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—
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Mr. Brian Pallister

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•(1105)

[English]

The Chair (Mr. Brian Pallister (Portage—Lisgar, CPC)):
Good morning, committee members.

Good morning to our witnesses. Thank you for being here.

Thank you to all for submitting the information that you have already submitted. You know that this morning will be limited somewhat in terms of the time available for presentations. I think we notified each of you that you'll have five minutes for introductory remarks.

Welcome again, and thank you very much for being here.

Pursuant to Standing Order 108(2), we'll continue with our briefing on tax havens and tax avoidance. We'll begin with Ben Arrindell from the Barbados Private Sector Association.

Mr. Arrindell, welcome and thank you. You've come a long way, and we appreciate your being here.

Mr. Ben Arrindell (Barbados Private Sector Association):
Good Morning.

My name is Ben Arrindell. I am the chairman of the Barbados Private Sector Association, and I am also the Barbados representative on the United Nations committee of experts on international cooperation in tax matters.

I thank you for the opportunity to address you this morning. The purpose of my address is to attempt to provide some balance to the current debate on the issue of the abusive use of tax havens, and to correct the portrayal of Barbados as a tax haven.

There is no universal definition of a tax haven. Many people, countries, and international organizations have attempted to provide their own definitions. In the debates over the past two weeks, which I have followed, I have seen some suggestions to the effect that any country with a tax rate lower than Canada's is a tax haven. In my view, that is an extremely simplistic view of the matter, and I would suggest that this kind of interpretation is fraught with difficulties.

The OECD, in its initiative on harmful tax competition, back in 1999-2000, focused on four issues in attempting to define a tax haven: a lack of transparency in tax laws and regulation, a lack of exchange of information, a country that levies no taxes or nominal taxes, and a country that encourages businesses that lack substance. With that definition in mind, let me seek to talk specifically about Barbados.

The Barbados strategy for the development of international business and financial services is based on transparency, free and active exchange of information within the framework of a tax treaty, and a lack of bank secrecy and legal impediments in its domestic laws to the exchange of information. Based on its commitment to these factors, and taking into account Barbados' compliance with these factors, the OECD removed Barbados from the list of tax havens, without Barbados having to sign any commitments to the OECD.

Since the OECD initiative, and since Barbados was removed from that list, there has been a grey network of double taxation agreements that have been signed and concluded by Barbados with OECD member countries. I think this is an indication that such countries do not regard Barbados as a tax haven. The Netherlands and Austria are just two examples of countries that have signed full double-taxation agreements with Barbados.

The OECD talked about low taxes. I've seen a number of references to this in this debate. I should mention that this only applies to certain entities involved in certain activities. These are the activities that Barbados has targeted for future economic growth—for example, the international business and financial services. But we also have incentives to encourage tourism, manufacturing, and so on.

The provisional incentives to investors are not unusual, as many countries, both developed and developing, offer such incentives—and this includes Canada. In that respect, Barbados is no different from other countries. I should mention that Barbadians can also own the entities that are specially tax-privileged.

I turn now to the Canada-Barbados treaty relationship. There has been mention of the fact that apparently Barbados has changed its legislation since the treaty was introduced. That is not the case. The treaty was signed in 1980, and at that time Barbados had international business companies that were able to benefit from a low tax regime. A testament to this is the fact that IBCs are excluded from being able to benefit from the Canada-Barbados treaty, so they did exist at that time.

Finally, I'll just talk very quickly about the contribution to Barbados of the international business and financial services sector, in terms of its contribution to foreign currency earnings, government revenues, jobs, tourism, development of specialized skills and transfer of those skills to Barbadians, and development of technology.

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

We'll continue with the Canadian Labour Congress representative, Erin Weir. Welcome. It's over to you, Erin.

Mr. Erin Weir (Economist, Canadian Labour Congress): Thanks very much for having me before this committee.

Broadly speaking, I think there are two ways in which Canada can address the issue of tax havens. The first is to continue to reduce Canadian corporate taxes to in effect make Canada itself a tax haven. That seems to have been the thrust of Canadian tax policy over the past decade.

The other option, and the one I'm going to be supporting, is that Canada can structure its tax system in a way that collects appropriate corporate tax revenue despite the existence of tax havens offshore.

In particular, I'd like to focus on the issue of interest deductibility, which has become entangled in this debate about tax havens. Yesterday the Government of Canada announced that it would continue to allow corporations, for the most part, to deduct from their Canadian taxes interest on loans to finance their foreign affiliates.

The proposal I would like to put to this committee is that if the government is going to implement that plan, it should also begin taxing the income of foreign affiliates of Canadian corporations.

The basic principle of corporate tax is that it should apply to profit, which is income minus the expenses incurred in generating it.

Prior to the last federal budget, corporate Canada was having its cake and eating it too. It wasn't paying any tax, or was paying almost no tax, on the income of its foreign affiliates, but at the same time it was able to deduct the financing costs of those affiliates from its Canadian taxes.

What budget 2007 proposed to do was to put Canada's corporate tax system on a purely territorial basis, so that Canada would tax income generated in this country and allow the deduction of expenses incurred in generating that income.

The criticism of that budget measure was essentially that Canada needed foreign affiliate interest deductibility in order to be competitive, because other countries had that type of deduction. What critics neglected to mention, of course, was the fact that other countries that allow that deduction, such as the United States, Britain, and Japan, also tax the incomes of the foreign affiliates of their corporations. In other words, they tax corporations on a worldwide basis, including the incomes of foreign affiliates, and allow the deduction of the expenses of those affiliates.

I'd just like to read into the record a quotation from Bruce Bartlett, in his brief analysis of corporate taxes for the National Center for Policy Analysis in the United States. The quote begins:

The United States' tax system is "worldwide," requiring domestic companies to pay taxes on income earned abroad.

Thus, for example, a territorial company that incorporates in Canada pays taxes only on its operations in Canada. If it has a U.S. subsidiary, the subsidiary pays U.S. taxes on its profits here, but none to Canada. However, due to the U.S. worldwide tax system, the exact same U.S. company with an identical Canadian subsidiary will pay Canadian taxes plus U.S. taxes on its Canadian operations. The U.S. company will pay more total taxes even if the United States and Canada have the same tax rates.

Of course, Canada will now have lower tax rates than the United States. So it seems that we're headed in the direction of becoming a tax haven ourselves.

To put the Canadian corporate tax system back on a consistent basis, what I would propose we need to do is start taxing Canadian corporations on a worldwide basis. That would put them on exactly the same footing as their American, British, and Japanese competitors, where they would be able to deduct the interest costs of setting up these foreign affiliates and then would have to pay Canadian taxes on the incomes of those foreign affiliates.

A final benefit of this plan is that it would guard against tax havens, because Canadian-based companies would be taxed at the Canadian rate on all of their activities in the world. For example, if a Canadian company were to set up a foreign affiliate in Barbados, it would pay the Barbados corporate tax and then would be able to deduct it from the Canadian tax it would pay on those operations. But overall, it would face exactly the same tax rate on its operations in Barbados as on its operations in Canada.

In addition to the fact that I think this just makes rational sense from a theoretical perspective and would put the Canadian tax system on a consistent basis, I also think it would go a great distance towards guarding against tax havens.

Thanks very much.

• (1110)

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

We'll continue now with Brigitte Alepin, chartered accountant and fiscalist.

Welcome. You have five minutes, Madam.

Ms. Brigitte Alepin (Chartered Accountant, Fiscalist, As an Individual): Thank you.

[*Translation*]

You ask me how we can solve the problem of tax havens, and this is an enormous issue. I've spent several years trying to answer that very same question. I should like first to clarify one point: when we are asked to solve a problem, we are not asked to solve the consequences of that problem. In dealing with the problem of tax havens, the Canadian government often makes the mistake of focusing solely on the consequences of tax havens. By dealing with a tax agreement of which Canada is signatory, or any of the tax laws you are referring to, we always deal with the consequences of the problem. Therefore, even if we were to find the perfect answer, the problem of tax havens would continue to exist. Since you are asking me to make suggestions on how to solve the problem, I assume that you are prepared to think in broad terms and that you want to solve the problem, rather than its consequences.

In attempting to find solutions to the problem of tax havens, I try to picture the situation. It is akin to a spectator who stands up alone in the middle of a seated crowd. And then, on his own he decides to watch the show standing up. Similarly, tax havens like this standing spectator, take advantage of the situation. In fact, other countries, including Canada remain seated. If we were to decide to imitate the spectator and all of us watch the show standing up, the spectator like the tax havens would lose their marginal advantage. They would therefore lose all of their benefits.

Regardless of how we complicate the situation, we always come back to two distinct possibilities: we can either ask tax havens to take a seat, or ask countries, such as Canada, for instance to be the victims of the situation, and accordingly ask taxpayers to allow this injustice to continue. In talking about tax havens, it is mostly a matter of intuition. In Canada, tax history dates back only 60 years. In terms of the global tax experience, tax havens are a relatively new problem. My impression is that if we were to ask other countries and Canadian taxpayers to keep on supporting the tax unfairness and injustice cause by tax havens, we might challenge them.

If some of you are skeptical and believe that the taxpayer is a passive being, incapable of rebelling, but capable of enduring this kind of injustice for long, I will remind you that America resulted from the Boston Tea Party. If I may say so, there are plenty of taxpayers who are simply fed up.

If we want to solve the problem of tax havens, there is only one choice: that is to ask those countries to follow the same rules as other countries, and sit down. One thing is certain: we will not reach that goal overnight. We must deal with this issue internationally. In the context of globalization, there are organizations that deal with a vast array of issues, including health, labour standards, and so on. However, since the advent of globalization, there is not a single world organization that is dedicated exclusively to tax matters. The OECD is not what I am alluding to now.

To my mind, this is the only way to establish a consultation table that would bring together all countries that are being treated unjustly because of tax havens. Together, we can talk about real issues loud and clear in an effort to convince the representatives of tax havens to sit with us so we can view together the show that is unfolding on the international stage.

Thank you.

• (1115)

[*English*]

The Chair: Merci, Madame.

We continue now with Professor André Lareau, from Laval University.

[*Translation*]

Welcome to the committee, sir.

Mr. André Lareau (Professor, Laval University): Thank you and good morning.

Canada has made a choice in its legislation. My comments will focus more on these legislative choices so that we can find solutions to solve the problems associated with tax havens.

In order to tax a Canadian company, the notion of residence must be taken into account. Residence must be initially established in order to levy taxes in Canada. A company located in Canada pays taxes on its global income. Of course, companies which have decided to lessen their tax burden have opted to put aside the notion of residence and go somewhere else. A foreign entity, in the form of a company, is then created in a tax haven such as Barbados, even though Barbados does not constitute a tax haven according to several economists, because tax rates are extremely low for IBCs, International Business Companies, and hover between 1% and 2.5%.

This is where the problem arises: under the current notion of residence as we know it, a company, even though established in Barbados, can be considered as residing in Canada if the control centre of that company is located in Canada. During a trip to Barbados in 2004, I quickly realized that for the sum of a few dollars, many professionals working in Barbados offer their services to incorporate a company. As such, one can easily find columns of professional plaques displayed in many of the law firms operating in Barbados. One simply needs to go to the Registrar's Office or to the Corporate Office to find a list of many companies that ultimately reside in Canada. A quick visit will reveal that there are many companies in Barbados, but that pay their dividends to Canadian residents.

Of course, Barbados has a tax agreement with Canada, as was mentioned earlier, and that even excludes IBCs. Yet, Canadian regulation, no. 5907(11.2)(c) specifically excludes entities created in Barbados, subjects them to Canadian tax and allows such entities to pay dividends to the Canadian parent company tax-free, something that is the exclusivity of companies that are subject to the agreement. However, the famous 5907(11.2)(c) regulation brings Barbados back into the fold, with regard to the pay out of tax-free dividends. This is an aberration.

Therefore, the first thing that must be done is to change the notion of corporate residence, doing somewhat what the Australians have done, a new notion of residence dealing specifically with directly or indirect shareholders with voting rights.

There is a second problem that also arises. When a company in Barbados pays dividends to the Canadian parent company, the dividends are not taxed. The Canadian company will then pay out the dividends to its shareholders, and perhaps individuals. The Canadian tax law includes the concept of integration which allows for a Canadian shareholder to receive a tax credit on dividends received, in order to compensate for the taxes paid by the company, thereby avoiding double taxation.

For example, suppose I were a shareholder of Bell Canada stocks or any other tax paying company. I receive my dividends, but I also receive a tax credit to compensate for tax paid by the company. This is an illustration of the concept of integration. Yet, if the dividend is received by a Canadian company that prior to this received funds from the Barbados subsidiary, no taxes are paid. Despite all this, a Canadian shareholder or individual is given a tax credit to compensate for a tax that was not even paid in the first place. Once again, this situation cannot be tolerated.

Lastly, there is the notion of disclosure. We cannot control what we cannot see. In 2005, the United States introduced *Circular 230*, an obligation to disclose aggressive tax schemes.

• (1120)

I therefore include in these aggressive tax schemes the planning to integrate tax havens, and thus the requirement, in all tax planning, to inform tax authorities. England passed a similar measure in 2004 called the tax avoidance scheme.

Thank you.

[English]

The Chair: Merci, Monsieur.

We conclude our presentations now with Mr. Walid Hejazi. He's a professor at Rotman School of Business.

Welcome, to you, sir. Five minutes is yours.

Mr. Walid Hejazi (Professor, International School of Business, Rotman School of Business, University of Toronto): Thank you very much, and thank you for the opportunity to speak to this committee on a topic that's very much related to the research I've been doing for the last decade.

The Government of Barbados has sought to contribute to the academic discourse on international business, especially as it relates to the longstanding relationship between Barbados and Canada. This study is part of that initiative, and the ongoing analysis of that longstanding relationship will involve researchers and academics from the University of the West Indies and the Rotman School of Management and others.

The objective of this study was to look at the effects of that longstanding relationship between Canada and Barbados on the Canadian economy. The results of the study clearly establish that the Canada-Barbados relationship has in fact enhanced the global competitiveness of Canadian multinationals.

Policy changes that adversely affect this relationship would hurt those multinationals, but more importantly, policy changes that adversely affect that relationship would negatively affect the Canadian economy broadly based. There would be reduced Canadian trade, Canadian employment, and Canadian business investment. It is incorrect to assume that changes in that relationship would necessarily result in increased government tax revenue in Canada.

To put this discussion into a broader perspective, let me take you back to 1970. In 1970, for every dollar of investment Canadians had invested abroad, there was \$4 invested in Canada. Canada was very much a host economy to foreign investment. Here we are 37 years later, when Canadian multinationals have more investment abroad than there is foreign investment in Canada. The pace at which Canadians have expanded abroad far outpaces the rate at which foreigners are investing in the Canadian economy.

When you dig deep into this data, two results clearly stand out that I think are very important for this committee to consider. First of all, when you look at the data, Canadian multinationals are increasingly locating outside the United States. Increasingly, multinationals are opening markets for Canadian exports in Latin America and East

Asia and in Europe. Second, much of these investments is facilitated by conduit jurisdictions like Barbados.

The next point is incredibly important to make, and I'm going to try to say it as clearly as I possibly can. Because Canadian multinationals are going into increasingly unfamiliar environments outside the traditional market, the United States, they're faced with a lot of risk, a lot more risk than they would face when they went to their traditional markets. Therefore, it's very difficult for these Canadian multinationals to compete against companies from the United States and Europe that have longstanding relationships with these markets.

Allowing Canadian multinationals to access these markets through a conduit jurisdiction such as Barbados results in a reduction in the cost of capital for these multinationals that results in the multinationals being more competitive and therefore better able to compete in the global marketplace.

There's a widely held view that simply because a Canadian multinational uses the conduit jurisdiction and there's a tax benefit associated with it, somehow this is bad for Canada. Well, the study I've worked on and the study that was cited to this committee last week by Professor Hines from the University of Michigan clearly show that you need to go beyond that very simple view. The simple fact that there's a tax benefit associated with using these conduit jurisdictions does not mean that the use of these conduits is somehow bad for the Canadian economy.

I want to point out one important distinction between a tax haven and an offshore financial centre. In the handout I circulated to the committee, on page 6 there's a really nice quote from the OECD, which clearly states that Barbados is not a tax haven. There's a fundamental distinction between a tax haven and an offshore financial centre, and it's fundamentally important that, in creating policies that relate to offshore financial centres and tax havens, this distinction be well understood.

The final point I want to make is that when a Canadian multinational accesses an economy in Latin America, the impact on Canadian economic activity is significantly larger than if that Canadian multinational had gone directly to those markets. When a Canadian multinational goes to Latin America through a conduit such as Barbados, that Canadian multinational experiences a reduction in the cost of capital. It's more competitive, and this results in increased production within Canada to service those foreign markets. There will be increased Canadian trade, increased Canadian employment, and so on.

• (1125)

The last two points I want to make are these. The results indicate that changes in the current use of Barbados would hurt the Canadian economy, broadly based; there would be reduced Canadian trade; there would be reduced Canadian production. And furthermore, you cannot assume that tampering with that relationship will result in enhanced tax revenue for the Canadian government.

Thank you.

• (1130)

The Chair: We begin our questions with Mr. McKay. You have seven minutes, Mr. McKay.

Hon. John McKay (Scarborough—Guildwood, Lib.): Thank you, Chair, and thank you, presenters.

The first point made by Mr. Arrindell and also made by Mr. Hejazi is that Barbados is not a tax haven. I think you've driven home that point. So if anybody, including the minister, refers to Barbados as a tax haven, it would be an error; I assume that's correct.

Mr. Ben Arrindell: I'm sorry, can you repeat that?

Hon. John McKay: It's simply a very small point, that you made a great effort to distinguish between Barbados and other offshore tax jurisdictions, and you want to say that Barbados is not a tax haven. I thought that was your essential point. Is that correct?

Mr. Ben Arrindell: Absolutely.

Hon. John McKay: Okay.

So anybody who refers to Barbados as a tax haven is just in error.

The Chair: Mr. McKay, I will not take this off your time, but I would want clarification from both witnesses.

It's my understanding that the OECD quote you referred to and the other reference you made to Barbados not being a tax haven in fact relate to a statement from the OECD that removed Barbados from the list of uncooperative tax havens to the list of cooperative tax havens. Is that correct?

Mr. Ben Arrindell: You have to make the distinction, because there is no such list of tax havens, as I understand it, within the OECD.

The Chair: So to be clear, removing Barbados from a list of uncooperative tax havens does not make the statement that you've made, that Barbados could not be defined by the OECD as a tax haven.

Mr. Ben Arrindell: I do not agree with that interpretation.

The Chair: Thank you.

Mr. McKay.

Hon. John McKay: I think precision of language is extremely important here. It becomes a pejorative exercise when it gets referenced as a tax haven, and that somehow or other everybody is getting off with a lucky break, which is frankly nonsense.

I want to get to Mr. Hejazi's testimony, and I appreciate the chair's not interfering with my time. Thank you.

You talked about the risk premium associated with investing outside of Canada, when going into foreign markets. Can you quantify that risk premium and say why it's such a necessary thing when Canadian companies go to invest in Latin America or other non-traditional markets?

Mr. Walid Hejazi: That's an excellent question. I would like to do a study exactly on that, because obviously the risk premium would vary from industry to industry, but country to country. What we do know is that the risk premium is increasing in markets that are decreasingly familiar to Canadian multinationals. Canadian multinationals, for example, have a long history in Latin America relative to, say, east Asia, so the risk premium within Latin America would be less than it would be in east Asia, for example. Quantifying the risk premium is a difficult question, and one that would be worthy of further study.

Hon. John McKay: You make a statement that is in some respects counterintuitive, which is that these forms of investment are in fact good for the Canadian economy. When Canadians are listening to that, they're thinking: how could that possibly be? All they're doing is getting a tax break and reducing their tax.

And yet even in my own riding, for goodness' sake, I can see that these kinds of investments are good for the Canadian economy. Who does all those back office jobs for these foreign acquisitions but people from Scarborough?

I understand it intuitively, but can you explain it and amplify it further so that Canadians start to understand that what's at risk is actually Canadian jobs?

Mr. Walid Hejazi: As Canadian multinationals expand abroad, the headquarter activities within Canada increase. That's number one. So we've seen a lot of discussion in the media about this sphere of headquarter activity.

Secondly, the evidence is very clear. This is true within the Canadian, American, and European contexts that when multinationals within any particular country move abroad, it's complementary to domestic trade.

So when the Canadian multinational moves into the U.S. or Latin America, it increases its footprint in that foreign jurisdiction. When it increases its footprint in that foreign jurisdiction, this increases the demand for Canadian production. So jobs within Canada increase to service those markets that are opened by the presence of Canadian multinationals in those foreign jurisdictions. The evidence is very clear on that.

But secondly, much of the income that's generated in those foreign jurisdictions flows back to Canada, and when it is paid out to individuals, to shareholders of these multinational companies, those dividends are taxed.

When the money comes back to a Canadian multinational, it may escape taxation at one level. But when that income is paid out to shareholders—and almost every Canadian has stocks in their RRSPs—the dividend payments that they receive are much higher as a result of these Canadian multinationals being more competitive in the global economy.

• (1135)

Hon. John McKay: I can see how it works for the big guys in the head office. I can see how it might work for shareholders. What this committee is generally concerned about is the average person on the street. How is it good for them?

Mr. Walid Hejazi: Forty percent of the Canadian GDP is exported to the global economy. So something on the order of half of international trade is intermediated by multinationals. This means that trade is not a company in Canada exporting to a party in the U.S. that's unrelated. It's all done within the multinational, because in this global economy, multinationals have to tap into global supply chains. It's part of the multinational network to service foreign markets.

To think that a Canadian company is going to sit inside Canadian borders, produce goods, and export them to the global economy without using a multinational network is simply incorrect.

[Translation]

The Chair: Mr. Crête, you have seven minutes.

Mr. Paul Crête (Montmagny—L'Islet—Kamouraska—Rivière-du-Loup, BQ): Five minutes?

The Chair: Seven minutes.

Mr. Paul Crête: Thank you, Mr. Chairman.

If I understand correctly, Mr. Lareau, Ms. Alepin and Mr. Weir, each year it is currently estimated that approximately \$4 billion worth of profit that returns to Canada from Barbados, is not taxed. We are therefore talking about perhaps \$800 million that is not taxed, and this is on top of the tax credits Mr. Lareau just finished talking about. Can you illustrate the impact this may have on tax fairness?

Mr. Hejazi is saying that this is good for the economy. This is a completely amoral approach. This is strictly an economic calculation. Perhaps Mr. Weir has something to add. I'd like to hear your comments on this.

From what I gather, someone who earns \$35,000 a year must pay on his salary a substantial amount of taxes to allow companies to earn money elsewhere, without his knowledge. Am I wrong in saying this?

Mr. André Lareau: You are completely right. Tax fairness is about redistribution according to the needs of Canadian taxpayers. When we talk about the needs of Canadian taxpayers, we talk about health and education that fall under respective areas of jurisdiction; and of course, we talk about having sufficient financial resources for the government to allocate these funds.

If there is less money coming in, it is true that there will be more people who will benefit from tax havens, to the extent that the door will be left wide opened. There is only a handful of people who are able to benefit from tax havens, whereas everyone else, unfortunately, will remain exactly where they are, and not draw a single benefit. It is true that jobs in Barbados are created. There are certainly Canadian companies that are able to benefit and possibly create jobs. But ultimately, tax fairness is certainly not being achieved. This is abundantly clear.

Mr. Paul Crête: Yes, Ms. Alepin.

Ms. Brigitte Alepin: I share your concern. Last year, I worked on a research project at Harvard University with Professor Brian Mandell, who is a former Canadian professor. We could talk about this issue extensively, something I would like to do. When we allow for a minority of taxpayers, who happen to be the most affluent, to benefit from tax havens on a global scale—something Canada is not alone in permitting—we are jeopardizing the entire process of voluntary contribution on which our freedom is based. If this process is put in jeopardy and that people can no longer trust the tax system, how can we continue functioning on the planet? This might be a utopic, perhaps feminine way of expressing it, but I believe that there is also an economic solution. For example, in the process of globalization that also affects capital, given the mobility of capital we must have a centralized tax system. This must be achieved at some point. I believe that Canada could raise this issue at the negotiating table. If we don't, we will be swimming upstream. By not acting, citizens across the world will say that multinationals are not paying taxes, and that this is unfair. We are working against the

economy and the goals that we want to reach. If we want globalization to work well for us, multinational companies must pay their fair share of taxes so that ordinary citizens across the world will accept the process of globalization.

• (1140)

Mr. Paul Crête: I would like you to tell us about the economic impact, perhaps in response to what Mr. Hejazi said. What is the true economic impact of this situation on the Canadian economy, as well as on tax fairness?

Mr. Erin Weir: I will answer in English.

[English]

Dr. Hejazi, I think, made the argument that investment in foreign affiliates abroad helps the Canadian economy in a variety of ways. That can be true, and I think we should wish Canadian corporations well in foreign markets. But there's no question that if our goal is to encourage activity in Canada, it makes sense to structure our tax system to promote activity in Canada rather than to promote Canadian investment in foreign countries and hope that some of the benefits trickle back to Canada. That's just a matter of common sense.

So certainly I believe that the effect of tax havens on the Canadian economy is bad both in terms of drawing investment out of Canada and in terms of reducing the tax revenues available to the Canadian government to promote economic activity here. That's essentially my response in a nutshell.

If Canada were to adopt a worldwide system of taxation for Canadian-based corporations, the effect it would have is really to shield us from these tax havens, because Canadian companies would pay the Canadian tax rate regardless of where they operated in the world. If they wanted to have a foreign affiliate in Barbados that—

[Translation]

Mr. Paul Crête: Developing elsewhere cancels out the detrimental effect on the Canadian economy. If there is universal taxation, they may then decide that there are other reasons to invest, and this might possibly be to the advantage of the Canadian economy.

Mr. Erin Weir: You are right, it is exactly that. The United States, England and Japan use a similar system, and it works well.

Mr. Paul Crête: How is it that Canada is lagging behind in that regard? Why have we not acted? There have been recommendations made by the Auditor General and plenty of other people. Why are we so hamstrung?

Mr. Erin Weir: I do not know why. I have noted that major companies bear great influence on governments. What we have to do is clear, you are right in saying that nothing is being done.

Mr. Paul Crête: Ms. Alepin.

[English]

The Chair: We'll continue with Mr. Del Mastro for seven minutes.

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

I have appreciated the input from all of the members of the panel today. I think actually there may be some support for what everyone is saying. Even though it appears as if several witnesses are coming from opposite sides, I think there may be some merit in several points that have been made.

Mr. Hejazi, I read your report—thank you for sending it to us in advance—and I was able to study it. One of the things that occurred to me is that you're coming to some conclusions I happen to agree with. But I think they're symptomatic of another problem that we have here in Canada, that corporations are seeking this as a solution to being competitive, when really, maybe the case you're making is that Canada is on the inverse side of the tax curve when it comes to corporate taxation.

Do you care to comment on that?

Mr. Walid Hejazi: I could talk about another study I did for Industry Canada that looked at the role of domestic taxes at the industry level to try to explain why Canadian multinationals are moving abroad. That study is different from the one I circulated.

Basically, I think, to answer your question, we have to understand why Canadian multinationals are moving abroad. If Canadian multinationals are moving abroad to exploit a firm, specific advantage, to open foreign markets to Canadian exports and Canadian talent, that's a good thing, and we should applaud it. On the other hand, if Canadian multinationals are moving abroad because of a poor competitive environment within Canada, that's a bad thing.

There's evidence that both of these things are at play. For example, I know in some industries a lack of skills, a lack of technology, and a lack of research and development are important factors that help explain why Canadian multinationals move abroad. On the other side, some industries within Canada are globally competitive, and multinationals are deciding to locate here. Think of the new Toyota production facility in southwestern Ontario.

The answer to your question is that in many industries, that's exactly the case; there's some underlying competitive issue within Canada, and we as Canadians need to think about how to fix those things.

• (1145)

Mr. Dean Del Mastro: If we draw that into the context of what the committee has assembled on, specifically the study of tax avoidance and tax havens, certainly no one would argue with the fact that Barbados is a low-tax jurisdiction. When we look at the use of low-tax jurisdictions by Canadian corporations, certainly nobody can make the argument that they're using Barbados because there are skills there that aren't in Canada, or that the financial services sector there is providing a service superior to what they could acquire here at home; they're using it so they can get a competitive advantage, so they can be competitive in foreign markets, and I understand that.

I also appreciate your point that the risk to access new markets is high, and it's important that we do access new markets; it's becoming a very global economy.

I want to talk a little bit about the corporate tax rate in Canada Mr. Weir mentioned. I don't think Canada needs to move towards being a tax haven, but I do think that the Government of Canada talked

specifically in *Advantage Canada* about a timeline to reduce the corporate tax rate down to 17%. We have gotten rid of the corporate surtax, and we will have reduced the corporate tax rate to 18.5% by 2011. Where do you see that Canada needs to be with respect to corporate taxes? Largely, the lower tax rates become, the less incentive there is for tax avoidance. We see that in black market economies and in every instance domestically and internationally that high tax rates encourage tax avoidance. Where do you see what I would call the best tax rate for Canada? It may be a moving target, but where do you see it right now?

Mr. Walid Hejazi: I'd like to start by saying I'd like to invite you to the Rotman School, because we could write several papers together on these topics you've raised.

I think the fundamental point that you're raising is a very good one. Before I answer your question, I want to say the following.

Making it more difficult for Canadian multinationals to access the global economy without policy changes to improve the competitiveness of the Canadian economy would hurt multinationals, but more importantly, it would hurt the Canadian economy, broadly based. If you want Canadian multinationals to do more investment in Canada, the right way to do it is not to mandate it and the right way to do it is not to make it more difficult for them to access the global economy; the right way to do it is to make it more attractive to invest in Canada. The dean of the business school, Finn Poschman, and many others have made the point that tax rates in Canada are very high. Some people say you should eliminate the corporate tax rate altogether, and tax that income when it actually flows to investors.

I'm not sure what the right tax rate is, but one thing on which there is a consensus is that within Canada corporate tax rates are very high, they're not competitive, and they're hurting the Canadian economy.

Mr. Dean Del Mastro: Thank you.

I will let you in now with a comment, Ms. Alepin.

Ms. Brigitte Alepin: Thank you.

[*Translation*]

I have asked myself the same question and I also took part in a study commissioned by Harvard University on the matter. I took the annual reports of 50 of the largest Canadian companies ranked this year and calculated their effective tax rate. The effective tax rate is the true amount of taxes paid by multinational companies. The effective tax rate of Canadian multinational companies is the same as rates paid by SMEs.

SMEs represent 98% of Canadian companies. If we want SMEs to become major corporations one day, they must be given favourable tax rates. Along the same lines, it was also said that SMEs must assume additional costs. The future of globalization depends on our ability to transform SMEs into major corporations.

If SMEs are taxed at the same rate as Canadian multinational companies, we are creating an obstacle that they cannot overcome in order to become major companies. I have proof of this, because I analyzed the list of the 1,000 largest Canadian companies, ranked by the *Globe and Mail*. Since this was a major undertaking, I focused on only 200 of the largest Canadian companies on this list. Over the last 20 years, no SME, aside from Calfrac Well Services, has become a major corporation.

In analyzing tax rates for multinational companies, do not forget to put them into perspective with the tax rate paid by SMEs. SMEs also need a helping hand in this globalized society.

• (1150)

The Chair: Thank you very much, Ms. Alepin.

[*English*]

Thank you, Mr. Del Mastro.

We continue with Madam Wasylycia-Leis now, for seven minutes.

Ms. Judy Wasylycia-Leis (Winnipeg North, NDP): Thank you very much, Mr. Chairperson, and thanks to all of our presenters today.

I think it's important to start off with the question of these tax incentives for corporations vis-à-vis creating a strong Canadian economy, something that Walid has focused on.

There's another side to this whole argument that I'd like to ask Erin, Brigitte, and André about, and that is, we've seen over the last ten years significant reductions in corporate taxes. There was a huge corporate tax break under the Liberals to the tune of about \$10 billion over five or six years. We've seen tax havens continue to the present and not addressed. We've seen all kinds of benefits on the corporate side but no return, as far as I can tell, in terms of investment in Canada.

So I think we need to address that for a moment before we go back to the issue of tax havens, because there is that whole side to the equation that needs to be addressed.

Erin.

Mr. Erin Weir: I think it's a critically important piece of context that Canadian corporate taxes have been cut to the bone in recent years. They're much lower than American and Japanese corporate tax rates, for example.

As a result, corporate profits have increased to their highest level, relative to gross domestic product ever. Since we started keeping those statistics, we've never seen corporate profits as large, as a share of the economy, as they are now.

The flip side is that business investment in the Canadian economy is at very sluggish levels. It's at low levels compared to where it's been at other points in Canadian history and compared to where it is in other countries. So it's certainly not clear that these corporate tax cuts have produced a lot of economic benefits. The case for further corporate tax reductions is really questionable.

I'd also point out that one consequence of corporate profits being so large is that the cost of corporate tax cuts is also very large. We're

talking in the tens of billions of dollars from cuts that have already been made. So you're absolutely correct about that.

Ms. Judy Wasylycia-Leis: Brigitte, do you want to add anything [*Translation*]

on the issue of competition between companies in Canada?

Ms. Brigitte Alepin: My fellow panellist touched upon the crucial issue of tax rate that should apply to our Canadian companies. I always compare these rates to rates that are imposed on SMEs. SMEs constitute the engine of the economy. We therefore must make sure that they benefit from a more favourable tax rate than large companies. In fact, this is written in all documents, interpretive bulletins and documents on deductions for small businesses.

Indeed, Canadian tax rates are surprising. I wonder why our tax rate is lower than that of the U.S. We have an abundance of resources that attract companies. We do not necessarily need a tax rate that is 5% lower than that of the U.S.

• (1155)

Ms. Judy Wasylycia-Leis: Thank you.

I have another question, and it is for Mr. Lareau. Perhaps you can answer both questions at the same time.

[*English*]

The Liberals would like me and us to believe that when we think about Barbados and other tax havens, this is a figment of our imagination. I doubt that Mr. Arrindell would be here if there wasn't some advantage for him to attract Canadian businesses that's not offered in Canada.

There was a recent study at the University of Quebec that showed that major corporations and banks have used tax havens to avoid paying \$10 billion in taxes since 1981.

The study goes on to say that in the House of Commons a few years back, when Scott Brison was still in the Conservative side of things, he said:

The tax treaty with Barbados is a special case because of the fact that there is a disproportionate percentage of Canada's foreign direct investment in Barbados that does not make sense given the size of its economy and the nature of the investment.

In 1994 Paul Martin closed a bunch of tax havens and said: "Accordingly, we are taking measures to prevent companies from using foreign affiliates to avoid paying taxes." Then he proceeded to justify why he needed to keep the Barbados tax haven open in terms of the Canada Steamship Lines.

Recently, we know that Revenue Canada is auditing Merck Frosst for \$2 billion in unpaid taxes because they'd used the Barbados tax haven.

Is this a figment of my imagination?

Mr. André Lareau, would you like to respond?

[Translation]

Mr. André Lareau: You are absolutely right. The Canadian tax system indeed allows openings mainly to Barbados. In the 2002 report, the Auditor General stated that \$23 billion had been invested in Barbados. There is a reason for that. Barbados, in particular, has a tax agreement with Canada. Because section 30 of the tax agreement stipulates that International Business Companies, IBCs, are exempt from the agreement, we are led to believe that Barbados has no preferential link to Canada.

With respect to what you said earlier about 1994, I will remind you that in 1995, an amendment was made to tax regulation 5907 (11.2)(c) according to which tax agreements concluded before 1995 could permit entry of tax-free dividends. This is not a random occurrence.

Earlier, Ms. Alepin asked why we should feel obliged to reduce Canadian rates. Indeed, that is a good question. In Europe, competition takes place within the European Union. There was an upward trend in recent years. Ireland increased its tax rates in 2001, 2002 or 2003. Hungary also increased its rates in 2006. Currently, Bulgaria has a tax rate of 10%, the lowest corporate tax rate in all of Europe.

Our closest competitor is the United States. Therefore, we always feel the need to tie yourselves closely to the U.S. But let us be careful! Our tax system is entirely competitive. For example, the exemption on \$500,000 of capital gain has been increased. The 1997 Mintz report clearly indicated that this measure did not create jobs in Canada and should be eliminated. Therefore, we should not only consider tax matters as they relate to tax havens, but also as they relate to our domestic tax matters.

[English]

The Chair: *Excusez-moi.*

The time for Madam Wasylycia-Leis is past, in terms of her questions at least.

Some hon. members: Oh, oh!

The Chair: So we'll go with a second round of four minutes, and I think that should allow everyone to get in.

We'll begin with Monsieur Thibault.

Hon. Robert Thibault (West Nova, Lib.): Thank you for your presentations and your answers.

Professor Hejazi, nobody argues with the fact that we have to eliminate the abuses caused by low-tax jurisdictions that become tax shelters. Nobody argues with that, and Judy pointed to a case where the Canada Revenue Agency was able to take corrective action, and if the party is guilty, hopefully the CRA will retrieve the funds.

But there's a reason these low-tax jurisdictions exist. You talked about the conduit helping our businesses carry on activities in other areas where they might be unfamiliar or have different court systems. Could you explain exactly what that conduit is in one minute? What is the advantage of that conduit with a place like Barbados or other jurisdictions?

● (1200)

Mr. Walid Hejazi: Basically, the results of the study show very clearly that when a Canadian multinational goes to Latin America, there is a complementarity between Canadian trade and Canadian foreign investment; when a Canadian multinational opens a production facility or an office in Latin America, that increases the footprint of Canadians in that foreign jurisdiction, which increases the demand for Canadian production in Canada to service that foreign market.

If they use a conduit like Barbados, the tax benefits associated with that use, because the income that flows back to Canada from those foreign operations, come back to Canada at a lower tax rate or at no tax. Then that Canadian company is better able to compete with American and European multinationals that are operating in those same foreign jurisdictions and that have access to the same financing structures. This is not something that's unique to Canada, and eliminating this conduit possibility for Canadian multinationals would make Canadians less competitive in those foreign jurisdictions.

Hon. Robert Thibault: Madame Alepin made the point that you either, through international negotiations or through a body, get everybody to abide by the same rules, or you have a laissez-faire approach.

The other thing would be to eliminate all Canadian investments through the conduit of low-tax jurisdictions. She didn't suggest that. I'm just saying that if you did that—if you eliminated them today, as the minister had a short while ago—what would be the effect on the Canadian economy? Would head offices move out?

Mr. Walid Hejazi: They would, absolutely, if it were made more difficult to use conduits like Barbados. If they were shut down, the Canadian economy would be adversely affected to a very large degree. Tax rates in Canada would have to rise. Tax revenues in Canada would fall. Canadians—

Hon. Robert Thibault: On the question of tax fairness, would taxes have to increase for the average working salaried employee?

Mr. Walid Hejazi: Her taxes or his taxes would have to rise, and their salaries would fall. It has been very clear, and I could point you to thousands of studies that have shown that globalization is the most important source of prosperity in developed countries over the last 30 years. If we prevent the ability for Canadian multinationals to access the global economy, it makes Canadian companies less competitive. It will result in reduced Canadian exports to the global economy and reduced government tax revenue. Simply put, this idea that somehow there's a tax benefit associated with using these conduit jurisdictions, that somehow this is bad for Canada and good for the multinationals, is incorrect.

This is something I've been researching for a long time, and I remember 20 years ago, when everybody was complaining about so much foreign investment in Canada—

[Translation]

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

Mr. St-Cyr, you have four minutes.

Mr. Thierry St-Cyr (Jeanne-Le Ber, BQ): Thank you, Mr. Chairman. I'm pleased to welcome two witnesses who are speaking to us in French today. It has been several months since we've had French speakers appear before the Finance Committee, and I'm very happy about this.

Please do not hesitate at all to express yourselves in your language.

I am a bit surprised when I hear the argument that companies which invest abroad, should pay lower taxes, and that this is profitable for Canada. It is the same argument as those who claim that the lower Canadians' salaries are the better the economy. I do not believe in this argument.

Let us consider the economic impact. Earlier, my colleague talked about the \$4 billion that comes back from Barbados free of tax, which deprives the federal government of some \$800 million in revenue. This calculation does not include the provincial tax or other tax havens and double dipping measures, etc. Therefore, we are talking about several billion dollars.

As a society, if we give up this billion dollars, then we must increase individual taxes, or cut back on services that keep the economy running. Is this good for the economy?

I would like for either Ms. Alepin or Mr. Lareau to answer.

Ms. Brigitte Alepin: I reiterate a point that I took some time to understand. When we talk about tax havens, what my fellow panellist said is neither true nor false. This is the first stage of reflection. In an era of globalization, we must make sure that the tax context in which Canadian multinational companies operate is competitive compared to what exists elsewhere. If we put an end to the present situation regarding tax havens, and cut off the possibility for multinational companies to conduct business in Barbados, there would be a negative impact because certain multinational companies will seek to do business elsewhere. Globalization is about capital mobility. Even though we've been discussing this for some time now in Canada, it is for this reason that many countries must also take part in the discussion. It is a decision that must result from international discussions, and Canada has a chance to shine. To my mind, of all the countries in the world, Canada is one of the those that should start talking about it.

•(1205)

Mr. Thierry St-Cyr: Mr. Lareau.

Mr. André Lareau: When we give up taxing profits earned, particularly in Barbados, and we are talking about \$800 million, there are no losses in Canada. That amount is not being taxed in Canada. Therefore, we cannot even talk about reduced revenues for Canada's Treasury.

On the other hand, Canadian jurisdictional sovereignty means that Canada has the power, through legislation, to impose the tax rate it decides upon. By not taxing profits earned abroad, particularly in a country with low tax rates, Canada is giving up its jurisdiction and handing it over to another entity. We cannot allow this to happen, because it makes no sense.

Mr. Thierry St-Cyr: I would like to come back to the issue you raised earlier, that of disclosure practices in other countries. Can you give us more details? Were you talking about a simple disclosure to

better understand the situation? Are there studies done to determine whether or not it is illegal, in some cases, to levy additional taxes?

Mr. André Lareau: In the United States, with *Circular 230*, that went into effect June 20, 2005, any taxpayer who wishes to set up an aggressive tax scheme with the assistance of accountants, lawyers or any other professionals, must submit the opinion letter issued by that professional with a description of his aggressive tax scheme as well as a request for a tax rebate. This is necessary in order to obtain authorization for the scheme. If this is not done, or if the aggressive tax scheme is attacked, stiff penalties and sanctions can be imposed. Professionals, lawyers and accountants are under the obligation to issue this opinion letter, otherwise they may also be subject to significant sanctions.

[English]

The Chair: Merci, Monsieur.

Professor Lareau, we know from Statistic Canada information that the growth in the use of Barbados in particular as a conduit has increased exponentially in the last number of years. Could you please explain further how there were exceptions made in the mid-1990s, in respect of Barbados? Could you explain what those were and to what degree that has affected the use of Barbados by Canadian companies?

[Translation]

Mr. André Lareau: Previously, during the 1980s and up until the 1990s, countries that handed over dividends in Canada tax-free, and received by a parent company tax-free, were called designated countries. There is a list of countries, and if anyone of those countries paid up dividends in Canada, they were exempt from paying taxes. Some of these countries had a practically zero tax rate. Therefore, shipping companies especially were created in these countries.

In her reports published throughout the 1990s, the Auditor General stated that these practices made no sense and that henceforth, Canada should favour countries with which it has tax agreements. The legislation was amended to stipulate that countries authorized to pay dividends in Canada tax-free were countries that had concluded a tax agreement with Canada.

Under section 30 of the Canada-Barbados agreement, International Business Companies, IBCs, are excluded from the tax agreement. This has created a problem, because maritime companies in particular have left certain foreign countries in order to go to Barbados. An amendment was made to regulation 5907(11.2)(c) of the Income Tax Act stipulating that even if a company was an IBC, it would also be subject to the tax agreement. Therefore, a company residing in Barbados, whose control centre is located in Barbados, and whose important decisions are made in Barbados, would henceforth be subject to the tax agreement.

From the research I conducted, the problem lies in the fact that companies located in Barbados do not necessarily make important decisions in Barbados. Professionals I met with clearly indicated to me that decisions are taken by a committee of professionals located elsewhere, abroad, or in Canada. Companies are able to repatriate dividends to Canada under subsection 5907(11.2)(c) of the regulation as is stipulated in the agreement signed before 1995, and that specifically deals with Barbados.

• (1210)

[English]

The Chair: Okay, we know that this doesn't relate. A previous ethics commissioner ruled on this issue with respect to the previous prime minister when he was finance minister, saying that he did not behave unethically in respect of shifting his private interests to Barbados.

How far-ranging is the potential to use Barbados as a conduit in the way that you've just described? In other words, Madame Alepin alluded earlier to SMEs and the importance of SMEs in the Canadian economy, with which of course we all agree. How difficult is it for other companies to utilize this conduit that is available for avoiding tax?

I'll allow Madame Alepin to commence, because I don't want to use up too much time. We have a couple of other questioners.

[Translation]

Ms. Brigitte Alepin: I have been a tax expert for some years. I will not tell you exactly how many years, because I do not want to appear too old. I have spent nearly my entire life in giving tax advice to SMEs. There is a very simple reason for this: SMEs have no access to the kind of fiscal planning that would let them use tax havens. This is unfair. I recently had a discussion about this issue. SMEs cannot afford to pay the professional fees of financial experts who do this kind of planning. It costs at least \$50,000 in fees to set up this kind of structure. SMEs cannot afford to pay such professional fees. Besides, an SME is usually not large enough to be able to open an account with certain financial institutions over there. I wrote about this in my book. This is really a selective kind of fiscal planning that discriminates in favour of more wealthy Canadians.

[English]

The Chair: Merci.

Monsieur Lareau, I'm sorry, but I've used enough time. We must allow other members to ask questions.

Monsieur Dykstra, please continue.

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

Ms. Alepin, I want to follow up, and I'm going to try to move as quickly as I can because we have only four minutes.

This government has addressed small and medium-sized businesses with respect to whether it will be reducing the general corporate tax rate, eliminating the corporate surtax, eliminating the federal capital tax. We moved the capital gains from 500 to 750, which was the first time since 1988 that any direction was taken on that.

We are certainly trying to address issues with small and medium-sized businesses in this country. I'm interested to hear whether you agree that we're taking the right direction, and specifically what you think we need to do in terms of further reductions, or are we moving in the right direction?

[Translation]

Ms. Brigitte Alepin: As a matter of fact, I held a series of lectures on fiscal planning for SMEs. As we look at the Canadian fiscal system, which is favourable to SMEs, we can see that the Canadian government is making efforts. Even if we recognize that the government is making the right kind of effort, we must make sure that our SMEs are subject to lower taxes than large companies are, because taxes should be proportional to the ability to pay. Naturally, SMEs are less able to pay than big companies are. If I were the Minister of Finance—although I do not want to—I would make sure that there is a fiscal system favourable to SMEs so that they can maintain the hope of becoming big companies some day. We presently do not have this.

• (1215)

[English]

Mr. Rick Dykstra: Mr. Hejazi, a couple of things intrigued me with respect to your comments. When you look at foreign investment, there's always this dichotomy that plays out when we have these discussions, based on what percentage of foreign investments are made by Canadian companies in other countries, versus how many investments are made by foreign companies in our country, or how high those investments are.

In the last couple of years, KPMG showed very clearly that investments by Canadian firms in foreign companies far outweigh the investments that foreign companies have made in this country.

When you spoke, you were moving toward comments with respect to the global economy and the importance of Canada playing a role in that. When you go into ridings like mine, where there's a high contingent of manufacturing and industrial jobs, many of which have left the community....

I was at a meeting on Friday, and I can tell you that they certainly wouldn't agree with your assessment in terms of what we should do, or that we should continue to do that. In fact they would say that we need to put more walls up to ensure that competitiveness within the country is here, in terms of investment or tax policy, to ensure that there are high tariffs when countries are trying to import into our country.

I know I haven't left you much time, but I really would appreciate your commenting further on the importance of why we need to be competitive, and why any tax savings or tax money that we find from closing loopholes will actually be, as the minister committed to yesterday, reinvested back into making sure that we can lower corporate tax rates here in this country.

The Chair: You have a very brief time to respond, unfortunately, sir.

Mr. Walid Hejazi: I think we're mixing together two really important issues. One has to do with how competitive the Canadian economy is and some of the challenges we have within Canada with respect to productivity, and so on. The second has to do with Canadian multinationals reaching out into the global economy.

There's one point I really want to make, going back to the question raised earlier. Roughly half of the world's trade goes through multinationals. The idea that we can sit in Canada, produce goods, and export to the global economy without having a multinational network—it just doesn't work. You have to be out in the global economy.

So these are two really important issues, and there are issues about how competitive and productive resources are within Canada. I would argue that allowing multinationals to move into the global economy enhances our competitiveness.

The Chair: Thank you.

To conclude, last but certainly not least is Mr. Pacetti.

[*Translation*]

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

I thank the witnesses for their testimony.

[*English*]

Only a panel like this can make a complex issue even more complex. We haven't been able to find very many solutions, but I'm going to try in four minutes.

My first question is to you, Mr. Hejazi. I think when you answered somebody's question you were a little contradictory. We just said that Canada doesn't have competitive corporate tax rates, yet we still have Toyota installing their plants here. How do you address that and compare it to a Canadian multinational—it doesn't matter if it is Canadian or not—investing offshore in another situation?

Mr. Walid Hejazi: Canadian multinationals and multinationals generally are going to locate production facilities where the resources and the environment are best. In the auto industry many multinationals, Toyota in particular, have made—

Mr. Massimo Pacetti: Fine. I'm going to cut you off, because time is limited. So corporate tax is just one factor of many?

Mr. Walid Hejazi: Yes.

Mr. Massimo Pacetti: Okay, so we agree on that. It's not the essential point. It's not just corporate tax that's going to make you competitive or not. Is there a point where we can say that government revenues are going to be affected, whether they go up or down?

Mr. Walid Hejazi: It's a very complicated question. I challenge anyone here to show that tax revenue in Canada goes down when multinationals move abroad. The reason is that when multinationals move abroad through an offshore financial centre, to the extent those multinationals are more productive, economic activity in Canada is higher. So tax revenue from that increased economic activity is higher, and the dividends that flow back to Canada are also higher.

• (1220)

Mr. Massimo Pacetti: But the jobs won't flow with the economic activity?

Mr. Walid Hejazi: The evidence is clear that when multinationals increase their footprint abroad there's an increased demand for production within Canada. This is the complementarity idea.

Mr. Massimo Pacetti: Okay.

[*Translation*]

Mr. Lareau, if we did not have an agreement with Barbados, what would be the solution for multinational companies that have to make investments abroad? What would they do?

Mr. André Lareau: If they do not go to Barbados, they could choose some other country with low tax rates.

For fiscal reasons, when doing business abroad, it is good to choose a country with which we have a tax treaty. Without a tax treaty, dividends that come back to Canada are taxable.

However, the most recent budget in March says that even if we are doing business with countries with which we have no tax treaty, we can still receive tax treaty dividends, if there is an agreement to exchange general fiscal information. The door has been opened more widely than before. Now this could be dangerous.

However, if it can no longer be done with Barbados, it will be done with other countries, like Iceland, for instance.

Mr. Massimo Pacetti: Would you rather have a company invest in a country with which we have no tax treaty or—

Mr. André Lareau: No, a country would never go abroad to create an entity in a country with which we have no tax treaty, it would be committing fiscal suicide.

We will deal with a country with which we have a tax treaty. However, the most recent budget provides that even without a tax treaty, we can nonetheless repatriate tax-free dividends if there is a general agreement to exchange information.

What is the reason for this? I presume that the Minister of Finance thinks that we would have information that could give us access to further information. Nevertheless, it is not working, because we have this kind of exchange program with Barbados—

[*English*]

Mr. Massimo Pacetti: Okay, thank you.

[*Translation*]

—inasmuch as there is an agreement to exchange information.

[*English*]

The Chair: It has been a very interesting panel. We very much appreciate all of your presentations and responses to questions. Thank you.

We'll suspend for lunch and recommence shortly.

•(1220) _____ (Pause) _____

•(1240)

The Chair: Welcome to our witnesses. Welcome back, committee members and interested viewers.

[*Translation*]

Pursuant to Standing Order 108(2), this is a meeting on tax havens and tax avoidance.

[*English*]

I understand that representatives today don't have a formal presentation, but they are here to respond to questions and exchange information with committee members.

Is that correct, Mr. Ernewein?

•(1245)

Mr. Brian Ernewein (General Director, Tax Legislation Division, Tax Policy Branch, Department of Finance): That's correct, Mr. Chairman.

I'm the general director of the tax policy branch in the Department of Finance. I'm joined by my colleague, Lawrence Purdy, who is the senior chief of the tax legislation division in the Department of Finance's tax policy branch.

We don't have any opening remarks. I had the privilege of appearing before this committee in the previous Parliament on essentially the same general issue. Committee members will be aware of the statement issued by the Minister of Finance yesterday. We have provided to the clerk copies of that statement and the accompanying material. They've possibly been circulated to committee members. During the course of our discussion we may have occasion to refer to at least some of the examples in that material.

We are in your hands.

The Chair: Thank you very much, sir. You're in very capable and friendly hands here.

We'll begin with Mr. McKay. Don't contradict that statement, please, Mr. McKay.

Hon. John McKay: I'm just feeling the love in this room as we speak.

This matter was convened for a variety of agendas that various parties had. From the Liberal Party's standpoint there was a fairly bald statement in the budget that we were going to eliminate interest deductibility, take on tax havens, ensure tax fairness, and things of that nature. It was a rather less precise statement than more.

Over time the business community started to get a little upset by this proposal and the minister issued a series of clarifications, the latest of which was yesterday.

Presumably when you launch into an initiative of this kind you conduct some form of macroeconomic study. You were in the room when Professor Hejazi made reference to a study he's conducting. I wonder whether the department has conducted a similar type of macroeconomic study that shows not only the losses due to

investments in so-called tax havens or low-tax jurisdictions, but also the benefits.

If you have a study, was it made available to the minister prior to the budget, and is it available to this committee?

Mr. Brian Ernewein: I believe the issue of interest deductibility has been examined on a number of occasions. The Auditor General had occasion to mention it specifically with some detail in 1992 and 2002. The technical committee on business taxation, the so-called Mintz committee, looked into it and made recommendations on it in 1997. Perhaps the report was released in early 1998.

From a tax policy perspective the issue is the balance one strikes between what some would describe as competitiveness and neutrality or fairness, and whether or not one should provide an interest deduction for foreign investments when the underlying income is not subject to tax. In the material put out by the minister yesterday, the balance is that interest will be allowed to be deducted in Canada for foreign investments, but it won't be allowed where that Canadian deduction essentially represents the second deduction supplementing one taken outside of the country.

Hon. John McKay: Starting with the macroeconomic issue, at one point in the 1970s Canada received more foreign direct investment than it put out. Then around 1996 the trend reversed and we now actually buy more from them than they buy from us.

You made reference to the Mintz committee. It was presumably working on the historical data prior to about 1999. Has the department done an update to look at how the environment has changed between 1997-98 and 2007? Did that form any of the basis for the minister's positioning in the budget?

Mr. Brian Ernewein: Certainly changes have occurred to the tax system and the economy generally in that time. One change in particular that I would point to is the rather dramatic reduction in our tax rate since that report was issued. I made the comment before a committee hearing on another matter in the past couple of weeks that within a couple of years' time, our tax rate will be 50% lower than it was at the time of the technical committee's work.

Now, I don't want to take up your time, Mr. McKay, but I think that can get into the point of whether, in the situation when you're talking about a double-deduction scenario, the prior or the given is that the first deduction would be taken in Canada or in another jurisdiction. If we're getting our tax rates down, then I think one can say, in a single-deduction scenario, it's more likely that the deduction will be taken in the other country, which means that the extra deduction is being taken in Canada, thus costing our tax base and affecting revenues.

•(1250)

Hon. John McKay: That was actually one of the criticisms of those who were looking at the minister's statement yesterday, that effectively the latest incarnation of this particular initiative will actually enhance revenues in foreign jurisdictions and won't make any difference, or will reduce revenues, in the Canadian jurisdiction.

You have to ask yourself, how does that make any sense at all?

Mr. Brian Ernewein: I was anticipating the question. Let me speak to it more directly.

The assumption or the premise in those sorts of contentions is that the deduction in Canada is a given and the deduction in the foreign country is the gravy. I think that's not immune to challenge.

To take our example, our major trading partner, the United States, has a statutory tax rate that will be roughly five points higher than Canada's. In that circumstance, if you're allowed to take an interest deduction on a borrowing for a U.S. investment and you have to choose to make it in Canada or the U.S., then all other things being equal, I'd suggest you would make it in the U.S., where the tax deduction of the interest will be worth 35¢ on the dollar versus 31.5¢ on the dollar in Canada in a couple of years' time. On that view, the extra deduction is the Canadian one.

I think you heard Roger Martin suggest that we have more work to do in relation to our tax rates, that we are in good shape, perhaps because the United States has a relatively high tax rate, but that we're not better than everywhere else in the world, or better than everywhere else in the industrialized world. However, with the type of strategy that gets our tax rates down—we're targeting to get ourselves at the bottom of the G-7 tax rate structure—that sort of analysis has more traction and leads you to the view that the deduction will be taken generally, all other things being equal, in the country where the investment is made rather than in Canada.

[Translation]

The Chair: Thank you very much, sir.

Mr. Crête, you have seven minutes.

Mr. Paul Crête: Thank you, Mr. Chairman.

Thank you for coming.

In 2002, the Auditor General made the following observation regarding the Department of Finance:

Tax arrangements for foreign affiliates have eroded Canadian tax revenues of hundreds of millions of dollars over the last 10 years.

Also, let me quickly read out recommendation

11.114: To protect the integrity of the tax base, the Department of Finance should obtain and analyze current information to reassess the tax revenue impact and the rationale of

allowing foreign-owned Canadian corporations to deduct interest on borrowed funds related directly or indirectly to investments in foreign affiliates, and allowing tax-privileged entities in treaty countries to bring income into Canada tax-free.

The Auditor General told us that you still have not answered this question. Could you tell us whether you have the information that she asked for? Do you intend to respond to this request made by the Auditor General?

[English]

Mr. Brian Ernewein: I believe we did provide a departmental response to the Auditor General in relation to the 1992 and 2002 reports. It does boil down, at its most fundamental, to a policy question for Parliament as to whether we should have an exempt surplus regime where we do or don't impose an additional Canadian tax on the active business income generated by foreign affiliates of Canadian companies.

The considerations that I think have led to the development and the institution of an exemption system in Canada are to, first, not tax the profits as a matter of international competitiveness, and second,

not impose a tax on their repatriation to Canada, to make it more neutral and to facilitate the payment of the profits back to Canada.

[Translation]

Mr. Paul Crête: But, sir, do you have any figures? Can you tell us where the Auditor General's request stands today? For the past, current or coming fiscal year, what are your real figures or your estimation of the impact of this motion? Can you give us a summary of your analysis of this matter? At present, we know that a sum of \$4 billion is being transferred from tax treaty countries tax-free. Could you give us a summary of what your department knows about this issue?

• (1255)

[English]

Mr. Brian Ernewein: Thank you very much for the question. We do not have the numbers today on the dividends being paid out. We saw that you raised this question with the Canada Revenue Agency when they were here last week, and we are trying to find some numbers on that front.

We do have some Statistics Canada information on the total levels of Canadian direct investment in various countries. I can give you my copy later if you're interested, or refer you to the location of that.

But I want to emphasize, in addition to answering your question directly, that I don't believe it's right to suggest that whatever the dollar value of dividends coming back from foreign corporations or foreign corporations in a particular country may be, you can simply apply a Canadian tax rate to that income to determine a revenue loss number.

[Translation]

Mr. Paul Crête: The Auditor General asked you for this in 2002. Five years later, you still have not responded. This morning, we heard about a tax credit that people could get for these dividends. The company receives tax-free money and the taxpayer is entitled to a tax credit on tax-free money. Do you have any figures for the tax credits awarded for these dividends? Surely, you must know how much they amount to.

[English]

Mr. Brian Ernewein: I don't believe we have the information to give you today on the actual amount of dividends on a per country basis. We are trying to get that, and assuming we're able to pull that together we will provide it.

I don't believe it's correct to suggest that multiplying the amount of the dividends by a Canadian tax rate would represent the amount of Canadian tax revenue involved. If one were to tax the profits from active business operations generated by foreign affiliates of Canadian companies in treaty countries, the likely result would be what we've seen in other countries that operate a foreign tax credit system—that the income wouldn't be paid back to Canada.

[Translation]

Mr. Paul Crête: Due to the fact that you are not giving us certain pieces of information, we have to make estimations based on the information that we have. In that sense, the department is still vague about the available information. On the international level, you know, for instance, how the fiscal system in the United States works with regard to dividends. Have you evaluated Canada's need for changing its tax system? Do you know whether it would be better to replace our model, which involves a tax treaty, with a system like the one used by the United States or Japan? Do you have an opinion about this issue?

[English]

Mr. Brian Ernewein: On the considerations that inform whether we have an exemption or credit system, with an exemption system we end up having a neutrality between us and other foreign competitors in relation to foreign investment. We don't have an additional Canadian tax, current or deferred, that'll apply to Canadian investors carrying on foreign operations. The counter to that is we lose neutrality in relation to the taxation of Canadian income versus the taxation of this foreign income.

The system Canada has had in place with treaty countries for approximately 35 years is an exemption system. We won't impose any current tax, and we won't impose any tax on the income when it's brought back.

Other countries, including some of the largest countries in the world—the U.S., the U.K., and Japan to a considerable extent—have the same deferral opportunity. They do not tax foreign business income of their companies' foreign affiliates as it is earned. It remains non-taxable by the U.S. as long as it's left outside of the country. If and when it is returned to the country it is subject to tax, with a credit for any underlying tax.

If the foreign affiliates of those U.S. companies, for example, invest outside of the U.S. and generate business income outside of the U.S., they are able to leave that income offshore free of U.S. tax. But when they bring it home they are subject to a potential 35% tax. That has led many U.S. companies to not bring the income home, and a couple of years ago there was what could be described generally as a tax amnesty by the U.S. to have companies bring the income home so it could be employed in the United States.

• (1300)

The Chair: Thank you, Monsieur Crête.

Mr. Wallace, seven minutes.

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

Thank you for coming. I appreciate the tax department being here. We had the revenue side last week, which was great. I'm assuming you guys are working together as departments to try to resolve the tax haven issue. You're on both ends of the equation.

One argument that has been made to me came via e-mail from some local constituents. Maybe you could help me out a little bit on this.

The claim, really, is that for Canada to have overall competitiveness, we have to have tolerance for the double dipping and the other

structures. That's the only way Canadian companies can be competitive.

From a tax department point of view, do you have any comment on whether that's an accurate statement? Or how do you feel about that?

Mr. Brian Ernewein: I think there are two levels at which to answer the question. In a mechanical, mathematical, or arithmetical analysis, you can't simply look at the value of the interest deduction....

I'm sorry, I should start further back.

There are some situations in which other countries will allow a double deduction to be taken. This is an international issue in other countries, including the U.S. and others. In our material that we put out yesterday, we provide brief descriptions of it. They are all recognizing that this is a challenge. They're all taking actions to try to deal with it in some manner. But you will find throughout the world other jurisdictions that may allow a double deduction in circumstances where we've proposed to constrain it.

Is that the end of the arithmetical analysis? No, I suggest not. I think, then, one has to go on to determine how, in their circumstance, if they're allowing an interest deduction, that stacks up against our system generally.

I made mention of the U.S. a little earlier. With the U.S. having a statutory tax rate, and a marginal effective tax rate that's going to be a few points higher than our own, then one has to consider whether our overall tax system and tax effects of our system essentially make a firm as well or better off under the general regime without being able to get a double deduction than another country's company that has higher tax rates, for example, or taxation of the income on repatriation to that country but with an interest deduction.

So you have to look at the tax advantage generally. You have to look at the overall business environment. Secondly, Advantage Canada from the fall identifies not only tax advantages but other advantages that Canada is working to build upon.

As a final point, I had mentioned the qualitative assessment or value judgment. Even when one is prepared to take other countries' systems and competitiveness concerns into account and to be very mindful in setting one's own tax policy, I think there's a question about whether there is a point of neutrality and fairness that causes one to ask whether, despite what some other countries might do in particular circumstances, we should allow a double deduction in our own case. The decision reflected in the minister's announcement is that this is where we will draw the line.

Mr. Mike Wallace: I have a second question. And by the way, I was here for all the presentations earlier, but I wasn't able to be here for the questioning.

In the report I have in front of me, we talk about the United States, Germany, France, and the United Kingdom as countries that we're using to compare with in terms of international tax avoidance. One of the previous presenters mentioned Australia, which we often look to in order to see if they have similar issues. Could you tell me what's happening with Australia and if they're doing anything different from what we're doing?

My second part to that question is that I think we've committed to a task force to look at this issue. I want to know, in terms of the international marketplace, your view of what that task force should be doing.

Mr. Brian Ernewein: Perhaps I'll take on the second part of the question and ask my colleague to speak to the first.

On the task force, I expect you're referring to the expert panel that the minister is proposing to set up. There was reference in the budget as well. It's to look at other issues or other possible modifications to the Canadian tax system for international income that might improve the fairness and the competitiveness of the regime.

I might mention one thing as an example. This suggestion has come to us from a number of quarters since the budget as something we should be looking at—and I'll concede that some have suggested we should be looking at it instead of what we're doing while others have said it's something we should be looking at as well as what we're doing. This is the issue of so-called debt dumping, the question of whether there's being too much debt placed by foreign owners of Canadian companies onto the Canadian firms, pointing out—and my colleague will pick up on this—some other jurisdictions and what they do with respect to limitations on the total amount of interest a firm could bear.

So no pronouncements on that, but it seems to us to be perhaps some fertile ground for the panel to look at.

• (1305)

Mr. Lawrence Purdy (Senior Chief, Tax Legislation Division, Tax Policy Branch, Department of Finance): To answer the first part of your question, the situation in Australia bears many comparisons to Canada on a lot of different fronts, including taxation. Historically, Australia and Canada have operated very similar systems. Indeed, many aspects of the Australian system were patterned on Canada's system.

But over the last 20 or 25 years, the Australians have been quite venturesome in working out how to deal with the kinds of challenges Canada is now faced with. They too have faced those same challenges, as every developed country does. They've moved through different approaches and they've ended up, for the time being, with a very different approach from anything that's currently under contemplation in Canada.

I must interject that I'm by no means an expert on the Australian tax system, so this reflects my understanding of it. But the Australian approach is to apply a limit on deductibility generally with respect not only to foreign investment, but also domestic investment, and to say a limited amount of debt can be used in the financing of a business's subsidiaries, for example, and representing debt in excess of that ceiling is not deductible.

We have a limited form of this rule with respect to inbound investment, in what we refer to as our "thin cap" or thin capitalization rules. But Australia and one or two other countries have taken this concept further and applied it across the board, domestically and foreign, inbound and outbound.

Mr. Mike Wallace: Very good. Thank you.

Thank you, Mr. Chairman.

The Chair: Thank you.

We continue with Mr. Pacetti now. Five minutes, Mr. Pacetti.

Mr. Massimo Pacetti: Thank you, Mr. Chairman.

Thank you to the witnesses. It's always good to have the finance officials here.

I want to focus on interest deductibility. I'm trying to understand. If CRA were to catch—for lack of a better word—a company double-dipping, they would disallow the deduction. They would not allow the deduction. So I'm not sure why double-dipping is something we're concerned about, because if we're able to catch it, they would deny it, and it would be up to the multinational to prove it wasn't the case.

Mr. Brian Ernewein: In some situations CRA may be challenging transactions as being too aggressive, and this may reflect on the discussion you had the other day with the agency. But for better or worse, CRA would not seek to challenge under the current law the sort of transaction outlined in the material we put out yesterday and—

Mr. Massimo Pacetti: But what would be the difference? Double-dipping is not allowed now. If you found out about double-dipping through whatever mechanism you want to use through your audits, it would still not be allowed. So nothing has changed.

Mr. Brian Ernewein: Well, again, I don't believe that's the case.

Mr. Massimo Pacetti: If a company decides to challenge, that's something else, but what we're talking about is that all of a sudden double-dipping seems to be a legal form of deduction, but it's not. And we're talking here of interest, but it's the same for anything, any type of expense in Canada.

Mr. Brian Ernewein: I'm not sure it is the case that all of a sudden it is legal. I think it has been the case that a borrowing made to invest in shares of a foreign affiliate by a Canadian firm is generally deductible in computing the taxable income and tax payable of a Canadian firm.

What you see in a classic double-dipping case is that the investment in those foreign affiliate's shares has been turned into a loan from that foreign affiliate to another country, and that country is also allowing a deduction for it.

Mr. Massimo Pacetti: I understand the mechanics, but if the double-dipping were proven, it wouldn't be deductible and the CRA would not allow it.

My other question would be—

• (1310)

Mr. Dean Del Mastro: Point of order.

The Chair: Point of order, Mr. Del Mastro.

Mr. Dean Del Mastro: Yes, thank you, Mr. Chair.

We had witnesses last week from the CRA who specifically illustrated an example of double-dipping that they went to court on and lost.

The Chair: That's not a point of order, Mr. Del Mastro.

Mr. Dean Del Mastro: But Mr. Pacetti is saying double-dipping is not currently allowed. They demonstrated an example where it was.

The Chair: That's not a point of order, Mr. Del Mastro.

Mr. Pacetti, continue.

Mr. Massimo Pacetti: Thank you, Mr. Chairman.

The other aspect I want to address is whether this is really an anti-tax-haven initiative, or is it about double-dipping? Which one is it? If we're going to say it's anti-tax-haven, it's one point; if it's double-dipping, it's another point, but we seem to have contradictory statements both by the minister and now in the department's press release. Can you address that point, please?

Mr. Brian Ernewein: Thank you for the question. Yes, I hope so.

People are projecting a definition onto the term "tax haven", and it's probably useful to speak to that for a moment. As the backgrounder to our material mentions, you can conceptualize or define a tax haven in at least one of two ways. One way is simply as a low-tax jurisdiction with nothing else, and some people think of tax havens in those terms. In that context, a number of countries in the world have low or no tax rates, but that's—

Mr. Massimo Pacetti: I understand that. We went through all that this morning, and my time is limited.

I'm asking that question because you seemed to infer when you were answering Mr. McKay's question that the U.S. was a tax haven. I just want to make sure we're not contradictory.

Even in your press release, one of the points you bring up is reaching an agreement in principle on the Canada-United States tax treaty. I'm not comfortable with the way the minister and the department have been shifting their position.

Mr. Brian Ernewein: I'm not aware of any connection between us signing the tax treaty and there being a tax haven angle to it. But it was the second point that I wanted to draw out.

In addition to simply having low tax rates, one can arrive at having low or no tax through lack of concordance in two countries' tax rules. That's the tower structure illustrated in the materials that were issued yesterday. It's a structure that's exclusively between Canada and the United States and involves no other country. But the effect of it is to achieve a deduction in Canada and a deduction in the U.S.

So I'm not calling us a tax haven and I'm not calling the U.S. a tax haven, but the effect of it is perhaps even better than one can get with some low-tax jurisdictions.

Mr. Massimo Pacetti: I have a quick solution to the problem. I asked the lawyers and the accountants. In Quebec we have a system where interest expense can only be deducted against interest income. Can we not do the same for interest deductibility and apply it only if there's revenue to offset it?

Mr. Brian Ernewein: It would have much different effects from the proposal as currently constituted. It would say that a foreign investment funded with debt in Canada would not be allowed any interest deduction unless and until any income were returned home, and it would—

Mr. Massimo Pacetti: That's the question.

The Chair: Sorry, Mr. Pacetti's time is up. Try to work it into a subsequent response.

[Translation]

Mr. St-Cyr.

Mr. Thierry St-Cyr: Thank you, Mr. Chairman.

Let me continue with the issue of double dipping. The department has not yet implemented its measures, and we still do not have the text of the notice of ways-and-means motion. According to the legislation that we have, is double dipping legal? Can a company apply to Canada and to the United States at the same time?

[English]

Mr. Brian Ernewein: Subject to these proposals, the current law would in some instances allow a corporation to claim a deduction in Canada and a deduction in another country.

[Translation]

Mr. Thierry St-Cyr: Companies do not have to hide this. They are entitled to it.

[English]

Mr. Brian Ernewein: It's not a question of evasion; it's a question of legal compliance with the rules.

[Translation]

Mr. Thierry St-Cyr: Should we use technical means to get the exchange of information that we need with the countries involved in this, so as to detect and prevent such cases?

[English]

Mr. Brian Ernewein: The question is largely yes, and there are some qualifications to that.

Double-dips work best with treaty countries, because the income you generate in the intermediate country is exempt surplus that can be brought home free of tax. From a tax planner's point of view that's the ideal result. So with our tax treaties we like to think and believe we have a good exchange of information procedures, and if necessary we can obtain the information necessary to validate what's being done.

You can do a double-dip with a non-treaty country. It doesn't work as well because the income generated will ultimately be subject to tax if and when it's brought home. In that case there may be more issues or greater issues with exchange of information. But in general terms, if they're limited to treaty countries, exchange of information is not an issue.

● (1315)

[Translation]

Mr. Thierry St-Cyr: Professor Lareau, who appeared before this committee earlier, told us that in the United States, in England and in other countries, if I remember correctly, the disclosure of aggressive fiscal planning is always mandatory. He said that this is not the case in Canada.

Is there any reason why we do not follow that procedure? Has the Department of Finance already considered the possibility of following it?

[English]

Mr. Brian Ernewein: In certain cases—an example being our tax shelter reporting requirements—we have an obligation on taxpayers to identify aggressive tax planning structures, or structures they're marketing to the public as producing significant tax benefits.

I don't know that disclosure or non-disclosure has been an issue with the sorts of double-dips we're talking about. They're generally large firms because they're multinational in scope. They are subject perhaps to routine audits by CRA, or certainly more frequent audits than smaller enterprises. So there isn't a general rule to disclose that you're engaging in this sort of transaction, but I don't think that presents a problem. We are able—and the Canada Revenue Agency in particular is able—to determine when these are being done.

[Translation]

Mr. Thierry St-Cyr: Earlier, we discussed subsection (11.2) of section 5907 of the Income Tax Regulations. Under the Access to Information Act, the Bloc Québécois obtained an account of the exchange of information among the high officials of the finance department. The officials explained that this subsection was specifically meant to allow Canadian companies to transfer tax-free money to companies in Barbados.

Do you agree that this was the intention of the section?

[English]

Mr. Brian Ernewein: No, I can't. I don't believe that was the intention of the regulation.

Prior to 1994, we did have a rule in our regulations that attempted to say that treaty countries, countries with which Canada had a tax treaty, qualified for exempt surplus treatment. That listing procedure was not very effective. At the time of its change in 1994, we had about ten countries on the list with which we did not have tax treaties. We might have had negotiations started with them, but we did not have tax treaties in effect, and I think we were getting behind so that there were about ten new countries with which we did have tax treaties that weren't on the list.

So trying to do a better job of it, and a more effective job of it, we changed the regulation to say that it had to be a country with which we have a tax treaty. We weren't going to run through a list. We were going to have as a condition that it had to be a country with which you had a tax treaty and the particular company in question had to be resident in that country, for purposes of the treaty. It was intended to, as I say, clean up our listing requirement. After the regulation was issued in draft form in the budget, we received some questions from a couple of tax firms, asking whether or not this was intended to affect any of our existing treaties, because you could read those treaties as perhaps saying that if a company weren't resident for all purposes, or weren't entitled to treaty benefits in all cases, that perhaps the regulation as drafted could have application to it.

Our answer was that it did not, and we issued letters—I think those are what you're referring to—to a number of people in the tax community who had written to ask us about this, saying that wasn't

the intention of the regulation. The regulation was revised and it was passed to reflect its original intentions.

• (1320)

[Translation]

The Chair: Thank you very much, sir.

[English]

Just for clarification, Mr. Ernewein, a previous panel testified something to the effect, I think, that there had been no change in the Barbadian tax structures since the signing of a tax treaty with that country. When was the tax treaty with Barbados signed?

Mr. Brian Ernewein: I think it was in 1980.

A voice: I think it was 1972 or 1973.

The Chair: Is the intention when we sign tax treaties, setting aside the need for transparency and disclosure and openness in the relationship, that we try to sign treaties with countries that have somewhat comparable levels of taxation? Or does that enter into the criteria when we sign tax treaties?

Mr. Brian Ernewein: I think it does enter into the consideration that goes into determining whether to have tax treaty negotiations and seek to get a tax treaty, because in the absence of tax in the other jurisdiction, one of the objectives of a tax treaty—to eliminate the risk of double taxation, or to reduce, at least, the risk of double taxation—doesn't have that much traction.

The Chair: So the answer is yes, we try to consider the level of taxation as one of the factors when we're signing a tax treaty—is that correct?

Mr. Brian Ernewein: As one of the factors, yes.

The Chair: That being said, we've got some contradictory information coming to our committee from different witnesses as to the changes or lack of changes in tax structures in Barbados. Some evidence says there was a significant increase in the use of Barbadian—what's the correct phrase—Barbadian corporations.

Mr. Brian Ernewein: Probably you're referring to international business corporations, IBCs.

The Chair: A major increase in the use of IBCs in Barbados in the late nineties in particular... Was there, or was there not, a change within Barbados in terms of its tax policies that would lead to or contribute to the increased use of the IBCs?

Mr. Brian Ernewein: You'll be expecting I'm always saying I can't give you a straight answer. The international business corporations were in place when we negotiated the treaty with Barbados in 1980. A reference is explicitly made to them in that treaty.

The Chair: Why the increased use? Why is Barbados now third, I think, in offshore Canadian investment after the U.S. and the U.K.? Why is Barbados all of a sudden becoming so incredibly popular for foreign investment?

Mr. Brian Ernewein: Without wanting to convey an impression I'm an authority on all of the factors that went into this, I think there are at least two things that could have borne upon it. One is that there's just greater foreign investment by Canadian companies and other companies throughout the world. I think the increase in investment in countries like Barbados that we have observed is also found largely in the U.S. and the U.K.

The Chair: There's been more foreign investment, but exponentially so in the case of Barbados. Okay. What's the second reason?

Mr. Brian Ernewein: I've forgotten.

The Chair: What's the special appeal? My friends from the Barbados back there will want you to tell us about the special appeal of the Barbados to Canadian and other foreign investors.

Mr. Brian Ernewein: I'm sorry, Brian, but we were diverted and I've forgotten the other point.

The Chair: What would a Canadian company that uses Barbados as a conduit pay if they're an IBC? What would they pay in corporate tax?

Mr. Brian Ernewein: It has been some time since I checked, but I believe the rate was between 1.25% and 2.5%.

The Chair: Perhaps that has something to do with it.

Some hon. members: Oh, oh!

Mr. Brian Ernewein: But, sir, just to be fair to our colleagues and friends from Barbados, I'm not sure if that rate has changed in the time since.

The Chair: Okay, it's just that Barbados' popularity has grown.

The second thing, if I get the gist of this, is that the U.S. has an approach that essentially takes into account the foreign taxes that have been paid, but then it taxes, in some manner, the repatriated money from earned income; whereas in Canada, we assume the money has been taxed in the foreign jurisdiction and we allow the repatriation of the money tax-free. Is that correct? Is that essentially the difference between the two countries' approach in terms of the repatriation of eligible earned income back to Canada versus the U.S.?

Mr. Brian Ernewein: You've accurately described the difference between the two in result, in that we don't tax and the U.S. will tax with a credit. My hesitation to confirm all of what you have said is that you included an assumption that the income bore underlying foreign tax roughly equal to Canadian tax rates. There has been an ongoing debate on that. It's not clear to me, frankly, that this was the intention in all cases. We have tax treaties we've negotiated with countries, with a range of tax rates among them, so it seems to me there's at least an argument, on the evidence of it, that our tax treaty network is not built exclusively on having treaties only with countries with rates equal to our own, but possibly just with important countries.

• (1325)

The Chair: Very good.

Finally, some of these supposed loopholes were supposedly addressed a decade ago, in the mid-nineties, but then some of them were reopened for Barbados. Can you explain what the exceptions

were in the mid-nineties and what effect they have had on interest in foreign investment, specifically in Barbados?

Mr. Brian Ernewein: I want to be careful not to characterize them as loopholes or having been opened or closed—

The Chair: Fair enough; we'll call them rule changes.

Mr. Brian Ernewein: Yes, I believe you're referring to some changes that were made in 1994 to our listing rules for tax treaties to make sure there was a treaty in effect for exempt surplus treatment to apply, corresponding with the actual treaties we had in place. There was not an intention to affect any of our current treaties then in place. To make sure that was the case, the regulation that went out said that any treaties in place, and any provision in those treaties that was not subsequently modified, would be respected. The effect of that was to leave unchanged the application of our exempt surplus regime for Barbados and other countries with which we had tax treaties.

The Chair: Thank you.

Madam Wasylycia-Leis, for just five minutes.

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

Pardon me if any of this is repetitive; I'm sorry, but I had to leave for a short period of time. Somehow I doubt that my questions will have been asked already.

I saw yesterday's announcement as quite a shift away from the budget. The budget actually states that

Canada's New Government has chosen to act, to ensure that everyone pays their fair share of tax. Budget 2007 proposes that interest expense on indebtedness incurred to acquire the shares of a foreign affiliate no longer be deductible, unless and until the shares generate income that Canada actually taxes.

It seems to me that except for double-dipping—and we're not quite sure how that will work now—there's been a complete restoration of interest tax deductibility on foreign investments. So I'm assuming that's the case and I'm asking you what will we do now? Businesses said this was going to cost them a billion dollars if the government had proceeded. Now that the government's backtracked, who's going to pick up the billion dollars? How do we make up for this lost revenue that was going to come from the government finally closing this corporate tax loophole?

You maybe can't answer that, but—

Mr. Brian Ernewein: I think the summation of my answer is that I can't, that is true.

There have been a lot of numbers thrown around on the effects of the budget proposal. It is not clear to us that those estimates are entirely accurate. Indeed, it's a difficult thing to measure. While the Canada Revenue Agency might determine, on audit of corporations' tax returns, what proportion of their debt relates to foreign investment and, as a subtotal, what proportion relates to double-dipping on foreign investments, that's not something we know with precision at this stage.

What the minister has represented in the material is that the tax revenues generated from this proposal will be returned to the corporate sector in forms that will further enhance the competitiveness of the Canadian tax system.

Ms. Judy Wasylcia-Leis: Well, that in itself was also a shock, and an indication of the government flip-flopping or bowing to corporate pressure. Normally when a tax change generates revenue, it goes into general revenue to better all Canadians. It's not targeted or directed at a specific area, in this case in terms of corporate taxes, already, as we heard earlier, among the lowest in the world.

It was clearly stated by others, and even in the minister's own briefing, that in at least three countries where this issue is allowed there's also commensurate taxation of the income of the affiliate. Is there any attempt by the Department of Finance to move in this direction, to move to worldwide taxation, or global taxation, or some way to address this proposal, as previously done in those three countries?

• (1330)

Mr. Brian Ernewein: No, that's not the policy proposal.

Ms. Judy Wasylcia-Leis: And why not?

Mr. Brian Ernewein: The policy proposal is built on the existing system. It reflects an exemption regime for foreign business profits that are brought home to Canada. I've already mentioned a couple of times today that there can be some perhaps perverse effects of imposing a system of taxation only on repatriation. It ends up providing the same deferral we do, but then preventing, essentially, the income from being brought home to possibly do good things, in our case in Canada. Other countries are struggling with that, sometimes actually imposing, as I mentioned, an amnesty, as in the U.S.

Ms. Judy Wasylcia-Leis: But if it's in the minister's own documents from the finance department... You mention that the United States, Great Britain, and Japan have the reasonable policy of both allowing for the deductions and taxing the income of the affiliates. So why isn't Canada looking at that as a proposal? Doesn't that make sense?

Mr. Brian Ernewein: I assume that there are people from the U.S., the U.K., and Japan who would argue that it does make sense. The observation we have, in addition to the one I've made, is that in our regime, by providing an exemption for foreign business profits, we help the competitiveness of our firms.

It's a balancing exercise. Parliament could choose that it wants to tax this income. It could choose that it wants to tax this income on a current basis. I think it might be alone in the world, but that's sort of the range of options it would have.

Not taxing it on a current basis, respecting essentially the international norms on it, the question is what you do with it at the end—tax it or allow it to be brought home exempt. The system is built on an exemption, and the interest deduction rules are built in part on that exemption as well.

The Chair: Thank you, sir.

We continue with Mr. Del Mastro now.

Mr. Dean Del Mastro: Thank you, Mr. Chair.

Mr. Ernewein, a few moments ago one of my colleagues from the Liberal Party indicated that double-dipping is currently not allowed. In a presentation the other day by the Canada Revenue Agency, we

had a very specific example of where they went to court and lost on a double-dipping case—or double exemption, if you prefer.

I want to go over this a little bit with you, explain to you what they presented to us, and then ask you a couple of questions on it.

They began with tax haven A, where company A borrowed \$200 million at 10%, incurring a \$20 million interest expense that they then deducted from Canadian taxes. They then loaned—

The Chair: I'm sorry to interrupt, Mr. Del Mastro, and I don't want to get in the way of your flow, but I think Mr. Ernewein knows the double-dipping issue pretty well. You may want to move ahead to the question, on the assumption that he's familiar with this.

Mr. Dean Del Mastro: I'm just making sure the viewers at home understand the situation.

The Chair: Oh, I see.

Mr. Dean Del Mastro: If the chair would be patient, I would appreciate that.

The Chair: Absolutely. It's your time; use it as you will.

Mr. Dean Del Mastro: The residents in Peterborough thank you for your understanding.

They then loan the \$200 million to another tax haven, which subsequently loans the money at 10% to company B in the United States. What happened was they got back most of the proceeds of the \$20 million that they had deducted from their income for loaning the money back to a second tax haven, claimed the expense, and brought the \$20 million back to Canada tax-free. Inherently it is wrong. They never incurred an expense, but they were allowed to claim the expense against Canadian taxes, and despite the fact that the CRA could prove that they did this, it was ruled that it was perfectly legal and legitimate.

Isn't this exactly what the finance minister is talking about cracking down on? It's not legitimate investment expenses abroad that will assist Canadian companies to expand. Rather, it's abuse of the system.

The Chair: Mr. Pacetti, on a point of order.

Mr. Massimo Pacetti: Mr. Chairman, the graph that he used... He tried to correct me while I was asking my questions, but there is the same picture or diagram in the finance department's brief on page 3 that he just translated, but the CRA is—

The Chair: This isn't a point of order, as you well know, so we'll move back now to Mr. Del Mastro.

I want to make it clear to the viewers in Peterborough that Coke in no way compensated anybody here on the committee for the product placement of that Coke can that was in the picture momentarily. It was an accident.

Mr. Del Mastro.

•(1335)

Mr. Dean Del Mastro: The record will show that is Mr. Dykstra's Coke can.

Mr. Ernewein, once again, isn't this exactly what the finance department, the finance minister, is trying to crack down on to bring tax fairness—this abuse of the current tax arrangement?

Mr. Brian Ernewein: Thank you for the question.

I do want to stay clear of any potential cases that are under litigation or any similar cases that are currently in appeal or before the courts, but I think I'm still able to answer your question. Yes, there are certain circumstances. The illustrations in the material we provided at the beginning of today demonstrate or provide examples of certain situations in which a deduction may be claimed in Canada and in another jurisdiction under the law as it's written today—perhaps not in every case, but it's not a hypothetical situation. The rules announced yesterday are intended to take that on and limit the ability to claim a double deduction.

Mr. Dean Del Mastro: The case has been made that this will somehow impede Canadian multinationals from being able to make strategic investments that will impede their growth, that it will cost employment, that it will cost foreign investment in Canada. Does any of this hold water? Do you feel that is the case? Ultimately, if none of us paid taxes, we could all spend more money, but that would hardly support our social safety net.

Do you feel this argument is legitimate, or are we hearing a lot of huff and bluster from Bay Street?

Mr. Brian Ernewein: I wouldn't land on either spot specifically. I would say that a situation in which you get a double deduction can provide real value to you. There's a question, in terms of balancing competitiveness with tax fairness and neutrality, of whether that's the regime you want to allow or whether you want to draw the line at allowing a deduction in Canada for a foreign investment, if that's what someone proposed to do, but not allowing them to do that along with a deduction elsewhere as well.

Mr. Dean Del Mastro: Thank you.

Thank you, Mr. Chair.

The Chair: Thank you, Mr. Del Mastro, for that non-compensated commercial opportunity.

We have Mr. Thibault now. Over to you.

Hon. Robert Thibault: Merci, Monsieur le président.

Thank you both for your appearance at the committee today.

Just to start off, we've been talking a lot about Barbados today, but would I be right to assume that if all financial arrangements with Barbados ceased tomorrow, IBCs would locate somewhere else? There are other low-tax jurisdictions that our corporations would take advantage of.

Mr. Brian Ernewein: Barbados does not hold a monopoly on a low-tax regime. That's right.

Hon. Robert Thibault: Okay.

When we look at this question, and we started when the budget first came out, we looked at it as a huge area. Now we're down to the

double-dipping. That's what we're talking about. But there are a lot of elements within it that are difficult to understand. It seems to me to be a little risky to launch a budget and then have to flip-flop. That study or that analysis was not done. What we heard was when the full elimination of foreign investment interests for tax deductibility... when Mr. Flaherty was talking about that, he said the increase would be \$40 million of revenue. The corporations out there and the tax experts told us the loss in national revenue because of the disadvantaged competitiveness would be in the billions.

Now we see the latest proposal by flip-flop Flaherty that by going to only the double-dipping, way out into 2012, the revenue generated to the treasury will be offset by a reduction in revenue from corporations within Canada. What are those amounts? If \$40 million was the full amount that turned out from a loss of billions, what is the anticipated win here?

Mr. Brian Ernewein: Thank you for the question.

I have two points in response.

First of all, \$40 million was not the full amount. The estimates in the budget material referenced a \$10 million revenue associated with the proposal in the first year and a \$40 million revenue gain for the government associated with it in the second year. Those were based in years during which, in the first year, the proposal would only apply for three months of that year and only to new debt. For the second year, it would largely apply only to new debt and some non-arm's-length debt. The proposal was to have come into effect in full in 2010, beyond the two-year budget projections, and there are no numbers that reflect it.

The second point is largely an historical footnote, because the proposal is to now apply as of 2012 to all debt, irrespective of its term or when it was entered into, as long as it's connected to a foreign investment double-dip. Today we don't have a revenue estimate for what it will produce in 2012 or beyond.

There will be some challenges in establishing it, because people will make plans and react to the proposal within the next five years. But as we get closer to the date, we will be striving to get a better handle on the associated revenue effects of it and, as I mentioned earlier, to make sure it translates into further corporate tax savings.

•(1340)

Hon. Robert Thibault: Wouldn't it be possible there would be no additional revenue generated and the investments in foreign markets would change in structure or in the way they remain competitive? Isn't it a possibility, on the other side, we'd be disadvantaged competitively and would reduce our revenue in that manner?

Mr. Brian Ernewein: It's probably a regret for our society that we have some very bright people employed in such things as tax planning, but we do have them, and they are very inventive.

There will be issues that will take place or new structures identified in the next few years that will have to be taken into account. We're also going to have to stay on top of it to ensure the rule is effective, but your point is well taken.

Hon. Robert Thibault: The flip-flop was a dream. Thank you.

The Chair: Yes, it's fair to note that a dead fish never flips or flops as well. The previous government's inaction on this file speaks well to that.

Mr. Dykstra.

Mr. Rick Dykstra: Thank you, Mr. Chair.

I have a couple of questions related to one of the things on companies. I shouldn't say "companies", because Mr. Martin made a good point that companies are not human beings. They are not entities that speak or talk back to us.

The point is that a lot of representatives from larger companies ask why the government should care about double-dipping, because it doesn't have an impact on them anyways. As long as they're receiving the money and as long as they're receiving tax revenue from the multinational company, why should you really care?

Why should the Government and Canadians be concerned about what some other country may or may not offer with respect to a tax loophole? I say "loophole", but I mean it in the very gentlest wording.

Mr. Brian Ernewein: Thank you.

I tried to speak to this earlier. A little of what you hear now will reprise that earlier point.

That kind of analysis would be valid if you take as a given that the Canadian tax deduction is fixed and the second deduction is the extra deduction. But if you've set up a regime, as I said before, where you're required to make a choice on where you take a tax deduction, then you can have a fair fight, if you will, and where you end up taking the deduction will be dependent on the competitiveness of your tax structure versus that of the other country.

You mentioned Mr. Martin saying we have to do more. It's true that we're already in good shape in relation to some countries in terms of our rate structure. As against those countries, with a rule that says you will be required to take the deduction or it will be in your best interests to take the deduction where it's worth the most to you, lower tax rates here mean it will be worth more to you to take it in the other country.

But there will be a discipline imposed on us. If and when other countries cut their rates further, there will be a discipline on us to be responsive to it to make sure we're not the ones bearing the debt and the expense.

Mr. Rick Dykstra: Our continued aggressive approach with respect to the reduction of corporate tax rates is going to at least continue to put us in a position where we may not be the end-all and be-all, but we'd certainly be the envy of all when it comes to either the G-7 or trading relationships with countries that may not be in the G-7. By that, I mean they will actually choose to pay their taxes in Canada, because it's going to mean that as a corporation they will be able to keep more of their money rather than paying tax on it.

Mr. Brian Ernewein: That's a regime we're trying to install and enhance to make everything you said true, and truer all the time.

Mr. Rick Dykstra: Are we getting there?

Mr. Brian Ernewein: Well, this last budget noted that actions included in that budget, and perhaps in combination with 2006's—I've frankly forgotten, I'm sorry—will move us from the third-highest tax rate in the G-7 to the third lowest. And with other possible changes, including movement at the provincial level in respect of capital taxes and possibly sales tax harmonization, we could conceivably have the lowest marginal effective tax rate in the G-7.

Mr. Rick Dykstra: I have just one final question. How many years has the ministry tried to move in this direction with respect to addressing this specific issue? Are there some in finance who have continued to come forward, regardless of who is in power and who is the government, to make these types of recommendations?

• (1345)

Mr. Brian Ernewein: It's been noted, I think by a private tax practitioner in the press, that these rules have been in place for about 35 years. I think the emergence of double-dips didn't occur the very first day. During the 1980s, largely, is when they started to take hold, and they've probably been the subject of commentary since then. As we know, and as I mentioned earlier, the 1992 report by the Auditor General identified an issue with them. So we have had it at least since that point in time.

Mr. Rick Dykstra: Thank you.

The Chair: Mr. Pacetti and Mr. McKay are going to share some time. We'll go to Mr. McKay, to begin.

Hon. John McKay: It's better to do nothing if you're not sure just what it is you're doing.

I take it that this issue, as the latest reiteration of the minister's position, would not only apply to tax havens or low-tax jurisdictions but would apply right across the board. So simultaneously, there have been discussions going on with the United States about withholding tax. I can readily see how the United States has wanted to tax this particular second part of the double-dip. Could you tell me what impact this latest reiteration of the minister's position would have on these negotiations?

As I said, I can readily see how the U.S. treasury benefits from this, providing, of course, that the U.S. rate is higher or slightly higher than ours, but I don't see where the benefit is for Canada in this exercise.

Mr. Brian Ernewein: I apologize, Mr. Chairman, but I'm not sure I followed Mr. McKay's question.

The Chair: You're not alone. Don't apologize.

Mr. Brian Ernewein: To try to be helpful, is it a discussion of the benefits of the Canada-U.S. tax treaty and the elimination of withholding tax on interest? Or is it the interest deductibility proposals, or is it some interaction of the two?

Hon. John McKay: It's the combination of the two, because the combination of the two would lead one to conclude that the U.S. treasury benefit is more than the Canadian treasury benefit.

Mr. Brian Ernewein: Well, I'm not certain if I follow that. The elimination of withholding tax under the Canada-U.S. treaty will be of benefit to both countries, and enhancing the ability to—

Hon. John McKay: But this aspect of the double-dipping was a particular irritation for the United States, was it not?

Mr. Brian Ernewein: I believe, from the U.S. perspective, that they were, in fact, supportive of eliminating withholding tax on interest because of the benefits it would provide their investors, as it would, conversely, ours. An incidental effect of that is that it would actually have allowed Canadian firms to invest in the U.S. from Canada and also from some third countries. But I don't know that the U.S. perceived that to be an issue for them, one way or the other.

Mr. Massimo Pacetti: Thank you, Mr. Chairman.

Just quickly, can you get back to this exempt surplus and the tax-free dividends the last panel brought up? Isn't there a comfort level that the corporation is flowing their tax-free income into Canada, and then Canadian corporations are issuing dividends to Canadians and there's a tax credit being given on those dividends, or income, that has been received, tax-free, from the corporation?

Mr. Brian Ernewein: If I understand the question correctly, it's a reference to the fact that individuals are entitled to a dividend tax credit on dividends they receive from Canadian companies, whether or not the dividends have been subject to Canadian tax.

That issue can arise in a purely domestic context if the firm itself is in a non-taxable position but is still able to pay some dividends. It can also, as you say, arise if the underlying income is foreign.

Mr. Massimo Pacetti: Yes, but I'm referring specifically to companies that derive income from Barbados, let's say. I'm not going to say tax havens in general, but from Barbados. You don't have a discomfort with that?

Mr. Brian Ernewein: All I can tell you is that the dividend tax credit is not set up to be based on the actual amount of underlying Canadian tax paid. It's set at a level that we hope will recognize the maximum amount of corporate tax paid.

• (1350)

Mr. Massimo Pacetti: I understand the mechanism, but you're not uncomfortable with that scenario at all? Finance officials must be uncomfortable with that and there must be a calculation, because that's going to be my next question: there must be a calculation as to how much money we're talking about. That's all. That's the ultimate question. The question is, has there been a calculation on how much tax leakage there is by companies flowing their income through Barbados?

Mr. Brian Ernewein: I'm not aware of there having been such a calculation either with respect to foreign income or with respect to underlying domestic income that may not have been subject to full tax.

You asked me about my discomfort level. It probably doesn't matter how comfortable or uncomfortable I am. I can tell you what I know, and that is that the rule is designed—

Mr. Massimo Pacetti: I can't believe that.

[Translation]

The Chair: To wrap up, let us hear from Mr. Crête.

Mr. Crête, you have five minutes.

Mr. Paul Crête: Thank you, Mr. Chairman.

The OEDC has set up a task force on the tax havens of its seven-member countries and Canada is a part of it. I was told that next June, there would be a conference call about this matter.

Is the Department of Finance represented on this committee? Is it a member of the Canadian delegation?

[English]

Mr. Lawrence Purdy: No. I believe the group you're referring to is a group of tax administrators, so it includes the Canada Revenue Agency on the part of Canada and their equivalents in the other countries.

[Translation]

Mr. Paul Crête: So then, the finance department is not participating in any of the activities of this committee or of any other committee.

[English]

Mr. Lawrence Purdy: In some countries the boundary line lies in a different place from where it lies in Canada along the spectrum between policy and administration, so it may be the case that some other countries would be represented in an exercise like that by their finance ministries, but in the case of Canada, the multilateral work on tax havens specifically is carried out through the Canada Revenue Agency.

[Translation]

Mr. Paul Crête: Do you have to collaborate in order to provide figures for the members of the Canadian delegation? If they are studying tax havens, they must study them by using figures and evaluations of the financial impact of tax havens. Have you been called upon to collaborate in this?

[English]

Mr. Lawrence Purdy: I'm not aware of any specific requests having come from the Canada Revenue Agency in connection with the call you're describing or the working group. Certainly there's an ongoing relationship at the working level between the revenue agency and the finance department in terms of the sharing of information to make possible this kind of work, but I'm not aware of any specific initiative oriented around that project.

[Translation]

Mr. Paul Crête: Strangely enough, last week, people from the Canada Revenue Agency told us that they did not have the figures and that they had to come from your department. Now you are telling us that you do not provide them with any information.

Basically, I would like to know whether you can tell us where things stand, and give us figures regarding the impact of tax havens and tax treaty countries with low tax rates. Could you tell us what the situation is?

[English]

Mr. Brian Ernewein: I believe we can. I'm not sure I appreciate the relevance of that information to the work the Canada Revenue Agency is doing with other countries. They're certainly doing important work to try to identify if there are transactions between countries that are leading to tax avoidance or tax arbitrage. That's fine. But I take it this committee is interested in knowing what it can about the amount of dividends coming back, for example. I've already spoken to that and suggested that won't lead you to the conclusion that you can read a tax revenue estimate into that, but as far as the number or the amount of dividends coming back, I believe we're going to be able to track that down. We haven't completed that exercise yet. We'll do it if we can and get it to the committee if we can.

[Translation]

Mr. Paul Crête: Do you think that we can improve the tax haven situation without an international agreement? Can we still go on making improvements? Would it not be better for the OEDC, the WTO or some other organization to be in charge of the discussions, just as they are in charge of other trade issues?

[English]

Mr. Lawrence Purdy: It's certainly true that especially where international tax evasion—and I say that deliberately to distinguish it from avoidance—is involved, international cooperation is vital. The OECD has actually been playing a role for some ten years in helping to coordinate the efforts of its member countries and other countries in this area.

One of the important things that the OECD has done, working actually in conjunction with some of the offshore jurisdictions, is

develop a model tax information exchange agreement, or TIEA, and that model forms the basis of the agreements that Canada is now committed to seeking with jurisdictions. So at that level, yes, multilateral effort is very important.

At the end of the day, though, it does come down, in the current context at least, to a matter of the bilateral relationships that Canada can establish with these jurisdictions and obtaining information exchange. That's why an important part of the budget initiative is oriented around securing information exchange agreements with jurisdictions that are not candidates for full-scale tax treaties, but with whom it's important, nonetheless, for the Canada Revenue Agency to have the kind of relationship that will enable them to enforce Canadian tax law in respect of our own taxpayers.

● (1355)

The Chair: Thank you very much, Mr. Purdy and Mr. Ernewein. It's nice to see you. We appreciate your testimony today. I think we're all cognizant of the slowness with which change occurs on issues like this that are extremely complex, and we appreciate your participation in the discussion.

Committee members, in reference to Bill C-52, should we receive an order of reference on Bill C-52 at some point in the near future, notice will be sent to your offices in the morning for a meeting to take place tomorrow afternoon from 3:30 until 5:30. So I give you possible notice of such a meeting occurring.

Thank you, committee members, for your rapt attention and focused discussion on this issue.

The meeting is adjourned.

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