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The Honourable James M. Flaherty, P.C., M.P. Minister of Finance
Department of Finance Canada
L'Esplanade Laurier
140 O'Connor Street
Ottawa, ON K1A 0G5

Dear Minister:

In February I unveiled the Canadian Chamber's *Top 10 Barriers to Competitiveness for 2013*. We undertook this initiative to draw attention to the barriers that are holding back Canada's progress and to urge all levels of government to act more swiftly to improve our country's ability to compete globally.

We urged the federal government to make changes to our tax system to support economic growth and enhance Canada's international competitiveness.

The last broad review of the tax system was conducted in 1996-1997 by the Technical Committee on Business Taxation. It is time that we put tax simplification and reform back on the national agenda.

We call on the government to immediately convene an expert panel (supported by a secretariat) to undertake a comprehensive review of tax legislation with the view of simplifying it, and to identify opportunities to facilitate administration and reduce compliance costs for taxpayers.

Piecemeal changes to tax legislation by successive governments and the enactment of temporary provisions have complicated the tax system and increased compliance costs.

The Fraser Institute estimates that it costs Canadians up to \$6.7 billion annually to comply with their personal income tax obligations and businesses as much as \$17.8 billion to comply with theirs. Additionally,



governments spend an estimated \$6.6 billion each year to administer the tax system — collect taxes, maintain records and enforce tax regulations.

In the United Kingdom, the Chancellor and Exchequer Secretary launched the Office of Tax Simplification in 2010 to provide the government with independent advice on simplifying the UK tax system. The Office of Tax Simplification has completed its review of small business taxation, which identifies areas of the tax system that cause the most day-to-day complexity and uncertainty for small businesses and recommends priority areas for simplification; it carried out a review into all tax reliefs, allowances and exemptions for businesses and individuals; and studied how the length of legislation is a factor that contributes to complexity.

Similar areas in relation to taxation need to be examined in Canada. The Canadian Chamber proposes the establishment of an expert panel with the broad mandate to (among others):

- Review and clarify the language used in tax law.
- Recommend specific changes to existing legislation that is not achieving its purpose or is unclear, or it entails costs that outweigh the revenue being raised or protected.
- Examine the processes used to formulate tax policy and to draft the legislation to give effect to that policy.
- Undertake a comprehensive review of the myriad tax-preference measures (exemptions, deductions, credits or rebates) that are part of the federal tax code to determine if they are cost effective and are achieving their intended purpose. Some credits simply subsidize activities many recipients would have done anyway. Others may stimulate spending in certain areas, prompting suppliers to raise prices, thereby negating the benefit of the tax credit. In many cases, the government is using tax preferences to achieve social objectives rather than funding the initiative through spending programs. Savings realized from eliminating or reducing such expenditures could support lower income tax rates. The broad-base low-rate approach to taxation has other benefits, including administrative simplicity and reduced opportunity for tax avoidance and arbitrage.

- Recommend broad tax policy changes in areas like the taxation of corporate groups. Many developed countries have a formal system to consolidate the tax reporting of corporate groups or to otherwise transfer corporate profits and losses among related companies. Canada does not. As a result, businesses use various tax-planning strategies to transfer tax attributes between related entities that are time consuming and entail significant internal reorganization which is costly. Businesses competitiveness would be significantly enhanced if Canada created a formal loss-transfer system to address corporate group taxation. While we appreciate the federal and provincial governments likely have concerns about the short-term fiscal costs, reengaging stakeholders in a more open dialogue and consultations can help the government resolve these and other concerns.
- Provide advice on whether improvements can be made to Canada's withholding tax system, including the withholding tax requirements themselves and the process for obtaining waivers from the obligation to withhold.
- Make recommendations on the use of, and possible improvements to general and specific anti-avoidance provisions with a view to simplify as well as improve the operation of these provisions.

In addition to reducing the complexity of the tax system, we urge the government to instigate a multi-year plan to reduce personal income taxes, once the books are back in balance. Savings realized from eliminating or reducing those tax-preference measures identified by the expert panel could support lower income tax rates.

Canada's personal income taxes are too high relative to other countries. Indeed, *Advantage Canada* confirms that "Canada needs lower personal income tax rates to attract and retain highly skilled workers; encourage more Canadians to realize their full potential and improve their standard of living here in Canada; encourage all workers to invest in training and education to fuel growing segments of the economy; and provide incentives for firms to employ highly skilled workers to invest in Canada."

The top marginal personal income tax rate in Canada (federal/provincial combined) averages 45.5 per cent and applies to anyone earning more than \$135,054 in 2013. In the U.K., the top 45.0 per cent rate kicks in at

£150,000 (approximately C\$232,000). The top marginal personal income tax rate in the U.S. (federal/state combined) of 42.8 per cent applies to income in excess of US\$400,000 for single individuals, US\$450,000 for married individuals filing joint returns, US\$425,000 for heads of households and \$225,000 for married individuals filing separate returns.

Going forward, Canada will face the increasing challenge of attracting and retaining skilled workers that are essential to our international competitiveness. To entice high-technology skilled workers, upper management, entrepreneurs and professionals to Canada, the Canadian Chamber recommends that the federal government raise the threshold at which the top federal marginal personal income tax rate kicks in to \$225,000 from \$135,054. As a result, income in the \$135,054 and \$225,000 range would be taxed at a rate of 26 per cent, down from 29 per cent.

Many low- and middle-income Canadian families with children and with income in the \$25,000 to \$45,000 range face marginal effective tax rates in excess of 50 per cent because many of the income-tested benefits and tax credit they receive (including child tax benefits, the GST and provincial sales tax credits, provincial property tax credits, student financial assistance and social welfare) end up being clawed back as income rises. This sends a strong negative message about the merits of working, upgrading one's skills and pursuing higher education.

Additionally, many low-income retirees encounter effective marginal tax rates as high as 80 per cent as their Guaranteed Income Supplement or their Old Age Security pension gets clawed back as taxable pension savings—RRSPs/RPPs—are withdrawn.

The Canadian Chamber recognizes that reducing personal income tax rates as they apply at the lower end of the income spectrum carry a high fiscal cost. Hence, it recommends a gradual approach, starting with a reduction in the 15 per cent personal income tax rate that applies on the first \$43,561 of taxable income to 14 per cent. It also recommends that the 22 per cent rate that applies to taxable income of between \$43,561 and \$87,123 be reduced to 21 per cent.

For Canadian families, reducing personal income tax rates would result in higher disposable income. The benefits to Canada from increasing the incentive to work, save, stay in Canada and undertake further education and training come in the form of higher productivity and economic growth. I hope our comments have been helpful. I, along with the Canadian Chamber's Taxation Committee, would be pleased to speak with you about any aspect of, and to address any questions you have concerning our proposals.

Sincerely

Perrin Beatty

President and Chief Executive Officer