

# Submission to the House of Commons Standing Committee on Finance

## 2010 Pre-Budget Consultations

Prepared by the Canadian Bankers Association

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# Introduction

The Canadian Bankers Association (CBA) welcomes this opportunity to participate in the 2010 pre-budget consultations of the House of Commons Standing Committee on Finance. Following two years of economic and financial instability, the Bank of Canada in its June Financial System Review stated that the global economic recovery is under way, but it has been uneven. Growth in the emerging-market economies has been strong, but less so in many advanced economies, some of which are still heavily dependent on government stimulus packages or struggling with debt problems.<sup>1</sup> In Canada, the economic recovery is stronger than in other G7 countries but is expected to moderate a bit, despite significant employment growth in June.

In this economic environment, Canada's healthy banking sector continues to contribute substantially to the Canadian economy. In 2009, banks in Canada paid \$7.5 billion in taxes to all levels of government and contributed approximately 3.8% to Canada's GDP. Banks employ more than 260,000 Canadians and full-time bank employment has increased 27% in the past 10 years. Banks provided financing to 1.2 million small and medium-sized businesses in 2008. And in 2009, banks paid out more than \$11.1 billion of profits in dividends. As most Canadians are shareholders in Canada's banks either directly or through the Canada Pension Plan, pensions and mutual funds, these payments benefit the vast majority of Canadians and their retirement savings.

And it is important to remember that Canada was one of a few countries whose banking system remained strong throughout the economic crisis, saw no bank failures and needed no bank bailouts.

In light of the banking industry's continued strength and its role in helping Canadians plan their financial security and making financing available for job creation, we are providing our comments on a number of important public policy issues that affect individual Canadians and entrepreneurs, as well as the Canadian economy as a whole: creating a single securities regulator; encouraging economic growth through tax policy; new retirement savings initiatives; and financial literacy.

## Single Securities Regulator

For many years, the CBA has advocated for efficient securities regulation, with the strong belief that a national securities regulator will benefit all Canadians. We congratulate the government for its perseverance on this important economic issue as Canada's current fragmented system puts us out of step with other countries around the world. A single, Canadian regulator will offer improved investor protection and greater efficiencies in capital markets and will reduce the cost of raising capital for businesses across the country and give Canada one voice on the international stage. It will also allow Canada to respond more nimbly and effectively to global policy and regulatory developments, and to ensure a consistent, national perspective is brought to bear when dealing with global standard-setters.

The CBA commends the Canadian Securities Transition Office for its work on the Transition Plan and the Canadian *Securities Act*, and is supporting the government's move to seek a decision from the Supreme Court of Canada about the proposed legislation.

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<sup>1</sup> Bank of Canada, "Financial System Review", June 2010.

# Encouraging Economic Growth through Tax Policy

Canada's fiscal position is widely recognized as one of the strongest in the world – a position which allowed it to play a leading role in developing coordinated policy at the G20 to reduce deficits and stabilize debt levels at a sustainable level. In its own 2010 Budget, the federal government set out a plan to eliminate its deficit by 2015, setting Canada on a course to be the only G7 country to do so in that timeframe.

One of the underpinnings of our strong financial position is the emergence of a more competitive tax system. Initiatives by the federal and provincial governments during the last decade have set Canada on a course to achieve the lowest corporate income tax rates and the lowest marginal effective tax rates on new business investment in the G7 and very competitive rates within the G20 by 2012. In its 2008 Budget, the federal government announced a schedule of corporate income tax cuts designed to reduce the rate to 15% by 2012. We commend the government for re-affirming its commitment to this schedule in the 2010 Budget despite the fiscal challenges created by the recession. Capital available for business investments is mobile. Lowering tax rates increases the incentive for businesses to invest in Canada which, in turn, raises Canadian productivity and ultimately creates more sustainable, high paying jobs for Canadians. It has been estimated that a 3% decline in the federal corporate income tax rate would generate \$47 billion in additional capital investment and 233,000 jobs over time.<sup>2</sup> In fact, other countries are now looking to Canada as a role model for fiscal restraint and tax competitiveness. For example, the UK government recently announced that it will gradually reduce its corporate income tax rates to 24% (compared to the combined federal-provincial target of 25% in Canada), while broadening its tax base, in order to improve its tax competitiveness.

**Recommendation:** Maintain the schedule of corporate income tax rate reductions announced in the 2008 Budget, which will see the rate decline to 15% by 2012.

A jurisdiction's taxation system is one of the factors which enhances the ability of its corporations to compete and expand internationally. As noted, the financial crisis revealed the relative strength of Canada's financial sector compared to that of other jurisdictions. It also created a unique competitive opportunity to expand internationally. We urge the government to address the issues which may deter Canadian corporations from taking advantage of this opportunity. For example, earnings of Canadian corporations could be more readily reinvested at home or abroad, if the exemption system were extended to cover all active business income of controlled foreign affiliates, regardless of whether Canada and the foreign jurisdiction have a Tax Information Exchange Agreement (TIEA). The current rules do not generate tax revenue in Canada but deter expansion and reduce the global competitiveness of Canadian institutions. While the negotiation of additional TIEAs is helpful, and we encourage the government to continue to do so, more can be done. In addition, the rules which protect the domestic tax base from erosion by taxing passive income earned abroad should be reviewed to ensure that they meet their policy objectives while not inadvertently impeding *bona fide* commercial business transactions.

In 2008, the Advisory Panel on Canada's System of International Taxation studied the impact of Canada's international tax rules on Canadian businesses investing in foreign markets and foreign businesses investing in Canada. Its report made a series of recommendations, in aggregate fiscally neutral, designed to improve

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<sup>2</sup> Jack Mintz, "We will all benefit from further business tax reforms", *Globe and Mail*, May 31, 2010

the competitiveness, efficiency and fairness of Canada's system of international taxation, minimize compliance costs and facilitate administration and enforcement<sup>3</sup>. These included the measures listed above as well as other practical suggestions such as taking initiatives to improve the dialogue between taxpayers, tax advisors and the Canada Revenue Agency. We support the conclusions of the Advisory Panel's report and believe that the government should implement its recommendations. The international tax system is very important for a trading nation such as Canada. The Advisory Panel noted that "Because the Canadian market is relatively small, Canadian companies often need to engage in cross-border trade sooner than other companies that are based in countries with larger domestic markets."<sup>4</sup>

**Recommendation:** Continue to implement the recommendations of the report of the Advisory Panel on Canada's System of International Taxation.

## **Taxation of corporate groups**

In its December 2009 report, the House of Commons Finance Committee recommended that the government review the federal fiscal implications of allowing consolidated tax reporting and the 2010 Budget included a commitment to explore whether new rules for the taxation of corporate groups – such as the introduction of a formal system of loss transfers or consolidated reporting – could improve the functioning of the tax system. Subsequently, in its 2010 Budget, the Ontario government offered to work collaboratively with the federal government to explore options to address the impact on interprovincial income allocation of transactions to utilize losses within corporate groups. The CBA welcomes these announcements and urges the government to initiate its review.

Absent consolidated reporting, losses incurred by some affiliates within a corporate group cannot be offset against profits earned by other affiliates. As a consequence, liquidity and international competitiveness of Canadian corporations are negatively impacted. Some form of tax consolidation for groups of related companies is common practice in other developed countries. A recent study on the issue of consolidated reporting by the CD Howe Institute found that Canada is the only country within the G7 which does not have consolidated reporting or a similar mechanism. The report concludes that "Providing a comprehensive group taxation regime would bring fairness, simplicity and certainty of tax outcome for Canadian corporations. As it is, Canada's approach to corporate group taxation gives rise to a number of problems, including higher administrative and transaction costs, unfairness among different types of corporations, uncertainty, and weakened international competitiveness."<sup>5</sup> Consolidated tax reporting would not have a material impact on aggregate government revenues since it primarily affects the timing of the utilization of losses to offset taxable income.

**Recommendation:** Review the taxation of corporate groups to develop a consolidated tax reporting regime that would improve the functioning of the tax system and the competitiveness of Canadian corporations.

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<sup>3</sup> Advisory Panel on Canada's System of International Taxation, "Enhancing Canada's International Tax Advantage", December 2008, p. 1,3.

<sup>4</sup> Ibid., p. 12.

<sup>5</sup> Alexandre Laurin, "Cleaning up the Books: A Proposal for Revamping Corporate Group Taxation in Canada", CD Howe Institute Commentary No. 284, March 2009.

## New Retirement Savings Initiatives

Many Canadians do not have access to employer pension plans. These Canadians have the option of saving individually in a variety of ways, whether tax assisted or not. While these individual savings offer a great deal of flexibility to savers, these Canadians miss out on the advantages associated with large, professionally managed pension plans. The CBA believes they should have the option to participate in such plans even if their employers choose not to sponsor pension plans.

Consequently, the CBA applauds the announcement by the federal Minister of Finance following the June 2010 meeting of finance ministers in Charlottetown that governments would be considering innovations that would permit financial institutions to offer broadly based defined contribution pension plans to all working Canadians. We believe that all Canadians, including small business owners and the self-employed, should be given access to structured pension plans by delinking pension plans from the employment relationship and allowing third parties (such as banks and other financial institutions) to provide such plans. Canada's financial sector is well placed to deliver such products in a convenient and efficient manner. In designing these new innovative products, governments should be cognizant of the fact that different financial institutions operate under differing legislative regimes. We believe the goal should be to design products that are of best value to Canadians and to allow the broadest range of financial institutions to offer these products on a level playing field basis. Our analysis and recommendations were included in a report entitled "[Enhancing Canadians' Savings Options: Strengthening the Third Pillar in Canada](#)" issued in April<sup>6</sup>.

### Personal income tax measures to enhance Canada's retirement income system

The personal income tax system contains many measures related to retirement savings including tax incentives to save, preferential tax treatment of retirement income and measures to ensure that savings in deferred tax plans are ultimately withdrawn and subjected to taxation. These measures could provide more flexibility in decisions on when and how to save for retirement, and on when and how much to withdraw to fund living expenses in retirement. We also believe that a review of personal income tax measures would be beneficial to address greater life expectancy and to remove incentives to retire early. Such a review should consider:

- a delay in the age at which RRSPs must be converted to payout mode;
- adjustments to, or elimination of, the minimum annual withdrawal amounts for RRIFs / LIFs, in view of lower investment returns and extended life spans which impact the sustainability of retirement income;
- lifetime, rather than annual, contribution limits for deferred tax plans and TFSAs to reflect the fact that financial and personal circumstances change throughout the working years;
- equity in the amount of tax deferral room provided in, and tax treatment of retirement income from, various types of deferred tax plans; and
- mechanisms to provide more equitable tax treatment of dividend income and capital gains earned inside a deferred tax plan, e.g. by reducing the tax rate on retirement income from deferred tax plans.

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<sup>6</sup> The report is available at [http://www.cba.ca/contents/files/submissions/sub\\_20100426\\_pension\\_en.pdf](http://www.cba.ca/contents/files/submissions/sub_20100426_pension_en.pdf).

**Recommendation:** Undertake a review of personal income tax measures related to retirement savings in order to provide Canadians with greater flexibility in decisions related to saving for retirement and utilizing retirement savings once retired, and to provide them with equitable access to preferential tax measures.

## Financial Literacy

The federal government has recognized that financial literacy is an important life skill and most people make financial decisions, either large or small, on a daily basis. The banking industry shares the federal government's commitment to improving financial literacy and for years, the banks, as well as the CBA, have been providing their customers and the general public with information to help them better understand the financial products and services that they use and the economic functioning of the country as a whole.

As an example, the CBA has brought financial literacy to Canadians through its high school seminar program, *YourMoney*, which has taught more than 186,000 senior high school students about budgeting, borrowing, saving, investing, and protecting themselves from fraud. Established in 1999, the non-commercial seminar uses volunteer bankers from the local community to teach young Canadians about responsible money management. *YourMoney* is offered in collaboration with the Financial Consumer Agency of Canada (FCAC).

In June of 2009, the federal government established its Task Force on Financial Literacy to make recommendations to the Minister of Finance, by the end of 2010, on a national strategy to strengthen Canadians' financial literacy. The CBA strongly supports the mandate and the work of the Task Force. We provided it with [a submission of recommendations](#)<sup>7</sup> and appeared before the Committee in May as part of its consultations. Included in the CBA's recommendations are the need to make financial education a part of the high school curriculum and that the national financial literacy strategy should tap into the broad expertise and experience of the private sector, including banks and other financial service providers.

We look forward to the Task Force's report in the coming months and to providing assistance to the Task Force and the government on strategies to implement some of the recommendations in the report.

## Conclusion

Canada has emerged from two years of global economic turmoil in a comparatively stronger competitive position. We recommend that the 2011 Budget focus on measures to take advantage of that position by enhancing the climate for business investment and job creation in Canada and improving the international competitiveness of Canadian businesses. This is also an opportune time to review and update tax measures to provide greater flexibility and equity in Canada's retirement income system.

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<sup>7</sup> The submission is available at [www.cba.ca/contents/files/submissions/sub\\_20100429\\_taskforcefinlit\\_en.pdf](http://www.cba.ca/contents/files/submissions/sub_20100429_taskforcefinlit_en.pdf)