



## The future of productivity

An eight-step game plan for Canada

Presentation for FEI  
April 19, 2012, Adam Burke



# Canada has long enjoyed a high standard of living and strong economic performance relative to most countries, however change is afoot...

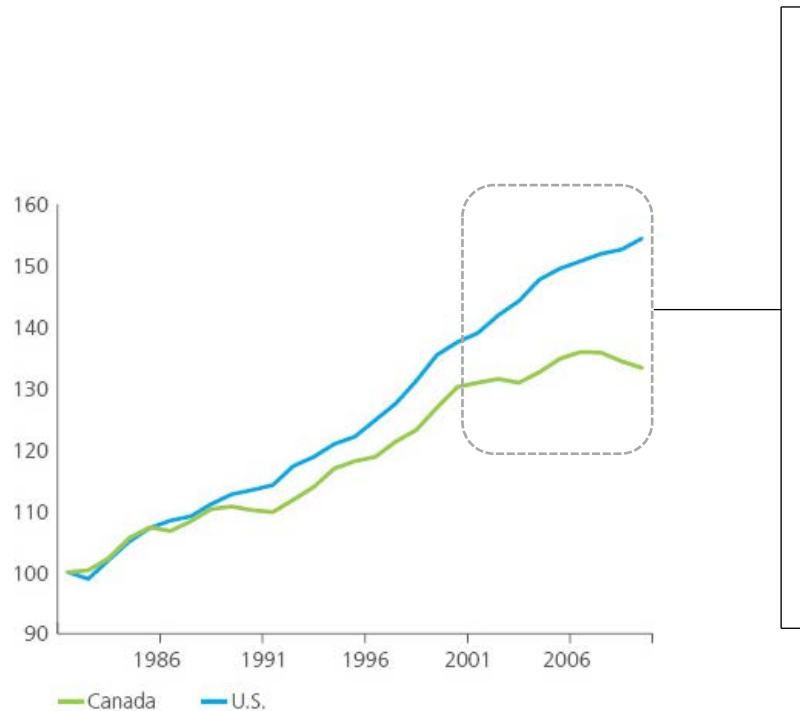
	In the past ...	Today ...
Demographics	Canada's labour force was growing as a percentage of the population; hours worked per employee was on the rise	An aging population is increasing the proportion of retirees and reducing hours worked
Canadian dollar	A low Canadian dollar created a price advantage, reducing other competitive pressures	A falling U.S. dollar is eroding Canada's price advantage
Access to U.S. markets	The signing of NAFTA in 1992 gave Canada unrivaled access to U.S. markets	Canada's share of U.S. imports is declining while the importance of non-U.S. markets is growing
Global marketplace	The global marketplace was dominated by mature economies with similar labour costs	The emergence of developing economies has heightened global competition and increased availability of lower-cost substitutes
Commodity extraction	Strong demand for commodities drove growth in Canadian resource extraction and depleted the most accessible reserves	Resource companies are now forced to explore less productive reserves such as the oil sands

# Canada now faces a significant and growing productivity gap relative to the U.S., which will threaten our long-term prosperity

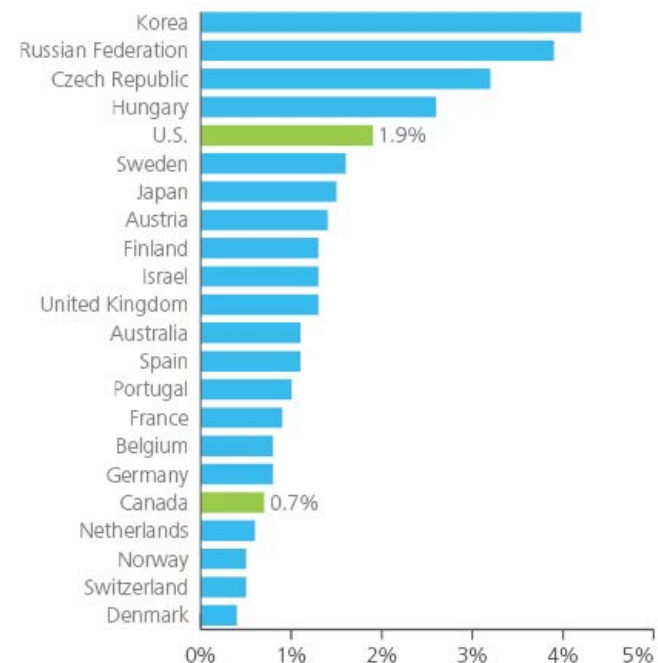
Over the past 30 years, productivity growth has taken divergent trajectories in Canada and the United States

The period from 2001 to present has been most challenging, as Canadian productivity growth has trailed most OECD nations

GDP per worker, indexed to 1981 baseline



Labour productivity CAGR, 2001-2009



Sources: Centre for the Study of Living Standards, OECD



# Deloitte believes that low productivity is, and will continue to be, the most significant threat to Canada's standard of living

$$\begin{array}{|c|} \hline \text{Employment rate} \\ \hline \% \text{ of total population} \\ \text{that is employed} \\ \hline \end{array} \times \begin{array}{|c|} \hline \text{Work effort} \\ \hline \frac{\text{Hours}}{\text{Worker}} \\ \hline \end{array} \times \begin{array}{|c|} \hline \text{Productivity} \\ \hline \frac{\text{Output}}{\text{Hour}} \\ \hline \end{array} = \begin{array}{|c|} \hline \text{Standard of living} \\ \hline \frac{\text{GDP}}{\text{Population}} \\ \hline \end{array}$$

Is this a problem for Canada?

**No**

Canada's unemployment rate has not surpassed 12% in the past 40 years, and has hovered between 6% and 9% in the past 10 years

**No**

While the average number of hours Canadians work has decreased slightly over the past 30 years, declines are in line with the OECD average

**Yes**

Canada's productivity growth has been declining in recent years on both an absolute basis and relative to its peers

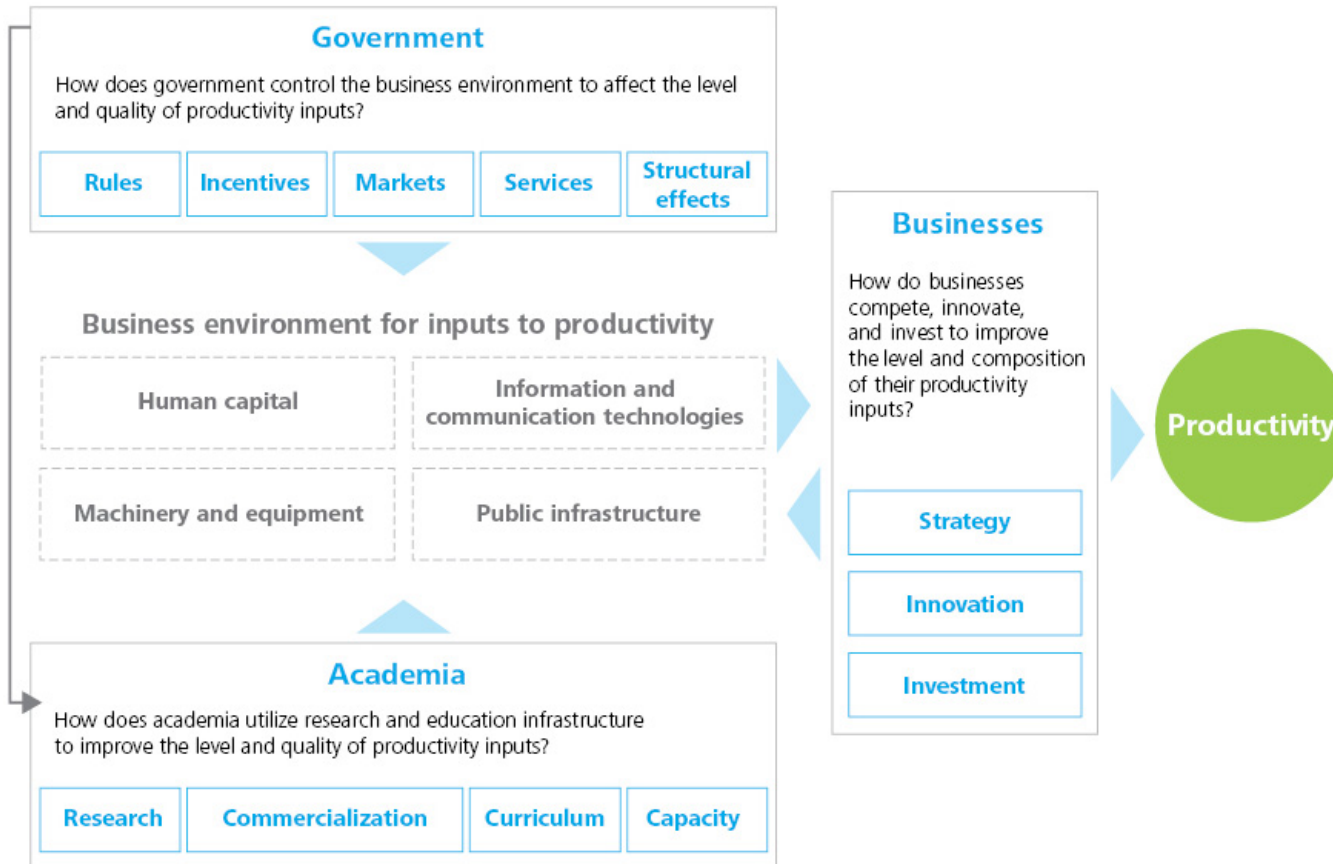
**Yes**

GDP per capita is increasing at a slower rate than many of our peers

Sources: OECD, Statistics Canada

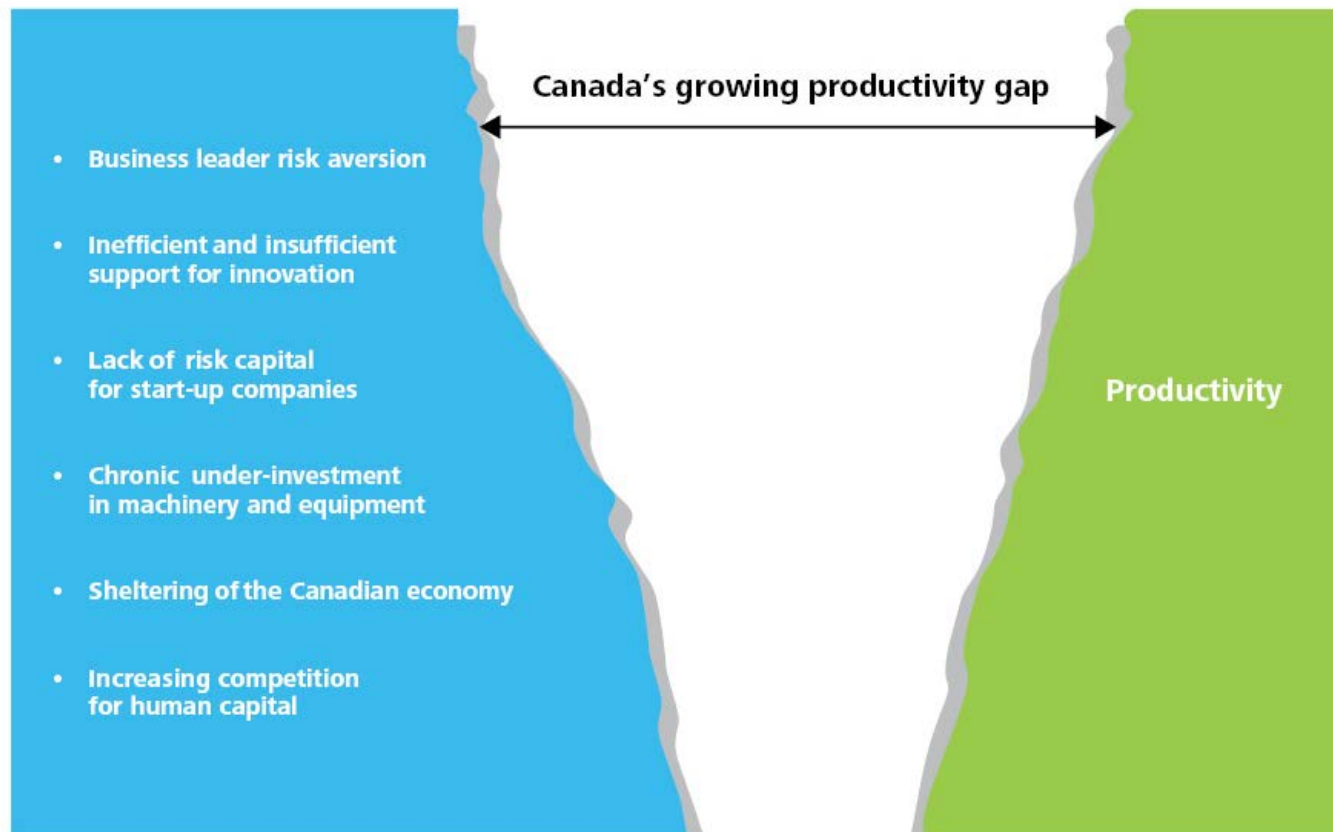


# We believe that to address the issue of productivity businesses, academia and government must act in a deliberate and collaborative fashion



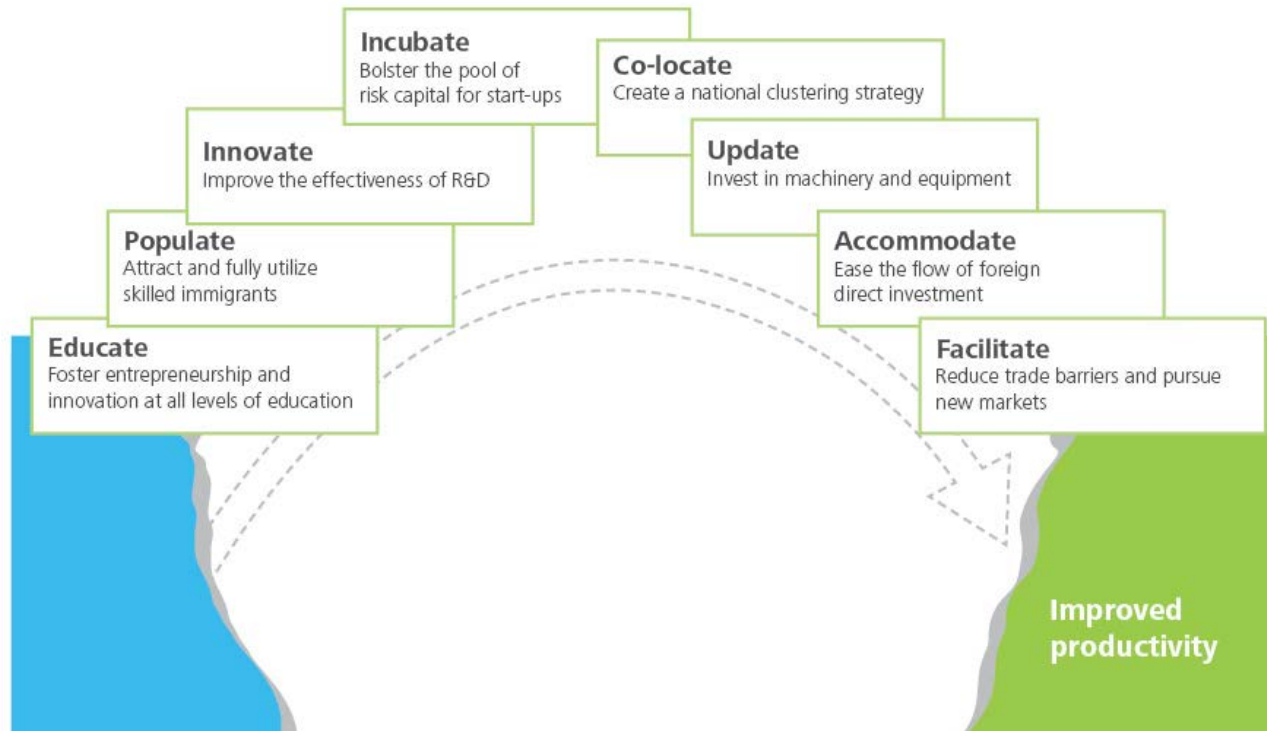


## Based on our research Deloitte believes Canada should focus efforts on addressing six key issues that are likely to have a material impact on productivity going forward



# Deloitte has put forward eight recommendations we believe are necessary to improve Canada's productivity in the near-term, and to foster ongoing productivity growth

In order to achieve meaningful impacts on Canadian productivity, businesses, academia and government will need to act in a deliberate and collaborative manner across eight key recommendations:



Each recommendation enables the success of others creating a self-reinforcing system for driving improvement in Canada's productivity

**Deloitte.**





# 2012 Federal Budget



**April 19, 2012, Norm Col**

# Tax Policy – Deloitte Perspective

- Attracting talent
- Innovation / Research
- Financing

# Projected Deficit

2011/2012	2012/2013	2013/2014	2014/2015	2015/2016
(24.9)	(21.1)	(10.2)	(1.3)	3.4

# Economic Update

- GDP growth 2.1% in 2012 and 2.47 in 2013
- Unemployment to decline 7.5% in 2012 to 6.6% in 2016
- Inflation to remain around 2% over next 5 years
- Canadian dollar above par compared to US dollar
- Interest rates to increase slowly over 5 years





# 2012 Federal Budget

## Business Changes

- SR&ED
- Thin capitalization
- Foreign affiliate dumping
- Partnership
- Other

# 2012 Federal Budget

## SR&ED

- Reduce SR&ED ITC to 15% for years after 2013
- Exclude capital expenditures after 2013
- Exclude lease payments after 2013
- Reduce proxy amount  
60% in 2013, 55% after 2013
- Limit contractor payments to 80%
- Exclude amount arms length contractor paid for capital expenditure
- Pilot pre-approval program
- Improve objection process, secondary review of eligibility

# 2012 Federal Budget

## SR&ED

- More direct investment to promote innovation
  - \$400 million to help increase private investment in early stage risk capital
  - \$100 million to BDC for venture capital activities
  - \$110 million for IRAP program
  - \$105 million for forestry innovation
  - \$95 million Canadian Innovation Commercialization Program
  - \$67 million in 2013 for NRC business (education, industry relevant research)



# 2012 Federal Budget

## Thin capitalization

- After 2012 reduced to 1.5 to 1
- Extend rules to partnerships
- Interest disallowed will be treated as a dividend after March 29, 2012
- Exclude interest expense if interest is FAPI of foreign affiliate

# 2012 Federal Budget

## Partnership

- No step up of partnership interest on wind up or amalgamation
- Gain on income assets taxable when partnership interest sold
- Designate one partner to waive 3 year time limit for partnership

# 2012 Federal Budget

## Foreign Affiliate Dumping

- Deemed dividend for non-share consideration
- No increase in PUC of shares given as consideration
- Withholding tax on deemed dividend
- Business purpose test
- Effective March 29, 2012

# 2012 Federal Budget

## Transfer Pricing

- Secondary adjustment treated as a dividend
- Subject to withholding taxes
- Codify that repatriation of excess amount will avoid the deemed dividend

# 2012 Federal Budget

## Other Business Measures

- Additions to class 43.2 for energy equipment
- Phase out the corporate tax credit for:
  - Exploration expenditures, eliminated 2014
  - Pre-production development expenses eliminated, 2016
- Phase out of 10% Atlantic Investment Tax Credit for oil, gas & mining
- Extend 10% Atlantic Tax Credit for certain electricity generation equipment

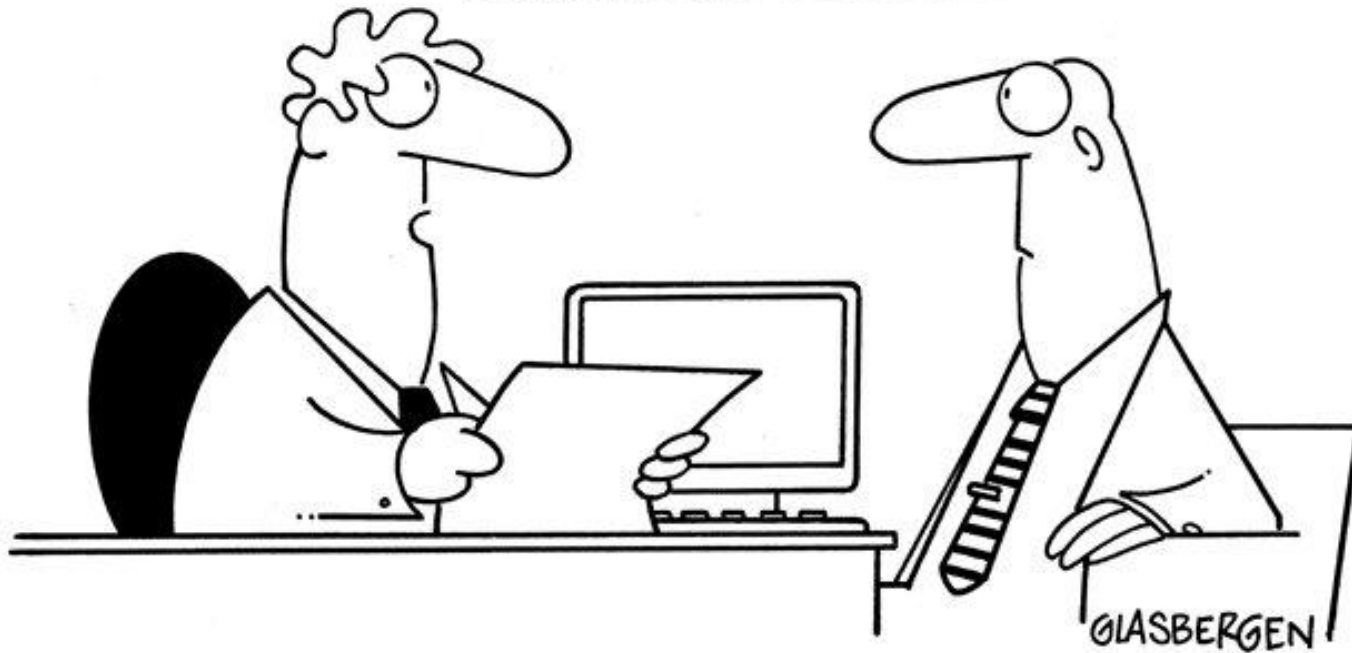
# 2012 Federal Budget

## Individuals Changes

- OAS eligibility
- Eligible dividend
- RCA's
- EPSP's
- Other



## INVESTMENTS AND RETIREMENT PLANNING



**“If you work hard and invest wisely, you can afford to turn 65 on your 80th birthday.”**

# 2012 Federal Budget

## OAS Eligibility

- Not affecting those 54 and older on March 29, 2012
- Gradually increased from 65 to 67, fully implemented January 2029
- Starting January 1, 2013 can defer receiving OAS for up to 5 years
- No changes to CPP contribution levels (9.9%)



# 2012 Federal Budget

## Eligible Dividends

- Designate at time of payment
- Can split dividend between eligible / ineligible
- Late designation within 3 years of initial notification time
- Effective March 29, 2012

# 2012 Federal Budget

## RCA's

- Prohibited investments for RCA with a specified beneficiary
- 50% tax on FMV of prohibited investment
- Penalty refunded if prohibited investment sold within the following year
- Concept of advantage
- Special tax equal to the FMV of the advantage
- RCA tax refunds if not attributable to prohibited investments and advantage
- transitional rules

# 2012 Federal Budget

## EPSP

- Payments from EPSP's not subject to source deductions
- Deferral of income tax
- Excess EPSP amount is defined
- Allocation to specified employee greater than 20% of salary received
- Special tax equal to top personal rate
- Effective for contribution on or after March 29, 2012

# 2012 Federal Budget

## Other

- Employers contribution – group sickness and accident insurance plans now taxable benefit
  - Contributions for coverage after 2012
- Life insurance policy exemption test to be revisited, effective for insurance policies issued after 2013
- Overseas Employment Tax Credit to be eliminated over 4 years
- Changes to registered disability savings plan
- Annual registration of tax shelter schemes and increased penalties for non-reporting
- Extend eligibility for mineral exploration tax credit, to flow through share arrangements entered into before March 31, 2013, for one year
- Expansion of eligible medical expenses

# Ontario Budget

- Freeze general corporate tax rate at 11.5%
- Corporate tax rate reduction to continue in 2017/2018
- SRED changes due to Federal Budget
- Continue to use Federal rulings in determining employee/employer relationship for EHT purposes



# Corporate Tax Rates

	2011	2012	2013
Federal	16.5	15.0	15.0
Ontario	11.75	11.5	11.5
	28.25%	26.5%	26.5%



**“The government is doing you a favor. If they didn’t take most of your money, you’d have to find time in your busy schedule to spend it yourself.”**

# Current issues and strategies for dealing with tax controversies



Thursday April 19, 2012

Shiraj Keshvani

Partner Global Transfer Pricing and Tax Controversy





# Introduction / Overview

- Ever changing environment when dealing with CRA as “tax landscape” changes
- Issues faced by taxpayers and tax practitioners are largely in response to CRA actions/positions
- We are in an era where significant challenges are being faced by taxpayers, tax practitioners, the CRA and the Department of Justice
- Diminishing levels of experience

# Canadian trends and developments

## Canadian Environment

- Taxpayer risk rating and related multi-specialist team audits
- Ever changing environment when dealing with CRA as “tax landscape” changes
- Issues faced by taxpayers and tax practitioners are largely in response to CRA actions/positions
- We are in an era where significant challenges are being faced by taxpayers, tax practitioners, the CRA and the Department of Justice
- Diminishing Levels of Experience

# Canadian trends and developments

## Domestic trends

- Taxpayer risk rating and related multi-specialist team audits
- Increased utilization of CRA audit powers
  - More requests for information and formal requirements to provide documents and information under s.231.2
- Multiple Audits and “bleeding” of information/data across functions
- Transfer Pricing
- SR&ED claims
- Applications of GAAR and aggressive tax planning
- Provincial planning
- GST / HST audits
- Cross Border travellers

# Recent TP controversy developments

Canada continues to be very active

## Audit and assessment practices

- High level of audit activity across the board
- CRA resourcing in transfer pricing: >450 full-time personnel

## Industry focus

- Automotive
- Pharmaceutical
- Financial
- Energy and natural resources

## Hot issues

- Royalties and Intangibles
- Interest rate/Guarantee fees
- Management fees/Intercompany service fees/QCCA
- Business restructuring

# Global trends and developments

## International trends

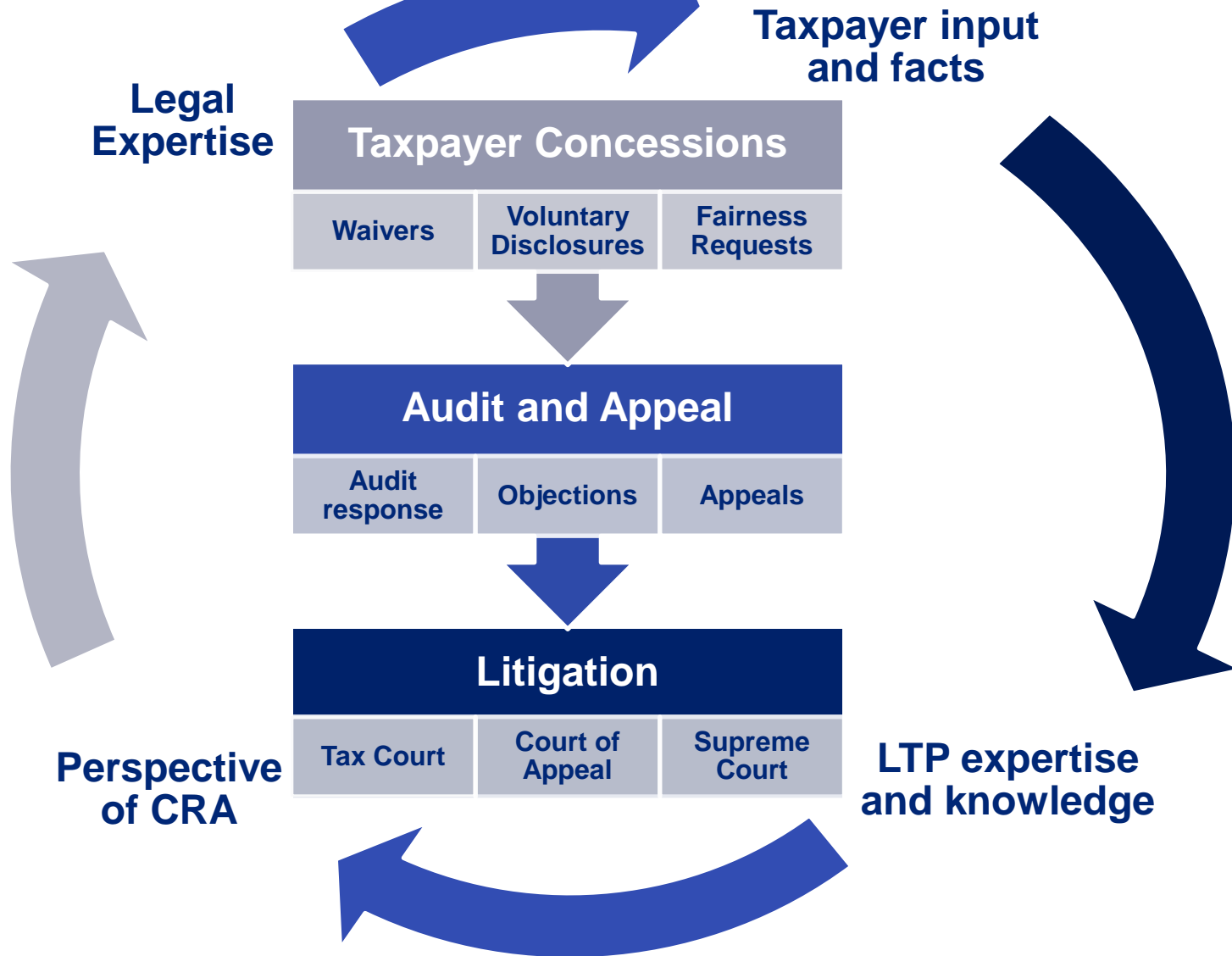
- Greater resources for International Tax Audits
- Information sharing and collaboration between Tax Authorities
- Transfer pricing methods of multinationals
- More governments “at the table”
- Views (of governments) may conflict

# Increased use of audit powers

## Requests and requirements

- Increased utilization of audit powers and in particular use of requests for information and formal requirements to provide documents and information under s.231.2
- Creates increased burden on taxpayers when formal 231.2 requirements are issued
- From a taxpayer's perspective often appears to be unnecessary and "overkill"
- Requests for foreign-based information and documents under section 231.6
- Cannot use general powers to issue requirements under section 231.2 to obtain foreign-based information and documents

# Strategic Considerations - Take into account **all** perspectives and avoid process bias

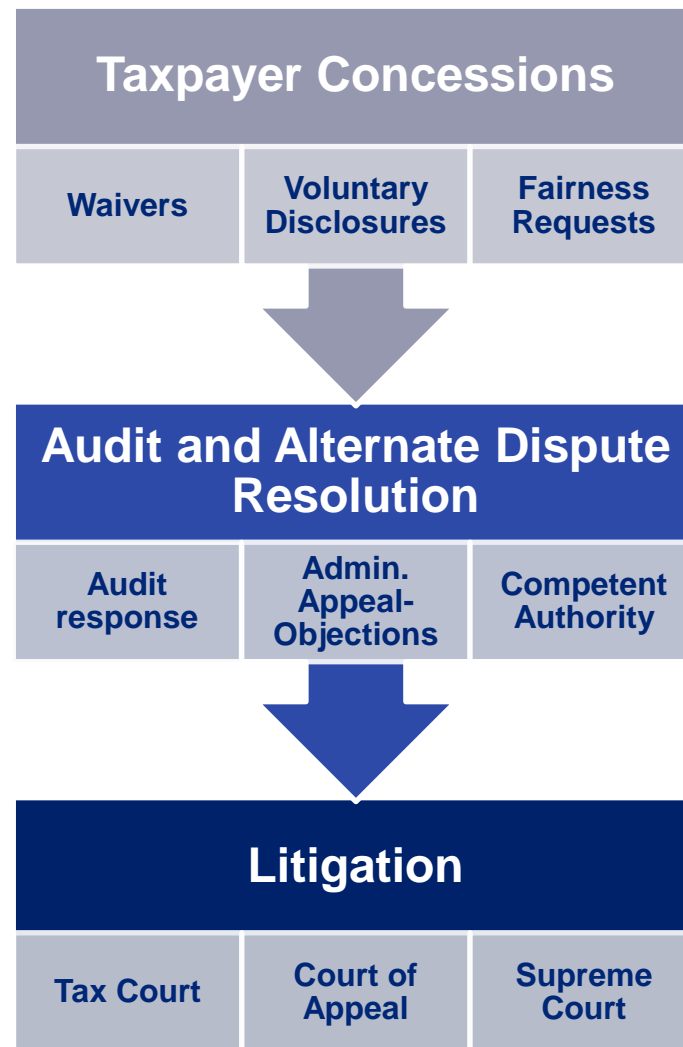


# Strategic Considerations: One size does not fit all

Does the taxpayer qualify for relief?  
What are the costs?  
How quickly can it be obtained?  
What if taxpayer doesn't qualify?

Ability to negotiate with auditors  
Should the audit be terminated  
Is there a better resolution at Appeal  
or Competent Authority  
What are the costs?  
How quickly can this be done?

What are the costs?  
What is the probability of success?  
Are the reputational risks?  
Are the facts ideal?





# Strategic Considerations -Perspective and experience influences biases

**Taxpayers may favour**

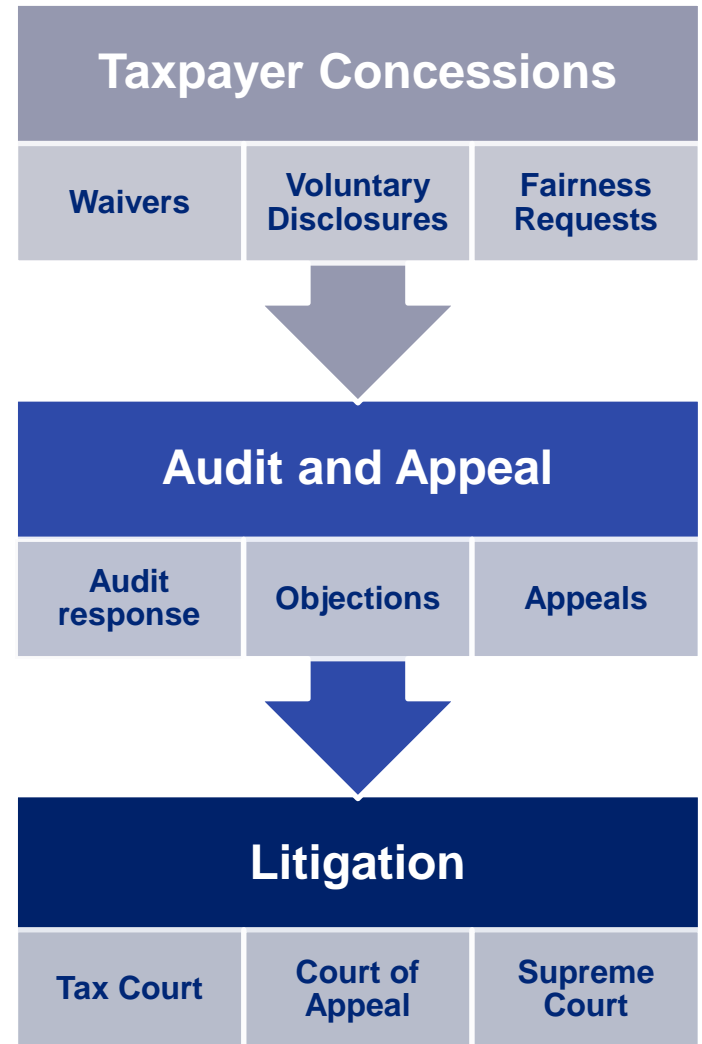
- Perceived as low cost approach

**CRA may favour**

- Perceived as “cost of doing business”
- Less costly than litigation

**Litigators favour**

- May be costly but perceived as “taxpayer friendly”



# Strategic Considerations: Increased use of audit powers/privilege issues

- Often taxpayers' desire to disclose some privileged information at early stage to clarify positions or support tax filing
- Methods to disclose privilege material without additional waiver of privilege
- Necessity of determinations by the Court
- Privilege issues arise requiring need to involve counsel at an early stage
  - Consideration of legal advice privilege

# Strategic Considerations: Appeals Division/notices of objection

## Considerations

- Delays/Timelines of dealing with Notices of Objection is the number one issue
- Subsection 165(3), “all due dispatch” . . . myth or reality?
- Reliance on subsection 169(1) to move matters to the Tax Court of Canada after 90 days, without review by the Appeals Division becoming increasingly more common:
  - Timeliness
  - Cost
  - Anticipation of “predictable result”
  - Necessity for more “in depth” legal analysis

# Strategic Considerations: Rectification

- Common law remedy, relief is outside jurisdiction of Tax Court of Canada
- Quebec Court of Appeal decision in *Services Environnementaux AES Inc.* confirms rectification available under Quebec civil law principles
- Requirements under common law
  - A prior agreement
  - A common and continuing intention
  - A final document which does not properly record the intention of the parties
  - A common or mutual mistake

# Strategic Considerations: Rectification

- Key rectification cases in the tax context
  - *Juliar*
  - *Dale*
  - *Bramco*
  - *Sussex Square Apartments*
- Expansion of remedies beyond rectification
  - *Stone's Jewellery Ltd.*
  - *S & D International Group Inc.*

# ***Copthorne Holdings Ltd.***

## **Analysis**

### **Tax benefit**

- Court found that a tax benefit arose from the restructuring that increased the amount of PUC eligible for tax-free repatriation.

### **Avoidance transaction**

- Court found there was a series of transactions that resulted in a tax benefit and an avoidance transaction that was a part of the series.

### **Misuse or abuse of the Act**

- At issue was the application of subsection 87(3) of the Act
- 87(3) provides that the PUC of the shares of the amalgamated corporation may not exceed the PUC of the shares of the predecessor amalgamating corporations, excluding the shares of an amalgamating corporation that were owned by another amalgamating corporation.

# ***Copthorne Holdings Ltd.***

## **Analysis**

- Court considered the “implied exclusion” argument, i.e., whether the fact that a particular transaction is not caught by these PUC provisions should lead to the conclusion that the transaction is not inconsistent with the purpose of these provisions
- Court further noted that one cannot find abuse based on a broad statement of policy, such as anti-surplus stripping, which is not grounded to the provision in question
- concluded that the object, spirit and purpose of subsection 87(3) is to preclude preservation of the PUC of the shares of a subsidiary corporation upon amalgamation where it would result in a return of PUC in excess of the amounts invested in the amalgamating corporations with tax-paid funds
- Court found that the transactions resulted in an abuse of subsection 87(3) of the Act

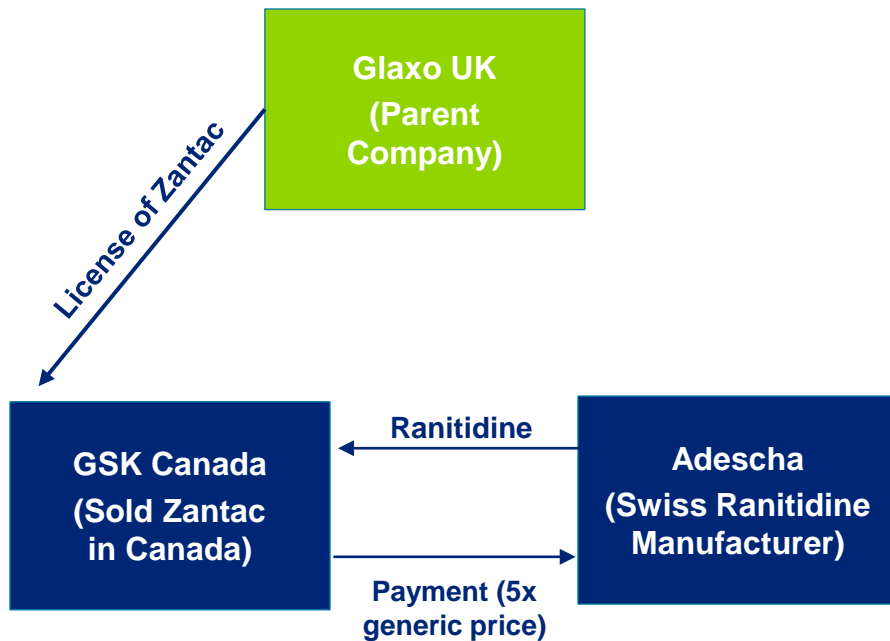


# Canadian Transfer Pricing Jurisprudence

- Rulings on transfer pricing cases still remain unclear and more guidance on section 247 from the courts is yet to come
  - Various cases are settling before reaching the courts
- Cases litigated have generally included more complex transactions (intangible property and financing transactions) or transactions involving low-tax jurisdictions
  - Cases involving intercompany services and management fees more likely to settle before being litigated
- TP cases have not necessarily involved large transactions
- Only four recent cases are the source of Canadian transfer pricing case law and precedent.
  - It is expected that more guidance on the application of section 247 will emanate from Court judgments still to be issued in the coming months

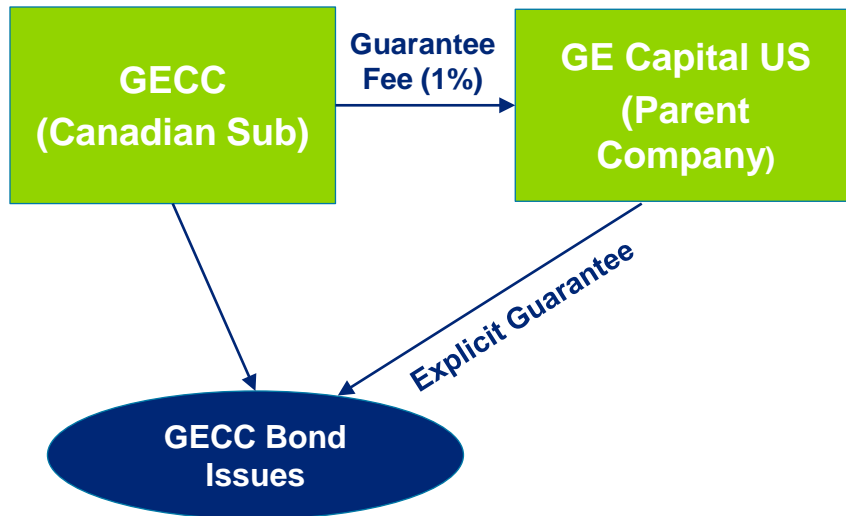


# Update from recent cases - GlaxoSmithKline



- First transfer pricing case heard at the Supreme Court of Canada on January 13, 2012
  - Identification of transaction limited to *bona fide* legal arrangements?
  - Bundling vs. unbundling of transactions for analysis
  - Arm's length standard vs. "reasonable business person" test
- CRA - only generic cost of ranitidine be considered as market cost (CUP method)
- GSK - question is whether arm's length parties would accept transaction as entered into, ignoring ingredient to be used by branded product Zantac-reasonable under the circumstances?

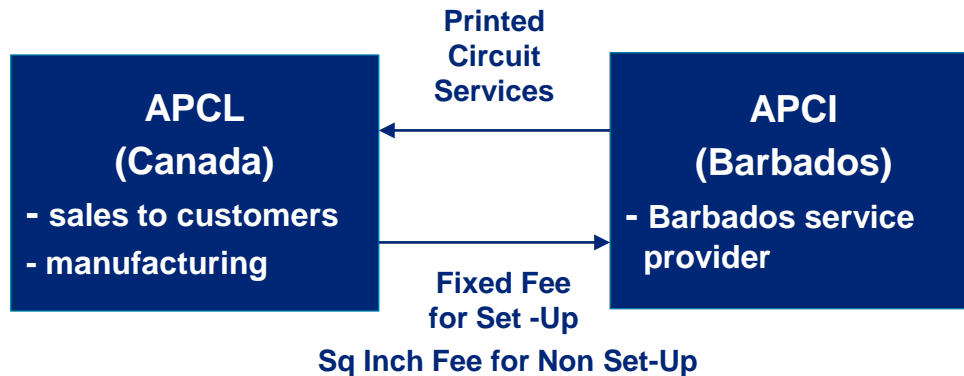
# Update from recent cases – General Electric Canada Company



- On December 19, 2011, the Tax Court dismissed a motion by General Electric Canada Company (“GECC”) and GE Capital Canada Funding Company (“the Appellants”)

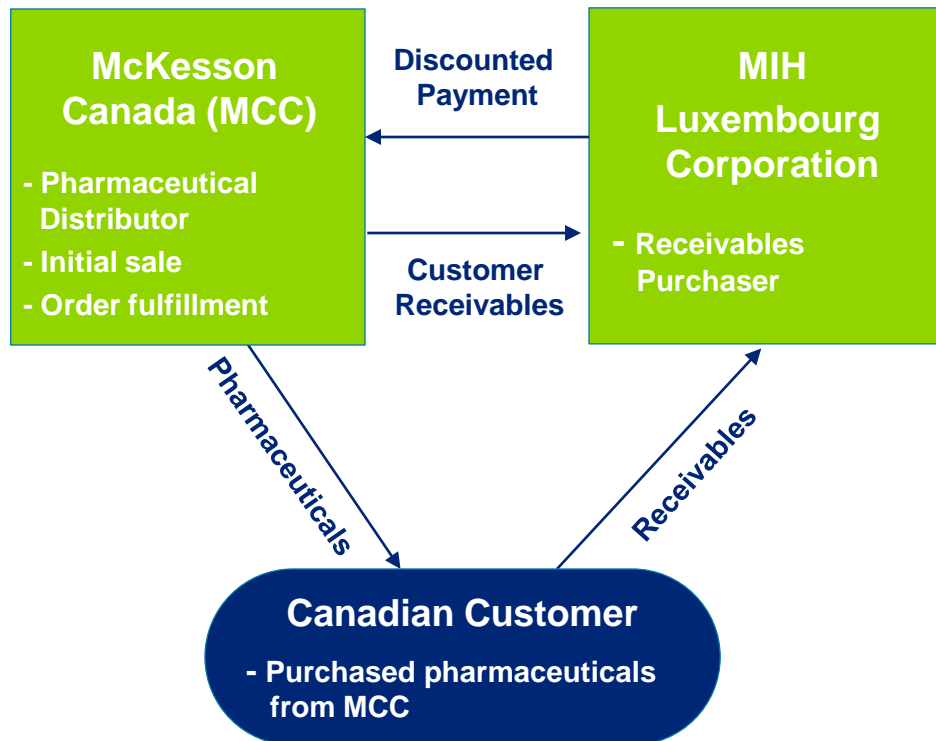
- The Appellants sought to strike several paragraphs from the Replies filed by the Crown on the basis that the Crown was re-litigating a previously-decided matter
- Motion dismissed on basis of different taxpayers and years in question
- Leave given to the Crown to make a small amendment to one of the Replies to clarify the distinction between legally binding guarantees and implied guarantees or support

# Update from recent cases – Alberta Printed Circuit Ltd.



- Taxpayer presented support for the use of CUP method
- Court agreed with taxpayer's position and strongly criticized CRA for not considering CUP as appropriate method
  - Comparatively much smaller transactions
  - Involved low tax jurisdiction (Barbados)
- Further evidence of endorsement of the CUP method

# Recent court experience - McKesson case

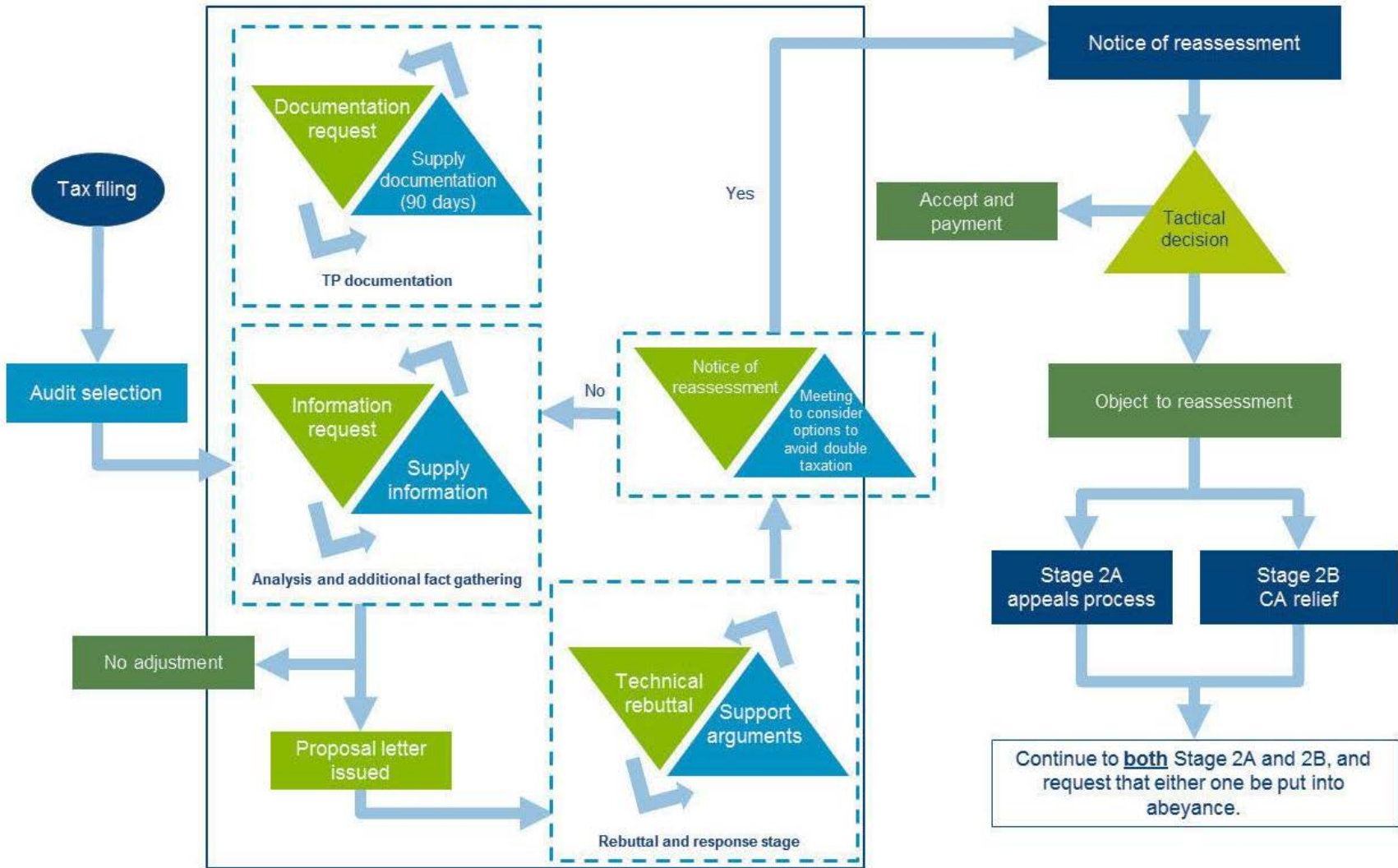


- Concluded on February 3, 2012 and judgment should be released in coming months
- Sale of receivables to related Luxembourg company
- CRA: The agreed-upon discount rate for factoring accounts receivable differed from the discount rate to which the parties would have agreed had they been dealing with one another at arm's length

# Canada

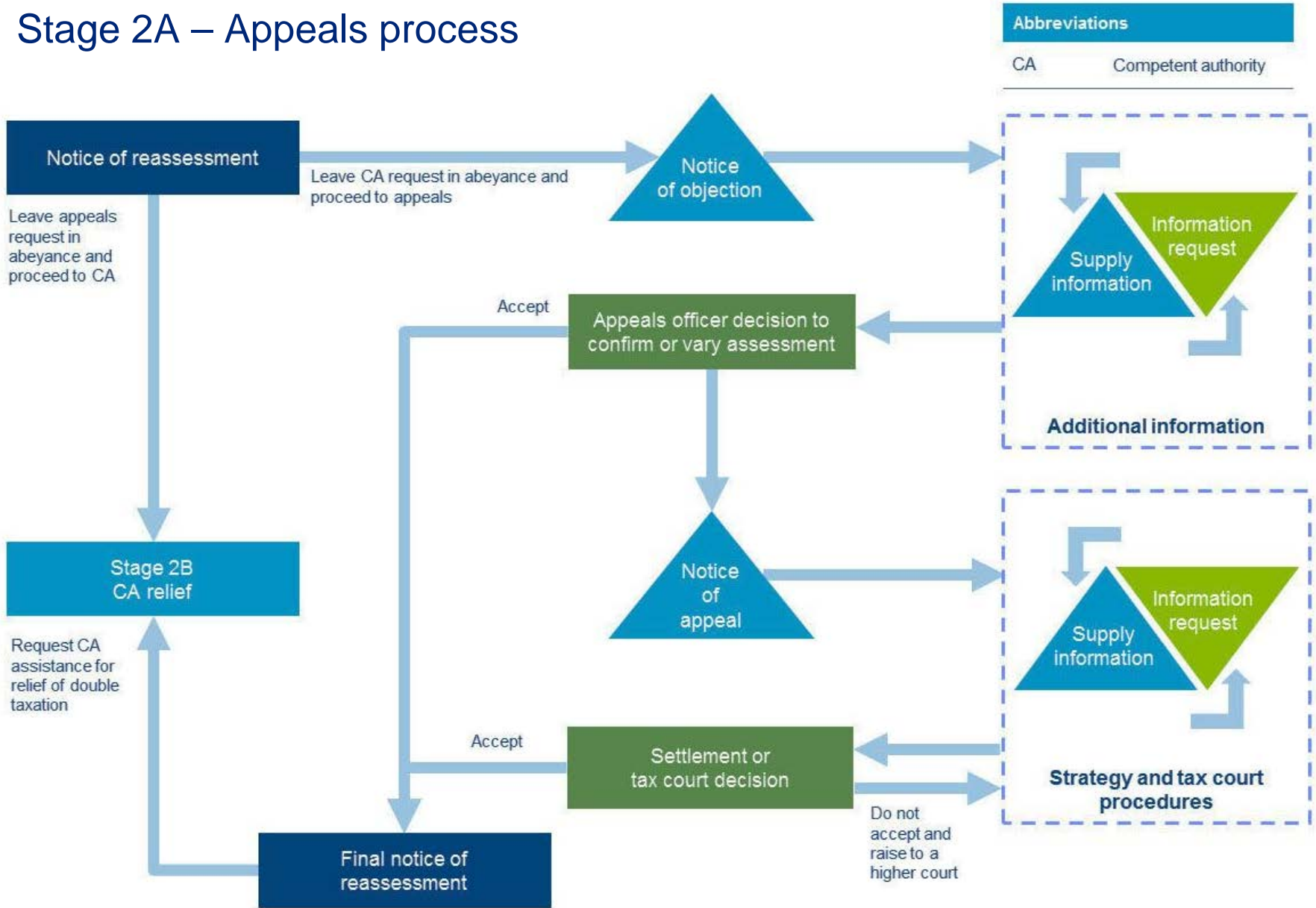
## Stage 1 – Tax authority audit

Abbreviations	
TP	Transfer pricing
CA	Competent authority



# Canada

## Stage 2A – Appeals process



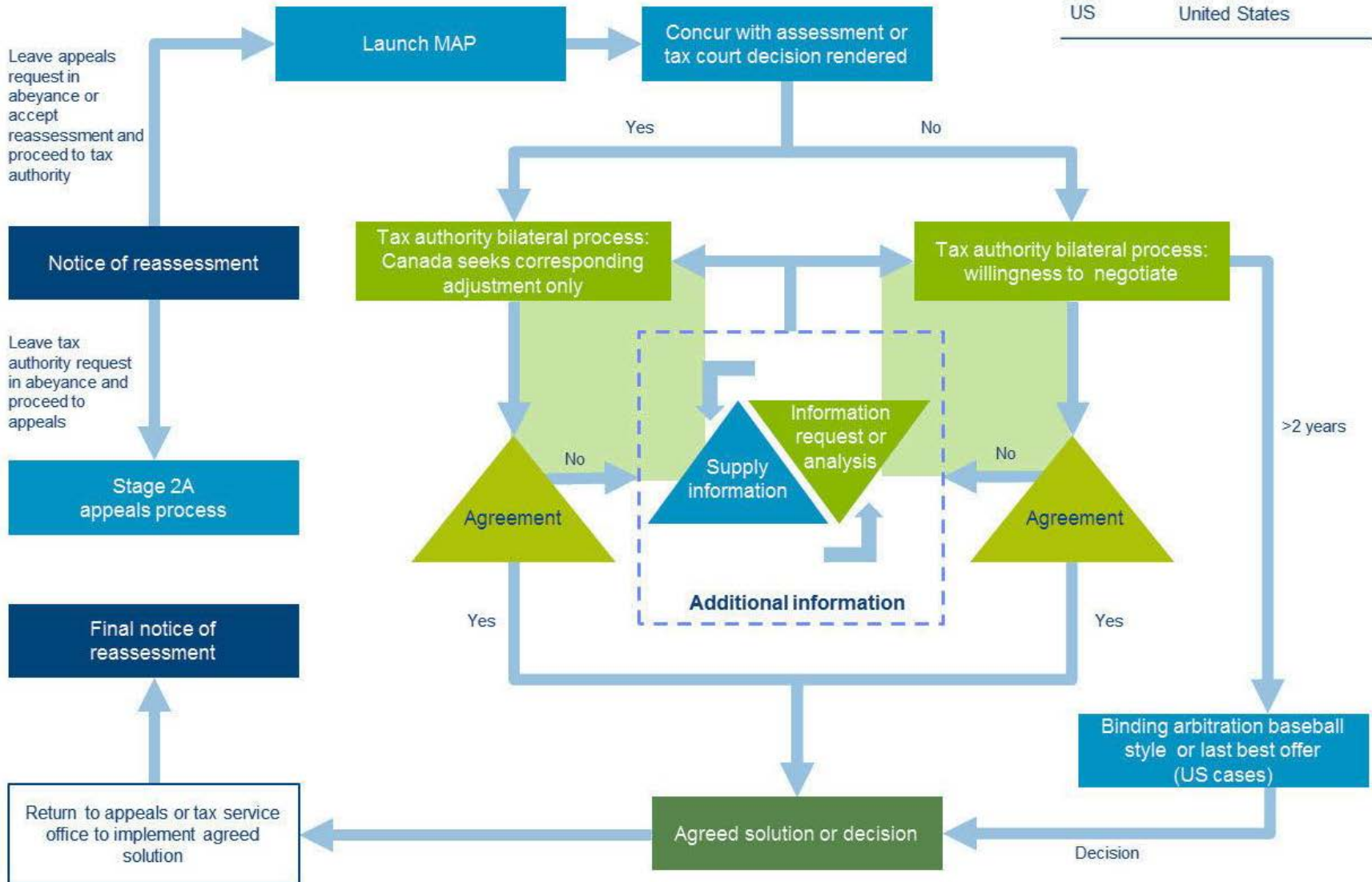
# Canada

## Stage 2B – Relief from double taxation

### Abbreviations

MAP Mutual agreement procedures

US United States




















# Number of new map cases initiated by reporting period

OECD member countries

EM

	2006	2007	2008	2009	2010
	<b>Number of new cases</b>				
 Australia	9	13	8	19	21
 Austria	29	26	36	30	38
 Belgium	31	30	71	213	120
 Canada	76	70	85	103	101
 Chile	0	0	0	0	0
 Czech Republic	5	10	5	6	8
 Denmark	15	18	21	22	20
 Finland	1	11	8	5	11
 France	104	100	154	169	--
 Germany	212	186	177	177	150
 Greece	1	2	--	--	--
 Hungary	4	3	1	2	1
 Iceland	1	0	0	0	0
 Ireland	3	3	2	6	7
 Israel	--	--	--	--	4
 Italy	14	20	14	31	22

 Japan	37	49	40	44	34
 Korea	8	9	13	25	13
 Luxembourg	22	31	31	25	35
 Mexico	14	11	5	10	4
 Netherlands	80	57	--	64	51
 New Zealand	4	5	2	6	4
 Norway	15	21	30	21	16
 Poland	11	7	19	14	7
 Portugal	10	7	5	14	17
 Slovak Republic	0	--	1	1	3
 Slovenia	--	--	3	0	2
 Spain	18	67	24	24	24
 Sweden	72	61	104	64	104
 Switzerland	--	45	99	119	65
 Turkey	0	2	1	3	4
 United Kingdom	--	55	44	56	68
 United States	240	257	308	326	252
<b>Total</b>	<b>1036</b>	<b>1176</b>	<b>1311</b>	<b>1599</b>	<b>1206</b>








# Inventory of MAP cases at end of reporting period

## OECD member countries

	2006	2007	2008	2009	2010
	<b>Inventory of cases at end of reporting period</b>				
 Australia	16	23	22	23	27
 Austria	144	152	105	120	106
 Belgium	81	95	152	265	142
 Canada	134	153	186	206	225
 Chile	0	0	0	0	0
 Czech Republic	13	13	4	8	13
 Denmark	82	82	79	86	67
 Finland	12	22	20	22	32
 France	254	233	328	427	427
 Germany	476	527	519	543	484
 Greece	4	5	5	5	5
 Hungary	12	9	10	7	8
 Iceland	1	1	0	0	0
 Ireland	4	6	7	13	16
 Israel	13	13	13	13	13
 Italy	52	63	56	67	80

## EM

 Japan	67	85	82	90	75
 Korea	28	30	30	47	44
 Luxembourg	31	34	35	38	59
 Mexico	26	23	14	18	13
 Netherlands	120	151	127	118	97
 New Zealand	2	4	1	3	1
 Norway	25	32	42	51	52
 Poland	26	25	33	32	26
 Portugal	43	45	47	47	41
 Slovak Republic	1	4	5	6	7
 Slovenia	--	--	3	1	2
 Spain	55	109	66	76	84
 Sweden	94	100	125	103	134
 Switzerland	33	33	88	143	142
 Turkey	2	3	2	4	8
 United Kingdom	84	109	126	120	131
 United States	430	500	578	724	705
<b>Total</b>	<b>2365</b>	<b>2684</b>	<b>2910</b>	<b>3426</b>	<b>3266</b>

**Deloitte.**