February 11, 2008

The Honourable James Flaherty, P.C., M.P.
Minister of Finance
Department of Finance Canada
140 O'Connor Street
Ottawa, Ontario K1A 0G5

Dear Honourable Minister,

Please accept this letter on behalf of the Tax Policy Committee of the Issues and Policy Advisory Committee of Financial Executives International Canada (FEI Canada), hereinafter referred to as "the COMMITTEE".

The COMMITTEE understands the importance of setting clear and principled objectives, prudent and disciplined fiscal management, and effective economic leadership. We applaud your government's aggressive debt reduction strategy, which will reduce the federal debt-to-GDP ratio to 25% by 2011-12; the new Expenditure Management System, which will control federal spending in line with economic growth; and the proposed introduction of legislation which will place formal limits on programs cost-shared with the provinces. It is encouraging to note that federal program spending is expected to be lower than the rate of economic growth in the near term, without sacrificing program growth to needy Canadians such as the elderly.

The COMMITTEE recognizes that an essential element of sustained economic growth is the maintenance of a competitive economy, both within Canada and vis-à-vis our trading partners. The scheduled corporate and personal rate reductions and other selective measures introduced in the October Economic Statement and recent budgets will significantly enhance the competitiveness of the Canadian economy, contribute to economic growth, and result in increased disposable income for all Canadians. All Canadians, especially seniors, recognize the significance of your government's RRSP and pension income measures.

Additionally, the COMMITTEE strongly endorses your government's adherence to tax policies based on core principles. We fully support the following comments contained in the Economic Statement:

“Canada needs a tax system that rewards Canadians for realizing their full potential, improves standards of living, fuels growth in the economy, and encourages investment in Canada.”

“Canada needs an internationally competitive business tax system to ensure investment and economic growth …”.

BUDGET PROPOSALS

The COMMITTEE recommends that your Department consider the following taxation initiatives for inclusion in the forthcoming budget. We strongly believe these will achieve our mutual objectives of providing a framework for sustained economic growth, enhancing the competitiveness of the Canadian economy, focusing incentives on risky acquisitions which improve productivity, and improving the standard of living of all Canadians.

More specifically, these proposals address some of the key taxation and education concerns of FEI Canada’s membership. If implemented they would (i) assist Canadian corporations and the government as they endeavor to improve Canada’s environmental performance, (ii) enhance the domestic and international competitiveness of Canadian corporations, (iii) improve the cash flow of many Canadian corporations, thus enabling firms of all sizes to reinvest more after-tax funds in capital and productivity enhancements, and (iv) alleviate a pressing problem related to the acquisition of timely and cost-effective continuing education by Canadian corporations and their employees. **Furthermore, these targeted initiatives are either (i) sustainable given forecast federal surpluses, (ii) revenue neutral over the near to medium term, or (iii) relatively negligible in terms of foregone tax revenues.**

In presenting these proposals, please note that the COMMITTEE believes it is the responsibility of government to continue efforts to simplify the tax system, and remove unintended anomalies and impediments from the system, especially those which do not serve a tax policy purpose.

These proposals were developed following consultations with our members. We have, therefore, benefited from the insights provided by taxpayers intimately familiar with the current tax rules, impediments imposed by those rules and the additional costs incurred by Canadian businesses because of these rules.

CORPORATE TAXATION PROPOSALS

1. MANUFACTURING MACHINERY AND EQUIPMENT

Budget 2007 introduced an enhanced CCA write-off for machinery and equipment used in manufacturing and processing that would otherwise be placed in CCA Class 43. However, the accelerated CCA deduction only applies to machinery and equipment acquired after March 19, 2007 and before 2009. Whereas this timeframe may be appropriate for stimulating new investment in relatively small projects, it is inadequate for major commitments of investment funds. Construction on many large-scale projects currently under consideration will not commence for some years, as projects of this size typically require several years from project initiation to completion. Therefore these vitally needed investments will not benefit from the Budget 2007 measure.

- **The Committee recommends that this measure be extended for at least an additional five years, and that the termination date be reviewed periodically.**

2. ENVIRONMENTALLY FRIENDLY CAPITAL INVESTMENTS

To provide incentives for the acquisition of environmentally friendly capital investment, the COMMITTEE proposes the following broad-based incentive.

- **The half-year CCA rule should be eliminated for environmentally friendly capital equipment.**

Currently, CCA is available only on one-half of all net additions to a CCA class in the acquisition year. This proposal, by allowing full CCA relief in the acquisition year, will enable Canadian businesses to assist the government reach its environmental objectives, at minimal cost.

To effectively target this initiative, careful definition of the term “environmentally friendly” will be required. Ideally, all investments that supplant less efficient plant and equipment should qualify. Should this prove administratively unfeasible, qualifying investments could, for example, be restricted to energy efficient acquisitions, or those which utilize renewable energy resources. Alternatively, designated sectors, for example, natural resources or manufacturing, or investments which achieve desirable outcomes, pollution abatement, for example, could be targeted. Capital acquisitions which contribute to the manufacture of more energy efficient motor vehicles are another potential example.

- Following the 2006 and 2007 budget examples, which enhanced CCA for specific environmental investments, **further efforts should be made to identify additional investments which could be similarly assigned a higher CCA rate.**

3. CORPORATE GROUP TAX REPORTING

In spite of the introduction of the 20-year loss carry forward period, Canadian corporations will continue to experience cash flow problems as they are unable to annually offset profits in one group member with losses of another group member in the loss year.

Most developed economies that directly compete with Canada for capital currently have tax systems that allow annual group-wide tax reporting, including the United States (tax consolidation), the United Kingdom (loss transfer), and the European Union. Such measures would greatly simplify Canadian taxation practices. Prior FEI Canada research has indicated that significant time and money is spent developing mechanisms to ultimately accomplish the equivalent of group-wide reporting.

- **The COMMITTEE recommends that, following comprehensive study and consultation, a loss transfer or tax consolidation system should be introduced which would allow Canadian corporations to directly access the unused tax attributes of other members of a commonly owned corporate group.**

Group tax reporting offers many benefits to the Canadian economy. It enhances fairness, competitiveness, neutrality, investment, consistency and cash flow; reduces abuse, unnecessary corporate concentration, and costly and inefficient corporate expenditures; and improves budget projections and corporate structure efficiency. Group reporting would extend these benefits to all corporate sectors, including the small and medium size sector, where tax efficiency, combined with financing and family planning, are critical concerns.

4. WITHHOLDING ON INTEREST AND DIVIDENDS

Capital formation is a critical component of economic development and growth. Without significant infusions of new capital, economic development is hampered, critically needed maintenance and renewal is delayed, productivity is impaired, and employment levels are lower than is optimal. Unfortunately, Canadian capital pools are, and always have been, insufficient to satisfy the constant need for new investment capital. Consequently, Canada has historically relied on foreign investors to provide the capital not available from Canadian sources.

Given the globalization of economic activity and capital formation, where international investors can place investments anywhere in the world relatively quickly and easily, government must provide additional incentives to lure mobile capital to invest in Canada.

Your government recognized this imperative in concluding the recent Protocol to the Canada-U.S. tax treaty with respect to cross-border interest payments.

In order to provide the required incentive, the COMMITTEE recommends that Finance work with all non-U.S. treaty partners to reduce or eliminate the withholding tax on interest and dividend payments to non-Canadian entities, and on dividend payments to taxpayers subject to the Canada-U.S. treaty.

5. INCOME TRUSTS

As a result of the changes to the dividend taxation rules, the perceived imbalance between the taxation of dividends from large corporations and distributions from income trusts has largely been resolved. The COMMITTEE is somewhat sympathetic to the rationale underlying the October 31, 2006 announcement of the proposed tax on distributions from income trusts. As a consequence of these proposals, many income trusts are likely to reconvert to corporate status prior to the 2011 date at which the distributions tax will become effective. As the income trust sector moves on, we believe a number of issues remain to be resolved.

- The COMMITTEE is puzzled by the exemption granted REITs from the distribution tax rules announced on October 31, 2006. Why are REITs exempt, whereas energy trusts are not? Surely a “greater public interest” case cannot be made for REITs than for trusts in the energy sector.

    - **The COMMITTEE recommends that your department publish a more definitive statement clarifying the rationale for taxing the energy sector but not the rental property sector, or exempt energy trusts from the distribution tax.**

- According to informal discussions with CRA officials, the Agency expects that income trusts reconverting to the corporate form will, pursuant to IT-143R3, treat the costs of re-conversion as eligible capital expenditures. This seems unduly harsh, given that such re-conversions will be the consequence of a totally unexpected policy announcement.

    - **As a matter of equity, and to cushion the financial impact of a re-conversion from a trust to a corporation, the COMMITTEE recommends that all costs of re-conversion from an income trust to the corporate form be immediately deductible in the year incurred. This measure should be retroactive to October 31, 2006.**

PERSONAL TAXATION PROPOSALS

1. TAXATION THRESHOLDS

In spite of recent budget initiatives, the tax burden imposed on individual Canadians is still too high, especially compared to the tax burden in many other countries. In addition, Canada's current and expected budgetary surplus provides an opportunity to return unnecessarily high personal taxes to hard-working Canadians. Increased personal disposable income is either saved or consumed. Additional savings enhance the overall financial well-being of Canadians. To the extent that decreased income taxes result in increased consumption, a portion of the lost income tax yield is recouped by consumption taxes. Furthermore, increased consumption leads to more revenue for Canadian businesses, especially hard-pressed small and medium-sized corporations, increasing their cash flow and potential to employ additional employees.

The 2007 personal income thresholds are $37,178, $74,357 and $120,887. The comparable top threshold in the U.S., our most important trading partner, is significantly higher. While the debate over the "brain drain" can generate conflicting conclusions, it is unquestionable that mobile taxpayers (a group which includes senior and middle managers and executives/professionals), are influenced in their employment location decisions by the impact of taxation on their income.

To reduce the tax burden on lower and middle income Canadians, and to create an after-tax position for managers and professionals more comparable with the U.S., the COMMITTEE recommends the following personal tax change, which builds upon recent beneficial tax reductions.

- **Income thresholds for the personal income tax should increase to $46,500, $93,000 and $151,000, which are approximately 125% of the 2007 amounts.**

Implementation of this proposal will fulfill your government's commitment to reduce personal taxes, and will ensure a fairer tax system and one which will attract and retain highly skilled workers.

2. RETIREMENT PLANNING

Canada's population is aging, and will continue to do so for the next fifteen to twenty years. The number of retired individuals is increasing rapidly. Consequently, the percentage of 30 to 65 year old individuals is declining relative to the 65 and over age group. Canadians are also living longer. Many older Canadians are choosing to maintain their employment beyond the normal retirement age, either for work-related satisfaction reasons or because they must supplement their pension income. The retirement rules, therefore, should be adjusted to take these changes into account.

- **Because the dollar limit for contributing to a registered pension plan and an RRSP is approximately one-half of comparable limits in the U.S. and U.K., the**

COMMITTEE recommends that the dollar limit for contributions to these plans be increased from the 2008 limit of $20,000 to at least $30,000.

- **To allow individuals to provide for adequate retirement income, the COMMITTEE recommends that RRSP contribution limits should be increased from 18% to 25% of earned income.**

3. THRESHOLD FOR MINIMUM TAX

When the personal minimum tax was introduced in 1986, the threshold was set at $40,000. In spite of increases in income since 1986, especially inflation induced increases, the threshold for the personal minimum tax remains at $40,000. While this amount may have met the policy objectives of the measure when it was introduced, it clearly is inappropriate at a time when approximately 19.5% of Canadian tax filers report annual income between $40,000 and $70,000 (Interim Income Statistics, 2007). Many individuals, for whom the measure was never intended, may now be caught by the minimum tax rules because of the relatively low threshold.

The CPI has increased nearly 70% since introduction of the minimum tax. Had the threshold been indexed since its inception, the threshold would now be approximately $68,000.

- **In order to restore a comparable balance between incomes and the minimum tax threshold, the threshold should be raised to $68,000.**

OTHER PROPOSALS

1. DEFERRAL OF CAPITAL GAINS

During the 2006 election campaign your party discussed a proposal to defer the taxation of capital gains if the disposition proceeds are re-invested in another capital property within six months. To date there has been little public discussion of this proposal. Although there are implementation issues to be resolved, experience with similar measures, such as the rollover of the proceeds on disposition of shares of certain Canadian-Controlled Private Corporations, suggests that deferral of taxation on capital gains appropriately re-invested has positive overall results for the Canadian economy.

- **The COMMITTEE recommends that Finance include a measure in the Spring budget which would provide for a deferral on the disposition of all capital properties if the proceeds are re-invested in the same or a similar asset within six months.**

2. HARMONIZATION

Many Canadian corporations transact business in two or more provinces. The larger corporations do so in all ten provinces and one or more territories. Sales tax rates vary from province to province. Differences exist between the PST and GST tax base in some provinces. Sales tax registrants are burdened by unnecessary compliance costs as they must submit sales tax returns to two or more taxing authorities. Ceteris paribus, a similar item purchased in a non-harmonized province costs the consumer more than if it was purchased in a harmonized province.

With respect to the non-harmonized provinces, the Economic Statement noted that, *"Harmonizing with the GST is the single most important action that these provinces could take to improve their provincial and Canada's overall tax competitiveness."*

Various studies have indicated the need to remove or reduce provincial sales taxes. Whereas retail sales tax jurisdiction rests with the provinces, the federal government is responsible for administering the GST. Greater harmonization of provincial sales taxes with the GST would enhance competition, reduce red tape, and reduce compliance and administration costs as taxpayers and government would only have to deal with one sales tax authority.

- **The COMMITTEE applauds Finance's stated expression of willingness to work with the non-harmonized provinces, and recommends that the federal government provide the necessary incentives to encourage these provinces to harmonize their provincial sales taxes with the GST**.

3. WORKPLACE TRAINING

Governments have traditionally extolled the virtues of life-long learning and re-training. Canadian workplaces require highly skilled and trained individuals to increase the productivity of Canadian businesses. To augment in-house training programs, and the skills developed by Canadian technical and vocational educational institutions (skills development which will be greatly enhanced by several measures introduced in Budget 2006), the COMMITTEE recommends that your government consider the following three proposals:

- **A deduction for personally acquired training and development.**

- **Establishment of a Centre for Continuing Workplace Training and Education (preferably at a university or leading community college), which would be designed to serve the continuing education needs of Canadian businesses and workers.**

- **A portion of the EI contributions should be placed in a "learning account" which would provide funds for employees in declining sectors to take charge of their future by seeking new skills and training which will enable them to become re-**

employable relatively quickly. As a result, demands on the traditional employment insurance program will be reduced over time.

These proposals would fulfill your government's commitment to invest in education and training programs which will provide incentives for Canadians to excel in the workplace.

CONCLUSION

As outlined in this brief, fiscal discipline and aggressive debt reduction, federal spending increases less than GDP growth, a competitive tax regime, continued simplification of the tax system, targeted tax incentives, and a more competitive, environmentally friendly and growing economy are fundamental tenets of the COMMITTEE. We believe the tax measures we have proposed conform to these principles. We strongly urge your government to consider these measures and implement them in the Spring 2008 budget. The COMMITTEE stands ready to assist the government in fulfilling our mutual objectives.

Sincerely,

Barry Gorman
Chair, Tax Policy Committee
Issues and Policy Advisory Committee
FEI Canada

Michael Conway
Chief Executive and National President
FEI Canada

About FEI Canada

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.

The Issues and Policy Advisory Committee ("IPAC") is one of two national advocacy committees of FEI Canada. IPAC comprises more than 35 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: corporate governance, capital markets, tax policy, pensions, internal controls and public sector accountability. 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.