SUBMISSION TO THE HOUSE OF COMMONS STANDING COMMITTEE ON FINANCE

PRE-BUDGET CONSULTATION 2012

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Mr. James Rajotte, M.P.
Chair, Standing Committee on Finance
House of Commons
Ottawa, Canada
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EXECUTIVE SUMMARY

In response to the federal government request on how best to balance the books and drive economic growth, FEI Canada has the following three recommendations:

1. A task force should be established to review the federal Income Tax Act ("the Act") which should be simplified while improving the clarity and competitiveness of the Act in conjunction with streamlining the system of tax administration to improve the tax audit and resolution process of the Act. The recommendations of the Advisory Panel on Canada's System of International Taxation in its document of December, 2008 entitled *Enhancing Canada's International Tax Advantage* is an example of how to make the Canadian tax system competitive while achieving simplicity. These recommendations should be included in the task force recommendations. Tax simplification will cut the administrative burden borne by government, which funds CRA, and clarity will reduce the cost of tax disputes. Reduced compliance costs will benefit small and medium sized businesses that help drive the Canadian economy but have the fewest resources to address complex tax provisions and administration.

2. Implement a tax loss transfer system for corporate groups. The tax system should transition towards the filing of one consolidated tax return in an effort to further reduce tax administration. Again, the benefits are a reduction in cost to taxpayers, achieved through a less complex administrative burden, and a competitive benefit to companies, which drive economic growth and therefore jobs and ultimately tax revenues.

3. Improve the Scientific Research and Experimental Development (SR&ED) program to encourage commercialization of innovation by expanding the scope of expenditures eligible for the SR&ED tax credits to include all activities related to developing a product to the point of commercial success and by allowing public companies to the same entitlements as private companies.

Dear Mr. Rajotte,

Recommendations to balance the books and drive growth

Resources which are best spent on innovation and the production of goods and services are being diverted towards compliance. While this is to some extent unavoidable, when the strain of compliance becomes burdensome, it can hinder economic growth. An overly complex tax regime increases costs for both business – the driver of economic growth – and taxpayers, who fund the bureaucracy which must administer regulations and enforce the laws. Simplifying the onerous burden of tax compliance will stimulate economic activity and benefit the population at large through reduced government spending on administration and the freeing of more resources for business innovation.

1. TAX SIMPLIFICATION: REVIEW THE FEDERAL INCOME TAX ACT

FEI Canada recommends that a task force should be established to review the Canadian Federal Income Tax Act ("the Act"). Keeping the goal of reducing federal costs in mind, FEI Canada recommends that the Act be thoroughly reviewed with the objective of eliminating complexity, in particular, those aspects of the Act which (a) do not lead to economic efficiency, growth and/or increased competitiveness, (b) create excessive compliance costs vis-à-vis their policy objectives (e.g. the proliferation of CCA classes), (c) are inconsistent with the characteristics of a simple tax system, and/or (d) result in unnecessary duplication.

The review should include a comprehensive and careful examination of every tax provision designed to incent a particular industry. Tax incentives should be timely, targeted and temporary. The stated objective of the tax provision should be measured against the cost of the initiative in order to determine whether it is yielding the intended benefit. If the provision is found to be no longer achieving its purpose, its elimination will help narrow the budget deficit and reduce complexity in the Act. Legislated sunset rules would also help to control the growth of non-efficient tax expenditures.

There have already been a number of recommendations made to the federal government on how to make Canada's tax system more competitive while achieving more simplicity. For example, the Advisory Panel on Canada's System of International Taxation in its document of December, 2008 entitled Enhancing Canada's International Tax Advantage, made a number of recommendations for which the Government has yet to act on. These recommendations should be included in the task force recommendations for immediate implementation.

Tax simplification will ultimately reduce the burden of tax administration for CRA and the Finance Department thereby reducing government costs and contributing to a balanced budget. Similarly, streamlining the tax audit process and resolution of tax disputes will again reduce costs for the government. Tax disputes have increased significantly over the past decade. For instance, notices of objection (or "intakes") filed by taxpayers increased 88% between 2005/06 and 2009/10; the overall caseload (or "inventory" of cases) increased during the same time period by 126%.[1] These levels of increases are neither efficient nor affordable and clearly call out for immediate change.

1. Lévesque, Anne-Marie. LLL; Paul Lynch, CA and Carman R. McNary, Q.C. "Tax Dispute Resolution -- Is There a Better way?" Presentation to the 2010 Annual Tax Conference, Canadian Tax Foundation. Vancouver, November 30, 2010.

2. TAX SIMPLIFICATION: TAXATION OF CORPORATE GROUPS

Introduce consolidated tax reporting and loss transfer

FEI Canada agrees with the government's comments in a previous consultation paper on the taxation of corporate groups that "an efficient tax system also contributes to providing a more competitive environment for business…" and that "it may be possible to further enhance competitiveness by improving the efficiency of the tax system with respect to the treatment of corporate groups".[2]

Any measure that simplifies and improves the effectiveness and efficiency of the current tax system in Canada will ultimately foster Canadian competitiveness and drive economic growth as well as stimulating job creation and consumer spending. In turn, economic growth and consumer spending increase tax revenues, offsetting the federal deficit.

The current system of transferring losses is neither effective nor efficient. Under the current rules, to utilize losses taxpayers undergo complex and costly planning transactions that add no value to the Canadian economy as a whole. Smaller taxpayers usually do not have the expertise or financing to implement costly tax loss utilization techniques. Certain corporations operate their business divisions in separate legal entities for valid business reasons or regulatory reasons. Divisions operating within the same entity, however, have the ability to offset tax losses from unprofitable divisions against taxable income from profitable divisions which creates inequitable advantages among taxpayers.

A number of large corporations have already adopted partnership agreements which allow the effective consolidation of previously separate tax returns. The change to consolidated tax returns via the partnership option is currently available to corporations who can afford the transition costs. Again, this disadvantages small to medium corporate taxpayers.

In addition, under the current system, the acceptance of the use of tax loss strategies by the Canada Revenue Agency is not always certain. This uncertainty increases the risk to taxpayers of incorrectly reporting their tax obligations to the government and to external financial statement users as well as increasing the potential for costly tax audit disputes. Providing a legislative framework to transfer losses would improve the clarity, predictability and fairness of the tax system for all taxpayers and the government.

FEI Canada acknowledges that the immediate need is to implement a form of tax loss utilization within corporate groups. However, FEI Canada believes that the tax system should transition towards the filing of one consolidated tax return in an effort to further reduce tax administration. A consolidated tax return appropriately recognizes the broader economic corporate group as the taxpayer. It is understood that a more in-depth analysis is required before a consolidated tax reporting system can be implemented. As such, FEI Canada believes that any tax loss utilization system adopted should be designed so that it may operate within the current tax reporting system and a future consolidated tax reporting system. For further details, please see FEI Canada's comments on the Department of Finance's consultation paper on the Taxation of Corporate Groups, dated 18 March, 2011, which can be found at http://www.feicanada.org/page/news/comment.

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2. Canada: Department of Finance. "The Taxation of Corporate Groups: Consultation Paper". November 2010, p. 2.

3. FOSTERING INNOVATION TO PROMOTE ECONOMIC GROWTH AND JOB CREATION

FEI Canada recognizes that innovation plays a significant role in achieving a strong and sustainable economy. Canada needs economic and taxation policies that encourage and facilitate innovation. The Scientific Research and Experimental Development (SR&ED) tax credit program was developed many years ago and has served Canada well until now. In order to continue to be effective, FEI Canada believes the program needs to be improved further.

FEI Canada recommends that the current SR&ED program should be expanded so that all activities related to development and commercialization of a product or process are eligible activities and that public companies are entitled to the same SR&ED tax credit treatment as private companies. Activities such as marketing, business development and quality assurance are necessary in order to gain valuable insights from customers and other parties so that the ultimate product or process is commercially viable. Commercial viability ultimately creates jobs, generates tax revenue and spawns additional innovation contributing to sustainable development and a strong economy. The availability of tax credits for the commercialization and development of products can be tied to the sale of product from a Canadian company to ensure that the tax credits are recovered through additional tax revenues generated from the sale of the products.

Smaller Canadian companies that are growing should get as much encouragement to continue their successes as those that in the start-up phase of their operations. The ownership status (public versus private) should not be a criterion for receiving different tax credit enhancements. The SR&ED program should not discourage smaller Canadian companies from seeking public funds to fund their research activities in Canada, but should encourage both domestic and foreign investors to provide capital investment for vital SR&ED projects performed and realized in Canada.

Peter Effer

Peter Effer, CA
Chair, Taxation Committee
Financial Executives International Canada

Michael Conway

Michael Conway, CA, ICD.D
Chief Executive and National President
Financial Executives International Canada

About FEI Canada (www.feicanada.org)

Financial Executives International Canada (FEI Canada) is an all-industry professional association for senior financial executives. With eleven chapters across Canada and more than 2,000 members, FEI Canada provides professional development, thought leadership and advocacy services to its members.

The Issues and Policy Advisory Committee (IPAC) is one of two national advocacy committees of FEI Canada. IPAC is comprised of more than 40 senior financial executives representing a broad cross-section of the Canadian economy who have volunteered their time, experience and knowledge to consider and recommend action on a range of topics of interest to Canadian business and governmental agencies. The current composition of IPAC is formulated to address the following areas: governance and risk, treasury and capital markets, taxation, pensions, private company issues and information technology. In addition to advocacy, IPAC is devoted to improving the awareness and educational implications of the issues it addresses, and is focused on continually improving these areas.