

# Submission to the Standing Committee on Finance and Economic Affairs

Prepared by the Canadian Bankers Association

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# Introduction

The Canadian Bankers Association (CBA) welcomes this opportunity to participate in the 2011 pre-budget consultations of the Standing Committee on Finance and Economic Affairs. The CBA works on behalf of 51 domestic chartered banks, foreign bank subsidiaries and foreign bank branches operating in Canada, most of which have significant operations in Ontario. Despite the turbulent economic environment of the last few years, Canada's banks have remained strong and continue to contribute substantially to the Canadian and Ontario economies. The industry accounted for:

- 4.8% of Ontario's GDP in 2009;
- 148,040 jobs in the province in 2009 (an increase of 2.8% from 2008), constituting over half of the industry's Canadian workforce;
- \$2.2 billion in 2009 provincial and municipal tax payments in Ontario (paid by the six largest banks alone), up strongly from the previous year; and
- \$389 billion in total business lending in the province of which \$32.4 billion was lent to small and medium sized businesses as of June 2010<sup>1</sup>.

We appreciate the Ontario government's identification of financial services as a key sector in the provincial economy and the government's ongoing support in improving the sector's competitiveness and its ability to create high skilled / high paying jobs. As noted in the fall Economic Statement, employment in Ontario's financial services sector increased to 365,000 jobs in 2009 and the sector also supports an estimated 280,000 ancillary jobs, including high paying business services jobs<sup>2</sup>. In total, it is now directly or indirectly responsible for over one out of every nine jobs in the province.

In this submission, we are providing our comments on a number of important public policy issues that affect Ontario residents and businesses and which impact the Canadian economy as a whole: a competitive tax regime; securing our retirement future; a single securities regulator; and, financial literacy.

## A Competitive Tax Regime

We commend the government on the substantial changes it made to its tax regime in the 2008 and 2009 Budgets, including the elimination of all capital taxes, a schedule of corporate income tax rate cuts that will reduce the provincial rate to 10% as of July 1, 2013, and harmonization of sales taxes with the GST. While the implementation of the HST has meant a substantial increase in the sales tax burden borne by the banking industry because of the exempt status of financial services, we recognize that the collective impact of the tax changes, aggregated across all sectors, will be a substantial reduction in the marginal effective tax rate (METR) on capital investment from 33.6% in 2009 to 19.4% in 2013<sup>3</sup>, placing Ontario on a competitive basis with Alberta, Quebec and British Columbia, as well as neighbouring U.S. states, and increasing Ontario's long term tax competitiveness for business investment and job creation.

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<sup>1</sup> Aggregate lending data for BMO, BNS, CIBC, HSBC, Laurentian Bank, National Bank, RBC and TD.

<sup>2</sup> 2010 Ontario Economic Outlook and Fiscal Review released November 18, 2010, p. 43

<sup>3</sup> Jack M. Mintz, "Ontario's Bold Move to Create Jobs and Growth", University of Calgary School of Public Policy Communiqué, Volume 1, Issue 4, November 2009, p.4

Clearly the government has difficult decisions to make in order to return to a fiscal balance. This may lead to calls for delays or reversals of the CIT rate cuts; however we would urge the government to hold its course. Businesses have made their investment plans based on the lower tax rates which were announced and legislated some time ago. Lower corporate income tax rates will stimulate economic growth and job creation by:

- allowing companies to retain funds to reinvest in their businesses to finance expansion, add jobs, invest in research and development and upgrade equipment and technology;
- increasing the return on investment and therefore increasing the willingness to take on risk;
- providing a strong incentive for businesses to invest in Ontario rather than other provinces or the U.S.; and,
- providing export driven businesses with an offset against the effects of a higher Canadian dollar.

Raising corporate taxes at this point will dampen economic growth and job creation and ultimately reduce overall tax revenue. A lower corporate income tax rate does not necessarily translate into lower tax revenue since the impact of the lower rate is mitigated by the increase in taxable income from increased economic growth and money not reinvested in the business is distributed to shareholders as dividends which are subject to tax. Dr. Jack Mintz, Palmer Chair of Public Policy at the University of Calgary, has estimated that, in aggregate, the changes to Ontario's tax regime will increase capital investment in the province by \$47 billion over 10 years and create an estimated 591,000 net new jobs<sup>4</sup>.

With this foundation in place, we would like to focus on another area that affects competitiveness – the taxation of corporate groups.

## Taxation of Corporate Groups

We welcome the recently released federal consultation paper on the taxation of corporate groups<sup>5</sup> and Ontario's offer to work collaboratively with the business community, the federal government and other provinces in developing a more efficient and competitive system of corporate group taxation. 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 C.D. Howe Institute<sup>6</sup> found that France, Germany, the United States, Australia, Italy and Japan, among others, all offer some form of consolidated reporting, and many others offer some sort of offsetting measure of similar effect. The report went on to state that Canada is the only country within the G7 which does not have consolidated reporting or a similar mechanism.

Corporations, including financial institutions, carry on business through a variety of organizational structures. Frequently these structures involve the use of separate legal entities which are nonetheless economically integrated into the corporate group<sup>7</sup>. In Canada, corporations are required to report and pay tax on their income on an unconsolidated or legal entity basis. Canadian tax law does not provide for consolidated tax reporting or other forms of group tax relief. As a result, losses incurred by some affiliates within a corporate

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<sup>4</sup> *Ibid.*, p. 1

<sup>5</sup> The consultation paper is available at <http://www.fin.gc.ca/n10/10-112-eng.asp>.

<sup>6</sup> Alexandre Laurin, "Cleaning Up the Books: A Proposal for Revamping Corporate Group Taxation in Canada" C.D. Howe Institute Commentary No. 284, March 2009.

<sup>7</sup> In fact, the *Bank Act* and governing legislation for other types of financial institutions require them to set up separate legal entities for certain lines of business.

group cannot be offset against profits earned by other affiliates in a timely manner. In the absence of loss consolidation (transfer) provisions within the *Income Tax Act*, the CRA has developed administrative practices to permit losses to be utilized through indirect means, such as inter-affiliate loans and internal reorganizations. The current *ad hoc* system has significant drawbacks, including the following:

- Some companies are precluded from using it due to business and regulatory constraints;
- The uncertainty with respect to the ability to utilize losses means that companies are less willing to take the risks of investing in new business ventures in Canada;
- Businesses incur permanent losses when they are unable to fully utilize tax losses stranded in a member of the corporate group;
- The process of planning and executing loss utilization transactions under the current system, including obtaining CRA rulings, is time consuming and involves sizeable legal, accounting and administrative costs;
- The system impairs cash flows within corporate groups;
- There is a loss of liquidity while funds are tied up awaiting the completion of loss utilization transactions.

We understand that the current system also has drawbacks for provincial governments in that it lacks certainty and transparency. Provincial tax revenues are unpredictable as they may change unexpectedly as a result of redistribution arising from *ad hoc* intercompany loss utilization transactions. Provinces have no advance warning of these transactions and the impact is only noticeable after the fact. For example, provincial tax revenues from a profitable Ontario corporation could be reduced or eliminated unexpectedly by an offsetting claim for the losses of an affiliate operating in another province (to the detriment of Ontario), or the reverse could happen (to the benefit of Ontario).

The CBA believes that a new legislated approach to the taxation of corporate groups could provide significant benefits both to businesses and governments, including:

- Greater certainty and transparency for businesses and governments;
- Efficiency gains from a reduction in the compliance burden for businesses and the administration burden for government tax administrators;
- Greater fairness in that a new system would be available to all corporate groups regardless of their size and other constraints which may be preventing them from utilizing the current system;
- Greater certainty and more timely access to tax losses would encourage businesses to make new investments critical to economic growth and job creation;
- More effective taxation in that the right amount of tax is applied at the right time leading to greater liquidity and fewer constraints on intercompany cash flows;
- Canadian corporate groups would be more competitive in domestic and international markets in comparison to corporations based in foreign jurisdictions with a system of group tax reporting;
- A more competitive tax regime would assist in attracting investment by foreign corporate groups.

A new approach to the taxation of corporate groups also necessitates re-examination of the current methods of allocating corporate income to provinces as these methods are based on taxation at the legal entity rather than the corporate group level. In addition, there are longstanding concerns that the current allocation methods for some sectors are, in any case, outdated.

## Interprovincial allocation of corporate income

The current method of allocating corporate income to provinces is based on factors measured at the legal entity level – typically gross revenues and salaries and wages. There are special factors for certain sectors including banks, insurers and trust and loan companies<sup>8</sup>. Changes in the manner in which financial products and services are produced and delivered, new financial instruments and increasing complexity in the structure of financial services groups have raised concerns that the existing allocation methods no longer produce an equitable result. There are frequent provincial challenges of the results in which individual provinces may unilaterally reassess an institution to increase their share of the total pie. Resulting appeals can take as long as 10 to 15 years to resolve. These disputes create uncertainty for all provincial governments with respect to their tax revenues for a particular year since all must ultimately agree to a revised allocation. They also create uncertainty for the financial institutions involved with respect to their tax liabilities since they may end up paying tax twice on the same dollar of income and are charged interest on “late payments” when the allocation between provinces is changed as a result of a challenge. All parties involved incur greater administrative costs.

In its fall Economic Statement, the government noted that “each province is entitled to tax the economic activity taking place within its jurisdiction”. In order to address the issues noted above, the development of an approach to taxation at the corporate group level should be accompanied by concurrent changes in the measurement of economic activity taking place in a province. The economic activity within each province of economically integrated corporate groups which operate across provincial boundaries would be more equitably measured and allocated at the group level to remove the distortions created by intercompany transactions, including loss utilization transactions<sup>9</sup>. In the financial sector where corporate groups currently have a mix of special allocation methods, there is an opportunity to re-examine the measurement factors and to develop a hybrid measurement system that better addresses the reality of the modern financial services industry.

The CBA looks forward to working with the federal and provincial governments and others in the business community to develop an improved approach to the taxation of corporate groups, including the methods of allocating corporate income among the provinces.

## Securing our Retirement Future

The CBA is very pleased that the Ontario government recognizes that the banking sector can be part of the solution to filling any retirement savings gap, and supports the directions emerging from the December 2010 Finance Ministers’ meeting in Kananaskis. Canadian bank financial groups possess all of the key requirements that are essential in the delivery of new, innovative pension products. They have nation-wide reach so they can serve all Canadians. They operate under a very robust prudential regulatory regime which is highly regarded internationally, and they have a strong multi-faceted consumer protection system – this includes a federal regulator (the Financial Consumer Agency of Canada), and a gold-standard complaints-

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<sup>8</sup> The measurement factors for banks are loans and deposits and salaries and wages; insurers – net premiums; and trust and loan companies – gross revenues.

<sup>9</sup> Alternatively, a method of allocation using factors measured at the provincial level could also be considered. For example, most HST revenue is allocated among participating provinces based on provincial data collected by Statistics Canada.

handling mechanism, including an internal ombudsman service within each bank, and independent external dispute resolution systems. Further, they have a long history of asset management on a large scale and provide a wide-range of high quality, well-priced financial products and services to their customers.

The experience with the new Tax Free Savings Account (TFSA) is a good example of how an innovative pension plan might be accepted by Canadians. Banks made the TFSA product available to customers, explained its features and advantages, and found that Canadians responded by depositing billions of dollars in these accounts in the first year. There are some key lessons here for public policy relating to retirement savings:

- If the public policy framework allows the financial sector to build a product that meets Canadians' retirement savings needs, Canadians will respond.
- Delivering a new retirement savings product directly to the individual can be successful.
- Banks, because of their extensive branch networks and range of touch points with customers, can ensure wide coverage.

In our submissions to the Ontario government (and to other jurisdictions across Canada) over the last year, the CBA has proposed a new type of defined contribution pension plan that would be offered by banks and other regulated financial institutions to employers who do not currently provide a pension plan, as well as to employees and the self-employed not covered by a pension plan. Such an approach would build on the experience, expertise and product-delivery capacity of Canada's financial sector, and would offer a flexible and innovative way of addressing the gaps in retirement savings coverage among Canadians. Accordingly, we strongly support the Pooled Registered Pension Plan (PRPP) proposal that emerged from the December 2010 Kananaskis Finance Ministers' meetings, and look forward to working with the Ontario government and other governments across Canada in making the PRPP a reality.

The CBA also recognizes that there is a desire on the part of some to consider modest improvements to the Canada Pension Plan as part of a pension reform initiative. There are a number of aspects to consider with respect to proposals to enhance the CPP. For example, the parameters of the CPP are quite blunt and hence make it difficult to target benefits to narrow groups of households where an identified preparedness gap may exist. Further, the mandatory nature of the CPP has significant impacts on individuals and firms.

The CBA is most concerned, however, by the fact that there has been insufficient discussion of premium increases and premium structures. We believe that a proper discussion of CPP reforms cannot be undertaken unless both sides of the equation are known. Increased premiums also mean lower disposable income with which individuals might contribute to a new innovative pension plan.

The CBA believes that governments should first permit the creation of a new, innovative pension plan as envisaged by the PRPP proposal. It is our assessment that, based on the TFSA record, Canadians would embrace a well constructed model, which would be much better suited to delivering savings opportunities where needed. If this approach proves inadequate, enhancements to the CPP could be considered.

## Single Securities Regulator

The banking industry commends the Ontario government for its continued efforts in support of a national securities regulator. Given the importance of the initiative for the future strength of the Canadian economy, improved consumer protection, and stronger influence on international policy development, the industry urges the government to continue its efforts in support of the Canadian Securities Regulatory Authority. We applaud the government's endeavours to ensure consistency with the proposed *Canadian Securities Act*, thus assisting in a seamless transition to a single Canadian securities regulator. In particular, we stress the need for uniform regulation in Canada, across all provinces and at the federal level, as the key to any global action plan and Canada's ability to deliver on its G20 commitments with respect to OTC derivatives regulation (such as the clearing of OTC derivatives). As has been discussed at the G20 level, there needs to be cooperation and consistency among regulators in different countries. We therefore recommend that the Ontario government proceed in collaboration with other derivatives initiatives in Canada. Since many of the substantive issues relating to derivatives will be addressed through new regulations, we look forward to working with Ontario toward a national framework for derivatives regulation in Canada.

## Financial Literacy

We applaud the Government of Ontario for its recognition of financial literacy as an important life skill and for its leadership in moving forward on including financial literacy in the high school curriculum. The banking industry shares the 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 brings financial literacy to Canadians through its high school seminar program, *YourMoney*, which has taught more than 192,000 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 and appeared before the Committee in May as part of its consultations. We also provided our submission and recommendations to the Ontario government's Working Group on Financial Literacy. Included in the CBA's recommendations are the need to make financial education a part of the high school curriculum across Canada, and that the national financial literacy strategy should tap into the broad expertise and experience of the private sector, including banks and other financial services providers.

## Conclusion

We commend the government on its fiscal management during these difficult economic times and on its detailed plans to reduce and eventually eliminate the deficit. We recommend that this budget focus on measures to enhance the climate for business investment and job creation. In particular, we urge the government to maintain the competitive tax regime implemented in 2008 and 2009, and to enhance it by working with other governments and the business community to update the taxation of corporate groups. A concurrent review of the interprovincial allocation of corporate income could reduce volatility in provincial tax revenues and address Ontario's concerns that the current system no longer equitably allocates corporate tax revenues among provinces.

We appreciate Ontario's initiatives to improve the financial services sector's competitiveness and the government's support for consumers of financial services, especially: the government's support for new innovative private sector pension plans; its continuing support for a single securities regulator and its endeavours to ensure consistency with the proposed *Canadian Securities Act*; and its recognition of financial literacy as an important life skill and its support for inclusion of financial literacy in the high school curriculum.

By building a strong financial services sector and an informed base of financial services consumers, the government will ensure that the financial services industry is a source of economic strength for Ontario for years to come.