financial executives international

canada

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Geoff Trueman
Business Income Tax Division
Department of Finance
L'Esplanade Laurier, 17th Floor, East Tower
140 O'Connor Street
Ottawa, Canada K1A 0G5

Dear Mr. Trueman:

Financial Executives International Canada (FEI Canada) welcomes the opportunity to respond to the Department of Finance's request for comments on its consultation paper on the Taxation of Corporate Groups. This submission has been prepared by the Taxation Sub-Committee of the Issues and Policy Advisory Committee of FEI Canada.

Last October 4, 2010, FEI Canada presented at the House of Commons Standing Committee on Finance (FINA) pre-budget consultations that the current income tax system had become too complex and that efforts should be undertaken to simplify the current income tax system. This call to simplify the income tax system was repeated in FEI Canada's pre-budget submission to the Minister of Finance dated December 6, 2010. In this submission, FEI Canada noted that the simplification of the income tax system would "*allow Canadian businesses to devote more resources to growing the economy" and that "complexity promotes a competitive disadvantage for smaller businesses that have fewer resources to navigate our often convoluted tax system*".

FEI Canada believes that simplification will lead to a more efficient and effective tax system that can be tax revenue neutral and reduce costs for both the public and private sectors in terms of reduced administration and tax audit disputes. FEI Canada is pleased with the release of the government's consultation paper on the taxation of corporate groups and feels that this consultation process is a positive step towards simplifying tax reporting in Canada. FEI Canada would like to reiterate the need for a task force to provide further recommendations to simplify the Income Tax Act, as noted in FEI Canada's follow-up letter to FINA dated December 6, 2010.

Attached, please find FEI Canada's comments related to the consultation paper on The Taxation of Corporate Groups. FEI Canada and its members are prepared to assist with this and any further mandate related to the simplification of the Income Tax Act.

Respectfully submitted,

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Peter Effer
Chair, Taxation Committee
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Introduction

The timing of the review of the taxation of corporate groups in Canada is an appropriate next step following the government's committed and admirable reduction of the corporate income tax rate in Canada. Canada is becoming the envy of the world on many fronts and any improvement in competitiveness and productivity will only serve to improve the lives of future generations of Canadians.

FEI Canada agrees with the government's comments in the consultation paper 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*". FEI Canada fully supports not only the review of the taxation of corporate groups, but any measure that simplifies and improves the effectiveness and efficiency of the current tax system in Canada.

The current system of transferring losses is 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 manner to transfer losses would improve the clarity, predictability and fairness to 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 the corporate group. 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 taxpayer as the broader economic corporate group. It is appreciated 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.

Design of Tax Loss Transfer System

FEI Canada would propose that the transfer system be designed as follows:

- Tax losses eligible to be transferred between legal entities of a reporting corporate group should include non-capital and capital losses as well as investment tax credits, hereafter referred to as tax losses collectively;

- The reporting corporate group should be defined as affiliated companies consistent with the current definition of affiliates in the Income Tax Act. Whether or not Canadian branches of non-resident corporations or trusts would be permitted to participate in the loss transfer system would have to be reviewed. FEI Canada, in general, favours broader inclusion;

- The issue of mandatory inclusion in the reporting corporate group would have to be reviewed based on the ultimate design of the system;

- Consideration should be payable for the value of tax losses transferred between two entities based on prescribed method of valuation and joint election process. Legislatively defining the consideration to be paid provides clarity regarding the amount paid for tax losses. This clarity allows taxpayers to accurately record the tax loss transfer for legal entity financial statement reporting purposes and minimizes potential tax audit disputes. Furthermore, establishing a standard for consideration paid for tax losses ensures that all minority shareholders of non wholly-owned affiliates are treated fairly;

- Tax losses existing prior to the implementation of the new tax loss rules should be able to be transferred within the reporting corporate group. It is likely that such inclusion would have to be phased in over time considering the impact upon the timing of revenues if such a measure was immediately adopted. In that event, traditional tax loss utilization techniques should be eligible to be implemented to utilize historical tax loss pools prior to their eligibility to be transferred within the reporting corporate group;

- It would seem appropriate that tax losses of an acquired entity would not be eligible for transfer within the reporting corporate group until the first taxation year of the acquired company's parent following the year of acquisition. Such a deferral is consistent with the current one year deferral rules when a subsidiary is amalgamated or wound up into its parent;

- Corporations ceasing to be affiliated with the reporting corporate group should no longer be permitted to participate in the tax loss transfer system.

Provincial Considerations

FEI Canada believes that any tax loss transfer system should be adopted equally by the provinces or the efficiency of the system is significantly compromised.

FEI Canada understands that the provinces are concerned with losses transferring from one province to another. This should not be an issue for the majority of taxpayers in Canada that, in fact, are small businesses that usually only operate within one province. It is primarily these same small taxpayers who are discouraged from taking business risks in new business ventures when tax losses can not be immediately monetized by transfers to the profitable corporations that often provide the start-up capital for these new ventures.

Tax loss transferring as well as consolidated tax reporting already occurs between divisions operating within the same legal entity. The recommended system simply expands this existing practice to the broader economic corporate group and recognizes that some businesses operate in separate legal entities for valid business reasons or for regulatory purposes as noted above.

The provinces may find it more equitable to transition in the near term from a loss transfer system to a consolidated reporting system with income allocated among the provinces consistent with the allocation method under the current legal entity tax reporting system. Such a consolidated reporting system should not be seen as any less equitable than the existing reporting system since the only difference is that the legal entity reporting unit is replaced with the economic group reporting unit.

FEI Canada strongly urges the federal government to play a proactive role to ensure that all provinces are participants in any loss transfer system once implemented.

Conclusion

FEI Canada believes that the implementation of a tax loss transfer system will assist with the simplification of tax administration and is an appropriate first step towards a full consolidated tax reporting system. Simplification of the Canadian tax system improves the productivity of Canadian business, particularly small businesses, which is vital for the continued economic recovery and competitiveness of Canadian business. FEI Canada is prepared to discuss any of the comments set out in this paper as required to assist with the timely and proper implementation of a new Canadian tax loss transfer system.

About FEI Canada (www.feicanada.org)

Financial Executives International Canada (FEI Canada) is an all-industry professional association for senior financial executives. With eleven chapters across Canada and more than 2,000 members, FEI Canada provides professional development, thought leadership and advocacy services to its members.

The Issues and Policy Advisory Committee (IPAC) is one of two national advocacy committees of FEI Canada. IPAC is comprised of more than 50 senior financial executives representing a broad cross-section of the Canadian economy who have volunteered their time, experience and knowledge to consider and recommend action on a range of topics of interest to Canadian business and governmental agencies. The current composition of IPAC is formulated to address the following areas: corporate governance, capital markets, tax policy, pensions, internal controls, information technology and public sector accountability. In addition to advocacy, IPAC is devoted to improving the awareness and educational implications of the issues it addresses, and is focused on continually improving these areas.