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—
Chair

Mr. Brian Pallister

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• (1105)

[English]

The Chair (Mr. Brian Pallister (Portage—Lisgar, CPC)): The orders of the day, pursuant to Standing Order 81(4), are the main estimates for 2007-2008: votes 1, 5, and L10 under Finance, part III, report on plans and priorities, referred to the committee on Tuesday, February 27, 2007.

Welcome to our witnesses. This morning we have officials from the Department of Finance. I understand there is a brief opening presentation.

Mr. Carney, please proceed.

Mr. Mark Carney (Senior Associate Deputy Minister, Department of Finance): Thank you, Chair.

Good morning, members.

[Translation]

Good morning, Mr. Chairman.

My name is Mark Carney, and I am Senior Associate Deputy Minister at the Department of Finance. Departmental representatives are with me today and will help me answer your questions.

We believe the committee has met with other members of the Finance portfolio on separate occasions: the Canadian International Trade Tribunal, the Financial Transactions and Reports Analysis Centre of Canada, the Office of the Superintendent of Financial Institutions and the Office of the Auditor General.

So the discussion today focuses on the Main Estimates of the Department of Finance. As you probably know, the department is responsible, in particular, for preparing the federal budget, developing tax and rate-setting laws and policies, managing federal loans in the financial markets, administering the main funding transfers to the provinces and territories, developing regulatory policy for the Canadian financial sector and representing Canada to international financial fora and institutions.

[English]

The estimates that have been tabled in the House identify total budgetary requirements for the Department of Finance of \$75.8 billion. It is important to note that \$75.5 billion, or over 99% of this amount, relates to statutory votes for items that have already been approved by Parliament through enabling legislation. These include items such as the payment of public debt charges, Canada health and social transfers, and equalization payments. These statutory votes are

displayed in the estimates document for information purposes and will not be included in the appropriations bill.

Within the statutory votes there is a net increase of \$2.4 billion over the last year, with the major contributing factors being a \$2 billion increase in transfer payments to provinces and territories and a \$302 million increase in public debt costs.

The non-statutory votes of the Department of Finance show a decrease over the last year. This consists of a \$183 million reduction in grants and contributions related to payments made by Canada under multilateral debt relief initiatives, as well as a decrease of \$3.8 million in the operating vote primarily related to sunsetted funding for the department.

We will be pleased to address any questions the committee may have.

Thank you.

[Translation]

The Chair: Thank you very much, sir.

We're going to start with Mr. McCallum.

[English]

Hon. John McCallum (Markham—Unionville, Lib.): Thank you, Mr. Chair.

It's a pleasure to have the opportunity to ask a few questions of Mr. Carney, a man I've known in a previous life. I have great respect for his professionalism, intelligence, and integrity, if not his ability to predict the timing of the shift-over of prime ministers in the U.K. The two of us have a bet on that subject.

I'd like to ask about interest deductibility. I must say I'm a little puzzled, because here is an item presented in the budget as if it will cost \$40 million a year. Now we have the Chamber of Commerce saying it will be \$1 billion to \$2 billion a year, and people in the private sector I've spoken to have a similar view. So how can this item, which is turning out to be a huge tax measure, be introduced into the budget with an estimated revenue impact a tiny fraction of what experts now tell us it will be?

Mr. Mark Carney: Thank you for the kind words at the start, and also thank you for the question. I'm feeling a bit shaky, and I take the advisement of the committee that this is a non-monetary bet on the timing of that change. That's much appreciated, because I think I might lose on my timing on that.

On the cost of the interest deductibility measure, it's important to note that the proposal in the budget has a transition mechanism, depending on the type of debt. What shows up in the budget framework—which is a two-year budget framework, as I believe the member knows—is new debt for foreign affiliates, so it only addresses new debt. With the arm's-length and non-arm's-length existing debt, the measure takes effect beyond the budget framework, and that explains the level of the estimate.

• (1110)

Hon. John McCallum: I don't think the experts claim, even in the time horizon of the budget, that \$40 million is a gross underestimate of that, because some of the transitioning will have taken effect.

With respect to my second question, it's clear that in a perfect world, if Canada was the whole world, this might be a good policy; farm subsidies might be a bad policy. But we are a smallish open economy. If Europe and the U.S. have big farm subsidies, we have little choice if we want farmers to exist.

Similarly, with interest deductibility, when most European countries, the United States, and Japan all allow interest deductibility or its equivalent, and we don't, then our companies are operating in global markets with one arm tied behind their backs. I've seen a mathematical calculation that if you're financing an acquisition of 50% debt and 50% equity, interest deductibility alone will mean that these foreign companies can pay 37% more for a foreign acquisition than a Canadian company.

It's a huge measure, which will seriously weaken our companies. In summarizing the impact, KPMG said it would lead to, and I quote, “more foreign takeovers of Canadian companies, stifled Canadian investment in global markets, an exodus of head offices and a weaker Canadian economy overall”.

So my question is, why would the finance department have such a huge hit on our relatively small number of global players? I acknowledge that there are some problems with interest deductibility, such as thin capitalization rules, but instead of dropping a bomb on the whole business, why did you not selectively go after those particular problems that I acknowledge to be problems?

Mr. Mark Carney: Thank you.

I believe the question relates to the competitiveness of Canadian corporations internationally. I'll make one observation that I'm sure we'll have a chance to discuss in detail later in the session. There is a broad competitiveness strategy of this government that is outlined in Advantage Canada, which was tabled with the fall update and began to be implemented in the course of this budget. I won't belabour the specific aspects of that, but I trust we will address some of them later on.

From a tax competitiveness perspective, the government firmly believes in tax competitiveness. It has made substantial strides in enhancing the competitiveness of the Canadian tax system.

Regarding another reference to Advantage Canada, the objective of the Canadian government is to achieve the lowest rate of tax on new business investment in the G-7. When the government came to office, Canada was sixth in the G-7, i.e., the second-highest marginal effective tax rate on new investment. As a result of measures put forth in budget 2006 and proposed in budget 2007, Canada will

move to third in the G-7. The intention of the government is to continue to advance that progress. So the totality of the tax system is important.

It is also important, when looking at other jurisdictions, to look at the totality of their tax system. Whereas some jurisdictions will allow this deductibility, in a normal case they will tax the repatriation of foreign income into their jurisdiction, or they will provide other limitations on the absolute amount of interest that can be deducted in funding foreign affiliates. So we would look both to the taxation of foreign income that continues to be exempt in Canada, which is a major competitive advantage for Canadian multinationals, as well as measures that include restrictions on the amount of dividends that can be repatriated, etc., in places such as France and Germany.

It is a broad subject. There are a number of issues. The government is committed to competitiveness in the context of tax fairness.

• (1115)

Hon. John McCallum: I think truth in advertising requires one to change the name from “Advantage Canada” to “Disadvantage Canada”. The annual survey of CEOs gave the government a failing grade on business taxation in general.

I've spoken to many experts on this interest deductibility issue. They are very clear that not every European country, but most, and certainly the United States and Japan, afford this privilege to their companies. We are the boy scouts of the world. Perhaps on the grounds that in some pure sense it's better tax policy, we are crippling our own companies in competition with those players.

The Chair: Merci, monsieur.

Hon. John McCallum: So I've run out of time.

The Chair: Correct.

Monsieur Crête.

[*Translation*]

Mr. Paul Crête (Montmagny—L'Islet—Kamouraska—Rivière-du-Loup, BQ): Thank you, Mr. Chairman.

In the Main Estimates 2007-2008, under the heading “Federal-Provincial Relations and Social Policy,” we note a significant cut to allocated funding, a reduction of 26.7%.

Does that mean that, for the Department of Finance, the entire question of the fiscal imbalance is no longer being addressed in anticipation of a future year?

[*English*]

Mr. Mark Carney: Thank you for the question. I'll introduce the answer and then turn to my colleagues to supplement it.

An important element of that decrease is that there was money allocated, as I believe you're aware, for the expert panel on equalization. That money is running off. It was a \$10 million budget amount spread over two years. As it runs off, it brings down the amount allocated to that branch—whose important work continues, absolutely. Then there's an additional impact, because we allocate overhead costs based on budgets. That also reduces the amount.

I don't know if you need a further supplement, but that's the thrust of the change.

[*Translation*]

Mr. Paul Crête: Do you intend to study the possibility of resolving the fiscal imbalance issue for good by focusing, for example, on tax transfers, the transfer of GST points? Does this budget cut simply mean that you have no intention of continuing to address these questions?

[*English*]

Mr. Mark Carney: The measures outlined in budget 2007 restore fiscal balance in Canada. The efficiency, effectiveness, fairness of federal-provincial programs—transfer programs and shared programs—will always be a subject of work at the department, and will continue to be an important subject of work going forward.

[*Translation*]

Mr. Paul Crête: I'll continue on in another line of thinking. You've had to look at the impact of a 1% GST cut. In your report, you state the following:

[...] reducing the GST by an additional percentage point starting no later than 1 January 2011 [...]

I'd like to know a little more about the criteria you use to evaluate the impact of this measure on productivity.

I'll submit an assumption to scenario: a 1% GST cut makes it possible to buy lower-cost products, but it is possible to buy products manufactured outside Canada, in China or other emerging countries. However, one could apply a strategy whereby the manufacturing sector has better coverage, as you started to do in the context of this budget.

Are you going to study this kind of question by evaluating the impact of the change to the GST?

[*English*]

Mr. Mark Carney: There is an important question embedded in your comments, and that's the impact of retail sales tax; I'll go to the impact on manufacturers particularly. In several of our larger provinces, there continues to be a retail sales tax, which punishes manufacturers because there's not the value-added component.

We demonstrate in the budget a desire—the minister has made this point repeatedly—to encourage tax harmonization in Canada so that those provinces, for example Ontario, would move toward a value-added tax, a PST like Quebec's. This would make a significant impact on the competitiveness of Canadian business. To be specific, I spoke earlier about our rate of tax on new business investment going to third. If Ontario and B.C. moved to a VAT, we would have the lowest METR in the G-7 by some considerable margin.

The other point, if I may, is that one of the first things the government said upon arriving was that Canadians pay too much tax.

Part of the impact of lowering the GST is clearly just to reduce the tax burden on all Canadians.

● (1120)

[*Translation*]

Mr. Paul Crête: To clarify my question, I'd like to know the measures you are going to evaluate in order to determine what contribution would be likely to increase competitiveness. I know that people are still paying too much tax, but it is possible that a 1% cut will result in increased consumption.

Are you going to examine the question whether that would have the effect of exporting jobs, in that the 1% cut would make it possible to buy more products manufactured in China, India or other countries of the world? The tax cut would then have the final result of reducing the positive impact on Canada's economic activity.

Are you going to evaluate this kind of question?

Mr. Mark Carney: Both countries pay GST. Consequently, the system is neutral whether the product is manufactured in China or in Canada.

I can turn the floor over to Director General Brian Ernewein so that he can give you more details.

Mr. Paul Crête: The question isn't whether both countries pay the tax, but rather to take into account the fact that a 1% tax cut will result in increased consumption. It remains to be determined whether it's consumption of products from outside the country that will increase or that of products manufactured in Quebec or Canada. You also have to evaluate that effect. I want to know whether you intend to do it.

[*English*]

Mr. Brian Ernewein (General Director, Tax Legislation Division, Tax Policy Branch, Department of Finance): I apologize for answering a question with a question, but it seems to me, following Mr. Carney's remarks, that as far as a sales tax or consumption tax in Canada is concerned, we have neutrality in the system today. Whether a good is produced in Canada or produced in China, when it is purchased in the retail sector by a Canadian consumer, it will be subject to the same level of tax. My suggestion, perhaps, is for us to consider whether underlying that we have the right level of taxation on the production of profits.

[*Translation*]

The Chair: We'll continue with Mr. Dykstra.

[*English*]

Mr. Rick Dykstra (St. Catharines, CPC): Thank you, Chair.

A couple of things that strike out in terms of looking at the overall estimates concern the increase from 2006-2007 to 2007-2008. I wonder if you could comment on how you arrived at the figures. I see the Department of Finance's main estimates increased by \$2.2 billion, or 2.9%, compared to the 2006-2007 main estimates.

Could you just comment overall on how we've arrived at those figures? Sorry if I've....

Mr. Mark Carney: No, no. It's on topic.

The first element is.... I'm sorry, I apologize for using your time to find the right tab.

Mr. Rick Dykstra: The chair is generally lenient on these issues.

Mr. Mark Carney: I appreciate the question, and I apologize for being slow in answering it.

The principal difference is there's a decrease in operating expenditures, as I mentioned in my opening remarks, and there is also a reduction of \$183 million in grants and contributions, principally because of debt relief initiatives. Then there are increases as a result of a number of transfers. There's \$72 million, territorial financing formula. A big one is the Canada health transfer, increasing by \$1.2 billion, and there's \$300 million more for the Canada social transfer. And public debt charges—also mentioned in my opening remarks—\$302 million, have gone up.

All of those elements, with the exception of the multilateral debt relief, the \$183 million, and obviously the operating expenses of the department, are statutory items. I would also make the point that all of these items are prior to the measures outlined in budget 2007. As you know, the budget and the mains are prepared concurrently. Those are the principal elements operating on the old system, and there is a subsequent reconciliation.

• (1125)

Mr. Rick Dykstra: You mentioned the increase in public debt charges. Could you expand on that a little bit to describe what that means?

Mr. Mark Carney: Thank you for that question.

The government has for a number of years been moving its balance of public debt to a 60% fixed-rate debt, a longer-term debt at a set rate, and then a 40% floating-rate debt. The increase in the public debt charges is a result of the increase in the average interest rate on all the debt, but effectively on the floating-rate debt, and I'll get the precise figure for you in a second. The difference is the treasury bill rate for the last mains was 3.4%, i.e. the short-term debt rate, which is the relevant rate, and it's increased to 4.1%, the projected rate now. That explains the difference between the two.

Mr. Rick Dykstra: How much larger would that figure be had we not made the two consecutive payments on our national debt?

Mr. Mark Carney: How much larger would it be if we had not made the \$22 billion—

Mr. Rick Dykstra: How much higher would it have been, yes. I'll leave that; it's a number. Instead of taking up too much time searching—

Mr. Mark Carney: It's \$1.1 billion. At 5%, the government has paid down \$22.4 billion worth of debt over the course of the last.... So it's \$1.1 billion, 5% of that \$22 billion, annually. And in the spirit of the gift that keeps on giving, the government is proposing to legislate a tax-back guarantee so that this saving will be returned to individual Canadian taxpayers.

Mr. Rick Dykstra: So over a billion. Thank you.

And, Mark, I don't want to get you scrambling again, but the other question I had relates more to our attention to international affairs. By that I mean international assistance. We're spending a great deal of time and money, obviously, assisting countries to become stronger and more self-reliant. It's one of the things that a lot of attention was paid to and we did pre-budget consultations across the country and heard from a lot of organizations that believe we need to continue to

make more investments. I wonder if you could comment on the year-over-year increases in international assistance.

Mr. Mark Carney: Yes. The government confirmed in budget 2006, and reaffirmed in budget 2007, the annual increase in international assistance of 8%, which is a significant figure, particularly since the government is committed to maintaining a rate of growth in overall government spending of less than the rate of growth of the economy. So if one uses a 5% figure for the overall rate of growth of the economy, international assistance growing more rapidly, you have to grow other things less rapidly.

The other point I would like to underscore is that in part in response to the consultations of this committee, and others, is the government outlines in budget 2007 a four-point program to enhance the effectiveness of that spending. So it's not just the volume, it's the quality and effectiveness.

Mr. Rick Dykstra: I appreciate your responding to that, because it was actually my next question, so thank you. It's not necessarily how much you spend, but the fact is it's what are the deliverables and what are the outcomes that are important.

Very quickly, one of the things relating to international assistance that I found, and maybe you can answer this after, is that in the section on the Office of the Superintendent of Financial Institutions, page 35, it refers to "ongoing responsibilities" in terms of international assistance. One of the things is to "contribute to awareness and improvement of supervisory and regulatory practices for selected foreign regulators through the operation of an international assistance program". I have no idea what that sentence means, and I was hoping to get a little bit of clarification. I don't necessarily need it now, but I'd love to get a response as to exactly what that—

Mr. Mark Carney: To give you an exact response, we will work with OSFI and provide a written response to the committee on that question.

It is important work. I will make two points on that. One is that increased regulatory cooperation internationally is absolutely crucial to effective functioning of the global financial system and combating any money laundering and counter-terrorist financing. This government has made a tremendous commitment on this part. We fully support the efforts of the superintendent in this regard. You see it also through our presidency of the financial action task force on money laundering.

• (1130)

Mr. Rick Dykstra: We dealt with one of those bills right here at committee, so I appreciate hearing that.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. Dykstra.

We continue now with Madam Wasylycia-Leis, who's glad she's not in a provincial election campaign today.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): I'm just glad we're not in two campaigns at once—thank you, Mr. Chairperson—so far anyway.

Let me ask a question about a press conference that was just held here in the House of Commons about the smuggling of cigarettes and the loss of revenue. It's a concern I've raised before. I put in order paper questions to try to get a proper estimate, and I haven't had a satisfactory answer yet. I'm wondering if you can give any kind of number in terms of the amount of money that is lost annually because of smuggling.

Mr. Mark Carney: I do not have an estimate for that at hand. We can undertake to provide one.

Ms. Judy Wasylycia-Leis: Okay.

The Canadian Council for Tobacco Control has said that at least \$200 million annually is lost. The concern is, this is money that could go towards cancer strategies, it could go towards a number of things. I'm wondering if you could indicate if you have any plans to deal with the fact that at least 10% of cigarettes smoked in Canada are untaxed.

Mr. Mark Carney: Yes, this is an important issue, and it is an issue we look at. Obviously, it's an enforcement issue, first and foremost. But also, it is a question of working with provinces, as well, in terms of designing the right combination of tax and compliance systems to ensure that the incentives are there. What has happened recently is that there's been a consistent increase in tobacco taxes, which has, in part, occurred in tandem with an increase—a potential increase—in smuggling. So it is an enforcement issue plus a tax and compliance issue. We do look at these issues, because we agree that they are important.

Ms. Judy Wasylycia-Leis: One related concern in this field is that I understand that at this point none of the normal grants and contributions dealing with anti-tobacco strategies are flowing to any of the groups involved. And there's growing concern about whether there has been a change of heart in terms of government commitment to programs in this area.

If you can't answer now, I would like to register that concern, and perhaps you could get back to us.

Mr. Mark Carney: We appreciate your registering the concern, and we'll discuss it in more detail.

Ms. Judy Wasylycia-Leis: Let me go to the broader issue of tax avoidance. I know there have been a number of concerns raised since the budget, especially in terms of foreign private equity. There have been calls internationally for this to be dealt with in respect of countries, including Canada. I'm just wondering if in fact this is on your agenda. What's the latest strategy regarding private equity? And are you dealing with this as part of any overall tax avoidance strategy?

Mr. Mark Carney: Thank you for the question.

The development of private equity globally has been marked over the course of the last couple of years. I just want to provide a bit of context. The short answer to your question is yes, we are looking at this. We are monitoring the developments, all major developments, in global financial markets. The development of private equity is a major development in global financial markets. For example, in the U.K., because of the amount of equity that was retired through private equity buyouts and share buybacks by companies, the market capitalization of the FTSE 100 did not increase over the last two years.

The activity of private equity in Canada is substantially less than the comparable activity of private equity globally. Further, Canadian companies have been more active. We have had net foreign purchases, if you will, on a private equity basis, over the course of the last several years. For example, last year Canadian firms bought something in the order of \$13 billion—invested \$13 billion—on a private equity basis, outside Canada, versus total investment in Canada of private equity, both of Canadian and foreign firms, in the order of about \$8 billion.

So it is a global development. Two other figures I will give you support your point. There was \$400 billion in private equity raised last year, globally, in U.S. dollars. The expectation is that a further \$500 billion will be raised this year. So it's something that is a topic of conversation internationally. We participate in those discussions. We are looking at the situation.

● (1135)

Ms. Judy Wasylycia-Leis: Do you think Canada has the tools to deal with this type of tax avoidance? Do we have the ability to crack down on those who avoid paying their fair share of taxes using debt leveraging? Do you think there is something more we could be doing as a country? Do we have ways to protect revenue, whether in the trust or standard corporate area?

Mr. Mark Carney: Here are a couple of observations we'd make on private equity or leveraged transactions, whether they are actual transactions that take a company from being public to becoming private or are merely adding more debt to the capital structure of Canadian corporations. Number one, leverage in Canada is quite low at the moment. That's a global phenomenon, but the actual amount of debt that's in the corporate system is very low relative to 25-year averages. That's point number one.

Point number two is that we recognize that in these transactions there is third-party debt. There is a market discipline to the amount of debt that is put on a company. It's not a structured tax-avoidance scheme, if you will, that takes advantage of a loophole, if I can use that term, in the tax system. Rather, it is a judgment by market participants of how much debt a certain business can support, given its investment plans, which provides an important distinction from other types of activity.

The Chair: Thank you very much, Madam.

We'll continue with Mr. Thibault for five minutes.

Hon. Robert Thibault (West Nova, Lib.): Thank you.

Thanks for appearing.

I have no doubt about the capacity of the Department of Finance to provide advice to do the research, but I have some serious questions about what kind of advice is being sought and accepted.

I think of the income trust fiasco and remember back to the previous government, when advanced rulings were stopped—not advanced taxation—and we saw the market react rather quickly. I assume that the department could have predicted that introducing a 31% tax on income trust distributions would cause a huge market reaction, and we saw it. We saw \$25 billion lost in market capitalization overnight. So I presume that type of advice was available from the department, but was probably disregarded or not sought.

It brings me to the same sort of question on interest deductibility on foreign investments. Let's say you're working in a global environment where your competitors, in order to grow or maintain their advantage, are able to invest in foreign markets and acquire companies in other markets where they need those links and relationships. If those competitors are able to have tax deductions on their investments and our companies aren't, one of two things is going to happen. Either our companies are going to stagnate and lose their competitive advantage with other companies, or they're going to be forced to sell out to foreign interests, as we saw in the income trust sector.

Has the department made that calculation? Was the department asked to make those types of calculations on adverse effects? If so, was the Minister of Finance made aware of those facts?

Mr. Mark Carney: I'm going to state government policy around the issue, because the discussions between the department and the minister, and the advice given to the minister and ultimately to cabinet, are subject to cabinet confidences.

Let's go to interest deductibility in terms of the incentives for Canadian corporations. I would refer to my previous answer to the interest deductibility question on overall tax competitiveness. We and the government believe that focusing on one aspect of the international tax system misses the broader issue of tax competitiveness—that the government is committed to tax competitiveness.

But one of the important things is that with the existing system, prior to budget 2006, as outlined in a number of Auditor General reports and the Minsk committee, and as referred to by this committee in recommendation 35 of the finance committee report, the use of tax havens resulted in a greater incentive to invest outside of Canada than in Canada.

When one goes back to the creation of jobs, productivity, and growth in Canada, we're looking to establish a neutrality for Canadian corporations between investing in Canada and investing abroad, in the context of providing an overall competitive corporate tax system, where there has been substantial progress over the last two budgets.

• (1140)

Hon. Robert Thibault: Wouldn't you agree that there is a huge difference between a tax haven where people hide money in order to avoid taxes and an investment in foreign markets—in plants, equipment, and assets that provide raw materials—an investment coming from Canadian-generated funds that bear interest that is deductible? There's a huge difference.

We see a hollowing out of our economic assets, first in the income trust, and now in our globally competitive companies with their losing of this advantage. We see our contracts with the Department of National Defence now going to original equipment manufacturers, including life cycle maintenance and supply. We hear from people in our aerospace industry and our defence contracting industry that they will have to consider selling out to foreign interests because over the long run they can't be competitive in that type of market.

The research your department does—and I'm sure it's excellent—is paid for by public funds, so the advice should be public. The decision the minister makes is his to make—the decision that cabinet

makes—but the advice provided by your research is included in these figures on how much taxpayers are paying for that advice.

The Chair: Thank you very much, Mr. Thibault.

We'll continue now with Mr. St-Cyr for five minutes.

[*Translation*]

Mr. Thierry St-Cyr (Jeanne-Le Ber, BQ): Thank you, Mr. Chairman.

I want to get back to the fiscal imbalance. I'd like to know your view. In the last budget, there were transfers, that is to say mainly increases in equalization and transfer payments.

Would you characterize those transfers as cash transfers or tax transfers?

Mr. Mark Carney: I'd like to turn the floor over to Barbara Anderson.

[*English*]

Mrs. Barbara Anderson (Assistant Deputy Minister, Federal-Provincial Relations and Social Policy Branch, Department of Finance): The transfers that were in the budget in the fiscal balance package were cash transfers to provincial and territorial governments.

[*Translation*]

Mr. Thierry St-Cyr: In that case, would you say there have definitely been gains in terms of budget transfers, cash transfers, but that there's been no progress, for the moment, from a fiscal balance standpoint?

[*English*]

Mrs. Barbara Anderson: No, I think the budget package restored fiscal balance.

[*Translation*]

Mr. Thierry St-Cyr: In that case, I'm going to ask you: what tax transfers does this budget contain? I haven't seen any. When I looked at the budget, I saw no tax transfers.

I'm trying to see how we can resolve the fiscal imbalance if there weren't any tax transfers.

[*English*]

Mr. Mark Carney: I think the question ignores fundamental powers of government at the provincial level. The provinces have the same taxing powers as the federal government, so there isn't the need to transfer tax points. In fact, the decision of the Province of Quebec has been to reduce some taxes over subsequent budgets.

[*Translation*]

Mr. Thierry St-Cyr: In that case, I'm going to ask you another question. I know you can't be partisan. I'm asking you to stick to the facts.

In Quebec, the Conservative Party distributed advertising that claimed, for example, that, if the Liberals were elected, they might take that money back, cut equalization transfers and reduce transfer payments. I'm aware that you can't be partisan, but are they right in saying that nothing, technically, would prevent the Liberal government, or another government, Conservative, NDP or I don't know what, from reducing equalization transfers or transfer payments in the next budget or a future budget?

• (1145)

[English]

Mr. Mark Carney: The measures to restore a fiscal balance outlined in budget 2007 are all on a long-term, sustainable, and predictable track. They all run to 2014, lining up with the Canada Health Act. Provided the budget is passed, those measures will be in place.

[Translation]

Mr. Thierry St-Cyr: Legally, is there anything that prevents this plan from being amended by the next government? Is there anything preventing the next government from reducing these amounts in the next budget?

I know the answer, but I want to know whether you know it as well.

[English]

Mr. Mark Carney: The law is the law. One cannot bind future Parliaments.

[Translation]

Mr. Thierry St-Cyr: I'm going to ask you a slightly more technical question, on equalization more particularly. Currently, under the rule presented by the minister, there is the possibility of including 0% or 50% of non-renewable resources in calculating the tax base. If 100% of resources had been included in the tax base calculations, how much equalization would that have yielded, and what would have been Quebec's share?

[English]

Mrs. Barbara Anderson: I certainly don't have the numbers with me, but we can get them on what 100% would be worth under the status quo, under the new program, and what 50%.... So we will get details.

[Translation]

Mr. Thierry St-Cyr: Thank you.

I have another question. Earlier my colleague referred to the impact of the income tax cut compared to the GST cut. You studied that in relation to productivity. If we had the same amount of money to spend, can you tell us what the most beneficial impact on productivity would have been?

For the same tax expenditure, what would have had the best impact on productivity: a GST cut or an income tax cut?

Mr. Mark Carney: What are the income tax cuts? Your question —

Mr. Thierry St-Cyr: Which would have been the most beneficial?

The Chair: Thank you very much, Mr. St-Cyr.

[English]

We'll continue now and I'll ask a couple of questions.

Various Auditor Generals' reports have been issued over a number of years, outlining the growing concern about offshore flow of capital to lower-tax regions of the world. I want to verify, just for the purposes of clarity, that nothing will stop that from happening in the future. Nothing contained in this year's budget would stop Canadian companies from being able to export capital to low-tax jurisdictions, if they chose to.

Mr. Mark Carney: That's correct.

The Chair: So they'd still be able to do that.

So what's at issue is the interest deductibility of borrowing money on these Canadian assets, writing off the interest charges to reduce Canadian tax obligations so that such capital could be sourced by that leverage. Isn't that the issue that's addressed in the budget?

Mr. Mark Carney: Yes, Chair, you are correct. And I'll go back to Mr. Thibault's question on the use of tax havens.

By using tax havens to make these investments, the indications of the Auditor General and others is the overwhelming number of these investments use tax havens. The reason they use tax havens is to get two deductions, if not more, for the same borrowing, for the same investment. That's what skews the incentive.

The Chair: So in effect the interest to be deducted against a Canadian company is allowed, encouraged in fact, to reduce its Canadian tax obligations domestically, to take the capital and move it to other jurisdictions where it would be subsequently invested as the company would see fit, and that is in essence the reality that has existed for a number of years. Despite recommendations in the report to the previous government, nothing has been done to change that reality.

Now the argument is being made that by forcing Canadian-domiciled corporations to pay this tax they would be made uncompetitive, and therefore—the phrase was used by Mr. Thibault—the economic activities of this country would be hollowed out.

Do you have any facts to present to this committee that would give evidence to the truth of that statement?

• (1150)

Mr. Mark Carney: To support the statement? No, I do not have facts to support it.

The Chair: Are there facts to support such a statement?

Mr. Mark Carney: The government believes the increases in the competitiveness of the Canadian tax system and the Canadian competitive environment through implementing Advantage Canada will help.

The Chair: But surely if we didn't force Canadian corporations to pay any taxes they'd be more competitive.

Isn't it impossible to argue against that statement?

Mr. Mark Carney: Yes.

The Chair: Yes. To be clear, if Canadian corporations did not have to pay taxes of any kind, they would be more competitive, would they not?

Mr. Mark Carney: Mr. Chair, you are correct that Canadian corporations would be more competitive. The changes in the other elements of the tax system that would be necessitated to make up for that shortfall might not make the country more competitive.

The Chair: Good. Thank you, sir. Okay.

In other words, as the phrase has been coined by a number of commentators as well, if we were to continue to reduce corporate tax obligations ostensibly to be competitive with other jurisdictions that have done so, or in fact other jurisdictions that don't impose corporate taxation of any kind, that would be a race to the bottom.

In any case, I'm also interested in knowing what other taxes businesses care about. You have done some extensive work, I'm sure, on the competitiveness ramifications of tax changes in this country. What do Canadian corporations care about when it comes to taxation? What are some of the major taxes they would like to see addressed? Could you comment on that?

Mr. Mark Carney: Thank you for the question.

One of the most important taxes for corporations in terms of what we're told and what our analysis shows is getting the depreciation rates on new capital investment right, so matching depreciation rates to useful life. The department has undertaken an extensive work plan to try to update a number of these estimates. The government has taken a number of decisions that have aligned CCA rates, depreciation rates, with useful life, including in the course of the last couple of budgets.

The second tax probably that Canadian corporations most strongly wanted removed was the capital tax, which was just a dead-weight loss tax, if I may, on capital, a deficit-fighting measure. The times have changed. It was eliminated in budget 2006. There were a number of CCA measures, as I say, in budget 2007 and 2006 as well.

Also corporations are very focused on the marginal or statutory tax rate. The government enacted a two-point reduction in the statutory tax rate in budget 2006 and another 0.5% reduction in the corporate statutory tax rate in 2011 as part of the tax fairness plan. It's part of the legislation for this budget. It will establish a tax advantage over the United States in manufacturing of more than 5% once fully enacted.

So getting on the marginal or statutory tax rates, getting rid of the capital tax, getting the depreciation correct are some of the most important elements. I would say there is one other tax that corporations tell us is incredibly important, which is out of our hands. These are the provincial sales taxes. The government has been discussing the concept of tax harmonization and harmonizing these sales taxes with the GST. That would have a real impact on the incentives for new business investment.

The last point I'll make, Chair, is that there was one other measure in this budget that was important to help our manufacturing sector adjust to both unprecedented competition from emerging markets at a time of globalization and the recent strength of the Canadian dollar, and that was a temporary increase in depreciation—the CCA rate, if you will—for manufacturing equipment to 50%. So effectively it's

an ability to write off new plant and equipment investment over two years, a very important shot of adrenalin, as I think the minister put it, for the manufacturing sector.

•(1155)

The Chair: Thank you very much.

Madam Ablonczy, for five minutes.

Ms. Diane Ablonczy (Calgary—Nose Hill, CPC): Thank you, Mr. Chairman.

I see at this committee the Liberals are dusting off some of their campaign rhetoric and doom and gloom scenarios. But it's pretty clear, I would think, Mr. Carney, that if someone, whether it's an individual or a company, is claiming a tax deduction, it should be against tax payable.

As I understand it, the loophole of interest deductibility has been plugged because there's no tax payable at the end of the day. That is why it makes sense financially that if you don't pay tax, you shouldn't have a deduction. Is that a correct analysis?

Mr. Mark Carney: That is correct.

Ms. Diane Ablonczy: I don't know why the Liberals would want to give a tax deduction to someone who is not paying taxes, but I guess they'll have to explain that one.

Mr. McCallum mentioned the U.K and Japan. I understand, Mr. Carney, that if investors in those countries earn dividends from foreign investments, they in fact have to pay tax on those dividends, whereas if Canadians earn dividends on foreign investments they don't have to pay tax. Can you explain how that works?

Mr. Mark Carney: I'll ask Mr. Ernewein to go into detail, please.

Ms. Diane Ablonczy: Sure.

Mr. Brian Ernewein: I think the question generally suggests the correct answer. With respect to the U.S. and Japan, and I'd add the U.K., which are probably the three largest countries that have a system whereby on foreign earnings—and we're talking all within the multinational group, not individual investors, but one corporation in one country investing in a subsidiary in another country—the dividends paid from the subsidiary to the head office in the U.K. or the U.S. or Japan are all subject to tax when remitted to head office or home office under those tax regimes.

Canada's system for the past 35 years has been actually to not tax or impose any sort of Canadian ownership charge on earnings remitted to Canadian owners, Canadian companies, from their foreign affiliates where it comes out of active business income and where it happens to be a country with which we have a tax treaty. That reflects our objective of having a competitive tax regime with respect to international income.

So the budget proposal that would restrict interest deductions claimed in Canada against investments in foreign affiliates reflects the prior decision, affirmed in this budget, to exempt foreign income of this type from Canadian tax. The income is exempt for competitiveness reasons. Following from that, with the exemption for the income, the expenses associated with it are not to be recognized for Canadian tax purposes.

Ms. Diane Ablonczy: So what's the bottom line? Does all that make Canadian businesses with foreign affiliates more competitive or less competitive relative to other G-7 countries?

Mr. Brian Ernewein: I'd love to give you a single yes or no to that, but the answer is that the change will restrict interest deductions in the future for Canadian companies where they would have been allowed to take an interest deduction in the past. So just viewed in that narrow perspective, it's a tightening change under the Canadian tax system.

Ms. Diane Ablonczy: That's with respect to the taxation of income earned from foreign affiliates.

Mr. Brian Ernewein: Yes.

Where it places Canada vis-à-vis other countries, such as the U.S., the U.K., and Japan, will depend on what happens. If the money is being brought home and there's more money being earned by the foreign affiliate than the interest expense associated with it, our regime is better, because there will be no net tax paid in Canada as a result of those profits. The U.S. system will impose a tax, and even though they gave a deduction for the interest up front, the tax result in our regime, at the end, will be a lower tax bill for the Canadian firm, all in.

But there are other factors. For example, while the income is left offshore, the U.S., the U.K., or Japan, in some cases—not in all cases—will have provided an interest deduction where we have not; and that, on a temporary basis, will be more favourable for them.

Ms. Diane Ablonczy: So what I hear you saying is that you have to look at each country's tax system as a whole before you can make comparisons.

Mr. Brian Ernewein: I believe that's right, and to reference Mr. Carney's remarks, on the whole there have been some very dramatic changes trying to make Canada's system overall more competitive. Our corporate tax rates at the beginning of this millennium were 50% higher than they'll be a decade after that, and that has to be taken into account in terms of calculating overall competitiveness.

• (1200)

The Chair: Thank you very much, Madam Ablonczy.

Mr. McKay, over to you.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Mr. Chair.

Mr. Carney, it's good to see you again. You seem to be looking a little thinner. I hope that has nothing to do with these budget policies.

You have three policies that are in this budget. The first is with respect to income trusts, the rather draconian imposition of a surprise tax; the second is the issue of interest deductibility, which you're familiar with; and the third is the scrapping of the border withholding tax.

Have you considered the combination of those policies? Surely to goodness a policy that makes Canadian trusts cheaper and more prone to be acquired by foreigners is not necessarily good for Canadian economic sovereignty.

Surely a policy that makes it more difficult for Canadian companies to acquire abroad—and it is somewhat disturbing to

hear Mr. Ernewein say it may be on a case-by-case basis as to whether this works or doesn't work—is not good for economic sovereignty.

Surely to goodness it's not good to make foreign companies entitled to buy Canadian companies and be able to in effect get a tax discount because of the scrapping of the border withholding tax.

Surely to goodness that combination of policies has hung out on Canada a huge “For Sale” sign and more than offset any other things you might have done in the budget to have brought corporate taxation rates or depreciation rates or capital taxes more in line with competitive regions. I fail to understand whether in fact you have considered these three policies as making it far more difficult for Canadians to compete in the world.

Mr. Mark Carney: Thank you for the question, Mr. McKay.

Your question relates to competitiveness. The government, in conducting tax policy, looks at fairness and competitiveness in all these policies, particularly with respect to income trusts. You're familiar with the issues there. We've talked a bit about fairness, probably not as much as perhaps we should, on the interest deductibility.

But to go to the competitiveness element of your question, which is there in terms of the proposed elimination of the withholding tax through a new, updated tax treaty with the United States, this will lower the cost of capital for Canadian business. The existence of a withholding tax on borrowing less than five years has raised the cost of capital for Canadian business.

Hon. John McKay: Why would you lower the cost of Canadian capital while eliminating the withholding tax, and then raise the cost of Canadian capital by eliminating the deductions? It's a contradictory policy.

Mr. Mark Carney: You lower the cost of capital by eliminating withholding tax, number one.

Hon. John McKay: Yes.

Mr. Mark Carney: You accept that.

Number two, in terms of the adjustment to the interest deductibility, level the playing field and achieve neutrality between investment in Canada and investment abroad.

Number three—

Hon. John McKay: But there's no reciprocity on the part of any other nation in the OECD. At least with the issue of withholding tax, there is a reciprocity between us and the United States. You gave away something for nothing.

Mr. Mark Carney: The interest deductibility is not a tax treaty issue. It is a domestic taxation issue, so it's not something that one coordinates.

To use up more than your seven minutes, I can ask Mr. Ernewein to go through all the measures that other jurisdictions are taking with the same ultimate end of restricting, either through thin cap or through taxation of repatriation, to end up with a very similar situation internationally—certainly all of our major competitors.

I want to make one point, though, if I may on the trust acquisition element. I'm looking at the acquisition premiums paid for those trusts that have been acquired or that have agreed offers. With only two exceptions, they are all at substantial premiums to the October 31 trading date, the undisturbed trust trading date. So it's not a trust tax change that has resulted in this.

Hon. John McKay: Mr. Carney, what is the difference between a low-tax jurisdiction and a tax haven, in 25 words or less?

• (1205)

Mr. Mark Carney: Mr. Ernewein?

Mr. Brian Ernewein: For this purpose—a low-tax jurisdiction when talking in the context of interest deductibility—what matters is that there's a low-tax jurisdiction with which we have a tax treaty. That's what makes a double dip work.

Hon. John McKay: So Ireland is not a tax haven?

Mr. Brian Ernewein: Its tax rate is lower than ours.

Hon. John McKay: It's a low-tax jurisdiction? Barbados would be a low-tax jurisdiction, not a tax haven?

Mr. Mark Carney: For clarification, that is the terminology of the Auditor General.

Hon. John McKay: I'm glad you're clarifying that.

The Chair: Thank you.

Mr. Del Mastro.

Mr. Dean Del Mastro (Peterborough, CPC): Thank you, Mr. Chair.

Well, here we go again, another day of Liberals standing up for a corporate tax holiday and the Conservatives standing up for broad-based tax fairness. I certainly hope the viewers are paying attention to that.

Mr. McCallum made this point on Friday that he's alluded to, about subsidies for farmers and therefore subsidies for corporations—between which, of course, there's no correlation. Our agricultural industry suffers from more than a decade of poor planning and leadership, and our corporations are actually doing quite well in Canada; hence the support required for our farmers.

Specifically, yesterday the *Toronto Star* made a point that I think is relevant to the discussions today. It said:

Although it makes no sense to allow companies to claim tax breaks against income on which they pay no tax... Dion seems to have it backwards. If a Canadian firm can cut its Canadian tax liability by exploiting the deduction for interest costs on tax-exempt investments made in the U.S., wouldn't the company be more inclined to expand its operations there instead of at home?

In addition to that, you also made the point that Canadian corporations are not overly leveraged. So this isn't a benefit they're exploiting to that great an extent anyway, really. They're not borrowing a lot of money; therefore, they're not deducting a lot of interest.

I think this argument flies in the face of common sense. If you can borrow money in Canada against Canadian assets and invest it elsewhere in a lower tax jurisdiction and then bring the income back into Canada and pay no tax on it, this is not going to encourage the creation of Canadian jobs.

Would you concur with that, Mr. Carney?

Mr. Mark Carney: The policy of the government is that having neutrality across those two jurisdictions makes the most sense, so that corporate decisions are made for business reasons as opposed to driven purely by tax considerations.

Mr. Dean Del Mastro: Right.

You talked about a very broad-based approach to taxation—tax fairness, as we call it. It was outlined in "Advantage Canada", and we spoke very specifically about improving Canada's overall competitiveness by reducing the overall tax rate.

It's very difficult to march back the overall tax rate if we don't have a level playing field, if we don't have tax fairness, isn't it? We'll have some companies that are playing by the rules paying quite a bit of tax, and that will mean that if you have others not paying their fair share, then you can't lower the rate. Isn't that correct?

Mr. Mark Carney: That is correct. The government would like to lower rates for companies, whether they are principally active in Canada or principally active internationally.

Mr. Dean Del Mastro: Okay, that's great.

I'm going to touch a little bit on the income trust issue, because that's the other point that they seem to be bringing up across the way fairly often: pandering to interest groups.

The income trusts have actually rebounded very substantially. There was an article in today's *National Post* that indicated that the index is now virtually where it was on October 1 last year, and there is kind of a green light to buy Canadian income trusts because of the advantages and some of the hot buys that are going on in income trusts. Do you see this as an industry that's rebounding and adjusting to the new tax environment that's there?

The other thing—and I don't know if the department has a view on this—is the increase in the value of traditional corporate shares, and the overall increase in the TSX, which has been extraordinary. These two are not unrelated. Money has gone from income trusts into traditional corporate shares, pushed up the TSX. Well-diversified portfolios have benefited from this economic activity, haven't they?

Mr. Mark Carney: Those are very good points.

Just to put some numbers around those, the income trust index, as a whole, relative to October 31, is off 6.6%, so it has come back quite strongly, as you indicated. The TSX, as a whole—which I would remind members is a \$2 trillion market now—is up 10.4% since October 31. So there has been substantial capital appreciation across a wide range of financial assets in Canada.

• (1210)

Mr. Dean Del Mastro: Thank you. I have nothing further.

The Chair: Thank you.

Committee, I propose that we have another round of four-minute questions, and then at 12:30 we move to dealing with the votes on these estimates. I hope that meets with your approval.

Mr. Pacetti, we'll continue with you for four minutes.

Mr. Massimo Pacetti (Saint-Léonard—Saint-Michel, Lib.): Thank you.

It's not the line of questioning I wanted to start with, but thank you for appearing before us, Mr. Carney.

Can you give me those numbers again? You're telling me that the trust sector has gone back up to the value it was at on October 31 by taking out the REITs?

Mr. Mark Carney: The trust capped index, the S&P/TSX capped trust index, as of yesterday, closed at 154, versus 164.9 on October 31. That's 6.6% down relative to October 31. So it's come back.

Mr. Massimo Pacetti: Right. And you removed the REITs because of course the REITs are not exempt from the income trust fiasco.

Mr. Mark Carney: Yes, I believe that's correct. I will verify that.

Mr. Massimo Pacetti: Yes, of course. You'd see that the numbers are above 10%. The market's still, in the income trust sector and the energy sector—

Mr. Mark Carney: In the energy sector, yes, but the energy section, as you know also, is impacted by the price of oil.

Mr. Massimo Pacetti: Can we get numbers that are accurate, if you can?

We're here to discuss the estimates, so could you take me through the estimates?

We're here to approve the \$78 billion of estimates. I understand most of them are statutory, and we've already voted on them. But on the big one, where's there's a \$1.2-billion difference, when I look at the health transfers, can you just tell me why there's a \$1.2-billion increase? That was according to the health agreement, the health accord, was that?

Mr. Mark Carney: Yes. As you noted, it's a 6% increase, which is under the 2004 accord, which runs to 2014.

Mr. Massimo Pacetti: Is that similar to the other increases, like the \$300 million in the fiscal arrangements of the Canada social transfer? Is that the same?

Mr. Mark Carney: The \$300 million Canada social transfers is—

Mrs. Barbara Anderson: Sorry, Mark. It's similar. It's the legislated amount.

Mr. Massimo Pacetti: It's the legislated amount, but what's in the legislated amount? Is there an increase forecasted for the next number of years?

Mrs. Barbara Anderson: Yes. The legislation expires at the end of this year, and part of the budget proposal is to extend it.

Mr. Massimo Pacetti: This is for the Canada social transfer portion?

Mrs. Barbara Anderson: Yes.

Mr. Massimo Pacetti: If we look at just the operating portion, which is non-statutory, I guess it's vote 1, where the budget's going to go down from \$93 million to \$89 million, is that correct—that's the department's budget? That's your operating budget?

Mr. Mark Carney: Yes. You should view it as a—

Mr. Massimo Pacetti: So that's what we should be questioning you on. Correct?

Mr. Mark Carney: It's a good thing to question on, yes.

Mr. Massimo Pacetti: Yes, okay.

So on the \$3.8 million, you're expecting to not have any more panels? Is that it? I see here you had some money put aside for expert panel and fiscal equalization and a task force on money laundering. That's the bulk of the decrease.

Mr. Mark Carney: That is \$4.1 million of the decrease, yes.

Mr. Massimo Pacetti: Are you not expecting to put out any task forces or expert panels or ask for any advice from external sources?

Mr. Mark Carney: No, we do intend to continue to solicit external advice. In fact, on the issue of international taxation, there was a proposal in the budget to have an independent expert panel to address the broader issues around fairness and competitiveness on the issue of taxation.

Mr. Massimo Pacetti: Are we going to see those numbers in the supplementary estimates?

Mr. Mark Carney: If necessary, it would be adjusted in the supplementary estimates, but not materially. Our expectation is not materially.

Mr. Massimo Pacetti: So the \$89 million that you're going to be spending is pretty well going to cover what you need for operating purposes this year.

Mr. Mark Carney: That is our expectation, yes.

Mr. Massimo Pacetti: Okay.

[Translation]

The Chair: The next speaker will be Mr. Crête.

Mr. Paul Crête: With regard to the capital cost allowance for the tar sands, could you give us the figures of your estimate—for 2008-2009, for example—of the cost of that tax expenditure, the accelerated capital cost allowance for the tar sands?

[English]

Mr. Mark Carney: The question is the current existing cost of having the accelerated capital cost allowance.

• (1215)

[Translation]

Mr. Paul Crête: I'd like to have the figures for the latest years, but also your projection for 2008-2009.

[English]

Mr. Mark Carney: We can come back if we're materially wrong. I think it is on the order of \$300 million to \$400 million. That is the current cost, if you will, of that acceleration, which, as I'm sure you're aware, is being gradually phased out, as the government phases in an accelerated cost allowance for green technology, including for carbon sequestration and storage.

[Translation]

Mr. Paul Crête: 2008-2009 could be the one with the biggest investment phase. Are the figures you're giving me for this year? Could those for 2008-2009 be higher?

Mr. Mark Carney: The figures are for the future.

[English]

To be precise, with respect to what is invested today, you only start to take the deduction when the plant is up and running. That's when the depreciation actually happens, which is one reason why the phase-out period goes to 2015, because people have made investment decisions today—they put the plan in place—and then they start to depreciate in the course...through to 2015.

[Translation]

Mr. Paul Crête: So that's a tax expenditure.

Let's move on to another subject, deductions in respect of interest on loans for investing outside Canada. We know that the Conservatives have come back to the initial position on Technology Partnerships Canada. On that subject, the minister told us that it would be possible to check.

Have you assessed the possibility of drawing a distinction between loans for investments that enable Canadian companies to carry out contracts and loans that are used only to grow the business?

I'm just going to cite an example. One business in my riding has a \$30 million contract in London. It may have to buy a small SME there in order to be able to operate. The tax deduction is justified because it enables it to take its place in a globalization context. However, there may be significant excesses.

Do you evaluate that to try to find a way to eliminate the negative aspect and retain the positive aspect?

[English]

Mr. Mark Carney: I'm afraid I didn't understand the question, whether it was referring to the interest deductibility measure that we've been discussing, or another—

[Translation]

Mr. Paul Crête: Yes, we've discussed the deduction of interest with the Liberals and the Conservatives. There may be a negative effect on fairness, but there's also the question of the impact on the global market of which we are now a part.

Are you currently evaluating the possibility of introducing guidelines that make it possible to retain the positive aspect and eliminate the negative aspect? Have you evaluated the actual situation?

[English]

Mr. Mark Carney: The department is charged with constantly assessing the competitiveness of the Canadian tax system, including for investing abroad and investing in Canada. So in the broad sense, yes, but if there's a specific situation in your constituency, we'd be happy to meet with the individuals and....

[Translation]

The Chair: Thank you, sir.

[English]

We continue now with Mr. Wallace. Welcome to the committee, Mr. Wallace.

Mr. Mike Wallace (Burlington, CPC): Thank you, Mr. Chair.

I apologize for missing your presentation today. I was defending my private member's bill in another committee at the same time. We won't say how that went.

You may have answered all these questions I have for you, but I appreciate the answers. I do appreciate the books. I am one who goes through them and has a look at them.

Let's start with finance. I just want to be clear, so I understand, that we're looking at about a 2% increase over the next couple of years, each year. Is that an accurate statement?

Mr. Mark Carney: In terms of the overall—

Mr. Mike Wallace: Financial resources, spending.

Mr. Mark Carney: Right. The overall votes for finance, which would include all the statutory elements, show a 2.9% increase, yes.

Mr. Mike Wallace: So 2.9%. From what I'm looking at, from 2007-08 to 2008-09 it goes up by about two points. It's on page 4 of this book.

I find it interesting that your actual FTEs go down in the same timeframe. They stay steady the next year. What's the reason for their going down?

Mr. Mark Carney: Thank you for the question.

The principal driver is the move of the Canada savings bond program into the Bank of Canada and the administration of the Canada—

• (1220)

Mr. Mike Wallace: So you lose those people.

Mr. Mark Carney: Yes.

Mr. Mike Wallace: And the funding follows them, I'm assuming.

Mr. Mark Carney: The funding follows, and there are some efficiencies, yes.

Mr. Mike Wallace: Okay. I appreciate that.

I don't want a long dissertation on this, but I understand you are responsible for domestic coinage.

Mr. Mark Carney: Yes.

Mr. Mike Wallace: Have you ever thought about getting rid of the penny? Is that your bailiwick? Any recommendations from your department on that issue?

Mr. Mark Carney: We constantly evaluate the effectiveness of the coinage program. I would note for the committee's benefit that we still earn substantial seigniorage from the coinage program as a whole. There are no plans to eliminate the penny at this time.

Mr. Mike Wallace: No plans. Okay. Your position, as the finance department, is not a policy issue in that area, is that correct? Or is...?

If I as an individual member wanted to push the government to say maybe we should be reviewing the role of the penny in this country, would I do it through the Department of Finance? Or where is that policy decision going to be made? The Mint makes them—

Mr. Mark Carney: Yes, ultimately the Mint, I believe.

Mr. Mike Wallace: Yes?

Mr. Mark Carney: Yes.

Oh, pardon me, it is the Department of Finance. We contract with the Mint.

Mr. Mike Wallace: The Mint actually makes the stuff.

Mr. Mark Carney: That's correct.

Mr. Mike Wallace: You guys decide, I guess, would you not?

Mr. Mark Carney: We do not decide. The minister and the government decide.

Mr. Mike Wallace: This is true.

Mr. Mark Carney: You decide.

Mr. Mike Wallace: On page 17, under "Tax Policy", it shows 244 employees in 2007-08. It goes up by four and then goes down by one.

What are you doing there that's making that change? Are we adding something there or taking something away? I don't know how you're figuring these things out.

Mr. Mark Carney: If I may—this will get me in trouble—that's a rounding error, if you will. I mean, it's a steady-state number of employees, more vacancies in one year, and fewer projected for going forward. The right number is running at about 248. There is no substantial change in either the responsibilities or the level of effort within the tax policy branch as projected for next year.

Mr. Mike Wallace: So when I'm reading these FTEs, are they—

Mr. Mark Carney: No, no, they're precise. They're precise numbers.

Mr. Mike Wallace: They are actually precise numbers.

Mr. Mark Carney: Yes. All I meant was that sometimes there is a shortfall in terms of vacancies. We are not growing the FTEs in the department, as you noted earlier.

Mr. Mike Wallace: Okay.

That's it, Mr. Chair?

The Chair: Yes, it is, Mr. Wallace. But those were good questions, considering your arrival time here.

We'll move now to our two final questioners. We'll begin with Madam Wasylycia-Leis.

Ms. Judy Wasylycia-Leis: Thank you, Mr. Chairperson.

I would first like to ask how you as a department are going to address your inadequacies on fiscal forecasting. That still seems to be an ongoing problem. We've had this discussion many times at our committee.

Given the last budget, the last fiscal year, and the one we're in...or the last two years, we're about \$22 billion out, according to my information. This has resulted, at least in this last fiscal year, in \$9 billion going against the debt without discussion, without dialogue,

without seeking input on priorities, as the government said they would do when they were in opposition.

What are you doing to address this problem?

Mr. Mark Carney: We have Paul Rochon, as the acting deputy minister of fiscal policy, to answer that.

Mr. Paul Rochon (General Director, Economic and Fiscal Policy Branch, Department of Finance): I'll begin with the \$9.2 billion surplus projected for the year that just ended, 2006-07. That's up from the fall update, but from a number that was \$8 billion in the fall update. Now, the fall update number didn't include the full extent of the budget numbers, so if you added those in, that \$8 billion in the fall update would have increased to something like \$14 billion. That's outlined in the budget.

Ms. Judy Wasylycia-Leis: About a year ago you were at \$3.6 billion. In the update it went up to \$8 billion, and we ended up with \$14 billion. So quite a—

Mr. Paul Rochon: That's correct. That reflects a couple of things. First of all, there is a rapid growth in personal income tax collections, which are growing roughly twice as fast as the underlying tax base. That is something we have been looking at and discussing for some time. We have made some adjustment in our assumptions going forward. The point I'd make is that this is not something that's unique to the federal government in Canada. Other countries around the world have experienced the same phenomenon.

As you know, we had a fairly lengthy report by Mr. O'Neill, who appeared before the committee. He made a number of recommendations. We continue to have dialogues with the private sector. We try to explain the risks, to the extent possible. But you have to understand that you are dealing with combined revenues and expenses of about \$400 billion, so a small error on either side translates into a fairly significant change to the bottom line.

Fundamentally, what we're dealing with is how you manage that risk. Our approach is to try to be upfront and as transparent as possible on the nature of those risks.

•(1225)

The Chair: We'll move to Mr. McCallum now.

Hon. John McCallum: Thank you, Mr. Chair.

First, on a point of fact, if the income trusts are down 6% since Hallowe'en, and the TSX, as a whole, is up 10%, the relevant statistic is that income trusts are down 16% relative to the stock market since Hallowe'en.

A voice: Yes.

Hon. John McCallum: That's not my question.

I refer to Mr. Flaherty's favourite economist, Jack Mintz, who said today that Flaherty now has a hornet's nest on his hands. What he is referring to is the fact that while Canadians are in the process of being deprived of the privilege of owning income trusts, it's the big guys with deep pockets who can buy the underlying assets directly and who are retaining the privilege of effectively holding income trusts. I'm referring, as you will be aware, to the large pension plans that are tax-exempt, in the minister's words, and the private equity concerns that arrange their affairs so as to pay little or no tax.

It is a double-barrelled problem, which has been identified by Jack Mintz and others. How is it possibly fair to deprive ordinary Canadians of the benefits of holding income trusts while giving those privileges to the big pension plans and the private equity concerns?

Second, how is it possibly good for the government's revenue base when those previous income trust holders paid lots of tax, albeit personal, whereas the pension plans and the private equity concerns pay little if any tax? It seems to me that the unintended consequence of this policy is bad for federal revenues and grossly unfair in terms of which Canadians—ordinary or privileged—are allowed to continue to benefit from the income trust model.

I'm asking you a double question on both fairness and protecting the revenue base.

Mr. Mark Carney: Thank you.

I have a point of fact, if I may, on the performance of income trusts. One has to add in the distribution of trusts. Since trusts yield 9%, 10%, that 6% is just a capital number. One would add that back in for making a comparative number, and obviously stocks don't.

On fairness, I would note that in terms of Canadian pension funds, particularly large pension funds benefit. The solvency of those pension funds, particularly CPPIB, directly benefits millions of Canadians in terms of the solvency of those pension funds.

Second, on the market test—to very briefly refer to the earlier answer in terms of buyouts and the revenue impact—there are capital gains, and capital gains that are reinvested if this becomes a substantial activity.

Hon. John McCallum: With all due respect, 70% of Canadians don't have these pension plans. That is point number one.

I don't think you have answered my basic question. Why is it fair to deprive ordinary Canadians of this income stream, and why is it good that this income stream falls into the hands of those who pay essentially no tax? Perhaps on capital gains...I'll concede you that point, but they pay essentially no tax on the income streams, whereas the holders of the income trusts paid high personal tax on those income streams.

I don't think you've answered my question. How can you dispute that it's bad for both fairness and tax revenues?

Mr. Mark Carney: On the tax revenue point, as I referenced earlier, there were \$9 billion worth of private equity buyouts last year on the \$2 trillion market, compared to a \$200 trillion total trust market capitalization at that time, so the orders of magnitude here are substantially different.

• (1230)

Hon. John McCallum: BCE is a case in point—

The Chair: No, no, no. Mr. Wallace will conclude with you now.

Mr. Mike Wallace: Thank you, Mr. Chair.

Page 57 has the departmental planned spending and full-time equivalents. You're listing it. Underneath you've got adjustments in supplementary estimates, and the forecast spending for 2006-07 is about \$750 million. You have nothing, or very little, in the planned spending for 2007, 2008, and 2009. Can you explain to me why that

is? Are we not going to see supplements from you guys? What's the scoop?

Mr. Mark Carney: I'm sorry, for clarity, the adjustment supplementary estimates reconciles the main from 2006-07 to what was actually spent, just as in this year, in part because of the budget, and we can go through in detail what the impacts of the budget are. There will be some changes in the supplementary estimates, which will change the total amount the department spent almost exclusively on transfers.

Mr. Mike Wallace: So we only see it during supplementaries that these things tend to get filled in. Then we see what happens.

Mr. Mark Carney: But I can assure you that at this stage the vast bulk of changes, 99%, will be because of the measures to restore fiscal balance that were included in budget 2007, so obviously this committee reviews that.

Mr. Mike Wallace: So one of your organizations here, I'm not sure which, I don't think asked for any supplementaries last year. Is that accurate? I went back to have a look and I think one agency didn't get any supplementary. I can't remember which one it was.

I'll ask another question. On FINTRAC, we have financial resources going down relatively significantly in 2008-09. It continues to reduce, but the staffing stays the same. How is that possible?

Mr. Mark Carney: My opening comments referenced the fact that FINTRAC has already appeared before this committee and that we were going to focus on the budget of the department.

We'll go back to FINTRAC and get you an answer, Mr. Wallace.

Mr. Mike Wallace: Okay, so you're only answering questions—

Mr. Mark Carney: Just on the \$76-odd billion of the department.

Mr. Mike Wallace: On this specific piece. Okay.

The Chair: Just as a closing question, you alluded earlier to a mix on Canada's debt of 40% floating and 60% fixed. Is that written in stone? That's a policy of the debt management aspect of the finance department?

Mr. Mark Carney: It's part of debt management strategy, and the minister does table that each year.

The Chair: Okay. The second thing, on the 60% fixed, is there a policy also on the average term length of the bond?

Mr. Mark Carney: We can—

The Chair: Is there a policy?

Mr. Mark Carney: There is a policy. We make adjustments to that. It is part of the debt management strategy. I'll give you one example. This year we increased the amount of inflation-indexed bonds the government's issuing because they're trading at a substantial premium right now, and there's no information in them for the Bank of Canada.

The Chair: I'm just curious, with the yield curve flattening, I think there's some movement on that policy in terms of longer-term interest rates. They seem to be relatively similar to five-year, versus ten. Isn't that different, in an historical context? I'm wondering if the finance department is looking to lengthen average—

Mr. Mark Carney: Maturity?

The Chair: Yes.

Mr. Mark Carney: It's a very good question. It's a topical issue. We look at it regularly, but the important consideration here is that the federal debt is like a supertanker: it's very hard to move rapidly. That's part of the reason.

We have done substantial analysis showing that the benefit of moving to a higher level of floating rate debt—i.e., to that 40%—will provide the Government of Canada with savings.

One other important point on debt strategy is that part of this budget is a proposal to consolidate the debt of a number of crown corporations, which will result in about \$90 million of saving to the Government of Canada per annum, once done.

The Chair: Just repeat that last point again, the consolidation of crown debts...

Mr. Mark Carney: A number of crown corporations, not all, had effectively issued on their own behalf. They were guaranteed by the Government of Canada and they issued at a slight premium to the Government of Canada, so it's slightly more expensive, 25 to 50 basis points. We're going to bring that in-house and save that amount of money, which can be given back to Canadians or reinvested in priorities of the government.

The Chair: What was the estimate again on savings?

• (1235)

Mr. Mark Carney: It was \$90 million per year.

The Chair: Wow, a \$90 million saving.

Thank you very much for your testimony here today.

Now, members, to the votes.

FINANCE

Financial Transactions and Reports Analysis Centre of Canada

Vote 25—Program expenditures.....\$41,312,000

(Vote 25 agreed to on division)

CANADA REVENUE AGENCY

Vote 1—Program expenditures and recoverable expenditures on behalf of the *Canada Pension Plan* and the *Employment Insurance Act*.....
\$2,607,505,000

(Vote 1 agreed to on division)

FINANCE

Finance Department

Vote 1—Operating expenditures.....\$89,343,000

Vote 5—Grants and contributions.....\$221,200,000

Vote L10—Issuance and payment of demand notes to the International Development Association.....

(Votes 1, 5, and L10 inclusive agreed to on division)

Canadian International Trade Tribunal

Vote 20—Program expenditures.....\$9,306,000

(Vote 20 agreed to on division)

Office of the Superintendent of Financial Institutions

Vote 30—Program expenditures.....\$784,000

(Vote 30 agreed to on division)

The Chair: Shall the chair report vote 1, under Canada Revenue Agency; votes 1, 5, and L10 under Department of Finance; vote 20 under Canadian International Trade Tribunal, vote 25 under Financial Transactions and Reports Analysis Centre of Canada; and vote 30 under the Office of the Superintendent of Financial Institutions, less the amount voted in interim supply, to the House?

Some hon. members: Agreed.

An hon. member: On division.

The Chair: We are adjourned.

• (1240)

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