FEI CANADA 2009 PRE-BUDGET SUBMISSION

DECEMBER 19, 2008

December 19, 2008

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 2009 pre-budget consultation. This submission has been prepared by the Tax Policy Sub-Committee (Committee) of the Issues and Policy Advisory Committee of FEI Canada. As an organization representing more than 2,100 senior Canadian financial executives, FEI Canada is acutely aware of Canada's precarious economic and financial position as preparation continues for the January 27th budget.

Fiscal surpluses are dwindling. Although some commentators suggest that Canada is the envy of other countries with respect to its economic and financial security, individual Canadians are concerned with the reality or threat of unemployment and the decline in value of their pension and savings portfolios. Offshore competition is placing Canadian manufacturers at a competitive disadvantage, resulting in plant closures and job losses. The worldwide financial crisis is creating a credit crunch and contributing to sharply declining corporate profitability or the threat of bankruptcy. Nevertheless, the Committee recognizes the government's capable stewardship of the Canadian economy and financial markets as we move through these distressing times.

As representatives of a cross-section of leading Canadian corporate entities, our members are keenly aware of the need for caution and prudence in troubled times. Similar to managing an individual corporation during a downturn in the economy, strategic errors by government policy-makers must be avoided. Canada must apply solutions to the current global economic crisis that are appropriate to the relatively stable condition of the Canadian economy and not simply mirror the actions of other countries that have been more severely impacted. Planned expenditures must pay off in the short term. The budget must be re-balanced before major new initiatives can be contemplated.

The Committee believes the following principles should form the basis of the government's thinking during the run-up to the January budget:

1. With regard to the fiscal balance, the Committee is aware that Budget 2009 is likely to result in a deficit fiscal position. However, government must avoid starting down the slippery slope to a permanent deficit position. Not spending Canada into unnecessary deficit is a prudent and pragmatic strategy for managing the public purse. We believe that any consideration of deficit spending must be approached as a temporary measure with a view to short-term recovery so as not to burden future generations with today's over spending.

   Therefore, the Committee suggests that the government adopt a three year budget horizon, clearly indicating that, should budget 2009 result in a deficit, the government has clearly outlined a framework for achieving a balanced budget position by fiscal 2011.

2. Policy initiatives should be prudent and incremental in nature, appropriate to Canada's relatively stable economic and financial situation, and benefit all Canadian taxpayers, businesses and citizens.

3. To the extent possible, initiatives should be revenue neutral over the short to medium-term or the legislated period of the initiative.

4. The focus should be on short to medium-term policies designed to alleviate the immediate negative impact of job losses or declining profits and cash flow. Budget measures intended to provide a major economic stimulus must await credible analysis and conclusions on the true state of our economy and be based on empirical evidence rather than public outcry.

5. Economic recovery will be secured by investment policies. However, major capital expenditure commitments must not be rushed into. Although infrastructure enhancements are urgently required in many regions of Canada, and over time will contribute to economic growth, many of the benefits will not be realized for many years, whereas the related expenditures will be over the short to medium-term. The Committee views the focus on infrastructure spending positively while cautioning the government against reactionary spending directed to select industries. Furthermore, Canada must support the growth of a knowledge-based economy by facilitating investment to restructure the economy and provide employment for generations to come. Infrastructure spending, therefore, should be strategically placed investments which will create short-term benefits. They should be prudent and fiscally responsible, as has been the past practice of your government.

6. Budget proposals should be readily measureable by policy analysts and should not unduly add to the complexity of the tax system or the compliance burden of taxpayers.

7. There should be no changes to the previously announced income tax rate reduction schedule.

8. Wherever possible, the approval processes for accessing government programs should be streamlined and, without compromising the integrity of the program, result in relatively quick decisions.

Pursuant to the above principles, the Committee recommends that Budget 2009 include the following measures.

A. BUILDING STRONG LABOUR MARKETS

1. **A personal deduction or tax credit should be provided for individuals who personally incur the cost of job-related education or re-training. Alternatively, displaced employees could be provided with a subsidy to undertake retraining.**

   The rate of job losses has increased in the last several months. These measures will assist displaced workers acquire new or upgraded employment skills. Both measures can be funded through the notional employment insurance account. A three-year timeframe is recommended for these initiatives, both of which should be re-evaluated at the end of this period.

2. **Measures should be introduced which:**

   (a) Average, over three years, the inclusion in taxable income of that portion of a job loss financial settlement invested in a new business.

   (b) Provide a two year income tax holiday for the corporations or new sole-proprietorship businesses established by such individuals who start a new business.

   Many displaced individuals decide to start their own business, often financed in part by a financial settlement from their former employer. These proposed provisions will assist these entrepreneurially inclined individuals make this transition, will allow them to retain cash flow which will be required to secure the financial stability of their new businesses, and will stimulate business innovation.

B. ACCESS TO CREDIT AND CAPITAL MARKETS

1. **To encourage financial restructuring of the economy, and to assist corporations who may require debt renegotiation to maintain the cash flow necessary to ensure the survival of the corporation, the Committee recommends that Budget 2009 include a measure which defers the allocation of forgiven debt for three years.**

   As a consequence of the financial markets crisis and deteriorating economic performance, some leveraged corporations have been forced to renegotiate their debt. In some cases, a portion of the debt has been forgiven in order to allow the corporation to continue operating. Pursuant to section 80 of the Income Tax Act, "the debt forgiveness rules", debt forgiven must be allocated to certain loss accounts in stipulated order. In essence, losses which are available to the corporation are reduced following the debt renegotiation.

Under normal circumstances, this tax treatment is both reasonable and fair. However, the current financial market situation is not normal. Not only are affected corporations facing a credit crisis, their cash flow is impeded as section 80 effectively results in an increased tax burden following debt renegotiation.

2. **The Committee recommends that Finance work with all non-U.S. treaty partners to reduce or eliminate the withholding tax on interest and dividend payments to non-Canadian entities, and on dividend payments to taxpayers subject to the Canada-U.S. treaty.**

   Capital formation is a critical component of economic development and growth. Without significant infusions of new capital, economic development is hampered, critically needed maintenance and renewal is delayed, productivity is impaired, and employment levels are lower than is optimal. Unfortunately, Canadian capital pools are, and always have been, insufficient to satisfy the constant need for new investment capital. Consequently, Canada has historically relied on foreign investors to provide the capital not available from Canadian sources.

   Given the globalization of economic activity and capital formation, where international investors can place investments anywhere in the world relatively quickly and easily, government must provide additional incentives to lure mobile capital to invest in Canada, an imperative your government recognized in concluding the 2007 Protocol to the Canada-U.S. tax treaty with respect to cross-border interest payments.

3. **Individuals in receipt of compensation from an early retirement or job reduction program should be permitted to deduct the portion of the settlement which is directed to a lump-sum reduction of their home mortgage principal within two years of receipt of the settlement.**

   Many Canadians receive a financial settlement when they are retired early or lose their employment due to plant closures or employment reduction programs instituted by corporations seeking to reduce their overall costs. Often, these financial packages are considerable in amount. The individual is taxed on the amount withdrawn from the package each year, at prevailing marginal tax rates, which are usually higher than the individual's average pre-settlement tax rate. Consequently, less disposable income is available to meet personal expenditures for accommodation, food and clothing, and perhaps children's education expenses.

   The Bank of Canada has announced that many Canadians are in danger of defaulting on their mortgage as a result of a job loss. This measure, by providing a greater amount of after-tax disposable income in the termination year, will reduce the number of defaults. In addition, it is an issue of equity for affected individuals.

4. **The Committee recommends that Finance include a measure in the January 2009 budget which would either temporarily reduce the inclusion rate for capital gains or provide for a deferral on the disposition of all capital properties if the proceeds are re-invested in the same or a similar asset within six months.**

   During the 2006 election campaign your party discussed a proposal to defer the taxation of capital gains if the disposition proceeds are re-invested in another capital property within six months. To date there has been little public discussion of this proposal. Although there are implementation issues to be resolved, experience with similar measures, such as the rollover of the proceeds on disposition of shares of certain Canadian-Controlled Private Corporations, suggests that reducing the inclusion rate or deferring the taxation of capital gains appropriately re-invested has positive overall results for the Canadian economy as it will provide the incentive to redirect money currently tied up in capital assets back to capital markets.

C. INDUSTRY SECTOR SUPPORT

1. **To encourage more Canadians to purchase environmentally friendly vehicles, the Committee recommends that, for a period of two years, on the purchase of an automobile which qualifies for the ecoAUTO Rebate program:**

   (a) the GST be reduced,

   (b) a tax credit be provided to purchasers, and

   (c) Canadians be permitted to withdraw funds from their RRSPs for the purchase of qualifying vehicles on a similar basis as the withdrawal of RRSP funds for new housing or education.

   The Canadian automobile industry is in crisis on both the cost and revenue side of their operations. Fewer Canadians are purchasing automobiles, especially environmentally friendly vehicles, because the purchase price has substantially increased and their personal financial security is uncertain. These measures will provide a positive stimulus for the purchase of new environmentally friendly vehicles, thus strengthening the balance sheets of Canadian automakers and dealers, and generally will be beneficial to the environment. Whereas the first two proposals will temporarily reduce federal tax yields, the latter proposal will be revenue neutral.

2. **The Committee recommends that the enhanced write-off for manufacturing machinery and equipment be extended for at least an additional five years, and that the termination date be reviewed periodically.**

   Budget 2007 introduced an enhanced CCA write-off for machinery and equipment used in manufacturing and processing that would otherwise be placed in CCA Class 43. However, the accelerated CCA deduction only applied to machinery and equipment acquired after March 19, 2007 and before 2009. Budget 2008 extended the qualifying time period to 2012. Whereas this timeframe may be appropriate for stimulating new investment in relatively small projects, it is inadequate for major commitments of investment funds. Construction on many large-scale projects currently under consideration will not commence for some years, as projects of this size typically require several years from project initiation to completion. Therefore these vitally needed investments will not benefit from the Budget 2007 and 2008 measures.

4. **Enhanced CCA write-off rates should be provided for new capital investment in the waste management and landfill sector.**

   As Canada approaches the post-Kyoto era, the waste management and landfill sector becomes increasingly more critical to achieving desired environmental goals. Innovation and investment are significant components of achieving pollution reduction and efficient disposal of waste. Corporations respond to positive incentives. This modest cost measure will improve the efficiency of affected corporations and result in more effective waste management processes.

D. RETIREMENT PLANNING

1. Provisions should be introduced which extend the mandatory date for:

(a) cutting off contributions to the Canada Pension Plan for those who are not yet eligible for the maximum pension payments,

(b) contributing to RRSPs, and

(c) converting RRSPs into RRIFs to the year in which an individual becomes 75.

Many Canadians now must consider working beyond their expected retirement date as the current financial crisis has significantly diminished the value of their pension plans or reduced the value of their investment portfolios set aside for retirement. These measures will add flexibility to the employment opportunities of older workers and will greatly enhance their retirement planning.

(d) To ensure that the latter proposal is revenue neutral, the number of years over which an individual is required to withdraw RRIF funds should be reduced.

CONCLUSION

As outlined in this letter, prudence, caution and revenue neutrality are fundamentally important budget-making principles during periods of economic and financial market turmoil. As Canada moves through the current real or near recessionary period, budget proposals should be short-term focused and developed based on the Canadian reality. Major new spending initiatives should be avoided unless they are based on solid evidence that they will stimulate the economy. FEI Canada believes the tax measures proposed in this letter conform to these principles and objectives. We strongly urge the government to consider these measures and implement them in the January 2009 budget. FEI Canada stands ready to assist the government in fulfilling our mutual objectives.

Sincerely,

Michael Conway

Michael Conway, CA, ICD.D
Chief Executive
and National President

Barry Gorman

Barry Gorman, PhD, CA, TEP
Chair, Tax Policy Sub-Committee
Issues and Policy Advisory Committee

SUMMARY OF FEI CANADA 2009 PRE-BUDGET CONSULTATION RECOMMENDATIONS

A. BUILDING STRONG LABOUR MARKETS

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3. Individuals in receipt of compensation from an early retirement or job reduction program should be permitted to deduct the portion of the settlement which is directed to a lump-sum reduction of their home mortgage principal within two years of receipt of the settlement.

4. The Committee recommends that Finance include a measure in the January 2009 budget which would either temporarily reduce the inclusion rate for capital gains or provide for a deferral on the disposition of all capital properties if the proceeds are re-invested in the same or a similar asset within six months.

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   (c) Canadians be permitted to withdraw funds from their RRSPs for the purchase of qualifying vehicles on a similar basis

2. The Committee recommends that the enhanced write-off for manufacturing machinery and equipment be extended for at least an additional five years, and that the termination date be reviewed periodically.

3. Enhanced CCA write-off rates should be provided for new capital investment in the waste management and landfill sector.

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About FEI Canada

Financial Executives International Canada (FEI Canada) is the all-industry professional membership association for senior financial executives. With eleven chapters across Canada and more than 2,100 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada's leading and most influential corporations. Further information can be found at www.feicanada.org.

The Issues and Policy Advisory Committee (IPAC) is one of two national advocacy committees of FEI Canada. IPAC comprises more than 35 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 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.