Recommendations

of

TAX EXECUTIVES INSTITUTE, INC.

for the

PRE-BUDGET CONSULTATIONS
IN ADVANCE OF THE 2021 FEDERAL BUDGET

Submitted to

HOUSE OF COMMONS
STANDING COMMITTEE ON FINANCE

August 10, 2020

- **Recommendation 1:** That the government amend the Income Tax Act[1] to allow for 100-percent deduction of capital expenditures in the year incurred and suspend the "available for use" limitation on deductibility.

- **Recommendation 2:** That the government amend the Act to extend the general carryback period for non-capital losses by five years.

- **Recommendation 3:** That the government amend the Act to defer the Minister of National Revenue's ability to collect disputed tax amounts from large corporations until an assessment is confirmed by the Canada Revenue Agency's Appeals Branch.

[1] Unless otherwise indicated, all references to "section," "subsection," or "paragraph" herein are to sections, subsections, or paragraphs of the Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), as amended (the "Act").

TAX EXECUTIVES INSTITUTE, INC.
PRE-BUDGET CONSULTATION IN ADVANCE OF THE 2021 FEDERAL BUDGET

Tax Executives Institute ("TEI") is pleased to participate in this year's pre-budget consultations and submits the following recommendations for building on the tax measures included in the federal government's *COVID-19 Economic Response Plan* to restart the Canadian economy, as it recovers from the COVID-19 pandemic. TEI commends the government's response to the COVID-19 crisis thus far and, in particular, the speed with which the government has implemented significant and unprecedented economic relief measures, including the Canada Emergency Response Benefit ("CERB") and the Canada Emergency Wage Subsidy ("CEWS").

The government's focus to date has appropriately been on promoting public safety and providing individuals and businesses with the near-term economic support they need to survive the pandemic. As that focus begins to shift toward ensuring the long-term, sustainable recovery of the Canadian economy, however, new priorities emerge. Lawmakers must pursue responsive policies that not only consider how Canadian businesses can efficiently access liquidity, without unnecessarily increasing corporate debt, but also instill confidence in the country's fiscal and regulatory environment such that businesses feel comfortable proceeding with projects and investing now to stimulate the necessary economic activity in Canada. Accordingly, TEI respectfully urges the government to adopt the recommendations set forth herein. In our view, the timely adoption of these recommendations will facilitate a more expeditious and sustainable long-term recovery in a fiscally efficient and responsible manner.

About TEI

TEI was founded in 1944 to serve the professional needs of in-house tax professionals. Today, the organization has 57 chapters across North and South America, Europe, and Asia, including four chapters in Canada. Our approximately 7,000 members represent 2,800 of the world's largest companies, many of which either are resident or do business in Canada. Over 15 percent of TEI's membership comprises tax professionals working for Canadian businesses in a variety of industries across the country. TEI members are responsible for administering the tax affairs of their employers and must contend daily with provisions of the tax law relating to the operation of business enterprises. The following recommendations reflect the views of TEI as a whole but, more particularly, those of our Canadian constituency.

As the preeminent association of in-house tax professionals worldwide, TEI is dedicated to the development of sound tax policy, compliance with and uniform enforcement of tax laws, and minimization of administration and compliance costs to the mutual benefit of government and taxpayers. TEI is committed to fostering a tax system that works—one that is administrable and with which taxpayers can comply in a cost-efficient manner. The diversity, professional training, and global viewpoints of our members enable TEI to bring a balanced and practical perspective to the issues discussed herein.

Recommendations

TEI's recommendations are predominantly timing measures intended to help Canadian businesses—across all industries—endure and rebound from the economic downturn associated with the COVID-19 crisis. All three share a common objective: allow companies to better utilize existing tax attributes to provide critical cash flow and liquidity during the crisis, enabling them to continue operations, keep employees on payroll, and plan new investments. And unlike the CERB or CEWS programs, adopting TEI's recommendations would not result in an absolute cost to the government.

I. Allow 100-percent Deduction of Capital Expenditures in the Year Incurred and Suspend the "Available for Use" Limitation on Deductibility

Under current law, the deductibility of most capital expenditures is limited by a system of "capital cost allowance" rules.[2] These rules generally limit the deduction available in any taxation year to a specified percentage of the expense incurred and prohibit any deduction until the property for which the expense was incurred has become "available for use" by the taxpayer.[3] As a result, most of the tax benefit associated with a capital expenditure incurred in a taxation year is not realized until future years.

The timing of cash flows and tax payments is a critical consideration in any business's decision to proceed with a capital-intensive project. Allowing taxpayers to currently deduct 100 percent of their capital expenditures would provide a strong and immediate incentive to proceed with investments they might otherwise defer—or even cancel—during these uncertain economic times by accelerating the realization of tax benefits associated therewith. Businesses currently in a taxable position could use the full amount of their expenditures to reduce current-year tax liability. Businesses that are not currently taxable but have paid tax in prior years could use the accelerated deduction to increase their non-capital loss, which could then be carried back to recover prior-year taxes. And businesses that can neither use the deduction currently nor carry it back to recover prior-year taxes could still benefit from the accelerated deduction by increasing their loss carryforwards available to offset taxable income in future years.

From a fiscal standpoint, it is important to note that providing for 100-percent deductibility of capital expenditures is effectively a timing measure. Allowing businesses to access the full tax deduction for capital expenditures now would mean that no amount of the deduction is available later. As a result, successful businesses would pay tax more quickly as they recover in future years, accelerating future tax revenues. Consistent with TEI's mission, adopting this recommendation would also drastically reduce administration and compliance costs for government and taxpayers alike. Taxpayers could forgo the burden of classifying expenses according to specified classes of depreciable property, and the government would be spared the

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[2] Paragraph 20(1)(a).

[3] Subsection 13(26).

burden of auditing those determinations. The underlying logic is simple: it requires less time and paperwork to deduct the capital cost of depreciable property in the current year than it does to depreciate that cost over multiple years through the capital cost allowance system.

TEI strongly recommends the adoption of measures allowing 100-percent deductibility of capital expenditures in the year incurred and suspending the "available for use" limitation on deductibility. And from a tax competitiveness standpoint, we note this recommendation is consistent with measures already adopted by Canada's trading partners—including its largest, the United States.[4] In short, adopting these targeted tax measures would be an efficient, fiscally prudent way for the government to promote capital investment and stimulate economic growth across all sectors of the Canadian economy.

II. Extend the Carryback Period for Non-capital Losses by Five Years

Under current law, a taxpayer's non-capital loss for the taxation year may be carried back three years and forward 20 years as a deduction in computing taxable income for those other years.[5] If the loss is not used within this statutory period, it expires and can no longer be used to offset taxable income. As a result, many Canadian companies facing significant non-capital losses this year due to the COVID-19 crisis may be precluded from carrying back their losses to recover taxes paid in prior years. And among those companies, many could face a prolonged return to profitability given the pandemic's widespread economic impact, delaying their ability to realize any tax benefit from the increased non-capital loss carryover in the future. For businesses struggling to continue operating and keep employees on payroll, this is an untenable result.

Facing a similar dilemma, the United States recently readopted a familiar, time-tested approach for providing necessary liquidity to businesses in past economic crises: the temporary relaxation of net operating loss ("NOL") deduction limitations. Like it did in 2002, 2005, and 2009, the United States now temporarily allows taxpayers to use NOLs to a greater extent to offset taxable income in prior years in order to provide taxpayers with liquidity in the form of tax refunds and reduced current tax liability. Recent federal COVID-19 response legislation provides for the carryback of any NOL arising in 2018, 2019, and 2020 to each of the five taxable years preceding the taxable year in which the loss arises.[6] Thus, for example, a U.S. taxpayer with a NOL arising in 2018 can now carry back that loss to offset its taxable income and recover taxes paid in 2013.

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[4] In December 2017, the United States enacted sweeping federal tax reform legislation that, among other things, significantly cut the federal corporate income tax rate—from 35 percent to 21 percent—and introduced 100-percent bonus depreciation (full and immediate expensing) for certain business assets that are acquired and placed in service before January 1, 2023. *See* Act of Dec. 22, 2017, Pub. L. No. 115-97, § 13,201, 131 Stat. 2054, 2105–08.

[5] Paragraph 111(1)(a).

[6] *See* Coronavirus Aid, Relief, and Economic Security Act, Pub. L. No. 116-136, § 2303, 134 Stat. 281 (2020) (extending the general NOL carryback period from zero to five years for NOLs arising in taxable years beginning after 2017 and before 2021).

TEI recommends that Canada enact a measure similar to the one adopted in the United States where, as here, the COVID-19 crisis has resulted in many businesses incurring unexpected and significant losses. Specifically, the government should temporarily extend the carryback period by at least five years (e.g., from three to eight) for non-capital losses arising in taxation years beginning in 2018, 2019, and 2020. Adopting such a measure could provide affected taxpayers in all sectors of the economy the ability to increase their cash flow through the refund of income taxes paid in prior years, and it would free up funds that could be used for capital investment or other expenditures that provide stimulus to the Canadian economy. Paired with 100-percent capital expensing, an extended carryback period for non-capital losses would provide Canadian businesses with efficient access to liquidity without increasing long-term corporate debt or government deficits.

III. Defer Ability to Collect Disputed Tax Amounts from Large Corporations Until Assessment Confirmed by Appeals Branch

The Minister of National Revenue ("Minister") is generally precluded from collecting amounts of tax that are in dispute (e.g., assessed amounts for which the taxpayer has filed a notice of objection) until the dispute is resolved.[7] If an amount of tax has been assessed in respect of a "large corporation," however, subsection 225.1(7) of the Act permits the Minister to collect one half of the amount so assessed notwithstanding any objection by the taxpayer (hereinafter, the "50-percent collection rule").[8]

TEI believes that the Minister's routine exercise of the 50-percent collection rule upon assessment imposes significant and unwarranted costs on large corporations seeking to access Canada's income tax objection and dispute resolution process. And for those companies struggling to access liquidity in today's uncertain economic environment, those costs can easily become insurmountable. Accordingly, TEI recommends that the 50-percent collection rule be amended to defer the Minister's ability to collect a disputed tax amount until after the assessment has been confirmed by the Canada Revenue Agency's Appeals Branch. TEI further recommends that the Minister be required to refund amounts previously collected under the 50-percent collection rule in respect of assessments not yet confirmed by the Appeals Branch. Collectively, these recommendations represent another discrete, easily implementable change that the government could make now to provide economic relief to affected companies without increasing corporate leverage or government deficits.

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[7] Section 225.1.

[8] The term "large corporation" is defined in subsection 225.1(8) and generally applies to any corporation that, together with any related corporations, has taxable capital employed in Canada in excess of $10 million.

These recommendations were prepared under the aegis of TEI's Canadian Income Tax Committee, whose chair is Kurtis L. Bond. Watson M. McLeish, tax counsel for TEI, coordinated their preparation. If you have any questions regarding TEI's recommendations, please contact Mr. Bond at (403) 260-1156 or Kurtis.L.Bond@conocophillips.com, or Mr. McLeish at (202) 470-3600 or wmcleish@tei.org.

Respectfully submitted,
TAX EXECUTIVES INSTITUTE, INC.

Katrina H. Welch
International President