Welcome Lorelei Bassi
Sign Out | My Profile

Search this site...

MEMBERSHIP | EVENTS & EDUCATION | TEI NEWS & VIEWS | TEI CHAPTERS | CAREER CENTER | TEI STORE | INTRANET | TEICONNECT | ORGANIZATION

TEI Submits 2009 Pre-Budget Recommendations to Canada's Standing Committee on Finance

- 8/10/2009

August 10, 2009

On August 10, 2009, Tax Executives Institute submitted written recommendations to the House of Commons Standing Committee on Finance in connection with the Committee's Fall 2009 Pre-Budget Consultations. TEI has also requested the opportunity to appear before the Standing Committee. TEI's recommendations were prepared under the joint aegis of its Canadian Income Tax Committee and Commodity Tax Commit-tees, whose chairs, respectively, are Rodney C. Bergen of The Jim Pattison Group and Diana M. Spagnuolo of Imperial Oil Limited. Jeffery P. Rasmussen, TEI Tax Counsel, served as legal staff liaison on this project.

Tax Executives Institute (TEI) is pleased that the Standing Committee on Finance has scheduled pre-budget consultations to gather input from across the country. TEI offers the following recommendations to foster economic growth and job creation, promote a favourable business environment for investments in Canada, and ensure a high level of innovation and productivity. We believe the implementation of our recommendations will spur economic efficiency, improve tax administration, and enhance the competitiveness of Canada's business tax system.

Background

Tax Executives Institute is the preeminent association of business tax professionals. Founded in 1944, TEI's 7,000 members work for 3,200 of the largest companies in Canada, the United States, Europe, and Asia. TEI's membership includes representatives from a broad cross-section of the business community, with members employed in all major industries and sectors of the economy. In that sense TEI is unique — we do not represent a particular group or industry. Canadians make up approximately 10 percent of TEI's membership, with our Canadian members belonging to chapters in Montreal, Toronto, Calgary, and Vancouver. In addition, many non-Canadian members work for companies with substantial Canadian operations, investments, and employees.

Executive Summary of Recommendations

TEI urges the Standing Committee to review the competitiveness of Canada's business tax structure, especially the recommendations of the Advisory Panel on Canada's System of International Taxation. TEI believes the competitiveness of Canada's business tax structure will be enhanced by:

- Eliminating withholding taxes for dividends under the Canada-U.S. Treaty and under Regulations 102 and 105 for cross-border services.
- Adopting a broader exemption system for earnings of foreign affiliates (FAs).
- Promoting increased harmonization of the federal and provincial tax bases and administrative systems by increasing incentives to eliminate remaining provincial capital taxes as soon as possible, encouraging the provinces to review and revise their tax policies to enhance the overall competitiveness of the Canadian business tax system, and promoting the benefits of full harmonization of the provincial retail sales tax systems with the GST.

Competitiveness Generally

Canada has enacted legislation to reduce the corporate income tax rate from 21 percent to 15 percent by 2012. TEI commends the government for taking this action because business tax rate reductions increase the attractiveness of Canada for both foreign and domestic investors. Increased capital investment in Canada, in turn, spurs productivity, promotes employment, and enhances the prospects for sustainable economic growth. The implementation of the phased corporate income tax rate reductions sends a strong signal to the capital markets about the government's commitment to enhancing the competitiveness of the Canadian business tax system.

Finance Minister James Flaherty has said that Canada "must establish a meaningful, marginal effective tax rate advantage . . . that goes beyond the statutory tax rate itself and takes the overall impact of the business tax system on investment decisions into account." TEI concurs and notes that a 2006 study raised questions about the competitiveness of Canada's business tax system,1 calling for additional tax rate reductions. The Institute recommends that the Standing Committee continue to monitor the competitiveness of the Canadian corporate income tax system, including the corporate tax rates.

Specific Recommendations to Enhance the Competitiveness of Canada's International Tax Structure

In November 2007, the government created an Advisory Panel on Canada's System of International Taxation (hereafter "the Advisory Panel") to study and recommend measures to improve the competitiveness, efficiency, and fairness of Canada's international tax system. The Advisory Panel released a consultation paper in April 2008, and TEI is pleased to have participated in those consultations. We are also pleased that the final report on *Enhancing Canada's International Tax Advantage* issued in December 2008 (hereafter "the Report") endorses recommendations that TEI made to the Panel (and, indeed, previously made to the Standing Committee). We believe Canada's international system of taxation will be improved by adoption of the following recommendations:

A. Withholding Taxes

1. Canada-United States Income Tax Convention. The United States and Canada have ratified the 5th Protocol to the Canada-U.S. Income Tax Convention. With the treaty's entry into force early next year, the maximum withholding rate on interest payments to non-arm's length persons will be reduced to zero over a three-year period. In addition, domestic Canadian legislation passed after the protocol's announcement eliminates withholding tax on interest paid to all arm's length nonresidents regardless of their country of residence.

TEI applauds the measures undertaken by the Canadian government. The reduction in withholding taxes for interest paid on arm's length debt will ensure that Canadian businesses have access to global capital debt markets at the lowest possible cost. We also applaud the reduction in the treaty's withholding taxes on interest on non-arm's length debt because it will strengthen the already formidable financial and trade ties between Canada and the United States.

More remains to be done, however, because *all* withholding taxes constitute unnecessary friction on cross-border transactions, especially in geographic regions where the economies are highly integrated and dependent on the cross-border flow of goods, services, technology, and know-how. To address this challenge, the European Union has eliminated withholding taxes on direct dividends on cross-border payments within corporate groups located in treaty countries. A nil withholding rate on dividends ensures tax neutrality within the EU and, hence, promotes job-creating investments throughout the EU free-trade zone. TEI believes that a tax-neutral environment within North America can be realized only by removing the friction of withholding taxes on cross-border dividends between the United States and Canada. Thus, we regret that negotiations for the Canada-U.S. treaty fell short of the goal of eliminating all withholding taxes, especially on payment of dividends to related group companies.

The Advisory Panel similarly concluded that *all* withholding taxes, including those on interest, dividends, and royalties, impede the expansion of Canadian businesses and urged the government to consider reducing withholding tax rates unilaterally or in bilateral treaty negotiations as the government's fiscal condition permits.2 The Advisory Panel emphasized reducing withholding taxes on group dividends and, because of the trade and investment volume, suggested that the Canada-U.S. Treaty should be the first treaty considered.3 TEI concurs. Thus, as a first step in advancing the goal of generally reducing all withholding taxes, TEI urges the Standing Committee to recommend that the Department of Finance review the competitiveness of the Canada-U.S. tax treaty and consider, at a minimum, negotiating a protocol that eliminates withholding taxes on dividends to related group companies.

The United States is a key market for Canadian goods, services, and investments by Canadians, as well as a key source of investment capital for Canadian enterprises. Since 2003, the United States has negotiated a nil withholding rate under its tax treaties with the United Kingdom, Mexico, the

Netherlands, and Sweden for direct dividends from companies that are more than 80-percent owned. In addition, recently ratified U.S. protocols with Germany, Denmark, and Finland and a treaty with Belgium include a similar provision. In the U.S.-Japan treaty, the ownership threshold to qualify for nil withholding is 50 percent. TEI believes steps should be taken to ensure that Canadian residents can secure benefits similar to those enjoyed by residents of other treaty partners of the United States and effectively compete with those jurisdictions for increased capital investments, exports, and jobs.

2. Regulations 102 and 105. In today's environment, business organizations staff their projects based on global skill sets rather than looking solely to the resources available within their home jurisdiction. Thus, access to skilled services and know-how is another key aspect of international competitiveness, especially where the skills or knowledge workers are not available in the Canadian market. To improve access to skilled services, the government should retain the current information reporting requirements for non-resident employees and service providers but repeal the withholding tax requirements under regulations 102 and 105, especially in respect of payments to U.S. employees and service providers. The Advisory Panel Report extensively discusses the pros and cons of the current withholding regimes and recommends that the current system be abandoned and replaced with a certification system similar to that in the United States. As important, the Advisory Panel recommended that the requirement to withhold taxes on services be eliminated where the nonresident service provider certifies that it would be exempt under a treaty such as the Canada-U.S. Treaty.4 We concur and urge the Standing Committee to implement its recommendations on withholding taxes as soon as practicable.

B. Exemption System

TEI urges the government to consider a broader — even a full — exemption system for dividends from foreign investments. A broader exemption would enhance the inherent economic advantages of foreign investments at a significant savings to taxpayers because the costs of complying with the complex FA rules to track and report exempt and taxable surplus would be eliminated or substantially reduced. Moreover, the administrative costs to Canada Revenue Agency (CRA) in administering those rules would be minimized. We are pleased that the Advisory Panel, in paragraphs 4.19 to 4.33 of the Report, substantially endorses this view.

In addition, while the government's 2007 budget announcement relating to Tax Information Exchange Agreements (TIEAs) signaled support for a broader exemption system, the expansion of the exemption system would be dependent on the negotiation of TIEAs with myriad foreign jurisdictions. Concededly, access to tax information in foreign jurisdictions is crucial, but the negotiation of such agreements can be slow and cumbersome. Rather than defer implementation of a broader exemption system or hold it hostage to the negotiation of TIEAs, Canada should adopt an approach whereby *only* active income earned in "black-listed" countries (*i.e.*, those designated by Canada as uncooperative in supplying information) will generate taxable surplus. The Advisory Panel reached a similar conclusion, stating that "the exemption system for foreign active business income earned by foreign affiliates should no longer be linked to tax treaties or TIEAs. The Advisory Panel believes there are sound reasons to detach the exemption system from tax treaties and TIEAs."5 Thus, the Advisory Panel rightly warned against precluding businesses from benefiting from the simplicity and other gains of a broader exemption system simply because a non-treaty country chooses not to negotiate a TIEA with Canada.6

Harmonization of the Federal and Provincial Tax Bases and Administrative Systems

The federal government has undertaken several initiatives to encourage the provinces to adopt tax policies that promote Canada's competitiveness and to improve the administrative efficiency of the provincial systems. We commend the government for providing financial incentives to the provinces to eliminate their capital and retail sales taxes. We urge the Standing Committee to consider additional incentives to the provinces in order to eliminate all provincial capital taxes and to promote additional investment in Canada.

We also commend the federal agreement with Ontario whereby Ontario will conform its corporate income tax base to the federal corporate tax base and the federal government will assume administration of Ontario's corporate income tax system. Similar moves by the other provinces would improve the overall efficiency of Canada's business tax structure. We also recommend that the Standing Committee encourage the provincial governments to review their corporate income and sales tax policies and effect rate reductions and tax base changes to enhance Canada's tax competitiveness. Finance Minister Flaherty rightly observed that "Canada stands out as one of four OECD countries that still impose capital taxes and one of three that impose retail sales taxes on investment. If provincial governments eliminated these taxes and harmonized their sales taxes with the GST, Canada would actually have the lowest marginal effective tax rate among G7 nations."

Tax Executives Institute has long supported harmonization of the provincial and federal sales tax systems.7 Substituting a value-added tax system for the current provincial retail tax systems

promotes a more neutral and competitive business tax environment by eliminating cascading sales taxes on business inputs. Hence, we are pleased that Ontario and British Columbia recently announced their intention to harmonize their retail sales tax regimes8 with the federal GST, but we are disappointed in the proposed temporary restrictions imposed on large corporations for claiming input tax credits for the provincial component of the tax on energy, telecommunications, vehicles, vehicle parts, and fuel, as well as for food, beverage, and entertainment costs. Equally important, in order to be fully effective, financial services should be treated as zero-rated (rather than exempt) supplies under the federal and provincial systems, just as they are treated under the Quebec sales tax regime. By failing to provide unrestricted input tax credits for all supplies to businesses and by failing to zero rate financial services, the harmonization is incomplete and economically inefficient. We encourage the Standing Committee and federal government to work with the provinces toward a *fully* harmonized system. TEI would be pleased to work with the Ontario and British Columbia Ministries of Finance (as well as other provinces) on the implementation of the harmonized sales tax and would be pleased to consult further with the Standing Committee, the Department of Finance, and the other non-harmonizing provincial governments about crafting a workable, *fully* harmonized system.

Conclusion

Tax Executives Institute appreciates the opportunity to participate in the 2009 pre-budget consultations by the House of Commons Standing Committee on Finance. If you should have any questions about TEI's written statement, we shall be pleased to respond. Please contact either Rodney C. Bergen, Chair of TEI's Canadian Income Tax Committee at 604.488.5231 (or Bergen@jp-group.com) or Sherrie Ann Pollock, Vice President for Canadian Affairs at 416.955.7373 (or sherrieann.pollock@rbcdexia.com).

Tax Executives Institute, Inc.

Vincent Alicandri
2008-2009 International President

1 Jack Mintz, *The 2006 Tax Competitiveness Report: Proposals for Pro-Growth Tax Reform*, C.D. Howe Institute Commentary No. 239 (September 2006), available at www.cdhowe.org/pdf/commentary_239.pdf.

2 "On balance, the Panel believes that further reducing withholding taxes is desirable for Canada. The Panel recommends that the government continue to reduce or eliminate withholding taxes in future tax treaties and protocols to those treaties." *See* Paragraph 6.20 of the Report.

3 "The Panel believes that further reducing withholding taxes, especially on direct dividends, would benefit Canada economically. Eliminating withholding taxes between Canada and the United States, for example, would remove an obstacle to cross-border flows of income and capital and help Canadian businesses, including small businesses, to expand in the United States and potentially elsewhere. Eliminating withholding taxes on interest and dividends could also reduce the cost of foreign capital for Canadian businesses. Reducing withholding taxes on royalties could lower the cost of importing foreign technologies, helping to improve the productivity of Canadian businesses." *See* Paragraph 6.8 of the Report.

4 *See* Recommendation 7.3 of the Report.

5 *See* paragraph 4.39 of the Report.

6 *See* paragraph 4.42 of the Report and recommendation 4.2.

7 As early as 1989, TEI expressed regret that the federal sales tax reform did not encompass the provincial sales tax systems. In addition, on January 20, 1997, the Institute testified in support of proposed legislation harmonizing the federal GST and provincial sales tax systems in the Maritime Provinces. TEI has also urged the Finance Ministers of the non-harmonizing provinces to consider harmonizing their sales tax systems so that Canada could have the benefit of a single national consumption tax with a single rate, identical base, and a unified administration. More recently, TEI submitted specific recommendations to Ontario and British Columbia to improve their implementation of a harmonized sales tax. Finally, TEI's previous pre-budget consultation statements to this Committee have consistently emphasized the need to eliminate direct taxes on capital at the federal and provincial levels.

8 British Columbia's retail sales tax regime is formally known as the *Social Services Tax Act*.

Membership

- Apply Online
- Application Forms
- Benefits
- Eligibility
- Standards Of Conduct
- Member Directory

Events & Education

- Special Chapter and Regional Meetings
- Education Calendar
- Become A Sponsor

News & Views

- Advocacy
- State & Local Tax Blog
- News Feed Blog
- Forums
- Forums Archive
- The Tax Executive Magazine
- President's Corner
- Less Taxing Matters
- TEI Canada

Find a Chapter

Type Chapter Name Go

Show all Chapters

Contact Us

About Us

F.A.Q.

Privacy Statement

Our Valued Sponsors

Exclusive Affinity Partner | Platinum | Gold | Silver | Bronze

© 2017 Tax Executives Institute

Tax Executives Institute, Inc. • 1200 G Street, N.W., Suite 300 • Washington, D.C. 20005 • 202.638.5601 (p) • 202.638.5607 (f)