

Summary

Enhancing Canada's International Tax Advantage

A Consultation Paper Issued by the Advisory Panel
on Canada's System of International Taxation

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For additional copies of this document, please contact:

Distribution Centre
Department of Finance Canada
Room P-135, West Tower
300 Laurier Avenue West
Ottawa ON K1A 0G5
Tel.: 613-995-2855
Fax: 613-996-0518

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Advisory Panel on Canada's System of International Taxation

In Budget 2007, the Government of Canada announced it would strike a panel to review Canada's system of international taxation. On November 30, 2007, the Minister of Finance announced the formation of the Advisory Panel on Canada's System of International Taxation ("the Panel").

The chair and vice-chair of the Panel are Peter C. Godsoe, OC, and Kevin J. Dancey, FCA. The other members of the Panel are James Barton Love, QC, Nick Pantaleo, FCA, Finn Poschmann, Guy Saint-Pierre, CC, and Cathy Williams.

The Panel intends to provide its recommendations to the Minister of Finance by December 1, 2008.

The Panel's Mandate

The Panel's mandate is to make recommendations to guide the government in establishing an international tax policy framework with respect to investment abroad by Canadian businesses as well as investment into Canada by foreign businesses.

The Panel's recommendations will aim to improve the competitiveness, efficiency and fairness of Canada's system of international taxation, minimize compliance costs for businesses, and facilitate administration and enforcement by the Canada Revenue Agency. We will attempt to propose changes that can be practically implemented and that will increase the certainty and simplicity of Canada's system of international taxation for large, medium-sized and small businesses.

The Panel's focus will be on how Canada's international tax rules affect Canadian businesses investing abroad and foreign businesses investing in Canada.

The Panel's mandate does not require recommendations that are fiscally neutral; however, the Panel will be cognizant of the revenue impact of any proposal.

The Panel is following the work of Canada's Competition Policy Review Panel (the "Competition Panel") with great interest, given the Competition Panel's complementary mandate and the government's need for a coordinated policy approach. The Competition Panel has set out two goals for Canada's economic performance:

- to promote Canadian direct investment abroad, and create the domestic conditions to foster the development of Canadian businesses
- to maximize Canada's attractiveness as a destination for talent, capital and innovation.

The Panel will seek to ensure its recommendations accord with the direction set out by the Competition Panel.

The Current Tax Environment

Building a tax advantage for Canadian businesses is a key element of the Government of Canada's long-term economic plan. Canada's international and domestic tax systems are linked and changes to the domestic tax system can affect the competitiveness of Canadian businesses within Canada and abroad. One of the most significant domestic tax factors influencing the competitiveness of Canadian businesses is the corporate tax rate. Canada's move to lower corporate rates and its objective to achieve the lowest effective tax rate on new business investment in the G7 support a competitive international tax policy.

Canada's system of international taxation should be supportive of both Canadians investing abroad and those investing in Canada in order to promote growth and productivity in the Canadian economy and create wealth for the benefit of all Canadians.

Ensuring the competitiveness of Canada's international tax system is especially important, given the changes in the global economic landscape in recent years. Canadian businesses are increasing their investments abroad, and foreign businesses are increasing their investments into Canada. A rising proportion of these investments are being made by tax-exempt organizations, including sovereign wealth funds.

The foreign competitors of Canadian businesses are growing in strength and number, aided in many cases by the tax policies of their home countries. Some countries have already reduced their corporate taxes in their efforts to compete for capital, jobs and growth. A country can change its rules regarding business investment and alter the landscape at any time. Canada's tax policy must anticipate continuous change in the global tax environment and have the flexibility to adapt accordingly.

Toward a Tax Policy Framework

Setting international tax policy entails trade-offs and practical constraints. Recognizing these considerations, the Panel's initial views on a framework for developing Canada's international tax policy are as follows:

- Canada's international tax system has served the country well in many respects over the past few decades. Changes to the system should be made only in areas where significant improvement will be achieved.
- Canada's tax system should support the goal of attracting foreign investment. In accomplishing this, Canadian tax rules should aim to create a level playing field for domestic business activity carried on by foreign and Canadian businesses while ensuring Canadian-source income is properly measured and taxed.
- Many countries seek to adopt international outbound tax rules that make their companies competitive. Canada's outbound international tax rules should aim to maintain and enhance the competitiveness of Canadian businesses operating abroad.
- For taxpayers, certainty and simplicity in tax legislation and its administration are important. Business investments are long term and sudden changes in tax policy without adequate transition cause significant disruption. Complexity should be avoided except, for example, where it is necessary to protect tax revenues.
- To ensure Canada's international corporate and withholding tax regimes remain competitive, they should be benchmarked regularly against international norms and should anticipate global trends and changes.
- Fairness in the international tax context needs to be clarified. The Panel recognizes that this issue involves making policy choices amid conflicting objectives. The Panel's initial view is that the notion of "horizontal equity," whereby taxpayers in similar situations are treated similarly, is useful as a guiding principle. This view of fairness is consistent with the principles noted above and may be summarized as follows:
 - Canada's taxation of inbound investment should facilitate a level playing field for domestic business activity.
 - Canada's rules regarding the taxation of outbound investment should be competitive vis-à-vis the outbound tax rules of other major countries.

Specific Areas for Review

Outbound Investment

Generally, the current international tax system governing outbound investment has served Canadians well in the past, and certain of its features are being considered by other countries. In examining potential modifications to the existing Canadian system, our preliminary view is that this system should be retained as the basic foundation for outbound investment.

We will review the current system and assess whether recommendations could be made to improve its efficiency, simplicity and competitiveness. In particular, we will review whether the existing taxation of foreign affiliate dividends could be improved by examining the scope of the exemption, the treatment of capital gains from the disposition of shares of foreign affiliates, and the allocation of costs to foreign-source income.

Inbound Investment

Canada needs to remain an attractive destination for foreign investment, and our tax rules should reflect this objective. To this end, Canada's tax rules should aim to balance the desire for domestic and foreign businesses to obtain similar treatment while ensuring that Canadian-source income is properly measured and taxed. Therefore, our review of the Canadian tax rules affecting inbound investment, such as certain interest deductibility rules, will be guided by the desire to achieve this balance.

Other

Canada recently eliminated its withholding tax on all arm's-length interest and will phase out withholding tax on Canada–U.S. non-arm's-length interest. We will review whether this policy objective should be broadened.

Transfer pricing rules are critical in allocating revenues and income with respect to international transactions. We will consult with taxpayers and the Canada Revenue Agency to identify potential areas to improve the administration of these rules.

A simpler, more user-friendly system that is easy to administer and comply with and that provides the appropriate information about Canada's tax system is desirable. We will consider how to improve these aspects of our international tax system.

The Panel is interested in understanding whether the increased outbound and inbound investment by tax-exempt organizations raises any specific issues that need to be addressed in assessing Canada's international tax system.

Consultation Process

The Panel is committed to an open and consultative approach to obtain input from a broad spectrum of interested stakeholders including small, medium-sized and large businesses.

The Panel invites written submissions from any and all interested parties. Submissions will be accepted until July 15, 2008. All written submissions will be given our full attention. Submissions will be posted on the Panel's website (www.apcsit-gcrfi.ca) unless we are instructed otherwise. We kindly request that the submissions be written in English or French.

Submissions should be directed as follows:

By e-mail: advisorypanel@apcsit-gcrfi.ca

By post:

Advisory Panel on Canada's System of International Taxation
Submission
Attn.: David Messier
333 Laurier Avenue West, 15th Floor
Ottawa ON K1A 0G5

By fax: 613-947-2289

For additional information, please contact:

Brian Mustard
Executive Director, Secretariat
613-947-9482