Canada suggests that the government 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. The flow-through share program has encouraged exploration and development of Canada's natural resources. This concept can also be applied 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. In the interest of tax simplification, FEI Canada suggests that expenses should become eligible for flow-through only once they have been audited by the CRA. This would eliminate the need to process multiple taxpayer reassessments should there be any audit adjustments to a company's estimate of eligible expenses.

Skills training: Shortages of skilled trades people are a growing concern for the Canadian economy. This concern will increase as skilled workers retire. A shortage of employees with skilled trades will hamper growth and productivity particularly in more rural areas. Many young people are deciding their futures path during an era when job uncertainty threatens the next generation. FEI Canada recommends that the government develop and launch an awareness campaign to inform people of skilled labour in demand, how to obtain the appropriate education and how to link up with employers within their field of interest. Organizations such as apprenticesearch.com are already in place and can be expanded to meet this need. Employment opportunities will be enhanced by the removal of interprovincial barriers that prevent mobility of skilled workers across the county.

DEMOGRAPHIC CHANGE

The demographic change in upcoming decades will provide both unique opportunities and challenges for the Canadian economy. In one regard, a healthy and vibrant aging population can continue to add to Canadian productivity and overall quality of life in our communities by remaining in the work force longer or by undertaking community and volunteer activities in their retirement. On the other hand, however, the challenges facing our seniors are considerable and include ensuring that retirement income is properly planned and is adequate for both known and unknown expenses and that health care and supportive living costs are provided for.

Retirement planning is not only an individual issue, but, as the demographic changes and the resources become scarce, it is a family and corporate matter as well. Increasingly, parents, grandparents, aunts and uncles will have to rely more heavily on the younger working generation for transportation, care and advice. FEI Canada encourages the government to conduct a study and develop a national framework on this issue. FEI Canada will continue to offer its support and ideas during this process. The following are some ideas that are for consideration either immediately or in the near future.

In respect of retirement income planning, there currently is a plethora of programs to encourage retirement income planning. These programs need to be reviewed and innovative ideas need to be introduced to provide a robust framework that encourages retirement income planning. FEI Canada recommends that policies could include:

- i) The reinstatement of the ability to transfer retiring allowances and severance amounts directly to an registered retirement savings plan (“RRSP”) possibly based on the years of service;
- ii) The ability to transfer registered pension plan (“RPP”) to an individual’s RRSP or spousal RRSP if the individual decides to remain in the work force and does not immediately require the retirement income;
- iii) Allowing senior couples to income split after both have attained the age of 65; and
- iv) Allowing family members to contribute to an elder family member’s RRSP similar to spousal RRSP plans. A family member could be defined as a related person including an uncle, aunt, nephew, niece or first cousin.

If Canadians wish to maintain social programs at their current level (and FEI Canada believe that they do), demographic trends will cause the government's fiscal expenditures to substantially increase. The ability to fund these "demographically-driven" higher costs will require either a substantial increase in tax revenue or a substantial decrease in other program costs if the government still wishes to balance its budget in the near term. FEI Canada encourages the Government to make policy choices that will actively support actions and behaviours that will proactively help individuals remain healthy and vibrant, both mentally and physically.

Health Canada states that healthy living means making positive choices that enhance your personal physical, mental and spiritual health. You make these choices when you eat nutritiously, build a circle of social contacts to create a supportive environment of people who care for you and respect you; stay physically active; choose not to smoke; and put an end to other negative lifestyle practices. [excerpt from Health Canada Website].

In this regard, FEI Canada suggests that policies could include:

i) After review with the medical community, expand the list of expenses qualifying for medical tax credits and therefore for reimbursements from corporate health spending account plans costs that support of health living and effective illness management such as consultation costs with a nutritionist, dietician or weight loss clinic, pharmacist and other health care practitioners currently recognized as medical practitioners in the Income and Excise Tax Acts;
ii) Allowing businesses a tax deduction for any membership to a health club or sporting facility to a maximum of $1,000 to encourage employees to become active. Due to the perceived abuses, golf fees should remain excluded from the above.
iii) Continue government support of the Canadian Mental Health Commission.

FEI Canada remains a strong proponent of a balanced budget and encourages the government to balance the costs of the above with the long-term savings opportunities that an effective program could offer. In the spirit of healthy living, the government could increase the "sin taxes" to help fund short-term deficits caused during the implementation of these programs.

PRODUCTIVITY

Review of the Income Tax Act: Consistent with the last two years, FEI Canada recommends that the Ministry of Finance establish a task force to undertake a comprehensive review of the Federal Income Tax Act with the objective of reducing its complexity, in particular, those aspects of the Act which (a) do not lead to economic efficiency, growth and/or increased competiveness, (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.

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

Loss transfer system: Consistent with its prior recommendations, FEI Canada believes that the government should implement, in the next budget cycle, some form of tax loss utilization system that transitions 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. 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%.[1] 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.

[1] 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.