

Broadening the base for growth

A submission to the House of Commons Standing Committee on Finance

Association of Canadian Financial Officers
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Introduction

In its call for submissions to this round of pre-budget consultations, the Standing Committee on Finance challenged stakeholders to identify measures that would help Canadians maximize, in the manner of their choosing, their contributions to the country's economic growth.

As the group that represents the accounting and financial management professionals in the federal public service, we at the Association of Canadian Financial Officers (ACFO) believe that in order for all Canadians to prosper, all Canadians need to be able to rely on strong, sustainable public services backed by a tax regime that treats everyone equitably.

The federal government under Prime Minister Justin Trudeau and Finance Minister Bill Morneau has made important steps in the right direction but there is more to do to honour both the letter and the spirit of some of their campaign promises. The following submission lays out a series of practical recommendations that could go a long way to broadening the base upon which our important public services are delivered. This stable base of public wealth is critical so Canadians can feel confident making their own contributions to the growth of our economy.

As in our submission to the 2016 budget, we focus on three thematic areas:

1. Tax fairness: Collecting what is owed
2. Progressive taxation: New ideas for generating revenue
3. Stopping waste: Protecting those who protect the treasury

Tax fairness: Collecting what is owed

In our submission to the 2016 budget consultation we argued that the aggressive tax avoidance strategies employed by large multinational corporations and high-net-worth individuals largely make the debate over posted tax rates moot. We are encouraged by the announced simplification of the tax code as we believe this simplification can help close loopholes and level the playing field for all taxpayers.

To set the table for this simplification exercise, we encourage the government to include the following two measures in Budget 2017. These measures serve the dual purpose of generating revenue to fund a progressive social agenda and bringing much-needed fairness to the Canadian tax regime so all Canadians can participate on equal footing.

Recommendation 1: Eliminate stock option deductions

Context

ACFO believes that the principles of fairness require that all Canadians pay their fair share of tax on their income regardless of how that income is structured.

The stock option deduction allows those whose compensation is partially comprised of stock options to pay taxes on only 50% of the income they receive from cashing in their company stocks. It should be noted this is not a widespread benefit: over 90% of the benefit of this loophole goes to the top 1% of income earners.¹

While the stock option deduction doesn't provide any value to the majority of Canadians, it costs them a great deal: this deduction costs the federal and provincial governments combined an estimated \$1 billion per year in revenue.²

Not only is the stock option deduction expensive and of little value to most Canadians, it is also economically dangerous. Top economists from across Canada have definitively stated that the stock option deduction should be eliminated. They assert that it encourages short-term thinking and risky, speculative behaviour – behaviour that former Bank of Canada governor Mark Carney has identified as one of the causes of unstable financial markets.

¹ <http://www.taxfairness.ca/en/news/stock-options-billion-dollar-tax-loophole>

² <http://www.taxfairness.ca/sites/taxfairness.ca/files/factsheets/stock-option-factsheet-april2.pdf>

Recommendation

ACFO has previously advocated for the elimination of all stock option deductions. After all, principles of fairness would dictate that stock options earned as compensation for employment should be considered regular employment compensation and taxed accordingly.

However, we recognize the concerns of Canada's startup companies reflected in the 2015 Liberal election platform "A New Plan for a Strong Middle Class." Rather than the total elimination of the stock option deduction, the Liberal platform pledged to eliminate the deduction on incomes over \$100,000. This promise was not included in Budget 2016. We strongly encourage the government to implement it in Budget 2017.

Value

Based on estimates contained in the Liberal election platform, eliminating the stock option deduction on incomes over \$100,000 could generate \$560 million per year.

Recommendation 2: Take the lead on the OECD BEPS action plan

Context

Budget 2016 reinforced Canada's commitment to the OECD's action plan on base erosion and profit shifting (BEPS). This global reaction to aggressive tax avoidance schemes has become increasingly important in the public eye in the wake of the Panama Papers.

While the steps outlined in Budget 2016 are a good start, we strongly encourage Canada take a leadership role befitting the return to global engagement spearheaded by Prime Minister Trudeau. ACFO and our partners are currently finalizing a detailed report on how progressive governments can take a leadership position within the OECD framework and we'd be happy to share this report with the members of the finance committee when it is complete. In the meantime, a summary list of the recommendations is below.

Recommendations

- First we call on the government to implement the OECD's first action item and address the challenges of the digital economy by requiring over-the-top service (OTTS) providers not based in Canada to collect sales taxes and pay corporate taxes.
- We recommend that the government take the OECD's most-discussed recommendation, country-by-country reporting, one step further by requiring it at a lower financial activity threshold than the one cited by the OECD, and by making most of the information contained in these reports available to the public in the interest of transparency and accountability.

- In this same spirit of transparency and accountability, we also call on the federal and provincial governments to work together to require all entities incorporated in Canada to reveal beneficial ownership, and we ask that this information be made available on a central public database.
- Canada is already leading on the OECD's Action 12, requiring taxpayers to disclose aggressive tax planning, so we recommend that government take one step further and require all tax products be vetted and registered with the Canada Revenue Agency before they are made available to consumers.
- We also call on Canada to take a leadership role on the international stage by supporting developing nations' calls to either move discussions on international tax reform to the United Nations, where all nations' voices can be equally heard, or find a more permanent way to make sure the discussions are inclusive.
- Finally, we recommend that the government commit itself more fully to not just investigating potential tax evasion, but enforcing existing penalties against tax evasion to the fullest extent of the law.

Value

An estimate by Canadians for Tax Fairness puts the amount of money stored offshore by Canadian corporations and individuals at \$199 billion³. However, until the the tax gap is independently calculated, as requested by Senator Percy Downe, it's impossible to know how much tax revenue is going missing on a yearly basis.

³ Canadian \$\$ in Tax Havens Reach \$199 Billion," Canadians for Tax Fairness, accessed July 22, 2016 <http://www.taxfairness.ca/en/news/canadian-tax-havens-reach-199-billion>

Progressive taxation: Finding new revenue sources

Simply collecting what is owed would be a great start but as the representatives of professional financial managers, we understand the importance of looking for new revenue sources as well.

One idea that has been evaluated and implemented extensively in more than 40 jurisdictions around the world could generate substantial revenue for the government with a marginal impact on the economic activities of everyday Canadians.

Recommendation 3: Introduce a Financial Transaction Tax

Context

A Financial Transaction Tax (FTT) is slated to be implemented in the European Union later this year. The tax has also been added to the Democratic Party's platform in the US in the run up to November's election. A similar measure introduced in Canada could generate upwards of \$5 billion in revenue without materially affecting economic growth.⁴

An FTT would tax transactions between financial institutions, charging 0.5% against the exchange of shares and bonds and less across derivative contracts.⁵

To avoid any unwanted negative impact on the real economy, such a tax would not apply to normal financial activities of citizens and businesses (for example personal loans, payments, insurance and bank deposits); investment banking activities for the purpose of raising capital; transactions carried out for restructuring operations; or refinancing transactions with central banks.

In addition to generating tax revenue, an FTT would have the added benefit of serving as an effective curb on automated high frequency trading and highly-leveraged derivatives that contribute to market manipulation and instability.

FTTs exist in approximately 40 jurisdictions around the world including many within the EU. A 2012 study concluded that these taxes generated \$38 billion per year.⁶

Recommendation

ACFO recommends that Canada follow the lead of our EU trading partners and the Democratic Party in the US and adopt a FTT similar to the EU model that is going to be implemented later in 2016.

⁴ https://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2015/03/AFB2015_MainDocument.pdf

⁵ Ibid.

⁶ <http://stephanygi.net/papers/FTT.pdf>

Value

\$5 billion annually could be generated through the establishment of an FTT that is equivalent to a tax of \$5 on a transaction worth \$1,000.

Stopping waste: Protecting those who protect the treasury

As we pointed out in our previous submission, cutting down waste and funds lost through mismanagement is a critical part of sound financial management – a fact also recognized in the mandate letters for Minister Morneau and Treasury Board President Scott Brison.

Canadians who want to contribute to Canada's economic growth need the peace of mind that comes from knowing their contributions to the federal treasury are protected. While not specifically a dollars-and-cents budget measure, we believe it is important to recognize and begin to tackle systemic barriers that are currently preventing some of this waste and mismanagement from being identified.

Recommendation 4: Review the PSIC mandate

Context

The Office of the Public Sector Integrity Commissioner (PSIC) was created in 2007 to investigate alleged wrongdoing in the public sector and to offer protection to those who expose misuse, waste or gross mismanagement of public assets. Upon its creation the plan was to review the enabling legislation after five years. Scheduled for 2012, this review is now approaching five years overdue.

Canada's anti-corruption and whistleblower protection regime is among the best in the world and PSIC, particularly under the leadership of Commissioner Joe Friday, does great work within its mandate. But that mandate is unnecessarily limited and the protections afforded to those who do the right thing are wanting.

The connection to good financial management and budgeting principles here is clear. Public servants who are in a position to see wrongdoing and gross financial mismanagement, including ACFO's own members, need to feel as though they can raise concerns without fear of punitive retaliation. Anecdotal evidence from past whistleblowers shows that being proven right by the system doesn't mean one is free from the harm of reprisal.

Recommendation

ACFO recommends that the members of the House Finance Committee push for the overdue legislative review of the PSIC enabling legislation. This review should begin immediately so that improvements can be made to the disclosure of wrongdoing and reprisal protection regimes in the federal public service. Consideration should also be given to expanding the mandate to include the private sector to help crack down on white collar crime involving government contracts.

Value

It's hard to quantify the value of this recommendation as we don't know how much waste or mismanagement is seen but not reported; however, recent experience has shown that even small instances of wrongdoing can add up to significant financial costs.

Conclusion

Maximizing the contributions of every Canadian to our economic growth requires a stable foundation of services upon which the country can grow and a level playing field for all those who are part of the system. The recommendations in this document have a minimal impact on Canadians but serve to broaden the base upon which our country can grow.

We hope the Standing Committee on Finance gives them careful consideration and we're happy to discuss any of them at length in person.