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February 1, 2010

The Honourable James M. Flaherty, P.C. M.P.
Minister of Finance
House of Commons
Parliament Buildings
Ottawa, Ontario
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Dear Minister,

On behalf of PricewaterhouseCoopers LLP, I am pleased to submit our tax proposals for your consideration in preparing the federal government's next budget to be tabled in Parliament on March 4, 2010.

At the outset, we want to express our support for the efforts the federal government has made to date to enhance Canada's economic performance. It is evident that the federal government is sensitive to the economic factors that drive the Canadian economy. Promoting economic drivers such as technological and work force productivity, efficient and effective infrastructures, and guaranteed access to foreign markets for Canadian produced goods and services are appropriate high priority goals. The government's awareness of the need for efficient and competitive regulatory and income tax laws is also evident. We encourage the government to maintain the diligent and focused efforts with respect to these matters. The effectiveness of such efforts will have a significant impact on Canada's future economic performance.

We believe our tax proposals are consistent with the federal government's policy of promoting the competitiveness of Canada's tax system and Canadian business, as articulated in the long term strategic policy set out in *Advantage Canada*.

In addition, we continue to believe that financial liquidity will remain an important issue for Canadian business, particularly over the medium term as the recovery from the recent recession remains fragile and the federal government and the governments of other nations withdraw their temporary spending support of the world economy. The financial liquidity of

Canadian business will impact its competitiveness in the international market place and the new emerging economy. We believe our tax proposals will improve the liquidity of Canadian business and put them in a better position to compete.

We encourage you to give our tax proposals serious consideration.

Income Tax Proposals

Maintain the current policy of reducing corporate income tax rates –

We believe that lowering corporate tax rates is an important economic and psychological factor which will make Canada an attractive place to invest for both domestic and foreign investors. Canada must compete with other nations for investment and the related economic spin-offs including increased employment. If Canada does not reduce its corporate tax rates, other countries will attract and retain that investment. The federal government's continued commitment to attracting and retaining investment is critical to Canada's long term growth and prosperity. We strongly believe the federal (and provincial) government needs to maintain the current policy of reducing corporate income tax rates to achieve this goal.

Facilitate the use by members of a group of related corporations of tax attributes of other group members –

We recommend the adoption of a tax consolidation system for members a group of related corporations to permit members of the group to utilize tax attributes, such as tax losses and investment tax credits, of other members of the same group. This recommendation was more fully discussed in our submission to you dated January 14, 2009, which was made on behalf of 13 prominent Canadian corporate groups and has the support of many other corporate groups in Canada.

This recommendation would enhance the liquidity of the members of a corporate group by allowing them to monetize tax attributes in a timely, cost efficient and effective manner. The current administrative practices of the Canada Revenue Agency to accommodate tax consolidation typically involves implementing transactions that are complex, expensive, inefficient, uncertain in respect of their effectiveness and in most cases, it is not possible to realize the tax benefits in a timely basis. Moreover, the current administrative practices are unfair because certain taxpayers are precluded from using them due to business and regulatory reasons. This puts members of a related corporate group based in Canada at a disadvantage from an efficiency, cost, liquidity and competitiveness point of view in comparison to foreign and domestic competitors that have immediate access to such benefits.

Providing a tax consolidation system for tax attributes of members of a commonly controlled corporate group would be consistent with other actions taken by the federal government to make Canadian business more competitive. Moreover, the adoption of a tax attribute transfer system should not result in a significant increase in the revenue loss of the federal or provincial over the fullness of time.

We urge the federal government to announce in the 2010 budget the adoption of a Canadian tax consolidation system for corporate group tax attributes or in the alternative, announce that a Canadian tax consolidation system for corporate group tax attributes will be the subject of consultation with the provinces and the tax community over the next 12 months for possible inclusion in the 2011 budget.

Announce support for the recommendations of the Advisory Panel on Canada's System of International Taxation –

We applaud the 2009 budget measures which adopted the Advisory Panel's recommendation to repeal section 18.2 of the *Income Tax Act* and promised to review the proposed FIE and NRT rules.

However, there are a number of other recommendations made by the Advisory Panel in their December 2008 final report that would enhance the international competitiveness of Canadian business and Canada's tax system while reducing the compliance and enforcement burden of taxpayers and the Canada Revenue Agency. Importantly during this time of economic restraint, the Advisory Panel noted that the consequences of its recommendations, taken together, should not result in any net fiscal cost to the government.

As a minimum, we urge the government to set out a clear direction and timetable for dealing with not only the Advisory Panel's recommendations, but also the numerous draft foreign affiliate and the FIE and NRT rules. Some of the latter draft rules have been outstanding for 10 years, giving rise to considerable uncertainty for taxpayers in planning their international business affairs.

GST/HST Proposals

In our 2009 budget submission, we endorsed the federal government's desire to move to a fully harmonized system of sales taxes and we expressed our support for any initiative to persuade the non-harmonized provinces to embrace this initiative. We indicated that harmonization would be particularly beneficial for the manufacturing sector because it would remove the provincial sales tax drag on exports that still exists in the non-harmonized provinces. Hence, we are pleased that the provinces of Ontario and British Columbia agreed to harmonize their provincial sales tax with the federal GST.

As the provinces of Ontario and B.C. proceed with harmonization, we recommend that the federal government assist with the implementation by ensuring the following.

- **Ensure outsourcing of information technology ("IT") and business processes by the financial sector is not constrained -**

  Financial Institutions rely on outsourcing of IT and business processes to enhance their productivity. Although the HST will generally improve the competitiveness of the Ontario and B.C. economies, it creates a significant cost barrier to outsourcing by the financial services sector. This distortion will reduce the competitiveness of the financial services sector and depress a major market area for business process and IT outsourcers.

  To mitigate the potential negative impacts of the HST in this area, the government should introduce a partial rebate for GST/HST incurred on outsourcing of these services by financial institutions, similar to that used in the Australian GST system. The rebate rate could be set to keep the level of unrecoverable tax on such outsourced services at the current rate.

- **Ensure labour-intensive services supplied to consumers are not driven underground -**

  Many services purchased by consumers are currently supplied by the "underground" economy, residential cleaning services being the most common example. The introduction of the GST at 7% in 1991 resulted in the closure of many compliant businesses because they were unable to compete with individuals functioning below the $30,000 GST registration threshold who were not obliged to register for and charge the GST. We believe there is a significant concern that a HST at 12% and 13% will extinguish the remaining compliant businesses in this sector unless targeted measures are implemented.

  The federal government should consider a package of tax measures that have been shown, for example, in France and other European Union countries, to have both a positive compliance and very significant positive revenue effect. Namely:

  - Lower the GST/HST registration threshold to zero for certain labour intensive services typically purchased by consumers.

  - Allow purchasers an income tax deduction for purchases of these services up to a specified level.

  The EU experience is that these measures actually achieve a net **increase** in overall tax revenues. In addition, there are socially positive effects, such as workers being part of the "above ground", as opposed to the "underground" economy, and reduced price pressure on working women to have to resort to the underground economy to remain in the professional workforce. An added advantage would a reduction of spurious unemployment insurance claims, and payment of GST rebates to workers active in the underground economy.

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We appreciate having the opportunity to submit our proposals. We would welcome any opportunity to discuss them in greater detail with you or your staff.

Yours truly,

PricewaterhouseCoopers LLP

Nick Pantaleo, FCA
Partner,
Canadian National Tax Services

cc Michael Horgan, Deputy Minister, Department of Finance
Stephen R. Richardson, Associate Deputy Minister, Department of Finance