CCUA | ACCF
Canadian Credit Union Association
Association canadienne des coopératives financières

2017 Federal Pre-Budget Submission

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Standing Committee on Finance

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Introduction

The Canadian Credit Union Association (CCUA) is pleased to participate in the 2017 pre-budget consultation process of the House of Commons Standing Committee on Finance.

The CCUA is the national trade association for 306 credit unions and *caisses populaires*. Credit unions are full-service financial institutions that are 100 per cent Canadian-owned competitors to the big banks. Currently, more than 5.6 million Canadians trust a local credit union for their day-to-day banking. Collectively, credit unions employ more than 27,000 people and manage $190 billion in assets, which represents a 6.3 per cent share of assets held by all federal and provincial deposit-taking institutions. By market segment, credit unions occupy seven per cent of the mortgage lending market, 11 per cent of the small business market and, outside of Québec, 11 per cent of lending to the agricultural market.

As financial co-operatives owned by the members they serve, credit unions are a very different kind of financial institution. Unlike chartered banks, credit unions are not motivated by profit maximization but rather focus on the benefit of their members and their local community. This unique emphasis translates into a variety of different practices, such as providing preferential rates for members, enhanced customer service or maintaining branches and service outlets in underserved communities. In fact, credit unions are the only banking service provider in 380 communities across Canada.

Our submission will focus on question 2 of the committee's priority areas for the 2017 federal budget. More specifically, the recommendations put forward in this submission will highlight some of the actions that the federal government can take to help credit unions contribute even more to Canada's economic growth by:

1. Promoting the principle of fair taxation across different kinds of businesses as a guiding aim of the government's review of tax expenditures;
2. Implementing a risk-based approached to the Common Reporting Standard to fight cross-border tax evasion; and
3. Modernizing banking in Canada through a truly comprehensive approach to the 2019 review of financial institutions legislation.

1. Promoting the principle of fair taxation across different kinds of businesses as a guiding aim of the review on tax expenditures

As announced in Budget 2016, the federal government launched a review of federal tax expenditures in June. Credit unions believe that a fair and efficient tax system is one that treats different corporate forms differently, so that they are able to compete on a balanced playing field that frees them to contribute to economic growth. To achieve this, credit unions are calling on the government to include the principle of fair taxation across business structures as a guiding aim of the review.

Historically, the federal tax system has treated different kinds of businesses in different ways. In doing so, the government accommodates the different structural realities and social purposes of co-operatives, joint-stock companies, non-profits and charities. As co-operatives, credit unions have been included in this common sense approach to taxation.

Unfortunately, the value of this approach has been eroding for credit unions in the past few years. Until recently, for example, the federal tax system recognized the important differences between cooperatively-owned credit unions and shareholder-owned banks by providing a specific income tax deduction to credit unions.

This treatment balanced some of the ways in which the tax system favours large banks through the capital gains tax exemption available to all joint stock companies. By taxing only half the value of a gain, this exemption provides investors with a strong incentive to purchase bank shares and provides banks with an advantage to sell shares in order to build capital as needed. While the capital gains tax exemption represents a significant tax expenditure - $6.3 billion annually – there is no equivalent measure to benefit cooperatively-owned credit unions whose member shares do not generate capital gains.

The promotion of different business structures benefits economic growth. The recent financial crisis demonstrated evidence of this. While globally many shareholder-owned banks reigned in their lending activities, credit unions tended to increase lending to small businesses and households. Credit unions responded in this way because their co-operative structure aims to meet member needs, while at all times protecting the assets we hold on our members' behalf.

Including fair taxation across business structures as a guiding aim of the federal tax review will ensure that current and future tax expenditures are designed to help different corporate forms compete fairly and efficiently so that they can ultimately be better positioned to contribute to economic growth. For credit unions, a fair and efficient tax system would enable them to increase their positive impact in local communities through loans, investments, and job creation.

2. Implementing a risk-based approach to the Common Reporting Standard to fight tax evasion

The federal government has announced that it plans to implement the Organization for Economic Co-operation and Development's (OECD) Common Reporting Standard (CRS) on July 1, 2017. In order to reduce new regulatory requirements on credit unions, and help the government achieve its policy objective of fighting tax evasion in as efficient a manner as possible, CCUA is urging the federal government to apply a risk-based approach to CRS implementation in Canada.

As currently proposed, legislation implementing the CRS would require <u>all</u> Canadian financial institutions to report on accounts held by non-residents of Canada or the U.S. to the Canada

Revenue Agency. But not all financial institutions pose the same risk for cross-border tax evasion, a fact that is implicitly recognized by the exemptions embedded in the Foreign Account Tax Compliance Act Inter-Governmental Agreement (FATCA IGA) that Canada signed with the United States in 2014, and on which the CRS is based.

However, size-based exemptions similar to those in the FATCA IGA were, by agreement of participating countries, omitted from the CRS during its development and are consequently also excluded from the legislative proposals. As a result, even financial institutions, such as credit unions, that are at low-risk of being used for cross-border tax evasion because they only have a handful of accounts held by non-residents[1] will be required to put in place new policies and procedures as well as alter their operational, record-keeping and reporting processes to comply with CRS. Moreover, since the U.S. will not be participating in the CRS, credit unions that have obligations under the FATCA IGA will have to maintain two separate, though related, recordkeeping and tax reporting regimes.

The CRS does, however, open the door to the designation of jurisdiction-specific "low-risk non-reporting financial institutions," subject to certain criteria being met, including a clear demonstration of their low-risk nature. To that end, CCUA is proposing that implementing legislation include a test similar to the "98 per cent Test" used under the FATCA IGA to annually exempt institutions that have two per cent or less of their assets held by non-residents from CRS obligations. In doing so, the federal government would reduce unnecessary regulatory burden on low-risk financial institutions, while compliance efforts in and on financial institutions could be focused where there is the greatest risk of being used for cross-border tax evasion.

3. Modernizing banking in Canada through a truly comprehensive approach to the 2019 review of financial institutions legislation

The CCUA is strongly supportive of the federal government's recent decision to postpone the financial services legislative review process by two years to 2019 as announced in Budget 2016, and confirmed in the 2016 Budget Implementation Act (Bill C-15). Given the transformative changes occurring in the financial services sector, we believe that the 2019 review needs to be a comprehensive one.

Since the financial crisis, financial sector policymaking has been focused on risk mitigation. Though Canada's credit unions posed no systemic risk, in our view this approach was and is entirely appropriate. However, in the rush to avoid a future crisis, the CCUA is concerned that the focus on stability and on meeting "one-size-fits-all" international norms has inadvertently led to a policy environment that more than ever, favours big over small institutions, especially co-operatively structured credit unions.

[1] *The overwhelming majority of credit union members are Canadian residents, and a survey conducted by CCUA, found that the median number of non-resident credit union members who are residents of countries other than the US was just three.*

Recent calls for Canada Post to offer postal banking services to under-banked populations is an example of other advocates who are calling for greater competition in the financial services sector. While CCUA is not supportive of the establishment of a postal bank in Canada, we share the concerns of those who desire to expand the availability of banking services in some regions and to underserved segments of the Canadian population. In fact, we believe that these types of questions and the appropriate role for provincial and federal credit unions in the overall baking sector need to be addressed as part of a comprehensive 2019 review.

To that end, CCUA recommends a comprehensive review to address large questions about the right balance between stability and competition and, in doing so, range widely to include discussions about ways that regulatory structures, tax policy and the treatment of smaller and co-operative financial institutions can have on improving service, competition and economic growth for Canadians.

Conclusion

In closing, the CCUA wishes to thank the House of Finance Standing Committee on Finance for undertaking the 2017 pre-budget consultation process. We hope to have the opportunity appear before your committee in the fall to elaborate further on the recommendations noted above.